"When You Talk - We Listen!"

MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE CORPORATION (MPI)

GENERAL RATE APPLICATION

2016/17 INSURANCE YEAR

Before Board Panel:

Karen Botting	- Board Chairperson
Regis Gosselin	- Board Member
Anita Neville	- Board Member
Susan Proven	- Board Member
Allan Morin	- Board Member

HELD AT:

Public Utilities Board

400, 330 Portage Avenue

Winnipeg, Manitoba

October 8, 2015

Pages 703 to 811

1 APPEARANCES

2

3	Candace Grammond	)Board Counsel
4	Kathleen McCandless	)
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8	Byron Williams	)CAC (Manitoba)
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16
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22
23
24
25

1 TABLE OF CONTENTS

2 Page No.

3 List of Exhibits 706

4 Undertakings 707

5

6 MPI PANEL 1 CONTINUED:

7 DAN GUIMOND, Previously Sworn

8 HEATHER REICHERT, Previously Affirmed

9 LUKE JOHNSTON, Previously Affirmed

10

11 Continued Cross-Examination

12 by Ms. Candace Grammond 709

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18

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20 Certificate of Transcript 811

21

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23

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25

LIST OF EXHIBITS

EXHIBIT NO.	DESCRIPTION	PAGE NO.
MPI-11	Response to Undertaking number 2	708
MPI-12	Response to Undertaking No. 3	741
MPI-13	Response to Undertaking No. 6	742

1 LIST OF UNDERTAKINGS

NO.	DESCRIPTION	PAGE NO.
19	MPI to advise of the importance of yield to the conclusions drawn by Aon with reference to slides 36 and 38	777

6
7
8
9
10
11
12
13
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1 --- Upon commencing at 9:05 a.m.
2
3 THE CHAIRPERSON: Good morning,
4 everyone. We're going to continue again today,
5 October 8th, with the MPI GRA hearings. And we're
6 going to open with Ms. Kalinowsky has an exhibit to
7 present. Thank you.
8 MS. KATHY KALINOWSKY: Good morning.
9 We have one (1) exhibit to file this morning. It's
10 Undertaking number 2, which is a rerun of the pro
11 formas with the September 2015 interest rate
12 information. It should be marked MPI Exhibit number
13 11, please.
14
15 --- EXHIBIT NO. MPI-11: Response to Undertaking
16 number 2
17
18 MPI PANEL 1 CONTINUED:
19
20 DAN GUIMOND, Previously Sworn
21 HEATHER REICHERT, Previously Affirmed
22 LUKE JOHNSTON, Previously Affirmed
23
24 THE CHAIRPERSON: Okay, thank you very
25 much. Ms. -- Ms. Grammond, are you ready to start?

1 Thank you.
2 MS. CANDACE GRAMMOND: Thank you,
3 Madam Chair, I am.
4
5 CONTINUED CROSS-EXAMINATION BY MS. CANDACE GRAMMOND:
6 MS. CANDACE GRAMMOND: So, Ms.
7 Reichert, yesterday we were speaking about the Aon
8 Hewitt ALM study, and we're going to continue in that
9 vein.
10 So, Diana, I would ask you to pull up
11 Attachment D of the investment income section of the
12 filing. And I believe when we concluded yesterday we
13 were talking about the tracking error that was
14 referenced within the study, and an undertaking was
15 given.
16 I'm going to ask, Diana, you to go to
17 slide 20.
18
19 (BRIEF PAUSE)
20
21 MS. CANDACE GRAMMOND: It would appear
22 here that Aon has provided a summary of its
23 recommendations pursuant to Phase 1. Would you agree?
24 MS. HEATHER REICHERT: Yes.
25 MS. CANDACE GRAMMOND: And if we look

1 at the three (3) bullets, the first one was:

2 "To amend the formulation of the

3 MFAD, or margin for adverse

4 deviation, to reduce or eliminate

5 the impact on duration."

6 That's correct?

7 MS. HEATHER REICHERT: Correct.

8 MS. CANDACE GRAMMOND: And the second

9 one was:

10 "To change the calculation of the

11 portfolio yield used for evaluation

12 to adopt the revised duration

13 weighted average yield methodology."

14 MS. HEATHER REICHERT: Correct.

15 MS. CANDACE GRAMMOND: And the third

16 was:

17 "To work with the manager to assess

18 and align its capabilities to

19 implement a tighter heading --

20 hedging strategy in light of the

21 provided list of characteristics and

22 tools required."

23 MS. HEATHER REICHERT: Correct.

24 MS. CANDACE GRAMMOND: Can you comment

25 upon each of these recommendations in terms of MPI's

1 view of each one, and changes that have been
2 implemented that are based upon these recommendations?
3 MS. HEATHER REICHERT: Yeah.
4 MR. LUKE JOHNSTON: I can speak to the
5 first couple for sure. The first piece is the --
6 related to the actuarial provisions. And one of the
7 issues we had when creating this strategy was that the
8 interest rate margin is obviously a component of the
9 impact when we're doing our liabilities.
10 So if we -- if we were only to
11 calculate interest rate impacts on the claim
12 liabilities without margin, we would be missing other
13 impacts to claim liabilities.
14 What they are suggesting here is that
15 we try to find a way to set the actuarial provisions
16 so they wouldn't affect -- they wouldn't be affected
17 by the ALM program. We disagreed with that assessment
18 in -- in the sense that we -- we made our fixed income
19 match the claims liabilities with provisions because
20 in terms of what actually changes for MPI, it's --
21 it's the liabilities with all actuarial provisions, so
22 that's what we did there.
23 Another -- in terms of the actual
24 discount rate, we use -- one (1) second.
25

1 (BRIEF PAUSE)
2
3 MR. LUKE JOHNSTON: Just making sure I
4 understand this one. When we determine the discount
5 rate for claims, we use a weighted average --
6 actually, a duration-weighted average yield of the
7 portfolio. So all that means is we have a matching
8 group of assets that we're matching to claims and the
9 yield on those assets is the -- what we're going to
10 use to discount the claims.
11 Since we have different types of bonds
12 in that portfolio, we had -- we talked yesterday, we
13 had the nonmarketable bonds held at book value. We
14 had marketable bonds held at market value. We've had
15 other types of items in there like floating rate notes
16 or -- or cash in the past.
17 The way we created our discount rate in
18 previous years was to take a sort of weighted average
19 of those -- of all those items. What they suggested
20 here is that a more accurate way would be to just
21 literally take the whole portfolio and do a bond-by-
22 bond yiel -- weighted average yield. When we looked
23 at that recommendation, we agreed, and that's what we
24 do now.
25 So we -- we actually got, I believe it

1 was nine (9) basis point yield pickup when we made
2 that change, but something less than ten (10) basis
3 points, so a slight yield pickup when we converted to
4 -- to their methodology.
5 MS. HEATHER REICHERT: And as it
6 relates to the -- the third one (1), as we move to a
7 more closely -- sorry, closely matched portfolio to
8 the claims liability, the -- our bond manager, and --
9 and we are providing this information, our bond
10 manager needs to know what the claims liability
11 duration is on a -- on a monthly basis so that they
12 can take what steps necessary in the subsequent months
13 -- they're monitored on a -- on a quarterly basis --
14 to -- to get the bond duration within that band that
15 we were talking about.
16 So we're aiming for plus or minus zero,
17 which is obviously very difficult to get right to
18 zero. So the manage -- and -- and are held
19 accountable to -- to manage within a plus or minus
20 point two-five (.25). So we provide our -- our
21 investment department provides them with what the
22 claims liability duration is at the end of each month
23 to allow them to have that information to adjust the
24 bond portfolio.
25 So this recommendation was just

1 ensuring that we would be able to provide the adequate
2 information to our bond manager for them to be able to
3 -- to meet the -- the duration-matching strategy.
4 MS. CANDACE GRAMMOND: Ms. Reichert,
5 where Aon refers in the third bullet to a tighter
6 hedging strategy, that's a reference to what you've
7 just described to bring the gap down to plus or minus
8 zero, or as close to that as you can get?
9 MS. HEATHER REICHERT: Yes, that's my
10 understanding, yes.
11 MS. CANDACE GRAMMOND: Approximately
12 when were these three (3) recommendations made by Aon
13 to the Corporation?
14
15 (BRIEF PAUSE)
16
17 MS. HEATHER REICHERT: The final
18 version of Phase 1 was received by the Corporation in
19 October 6th -- on October 6th.
20 MS. CANDACE GRAMMOND: Of 2014?
21 MS. HEATHER REICHERT: Yes, of 2014.
22 MS. CANDACE GRAMMOND: Now, Diana, I'm
23 going to ask you to pull up PUB/MPI-2-3. And while
24 that's being done, Ms. Reichert, you and I had an
25 exchange yesterday about the scope of the Phase 1

1 study. We reviewed the mandate that was set out at
2 the beginning of Attachment B. And you had advised --
3 this is at page 686 of the transcript -- that when Aon
4 did Phase 1, they looked solely at the interest rate,
5 and that it was on a preliminary basis. And it wasn't
6 until Phase 2 that the interest rate piece was
7 combined with the claims liabilities piece. I'm --
8 I'm paraphrasing, but...
9 MS. HEATHER REICHERT: Yes. Correct.
10 The -- the Phase 1 was an asset-only exploration, and
11 it was not until Phase 2 that they looked at the
12 combination of what was the portfolio of assets that
13 would best -- best match our portfolio of claims.
14 MS. CANDACE GRAMMOND: Diana, if you
15 scroll, you'll get to the answer at 2-3(a), which is
16 similar in content -- that's perfect, thank you --
17 which is similar in content to what you've just
18 described, Ms. Reichert, that Aon Phase 1 report was
19 conducted on an asset-only basis. What we're trying
20 to understand, given what we see on the screen and
21 given the evidence that you've provided, is the basis
22 on which the Corporation makes those statements.
23 And I'll -- I'll explain further. If
24 we go, Diana, back to Attachment B, we see discussion
25 of the tracking error that we spoke of yesterday. We

1 also see on pages 37 and 38 -- and, Diana, I'd ask you
2 to go to page 37 -- a comparison of estimated cash
3 flow of liabilities and current fixed income
4 portfolio.
5 So why does the Corporation take the
6 position that this was an asset-only analysis in Phase
7 1?
8 MS. HEATHER REICHERT: Because it --
9 because it was. The -- that was -- the -- the work
10 that they did was to look at our bond portfolio, and
11 look how -- from a -- from the -- the -- what's --
12 what's the word I'm looking for? From the management
13 of that bond portfolio, from the performance of that
14 bond portfolio, how could we improve that irrespective
15 -- this is my understanding -- irrespective of the --
16 the liabilities?
17 It wasn't until Phase 2, and you can
18 see in Phase 2 in the recommendations where the
19 risk/reward was very clearly looked at as to what were
20 the different hedging strategies that would reduce our
21 risk, while not as significantly impacting the yield
22 of our -- of our portfolio? And if you -- actually,
23 we could probably turn to that, because it think that
24 that would be appropriate. In Attachment C, there's a
25 -- just one (1) minute.

1 (BRIEF PAUSE)
2
3 MS. HEATHER REICHERT: In Attachment
4 C. Okay. Sorry. Just one (1) moment.
5
6 (BRIEF PAUSE)
7
8 MS. HEATHER REICHERT: Okay. So on
9 Attachment C, page 34. Diana?
10
11 (BRIEF PAUSE)
12
13 MS. HEATHER REICHERT: Oh, it's up
14 there already. So on this particular slide -- and
15 this, from -- from my perspective, was the -- the most
16 important slide. This is taking the various
17 approaches to -- to hedging that I described
18 yesterday: Cash flow, bucket, and duration. The more
19 closely duration match. And plotting it between the
20 volatility, so the -- the risk of achieving the -- the
21 risk of achieving the -- the returns that you are --
22 or the matching that you're trying to achieve compared
23 to on the -- on the vertical access, the impact to
24 Basic net income.
25 So when -- ultimately what we -- the

1 recommendation that was made by Aon and that was
2 accepted by MPI was to move to the 70 percent of fixed
3 income on a duration match -- duration match approach.
4 So when you look at this particular graph and you see
5 the bubble that has the 70 percent in there and you
6 see the -- the circle, which represents duration
7 matching, so we have reduced the risk from what we
8 were currently doing.
9 And what we were currently doing was
10 the -- the base case, which I think is actually
11 covered up by -- it's hard to see. It looks like it's
12 a square, but it's actually the circle which is at the
13 60 percent, the -- the intersection of the two (2)
14 lines that you see there at the 60 percent, because
15 that was what our portfolio was at, was a 60 percent
16 bond percentage.
17 So you can see from the -- from this
18 graph the base case -- the -- the blue circle at 60
19 percent compared to the recommendation that was made
20 and accepted of the orange circle, if you will, in the
21 70 percent bubble, we reduced our risk substantially
22 without decreasing the return significantly.
23 The other options increased our risk.
24 Maybe gave us more return, but unnecessarily, in our
25 opinion, increased our risk. And then the other

1 options going to eighty (80), ninety (90), 100
2 percent, while it would have decreased our risk even
3 more than what we implemented, the impact on our net
4 income was more significant, more severe.
5 So that's -- they went through the
6 process of -- of analyzing and came up with the -- the
7 70 percent being the optimal reducing risk and not as
8 negatively impacting on the Basic income. And that's
9 where -- that's where the Organization went in the
10 implementation.
11 This Phase 2 that did this was not
12 finalized until December 5th, 2014, is when it was
13 reviewed by the investment department, distributed to
14 our investment committee working group, and
15 subsequently was accepted -- those recommendations
16 were accepted December 17th, 2014, and we reported it
17 to the invest -- sorry, distributed it to the
18 investment committee members and it was accepted by
19 them in a presentation January 16th, 2015.
20 So this construct was not determined
21 and was not finalized until December and then accepted
22 by our investment committee in January of 2015.
23 THE CHAIRPERSON: Can -- can we just
24 take a moment.
25

1 (BRIEF PAUSE)
2
3 THE CHAIRPERSON: Okay. Thank you
4 very much. You can continue.
5
6 CONTINUED BY MS. CANDACE GRAMMOND:
7 MS. CANDACE GRAMMOND: Diana, can you
8 go back to Appendix B and pull up -- or Attachment B,
9 sorry, and pull up page 37. Thank you. Ms. Reichert,
10 you agree that there is a reflection on this graph of
11 estimated cashflows of liabilities?
12 MS. HEATHER REICHERT: Yes, I do.
13 MS. CANDACE GRAMMOND: We're
14 struggling to reconcile what we see on this graph with
15 the Corporation's position that liabilities were not
16 considered at all in Phase 1.
17 MS. HEATHER REICHERT: Maybe I can
18 restate. So, yes, I see that this graph is showing
19 claims liabilities cashflow against some current fixed
20 income portfolio for them to get an understanding of
21 what our current matching strategy, in fact, was
22 doing.
23 But it was not until Phase 2, and the
24 graph that I just showed you, that they looked at the
25 optimization of the bond portfolio with our claims

1 liability and made the recommendation to have 70
2 percent of our portfolio in bonds, and with a more
3 precise duration matching that, that was an optimal
4 position for the Corporation to look at. And we
5 looked at it and agreed, and implemented that.
6 MS. CANDACE GRAMMOND: We're not
7 disputing that the recommendation was part of Phase 2,
8 but what we're struggling with is the chara --
9 characterization by the Corporation of Phase 1 at --
10 as asset only when looking at this graph, and looking
11 at many other references within the Phase 1
12 PowerPoint, there are clearly references to
13 liabilities. Do you accept that?
14 MS. HEATHER REICHERT: Yes, I accept
15 that. But I guess I -- I'm not sure that I understand
16 why that is at all relevant when within Phase 1 there
17 was not a clear -- like it was not until Phase 2 that
18 there was a clear recommendation of what the optimal
19 strategy was that we should be pursuing.
20 So while there may have been graphs
21 like this where they were comparing the -- the
22 liabilities to the -- to the fixed income portfolio,
23 they didn't do the optimization work until Phase 2.
24 And then that is when -- when we accepted their report
25 and continued on. I -- from my perspective, that is

1 how -- how it unfolded.
2 MS. CANDACE GRAMMOND: Let's go then
3 to Attachment C, which we looked at a moment ago, Ms.
4 Reichert, and we'll start closer to the beginning of
5 that document on page 4. That's where we'll find the
6 mandate of Phase 2 as stated by Aon.
7 If we look at the first section, we see
8 that Aon has stated its mandate was to determine an
9 appropriate asset allocation for MPI's investment
10 portfolio. We're agreed on that?
11 MS. HEATHER REICHERT: Yes.
12 MS. CANDACE GRAMMOND: Now, if we go
13 to page 5, the very next slide, can you comment upon
14 how the stated objective in the middle of the page,
15 that is that MPI indicated short-term volatility of
16 the premium rate requirement was a primary concern,
17 affected Aon's approach to Phase 2?
18
19 (BRIEF PAUSE)
20
21 MS. HEATHER REICHERT: Can you repeat
22 the question, please?
23 MS. CANDACE GRAMMOND: Yes. Being
24 mindful of the objective that's reflected in the
25 middle of the page, can you comment upon how the

1 approach taken by Aon to Phase 2 was affected?
2 In other words, how did the state of --
3 stated objective effect Aon's approach to Phase 2?
4
5 (BRIEF PAUSE)
6
7 MR. LUKE JOHNSTON: I -- I can answer
8 this one. All -- in my -- my recollection of this,
9 all this is is MPI saying that rate stability is a
10 very important goal of the Corporation, right. It
11 didn't limit their analysis in terms of -- Ms.
12 Reichert just showed you the risk return relationship,
13 and we could have chosen to be at a higher risk,
14 higher return point on that graph but it's important
15 for Aon to know how important rate stability is for
16 MPI, and in the context also of our -- our existing
17 capital ranges and -- and such.
18 But that was just -- that's just given
19 as information, and -- and so they know what kind of
20 the corporate objectives are.
21 MS. HEATHER REICHERT: And I think if
22 I can add to that. It is indicative that we've said
23 many times rate predictability and stability is very
24 important to the corporation. We have also stated
25 that -- that our objective is to first have the

1 appropriate cashflows to manage our claims liability.
2 And then secondary to that is to get as good a yield
3 as possible.
4 So first is protect the liabilities.
5 And second is to enhance our -- our yield as much as
6 possible in that construct while trying -- always
7 keeping in mind rate predictability and stability.
8 MR. LUKE JOHNSTON: And just -- just
9 to add to that, going back to that graph --
10 MS. HEATHER REICHERT: On page --
11 MR. LUKE JOHNSTON: -- on page 34 of
12 the -- the slides that you're on, in terms of what
13 impact would -- knowing MPI's objectives would have on
14 this, if you -- if you look at the bottom, the
15 horizontal ax -- axis, it's average annual volatility
16 of retained earnings that is -- is the measure of the
17 risk reward relationship.
18 So as we've talked a lot about in the
19 DCAT and rate stability, that -- that was their
20 measure of -- of how to -- how to calculate
21 volatility.
22 MR. REGIS GOSSELIN: Looking at that
23 graph, you know, so by going -- by -- by going to 60
24 percent you would get -- looking at the duration match
25 approach, you get an incremental gain of about fifteen

1 (15) basis points versus a risk -- enhanced risk
2 profile -- or enhanced risk vol -- enhanced volatility
3 of about, eyeballing that, twenty (20).
4 So -- so why go to seventy (70) as
5 opposed to stay with sixty (60)? Is it just you
6 weighted the -- weighted the -- you just weighted the
7 stability higher than you would have weighted the sort
8 of...?
9
10 (BRIEF PAUSE)
11
12 MS. HEATHER REICHERT: If -- while
13 we're just getting organized, if you can move to slide
14 37.
15
16 (BRIEF PAUSE)
17
18 MR. LUKE JOHNSTON: Okay, thank you.
19 So on slide 37 here there's two (2) kind of sections
20 to this graph. Desired state rules are the
21 information we gave them about the RSR targets. We
22 didn't have certainty on those targets. What we said,
23 you know, For this analysis assume roughly the DCAT-
24 based target and the MCT upper target as your
25 operating range for where to issue rebates and

1 surcharges.
2 We -- we wanted something, like, so an
3 approximation. And then the other side is just having
4 no RSR targets at all. If you looked at the desired
5 state portion of the graph, the -- where it says, "60
6 percent," the blue diamond shape is the risk return
7 relationship for cashflow matching in -- in that -- in
8 that portfolio.
9 And if you slide over, you can see in
10 the 70 percent fixed income portfolio, we can get the
11 -- based on this analysis -- the same return for less
12 risk. Sorry, with -- with the duration matching
13 approach.
14 So that was -- you know, we -- we
15 looked -- we're looking at all the strategies, but
16 from that perspective we could use a duration based
17 approach and expect to get about the same return as
18 cash flow matching at the -- so that -- that was --
19 that was one (1) of the key drivers. Obviously we
20 have to select a risk tolerance regardless, but this
21 graph was an important part of that decision. Yeah.
22 MR. REGIS GOSSELIN: Yeah, I get that.
23 But the -- but -- but looking at the two (2) orange
24 points there. So -- so you get duration matching at
25 70 percent and duration matching at 60 percent.

1 Why go to seventy (70) as opposed to
2 sixty (60)? I mean, you could have -- you could have
3 just said, you know, for -- for maybe a -- a little
4 bit more risk I get a potential fifteen (15) poi -- I
5 get, you know -- I -- I get a fairly reasonable
6 return.
7 MR. LUKE JOHNSTON: Agreed. And
8 there's -- there's always going to be a selection that
9 has to happen, a -- a risk tolerance selection. When
10 -- the 70 percent brings us very close to ensuing that
11 all of the claims liabilities are matched to fixed
12 income.
13 MR. REGIS GOSSELIN: Yeah.
14 MR. LUKE JOHNSTON: Right? And so to
15 the extent we're at sixty (60), or fifty (50), or --
16 or -- we will have more interest rate volatility. But
17 you're right, like, equities are going to probably
18 return more on average. But in terms of, again,
19 thinking about this is MPI. We -- my -- my view is,
20 you know, really protect the claims liabilities,
21 matched, the -- the other people we have to pay money
22 to, et cetera. Excess retained earnings -- you know,
23 more appropriate to invest in equities and -- and
24 such.
25 But even our -- our new policy going

1 forward is to always ensure that the claims
2 liabilities have coverage from -- by fixed income.
3 And even if they fall -- if they fall short, even it
4 means going above an allocation, we're going to make
5 sure that they continue to be matched. Yeah.
6
7 CONTINUED BY MS. CANDACE GRAMMOND:
8 MS. CANDACE GRAMMOND: Diana, I'm
9 going to ask you to go back to slide 5, where we had
10 the stated objective for phase 2. And just before I
11 ask a specific question about that, I -- I appreciate
12 this is where this last back and forth started. And
13 then the -- the panel -- the witness panel took us to
14 slides 34 and 37. You would agree that stability of
15 retained earnings is affected by many factors other
16 than rates.
17 MR. LUKE JOHNSTON: Other than
18 interest rates? Or other than -- or what kind of
19 rates?
20 MS. CANDACE GRAMMOND: Insurance
21 rates. Premiums.
22 MR. LUKE JOHNSTON: Premiums would --
23 I might not be understanding the question. But -- but
24 premiums would be our most stable forecast. I'm --
25 I'm not sure what -- what you're meaning.

1 MS. CANDACE GRAMMOND: Right. So the
2 stability of retained earnings is dependent on many
3 other factors than insurance premiums?
4 MR. LUKE JOHNSTON: Retained -- the
5 stability of retained earnings would be driven by any
6 -- any of our forecasts deviating, the most
7 significant being assets and claims, et cetera. The
8 premium would be generally very stable with -- with
9 the exception of having rate changes to respond to any
10 kind of changes in forecasts. I don't think I'm
11 totally understanding, but if that's helpful.
12 MS. CANDACE GRAMMOND: No, I -- I
13 think we're -- we're okay. What we're trying to
14 understand is: we've got on slide 5 on the screen a
15 stated objective.
16 And we're trying to understand where
17 does that stated objective manifest itself within the
18 balance of the phase 2 document?
19 MR. LUKE JOHNSTON: Sorry. If -- if
20 you're constantly going in and out of your RSR target
21 ranges, so falling way below or going way over, you're
22 going to have rate volatility. And that doesn't mean,
23 like, the 2 percent rate change. It -- it would more
24 typically mean rebates and -- and RSR fees. But in
25 this context we mean that to -- as rates.

1 So there would also be just general
2 rate changes volatility, but it's more the volatility
3 outside of the RSR targets that we're -- we're talking
4 about here.
5
6 (BRIEF PAUSE)
7
8 MS. CANDACE GRAMMOND: So the
9 manifestation, then, of this objective is within the
10 desired state rules that we looked at a minute ago on
11 slide 37, I believe it was?
12 MR. LUKE JOHNSTON: Yes, we modelled
13 both, but clearly our focus was on -- or at least
14 approximation of the desired state. No doubt if -- if
15 we had a -- say, a much tighter RSR bandwidth, the --
16 obviously, the analys -- type of analysis would be the
17 same, but it would show more volatility outside of
18 that bandwidth relative to the one we've -- we've put
19 forward.
20 But that -- that's a reasonable
21 assessment of -- of how it -- you could see that that
22 was our focus, yeah.
23
24 (BRIEF PAUSE)
25

1 MS. CANDACE GRAMMOND: So when we see
2 the phrase in the objective premium rate requirement,
3 really, it's a reference to minimizing fluctuations in
4 rebates and surcharges outside of those -- or -- or
5 the balance being outside of the proposed bands of the
6 RSR?
7 MR. LUKE JOHNSTON: That would be the
8 -- the typical impact of these type of swings. And --
9 and per the slide you saw earlier, it is specifically
10 stated the -- the -- I can't remember the exact word,
11 but the variability in retained earnings is -- is the
12 -- the measurement of -- of risk. So that -- that's
13 correct.
14 MS. CANDACE GRAMMOND: Diana, I'm
15 going to ask you to go to slide 9 of this document
16 Attachment C. So we see a heading, firstly, "Risk
17 Diagnosis." And then secondly, a heading in bold,
18 "Key Takeaways From the Risk Diagnosis."
19 Can you discuss for the panel the
20 approach taken by Aon, firstly with respect to risk
21 diagnosis?
22
23 (BRIEF PAUSE)
24
25 MR. LUKE JOHNSTON: So this is just

1 essentially their own assessment of our base case
2 scenario with the exception noted, which we just
3 discussed. We -- we did provide them with a proxy of
4 a -- of a rate stabilization reserve range on the
5 basis listed.
6 Obviously, we can't recreate DCATs in -
7 - for ten (10) years out into the future. So what we
8 did is sai -- we said, Well, the most recent DCAT is
9 about 65 percent MCT. So use that as a -- a proxy for
10 your lower bound, and then use a hundred percent for
11 the maximum. And then also noted for -- in terms of
12 their modelling, they assumed a bucket -- a bucket
13 approach to liability matching. And then at the
14 bottom -- oh, sorry.
15 MS. CANDACE GRAMMOND: Mr. Johnston,
16 I'm just going to interrupt you there. Before you go
17 to the bottom section, that last reference to the
18 fixed income portfolio being assumed to follow a
19 bucket approach to liability matching, can you comment
20 on why the -- the base case results make that
21 assumption?
22
23 (BRIEF PAUSE)
24
25 MR. LUKE JOHNSTON: We're just looking

1 for a Phase 1 reference.

2

3 (BRIEF PAUSE)

4

5 MR. LUKE JOHNSTON: In -- in Phase 1

6 slides, I don't know if we need to go to them, but

7 page 21, Phase -- in Phase 1, they do -- Aon makes a

8 recommendation to use a more flexible bucket-type

9 approach, and if -- if you see that about -- I guess

10 the -- three (3) bullet -- there's the initial bullet

11 point, and then the three (3) bullet points

12 underneath, the third one.

13 So that's where they were initially

14 going in Phase 1, and -- and that's what they used to

15 initially model the base case in Phase 2 without any

16 particular direction in mind. But they didn't model

17 all three (3), or multiple versions of the base case.

18 That's as a -- just an initial base case starting

19 point. Okay.

20 MS. CANDACE GRAMMOND: Mr. Johnston,

21 was there a subsequent base case that was done

22 differently?

23 MR. LUKE JOHNSTON: I don't believe

24 so.

25 MS. CANDACE GRAMMOND: So if there was

1 only the one (1), then why is it characterized as a
2 preliminary base case? Usually that would imply that
3 there is a preliminary and a final.
4
5 (BRIEF PAUSE)
6
7 MR. LUKE JOHNSTON: Yeah. Just -- if
8 you go back to the slide that we were just discussing
9 on the risk diagno -- nostics -- diagnosis, this is
10 just their initial risk assessment of -- of MPI's
11 asset liability portfolio. Yeah, I -- I didn't get
12 the impression that we needed to go back and redo the
13 risk diagnosis with the final program that -- I guess
14 we could have, but we didn't.
15 MS. CANDACE GRAMMOND: When you say
16 this is their initial assessment, though, this is
17 Phase 2 executive summary. Isn't this the end of the
18 analysis?
19 MR. LUKE JOHNSTON: This is an -- a
20 base case assessment, and then they go into the
21 details of all the modelling and -- and variability
22 around the base case.
23
24 (BRIEF PAUSE)
25

1 MS. HEATHER REICHERT: So while --
2 we're just getting organized. So this is the
3 beginning of the executive summary. So the executive
4 summary goes through the process that they undertook
5 to come to the final recommendation that they make,
6 which is the 70 percent fixed income duration matched.
7 So they did a risk diagnosis of the base case that was
8 used in Phase 2, and describe it there. And the base
9 case that they used was the bucketed hybrid approach.
10 And then from that, they talk about
11 retained earnings. And then they go into, on page 11,
12 the optimization and how they approached the
13 optimization, and then resulting in their ultimate
14 recommendation. So that's -- it's -- it' an executive
15 summary going through the process they undertook to
16 arrive at their -- their final recommendations.
17 MS. CANDACE GRAMMOND: And we -- we
18 definitely want to come to slide 11. We're going to
19 go there shortly, but just before we do that, what
20 we're trying to understand is if the base case that
21 was used for comparison purposes doesn't reflect what
22 MPI actually does, then doesn't that impact the
23 validity, or the weight, of the overall conclusions?
24
25 (BRIEF PAUSE)

1
2 MR. LUKE JOHNSTON: Sorry, the -- it's
3 hard to remember everything we discussed at this time.
4 But there was -- obviously we've already modelled our
5 MPI-base case. And when we were doing this analysis I
6 think everybody went in with the expectation that
7 MPI's base case was no longer going to be what was
8 used.
9 So we talked last year about cashflow
10 matching. We talked with Aon about maybe something
11 not quite as complicated as cashflow matching, like
12 hybrid. This was the initial base case diag --
13 diagnosis that they did, I'd say it -- like, on just
14 their initial assessment, again recognizing that we
15 didn't think we were really going to stay with the
16 duration two (2) year gap type methodology that MPI
17 was currently using.
18 When you go further down into the
19 executive summary they do talk about that they looked
20 at the optimization of all the different approaches
21 and hedging strategies. So I don't think it's like
22 we're missing something here. I don't -- like, I -- I
23 don't -- this is just saying their initial kind of
24 assessment, but the other approaches are -- are
25 modelled. So I -- I'm struggling a bit with what --

1 what we're looking for here in this discussion, but
2 that's all I can say on that.
3
4 (BRIEF PAUSE)
5
6 MS. CANDACE GRAMMOND: Mr. Johnston,
7 would you agree that if the base case doesn't reflect
8 what MPI is actually doing, then we just shouldn't pay
9 heed to the base case?
10 MR. LUKE JOHNSTON: Well, this is Aon
11 running through their own optimization models -- our
12 information. So as we talked about, out of Phase 1
13 they were kind of pushing towards a bucket type
14 approach and they use their modelling to run a base
15 case assessment. It's good to know that they're own -
16 - this is -- again, this is their own proprietary
17 models. They're running this through just to get an
18 initial assessment. I think that's all we're really
19 talking about.
20
21 (BRIEF PAUSE)
22
23 MS. CANDACE GRAMMOND: So Aon's
24 initial assessment was to get a sense of what the
25 outcome of its own model would be, not what MPI

1 actually does? In other words, the base case isn't
2 supposed to reflect what MPI does?
3 MR. LUKE JOHNSTON: That's correct.
4 It's very much went into this with the expectation
5 that we were going to change something. Like, it's
6 there. Here's all -- you know, all our cashflows,
7 liabilities, investment, you know, your model, Aon's
8 model. Do your optimization. Let's see what comes
9 out. Make a recommendation. Make decisions, et
10 cetera. Yeah, it wasn't intended to -- to model MPI's
11 existing world base case at all.
12
13 (BRIEF PAUSE)
14
15 MS. CANDACE GRAMMOND: Mr. Johnston, I
16 want to clarify another aspect of this. You've
17 testified that the desired state rules include
18 reference to the RSR range, as opposed to -- oh,
19 sorry, and it's right on the screen. The desi -- the
20 desired state rules apply to the RSR itself.
21 But what about the total equity range
22 instead?
23
24 (BRIEF PAUSE)
25

1 MR. LUKE JOHNSTON: I can't at --
2 right now I can't remember off the top of my head of
3 the -- the mechanics of how the rebates were derived.
4 So clearly, right here the -- the MCT was used as a
5 basis for the upper and lower targets. But in terms
6 of what triggered the rebate or surcharge under that
7 range, I'd have to -- I'd have to look that -- look
8 that up in the documentation.
9
10 (BRIEF PAUSE)
11
12 MS. CANDACE GRAMMOND: But, to be
13 clear, the targets that we're speaking about, upper
14 and lower, are for RSR, not tot -- total equity?
15 MR. LUKE JOHNSTON: They're total
16 equity targets, but the rate stabilization reserve is
17 a word we're struggling with here, right? Like,
18 historically rate stabilization reserve has meant
19 retained earnings. So that's what Aon's referring to
20 as rate stabilization reserve, these -- the two (2)
21 MCT total equity targets. Is that fair?
22 Like, rather than saying rate
23 stabilization total equity reserve -- or some --
24 something like that, right? We -- this is just the
25 term that we've described the -- the bounds -- the --

1 the bands that that's in.
2 MS. CANDACE GRAMMOND: So even though
3 it says 'rate stabilization reserve', you -- your
4 evidence is that the intention was total equity
5 balance?
6 MR. LUKE JOHNSTON: Yes, and same --
7 same thing. If we -- if we were to decide on total
8 equity bands here, we have to decide what we're
9 calling that. Are we still calling it the rate
10 stabilization reserve, or do we need a new name for
11 that? Or we just redefine the -- what it means to
12 have rate stabilization reserve, yeah.
13 MS. CANDACE GRAMMOND: Obviously the
14 difference being the total equity bands include
15 accumulated other comprehensive income?
16 MR. LUKE JOHNSTON: That's right.
17
18 (BRIEF PAUSE)
19
20 MR. DAN GUIMOND: Excuse me. I --
21 it's Dan here. I -- I'm just wondering if -- if it'd
22 be okay if we took a little break? I -- I don't know
23 if that would be possible. I -- I have to -- I
24 apologize, I have to excuse myself maybe for a little
25 while. But I was just wondering if it would be maybe

1 the time to -- to take a -- a break maybe?
2 MS. CANDACE GRAMMOND: That's fine
3 with me, but up -- up to the panel for sure.
4 THE CHAIRPERSON: Yes, that would be
5 fine. We could take a fifteen (15) minute break.
6 Thank you.
7
8 --- Upon recessing at 9:57 a.m.
9 --- Upon resuming at 10:20 a.m.
10
11 THE CHAIRPERSON: Thank you very much.
12 We're ready to begin again. And I'm going to call
13 upon Ms. Kalinowsky to present two (2) new exhibits.
14 MS. KATHY KALINOWSKY: Thank you. I
15 have two (2) exhibits here that are to be filed, the
16 responses to Undertaking number 3, which is modelling
17 the flat interest rates from the end of August to the
18 current fiscal year. And that should be marked as MPI
19 Exhibit number 12.
20
21 --- EXHIBIT NO. MPI-12: Response to Undertaking
22 No. 3
23
24 MS. KATHY KALINOWSKY: And Undertaking
25 number 6 should be marked as MPI Exhibit number 13.

1
2 --- EXHIBIT NO. MPI-13: Response to Undertaking
3 No. 6
4
5 MS. KATHY KALINOWSKY: And with that I
6 do know that Ms. Reichert wanted to put something in
7 on the record for clarification purposes right now.
8 If she could proceed with that before the commencement
9 of the cross-examination once again?
10 THE CHAIRPERSON: Thank you. Ms.
11 Reichert, please go ahead.
12 MS. HEATHER REICHERT: Thank you. I
13 just -- I, before the break, was a bit concerned about
14 the -- the line of questioning that -- and our
15 responses to that. That might be leaving the panel
16 with the impression that the -- that the base case
17 that was used by Aon in the study, and then
18 subsequently in -- on phase 2, was somehow not a
19 legitimate base case for them to use.
20 That, from my perspective, it's not
21 accurate. The base case is really a -- a minor point
22 in the whole study. What Aon did was they used our
23 existing asset allocation of 60 percent to fixed
24 income bonds, and modelled that -- and -- and modelled
25 that using a bucket approach, which was their

1 recommendation from Phase 1, that they thought a
2 bucket approach was going to be the -- the way to go,
3 but they took our existing asset allocation and
4 modelled that.
5 And then after they did that, they
6 completed the optimization work where they modelled
7 every other, like, cashflow bucket and duration at
8 varying asset allocation mixes. And it was that
9 optimization, based on what we had said was our -- our
10 risk -- like, our -- sorry, by them defining and --
11 with us what the risk and reward was that we were
12 concerned about.
13 So our risk that they had on the
14 horizontal axis was fluctuations or volatility of
15 retained earnings, which will ultimately impact on
16 whether or not we have to have a RSR rebuilding fee,
17 which is a concern that we have. So they took that as
18 our risk identification against net income being the
19 reward and not sacrificing too much income.
20 So -- so based on that assessment of --
21 of our risk and reward, they then determined the best
22 approach to mitigating the interest rate volatility
23 was that more precise duration matching. And -- and
24 as we showed you on that one (1) line, that more
25 precise duration matching achieved the same kinds of

1 net income impact, if you will, as a -- a more precise
2 cashflow matching would -- would do.
3 So from that, we said the
4 administrative costs of a cashflow matching scenario
5 is -- is very, very significant. If we can achieve
6 the same kind of net income from a duration matching
7 with less risk, then that was the route that we wanted
8 to go.
9 Once we decided that was the
10 recommendation that we were going to proceed with, our
11 forecast presented to the -- the panel through our GRA
12 has used that -- that assumption as -- as we've talked
13 about already in the -- in this -- in this hearing.
14 So as of August 31st, we moved to a more precise
15 duration matching, and our model underlining our rate
16 recommendation uses that as our base model, if you
17 will.
18 So I just wanted to make sure that that
19 was -- was very clear, because the -- the questions
20 around the base model, it was our 60 percent
21 allocation. It was our investment portfolio modelled
22 using a bucket approach that they thought initially
23 would be more appropriate, but when they optimized it,
24 did the -- the risk/reward, it came out to being a
25 more perfect duration matching would achieve what we

1 needed to achieve. Thank you.
2 MS. CANDACE GRAMMOND: Diana, I'm
3 going to ask you to pull up slide 11 of the same
4 Attachment C that we were looking at. So we have on
5 pages -- or slides 11 and 12, a discussion with
6 respect to optimization.
7 What I'd ask that you comment on with
8 respect to Aon's approach to opt -- optimization is
9 how and why the Phase 1 recommendation for a tighter
10 hedging strategy that we spoke about was changed.
11
12 (BRIEF PAUSE)
13
14 MS. HEATHER REICHERT: I think it says
15 in this optimization executive summary that the cost
16 of more precise matching is too high for the reduction
17 and the risks. So more precise matching has a higher
18 cost because the portfolio yields are lower. Duration
19 matching has the highest yield. The bucket approach
20 has a lower yield, and cashflow matching has the
21 lowest yield.
22 This occurs because as you more closely
23 match cashflows, the portfolio invests more in
24 shorter-term lower yield bonds. So when they did the
25 full work that they were hired to do, the full

1 optimization and comparison of all of the different
2 scenarios, it was a balance between the risk of -- of
3 not getting as high a yield, the impact on the net
4 income versus -- or the volatility, sorry, in retained
5 earnings versus not sacrificing too too much of the
6 yield. So it's -- it's a balance. It's always a
7 balance. And going through that whole -- the whole
8 process, that was the ultimate recommendation that --
9 that met what the Corporation has been trying to do.
10 MS. CANDACE GRAMMOND: Diana, I'll ask
11 you to go to slides 14 -- or slide 14, I should say.
12 Ms. Reichert, we'll find on slides 14 and 15 the
13 recommendations of Aon, and you'll see the -- that
14 first heading on slide 14 of 'Policy Considerations'.
15 I'm going to ask firstly that you
16 comment upon Aon's recommendations with respect to
17 policy, and then we'll go to slide 15 and talk about
18 portfolio composition.
19 MS. HEATHER REICHERT: Yeah. Okay.
20 So -- sorry, it's on the -- on the screen. So Aon, in
21 conducting their work, had observations about policy
22 considerations that they thought would help with
23 issues of potential liquidity. So they noted that if,
24 in fact, a surplus distribution was in the future
25 indicated, so, i.e., excess retained earnings above

1 what was required from a capital nature, that from
2 their perspective, they thought that a -- a policy
3 that took that distribution and spread it over a
4 number of years as opposed to in a one (1) -- one (1)
5 payment would ease potential liquidity issues that
6 might result otherwise.
7 So that's not a policy that -- that we
8 are in -- embarking on. That isn't really in -- in
9 MPI's ability to accept because if, in fact, there is
10 a rebate, it is ordered by the Public Utility Board,
11 and -- and I would expect that the order also orders
12 how quickly or -- or not a particular rebate has to
13 occur. But that was -- from a cashflow management
14 perspective, that was their recommendation.
15 The second was with respect RSR
16 targets. They -- they -- we had to give them some
17 kind of a gauge on an RSR range, which, as Mr.
18 Johnston indicated, was based on MCT total equity, so
19 65 percent equated to approximately what the DCAT --
20 DCAT was showing, and then the 100 percent for the
21 upper limit. They noted that because of the
22 narrowness between the lower and the upper limit, that
23 that was resulting in more frequent and larger rate
24 adjustments.
25 So they in here were recommending a

1 policy that would see a larger distance between the
2 lower and the upper limit. Again, that is in front of
3 this panel at this hearing, of -- the issue of: What
4 should the minimum and what should the maximum target
5 be? So again, that was their observation that -- from
6 our -- from what they understood our objective being,
7 not wanting unstable and unpredictable rates, that
8 their recommendation was we should look at having a
9 wider minimum/maximum target range.
10 MS. CANDACE GRAMMOND: Ms. Reichert,
11 just before you go to the next one: When we talk
12 about rate adjustments in this context, that's a
13 reference to surcharges and rebates?
14 MS. HEATHER REICHERT: I'm sorry. Can
15 you repeat the question?
16 MS. CANDACE GRAMMOND: Sure. When
17 we're talking about the phrase 'rate adjustments' in
18 the evidence that you just provided, we're -- what
19 we're really referring to are surcharges and rebates
20 relative to the RSR?
21 MS. HEATHER REICHERT: It includes
22 surcharges and rebates, yes. That would likely be the
23 -- more of the focus in this respect, but rate --
24 regular rate adjustments could also be considered in -
25 - in this -- in this particular consideration.

1 (BRIEF PAUSE)
2
3 MS. CANDACE GRAMMOND: Can you help us
4 understand how lower and upper RSR targets are, in
5 part, responsible for large rate adjustments, then, if
6 -- if we're not just talking surcharges and rebates?
7 MR. LUKE JOHNSTON: So -- so part of
8 this recommendation is -- is kind of self-evident for
9 -- like, if you have a larger band, you're going to
10 have less variability out of the band, right? If you
11 smaller band, then you're going to have more var --
12 like, so that's obvious.
13 So similar to just the risk tolerance
14 in general, we -- MPI has to come forward with a
15 recommended RSR range, so we -- we've made our
16 recommendation to the Board. Aon's simply saying that
17 you'd have less variability outside of the band if you
18 had a bigger band. Great, right? We get it.
19 The variability obviously can -- from
20 budget. So if you have a big equity decline and
21 you're -- have a $80 million loss or something like
22 that, that's going to hit the RSR, but there's going
23 to be implications for -- for rate setting, as well.
24 If you've -- if your assets have gone down
25 significantly and you make a new forecast, you might

1 not be getting the investment income that you used to
2 have, so there's ripple effects.
3 So when Ms. Reichert says, Includes
4 rebate surcharges, it would definitely include the
5 impact to that. But any rate changes that are caused
6 by the fluctuations would also be included.
7 MR. REGIS GOSSELIN: Could you --
8 could you interpret that line that says:
9 "The distance between targets should
10 reflect the volati -- volatility of
11 the RSR."
12 So how do you interpret that line?
13 MR. LUKE JOHNSTON: Yeah, very much as
14 we're talking about the -- the DCAT should reflect the
15 volatility of -- of our business, I interpret their
16 reference as saying, If you have an expected amount of
17 volatility and, say, you'd like it to stay within some
18 kind of a -- a band, you could look at the range and
19 say, okay, well, we think it would stay within that
20 band 75 percent of the time or -- or whatever the case
21 may be. That's how I interpret that recommendation,
22 yeah.
23 MR. REGIS GOSSELIN: But -- but that
24 would suggest to me that, you know, you -- you
25 increased the probability of the DCAT to encompass

1 that higher range as opposed to going through the MCT.
2 Now, the -- there's an element of decision-making that
3 occurred there.
4 Could you explain why you didn't go
5 with a higher probability on the DCAT and -- as
6 opposed to the MCT?
7 MR. LUKE JOHNSTON: Yes, we -- our --
8 our view on the MCT is very much that it's -- it's
9 that supplementary external objective target that
10 supplements the DCAT -- the internal DCAT approach at
11 -- at one (1) in forty (40). So there has been
12 questions here about, Well, why don't you just use a
13 one (1) in forty (40) DCAT to a one (1) in one hundred
14 (100)?
15 I -- I don't know the exact range that
16 that would produce right now off the top of my head,
17 but let's say it was 230 million to 275 million or 300
18 million. We'd have to look and say, well, that's not
19 a very large range for -- to operate, say, a 50, $60
20 million range. We've lost amounts of that size just a
21 couple times in the last few years, right?
22 So the MCT, from our perspective again,
23 is that external piece, it would encompass all the
24 risks that are being used by the industry -- like, the
25 risk assessment being used by the industry that maybe

1 includes and recognizes risks that we haven't
2 specifically, you know, addressed in the DCAT. Again,
3 this is a collaborative internal risk assessment,
4 right, so.
5 And then the other piece that Mr.
6 Guimond talked about is having that range that's large
7 enough for this recommendation to manage that
8 variability.
9 MR. REGIS GOSSELIN: Now, there's
10 another component there, and it -- which is that
11 smooth rate adjustments could be used to reduce rate
12 volatility. So let's -- let's think about that for a
13 second.
14 So last year, we granted 3.4 percent
15 rate increase. So if we were to follow that
16 recommendation, we would have said two point four
17 (2.4) this year. Next year, we'll do 1 percent. That
18 way, you don't get three point four (3.4), then zero,
19 and next year, who knows what it'll be. You know,
20 it's -- you're getting this lumpiness.
21 And this is suggesting that that is
22 probably the wrong approach. What we should have
23 done, probably, is go two point four (2.4) last year,
24 maybe we'll address the rate rider this year, just to
25 get more of a smoothing. I -- I realize that it's --

1 it's sort of addressing something in retrospect, but -
2 - but this is clearly indicating that what we should
3 be aiming for, both MPI and the PUB, is to make sure
4 that the smooth rate adjustments would be a better
5 approach.
6 MR. LUKE JOHNSTON: I -- I don't -- so
7 when they talk about smoothing, I'll tell you my
8 interpretation of it. So I talked yesterday, I
9 believe, about that I -- I think we sh -- I -- I like
10 our approach of continuing to break even. Break even
11 net income, that's going to create up -- ups and
12 downs. But you can see how hard it is to predict
13 break even net income from year to year, right? So if
14 we were dealing with a really, really large rate
15 change maybe there -- we'd have other discussions,
16 right?
17 But we track the break even net income
18 through time. We make the -- what has historically at
19 least been fairly minor adjustments to keep it in
20 line. We don't let anything build up. You know, if
21 we -- come one (1) year and it's, oh, a 4 percent rate
22 increase, well, let's just, you know, wait and then
23 we'll put two (2) in, or one (1) in. And then the
24 next year all of a sudden it's seven (7). And, like,
25 you haven't -- right -- you -- you could get into a

1 bigger problem.
2 So from the Corporation's perspective,
3 the -- the current approach that looks at break-even
4 net income we're -- we're very much in support of that
5 approach to continue. Where the smoothing comes in, I
6 think, is if we've already kind of looked at that in
7 the DCAT.
8 So when we talk about the management
9 action, if we are hit with one (1) of these big
10 adverse scenarios, we don't just assume the Board's
11 going to have a 10 percent surcharge, right? We say,
12 No more than an additional 2 percent at a time, in
13 terms of a RSR rebuilding fee.
14 And that, from my -- from my
15 perspective, is where you could do the smoothing,
16 right? You don't need to reco -- rebuild the whole
17 RSR in a year. You can, you know, add, you know, a 1
18 or 2 percent fee, re -- recalibrate, recheck the next
19 year. But keep the Basic rates on that break even
20 perspective. That's my interpretation anyways. Yeah.
21 MR. REGIS GOSSELIN: Now, you know,
22 the -- looking at -- at the -- what MPI wants to do,
23 which is to use the MCT as the upper limit for -- I
24 mean, it's a very much -- that's very much a strategic
25 decision, as opposed to a risk decision. You know,

1 it's very much -- in my opinion, and from what I'm
2 hearing, and because if we were to go to a risk
3 decision it might be a different number than the NC --
4 the -- than the MCT -- a hundred percent of the MCT.
5 Am I -- am I wrong there?
6 MR. LUKE JOHNSTON: Currently it's
7 MPI's choice. But I don't -- the MCT is very much a
8 risk decision. It's the industry standard risk
9 assessment. It's -- we've -- we've used the 100
10 percent, so these other more subjective factors that
11 are -- that are included with this -- with the
12 additional 50 percent that the private sector uses, we
13 haven't included those.
14 But in terms of the MCT itself, it --
15 it's the actual calculation and we could go through
16 and see, you know, where we're getting these risk
17 margins added on. And -- and so it is -- it is risk
18 based for sure. And it -- it -- some people's view
19 might be, like, well, why -- why wouldn't we be in
20 line with how everybody else assesses a risk, right?
21 So I agree with that view, too.
22 But for -- for MPI the monopoly we've
23 said in these hearings that, Well, we need our own
24 approach to recognize the monopoly. And the Board's -
25 - and the Corporation's manager in regulatory actions

1 and such and we've met, and we've developed these
2 models, and come up with a -- a target. And that's
3 the two thirty-one (231), right?
4 But we still think it's very important
5 that we still look at this, you know, industry
6 standard risk assessment that, like, everybody else
7 uses, and know what that number is, and -- and
8 recognize that, you know, other people use that to
9 assess their level of risk. And most assess
10 themselves to be -- need even more than that.
11 MR. REGIS GOSSELIN: Yeah, I get -- I
12 get that. But, you know, what you also -- the -- the
13 next piece of that is that's asking this Board to say,
14 You get a hundred percent of MCT. Until you get
15 there, no rebate, no re -- no refunding of -- of
16 premiums back to ratepayers. So, I mean, it -- it --
17 you know, we're -- we're both -- both concerned about
18 the one (1) game which is to make sure there's enough
19 money there to -- to protect against the risk exposure
20 of the Corporation. So -- and that the quality of
21 asse -- the qualitative judgment as to whether that is
22 better accomplished by the MCT versus some other risk
23 based methodology that we're using for setting the
24 minium.
25 So -- and I guess what I -- what I want

1 to hear from you is why is the MCT a better tool than
2 the DCAT that we've been working on for four (4) or
3 five (5) years. And -- and really, I think that
4 you're looking for a cogent argumentation that
5 surround why is it that we should go MCT as opposed to
6 a higher probability?
7
8 (BRIEF PAUSE)
9
10 MR. DAN GUIMOND: From a -- if you
11 think of the -- like, you know, how I think of it as -
12 - as president/CEO, our customers they -- they want to
13 be able to have rates that are predictable and stable.
14 That -- that is so clear with the regression analysis
15 that we did, that price is absolute paramount for the
16 long-term success of public auto insurance.
17 If we start to have ups and downs to
18 the consumers on a yearly basis that's the start of
19 privatization of MPI. They won't tolerate that. So
20 we know that just by natural growth we get about 4
21 percent a year additional premium, right, in terms of
22 the upgrade factors and so on.
23 As a Corporation what we mean by rate
24 predictable stabilized as we understand it from our
25 customers, it means that if I'm on a monthly payment

1 and I keep my car, that next year's rate is the same
2 as this year's rate, or very close. Like they'll
3 accept, in terms of, you know, the territory, the DSR,
4 and so on, if -- if I did something and I'm not a good
5 driver I have to pay a little bit more, they get that.
6 But everything being constant they
7 expect us to manage the company not to have any rate
8 increases year over year and that's why we work so
9 hard on the incurred and that's why we do everything
10 we keep -- do to keep grinding to stay below that 4
11 percent to not have to have a rate increase.
12 Now, bad things happen, unforeseen
13 things happen. And the bigger we get the larger the
14 variance from the forecast, because there's so much
15 volatility with weather, with the financial markets
16 and so on. And so the Corporation to be able to say,
17 what you've asked about use of excess retained
18 earnings and so on of our competitive lines, we said
19 to ourselves, Okay, we agree that when it goes below
20 the minimum amount that we're going to take our excess
21 retained earnings and replenish because -- because
22 people shouldn't -- we shouldn't extract the money out
23 of the economy. It's something that happens really
24 bad. Something bad happened and we're below the
25 minimum so let's -- let's accept that for the Basic

1 we'll close the gap when it comes from a -- from a
2 capital deficiency perspective.
3 We also believe that Basic has to hold
4 its own, that there should be no cross-subsidizations
5 between the lines of business. So if you look at
6 break even as time goes by and you look at the
7 volatility, what makes sense to the public. Did we
8 use -- did -- if -- if something really bad happens
9 that you need 10 percent, or 15 percent, or whatever,
10 is it because we didn't follow industry standard.
11 Like did we start creating a home brew, you know,
12 moonshine that we didn't go with what the industry
13 does or did we take -- or did we do due diligence and
14 did we align with what the rest of the industry does
15 and also with what our sister companies like SGI and
16 ICBC does.
17 So from a customer perspective, did we
18 -- are we consistent with what everybody's doing if
19 something really bad happens so we don't lose the
20 support of the public. So then we said everybody
21 uses, you know, DCATs and MCT. That would be the
22 public's expectation of us to say, You know, did you
23 do what others do and if we get audited by the auditor
24 general and so on did you start to do some homegrown
25 stuff there, and say you were special and you didn't

1 do what the rest of the world did? So we said, Okay,
2 it's important to meet that expectation.
3 Now, we agree it needs to be tempered
4 because we are a monopoly. So if we used the minimum
5 DCAT as the lower range of the RSR, and MCT at 100
6 percent puts us at three sixty-six (366), and we're
7 currently at one eighty (180). So what we're saying -
8 - and then if you look at the deviation from the
9 forecast, a lot of that is judgment but it'll go --
10 it'll go -- like the swing can be, you know, a
11 hundred, 150 million, in any given year for whatever
12 reason.
13 It's probably closer, but if you look
14 at the -- the bell curve, and this is where, you know,
15 judgment is -- is required but if you say, Okay, so I
16 can move either way by 100 million real easy, what's
17 going on in the world right now, then I need to be
18 able to be an RSR that as we build it over time --
19 let's say I get to three hundred (300), three twenty
20 (320), I mean what -- we're at one eighty (180) right
21 now, that's why we suggested last year it's going to
22 take four (4) years to shake this out -- to get back
23 financially strong.
24 But if we -- if we can bring it back up
25 to three hundred (300), three twenty (320), and then

1 we can have swings from the forecast because of all
2 this volatility, it protects consumers in the sense
3 that every year, as long as we keep grinding to stay
4 below that natural 4 percent, they won't have any rate
5 increases, and the RSR absorbs the ups and downs from
6 the forecast.
7 It also can absorb the unforeseen
8 events. And the unforseen events, for me, when I --
9 when I articulated, there's -- there's two (2) kinds
10 of -- there's the deviation from the forecast for
11 whatever reason, and -- and there's events like we
12 just had two (2) bad winters. So you need a tolerance
13 in there that -- that you don't always have to -- to -
14 - so -- so that Basic can hold its own. That's --
15 that's a real important principal.
16 You meet the customers' expectations,
17 and that's also why, to your point, that we're
18 recommending, you know, that the MCT be reviewed in
19 four (4) years. And say, Okay, like what happened
20 during those four (4) years with all this volatility
21 because we know that the volatility in the past is not
22 a good predictor of the unforseen events in the future
23 because of weather and the financial markets, and
24 everything that's happening in our economies, that
25 it's going to be worse. It's not going to get better.

1 We just don't know how worse.
2 So by having the MCT at 100 percent,
3 three sixty-six (366) to two thirty (230), and if we
4 build it up to three hundred (300), there will be this
5 swing of fifty (50) to 60 million, or whatever, over
6 the next -- but it gives people protection.
7 And as long -- that goes back to the
8 benchmarking. As long as we keep grinding to get
9 below that 4 percent natural growth, like Manitobans
10 will be okay in the sense that they'll never see a
11 rate increase, and they'll -- they'll be protected by
12 the RSR. And we can review it in four (4) years from
13 now but at least it -- it puts this whole situation
14 that we're in at risk -- puts it over.
15 But it also protects public audio
16 insurance on the long term because I can assure you
17 that if we are in a situation where we need a 10
18 percent rate increase, I really believe that's the
19 catalyst to privatization. People are not going to
20 accept that. They just won't. And they won't
21 understand -- they'll never, never understand why they
22 got all this money back and now they're in this
23 situation. They just won't.
24 And they'll say, You know what, you
25 guys didn't follow the -- the proper protocols. You

1 didn't align yourself what everybody is doing. You
2 thought you were special. Now, I'm up with -- you
3 know, and plus we're paying four (4) or $5 million for
4 all of these hearings a year. Then, you know what,
5 we're just going to lose the support of the public.
6 So it's a combination of meeting
7 customer expectations, about rate predictability and -
8 - and stability, having an RSR range that allows you
9 to fluctuate to absorb the ups and downs including the
10 deviation from forecast, and the unforseen events.
11 And then I agree that as time goes by you need, as a
12 regulator, to review the upper range.
13 But let's put one up there, and we know
14 that -- that the deviation from forecast can vary
15 quite a bit because of what's happening right now. So
16 let's give ourselves some stability. Let's go to it.
17 And -- and then let's review it in four (4) years or
18 three (3) years, and then say, Okay, is MCT 100
19 percent? Does that make, still, some sense?
20 But right now, I would say that two
21 thirty (230) to three sixty-six (366), I know it
22 sounds like a lot of money, but you're talking what,
23 130 million, something like that? You're going to go
24 up and down. You're going to two (2) years down
25 50/50. You're going to go on one (1) other year up

1 maybe, you know. Like, you need a range if you look
2 at the bell curve and the standard deviation to absorb
3 this and give people rates that are predictable and
4 stable. And that's what's going to make sure that we
5 have the long-term success of -- of the Corporation.
6 And -- and the way it's modelled right
7 now and the way we do things, I can say as president
8 and CEO, that what I'm putting before you, that I'm
9 bringing to you the support of -- of the business
10 partners that are helping us to control our costs. If
11 -- if this happens, I'm bringing you the support of my
12 board. I'm bring you the support of Crown Corporation
13 counsel, because I have to report to them, and they're
14 very concerned, too. And I'm bringing the support --
15 the Government of -- of Manitoba is okay with what I'm
16 doing.
17 So it's -- it -- there's -- I
18 understand that it's not a black and white answer,
19 that there is discretion, but I'm telling you that I'm
20 bringing you this -- I'm putting this before you. I
21 believed -- I've been doing this for twenty-five (25)
22 years. That's what we need to be successful. And I
23 can meet my mandate and I can be held accountable for
24 the performance of the Organization if we do this.
25 If we don't do this, I sincerely

1 believe that we're going to end up with some really
2 bad stuff happening to us, and then we're going to
3 lose the support of the public, and then we'll get
4 privatised. I really believe that, because the --
5 there's not going to be another Kopstein report
6 because if people think that we didn't do best
7 practice and we got back to muddling with their rates,
8 I think we're done.
9 THE CHAIRPERSON: For clarification,
10 Mr. Guimond, my understanding is the MCT at 100
11 percent -- last year's was 366 million, but I
12 understand it also changes, fluctuates how they
13 determine the amount.
14 So are you saying three (3) -- like,
15 when you're mentioning three sixty-six (366) MCT is
16 the upper limit, are you -- and then reviewing it in
17 four (4) years, are you saying the hundred percent as
18 of last year at three sixty-six (366), over the four
19 (4) years, so that the --
20 MR. DAN GUIMOND: Yeah.
21 THE CHAIRPERSON: -- top end will be
22 three sixty-six (366), or are you saying, if it
23 changes, it's going to be the top end of MCT 100
24 percent?
25

1 (BRIEF PAUSE)
2
3 MR. DAN GUIMOND: Yeah, so -- so what
4 I mean is over four (4) years, like, every time MCT --
5 100 percent, whatever that amount is, that becomes the
6 higher limit just -- just like the DCAT amount. If --
7 if it -- if it changes the lower range and it goes up,
8 you know, and we're below that, the -- the Company
9 will take care of that. But it's -- it's because --
10 because the two (2) should stay in -- in tandem in
11 terms of risk, right? And, therefore, you need that -
12 - that bandwidth to absorb. And -- and so that's what
13 I mean.
14 And then I'm saying also that I totally
15 agree that in three (3) or four (4) years, that we --
16 we should do our due diligence again and say, Does --
17 does the 100 percent make sense?
18 THE CHAIRPERSON: Thank you.
19
20 CONTINUED BY MS. CANDACE GRAMMOND:
21 MS. CANDACE GRAMMOND: Diana, I'm
22 going to ask you to go down to the next slide, slide
23 15, where we have Aon's recommendations regarding
24 total portfolio composition.
25 Ms. Reichert, can you comment upon each

1 of the three (3) recommendations that we see, and you
2 can do so at a high level?
3 MS. HEATHER REICHERT: I think we've
4 probably talked about most of these. But as we've
5 said, the recommendation was to do -- use duration
6 matching on a more precise basis. They -- the
7 rationale risk reduction and more precise matching of
8 more preci -- the risk reduction of more precise
9 matching strategies, such as the bucket approach and
10 cashflow matching, is too small for the reduction and
11 reward as a result of the lower yield that those two
12 (2) approaches would give.
13 They were correct in perceiving that
14 MPI has a low risk tolerance. And we've talked, I
15 think, a fair bit about our risk tolerance, and about
16 the -- the inability to -- or -- or not inability. No
17 desire to have volatile rates. So that -- that, in
18 and of itself, means that we are more risk adverse.
19 And adopting portfolio 2, when they're
20 referencing portfolio 2, that was the 70 percent fixed
21 income allocation at the more precise duration
22 matching, which we've already explained reduces our
23 risk without as significantly reducing our income. So
24 it was a balance that met our risk tolerance
25 objectives.

1 MS. CANDACE GRAMMOND: Thank you.
2 Diana, I'm going to ask you to go to slide 25, please,
3 of this attachment. We're going to find a graph that,
4 as I understand it, presents Aon's base case
5 stochastic projection of Basic's net income.
6 Is that correct?
7 MS. HEATHER REICHERT: Yes.
8 MS. CANDACE GRAMMOND: And, as I
9 understand it, the black line that we see roughly in
10 the middle of the spectrum represents the median
11 forecast.
12 That's correct?
13 MS. HEATHER REICHERT: Yes.
14 MS. CANDACE GRAMMOND: Can you tell us
15 what drives the roughly upward or generally upward
16 pattern in that black line median forecast, and
17 specifically the anomaly that we see between 2019 and
18 2020, that increase?
19
20 (BRIEF PAUSE)
21
22 MR. LUKE JOHNSTON: Yes, we did --
23 when we got the results on this particular graph, we
24 were a little bit -- bit surprised by the upward net
25 income projections and how that related to our

1 forecast. So their model is obviously prop --
2 proprietary, so we can't get into the complete details
3 of it. They don't apply rate decreases. So if we
4 continued -- if -- if the long-term trends that
5 they're projecting through an increasing interest rate
6 environment, or a long-term claims trends that are
7 relative to our 4 to 5 percent annual premium growth,
8 that would obviously produce growing net income as
9 well.
10 So our focus more on this one was to
11 look at the bounds around whatever their median or --
12 an average net income was that the range of
13 variability around -- around that. We know that we're
14 never going to come to the Board and ask for $81
15 million net income in a -- in a year, right? So that
16 will constantly be adjusted to zero. But it shouldn't
17 change the variability produced in their asset and
18 claim modelling around that average.
19 MS. CANDACE GRAMMOND: Now, if we can
20 focus on the first few years shown, I -- we see the
21 table starts at 2014 and -- and continues from there.
22 Can you comment upon how the net income
23 reflected in this table or graph compares to the
24 forecast filed with the GRA for those same years, and
25 whether any differences are important to Aon's

1 conclusions?

2

3 (BRIEF PAUSE)

4

5 MR. LUKE JOHNSTON: No, again, we
6 don't have all the details of their optimization that
7 explains why they have a slightly higher net income,
8 or in some cases, a much higher net income than us.
9 Our -- again, our focus was around the variability
10 around their -- their forecasts.
11 We don't -- we -- you know, we have
12 fully supported all their forecasts, so we'd have no
13 issue with what we have in our rate application,
14 obviously. Their modelling may be more simplistic or
15 different on certain -- certain items. But again,
16 it's the variability we're focussed on.

17

18 (BRIEF PAUSE)

19

20 MS. CANDACE GRAMMOND: Diana, if you
21 could go to slide 26, please? We're going to see a --
22 a somewhat similar graph, but this chart -- or -- or
23 this graph retain -- pertains to Basic retained
24 earnings as opposed to Basic net income. Again, we
25 have the black line running through the middle.

1 Sorry, before we get to the black line,
2 can you tell us where we see the title, "Basic
3 Retained Earnings," with respect to this graph, what
4 does that include, as in, does that actually mean
5 retained earnings and total equity inclusive of AOCI,
6 or does it just mean Basic retained earnings?
7
8 (BRIEF PAUSE)
9
10 MR. LUKE JOHNSTON: Given the title,
11 my -- my belief is it's -- it's retained earnings, but
12 I was just seeing if I could find a reference to
13 confirm that. As we already discussed, our targets
14 were given on a total equity basis, but I wouldn't
15 expect Aon to produce a graph called, "Basic Retained
16 Earnings" if it was for Basic total equity, so, yeah.
17 MS. CANDACE GRAMMOND: So your best
18 evidence at the moment is that it excludes AOCI?
19 MR. LUKE JOHNSTON: I don't know for
20 sure, but that is what I would expect based on the
21 title, yes.
22
23 (BRIEF PAUSE)
24
25 MS. CANDACE GRAMMOND: I understand, I

1 -- I think where you're coming from, Mr. Johnston, but
2 the -- what we're trying to ensure that we understand
3 and that the panel understands is the terminology,
4 because in an earlier context with respect to one (1)
5 of the Aon documents, we talked about what 'retained
6 earnings' meant. And in that context, you thought it
7 meant inclusive of AOCI and really, total equity.
8 So we need to know if definitions are
9 changing as we go through.
10 MR. LUKE JOHNSTON: Yeah, just for the
11 record, I -- I didn't say that retained earnings
12 equalled total equity previously. I -- I -- the
13 question was about the RSR targets. So when I said --
14 What are the RSR targets? I said, Well, the RSR
15 targets we're giving them are total equity targets.
16 And then I said that I would check and make sure that
17 that is what was being used.
18 This particular case where it says,
19 "Basic Retained Earnings," I have to assume that they
20 mean Basic retained earnings. It doesn't say Basic
21 RSR.
22 MS. CANDACE GRAMMOND: Okay. Thank
23 you, Mr. Johnston, for that clarification. So the
24 black line that we see within the graph represents the
25 median forecast, correct?

1 MR. LUKE JOHNSTON: Correct.
2 MS. CANDACE GRAMMOND: And again, we
3 see a generally upward pattern in the median forecast
4 from left to right with a rise between 2019 and 2020.
5 Can you comment upon that upward trend, and in
6 particular, the shift in 2019/'20?
7 MR. LUKE JOHNSTON: Again, the -- our
8 concern with their modelling is the variability around
9 whatever mean that they produce. In terms of the --
10 MPI's reality, we would continue again to adjust for
11 break-even. So inclusive of rate changes, which are
12 not in here, you would expect the retained earnings to
13 stay flat forever if you're always right, and again,
14 you're always putting in zero, zero, zero.
15 Obviously that's not the reality, and
16 what they're modelling here for us is that range
17 around the mean, and that's our focus with reducing
18 that -- that band around their median, or mean,
19 forecast.
20
21 (BRIEF PAUSE)
22
23 MS. CANDACE GRAMMOND: Diana, if you
24 could go to slide 34, please? We did look at it
25 briefly earlier in the context of an answer that was

1 provided. So, Ms. Reichert, you've commented on 34 a
2 little bit already, so I'm not going to ask you to do
3 so again, but I do want to clarify a couple of things
4 with respect to this graph.
5 Mr. Johnston, you had commented on the
6 -- the horizontal axis of the graph being titled
7 'Average annual volatility of retained earnings'. Can
8 you confirm whether in that context, the phrase
9 'retained earnings' includes total equity, or not?
10 MR. LUKE JOHNSTON: It would be
11 similar to my previous comment. I -- I would expect
12 if they say 'retained earnings', that that would be
13 what they mean. Again, we're -- we're checking that.
14 MS. CANDACE GRAMMOND: On the vertical
15 axis, we see the heading "Ten (10) Year Average Annual
16 Basic Net Income." Can you explain how that term is
17 defined? There --
18 MR. LUKE JOHNSTON: Basically, exactly
19 as --
20 MS. CANDACE GRAMMOND: -- there may be
21 an IR that --
22 MR. LUKE JOHNSTON: -- yeah --
23 MS. CANDACE GRAMMOND: -- that you
24 want to refer to, but I'll leave that with you.
25 MR. LUKE JOHNSTON: Sorry, I'll --

1 I'll just -- can I ask you to repeat that, please? I
2 didn't hear that.
3 MS. CANDACE GRAMMOND: Sorry. I just
4 added that there is an IR that refers to this. If you
5 want to refer to it, I have the reference, or if you
6 just want to explain the definition, that would be
7 fine also.
8 MR. LUKE JOHNSTON: My understanding
9 is it -- exactly as what it says it is, the ten (10)
10 year average net income. Yeah.
11
12 (BRIEF PAUSE)
13
14 MS. CANDACE GRAMMOND: Thank you, Mr.
15 Johnston. Just going back to the horizontal axis for
16 a moment, the phrase 'annual average volatility of
17 retained earnings', I asked you specifically about the
18 retained earnings piece of that.
19 Can you explain or define the whole of
20 that phrase?
21
22 (BRIEF PAUSE)
23
24 MR. LUKE JOHNSTON: I can get --
25 undertake to get the specific definition, but if -- if

1 -- a more general sense is -- is sufficient, my
2 interpretation of annual average volatility would be
3 to take the absolute differences from the expected net
4 income, so negative a hundred would be one hundred
5 (100), positive one hundred (100) would be one hundred
6 (100), and we're talking about on average, what kind
7 of variability are we seeing from that particular
8 approach?
9 But we will try to -- we will undertake
10 to get a -- a specific definition on that.
11
12 (BRIEF PAUSE)
13
14 MS. CANDACE GRAMMOND: If you want to
15 refer to the IR response, that may be of assistance.
16 It's PUB/MPI-2-38.
17 (BRIEF PAUSE)
18
19 MS. CANDACE GRAMMOND: Just scroll a
20 little further, Diana, if you would. Keep going.
21 Thank you. So there's a reference that may assist.
22 We -- can you comment upon this response for the
23 benefit of the panel?
24 In -- in other words, what are we
25 measuring on the horizontal access of the graph that

1 we looked at?

2 MR. LUKE JOHNSTON: I think this is

3 consistent with what I said. I can read the first

4 line in.

5 "The average annual volatility of

6 retained earnings is the average

7 over the projection peri -- period

8 of the yearly standard deviations of

9 Basic retained earnings."

10 So my words weren't those exact words,

11 but the same idea.

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: Thank you, Mr.

16 Johnston. Diana, I'm going to ask you to go back to

17 Attachment C, page 36. And I'm going to ask, Mr.

18 Johnston, for you to comment, or Ms. Reichert, as you

19 see fit upon the importance of yield to Aon's

20 conclusions. And you may want to refer to this slide.

21 You may want to refer to slide 38.

22 But what I'm looking for is for you to

23 comment upon the importance of yield to Aon's

24 conclusions.

25

1 (BRIEF PAUSE)
2
3 MS. HEATHER REICHERT: Ms. Grammond,
4 was there an IR on this particular issue already? We
5 were thinking that there was, but, no?
6 MS. CANDACE GRAMMOND: We don't think
7 so, but --
8 MS. HEATHER REICHERT: Okay. So then
9 we'll --
10 MS. CANDACE GRAMMOND: -- be corrected
11 if --
12 MS. HEATHER REICHERT: We'll -- we'll
13 take as an undertaking to get into the specifics of
14 that order for you.
15 MS. CANDACE GRAMMOND: That'll be
16 fine. Thank you. So the undertaking is to advise of
17 the importance of yield to the conclusions drawn by
18 Aon with reference to slides 36 and 38. Perfect.
19
20 --- UNDERTAKING NO. 19: MPI to advise of the
21 importance of yield to the
22 conclusions drawn by Aon
23 with reference to slides
24 36 and 38
25

1 CONTINUED BY MS. CANDACE GRAMMOND:
2 MS. CANDACE GRAMMOND: Thank you.
3 Diana, if you could go then to slide 37 which we did
4 look at briefly earlier. We've heard some evidence
5 with respect to the desired state rules.
6 Can you comment upon the sensitivity of
7 the findings of Aon to how the desired state rules are
8 defined?
9
10 (BRIEF PAUSE)
11
12 MR. LUKE JOHNSTON: Yeah, in a -- at a
13 very high level, when you have constraints on the RSR,
14 such as it can't be above a certain amount or
15 otherwise you rebate, that would obviously reduce the
16 variability, in -- in this case retained earnings,
17 relative to a strategy that just let it go on
18 uninhibited as high as it needed to go. So that --
19 that's why the desired state results are on the left
20 side of the -- of the graph, re -- relative to the no
21 RSR range results on the farther right.
22
23 (BRIEF PAUSE)
24
25 MS. CANDACE GRAMMOND: Mr. Johnston,

1 can you confirm our understanding that within the
2 context of the desired state rules each of the three
3 (3) matching strategies that are discussed here, so
4 cash flow, duration, and hybrid, all give rise to very
5 similar results in terms of volatility.
6 MR. LUKE JOHNSTON: Relative to the
7 volatility axis? Yeah, that's correct.
8 MS. CANDACE GRAMMOND: I'm going to
9 ask, Diana, that you jump for a moment to Appendix G
10 of this document, which starts on page 123. What
11 we're going to find here is an analysis of alternative
12 RSR rules. What I'd ask you to do is walk us through
13 what is reflected here, and advise of what -- what we
14 learn from this, what we see here.
15
16 (BRIEF PAUSE)
17
18 MS. CANDACE GRAMMOND: And if it helps
19 you there's a graph on page 125 that reflects the
20 information as well. So refer to that as you see fit.
21 MR. LUKE JOHNSTON: Yeah. So we
22 talked about the desired state not being in any way
23 the confirmed state. It's just what the Corporation
24 put forward as the de -- a desirable state. The
25 current state is also -- is modelled. So at the time

1 our target range was 10 to 20 percent of written
2 premiums.
3 We have to make some kind of
4 assumptions here obviously. So if we assumed if we
5 were below that amount we'd need to surcharge or have
6 an RSR rebuild up to 2 percent a year. And if the RSR
7 was to get sufficiently above that 20 percent then
8 you'd rebate. Like, we don't think the Board would
9 rebate at 21 percent of written -- like -- but once
10 you had a big enough amount that it made sense to --
11 to issue a rebate then -- then you would. So that --
12 we thought that was a relatively good interpretation
13 of the percent -- of how we operated under the
14 percentage of premium RSR targets.
15 And then, as already discussed, let's
16 model if there is no RSR targets, just without any
17 assumptions about behaviour. Just let it -- let the
18 model produce what it produces. And then an SG -- we
19 called it an SGI type target of 100 percent MCT. And
20 then the -- the surcharges and rebates are kind of
21 tied to this one-fifty (1/5), 20 percent of MCT plus
22 or minus.
23 So three (3) -- three (3) different
24 other op -- oh, there's another one (1)? Oh, sorry.
25 And then the -- yeah, the last one (1) is an attempt

1 to look at ICBC type range. I believe this has
2 changed a little bit since the time we did it.
3 But again, a similar idea, just looking
4 at some -- another jurisdiction's rules, or attempting
5 to model their rules.
6
7 (BRIEF PAUSE)
8
9 MS. CANDACE GRAMMOND: Thank you.
10 Just before we leave that topic, Diana, if you can go
11 to 125, it's the graph that I referred to. What we're
12 going to see here in the middle of the screen is the
13 heading, "Current State," pointing to two (2) of the
14 bubbles, one (1) referencing 70 percent, one (1)
15 referencing sixty (60). And then we see again for,
16 "Desired State," two (2) bubbles, also one (1) at
17 sixty (60) and one (1) at seventy (70).
18 And we see that there's some overlap
19 between the 60 percent bubble relative to current
20 state and the 70 percent bubble to desired state. And
21 if we're reading this correctly we see that the
22 returns, at least in the context of net income are
23 fairly similar.
24 So can you comment on that -- what we
25 see portrayed here and that similarity and why there's

1 a need to make a change?
2
3 (BRIEF PAUSE)
4
5 MR. LUKE JOHNSTON: So again, this is
6 -- the -- the risk measurement here is variability of
7 retained earnings. The current approach has a lower
8 RSR range and a tighter bandwidth. So if you're -- if
9 you're continually rebating and surcharging all the
10 time that would produce a -- the tighter long-run
11 average retained earnings that's not desirable.
12 That's not -- yeah, that's more volatility in rate,
13 not necessarily in retained earnings.
14 We could keep the retained earnings
15 like at the -- almost the exact same amount if we just
16 constantly surcharge and rebate immediately. So I
17 don't want that to be seen as the only consideration
18 in terms of this graph. On the following page 126 you
19 see the desired state does sit above the current state
20 in terms of ten (10) year average net income, at least
21 in the Aon modelling, so that's an improvement to the
22 -- to the current state.
23 MS. CANDACE GRAMMOND: Thank you.
24 Diana, I'm going to ask you to go back to slide 40 --
25 or to go to slide 40. We haven't actually looked at

1 that one (1) yet. So what we see here under the
2 heading of, "Optimization," are a series of
3 conclusions with respect to the hedging strategy.
4 Can you comment upon these, please?
5
6 (BRIEF PAUSE)
7
8 MR. LUKE JOHNSTON: So the -- the
9 conclusion is to use duration matching with allocation
10 up to 70 percent for a fixed income. They note, as
11 they did earlier, that a key benefit of this strategy
12 is the assumed additional yield you get from not --
13 like in a cashflow strategy, investing a lot of money
14 in shorter term instruments and losing yield there.
15 And they note that that's -- that's an important
16 consideration if the yield curve changed or yields
17 changed there could be an impact, but -- they note
18 that.
19 And then, of course, they say if you
20 could somehow get the same yield then the approaches
21 would be closer, or converge, or -- as such.
22 MS. CANDACE GRAMMOND: Thank you.
23 Diana, if we could go to slide 42, please? What we're
24 going to find on slides 42 and 43 relates to the
25 characteristics of the various optimal portfolios

1 represented by the Green Diamonds (phonetic). What
2 I'm going to ask you to do is comment on the
3 characteristics of those portfolios and how those
4 compare to the base case, and as well the basics of
5 the modelling that Aon used to form its
6 recommendations.
7
8 (BRIEF PAUSE)
9
10 MR. LUKE JOHNSTON: So the -- the
11 graph represents moving to the duration matching
12 approach, and then it's essentially showing the
13 efficient frontier. And if you go to the next slide
14 of -- of different levels of fixed income, or
15 different asset allocations, so there's obviously
16 risk/reward relationship between how you want to
17 invest your assets in -- in different categories.
18 There's also more variability as well, obviously.
19
20 (BRIEF PAUSE)
21
22 MS. CANDACE GRAMMOND: We spoke before
23 about the fact that the base case doesn't represent
24 the current portfolio of the Corporation. Can you
25 comment on where on this graph the current portfolio

1 would reside? Just approximately obviously, not
2 absolutely.
3
4 (BRIEF PAUSE)
5
6 MR. LUKE JOHNSTON: The portfolio as
7 it existed when this was done wouldn't -- isn't total
8 apples to apples. The duration isn't -- like we'd
9 have to match the current portfolio's duration, and
10 then whether all the other asset allo -- allocations
11 are consistent with our current portfolio in -- in any
12 of these, I'd have to check -- have to check that.
13 But, yeah...
14
15 (BRIEF PAUSE)
16
17 MR. LUKE JOHNSTON: Yeah, just to say
18 that our -- our current approach at the time was not
19 any of these.
20 MS. CANDACE GRAMMOND: Thank you.
21 Diana, I'm going to ask you to go to slide 48. And
22 for reference, what we find on slides 48 through 50 is
23 -- or are a series of conclusions under step 2 again
24 relative to optimization.
25 What I'm going to ask you to do, Mr.

1 Johnston, is to just summarize for the panel the
2 optimization conclusions that were reached by Aon.
3
4 (BRIEF PAUSE)
5
6 MR. LUKE JOHNSTON: Okay, so there
7 were some constraints given by the Corporation,
8 particularly a minimum constraint to Canadian
9 equities. And I believe once --
10 MS. HEATHER REICHERT: Minimum --
11 MR. LUKE JOHNSTON: -- and a -- and a
12 minimum constraint for real estate and infrastructure.
13 So with those constraints in mind, there's -- it's
14 just saying that there's limited room to make other
15 movements. And then it goes on to say that
16 allocations for some of the more risk asset categories
17 increase when you move to higher risk portfolios.
18 However, the allocations to real estate and
19 infrastructure never exceed the minimum.
20 MS. HEATHER REICHERT: If I can just
21 add. The reason that there was a minimum constraint
22 on real estate and infrastructure, and it would have
23 been based on what we were currently holding, is that
24 we did not want to have a recommendation that was
25 suggesting that we should be selling any of our real

1 estate or infrastructure investments in that they
2 illiquid.
3 So we've got them. We intend on -- on
4 keeping them. That is not something that you can
5 just, you know, tomorrow say, oh, gee, we're going to
6 -- we're going to sell them to -- to reach some lower
7 allocations. So in order to have a realistic
8 portfolio provi -- or portfolio allocation provided to
9 us, we said the minimum is what we currently have in
10 real estate and infrastructure.
11 And we also wanted to have some
12 investment in Canadian equities, being a Canadian
13 corporation. So we established a minimum for Canadian
14 equities, as well.
15 MS. CANDACE GRAMMOND: Diana, if you
16 could go to page 52 -- or slide 52. We're going to
17 find here the beginning of the conclusion section. So
18 just for reference, the conclusions run from slides 52
19 to 60.
20 What I'm going to ask you to do, Mr.
21 Johnston or Ms. Reichert, is to review and comment
22 upon any recommendations that we have not already
23 spoken about just so that we have a fulsome discussion
24 with respect to those recommendations.
25

1 (BRIEF PAUSE)
2
3 MR. LUKE JOHNSTON: Just -- just to
4 make sure I understand your question, just to go
5 through everything in the conclusion and
6 recommendation section and highlight anything that we
7 haven't already spoken about?
8 MS. CANDACE GRAMMOND: Correct.
9
10 (BRIEF PAUSE)
11
12 MR. LUKE JOHNSTON: I'll just do these
13 one (1) at a time as we go through the pages. So I
14 already spoke to comments. In -- on page 52, at the
15 middle, it says:
16 "There's a probability of 20 percent
17 that Basic ne -- net income will be
18 negative."
19 Well, we're going to always have rate
20 changes to make sure that we don't make net income as
21 a forecast. So the re -- MPI's reality, would that --
22 that would be closer to 50 percent chance.
23
24 (BRIEF PAUSE)
25

1 MS. HEATHER REICHERT: Can you go to
2 the next line?
3
4 (BRIEF PAUSE)
5
6 MS. HEATHER REICHERT: I -- I think we
7 -- we've covered or talked about each of those items,
8 so the next. We definitely talked about optimization
9 duration matching. Next.
10
11 (BRIEF PAUSE)
12
13 MS. HEATHER REICHERT: Next. Next.
14 MR. LUKE JOHNSTON: The peer -- the
15 peer comparison is important because in early
16 discussions with Aon, I think they realized quite
17 quickly that we weren't a typical P and C insurer when
18 they started getting huge dumps of our liability cash
19 flows, and -- and such. So it is hard to -- other
20 than maybe SGI, it's -- it's pretty hard to compare us
21 to any other P and -- P and C insurer in terms of the
22 asset and liability matching requirements.
23 MR. LUKE JOHNSTON: Next -- next
24 slide.
25

1 (BRIEF PAUSE)
2
3 MS. HEATHER REICHERT: We definitely
4 covered all of the policy considerations. So the next
5 slide. And I think we talked about the low risk
6 tolerance, and the -- adopting portfolio 2 was the --
7 the one (1) that provided us with the -- the best
8 balance of risk tolerance and -- and return. I think
9 that's been covered.
10
11 (BRIEF PAUSE)
12
13 MS. HEATHER REICHERT: That's it.
14 MS. CANDACE GRAMMOND: Thank you.
15 MS. HEATHER REICHERT: There's one (1)
16 more page.
17 MS. CANDACE GRAMMOND: Page 60 is the
18 last.
19 MS. HEATHER REICHERT: Sorry. I think
20 this was just talking about a couple of other
21 portfolios and why -- why they didn't -- why they
22 didn't meet the criteria for -- for selection, so I
23 think we covered that through the fact that num -- the
24 portfolio number 2 was the optimal one (1) based on
25 the criteria we had established. This is just talking

1 about why the -- the one (1), two (2) -- why one (1)
2 and three (3) to eight (8) were not, so.
3 MS. CANDACE GRAMMOND: Thank you.
4 Diana, can you go to slide 105 please? What we're
5 going to find here within Appendix E is relative to
6 Aon's analysis of the merits of segregating the assets
7 for pension obligations from those supporting Basic
8 claim liabilities, from those supporting competitive
9 line claim liabilities.
10 You're familiar with this analysis by
11 Aon?
12 MS. HEATHER REICHERT: In a general
13 sense, yes.
14 MS. CANDACE GRAMMOND: What is the
15 Corporation's response to the analysis?
16 MS. HEATHER REICHERT: At -- at this
17 point in time we have no intentions on segregating
18 pension assets from our -- our other assets. We -- we
19 are -- we are comfortable with how our pension
20 liabilities are -- are treated, and how we are able to
21 get the kind of return that we need in order to fund
22 those pension liabilities. So we are not entertaining
23 segregating them at this point.
24 MS. CANDACE GRAMMOND: And that
25 includes not segregating Basic from the competitive

1 lines in terms of claims liabilities?
2 MS. HEATHER REICHERT: That's correct.
3 MS. CANDACE GRAMMOND: Thank you.
4 Diana, can you go to PUB/MPI-1-50 please? And in
5 particular we're going to go to 1-50(a), Attachment G.
6 What we're going to find there is a letter from Aon,
7 which includes its overall comments arising from the
8 investment policy statement, or IPS, of MPI. Thank
9 you, Diana.
10 So just near the bottom of that first
11 page of this letter we -- we're going to see the
12 heading, "Overall Comments." There we go. And I'm
13 just going to read-in one (1) of Aon -- a couple of
14 Aon's comments. Firstly it says:
15 "As noted during earlier asset
16 liability study discussions the
17 comingling of assets backing pension
18 obligations and assets backing
19 insurance claims is not an industry
20 best practice."
21 Aon goes on to say, "However..." and
22 this is just at the top of the next page. Aon goes on
23 to say:
24 "However, it is well established
25 within the industry that backing

1 insurance [sorry] within the
2 industry that pension assets should
3 be held separately from other
4 assets."
5 Firstly, can you confirm that I read
6 that in correctly and then advise us of the
7 Corporation's position in response to those
8 statements?
9
10 (BRIEF PAUSE)
11
12 MS. HEATHER REICHERT: Yes, I believe
13 you read that in correctly -- in correctly. So again,
14 the -- because we are -- our pension plan is the civil
15 sep -- service superannuation benefit plan, the
16 contributions that we make to CSSB are with resplect -
17 - respect to the employee share, or their
18 contribution.
19 So part of the pension assets, if you
20 will, are actually held by the Provincial Government.
21 So we are holding the -- the employer portion of that,
22 if you will. It has been our experience that because
23 we have been able to comingle the assets, the pension
24 assets with those that are matching the -- the
25 liabilities we have a better capability of achieving a

1 -- a better return overall.
2 And when we value the liability the
3 discount rate that we are required to use is a double
4 A corporate bond or another actually determined rate
5 based on what the actuaries are saying should be the -
6 - the rates that you use to value the pension
7 liabilities, in and around that. So as long as we are
8 earning in our asset pool at least what the discount
9 rate of the pension liabilities are then we feel we
10 are in a good position and we've been able to do that.
11 So we don't -- at this juncture don't
12 see a benefit in separating those assets, having them
13 managed separately, which will be more administration
14 and more costs. So from an overall perspective we --
15 we are at this juncture content with how we're
16 managing the pension assets.
17 MS. CANDACE GRAMMOND: Thank you.
18 Diana, can you go to PUB/MPI-2-38, please. What we're
19 going to find there, this is at 238-C or -- yeah,
20 238(c), pardon me, the Corporation has made the
21 statement with respect to this idea of creating a
22 segregated investment portfolio by line of business,
23 that this would require matching only fixed income
24 assets to the claims liability and the loss of growth
25 assets would significantly reduce the return

1 attributable to the Basic line of business.
2 My question is: Why does the
3 Corporation make that statement?
4
5 (BRIEF PAUSE)
6 MS. CANDACE GRAMMOND: Perfect. So
7 what I just read in is the lion's share of that second
8 paragraph on the screen.
9
10 (BRIEF PAUSE)
11
12 MR. LUKE JOHNSTON: So the thinking
13 behind this response is that -- that we want fixed
14 income to be matched to Basic claim liabilities. And
15 if we perform that match within Basic, we'll
16 significantly limit our ability to invest in any other
17 asset categories and sacrifice even -- even more
18 return to the Basic line. So that -- that was the --
19 the reasoning behind that answer.
20 MS. CANDACE GRAMMOND: Thank you.
21 Diana, if you could now go to PUB/MPI-2-33? This is
22 an IR that summarizes the Corporation's responses to
23 date to each of the Aon ALM study recommendations.
24 And what I'm going to be asking you to do is to go
25 through the instances in which the Aon recommendations

1 were not accepted, and to comment on why they were not
2 accepted.
3 So it would appear that what's on the
4 screen right now does not fall under that category, so
5 maybe we can scroll a little bit more until we get to
6 one that's not being -- oh, sorry, if -- if I missed
7 one, please, correct me.
8 MS. HEATHER REICHERT: Yeah, can we
9 just go back up? Okay. So Phase 2, part A, provide -
10 - provide in the policies that surplus distributions
11 be spread over time. Obviously I commented on that
12 before, that, that is not a policy that we are at
13 liberty to -- to invoke. That would be the Public
14 Utilities Board. And we said it there:
15 "It's still under consideration by
16 the PUB, and until the maximum
17 amount is finalized no policies for
18 surplus distribution are being
19 considered."
20 So -- so that one is wait-and-see. And
21 -- and then the -- their recommendation to revise RSR
22 targets. Again obviously we're not solely able to
23 implement that. That's under the purview of the --
24 the Public Utilities Board. Okay, next page.
25

1 (BRIEF PAUSE)
2
3 MS. HEATHER REICHERT: So -- so the --
4 the next one, the one on the top of that page, we're
5 continuing to study that so it hasn't been implemented
6 -- it was not implemented immediately. Again the --
7 that follows with the next recommendation, as well.
8 Keep going.
9 Most -- you can see most were included
10 and adopted within the investment policy statement.
11 We are looking at the -- the...
12
13 (BRIEF PAUSE)
14
15 MS. HEATHER REICHERT: The one about
16 the benchmark for the IPD Canada -- Canadian Property
17 Fund, we're saying there it was -- the next index was
18 relatively small, so the index has extremely limited
19 historical returns. On that basis it was deemed
20 unsuitable at the current time, so we'll revisit it if
21 -- if warranted.
22 And then I believe the last one in
23 regards to debt obligations -- yeah, we didn't
24 implement that one because we felt that that weakened
25 our -- our rule as it was currently written. Is that

1 all of them? Keep going.
2 I think the -- this is a similar
3 corporate bonds target range within the fixed income
4 portfolio. Again, that's something that we'll --
5 we'll look at. We need to -- the desire is to keep as
6 much flexibility as possible for our bond manager
7 while still maintaining the duration matching and --
8 that we want.
9 And then treatment of currency risk, we
10 felt that that was sufficiently covered. And -- yeah.
11 So I think the other ones we've adopted or -- as much
12 as possible. Is there more? There might be more.
13 No, that's it? Okay.
14 MS. CANDACE GRAMMOND: Thank you.
15 Those are my questions with respect to the ALM study.
16 I note we have a few minutes before noon, so I do have
17 some questions with respect to one (1) of the pre-ask
18 answers that was filed, so I'll go through those with
19 the Board's permission. That's Board Pre-Ask 2, which
20 has been entered as Board Exhibit 16.
21
22 (BRIEF PAUSE)
23
24 MS. CANDACE GRAMMOND: It might just
25 take a minute to get it up on the screen because I

1 didn't give Diana a warning.

2

3 (BRIEF PAUSE)

4

5 MS. CANDACE GRAMMOND: Thank you. So
6 that's actually right where I want to start. We see
7 before us -- and -- and just for context, we asked the
8 Corporation to file a DCAT equity decline adverse
9 scenario reflecting a year 1, quarter 1 total return
10 of a negative 45.41 percent followed by a year 1
11 second through fourth quarter total return recovery of
12 46.93 percent on the positive side, a year 2 total
13 return of 15.02 percent, a year 3 total return or
14 reduction of 6.7 percent, a year 4 total return of
15 5.79 percent, and a year 5 total return of 14.95
16 percent.
17 So what we see in the table that's on
18 the screen is the outcome of that request. What I'd
19 ask you to comment on, and I'm assuming this will be
20 Mr. Johnston, but if it's you, Ms. Reichert, please
21 jump in, if you can comment -- or comment upon the
22 contrast of the patterns of successive equity total
23 returns in each of the scenarios shown?
24 MR. LUKE JOHNSTON: Okay, so, as you
25 know, this is a scenario requested by the PUB or the

1 PUB advisor. Just for some clarity, the -- there's
2 some big numbers in the -- in Part A, like, a 45
3 percent decline, and then a recovery. It looks like
4 the two (2) should be maybe offsetting, but in -- in
5 reality, that -- that isn't how it would work. And
6 I'll just explain that because the first time I looked
7 at this I was a little confused by the result, as
8 well.
9 So if you start at a hundred million,
10 just pick a number, and you decline 45 percent, you're
11 down to 50 -- 55 million. But if you then apply 46
12 percent recovery to 55 million it only brings you up
13 to about 81 million, so that's where you get the 19
14 percent decline. It -- it sounds -- it looks weird,
15 but... So that's how we came up with that number.
16 And then the numbers after that are just as -- as
17 listed in the question.
18 So in terms of the question that I was
19 just asked, if you go to page 3 of -- is that right?
20 Yeah, page 3. It should be the balance sheet. So for
21 the first part of this question, just going to the
22 total equity line, the first -- this impact -- this
23 scenario hits in the 2017 'P' year, or '16/'17 year.
24 So you can see a 20 percent decline in terms of total
25 equity brings your total equity balance all else equal

1 from two sixty-two (262) down to a 120 million. If
2 you can see those numbers, they're the second last
3 line from the bottom. And then there's a recovery in
4 equities of 15 percent, and then some kind of back and
5 forth impacts that essentially return it back to about
6 120 million. Again, all else equal. Whatever else is
7 going on in this -- in the base scenario, okay?
8 So similar to the equities scenario,
9 the equity-only scenarios that we ran in the DCAT,
10 they don't exhaust retained earnings. But they do
11 have a -- a fairly large impact, this -- this example
12 being about 140 million decline in year 1 from where
13 were at the year before, okay?
14 If you go back to the first page, this
15 is asking for a different type of scenario where you
16 gradually -- you have a four (4) year decline followed
17 by a year 5 recovery. I believe we noted in the
18 answer that we don't actually model out. Since we
19 start our scenarios in the second year end, we don't
20 actually hit year 5. So that's a bit unfortunate.
21 But I think the point is -- is -- I think we still
22 make the point here.
23 So this is a gradual decline instead of
24 a -- an all -- you know, up and down, highly volatile
25 decline. And if you go to -- I guess this is page 3

1 of the 2(b) answer. Exhibit 2(c), I guess. Yeah.
2 Page 3. This scenario, again, starts at -- let's see
3 if we're at the right page here, 2(c). Yeah, if you
4 could just let the -- the bottom lines show? This
5 scenario, being more gradual in nature, starts at,
6 again, the two sixty-two (262) in 2016 or 2015/'16,
7 and declines to one thirty-four three-six-seven
8 (134,367) by the end of the period.
9 Just to put that in context, that's a
10 little bit higher, but -- than the other scenario that
11 fell to a low of one twenty (120) by the end of the
12 period. I didn't check if the returns were equal or
13 anything like that. I don't know if that was the
14 point. We just modelled the scenarios as is. And I
15 think -- well, this example shows that there's several
16 different ways you can get to 120, 130 million in
17 total equity by the end of the period.
18 MS. CANDACE GRAMMOND: Mr. Johnston,
19 would you agree that these two (2) total equity
20 patterns are meaningfully different?
21 MR. LUKE JOHNSTON: They -- yeah,
22 they're -- they're definitely different. One (1) of
23 the reasons that we do this one (1) year, two (2)
24 year, three (3) year, four (4) year modelling is for
25 that -- is for that reason.

1 So I -- I might -- I may have spoke
2 about this already, but when we're doing the DCAT, if
3 our total equity falls to zero, we need to know about
4 it, whether it happens in one (1) year or four (4)
5 years later.
6 So when we want -- when we run the one
7 (1) year scenarios, we're saying, What's the worst
8 that can happen at a one (1) in forty (40) level in
9 one (1) year? And that's -- for equities, that's
10 going to be a bigger impact than what would happen
11 after four (4) years when you've had a chance to maybe
12 rebound or average out over a longer period. But it
13 still matters.
14 It still matters if you -- if you're --
15 you fall into a negative balance. So that's what --
16 that's the whole purpose for the -- showing the -- the
17 scenarios like that. And this -- these two (2) Pre-
18 Ask scenarios are doing a similar thing in the sense
19 that the first one is more, maybe, a -- a one (1) or
20 two (2) year scenario, where you have a bigger swing,
21 whereas if you were to take a four (4) year cumulative
22 total impact and look at what happens by the end of
23 the fourth year, it should be -- it -- it should be
24 less than any kind of one (1) year event.
25 But I -- I get the point that the

1 timing is -- is relevant, I think is what you're --
2 what you're getting at and that's what we try to
3 address with the different years that we run in the
4 DCAT.
5 MS. CANDACE GRAMMOND: Would you
6 expect the -- the differences in the two (2) patterns
7 to lead to different conclusions with respect to a
8 required lower limit target capital level implied by
9 an equity declined scenario based on the two (2)
10 modelling approaches?
11 MR. LUKE JOHNSTON: They -- clearly 2A
12 puts stress on total equity immediately and that's
13 relevant. And -- and again, that's why we model one
14 (1) year, and two (2) year, and three (3) year, and
15 four (4) year scenarios. So all this talk about are
16 you including the rebound in equities and all that,
17 it's -- for the one (1) year scenarios we're not,
18 we're saying, here's what happens in one (1) year, we
19 all need to know that, that -- that it could go this
20 low in one (1) year.
21 Here's what can happen in two (2)
22 years. And this is where it could be at the end of
23 two (2) years based on a 1:40 event. So that's --
24 that's very much we're -- what we're trying to do in
25 our models is address this particular situation.

1 MS. CANDACE GRAMMOND: So the
2 Corporation continues to believe that it's preferable
3 to model the equity decline smoothed over the return
4 period?
5 MR. LUKE JOHNSTON: Yeah, our
6 interpretation of one (1), two (2), three (3), and
7 four (4) year impacts is we're looking at the -- the
8 relevant scenario as at the end of each of those
9 yearly intervals. Again, recognizing that the one (1)
10 year is going to be the worst, two (2) years is going
11 to be a little bit less worse as -- as time recovers,
12 but that's -- that's our method that we used to -- to
13 assess those year to year fluctuations.
14
15 (BRIEF PAUSE)
16
17 MS. CANDACE GRAMMOND: Mr. Johnston,
18 you agree that the cumulative total return to the end
19 of 2019/'20 in the Pre-ask 2A scenario, so the first
20 of the two (2) is approximately the same as in the 2B
21 scenario that is allowing for differences in rounding?
22 MR. LUKE JOHNSTON: If -- if they are
23 I -- that's fine. What I'm saying is that the type of
24 event that's being proposed here as Pre-ask A is
25 something that would show up in our one (1) and two

1 (2) year scenarios, where those larger impacts in
2 short intervals occur. And then for a four (4) year
3 scenario we're again looking at the four (4) year
4 cumulative effect and whether on that particular
5 scenario it happens immediately or in between for that
6 particular four (4) year exercise. We're looking at
7 how bad it can get over four (4) years. And we --
8 again, we scale that back to one (1), two (2), three
9 (3), and four (4) to -- to address these big spikes
10 that can happen in short time periods.
11
12 (BRIEF PAUSE)
13
14 MS. CANDACE GRAMMOND: But in the
15 Corporation's modelling of the one (1) and two (2)
16 year scenarios, don't you tell us not to look at
17 what's beyond that, that, that area -- those areas are
18 shaded typically?
19 MR. LUKE JOHNSTON: That's right,
20 because what is -- we want the focus to be
21 specifically on the issue you've addressed right here,
22 what can happen 1:40 years in a one (1) year time
23 frame. Forget about anything that happens in the next
24 three (3) years. In one (1) year let's say 1:40 times
25 the stock market declines 25 percent, okay. That's --

1 that answer. Okay.
2 So one (1) year after that, two (2)
3 years, now let's say over any two (2) year stretch
4 what's the worst 1:40 total -- or -- or sorry, equity
5 return we've had in our history. Okay. Let's look at
6 all those and see what's the worst it can do at -- at
7 two (2) years, at three (3) years, and at four (4)
8 years. So yes, I absolutely tell you not to look
9 beyond that, because that's not -- our focus is
10 strictly on the -- on the worst it can be at a 1:40
11 level in two (2) years. That's the whole point of it.
12 For...
13
14 (BRIEF PAUSE)
15
16 MR. LUKE JOHNSTON: Yeah. And just to
17 be clear, all -- one (1) year, two (2) year, three (3)
18 year, four (4) year, this is completely tied to the
19 1956 to present equity experience. We have to
20 obviously fit a model to -- to match it but -- I could
21 reference a document in the DCAT but the models fit
22 pretty well.
23 Like we have lots of stock market
24 return history. We're not taking any big stretch here
25 to -- to estimate a one (1) in forty (40) event with

1 more than fifty (50) years of stock returns.

2 MS. CANDACE GRAMMOND: On the issue of

3 the cumulative results under the two (2) scenarios

4 being similar, when we say that we're thinking about

5 the fact that one outcome is 120 million whereas one

6 is one thirty-four (134). That's a $14 million

7 difference.

8 But is that something that the

9 Corporation would normally consider material?

10 MR. LUKE JOHNSTON: Well, first of all

11 I'm not considering these scenarios to be the same.

12 The impacts occur at different times, so the -- the

13 fact that I don't consider them to be the same doesn't

14 require me to believe that they should match.

15 Like -- so as we've -- if -- if returns

16 happen at different times the -- our -- our balance of

17 assets in the equity pool might be a different amount,

18 right. We might -- our -- our base forecast might

19 have five hundred (500) at the beginning -- beginning

20 of the period growing to seven hundred (700) at the

21 end.

22 It -- it does matter when -- when it

23 occurs, for sure, but it doesn't cause any issue to me

24 that those two (2) scenarios don't match in exact

25 dollar terms because of the timing of when -- when it

1 happens.

2

3 (BRIEF PAUSE)

4

5 MS. CANDACE GRAMMOND: Madam Chair,

6 those are the questions that Board counsel has for the

7 MPI panel today. We may have more questions in the

8 future arising from Pre-Asks and undertakings, and so

9 forth, but those -- those are our questions for the

10 time being.

11 So I would suggest that we adjourn for

12 the day, knowing as discussed yesterday that we're not

13 planning to have cross from other parties at this

14 time, and that we reconvene the hearing on Tuesday

15 morning, which is our next scheduled hearing date, at

16 9:00 a.m.

17 THE CHAIRPERSON: Okay. Thank you

18 very much. I do declare then our meetings -- our

19 hearings for today adjourned. And we will reconvene

20 on Tuesday at 9:00 a.m.

21 MS. HEATHER REICHERT: Happy

22 Thanksgiving.

23 THE CHAIRPERSON: Yes. I mean to say,

24 Happy Thanksgiving. Enjoy your weekend.

25

1 --- Upon adjourning at 12:10 p.m.
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5
6 Certified correct,
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10 ________________________
11 Robert Keelaghan, Mr.
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