MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE (MPI)
GENERAL RATE APPLICATION
FOR 2007/'08 INSURANCE YEAR

Before Board Panel:

Graham Lane - Board Chairman
Eric Jorgensen - Board Member
Len Evans - Board Member

HELD AT:

Public Utilities Board
400, 330 Portage Avenue
Winnipeg, Manitoba
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Pages 464 to 649

APPEARANCES

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EXHIBITS

UNDERTAKINGS

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--- Upon commencing at 9:14 a.m.

MPI Panel:

BARRY GALENZOSKI, Resumed
DON PALMER, Resumed
MARILYN MCLAREN, Resumed
WILF BEDARD, Resumed

THE CHAIRPERSON: Good morning, everyone. Mr. McCulloch, you have some exhibits to begin with?

MR. KEVIN MCCULLOCH: Yes, Mr. Chairman, the first exhibit that I want to file this morning consists of three (3) undertakings relating to the upgrade factor and the volume factors. Mr. Palmer would like to speak to that exhibit once it's -- once it's filed and by my record that would be MPI Exhibit Number 11.

--- EXHIBIT MPI-11: Response to three (3) undertakings relating to the upgrade factor and the volume factors

THE CHAIRPERSON: Very good.

MR. KEVIN MCCULLOCH: The second item is the pre-ask from CAC/MSOS and we'd file the response to that pre-ask as MPI Number 12.

--- EXHIBIT MPI-12: Response to pre-ask from CAC/MSOS

THE CHAIRPERSON: Thank you, Mr. McCulloch. Mr. Palmer...?

MR. DON PALMER: The basis of a couple of these upgrade questions was discrepancies or seeming discrepancies between the answer that was provided in PUB-1-2 and CAC-132B.

The answer to -- to -- some -- some of that is that PUB-1-2 does -- does contain an error. I will -- I will call it a typographical error; you could call it a -- a cell reference error. The correct numbers with -- on the actual -- in the '05/'06 year, the upgrade should be 3.3 percent; the volume factor there should be 1.3 percent rather than 3, 0, and 1.5. So Undertaking 1, that essentially -- the question goes away with -- with that change.

Undertaking 2 is -- is okay as it doesn't really reference that table.

The other question with Undertaking Number 3 is the volume factors and even with that change these are -- are different in those two (2) exhibits.

The reason they're different is there's a couple of different ways that volume can be measured. In -- the numbers that are shown in 1-2 are transaction counts. Those are counts that come directly from our AOL system.

The -- the volume numbers shown in 1-32B are earned unit counts so the -- there certainly is a -- a very huge correlation between those numbers. As you -- as you go down the column you'll see that the numbers are -- are not exact; they're very close.

When you ask which one you should be looking at for a direct translation into the forecast I would say that probably the earned unit numbers, because we're talking about earned units in our -- in our projects that that's probably the number that is closer tied, although really the correlation between the two (2) sets of numbers are very, very close.

THE CHAIRPERSON: Thank you, Mr. Palmer. Mr. Saranchuk...?

MR. WALTER SARANCHUK: Thank you, sir.

CONTINUED CROSS-EXAMINATION BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: We're still dealing with the Rate Stabilization Reserve at this point of the cross-examination and just before moving on to some questions about the risk analysis versus the MCT and to essentially conclude a discussion on the preliminary matters pertaining to the RSR, namely the purpose of the RSR, my first question is as follows.

In PUB Order 168/90 at page 33, this is some sixteen (16) years ago, the comment made by the Board was as follows. Quote:

"The Board considers that the RSR should be used primarily to offset any catastrophic event causing unforeseen cost increases." End of quote.

Does the Corporation share that view?

MS. MARILYN MCLAREN: Cost increases as it would relate to the need to rebuild a RSR; within the rating context cost increases, generally means the future cost of the risk transfer.

So I don't think -- we certainly would not share that view today. And I can't remember what anyone believed about this issue in -- sixteen (16) years ago in that kind of a detail.

We have all learned and evolved our thinking in this matter. So if there was a point in time when someone thought an unexpected increase in costs could be staged into future rates; maybe that's what that Board meant at that time, I don't know.

But in terms of primarily used to offset catastrophic losses, if that's the word you're focussing on, I wouldn't disagree completely, but I think there's an awful lot to it. I think in the last sixteen (16) years there have been many, many discussions in this forum about all the other kinds of huge increases in costs beyond catastrophe.

MR. WALTER SARANCHUK: And if I focussed on the word, unforeseen, what would your comment be in that respect?

MS. MARILYN MCLAREN: Sure and I really want -- again, I want to make sure that everyone understands the way the Corporation is using unforeseen and others may have different definitions.

But what we and you know, back to the conversation yesterday and with use of the word, unforeseen. When we established a rate, the costs were unforeseen. When we first set the claims reserves in the context of unforeseen increases in the cost of claims already on the books; the context of that is when we set the rate those costs were not foreseen and we set the first reserves, those costs were not foreseen.

So, clearly, we would agree with the context of unforeseen in that context. No -- through no discussions in this forum has there ever been a definition of unforeseen that says, when you make the decision to use the RSR, can you foresee that there will be costs associated with it?

That's not the definition of unforeseen. It's what I said, thirty (30), forty-five (45) seconds ago.

MR. WALTER SARANCHUK: In that context, can you explain then why the rebuilding plan, the surcharges, the dedications for the RSR were put into place in some of the prior years?

In other words, if you had a separate dedication to rebuild the RSR, didn't that address the fact that there had to be separate treatment of the RSR, as opposed to rates?

MS. MARILYN MCLAREN: Absolutely and that's what happened beginning in 1996. And what I was trying to do is put some context around the different view we had all adopted by 1996, compared to the discussion in 1990, that you read.

MR. WALTER SARANCHUK: In 1992, the Board Order 174/92 at page 9 contained the following comment by the Board, quote:

"The purpose of the RSR is to provide rate stability in light of the inherent volatility of claims costs. The RSR is not intended to offset increases in

premiums that would normally be
required to cover increases in claims
costs due to inflation or changes in
benefits or coverages. Nor is the RSR
intended to act as a cushion against
abnormal rate increases during tough
economic times."

End of quote. Does the Corporation share that view?

MS. MARILYN MCLAREN: Yes, completely, with the context that the inflationary increases referenced in that quotation are talking about future policies, future rates, future costs of claims, future increases due to inflation in the cost of the risk transfer, ought not to be covered by the RSR.

It doesn't speak at all to what the heck you do with any potential inflationary increases in your existing claims liabilities, which is truly what the RSR is partly for.

MR. WALTER SARANCHUK: How about changes in benefits or coverages of which I would suggest RIB is one?

MS. MARILYN MCLAREN: Again, I suggest the context of that quotation is on a going forward basis. We would never expect -- the context of that quotation, in my opinion, in that we would never expect to accommodate the cost of benefit enhancements going forward by drawing down the RSR and the Corporation would agree with that position.

MR. WALTER SARANCHUK: Subject to any questions by the Panel, I intend to move on to the other subject within the RSR context.

THE CHAIRPERSON: Thank you, Mr. Saranchuk. We just have a couple.

Does the MCT process address or take into account the risk of a new material benefit applied retroactively?

MR. DON PALMER: Not specifically. No.

THE CHAIRPERSON: Does MPI have the authority to revise benefits absent of legislative or regulatory sanction?

MS. MARILYN MCLAREN: No.

THE CHAIRPERSON: Does MPI have or it is aware of any plan to amend benefits associated with material costs in a retroactive application?

MS. MARILYN MCLAREN: No. Not at this time.

THE CHAIRPERSON: In principle, should today's or yesterday's motorists be held accountable directly or indirectly for tomorrow's benefits?

MS. MARILYN MCLAREN: That's a really broad question and I think it begs a fairly broad answer. You know, I think in the context that we're talking about it, tomorrow's benefits for tomorrow's claimants, tomorrow's ratepayers absolutely have to pay for that.

But when we talk about the context of retroactive increases to benefits for existing claimants, and particularly given MPI's situation where it doesn't have a bunch of different reserves for different purposes, we have an IIF and we have the RSR, I think if you have, given the context of our history and if you have a proven need to enhance a benefit and you have an existing claimant that by practice has become entitled to those benefits, who better to pay the cost of that increase than the previous ratepayers through the RSR.

THE CHAIRPERSON: Thank you.

Mr. Saranchuk...?

MR. WALTER SARANCHUK: Thank you, sir.

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: The reference for this cross-examination portion is AI-15 in Volume III, Part 2 of the application. And this is the Corporation's filing entitled "A discussion on the Rate Stabilization Reserve".

And my first question relates to the commentary on page 4 under the heading "operational risk". And that heading appears in the section posing the question, quote:

"Why MPI should not use the operational and investment risk analysis."

End of quote. Number 2 under the "Operational Risk" subheading indicates that, quote:

"The operational risk is only added for variations that have actually occurred in the past twelve (12) years instead of looking at all potential risks to the Corporation."

End of quote. My question is; what is the message that is being conveyed here? Is it that extreme events if present in the history distort the risk analysis or is it that the absence of such events distorts the risk analysis?

MR. DON PALMER: I would say it's both but probably more the absence of such events. We're looking at a twelve (12) year history. The -- what the operational risk analysis does is analyses the variances between actual -- actual results and forecasted results. There's many, many things that could happen to us that haven't happened to us in the last twelve (12) years;

that doesn't mean that they can't happen next year.

MR. WALTER SARANCHUK: Why are we talking only about twelve (12) years, for the introduction of PIPP for example?

MR. DON PALMER: Because that is the methodology that was approved by this Board in the operational risk analysis and specifically to use PIPP only data.

MR. WALTER SARANCHUK: Thank you, sir. On page 6 under the -- continuing from page 5 where the heading is, "The Combined Operational Investment Risk." At the top of 6 in the clause numbered "2" is the comment addressing what is perceived as the second problem of the combined operational investment risk to the effect that the risk analysis is not consistent with the stated purpose of the RSR which -- and it goes on there to reference -- which references unexpected events and losses arising from non-recurring events or factors.

Again, what is the message here, that the RSR should not make provision for recurrence of an event that is considered unlikely and unexpected just because the event has previously occurred?

MR. DON PALMER: No, I don't think that's quite the message. The -- the message is if it hasn't occurred as yet that's not precluding the -- the chance that it might occur in the future.

I would say that some unforeseen event in the -- the past doesn't mean that it's not unforeseen in the future. I mean we -- we can't -- there's a number of things that have happened once and -- and I'm not sure that it has to be both non-recurring and -- and unforeseen.

If something has happened in the past I don't think that precludes it from -- if it does happen in the future that you say, Well, we can't use the RSR for that anymore because it happened once.

MR. WALTER SARANCHUK: Given the two (2) provisions that I have cited, is there an apparent conflict between the two that you foresee and perhaps can explain?

MR. DON PALMER: I don't really see a conflict and I guess it's -- it's whether you say that something that would be funded by the RSR has to be non-recurring and unforeseen. We've said non-recurring unforeseen events; if it's one or the other I think it's still within the purview of the RSR.

MR. WALTER SARANCHUK: Thank you, sir. The next question that I have references Mr. Galenzoski's pre-filed testimony at pages 5 and 6.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: And to some extent this matter is addressed in the -- the interrogatory posed as Number 24 in the first round of interrogatories of the Public Utilities Board which appears at Tab 25 in the book of documents.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: With reference to your testimony, Mr. Galenzoski, and the material, or at least the content of your pre-filed testimony at page 5, to what extent were the results of the adverse scenario testing as presented in the DCAT or the Dynamic Capital Adequacy Testing Report available at the time considered by the Corporation in forming its recommendation of using a 50 percent to 100 percent minimum capital test or MCT ratios to define the target RSR range?

MR. BARRY GALENZOSKI: We've been proposing the MCT for several years as the methodology to be used to establish the RSR. And so we've had the advantage of looking at DCATs for several years now with respect to this question, so it wasn't just one specific set of DCAT reports that were available, it was those for the last several years that we've had to look at.

MR. WALTER SARANCHUK: And in cross-examinations questions yesterday I mentioned the word judgmental, and there was some discussion on that that I had with Ms. McLaren. Is it fair to characterize the Corporation's selection of the proposed 50 percent to 100 percent, MCT in terms of target ratio as judgmental?

MR. BARRY GALENZOSKI: Yes, I think we put that on the record that that was our opinion.

MR. WALTER SARANCHUK: And if the Public Utilities Board were to accept a target range for the RSR based on MCT ratios, how would the Corporation propose to monitor and report on the ongoing appropriateness of these target ratios going forward?

MR. BARRY GALENZOSKI: We would do it in the same manner that we've been doing it up to now. We would provide the same documentation, the MCT report would be provided as well as the DCAT analysis on an annual basis.

MR. DON PALMER: If I can add to that, remember that the MCT score is a very objective test. There is no judgment involved in the actual score. It's not a difficult calculation and really could be part of our regular quarterly financial statements.

So the ongoing monitoring of that score

can become just part of our normal financial reporting.

MR. WALTER SARANCHUK: Under what, sir, I'm sorry?

MS. MARILYN MCLAREN: And with respect to the target itself I think what the Corporation would do, would be to continue to report to the Public Utilities Board with respect to the targets of the other automobile insurers in the public sector, as well as, any potential changes to the MCT objective methodology through the years, as utilized by OSFI.

So I think in terms of the test itself, Mr. Palmer has addressed that. With respect to the Corporation's target, clearly, we will be reporting to the -- we would be reporting to the PUB on the Corporation's performance against the targets, as well as, any activity in changing targets or anything along those lines with respect others who use the MCT and have adopted targets for their reserves.

MR. WALTER SARANCHUK: And just on that point, when would the Corporation propose amendments to the target ratios?

MR. BARRY GALENZOSKI: Those would be proposed as the calculations were evident, in other words, on an annualized basis at the very minimum we'd be looking at whatever the MCT at 100 percent developed based on our situation.

In other words, looking at the specific situation for basic insurance it says -- Mr. Palmer said it's a fairly straight forward calculation based on numbers that are contained in our balance sheet and that would be just brought forward on a regular basis.

It would be similar to any other calculation that we do, for instance, on the financial provisions through the IBNR calculations that we do, those things are all well established processes and easy to come up with the figures and adjust to them on a regular basis.

MS. MARILYN MCLAREN: Were you asking about when we would redo the test or when we might revise the targets?

MR. WALTER SARANCHUK: When you would revise the targets.

MS. MARILYN MCLAREN: We see no compelling need to do that on this basis. When the Corporation has established RSR targets in the past years, the preference is to establish them over more than a one year basis, so there's a fair bit of stability.

Given the dynamic nature of this target that is a percent of another score I think that gives us a fair bit of confidence that it is unlikely to change frequently, or certainly not in the short term.

The Corporation would need compelling arguments to change its targets.

MR. WALTER SARANCHUK: Is it practical for the Corporation to show routinely the actual and forecasted basic insurance MCT balances, that is the major components and totals for capital available and capital required and the resulting MCT ratios in each basic insurance statement of returned -- retained earnings such as that shown in the filings every year?

MR. DON PALMER: Yes. It would be, again, part of the projection of the balance sheet and it's -- wouldn't be difficult thing to do.

MR. WALTER SARANCHUK: Can the risk analysis be adjusted annually?

MR. DON PALMER: It can be adjusted annually. I don't think it can be adjusted prospectively as -- as the MCT could be. Just by definition if you're comparing actual results to forecasted results and the actual hasn't happened yet there's no comparison to be made.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: My understanding

is that the MCT is based, essentially, on the balance sheet and that there is some question as to whether or not, on recalculating it, it could take into account prospective changes; is there any comment you can make on that?

MR. DON PALMER: When -- when we do our pro formas going forward we do not only operating statement projections but we do balance sheet projections as well.

So on the basis of those projections we would include an MCT score. I -- I --

MR. WALTER SARANCHUK: You're free to comment further, sir.

MR. DON PALMER: I prefer not to at this point.

MR. WALTER SARANCHUK: Thank you. Can you, however, comment on the reasonableness of using actual and forecasted basic insurance MCT capital required balances and MCT ratios as a means of assessing the relative adequacy and reasonableness of the basis RSR? That is, it's a movement toward becoming either too high or too low.

MR. DON PALMER: As long as the -- the projected scores are within the range, I don't see that there's issues there.

MS. MARILYN MCLAREN: Again, that really comes back to the matter of the test itself and then the targets and separating the two (2). You run the test and given that the objective methodology is -- simply continues to be a test where it compares capital required to capital available, we don't see that as being an issue and then separately we have the target that the Corporation has selected of 50 to 100 percent against that test.

So within that context we think we have a fair bit of variability and stability. Stability going forward.

MR. WALTER SARANCHUK: Thank you.

I'll now ask you to turn to AI-16 in Volume III, Part 2 which is the Basic Autopac Operational Investment Risk Analysis dated June 14th, 2006. And, in particular, turn, if you would please, to page 8 where this document addresses in Section 5, Alternate Scenarios.

And my first question is with respect to alternative scenario 1 on page 8. It is to shorten the time -- sorry the investment time horizon to one (1) year.

Can you summarize, Mr. Galenzoski, the rationale and the basic elements for this proposed change?

MR. BARRY GALENZOSKI: Yes, those are detailed in the -- in the document itself. There are several reasons the time horizon for the VAR calculation should be shortened to one (1) year. MPI files its rate application on an annual basis. API adds that Performance Inc. now recommends a one (1) year time horizon for VAR estimates. Risk does not decrease as the time horizon increases and VAR is less accurate as the time horizon increases.

MR. WALTER SARANCHUK: And can you confirm that the value at risk calculation is identical to that previously approved by the Board except with respect to the time horizon?

MR. BARRY GALENZOSKI: Yes, we can.

MR. WALTER SARANCHUK: Now, turning to page 16 of AI-16 and in particular referring to Table 19, would you please, sir, characterize the dollar significance of this change to the PUB approved methodology?

MR. BARRY GALENZOSKI: Again, this is -- is documentation that summarizes the recommendations that are in the report and it -- it then contrasts to what the various dollar values would be given the ranges that we're provided with.

So if you look at just the -- the previous PUB approach -- it's been classified as the "PUB approach" -- that would come up with an RSR range of between 52 and $79 million. And then we've added each of the scenarios in separately just for demonstration purposes so that you can see the effect of the single scenario against the previous PUB-approved approach.

And then Scenario 4 combines the scenarios 1, 2, and 3 with -- and says that the number comparable to the PUB approach would be 101 million to $184 million.

MR. WALTER SARANCHUK: Yes, and with respect to alternative Scenario Number 2 on page 9 where it is stated that there should be an adjustment of the historical data to current levels, can you summarize the rationale and basic elements of that change that's proposed?

(BRIEF PAUSE)

MR. DON PALMER: The size of -- of the Corporation in terms of premium dollars, in terms of reserves, in terms of investment portfolio has grown substantially over the last number of years, twelve (12) -- twelve (12) years specifically but -- but certainly even since the PUB approach was first adopted in 2001, if that was the year.

What we did was we looked at the percentage variances that were indicated in the risk analysis and we applied those percentages to the current portfolios, the current premium size, the premium -- the reserve size, the investment portfolio.

MR. WALTER SARANCHUK: Can you confirm, sir, that the operational risk analysis is otherwise identical to that previously approved by the Board including use of actual correlations?

MR. DON PALMER: Except for the actual correlation part, I would -- I would confirm that.

MR. WALTER SARANCHUK: Sorry, excluding the actual correlations; is that your point?

MR. DON PALMER: Sorry, I stand corrected. It does include the correlations.

MR. WALTER SARANCHUK: Thank you, sir. And referring again to page 16 and Table 19 within this document, can you characterize the dollar significance of this change to the PUB-approved methodology?

MR. DON PALMER: That would be Scenario 2 and only doing that change would increase the range from fifty-two (52) to seventy-nine (79) according to the original PUB-approved approach to 79 to $111 million.

MR. WALTER SARANCHUK: Thank you, sir.

With respect to alternative scenario 3 addressed on page 12 of AI-16, the heading there is, "To Adjust the Historical Loss Costs and Revenues to Reflect the Corporation's Current Re-insurance Terms."

Can you summarize the rationale and basic elements of that proposed change?

MR. BARRY GALENZOSKI: The -- again the Corporation's reinsurance program has changed quite significantly over the last number of years, particularly with respect to the PIPP claims, the large claims that we see coming out of the injury side.

Where our retention now is the first $5 million of every loss, where in past years that was as low as $1 million. And that isn't reflected in the data when you look at historical data. So the idea here is to change the data to what we're looking at today, that type of coverage rather than stating it in terms that are no longer available to us.

MR. DON PALMER: If I can add to that, the reinsurance portfolio isn't transfer of risk. So we're not transferring as much risk to day as we did when some of this data was complied. So on that basis, our riskiness has increased because we're retaining that risk rather than transferring it.

MR. WALTER SARANCHUK: Thank you,

gentlemen. Can you confirm that the operational risk analysis is otherwise identical to that previously approved by the PUB, including use of actual correlations?

MR. DON PALMER: Confirmed.

MR. WALTER SARANCHUK: And with reference to table 19 again, can you characterize the dollar significance of this change to the proposed PUB approved methodology?

MR. DON PALMER: It increases the range again from the original 52 to 79 million to 58 to 85 million. You want just the reinsurance adjustment, scenario 3?

MR. WALTER SARANCHUK: Yes sir.

MR. DON PALMER: Thank you.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: Now, with reference to alternate scenario number two 2 that we dealt with, this was addressed on page 9 of AI-16, that deals with the adjustment of the historical data to current levels.

This was addressed in PUB IR II-7, which appears in Tab 39 of the book of documents. Could you please summarize the rationale and basic elements for this requested refinement?

(BRIEF PAUSE)

MR. DON PALMER: We can guess at the rationale, I think the question came from the PUB and the PUB advisors. But my understanding of what the rationale would be is that the mix of claims can change over time and has changed over time.

So from that standpoint the mix of the risk of the different claims categories, could change as your mix of actual claims changes.

MR. WALTER SARANCHUK: And can you confirm that the operational risk analysis is otherwise identical to that previously approved by the Board, including use of actual correlations?

MR. DON PALMER: I can confirm that. There's an awful lot of changes that you've referenced, but all other things being the same, I'll confirm that.

MR. WALTER SARANCHUK: And using the revised table 19 that was filed in response to part B of that question; where the question was effectively to re-file incorporating the restatement of alternate scenario number 2, provided in response to PUB/MPI-I-33.

And using that revised Table 19, can you characterize the dollar significance of the refined change to the PUB approved methodology?

MR. DON PALMER: The range changes from 52 to $79 million to a new range of 78 to $109 million under revised scenario 2.

MR. WALTER SARANCHUK: And using that revised Table 19, can you characterize the dollar significance of the change to the PUB approved methodology resulting from combining alternate scenarios 1 and 3 with the refined alternative scenario 2?

MR. DON PALMER: No. I can't do that. I can advise, using scenarios 1, 2 and 3, not just 1 and 3 as you had indicated. But if we combined all scenarios the ranges go from original PUB approach 52 to 79 million to 97 million to 178 million.

MR. WALTER SARANCHUK: Thank you, sir.

Now, as we know, there will be cross-examination of expert witnesses next Wednesday, 12th October, but in terms of some very general questions with reference to the Hum and Simpson evidence that was filed by CAC/MSOS and, in particular, the pre-filed evidence dated September 8, 2006, I would just draw the Corporation's attention to page 29 and ask the very general question; how does the Corporation respond to the conclusion to the effect -- that the Professors Hum and Simpson, quote:

"See no basis for the MPI adjustment to reflect current magnitudes in alternative scenario 2."

End of quote?

MR. DON PALMER: We would disagree with that assertion. Very strongly.

MR. WALTER SARANCHUK: Okay. Can you elaborate?

MR. DON PALMER: As I mentioned before, we are not the same corporation as we were five (5) years ago or twelve (12) years ago. As the -- and I'll use the example of our claims reserves. If we look twelve (12) years ago at our PIPP reserves we only had one (1) year of PIPP and any percentage deviation would be a small dollar number. So you may say that, for instance, unexpected inflation only would be -- have the effect of increasing the reserves for one (1) loss year.

Twelve (12) years later, if we had that same unexpected inflation, that would impact twelve (12) loss years which is much bigger. I don't know -- so if we look at the actual variation that happened in our reserves from a very small sample, one (1) loss year, the variation today would be much, much bigger.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: So when you have only one (1) year of PIPP experience the chance of a forecasting error would be higher; is that correct?

MR. DON PALMER: A forecast error would be higher when you apply it to one (1) year of data, sure. But if -- if you apply that to your entire claims reserve maybe your percent deviation is going to be less, but your actual dollar will be much, much bigger.

MR. WALTER SARANCHUK: And one (1) final question with regard to the Corporation's general response to a conclusion in this report.

With reference to page 35 how does the Corporation respond to the comment, quote:

"The MCT simply does not address the primary issue at hand, mainly how much liquidity is required to finance an unexpected non-recurring loss event."

End of quote.

MR. DON PALMER: I -- I don't see any discussion of the RSR as being one of liquidity. The risk analysis itself looks at the variation in the statement of operation which is not a cashflow statement so again includes -- includes changes in reserves. It's not a question of -- of cash available.

So I guess if I -- if I was to compare those two (2) tests, the risk analysis and the MCT, and they say it is a -- a question of liquidity, well, the MCT does include risk adjustment factors on -- on the assets that are held which are partially set because of the liquid or illiquid nature of those assets, but again I don't see the setting of an RSR being related to liquidity whatsoever.

MR. WALTER SARANCHUK: Doesn't the Corporation's approach amplify the error in adjust -- by adjusting it to the current year for example in respect of inflation when you talk about the one (1) year experience and then adjusting it to the current year?

MR. DON PALMER: I'm not sure I understand the question.

MR. WALTER SARANCHUK: You had a larger prospect for a forecasting error because you only had one (1) year's experience twelve (12) years ago. So now when you adjust it to current levels, aren't you amplifying the error? In other words should you be doing some weighting?

MR. DON PALMER: We -- we are adjusting all twelve (12) years to -- to current realities, so I don't see that that's necessarily an amplification of the error. There's years in there that our forecast errors were very, very small so you can say that -- that -- there are years where we would reduce the error.

So I would say that it balances out. To -- to actually focus in on -- on one (1) year is not really the -- the nature of the exercise. The nature of the exercise is to look at the available experience in totality.

If I can refer you to PUB-1-26.

(BRIEF PAUSE)

MR. DON PALMER: There's a chart in there that shows the -- the variance of the various components by year so actually what that shows is that the forecast error has increased; it's higher in the last six (6) years than it was in the first six (6) years.

MR. WALTER SARANCHUK: Which chart are you referring to, sir?

MR. DON PALMER: That's the chart at the bottom of page 2 of that information request.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: Thank you for

that. I'll now ask a series of questions addressing the overall financial wellness of the Corporation, which is a consideration of this Board and has been for a number of years.

And I would draw your attention firstly to AI-14, which in the book of documents at Tab 8 --

THE CHAIRPERSON: Mr. Saranchuk --

MR. WALTER SARANCHUK: Yes?

THE CHAIRPERSON: -- before you begin, if we could ask a couple of --

MR. WALTER SARANCHUK: Sorry, sir.

THE CHAIRPERSON: We understand that MPI supported the proposal that New Brunswick adopt public no-fault auto insurance. Is our understanding correct that MPI was helping New Brunswick prepare for the possible adoption of no-fault public auto insurance?

MS. MARILYN MCLAREN: We're not doing that at this time, no. A number of years ago I believe it was in '03 and '04; the legislature of New Brunswick had a select committee on public auto insurance.

At that time there were -- they'd asked for information, we'd done a couple of presentations to them and shortly subsequent to that my predecessor Jack Zacharias had written to that committee and indicated that should the people of New Brunswick decide to adopt a public auto insurance scheme, the Corporation would be prepared to assist if they wanted us to assist.

Since that letter went forward, things have evolved in a number of different ways, and nothing new has happened since then. But, I -- with the exception that I know, the new government of New Brunswick is aware of that letter.

THE CHAIRPERSON: At that time, if we recall properly, MPI was involved in a sense in their proposal, because were you not going to provide certain services to support the new plan?

MS. MARILYN MCLAREN: Well, what the letter indicated was that the Corporation would be prepared to support their implementation and ongoing operation if they would so choose.

That we actually could on a fee for service basis allow them to use our Autopac online system or claims systems, financial systems, things like that, but offered as well, you know the management support and staff support to get themselves up and running.

THE CHAIRPERSON: Just in a general nature, would MPI have supported the proposal if it felt that the plan wouldn't benefit New Brunswick's motorists?

MS. MARILYN MCLAREN: I think Manitoba Public Insurance is on the record as saying we believe that people are better served with public auto insurance systems than with private systems.

THE CHAIRPERSON: Would the New Brunswick plan, if it had been adopted and implemented, face similar risks of unforeseen events as does MPI?

MS. MARILYN MCLAREN: Certainly.

THE CHAIRPERSON: Would New Brunswick have begun their plan with an RSR meeting MCT standard?

MS. MARILYN MCLAREN: I have no idea if it had gone that far or if it does go that far, how they would choose to determine their capital requirements, that is at a start up point.

THE CHAIRPERSON: In a general basis, would you say that today's Manitoba policyholders are in better or worse or the same general financial situation as was the case when MPI came into existence in '71?

MS. MARILYN MCLAREN: Better -- better position particularly with respect to predictability and stability. In the early years when the Corporation came into existence very little capital, certainly; but also there was a very -- it was a real growing process to understand what it was going to take to provide year to year predictability and stability, as well as, guaranteed access.

THE CHAIRPERSON: So there was clearly

substantial risk at the start of the program when -- with respect to the existence or non-existence of RSR or retained earnings?

MS. MARILYN MCLAREN: Yes.

THE CHAIRPERSON: Is there a material percentage of extension and SRE policyholders that are not involved in basic?

MS. MARILYN MCLAREN: I would say, yes, on the SRE side of things. A smaller percentage on extension but there are some on the extension side of things.

THE CHAIRPERSON: Is the percentage of basic policyholders represented in one (1) extension and two (2) SRE policy lists high? Are most basic policyholders involved in extension?

MS. MARILYN MCLAREN: Yes.

THE CHAIRPERSON: If an unforeseen event decimated the basic RSR to the point that rate shock premium increases would be considered for basic and the retained earnings were available in extension and SRE, would MPI then consider the transfer of retained earnings in extension and SRE to the basis RSR to mitigate the magnitude of the otherwise basic premium increase?

I just said "consider".

MR. BARRY GALENZOSKI: The Corporation

has, in its past history, done exactly that with respect to transferring of balances in retained earnings from the extension line of business particularly to the basic plan and that has also been the more recent history with respect to how we are rebuilding the Rate Stabilization Reserve.

I think you were talking about a situation where rate shock may be employed and we would have to cap rates because of rate shock, if I'm interpreting that correctly, and let's say the figure of 20 percent came into play. In other words, a basic rate increase of no more than 20 percent would be allowed and yet 25 to 30 percent was required. I think then the Rate Stabilization Reserve obviously would come into play as far as having to fund that so that this could happen.

But that hasn't happened in our situation although we've had some very large rate increases in our past history and that speaks to the -- a little bit of the instability of -- of the plan in its early years.

You've got to remember that MPI started off the basic insurance plan with no capital being provided by the Provincial Government. In fact, it was a small loan initially that was repaid immediately out of funds received from customers and over the years we've built the Rate Stabilization Reserve.

But, you know, the -- the need for the Rate Stabilization Reserve wasn't as clearly understood, I think, as it is now. And, in fact, even the -- all -- the wherewithal for establishing the reserves for claims wasn't as well established as it was today and nor as rigorous.

You know, I can recall a time when the then Provincial Auditor, we had about 4 or $5 million set aside in financial provisions over and above our case reserves on our claims files and they -- they were characterizing that as hiding funds.

Okay. Well, that whole school of thought has evolved much over time to the point where we are today with very adequate reserves being set aside, generally speaking, and financial institutions being monitored.

And this whole process has been evolving including how you establish Rate Stabilization Reserves or retained earning levels.

MS. MARILYN MCLAREN: With respect to your prospective question, in the future would the Corporation consider, --

THE CHAIRPERSON: In the context we're discussing -- at least Mr. Palmer was, unforeseen events.

MS. MARILYN MCLAREN: Yes. You know, I

think in a -- in a -- in a terribly massive financial catastrophic event we would consider every possibility that was open to us.

But I think in the context of the discussions about RSR and the target and so on and so forth, I think it's important to point out that, you know, and some of the experiences Mr. Galenzoski was talking about through time, we didn't really have structured targets for any of the lines of business as we do today.

And, you know, there -- it is foreseeable that if the Corporation completely and utterly fails to move the Public Utilities Board off $100 million upper target it's not just that we would then see no legitimate reason to keep transferring money into a line to have it go back to what may not be the same people who contributed to those surpluses.

The surpluses themselves, over the long term, may very well not be there. We would not continue to run those lines of business so that surpluses that we didn't have any particular purpose for would continue to grow. So, in a circumstance such as that, five (5), ten (10) years from now, we've been living in that world. There's not likely to be significant excesses retained in either of those lines of business.

THE CHAIRPERSON: Thank you. Mr. Saranchuk...?

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: Dealing with the overall financial wellness of the Corporation I would refer everyone to AI-14 which is in document -- the book of documents at Tab 8.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: And I would ask that it be confirmed that the total basic retained earnings as at February 28th, 2006, for basic insurance was $173,134,000; is that correct?

MR. BARRY GALENZOSKI: Yes, that's correct.

MR. WALTER SARANCHUK: And that the retained earnings for Extension and Special Risk Extension, SRE, totalled $90,378,000; is that correct?

MR. BARRY GALENZOSKI: Yes, that's correct.

MR. WALTER SARANCHUK: I'm advised that combined that amounts to some $263.5 million. Do you agree with that?

MR. BARRY GALENZOSKI: Yes, I would.

MR. WALTER SARANCHUK: And we know that at the end of the first quarter of the current fiscal year, the one that commenced March 1, 2006, according to the first quarter report that was filed that that total was approximately $320 million; is that correct?

MR. BARRY GALENZOSKI: I'll take that as being correct.

MR. WALTER SARANCHUK: And we appreciate -- I think it can be appreciated that we're talking about a good time if there is such a thing in the insurance year relatively speaking as -- spring and summer as opposed to fall and winter and the accident frequency.

But looking at the information in Tab 8 and AI-14 specifically there is reference of course to two (2) transfers having been made last year, one (1) from Extension to the tune of $8.3 million and one (1) from the -- sorry, one (1) from SRE for $8.3 million and one (1) from Extension of some $11 million; is that correct?

MR. BARRY GALENZOSKI: Yes, that's correct.

MR. WALTER SARANCHUK: Now, at Tab 23 in the book of documents is the Corporation's response to Interrogatory Number 19 of the Public Utilities Board in the first round which asked the question:

"For the statement of Extension and SRE retained earnings please extend the schedule for 2006/'07 and '07/'08 consistent with -- excuse me -- with that filed at last year's application in response to PUB/MPI-1-25."

Would you please read in the Corporation's response?

MR. BARRY GALENZOSKI: Response is:

"As indicated in the pre-filed testimony, transfers of retained earnings from Extension and SRE to Basic RSR have been suspended. As a result the Corporation is only providing historical financial information for Extension and SRE. Additionally, depending on the outcome of the discussion on the RSR and assuming that PUB retains its position on the level of RSR for rate setting, the Corporation will have further decisions to make. Please see PUB/MPI-1-37 and CAC/MSOS-1-5."

MR. WALTER SARANCHUK: And with reference to the pre-filed testimony that is mentioned in that response I would draw you attention, Ms. McLaren to your pre-filed -- pre-filed testimony at page 6 and I would ask you please to address the rationale for the suspension of the transfers from SRE and Extension to Basic.

MS. MARILYN MCLAREN: The suspension of the transfers of excess retained earnings from extension and SRE to basic RSR was done because of the fact that the original rationale for those transfers was to assist in the rebuilding of the RSR.

PUB Order 150/05 clearly indicates that the PUB considered the RSR to be fully funded.

MR. WALTER SARANCHUK: And then if you move on in that paragraph, there's further commentary in terms of the rationale and I'm talking about page 6 of your pre-filed testimony, the second paragraph, where you refer to the fact that:

> "If the PUB accepts the Corporation's RSR target of 50 percent to 100 percent of MCT, current financial projections show these transfers would to be required for several years. Under such a scenario the Corporation would reinstate the transfers according to

its policy."

That is part of the rationale?

MS. MARILYN MCLAREN: I'm sorry I'm having trouble finding that reference; but I certainly agree with what you've said, yes.

MR. WALTER SARANCHUK: This is at page 6 of your pre-filed testimony.

MS. MARILYN MCLAREN: I'm sorry, I was looking at Mr. Galenzoski's pre-filed testimony. Yes, got it.

MR. WALTER SARANCHUK: So let me just ask you to elaborate further on what you said in your pre-filed testimony in that second paragraph, now that you know where we're coming from.

MS. MARILYN MCLAREN: Yes, the Corporation does intend, if the PUB should amend its position on RSR and choose to adopt a target for the RSR that's similar to what the Corporation has, based on a 50 percent to 100 percent target for the RSR; based on 50 percent to 100 percent of MCT, the Corporation would expect to reinstate those transfers and would expect them to continue as needed.

MR. WALTER SARANCHUK: And as I understand it, you're concern with the Board's approach is that if you were to continue with the transfers you would be benefiting motorists who are not part -- not all of whom are part of the plan, is that correct?

MS. MARILYN MCLAREN: Yes that's certainly part of it. The other part of it is though that the rebuilding strategy by definition, is rebuilding something. If it's full, if it's at its maximum, the concept really starts to fall on its face.

So I think we have to really think differently about that if we are looking an expectation that the RSR would continue to be full at a much, much lower level than the Corporation believes is required.

Not only is it that we would be transferring the money from a certain group of policyholders, many which are the same as basic policyholders, but not all.

It simply is contrary to the initial purpose for those transfers and the fact that the conclusion to that incongruence with the initial purpose is that you'd be taking money from potentially one (1) group and mailing it out in cheques to another; is problematic for the Corporation.

MR. WALTER SARANCHUK: Is it problematic for the Corporation to advance a free immobilizer plan to motorists who own vehicles that have never been stolen, in rural Manitoba, for example?

MS. MARILYN MCLAREN: No, if we were going to advance a free immobilizer program to only those people whose vehicles had been stolen this would be a much, much longer process. Many more lives would be lost, many more millions of dollars would be spent.

MR. WALTER SARANCHUK: What I'm getting at is, in that scenario where you've extended the free immobilizer, you have benefited motorists who really have never presented a problem, they're not part of the mix.

How do you reconcile that with your comment that you don't want benefit individuals on the basic plan who don't carry extension insurance?

MS. MARILYN MCLAREN: The rationale for an aggressive fight against auto theft has really been based on two (2) objectives. One is to make our communities safer. The second is to lower the insurance costs related to auto theft.

The reason that you see rates decreasing in virtually every territory and most of the insurance categories when we propose a 2.6 rate increase is because every ratepayer in this province is paying the cost of auto theft because the people whose vehicles are at risk are not paying their fair share of the way.

They are being subsidized. There is simply no argument to carry that over between lines of business where we have all worked very hard in Manitoba Public Insurance to make sure there is no subsidization between product lines, between lines of insurance.

MR. WALTER SARANCHUK: Ms. McLaren, as part of your response to PUB Interrogatory number 19 in the first round, that was addressed in Tab 23, the Corporation indicated that:

> "Depending on the outcome of the discussion on the RSR and assuming the PUB retains its position on the level of RSR for rate setting, the Corporation will have further decisions to make."

What do you mean by that?

MS. MARILYN MCLAREN: Part of what we meant there is the conversation I had with the Chairman a few minutes ago. If, you know, we lose all hope with respect to convincing the Public Utilities Board that a larger RSR is required to provide stability and predictability for Manitobans, there will be no rationale to continue those transfers. There will likely be no rationale to continue to run those two lines of business in a manner that would generate excess retained to facilitate transfers or any other purpose.

If the long-term strategic plan of the

Corporation changes with respect to retained earnings and RSR there will likely not be excess retained earnings to the extent there has been in those two (2) lines of business.

MR. WALTER SARANCHUK: Are the number of basic insurance customers that have extension and SRE coverage in the order of about 88 percent?

MS. MARILYN MCLAREN: With respect to private individuals, private passenger vehicles, yes. It's up well over 80 percent.

MR. WALTER SARANCHUK: Can you give me a more exact percentage? Is it 88 percent or more?

MS. MARILYN MCLAREN: I wouldn't be able to confirm that right now. I would suggest that it's not likely much more. And with respect to particular components of the extension line of business, we're probably very -- very near 88 percent. But that's -- it might be something as simple and low cost as an extension of liability coverage.

MR. WALTER SARANCHUK: Yes. And looking at the second quarter report that was filed by the Corporation and distributed yesterday, I believe it was.

MS. MARILYN MCLAREN: We have distributed them all. We are just looking for one. Just a sec.

MR. WALTER SARANCHUK: Thank you.

MS. MARILYN MCLAREN: Mr. Galenzoski has one.

MR. WALTER SARANCHUK: Looking at page 4 -- I'm sorry, page 5 where there -- the columns shown for liabilities and retained earnings; is it a fact that the updated figure for retained earnings of the Corporation, including some $221 million for basic and 108 million for the competitive lines, that the total is now closer to $330 million?

MR. BARRY GALENZOSKI: It's $329,213,000.

MR. WALTER SARANCHUK: And turning to page 3, and with reference to goal number 5, which states that:

> "Retained earnings in the rate stabilization will be maintained within established target levels."

Dealing with the semi-circular graph dealing with the basic RSR where it shows, as I understand it, that the amount of the basic RSR at the end of the second quarter is 84 percent of the target. That refers to the $180 million in Basic after -- after deducting the allocation for the IIF; isn't that correct?

MR. BARRY GALENZOSKI: Yes, it's the RSR is within target range.

MR. WALTER SARANCHUK: But the point is

that it doesn't include the IIF dedication?

MR. BARRY GALENZOSKI: That's correct.

MR. WALTER SARANCHUK: And so when you take into account the overall figure of some $221 million -- $221 million including the IIF, the range for both PUB in terms of a 65 to $100 million range and the Corporation which shows a target based on MCT of $107 million to $214 million, both are exceeded, correct, at this juncture?

MR. BARRY GALENZOSKI: Yes.

MR. WALTER SARANCHUK: And looking at the semi-circular graph for Extension retained earnings it's indicated that there is 142 percent of the target of $35 million that is currently represented in the retained earnings for Extension at this juncture; is that correct?

MR. BARRY GALENZOSKI: That's correct.

MR. WALTER SARANCHUK: And in respect of the SRE retained earnings at this juncture you are at a 158 percent of your target of $37 million; is that correct?

MR. BARRY GALENZOSKI: Yes, that's correct.

THE CHAIRPERSON: Mr. Saranchuk, I think we'll take a break right now.

MR. WALTER SARANCHUK: Thank you, sir.

--- Upon recessing at 10:30 a.m.
--- Upon resuming at 10:53 a.m.

THE CHAIRPERSON: Okay, Mr. Saranchuk...?
MR. DON PALMER: Excuse me, Mr. Chairman.
THE CHAIRPERSON: Sorry, Mr. Palmer.
MR. DON PALMER: If -- if I may I'd like to expand a little bit on the conversation that we had on liquidity this morning.
THE CHAIRPERSON: Please, do so.
MR. DON PALMER: When we were talking about the risks, the unforeseen, unexpected events and we have talked about all of the things that that may be, what -- what keeps me awake at night are those large changes in our unpaid claims reserves and we've seen them a number of times through our -- in our history, my history at MPI. The -- the biggest one that -- that comes to mind is our Tort liability reserve deficiency of -- in the 1994/'96 period.
And that really impacted the -- the RSR and the -- and hence the rate requirement or RSR rebuilding requirement. That was certainly the -- the first real issue when we -- when we saw major deficiencies and I don't -- and our RSR at that time was less than zero.

Those monies were not paid out immediately. We weren't looking at a requirement for liquid cash, but actuarial and accounting principles require us to put that money away for the whole amount.

We talked about in my -- or Ms. McLaren's direct testimony an increase in inflation of -- of 1 percent affecting our claims reserves, our PIPP reserves. That money very well may not be paid out for forty (40), fifty (50), sixty (60) years.

Again, there's no liquidity requirement but absolutely we're required by my statement of principles and standards of practice and by GAAP to fully fund those amounts with cash. That -- that money is earmarked, so to speak, and affects the -- the bottom line of the Corporation. We're not talking liquidity; we're not talking cash.

There are some unforeseen events that admittedly could have a drain on cash. We saw a few years ago a really unexpected winter. Those are short-term claims; short-tailed claims that could have a drain on our -- our cash reserves and hence liquidity, but the major, major risks that we're talking about do not affect liquidity.

So -- so certainly I -- I think the -- the HUM/SIMPSON report said primarily an issue of liquidity;

that's absolutely not true.

To the extent that there -- as I said there are some minor -- minor cases where liquidity could come into question the risk analysis doesn't talk about those at all. Again, it's a -- it's a comparison of the statement of operations actual to expected results and it's not liquidity, it's -- it's the incurred claims which we've identified as being the biggest portion of -- of the risk assessment. Incurred claims is paid plus the change in reserves.

Again, that change of reserves in addition presumably is -- may not be paid for twenty (20), thirty (30), forty (40), fifty (50) years. Again, not liquidity.

Where there is cash required there is no mention in the risk analysis at all. At least the MCT does have risk factors that are applied to the various assets and the reason that those risk percentages have been chosen by OSFI and -- and all the OSFI advisors is partially because of liquidity. Cash is the most liquid asset that's -- that's available and the risk load for that asset is zero.

As we go into higher, more illiquid types of securities, such as MUSH bonds, that percentage of -- of risk is much higher I think for those particular ones

-- none marketable bonds is 8 percent and we -- we did file in CAC/MSOS MPI-1-49 is the calculation of the MCT and all the asset scores are included on page 2 of that.

So where there is liquidity required there is some factors included in the MCT score. Again, there is nothing in the risk analysis at all that talks about liquidity.

I think Mr. Galenzoski may have something to add on that.

MR. BARRY GALENZOSKI: Yes, that's the actuarial perspective. From the financial perspective of the Corporation we were quite intrigued when we saw the page 35 document that talks about liquidity and how -- how the risk analysis addressed liquidity whereas MCT -- MCT didn't address liquidity. That was kind of interesting just that they thought there was something in the risk analysis that -- that addressed liquidity and didn't see what was in the MCT as was explained by Mr. Palmer.

The very fact that the -- in -- in the last paragraph before Section 7 on page 35 of their report, the authors say that the MCT simply does not address the primary issue at hand, namely, how much liquidity is required to finance an unexpected and non-recurring loss event.

And then when they were asked under the question the PUB put to them under PUB/CAC/MSOS-I-10 to provide a definition of liquidity or describe how MCT fails to address this, they go into in more detail where they talk about it being a spike in claims.

So they're limiting their view to this liquidity problems as a claims issue. Nothing else. Not the loss of investment income which could have some liquidity requirements associated with it because you wouldn't have any cash coming in on that. They just -- they deal specifically with losses, the spike in claims.

And they go on to define their definition of liquidity which I can generally agree with. I don't think we have any major disagreement there.

The fact is, is that through, you know, GAAP accounting processes, the accrual accounting that we follow, as Mr. Palmer has explained, it's very unlikely that the claims spike that they're talking about is going to result in any kind of liquidity situation for the Corporation whatsoever. These are likely going to be spikes in long-term claims that are going to get paid out over many years in the future rather than having to be funded immediately.

And they talk about the risk assessment as being a way of -- or the -- of the Rate Stabilization

Reserve as being a methodology to fund claims as though they're, you know, going to start writing cheques against it tomorrow, type thing. And that simply is not the case.

Even in the remotest of claims situations, for instance, a major hail loss that we might have where we could have a 50 or $60 million loss where we have reinsurance capabilities, you know, we have no funding requirements there either because the reinsurers are required to fund that based on our estimates of claim payouts. So the liquidity issue is taken care of there from that side of it.

And that has proven to be the way it worked in the two (2) large hail losses that we had. One (1) in 1996 and one (1) in 2001.

So we're really mystified and I think it -- it really does speak to their level of expertise in our business. I'm not knocking their expertise as economists. I'm just saying that they're applying that level of expertise into a specific business against a very specific business element, being the retained earning requirements for a company like MPI. They're simply not on base. They've missed the point totally. And my advice is that the Board pay very little attention to what they say with respect to that part of it.

THE CHAIRPERSON: Well, I imagine we'll have an opportunity to examine them with their evidence when they appear and you'll have an opportunity to cross-examine as well.

On a sort of a tangential point, of course, when you -- when you're forced to, how do you put it, lay out more cash than you otherwise had planned to, actual cash, I guess one other problem you could encounter is the requirement to sell securities that you otherwise wouldn't sell at that point in time and trigger a potential loss, I suppose.

MR. BARRY GALENZOSKI: We have several methods available to us on that and, you know, take, for example, the requirement to pay out $58 million for the rebate that was just done. Just a few months notice and we were able to plan for that and we had the cash available by year end.

And so the Corporation has -- we have pretty significant cash flow on a month to month basis. So whether, you know, I -- it would be very rarely we'd take the step of actually cashing in an investment to take care of that problem.

Similarly, we also have arrangements that we would look at it as a business case and if it was actually less expensive to go out and borrow the money on a short-term basis we would do that. Okay. We have that ability to do that.

So we don't look at it just from one (1) level and that is just the assets that we have and we may have to dispose of. We have ways of planning for this. A significant inflow of cash coming in on a regular basis and we can deal with most situations that we see coming in front of us.

THE CHAIRPERSON: With $2 billion in assets you've got a significant time window to address unforeseen events?

MR. BARRY GALENZOSKI: That's correct.

THE CHAIRPERSON: Mr. Saranchuk...?

MR. WALTER SARANCHUK: Thank you, sir.

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: Still dealing with the overall financial wellness of the Corporation, Ms. McLaren, last year, as you know, the Corporation filed evidence with this Board for the outlook period.

Indeed, that was quoted at page 12 of the order last year and that information indicated that there would be transfers over the next five (5) years on which the Board -- and on the basis of which the Board granted its order last year.

You will recall that the Corporation -- I'm sorry. You will recall that the Board had some reservations about accepting the Corporation's indication that these transfers would be made. Are those concerns not effectively borne out?

MS. MARILYN MCLAREN: We spent a fair bit of time -- a significant amount of time, reviewing last year's proceedings and comments by the Board in their order with respect to that matter as well and concluded that on the face of it, you know, without all -- without full knowledge and context necessarily on the point of MPI, that it did seem like there was a little bit of a disconnect, in the short-term anyway, with respect to the Board's position that it in any way needed to rely on those transfers and concluding that the RSR was over-funded.

So, the Corporation has put forward its position on the transfers. We've been very clear about that -- the purpose for those transfers. We've been very clear about it, year after year after year and it seemed clear to us that with the decision that -- with the decision of the PUB that the RSR was over-funded, their conclusion at last year's proceedings, the purpose for those transfers had ceased at that point in time.

So, no. I don't think their concerns were borne out given the complete context.

MR. WALTER SARANCHUK: So, when you present evidence at a general rate application asking the Board to take into account on an outlook period of some five (5) years of a transfer from SRE totalling something in excess of -- well, approaching $60 million over the next five (5) years and a transfer from extension approaching something in the order of 25 -- or $20 million over the next five (5) years, how do you expect the Board to deal with evidence like that in the future?

MS. MARILYN MCLAREN: We would ask that the Board deal with evidence like that within the context of those forecasts. If you look at the forecasts, if you look at the financial statements put forward through that process it will also show the Corporation's RSR target of 50 percent to 100 percent of MCT and the Corporation's belief that the RSR would be built to the upper level primarily through transfers from those extension lines; that is the context within which the forecasts were put on and the outlook showing those transfers also shows the 50 percent to 100 percent of MCT. It's entirely consistent.

MR. WALTER SARANCHUK: So what you're saying, effectively, is that the Board better see it your way or else you're going to take your bat and ball and go home?

MS. MARILYN MCLAREN: That's not the way the Corporation has -- has brought this forward. If we had told the Public Utilities Board that we intended to continue to transfer excess retained earnings from the competitive lines of business into the RSR, regardless of the size of the RSR, regardless of the deemed necessary size of the RSR, regardless of anything else happening, perhaps one might choose that kind of a characterization.

The Corporation stated its intention to transfer those monies as a mechanism -- primary mechanism -- to rebuild the RSR. That was always the context of those transfers.

THE CHAIRPERSON: Just to jump in for a minute. Your comments seem contradictory to your six (6) month returns because there you're ignoring the Board's established target for RSR and the RSR that you're comparing your position with is actually the one that's based on the MCT.

You're saying in this goal number 5 that you're only at 84 percent of the RSR level. So according to your own reports your RSR is not adequate.

MR. BARRY GALENZOSKI: I can maybe address that. I think the distinction that's being made here is that you're establishing an RSR for rate setting purposes and the reporting that we're doing in here is to substantiate our case around the rate setting for the coming year.

The -- we have not abandoned our policy of having -- the Board is not abandoning -- our MPI board has not abandoned its policy of a higher RSR target than what you are allowing with respect to rate setting.

So we're reporting our financials based on our Board requirements from MPI, not based on rate setting processes. Anything that you're seeing here reflects that in -- in the -- you're getting all the information based on -- on what your view is with respect to the Rate Stabilization Reserve. You've got both sides of it. You've got the MCT ratios that we're putting forth and the resulting dollar values plus your -- you can impose your figures with respect to the level of RSR that you see appropriate for rate setting purposes.

So you don't see any differences there.

THE CHAIRPERSON: Aren't you reacting to an unforeseen event? Like according to your reporting to the public, you're way short of your RSR reserves so based on the evidence that you have right now and what you've said, consistently you'd continue the transfers until you reached your level. Any action that the Board might take is outside of this; is it not?

MR. BARRY GALENZOSKI: No, I think our Board has -- has clearly spoken and that's what Ms. McLaren has been telling you is that until we've resolved the issue the transfers have been suspended until such time. We're still reporting based on our target and based on what the Basic line of business is able to do on its own at this stage, but we're -- we've suspended the transfers.

MS. MARILYN MCLAREN: See, the reality from our perspective is that we took the words in the order at face value, that the Public Utilities Board had selected an upper end of the RSR for rate setting purposes for the -- for a period going forward. It was not retrospective. It didn't end in February of '06.

You selected that 100 million target for rate setting purposes until I think it was '09/'10, but there -- there's words in the order that said, you know, this is the reality, this is your context, and the position of the Corporation is until that context changes there -- there is no rationale to continue transfers that were intended to rebuild something that you have articulated in your order as being full if not over-funded.

THE CHAIRPERSON: No, I understand your perspective and I think we're just trading words around something that's very difficult to resolve in a sort of optical way. All I was saying was that in your public reporting and transparent reporting to the public you have retained the targets for the RSR set by the Board which were based on MCT and that's what you're reporting on.

At the same time you're reporting on your Extension and your SRE being well over your targets, but there's no reference to a -- if you want to call it a disagreement or difference in RSR targets as established by the Board and the Corporation.

MR. BARRY GALENZOSKI: No, and that wouldn't be required in -- in the discussion -- in a management discussion and the analysis section of the report. We did indicate in there that a rate refund or rebate was ordered by the Public Utility Board so, you know, we have -- the relevant things that affect the customer have been reported on that side, but our disagreement with respect to Rate Stabilization Reserve is not mentioned in there.

And I guess just one (1) thing else I'd like to add is that, you know, this is a difficult subject and we're trying to be as polite and respectful as possible in how we word ourselves with respect to the fact that these transfers have been suspended. We're not trying to do something here that looks like it's unilateral or anything along that line. We're -- we're hoping for some open dialogue on this.

Once we have some idea, then I guess everybody can move forward on that basis.

THE CHAIRPERSON: Well, in fairness, it's a quarterly report too. Mr. Saranchuk?

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: Yes, if I can preface this remark, you can appreciate, members of the MPI Panel, that the Board obviously has some concerns about the position taken in respect of the Corporation's cessation of these transfers.

You should also appreciate that it's understood that this is a decision of the board of directors of MPI and essentially you are presented here -- sent to defend it.

So in that whole context, when the Board is faced with less than a year ago evidence -- or about a year ago evidence to the effect that there will be a continuation of these transfers and then it finds itself faced with a situation where the Corporation's board has taken the position that there will be a cessation of the transfers unless, on the face of it, it appears, the

Board changes its views on the matter, the concerns that arise, for example, that -- include the fact that you are operating and taking that position contrary to your own goals and your strategic plan.

And let me give you an example. When you take a look at your annual report at page 25, this is in AI-11, you refer to your goal number 5 that the retained earnings and RSR will be maintained within established target levels.

Also, at AI-11, in your Corporation's annual report on basic and in your corporate strategic plan, in the latter case at page 13, again, repetition of the goals of the Corporation is that you're maintaining a steadfast undertaking to meet those goals. Again, goal number 5, page 13:

"Retained earnings and RSR, rate stabilization, will be maintained within established target levels."

Under that goal there are strategies listed. And number three (3) is:

"To develop business strategies to ensure competitive lines of business are profitable and able to contribute to the rate stabilization to the benefit of all Manitobans."

So, given this position by the board of directors; doesn't that fly in the face of that goal?

MS. MARILYN MCLAREN: I think it's fair to say that it's entirely possible, given the context of this Corporation's legislative framework, the number of bodies to whom it's accountable, that it may very well have a corporate goal that is not necessarily supported by some of the bodies to whom it's accountable.

You simply can't look at the context of the Corporation's decision to retain that goal outside of the rest of the context. Look at the board discussion and the minute to the board, which we have filed on the record, just above the decision to stop the transfers.

Why are we here again talking about the RSR again. Why are we here again? Why did we do so much work to document and support the Corporation's rationale for an MCT goal -- MCT based goal of 50 to 100 percent of that test? Because the directors decided they are completely committed to that goal. They intended us and directed us to get back here again and do whatever we possibly could on the basis of sound analysis and sound rationale to bring forward the Corporation's position and bring forward the Corporation's position in such a way that the Board -- this Board would have compelling evidence before it to reconsider last year's judgment with respect to the RSR and the upper target for the RSR.

The mechanism to measure financial strength and the target to which the Corporation should be held with respect to RSR, they directed us to come back and do our very best to make the case again. When that's their direction, it would be entirely incongruous to do anything other than to suspend the transfers and also retain a corporate goal that says we believe in what we have decided to do and what we've directed management to try to get support for in one of the bodies to whom we're accountable.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: Let me draw your attention to your testimony in direct examination on the first day, at page 64, lines 21 to 24.

MS. MARILYN MCLAREN: I remember most it, that's okay.

MR. WALTER SARANCHUK: Okay. Let me quote you, quote:

"We believe the Corporation's RSR strategy is target range, rebuilding primarily [I think that should read] through transfers and extension lines.

Prudent management is the best way to
deliver that expectation that
Manitobans have of us." End of quote.

How do you reconcile that with what you've just said -- told us about the rationale behind this cessation of transfers?

MS. MARILYN MCLAREN: Key word being "rebuilding." The Public Utilities Board Order 150/05 indicated the Board's view that there was no rebuilding required, in fact, that it was over funded.

We believe, based on our corporate target and based on the arguments that we have put forward through these proceedings, there is ample justification for a higher target, at which point, rebuilding will continue to be necessary.

MR. WALTER SARANCHUK: Well, let me suggest to you, Ms. McLaren, that while no one wants to suggest for one (1) moment any nefarious intent on the part of the MPI Board, it's not beyond the realm of possibility for someone to conclude that with the Board of MPI taking the position that it now has, to cease these transfers, that in effect the real reason for that is because they want the extension side to keep making up the loss that it's incurring from DVL.

MR. BARRY GALENZOSKI: I can answer that, you can see that it's more than making up that loss as we speak, we don't need to have additional funds to do that. There is no concern that the Corporation isn't going to be able to cover the short term losses that we're experiencing with respect to DVL.

So that argument totally doesn't wash in any view that you would look at it.

MR. WALTER SARANCHUK: I'm just looking at the overall projection of some $30 million over the course -- sorry $37 million over the outlook period; in terms of the DVL cost bottom line.

Given that there's a cessation of the commissions, given the overall loss and given as a result of the merger, this is at your response to PUB/MPI 38, I, which is at page -- I'm sorry, Tab 27 of the book of documents, Mr. Galenzoski.

MS. MARILYN MCLAREN: Mr. Saranchuk, you just read into the record a few minute ago from last years proceedings the expected transfers from extension to the basic RSR, which were clearly, as Mr. Galenzoski stated, adequate to cover short term losses in the DVL lines.

Last year those projections were also based on worst case scenario of expecting to lose more money on DVL than we now expect to lose, since we have managed to identify $5 million of savings per year.

So the argument doesn't stand, in our respectful opinion.

MR. WALTER SARANCHUK: Fine. Now, just to wrap up with a few questions in this particular area of RSR. If you wouldn't mind taking a look at -- unless the Panel might have some further questions.

If not, then I would ask you to look to Tab 11 in the book of documents --

THE CHAIRPERSON: Mr. Saranchuk, we have one (1) other potential question that we're mulling over, but we'll leave it mulling now.

MR. WALTER SARANCHUK: Thank you, sir.

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: I would ask that the Panel then -- the Board Panel and MPI's Panel refer to Tab 11, which is the Corporation's response to question 1 of the Public Utilities Board in the first round.

And that was with reference to the effect of a 0 percent base rate premium change and a 5 percent base rate premium decrease for 2007/'08 and the impact on the RSR as reflected in the attachments 1A and 1B.

Mr. Galenzoski, if you wouldn't mind could you just review at a high level for us what the impact would be?

MR. BARRY GALENZOSKI: Yes, with respect to the Scenario A which is no motor vehicle premium change in any of the years including '07/'08 where we're already now previously suggesting 2.6 percent reduction; what would end up happening in that particular year '07/'08 is that the net income from operations would be $2.4 million for '07/'08. The transfer from the Immobilizer Incentive Fund would remain the same, and the net income for rating purposes would then be $13.5 million approximately.

That would then flow through to a better outlook for the -- the years going forward and it would be 11. -- almost $12 million net income from operations with another $3.5 million coming from the Immobilizer Incentive Fund so that net income for rate setting purposes would be 15.5 and there'd be slight increases in -- in the future years going ahead.

MR. WALTER SARANCHUK: And then just turning over to the Attachment 1A with reference to the RSR, what's the impact there of a zero change in rates?

MR. BARRY GALENZOSKI: Well, the impact is that the RSR continues to build to a high of $259 million by '10/'11.

MR. WALTER SARANCHUK: Could you give me that last figure again, please?

MR. BARRY GALENZOSKI: Yes, if you're looking at Attachment 1A, you'll see that -- the statement of Basic insurance retained earnings and when we look at the -- the reserve -- Basic insurance Rate Stabilization Reserve balance by the year 2010/'11 the number rises to $259,057,000.

MR. WALTER SARANCHUK: Yes, and then in terms of the impact of a 5 percent rate decrease?

MR. BARRY GALENZOSKI: The 5 percent rate decrease shows substantial losses going from insurance operations starting in '07/'08 with a $14.4 million loss and increasing to 20.8 million in the subsequent year, then starting to decrease to around $14 million loss and $8.4 million loss.

There is some offset because of the transfer from the Immobilizer Incentive Fund, but all years going forward are negative with respect to rate setting as far net income. And then if we look at the Rate Stabilization Reserve on the next page over we'll see that that number by 2010/'11 drops to $134.8 million.

MR. WALTER SARANCHUK: If the balance of the RSR fell below the target range, the Corporation has indicated that it would take steps to rebuild the RSR and if the balance of the RSR exceeded the target range the Corporation would possibly seek a rebate.

Does that policy still hold?

MR. BARRY GALENZOSKI: That policy is still in place yes.

MR. WALTER SARANCHUK: And in fact in the past there have been dedicated surcharges sought in order to rebuild the RSR; is that correct?

MR. BARRY GALENZOSKI: Yes, that's correct.

MR. WALTER SARANCHUK: And more recently there have been two (2) instances at least where the excess -- excess RSR has been returned to motorists, one by way of a rebate of premium on renewal and more recently last year a cheque; is that correct?

MR. BARRY GALENZOSKI: Yes, that's correct.

MR. WALTER SARANCHUK: Those are all the questions I have in respect to the RSR, Mr. Chairman. Unless there's something that the Panel Members might have I intend to move on to the topic of claims incurred.

THE CHAIRPERSON: Very good, Mr. Saranchuk. We may return briefly to this.

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: Now, dealing with claims incurred, Mr. Galenzoski, if you wouldn't mind looking at the document at Tab 2 of the book of documents which is a reproduction of what was filed by the Corporation in TI-6.

Could you please, sir, at a very high level compare the PIPP, Collision, and Comprehensive figures from year to year in terms of the forecast projections to the actual?

MR. BARRY GALENZOSKI: Yes. It starts off by looking at the actuals that we had for years 2004 and 2005; that would be ending at the end of February in both those years and the increase, decrease to the previous year and there's a substantial decrease on the PIPP of $74.4 million.

Fairly close on the collision. Comprehensive is up by $9.6 million for an overall decrease of -- or an decrease compared to the previous year of $56.3 million. That $74 million decrease with respect to PIPP is entirely attributable to the reserving practices changes have occurred in that particular year.

Moving forward, you can see what we would classify as more normal increase, decreases with respect to the forecasts that we're looking at for both '06 -- well, '06 would be actual and what -- as that occurred to

'05 and then the forecast going forward and the projection for both 2007 and '08.

MR. WALTER SARANCHUK: Can you comment, at a high level, in respect of the collision line going forward through to the projection?

MR. BARRY GALENZOSKI: Yes. The collision line is -- is showing some fairly significant increases -- fairly straightforward going up. These would be expected norms because of more vehicles in the fleet as well as higher repair costs that we're incurring on those models.

MR. WALTER SARANCHUK: And what can you tell us in terms of a commentary on the comprehensive line?

MR. BARRY GALENZOSKI: The comprehensive line is showing a little bit more variability. Some of that is because of what would've seen in other years with respect to losses, for instance in '06. There was higher weather related losses and so that's been factored out when we look at the forecast for '07 so there's a reduction shown there and then a small reduction going forward.

MR. WALTER SARANCHUK: Is there any impact of the anti theft initiatives shown here?

MR. BARRY GALENZOSKI: The anti theft is

also a major impact on this side too, yes.

MR. WALTER SARANCHUK: Now, turning to the Corporation's response to Interrogatory Number 13 of the Public Utilities Board in the first round, shown at Tab 20 of the book of documents, where Schedule 1 was filed in partial response to the question asking that the frequencies and severities by type of claim be identified, and looking at the third type of injury, if you will, that is brain damage, and the reference to some ninety-seven (97) claims in that area in 2004, that would appear to be a one-time blip, if you will.

Can you confirm that is the case and perhaps amplify on that?

MR. BARRY GALENZOSKI: Yes. I believe this was a significant concern that we brought to these hearings a couple of years ago with respect to a potential outcome of losses. Concern as to whether this was a one-time event or something that we could look forward to in the future and we have determined that we thought this was an anomaly in our numbers and that proved out as the next year went back to more normal numbers.

And you can see that for '06 they climbed up again slightly.

MR. WALTER SARANCHUK: And also now with

reference to the Corporation's response to the Interrogatory shown at Tab 21, this is the response to Interrogatory of the Public Utilities Board number 14 in the first round, and turning to page -- or the second page actually in that response showing Schedule 1 where you provide the data with respect to a distribution of PIPP costs and dealing with direct claims incurred, just moving to the figures for 2006 and the income replacement line.

What does the negative number of $79.7 million represent?

MR. DON PALMER: That would be changes in our reserving methodologies that we had referenced before.

MR. WALTER SARANCHUK: Now, we heard Mr. Palmer, about your concern in respect of the IBNR adjustments upwards from time to time. What gave rise to this adjustment downward?

MR. DON PALMER: If I can refer you to the response in I-14, just the previous page; the revised -- and I'll read it in:

> "The revised factors used to set case reserves were changed to the same mortality and morbidity assumptions as those used in the policy liability

evaluation report as filed in AI-10."

So what that generally means especially for the income replacement reserves, is that we did drop the case reserves. There was an offsetting increase in the incurred but not reported reserves, which isn't shown here.

MR. WALTER SARANCHUK: Now, why is there a negative number for income replacement and personal care of some $54 million; also because of an adjustment?

MR. DON PALMER: Same thing. The personal care reserves are based on ongoing personal care of injured claimants. Very much like an income replacement, it's an ongoing annuity that will likely be paid for the lifetime of the claimant.

So the reserving methodologies for those personal care expenses are very, very similar to the methodologies employed in the income replacement, with the difference being that the personal care are generally reserved for the lifetime of the claimant, whereas the income replacement is reserved until the claimant is age 65 and then reduces based on the retirement income benefit thereafter. So the factors are slightly different but, the methodology is very similar.

MR. WALTER SARANCHUK: Can you, sir, comment on the PIPP experience noting the percentages for income replacement over ten (10) years has grown from 25.8 percent income replacement in 1995; through to some 60.2 percent for 2005?

MR. DON PALMER: Income replacement has become a much bigger part of the benefit. Part of that is because of the inclusion in the 1999/2000 year of retirement income benefit. You'll notice that there is a fairly big spike at that point in time.

MR. WALTER SARANCHUK: I'm sorry, what year was that that showed in here?

MR. DON PALMER: From the 98/99 year the column being headed 1999 year ending, February 28th of 1999, had 29.5 percent and the year after it spikes to 46.5 percent.

MR. WALTER SARANCHUK: All right. And can you comment then in those terms, what would have -- to what can be attributed the increase from 2002 some 43.2 percent to 60.2 percent some three (3) years later, 2005?

MR. DON PALMER: There's a couple of factors happening here. There's not only an increase in the income replacement benefits -- I think The Chairman has talked about virtually every plan has increased durations over time, that's part of the evolution of the program.

Also a decrease that year in personal care expenses, huge decrease. And again this is change of -- of reserves so the spike is one (1) goes up and the other one comes down and just the calculation shows a -- a leveraged effect of those two (2) things.

MR. WALTER SARANCHUK: And finally, with reference to the schedule, you'll note the 89.8 percent figure in 2006, what does that represent?

MR. DON PALMER: You could almost throw away 2005/'06 because to use an actuarial term it's a bit wonky just because of the huge decreases in reserves. So, in fact, that's a negative number as a percentage of another negative number which if you're looking at it as to indicate any kind of a trend, it doesn't do it.

MR. WALTER SARANCHUK: So, "wonky" is an actuarial term?

MR. DON PALMER: It is now.

MR. WALTER SARANCHUK: Turning to the information provided in TI-13 which is at Tab 3 of the book of documents, very quickly, dealing with the claims costs.

There's an indication of a reduction of some $10.16 million from that forecast last year. What factors have led to that decrease? Is that mainly due to decreased costs for PIPP or comprehensive and bodily injury claims or is there something there that is more telling than that?

MR. BARRY GALENZOSKI: Yeah, it's not much more telling, but if you look over on the next page under, "Claims Costs," it'll tell you that net claims incurred are $10.4 million less than forecast mainly due to decreased costs for PIPP, comprehensive, and bodily injury claims. And then we refer you to the claims variance analysis on Schedule 1.

MR. WALTER SARANCHUK: Just looking at Schedule 1 and reviewing those results I take what -- I take it that what is of some significance is the PIPP line where there some one ninety (190) -- $194 million worth of claims compared to -- sorry, $194 million worth of claims, period.

When you look at that result compared to the forecast is that where the -- the greater amount of the reduction appears?

MR. BARRY GALENZOSKI: Yes, that accounts for something like $16.7 million worth of change right there.

MR. WALTER SARANCHUK: And when -- looking at the $194 million figure for PIPP claims as shown on Schedule 1, how does that compare with the $88.9 million shown in Schedule 1 to PUB/MPI-14 at Tab 21?

MR. BARRY GALENZOSKI: Well, again -- you're talking about the negative $88.9 million?

MR. WALTER SARANCHUK: Yes, sir.

MR. BARRY GALENZOSKI: And that is the direct claims incurred only so that doesn't show anything to do with respect to financial provisions and/or re-insurance recoveries.

MR. WALTER SARANCHUK: I see. Thank you. Now, looking at the information provided at TI-14 at Tab 4 in the book of documents and noting the increase in total claims costs of some $8 million from that forecast the previous year, what factors are expected to lead to that increase?

MR. BARRY GALENZOSKI: That's pretty much entirely related to the Immobilizer Incentive Program. Those costs relating to that program are flowing through the Road Safety Loss Prevention and there's -- we're showing those costs being higher by $8.8 million and that would then flow through to the bottom line, the bottom line would get replenished in the -- in the retained earnings section, and -- as we've talked about before.

And you can see it in the bottom, transfer from Immobilizer Incentive Fund is $8,844,000 resulting in what we expect is a net income of $34.3 million, for rate setting purposes I will add again.

MR. WALTER SARANCHUK: So these are special purpose financial statements, not GAAP statements?

MR. BARRY GALENZOSKI: Well they're GAAP up to that last line, transfer from immobilizer incentive fund and then they become special purpose from that point on. So if you want to choose just to read so far down, you're okay with GAAP.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: So, effectively this approach is to represent the replenishment of the RSR through the involvement or, at least, the transfer from the IIF?

MR. BARRY GALENZOSKI: Well it has the effect of that, but this is really just to clearly demonstrate for rate setting purposes what's going on and that's why we do these.

And you know, my GAAP expert in the back row is telling me that even GAAP would expect that these special purposes statement are within GAAP rules.

MR. WALTER SARANCHUK: So you don't want rates to be distorted by spending the money that you do on this special project, is that correct?

MR. BARRY GALENZOSKI: That's right.

MR. WALTER SARANCHUK: Now, turning to Tab 5 in the book of documents, this is TI-15 and turning to Schedule 1, dealing with the claims variance analysis, you'll note that there is a $25 million swing upward in claims incurred.

Can you address that please, Mr. Galenzoski?

MR. BARRY GALENZOSKI: This is again with respect to the forecasts that we're projecting for '07 to the end of '08; compared to the forecast that we've got for '06 to '07.

And it's expecting that we're going to see PIPP claims rise by $11.1 million; that collision will rise by $13 million and there will be a slight reduction in comprehensive property damage claims of $1.9 million; for a total of almost $25 million worth of increase in the overall claims.

Some of that is obviously being driven by increase in severity with respect to the losses we're going to see, as well as, an increase in the overall numbers of vehicles that are insured in accidents that we're expecting to come in.

MR. WALTER SARANCHUK: And turning to Tab 7 and, in particular, TI-17A, with reference to the claims cost outlook, the claims cost -- total claims costs were, according to TI-13 anyway, something in the order of -- somewhere in the order of $600 million actual for 2005/'06 and the forecast through the outlook period to 2010/'11 is for them to be in the order of $755 million.

Can you comment on that trend from the Corporation's standpoint?

MR. BARRY GALENZOSKI: Well, I guess you're looking at three (3) things that are wrapped up into this particular line, total claims cost.

The first is the actual claims experience themselves. And that shows an increase on the projected for '07/'08 of $582.4 million rising to $663.3. That would be just the claims that we're expecting to see come in year over year and the changes that we're making on those on an ongoing basis.

The next line is claims expenses. This is the cost for administering the claims process, the various drive-in facilities we have, our salvage operation, all those types of operations. And we're seeing those costs increase from the $71.9 million in '07/'08 to $79 million in '10/'11.

And then road safety loss prevention has a major cost increase with respect to '07/'08 because of the immobilizer incentive fund and that diminishes slightly going forward and you can see from the second bottom line the transfer from the immobilizer incentive fund in '07/'08 there's $11 million being transferred back to cover the costs that are included in the $19.7 million under road safety.

And then that starts to taper off to about $3.5 million in the subsequent years after that.

MR. WALTER SARANCHUK: Thank you sir. And just to bring matters up to date on that score of claims costs, if you wouldn't mind referring to the second quarter report that was filed and which we referred to earlier dealing with claims costs as shown in the statement of operations on page 4.

Can you comment on the claims experience for the six (6) months ended August 31st, 2006, particularly compared to last year at this juncture or at least after six (6) months rather -- $351 million versus $325 million?

(BRIEF PAUSE)

MR. BARRY GALENZOSKI: We're talking the different between the 427 and the 401?

MR. WALTER SARANCHUK: No, at this

juncture we're talking about claims costs, the third line.

MR. BARRY GALENZOSKI: Okay. Yes, that is primarily weather-related claims, increases that we've seen in this current fiscal year. We had a lot of early spring rain and hail that has affected the numbers to some degree.

MS. MARILYN MCLAREN: Theft claims costs are also up this year compared to last year.

MR. WALTER SARANCHUK: Now, moving on to another topic very briefly, we'll give a chance to Mr. -- for Mr. Bedard to shine again every -- as he does every year.

THE CHAIRPERSON: Mr. Saranchuk...?

MR. WALTER SARANCHUK: Sorry.

THE CHAIRPERSON: Just before we go on. Maybe Mr. Palmer could provide some help here. What if any is the connection between the large drop in the case reserves and large increase in the IBNR?

MR. DON PALMER: It's a -- it's a direct offset and let me explain.

THE CHAIRPERSON: No, I mean there must be some human thing that lies behind this. I'm sure it's not just squiggles on a piece of paper.

MR. DON PALMER: Thank you for

acknowledging that actuaries are human, very few other people do that.

THE CHAIRPERSON: Sometimes people think accountants and actuaries are pretty close together too.

MR. WALTER SARANCHUK: Lawyers think they're both wonky.

MR. BARRY GALENZOSKI: And it isn't polite to put on the record what accountants think.

THE CHAIRPERSON: That's why I didn't say anything.

MR. DON PALMER: Within our methodology for calculating policy liabilities there are a number of different methods that we employ and then at the end of the day pick -- pick one (1) or -- or average them out.

A few years ago when we were looking at our -- our long-tail claims and our annuity reserves we did employ a new set of tables within the incurred but not reported liability calculation. What we didn't do at that time was change the tables and the factors that was used to calculate the case reserves.

So every -- every year we would have case reserves and then the IBNR calculation would be done and the total liabilities in fact were -- were less than that reported by the case reserves and that has been highlighted in -- in this forum in past years as a negative IBNR -- that's negative incurred but not reported for the old income replacement.

And the reason for that was that we had these different set of mortality tables. So what we did last year was we said this large negative incurred but not reported isn't particularly helpful in -- in all of us understanding what's going on here. Let's synchronize those two (2) tables within one (1) fiscal year and then when we get to the end of the year we've -- we've largely taken money out of the case reserve pocket and put it into the IBNR pocket, so to speak.

THE CHAIRPERSON: So they're directly related then?

MR. DON PALMER: Absolutely.

THE CHAIRPERSON: Thank you. Is there any effect on the PAD as a result of the change?

MR. DON PALMER: No and actuaries refer to call it the PFAD, not the PAD.

THE CHAIRPERSON: I just -- I like the old definition.

MR. DON PALMER: That's why we changed it.

No, there is not. The provision for adverse deviation is driven off the total claims liabilities not either the IBNR or the case reserve.

It's based on the total amount, since the total amount didn't change because of that particular reason there is no effect.

THE CHAIRPERSON: Thank you. One (1) last question and I'm sure you've got a good answer for this one.

MR. DON PALMER: Just may I -- may I add one (1) little correction to that. Whenever we change methodologies and bring down case reserves and this would have had impact on both; because we are changing methodologies, there's always a risk associated with any change.

And not exactly the offset, but for some other reasons, there was a decrease in total liabilities. What we did is we increased the provision for adverse deviation margin because of that methodological change.

So not -- so we did increase the PFAD for that reason just because whenever you make a substantial change, we've moved I think $250 million of reserves around. That sets off some warning bells in an actuary's head.

When we did that, we said let's -- let's increase the provision for adverse deviation just so we're not putting in more risk into the balance sheet.

THE CHAIRPERSON: Okay. The other

question I had was on the -- we note on the adjustment to the pre-PIPP that only six (6) covers are involved. And we're talking about no-fault accident benefits versus $17 million on TI-1?

MR. DON PALMER: The covers refers to new reported covers. We -- this does not -- that cover count does not refer to the number of claim files that are currently open. So --

THE CHAIRPERSON: The long and short of it, we just wondered it seems very, very large.

MR. DON PALMER: The activity isn't based on those six (6) covers, is the bottom line. There is one (1) addition to it, when we had talked about that adjustment I believe on Tuesday of this week; and we had talked about changes in mortality and morbidity changes, there was one (1) other change that we made as well, and that was we changed the interest assumption on that particular group of claims.

THE CHAIRPERSON: Would that be because the interest rates have fallen?

MR. DON PALMER: No --

MR. BARRY GALENZOSKI: No, that's because we had attached the discount rate to an actual investment that we had and we wanted to free that up so that it could be available for sale at some point in time.

THE CHAIRPERSON: So you had it matched, so to speak, the liability and the risk?

MR. DON PALMER: We had earmarked funds for the pre-PIPP weekly indemnity liability, we have freed that up.

THE CHAIRPERSON: Now, this hasn't got anything at all to do with the adjustments to the PIPP line?

MR. DON PALMER: No, well --

THE CHAIRPERSON: It just happens to virtually offset the other?

MR. DON PALMER: To the -- to the -- we use -- the liabilities are matched in the methodology the same, but that's the only linkage.

THE CHAIRPERSON: Okay. Thank you.

Mr. Saranchuk...?

MR. BARRY GALENZOSKI: I wonder if, Mr. Saranchuk, I might be allowed just to put a little bit better answer on the record, with respect to the increase in the claims cost for the first six (6) months of the year?

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: Please do.

MR. BARRY GALENZOSKI: It's really

spelled out quite well in the quarterly report that you have in front of you and I'll just read that in:

"Claims costs for the six (6) months ended August 31, 2006 increased by 25.4 million or 7.8 percent compared to last year. Physical damage claims incurred increased by $9.2 million due mainly to a 3.3 percent rise in the number of claims reported. Bodily injury claims incurred rose by 8.4 million as the number of personal injury protection plan coverage types such as income replacement and medical expenses increased by 11.5 percent. Contributing to the rise in claims costs was a $5.6 million increase in loss prevention road safety expenses which includes reimbursement to customers under the Immobilizer Incentive Strategy and related costs of administering the Immobilizer Incentive Fund."

THE CHAIRPERSON: Just before you go on, just for a minute, it's in the back of my head, Mr. Palmer, between yourself and the independent actuary, I believe, Mr. Christie, I presume that over a period of time the general reserves, the IBNRs and the approach being taken consistently has improved as you keep fine tuning it; is that a fair statement?

MR. DON PALMER: I'd like to think so.

THE CHAIRPERSON: Is there any projects ongoing right now that could lead to another significant shift between categories and approaches? Anything going on within the profession?

MR. DON PALMER: There are -- with the new CICA guidelines there is an actuarial component to that as well with -- in regard to the selection of discount rates so that we will be employing it for our '07/'08 actuarial evaluation of liabilities.

THE CHAIRPERSON: Well, what I'm thinking of, for example I'm aware of in the pension world for example the actuarial association became involved. It ended up changing commutation factors considerably, things of that nature. This work that you're talking about right now, do you expect it to have any significant impact on the total unpaid claims and if so, up or down?

MR. DON PALMER: I -- I think I'm asked to be -- at this point to do my evaluation of policy liabilities at February 29th of 2008, and -- and I'm a little reluctant to do so.

The difference in the discount rate that I talked about, that will be tied to the selection of assets and how we designate those assets that Mr. Galenzoski had talked about with the changes in the CICA reporting. So they -- those will be tied together and exactly how much are earmarked for available for sale and -- and hold until -- and hold until maturity. How that splits could very well affect the selection of the discount rate.

Now, -- and -- and I don't know right now if that discount rate will go up or down from -- from our current assumptions, but I will alert the Board that with our large and -- and growing amount of policy liabilities that small changes in the discount rate can have an amplified effect and certainly a leveraged affect.

We talked about a 1 percent change in -- in inflation. Well, a 1 percent change in -- in the discount rate would have the same affect. So we may be looking at -- at something insignificant when we talk about the overall policy liabilities, but certainly could be very significant as it moves through the operating statement.

THE CHAIRPERSON: Yeah, that's sort of what I was wondering about. For example, in pension land again, I mean if you -- leaving aside the mortality tables -- if you are to assume that the rate of return on investments, reasonable rate of return, is going to fall it's going to have a significant impact on your liabilities, unpaid benefits, if you like, in the pension.

Like for example, often times they used to use, say 7.5 percent, in some pension plans they've cut it to 6.5 or even 6 -- fantastic impact on the unfunded liability result.

MR. DON PALMER: Very much so. I would advise that the effect on our evaluation might be somewhat less than that because all our benefits are indexed.

So we're discounting at a real rate of return, not a nominal rate of return that would normally be used in a pension evaluation; if benefits were not indexed, for instance.

So we're using a rate before -- a real rate before margin of 3 percent. So how that changes probably won't change a great deal.

THE CHAIRPERSON: You're providing us some comfort, I think, I just want to make sure you understand that our reception of your comments is comforting. I mean, in the fact that you're suggesting to us that there's not some massive re-evaluation that's likely to occur as a result of this work.

MR. DON PALMER: I don't foresee that at this point in time. As we go through next year and have the assets re-stated I'll be in a better position to comment on that at next year's hearing.

But right now, I'm not seeing a huge effect, no.

THE CHAIRPERSON: Thank you, Mr. Palmer, I'll think on all this.

Mr. Saranchuk, maybe we should have our lunch break now?

MR. WALTER SARANCHUK: Fine, Mr. Chairman.

THE CHAIRPERSON: I think we have a presenter, do we not? Is it today? So apparently we have one (1) last presenter at 1:30. I think MPI has been apprized of this.

So we'll return at 1:30. Thank you.

--- Upon recessing at 12:07 p.m.

--- Upon resuming at 1:33 p.m.

THE CHAIRPERSON: Welcome back everyone. Is there any exhibits to be filed, Mr. Saranchuk?

MR. WALTER SARANCHUK: Yes, sir.

THE CHAIRPERSON: Thank you.

MR. WALTER SARANCHUK: Further to the discussion on the valuation technique by Ibbotson, I-B-B-O-T-S-O-N, the documentation to be entered into the evidence as the next PUB exhibit is the publication by Ibbotson Associates dealing with the equity risk premium. So, perhaps, that can be marked in the evidence as PUB Exhibit 12.

--- EXHIBIT NO. PUB-12: Publication by Ibbotson Associates dealing with the equity risk premium

THE CHAIRPERSON: Anything else, Mr. Saranchuk?

MR. WALTER SARANCHUK: Yes. There is to be marked as the next PUB exhibit, that's number 13, a report entitled "An Examination of the Equity Risk Premium Assumed by Canadian Pension Plan Sponsors". And that document has been distributed, as I understand it, amongst the parties here present, along with the Exhibit PUB-12.

THE CHAIRPERSON: Is 13 entitled "Key Variables in Estimating the Cost of Capital"?

MR. WALTER SARANCHUK: No. It's entitled

"An Examination of the Equity Risk Premium Assumed by Canadian Pension Plan sponsors".

THE CHAIRPERSON: Everyone will find it near the back of the package. It's got its own staple so, it is entitled "Examination Equity Risk Premium Assumed by Canadian Pension Plan Sponsors" and that's PUB Exhibit 13?

MR. WALTER SARANCHUK: Yes, sir.

THE CHAIRPERSON: Thank you, Mr. Saranchuk.

--- EXHIBIT NO. PUB-13: Report entitled "An Examination of the Equity Risk Premium Assumed by Canadian Pension Plan Sponsors"

MR. KEVIN MCCULLOCH: Mr. Chairman, if I might...?

THE CHAIRPERSON: Yes, Mr. McCulloch.

MR. KEVIN MCCULLOCH: I'd like to reserve the opportunity for the MPI Panel to perhaps take a look at the exhibits and make a comment, if appropriate, after the break.

THE CHAIRPERSON: Very good.

Now, as indicated before, we have one

further presenter, Mr. Warren Mills. Is Mr. Mills here?

MR. WARREN MILLS: Yes, sir.

THE CHAIRPERSON: And you have a speaker phone there?

MR. WARREN MILLS: Yes. I do, sir.

THE CHAIRPERSON: Okay, Mr. Mills. If you wouldn't mind giving your presentation. As you know, the Public Utilities Board its basic role here is a review of their financial situation for the purposes of establishing rates and matters related thereto?

MR. WARREN MILLS: I understand.

THE CHAIRPERSON: Okay, Mr. Mills, please proceed.

PUBLIC PRESENTATION BY MR. WARREN MILLS:

MR. WARREN MILLS: Thank you very much for allowing me in at the late date, Mr. Chairman. I appreciate it.

As a result of a recent relationship -- a business relationship with MPIC I experienced the PIPP process first hand with regards to a matter that had to do with my son.

And although the matter has, I believe, been resolved as a result of it, several things came to my attention. And when I discovered that there was an opportunity to bring this to the Public Utilities Board's consideration; I asked and you've granted me the opportunity and I thank you.

The experience which I've had first hand with my son was not a pleasant or enjoyable one and I realize this is not my soapbox to pursue that matter. It did allow me to draw a few conclusions and then when I read in the press about the amount of funds that are available in MPIC's coffers these days, a couple of points came to mind that I wanted to express.

I'm driven by my reaction to witnessing my son's experience, so my presentation -- I will try and keep it as unpassionate as I can.

I think that MPIC, with the funds they have, has an opportunity to do many things. The two (2) things which I would encourage the Public Utilities Board to encourage MPIC to consider, are two (2) items.

Staffing within the PIPP process, I don't know whether it's staff or process, or whatever the issues are. I'd like to offer just some very brief examples.

Authorization for release of health care information provided to a caseworker on June the 8th, forwarded to the doctor involved for his release of information six (6) weeks later on July the 19th. My son was the victim of a drunk driver, was quite innocent and quite unfortunate.

And the matter took three hundred and twenty (320) days to reach a unsatisfactory hostile solution. I may have contributed to that and I've attempted to apologize, as able, but the facts are that the time that MPIC takes to move things with regard to PIPP claims is very difficult on the victim who is attempting to put his life back in order.

And I would encourage the Public Utilities Board to encourage MPIC to spend some of this available surplus to do everything they can to get the victim, be it drunk driver or any other motor vehicular accident, their solution as promptly as possible.

It's stated in their corporate vision, that they will deal with care, efficiency and justifiable pride in arriving at a victim's solution. And my sense and it's one (1) only case, is that perhaps that vision could be refocused and re-emphasized and the Public Utilities Board could encourage MPIC to spend some of this very substantial amount of funds I understand they sit on to do everything they can to shorter the victim's dangling.

My second observation, Mr. Chairman, is that the Province of Manitoba has a Victims Bill of

Rights. And regrettably the threshold for a victim of a motor vehicular accident is that he must be deemed to have been substantially damaged.

The test is driving under the influence and causing bodily harm. Regrettably with the amount of drunks being charged, Crown Attorney's tend to deal away the bodily harm portion of the charges in order to satisfy and achieve a conviction and a solution.

Today I'm told there are one hundred and sixty-eight (168) charges pending of driving under the influence. And Crown Attorney's as well know are peddling as fast as they can to deal with the matter.

Regrettably wise defence counsel attempts to remove the causing bodily harm. The Crown has a job to do, but removing the bodily harm drops the victim out of the Province of Manitoba's Victims Bill of Rights and the Victims Assistance Office.

And it leaves the victim on the one hand dealing with MPIC and what they are required to do and I appreciate. On the other hand, with no assistance, advice, compassion or support whatsoever from the Province because the bar is set, if you are the victim of drunk driving, you have to have been bodily harmed. And the Crown Attorney establishes that.

So my observation for the Public Utilities

Board today is, I've done some pencil pool and I -- I'm not allowed access to the numbers, but the Province of Manitoba Victim Services Department Staff could be doubled with a contribution from MPIC of one-fifth (1/5) of 1 percent of the funds they're currently sitting on.

I've heard MPIC contribute funds to police, to probation officers, large sums. I sat here yesterday, heard nine hundred thousand (900,000), four hundred and sixty thousand (460,000) annualized standing agreements. For a few hundred thousand dollars Victim Services in the Province of Manitoba, Minister of Justice, MPI's same minister, it should be an easy conversation, MPIC could contribute to the Victims' Bill of Rights and the Victim Services Departments.

It's a softer contribution than buying devices that stop motor vehicles and hiring cops and probation officers. But trust me, having witnessed what a victim goes through it's a very worthy consideration and with the funds available rather than giving me back another buck and half on the rebate which might be considered, I strongly encourage the Public Utilities Board to ask MPIC to consider contributing to supporting financial assistance to hire additional Victim Services officers so as to allow Victims Bill of Rights and Services to lower the threshold so that a victim doesn't have to satisfy a Crown Attorney that he was bodily harmed.

You can, as my son is living proof, fortunately living, you can have a twenty-seven thousand dollar ($27,000) car destroyed around you, you can be given prescriptions for pain killers, muscle relaxants, neck braces, and you can lie in bed for a month and you do not meet the threshold of Victim Services rights and privileges in the province of Manitoba.

The rights and privileges that are available to a victim aren't -- aren't spectacular items but when you have been through the process any additional support that could be offered to victims, particularly of drunk drivers, but all victims -- I understand that there are other areas where victims are denied access to the Bill of Rights and the Victims' Assistance Department because the severity of the crime doesn't qualify.

I think this is a tremendous opportunity for MPIC to invest in providing additional support albeit not financial but access to resources that would provide great appreciation and compassion to those who a Crown Attorney deems are not sufficiently battered to qualify for the Victims' Bill of Rights.

So if there's -- in summary, Mr. Chairman, if you could consider asking MPIC to contribute some funding to Victim Services so that the people they deal with on a daily basis can be sent by MPIC with pride, dignity and compassion and support to another mechanism to help them put their life back in order. And that's my submission. Thank you.

THE CHAIRPERSON: Thank you, Mr. Mills. We appreciate your presentation. We'll ask MPI in the normal course to provide any comment they may have on your suggestions and situations.

And again we appreciate your coming. Thank you.

MR. WARREN MILLS: Mr. Chairman, I've -- I've provided copies of the six (6) or seven (7) letters that I forwarded to the Chairperson of MPIC and I ask that they be entered into my presentation.

THE CHAIRPERSON: Very good. Is Mr. Singh still...

MR. WARREN MILLS: The correspondence is as recent as yesterday.

THE CHAIRPERSON: Very good, sir. Thank you.

MR. WARREN MILLS: Thank you very much.

THE CHAIRPERSON: Mr. Saranchuk?

MR. WALTER SARANCHUK: Thank you, sir.

MR. WARREN MILLS: Have a good day.

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: Dealing quickly with what we've known in the past and now know to be the bodily injury tort run-off can Mr. Bedard please provide an update on the status of the remaining pre-PIPP tort claims?

MR. WILF BEDARD: Yes, I can do that. Currently we have seventeen (17) outstanding -- outstanding cases; that's all that is left. It involves fifteen (15) plaintiffs, seventeen (17) files. One (1) plaintiff has three (3) actions going and it'll likely be one (1) settlement so it's getting down to the wire. There's not much left.

MR. WALTER SARANCHUK: And the reserves are in what order and can you tell me are they sufficient?

MR. WILF BEDARD: Certainly the reserves are sufficient. The case reserves currently are approximately $2 and half million with the financial provisions being approximately 1.3, 1.5 million. I might stand to be corrected by Mr. Galenzoski but I believe those numbers are -- are correct.

MR. WALTER SARANCHUK: But the point is, that you're satisfied that the reserves are sufficient?

MR. WILF BEDARD: Yes, sir. Absolutely.

MR. WALTER SARANCHUK: Fine. Thank you. Those are all the questions in that area.

Now, proceeding with claims forecasting, this is dealt with in Volume I of SM 5.2 in Volume I. And, in particular, at page 6. Mr. Galenzoski, I wonder if you would, again, at a high level, as you have in the past, review the claims forecasting methodology with respect to the three (3) methods or processes? Or Mr. Palmer.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: SM 5.2.

MR. DON PALMER: I have it. The -- there are three (3) methods that are utilized in the claims forecasting. The main one we have called here the financial forecast. Is -- is forecast by committee. Our claims forecast committee is a -- a committee of the Corporation, multi-disciplinary. It includes people from the pricing and economics department, from the finance department, from the claims department to give the -- the best forecast of future years' claims.

And that is starting with some actuarial or financial models and then tempered with real life experience and things that are going on in the field that the claims people are telling -- telling us about. So that we can -- any turning points, any new claims that maybe have not been in the -- in the historical data are reflected in the forecast.

MR. WALTER SARANCHUK: So we're talking an element of judgment that's used here?

MR. DON PALMER: That's correct. It's -- it's also late-breaking information and, using your word, any of that late-breaking information and how we feel it will influence future claims activity is included in the forecast.

The two (2) other methods that we use are purely actuarial methods. They're not vetted through the claims forecasting committee. The linear forecast is on each line of business assuming that the increases or changes year over year are on a flat dollar basis. Again, on an amount per vehicle so that it's at least normalized to our growing vehicle population.

So to give you an example, the loss cost of collision claims that may be a hundred and fifty dollars ($150) per vehicle today. Next year we might assume that to grow five dollars ($5) a year. So it would be a hundred and fifty-five dollars ($155) next year. A hundred and sixty dollars ($160) the year after.

Hundred and sixty-five (165) the year after that and so on. So that's one (1) mathematical model that -- we fit a straight line to the historical data and -- and project it forward.

The other model is exponential. And that means that we expect to -- that the claims will increase on a percent basis every year. So rather than saying that they will increase by five dollars ($5) every year, we may say that they increase by 5 percent every year. And that generally gives a somewhat bigger increase into the future than a linear model would.

So those two (2) are used as benchmarks to -- to test the financial forecast and see that it's in the same ballpark.

MR. WALTER SARANCHUK: And is it a fact that only the linear and exponential are statistically sound and actuarially driver?

MR. DON PALMER: No, I wouldn't agree with that. Actuarially sound, to me, means that we're getting the expected value of future costs.

So I would say that the -- I would agree that the lineal method and the exponential method are more traditionally actuarial. I would say that all three (3) methods, the aim is to get the expected value of the future costs.

So to say that the financial forecast is not actuarially sound, I would not agree with.

MR. WALTER SARANCHUK: Yes, I'd just ask you now to turn to the response of the Corporation to IR 11, asked by the Public Utilities Board in the first round, this is not in the book of documents. So please turn to PUB/MPI I-11.

(BRIEF PAUSE)

MR. DON PALMER: I have it.

MR. WALTER SARANCHUK: Yes and you'll note there is in response to this Interrogatory, a couple of pages, one (1) entitled part A and one (1) part C, the last two (2) pages of the response.

MR. DON PALMER: If you're going to ask me what happened to part B, I'll have to take that as an undertaking.

MR. WALTER SARANCHUK: Actually I wasn't.

MR. DON PALMER: Okay then, I won't.

MR. WALTER SARANCHUK: In respect of the information presented in the first attachment, that's part A, can you provide a brief explanation of it?

MR. DON PALMER: What this particular exhibit does, is compares the -- by type of claim, bodily injury property damage, weekly indemnity, other accident benefits, those two (2) together, the WI and accident benefits, other combine to become all of PIPP, collision and comprehensive, looks at the historical data and compares the trends that are inherent in the data and compares the three (3) approaches of the lineal trend and the exponential trend and the financial forecast, for both frequency, severity and total loss costs of each one (1) of those categories and claims.

MR. WALTER SARANCHUK: And is it appropriate to interpret the information presented for 2007/'08 in each case as representing movement from an expected level for '06/'07 to an expected level for '07/'08?

MR. DON PALMER: That would be accurate, yes.

MR. WALTER SARANCHUK: And focussing on the loss cost trends, how should the Board interpret any significant differences between the financial forecast selections on which the proposed rates are based; and the comparable fitted exponential trends?

For example, in the bodily injury section the 2.25 percent under the financial forecast approach to the 5.5 percent on the exponential trend?

MR. DON PALMER: What that would indicate is we -- the claims forecasting committee feels that the future trend will be less than that that's historically been observed.

MR. WALTER SARANCHUK: And does the same comment apply in respect of weekly indemnity and comprehensive?

MR. DON PALMER: Yes. Comprehensive certainly even more so. And we have talked about the recognition of the immobilizer program and that would have an impact on that.

MR. WALTER SARANCHUK: Now, referring to the second attachment that's part C, can you provide a brief explanation of the information there? For example, can you confirm that it reflects the actual experienced year-over-year changes in frequency, severity, and loss cost?

MR. DON PALMER: Yes, I'll confirm that.

MR. WALTER SARANCHUK: Now, there would appear to be some significant volatility in these statistics for some coverages and I guess that illustrates the difficulties of doing these forecasts; would you agree?

MR. DON PALMER: I would agree with that, sure.

MR. WALTER SARANCHUK: And so, again,

focussing on loss trends or loss cost trends how should the Board interpret the selected financial forecast trend for accident benefits weekly indemnity from Attachment A at 2.25 percent compared to the recent history which would appear to reflect some wild swings from a high of 43.6 percent to a low of minus 32.42 percent over the last three (3) years.

(BRIEF PAUSE)

MR. DON PALMER: What this comes down to, in my mind, is the difference between a forecast and a prediction and there are wide variations from year to year. We know that. We know that there will be. Our task is to come up with the expected value of claims. Some years we're going to be wrong; some years we're going to be -- or we're going be low; some years we're going to be high.

Our goal is to predict the outcomes over the longer term and I'm sometimes challenged when -- when our forecasts are -- are high or low, saying well, you couldn't get that right again, Mr. Palmer? And I -- and I say, Well, the idea is that there -- the expected value is right, it's just that the -- the actual world was different than -- than expected. And that doesn't mean that the forecast was wrong, it just means that there's a variation in -- in the world that we operate in.

MR. WALTER SARANCHUK: What is the difference between a prediction and a forecast? Sorry for the interruption, but...

MR. DON PALMER: The -- the -- I would say that prediction, you're probably trying to get an exact value and that you really try to time the swings and say, Okay, next year I predict that we're going to have a bad winter and I will have higher claims and the year after I think we're going to have a mild winter and we have lower claims. That we will -- we will never be right.

What we're looking for is over the longer term and the expected value that when we measure how good or -- or bad our predictions or forecasts were, that we measure that over the longer term and I think we've done that. I recognize that we -- in our risk analysis for instance it has been observed that we've been -- over the long term we've been very, very accurate in our -- our forecasts.

The average over the last twelve (12) years that we mis-forecast by eight hundred thousand dollars ($800,000) over 700 million, but if you look at each one of those years in isolation we've had some pretty wild variations.

MR. WALTER SARANCHUK: Are assumptions and predictions included in forecasts?

MR. DON PALMER: Assumptions are, yes. Not predictions. I -- I would -- I wouldn't include that. It's -- again it's -- it's forecasting expected value over the longer term.

MR. WALTER SARANCHUK: So when you look at Collision, for example, a selection of 3.75 percent on page 1 in Part A under the financial forecast approach versus a recent history ranging from 1.73 percent down to minus 0.38 percent over the last couple of years and for Comprehensive a selection of minus 4.07 percent versus a recent history of over twelve (12) percent over the last three (3) years, what can you say in the way of additional comment there?

MR. DON PALMER: First of all, with the collision you gave the last two (2) years. If you go back the previous two (2) years to that you've got values of 9.43 and 6.58 percent which is significantly more than the recent but could happen again. And, again, we're looking at something on -- an average increase year to year.

On the comprehensive that's a number of factors. Certainly there's some -- a lot of weather-related claims that are included in comprehensive that will cause some pretty wild swings. We also have the theft issue that we've talked at length about.

The increases here, we are relying on some intervention in our claims forecasts that will influence the level of theft claims in the future. So that's why there's a lower -- a lower trend expected at that point in time.

MR. WALTER SARANCHUK: Thank you, sir.

I'd now draw you attention to the response by the Corporation to PUB Interrogatory number 10 in the first round and this is reflected at Tab 19 in the book of documents.

MR. DON PALMER: I have it.

MR. WALTER SARANCHUK: And there are three (3) exhibits, if you will, or tables that have been filed in response. Could you please describe the information shown on these exhibits?

MR. DON PALMER: What -- what these show is the differences between our forecasts -- two (2) sets of forecasts. One (1) is labelled as "projected" which would be the year in which we're making application for rates. For example, this year the projected year would be '07/'08.

The revised -- the following year when we come back to the Public Utilities Board we, again, file a revised forecast for the year that we would currently be in so this year we have a revised forecast for 2006/'07.

And then the actual would be the year after once we -- once we have actually closed the books on a -- on a given fiscal year. So, for instance, we now have actual results for 2005/'06.

The three (3) tables that you've referenced, one (1) is the claims frequency. So that would be how many claims there have been. The second one is severity. So the average cost of each claim. And the third one being incurred claims costs. So that's the total dollars expended.

MR. WALTER SARANCHUK: Can you give us an idea of the timeline in terms of the difference time-wise between the projection and the revision?

MR. DON PALMER: They're -- they're all a year apart.

MR. WALTER SARANCHUK: So it's, I think, I would suggest, quite a challenge to forecast that far out?

MR. DON PALMER: It certainly is a challenge. Yes. I would agree with that.

MR. WALTER SARANCHUK: And looking at the Table 1, dealing with the five (5) year claims frequency comparison, to what does the Corporation attribute the improved accuracy for the physical damage coverages in '05/'06 that is projected versus actual compared to what appears to be the persistent under-estimation of prior years?

Does that mean you were doing your homework, Mr. Palmer?

MR. DON PALMER: I've been -- I've been sitting at the Public Utilities Board long enough to know if I take credit for anything then next year it's going to come back and bite me.

I think we have improved our forecasts. We have improved our understanding of the business. Certainly with the personal injury protection plan, we have twelve (12) years of experience now.

And it certainly was a huge challenge at the beginning because we -- we had this new program and didn't have any history and didn't know exactly how it was going to function or pan out.

So we can -- we continue to learn about the program and I think we're getting better, that claims forecasting committee that I referenced has a better understanding, we have more field information.

So I think there is better information available. But to say that we can necessarily expect that there will be less variance or no variance next year, we're certainly still subject to large fluctuations.

MR. WALTER SARANCHUK: And has the actual year to date experience for 2006/'07, that is since the time of the GRA filing last year, tended to narrow or widen the gaps between projected and revised frequencies as shown in Table 1?

MR. DON PALMER: As Mr. Galenzoski said this morning that there are variances because of weather related claims and our bodily injury claims are also somewhat higher.

MR. WALTER SARANCHUK: And with reference to Table 3, the five (5) year claimed incurred comparison, can you comment on what appears to be persistent over projection in respect of bodily injury?

(BRIEF PAUSE)

MR. DON PALMER: Could you point me to a specific reference please, Mr. Saranchuk?

MR. WALTER SARANCHUK: Well I have highlighted here the public liability, for example, post-PIPP, post March 1, 1994 and in respect of PIPP 2004/'05, '05/'06.

(BRIEF PAUSE)

MR. DON PALMER: First, let me just itemize what exactly that coverage is. We're talking about tort claims for -- that are -- well, all out of Province claims, since there's no tort recovery.

So these claims are -- there is a low frequency, high severity. There is great fluctuation in those numbers and we're still talking something in the order of $7 or $8 million out of $500 million of claims cost.

So we've probably been a little conservative on that side, but in terms of overall materiality to the forecast I don't think there's very much effect.

MR. WALTER SARANCHUK: What about PIPP for the last couple of years?

(BRIEF PAUSE)

MR. DON PALMER: We've been -- the actual has been under-forecasted for the last couple of years, but was over for a few years before that. Again there's some fairly significant swings.

MR. WALTER SARANCHUK: I guess the

question was, in terms of what appears to be an over-projection and in respect of PIPP for the last couple of years that certainly would appear to be the case.

And so, like, I'm asking, is there any comment you can provide in respect to that?

MR. DON PALMER: I would -- I would go back and make the judgment over the longer term. One (1) or two (2) years of over-projection or under-projection, I don't think tells -- informs the Board very much.

MR. WALTER SARANCHUK: Okay. And we, of course, earlier alluded to the second quarter report. Given the information, I don't know if you necessary have to refer to it, but just offhand given the results for the last six (6) months, has that tended to narrow or widen the gaps between the projected and the revised for the claims incurred?

MR. DON PALMER: PIPP claims are up so we may very well be in front of this Board next year explaining a negative variance, claims greater than forecast.

MR. WALTER SARANCHUK: And can I ask you, sir, in your view do these tables that we've just been reviewing provide any evidence of systemic bias in claims forecasting?

MR. DON PALMER: No.

MR. WALTER SARANCHUK: We earlier alluded to the conclusion of the CAC/MSOS expert witnesses sirs Hum and Simpson and let me ask you, sir, does the Corporation accept the conclusion that they have given that MPI forecasting, quote:

"...has a positive bias that has systemically underestimated net underwriting income over the period from 1994/'95 to 2005/'06."

End of quote. This is referred to at page 25.

MR. DON PALMER: I -- I've read that reference quite a lot over the last couple of weeks and -- and no, I don't think there's any -- or there is no systemic bias there.

We're talking about eight hundred and some odd thousand dollars ($800,000) on a total revenue of $700 million. And as I mentioned on Tuesday in -- in my direct, if we had -- if you had asked me the same question last year you would have been asking if there was a negative bias of some seven hundred thousand dollars ($700,000) because we were under our forecast in the most recent year by -- by an amount that pushes the number from an under-forecast of seven hundred (700) -- or over-forecast of seven hundred thousand (700,000), the other way, to eight hundred thousand dollars ($800,000).

So when you see that kind of fluctuation from the positive and negative based on one (1) year's experience I think that's evidence that there is no bias.

MR. WALTER SARANCHUK: Has the Corporation made what it considers to be improvements in its forecasting accuracy over that time frame of 1994/'95 to '05/'06?

MR. DON PALMER: The main improvement, I would suggest, is our understanding of the PIPP program.

MR. WALTER SARANCHUK: Is there any other line, any other item in the overall scheme of things that you can attribute improvement to, aside from PIPP, generally speaking?

MR. DON PALMER: The overall experience of the forecasting team, when -- when I started with the Corporation back in the early -- in 1989, that's when the claims forecasting -- or when I jointed the Claims Forecasting Committee and there was a few new faces on that -- our overall understanding of the -- the Corporation and collision claims has improved over time.

We have certainly been able to get valuable experience information from the claim -- from the Claims side of the business and I think that they have got some valuable information from -- from us "forecasters," quote unquote.

So I think the whole -- the whole process has improved, not just over the last twelve (12) years but over the last fifteen (15) or so years.

MR. WALTER SARANCHUK: Would that apply to premium components and expense components as well?

MR. DON PALMER: I would say it -- it would apply to all components.

MR. WALTER SARANCHUK: Thank you.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: Just referring to the Hum/Simpson Report again and its reference to positive bias, can the source of that perceived positive bias be isolated to one or more components of net underwriting income, either over the entire period or portions?

MR. DON PALMER: Is there a specific reference in the Hum/Simpson Report, please?

MR. WALTER SARANCHUK: I'm looking at the top of page 25, sir, and it's also addressed on the prior page in 5.2 -- Section 5.2 there.

(BRIEF PAUSE)

MR. DON PALMER: We have filed in AI-16 in Appendix A, a list of all the variances for earned revenues, loss cost claims expense and operating expense. Our, in fact, the forecast error is...

(BRIEF PAUSE)

MR. DON PALMER: Looking at that Appendix A exhibit and the -- the bias of eight hundred and forty-five thousand dollars ($845,000) that has been identified is on net underwriting income. We actually -- our actual claims have been greater than what we expected over that same period of time and our -- our revenue -- our forecast revenue was less than what has actually been experienced. So, -- but it does flip around and I -- and certainly the -- the error on the revenue side is a lot less in the last three (3) years than it was previously.

MR. WALTER SARANCHUK: So has the Corporation made progress in the forecast?

MR. DON PALMER: I think I've indicated that we have. Yes.

MR. WALTER SARANCHUK: Fine. Those are all the questions I have in respect of forecasting, Mr. Chairman, unless the Panel has some questions.

MR. LEN EVANS: Thank you. I notice on

page 25 of the document prepared by Professors Hum and Simpson, they -- and I don't believe that Mr. Saranchuk touched upon this or the answer but that is the question of accumulation.

It says any one (1) year it may not be that significant but when you accumulate it it comes to 10.152 million. This is the -- this is the very top of page 25 referring to net underwriting income per se.

And then it says, similarly, for net underwriting income excluding operating expenses the mean forecast error is five hundred and seventy-nine thousand (579,000) which has resulted in accumulation of 6.9 million plus since 1994/'95. And as you can read, the forecast errors are small, only 5.2 percent of mean actual net underwriting income and 2.7 percent of mean actual net underwriting income including operating expenses over the net period.

But the cumulative effect over many years, can be quite significant. And then he suggests 5.2 percent growth in net underwriting income exceeds the rate of growth of inflation during the period and indeed exceeds all inflation forecasts in the foreseeable future.

I'm just really quoting from that statement, so the point I'm making is, we should look at the accumulative effect rather than any one (1) year.

MR. DON PALMER: I think I would disagree with that conjecture or -- and again because the variances, the $10 million seems like a large number. I don't think anybody is going to say it's not.

And I've just taken a round -- a round number estimate and said, okay, for the last twelve (12) years our average revenue has been about $500 million. It's about 700 now, it was lower than that, so just as a ballpark estimate I took 500 million.

So you're talking about a variance of $10 million on a revenue of $6 billion. Again, very, very small numbers. The $10 million swing is one (1) year. I think if we're within forecast -- in any given year now, at $10 million I think we've done a very good job.

So to say that that is a cumulative bias, I would not agree with that portrayal at all.

MR. LEN EVANS: What about in the second paragraph on page 25, when he makes reference to the 5.2 percent exceeding the rate of growth of inflation?

MR. DON PALMER: Again to compare it to net underwriting income, when our target fluctuates a fair bit and I -- I remember talking about net income one (1) time and we're balancing for a break even over the long term.

And I remember somebody coming to me and I thought we had done, on a given month, we were within -- our net income was like a hundred thousand dollars ($100,000); it was so close to zero that we couldn't -- we couldn't hope for anything better than that.

In our forecast, because we do monthly forecast, was two hundred thousand dollars ($200,000). And someone came to me with a very straight face and said, "Palmer we've got to do something about these forecasts, you've missed it by 100 percent."

And it's just -- I think it's twisting the truth. And to relate to net income, I think what we have to do again is relate it to the total revenues, understanding that our total revenues is going to be break even, bottom line.

MR. LEN EVANS: Thank you, Mr. -- so the observation that 5.2 percent growth in net underwriting income exceeds the rate of growth of inflation during that period or during the period; and exceeds all inflation forecasts in the foreseeable future you don't--

MR. DON PALMER: It's irrelevant.

MR. LEN EVANS: That's irrelevant. Okay.

(BRIEF PAUSE)

MR. LEN EVANS: Okay. Thanks.

THE CHAIRPERSON: Should we take a short break now, Mr. Saranchuk?

MR. WALTER SARANCHUK: Might I suggest in five (5) minutes, sir?

THE CHAIRPERSON: Very good.

CONTINUED BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: I'm going to now address very briefly, claims cost control initiatives that are addressed at Volume I at SM 5.3 and 5.4. And the initiatives are addressed there and set out clearly.

Is there any additional comment that you can provide, Mr. Bedard, in respect of these bodily injury claim costs saving initiatives that are addressed in SM 5.3? In particular, I'm looking at the practitioner education liaison, the negotiated fee agreements and the prolonged recovery unit?

MR. WILFRED BEDARD: Well, the Practitioner Education Liaison Initiative is -- is one that comes out of our healthcare services team. They're of the belief -- the physicians that work with us are of the belief that there is not a lot of education given to doctors with respect to managing soft tissue injuries, whiplash-associated disorders, and there's a lot of new literature on that that most of the medical profession perhaps is not privy to.

They spent a lot of time talking with people in -- in clinics, in hospitals, and whatnot talking to them about how to manage those types of losses to ensure that we don't deal with -- they manage avoidance of chronicity and chronic pain issues, post-traumatic stress disorder and whatnot.

They spent a lot of time talking to -- to the medical profession about that. That activity continues to go on. It has been going on for -- for some years now. They, as mentioned in the document, have completed twenty-two (22) such presentations over the course of the last fiscal year and that exercise does continue.

And it's very important for us to help managing our costs because as you've seen in the -- in the application many of the injury claims, a vast majority of injury claims reported to MPI are of whiplash-associated disorder in nature. There's a lot of funds both from MPI and the medical profession expended on managing these losses so to try educating the medical profession is -- is something that we feel strongly about and we exercise that responsibility through these initiatives through our healthcare services team.

As far as the negotiated fee agreements are concerned we believe that negotiating fee agreements is the proper way to -- to manage costs, getting a firm understanding in terms of the type of -- of services and the type of fees that ought to be paid creating a lot of consistency and expectation throughout the -- throughout the province.

We are very pleased that we do have a very positive working relationship with those practitioners and are able to agree on the terms and conditions of these contracts on an ongoing basis.

As far as the prolonged recovery unit is concerned we are in the two (2) -- second year of a two (2) year pilot project on that effort and we have had very good success in revisiting the rehabilitation of people who have fallen into chronicity if you will and chronic pain and not been able to resume normal activities. We have benchmarked the fact that we would try and reduce our expenditures by about $2 million or our reserves rather by $2 million per year on this initiative.

We were successful in exceeding that the -- the first year of the pilot and we're well on our way to exceeding that in the second year of that pilot. It clearly is a -- is a worthwhile initiative that once we do our two (2) year evaluation will likely become part of the regular way we do business well into the future.

MR. WALTER SARANCHUK: Thank you, sir. And then moving on to all perils claims cost savings initiatives at SM 5.4 on the next page, with reference to SM 5.4.A After Market and Recycled Parts Usage, this is addressed in the book of documents Tab 22, the Corporation's response to Interrogatory Number 18 asked by the Public Utilities Board in the first round.

And can you comment, sir, on the utilization of after market parts and the recycled parts? There's a definition there for each as shown in SM5.4. It would appear that the Corporation is increasing its utilization on both counts. Could you briefly give us an overview?

MR. WILF BEDARD: Yes, certainly. We are very committed here in Manitoba to utilize after market parts which are brand new parts that are manufactured by somebody other than the original manufacturer of the vehicle. The number of those parts in the industry are continuing to grow; the quality of them are continuing to grow. You're seeing increases all over the -- the country really in terms of the use of after market parts. We're no exception. We continue to use them. They are fully warrantied no different than -- than a -- an OE, original equipment manufacturer, and as a consequence we're using more of those parts on an ongoing basis.

As far as the recycled parts which are -- which are recycled parts from -- from total loss vehicles, we do purchase a significant number of -- of recycled parts throughout the province. The percentage, as you see, has grown from 11 percent of the parts purchased in 2001 to 16 percent in 2005.

Again, we're treating this as a sustainable development initiative. We're taking existing parts and re-using them in the repair process. As a result of that we're saving vehicles that may otherwise be total loss and, as a result, we're saving money to premium payers as well.

So it's, in essence, the initiative there and as you can see, you can see a significant shift year over year from the use of new manufactured parts from OE's to the aftermarket and recycled parts.

MR. WALTER SARANCHUK: Thank you, Mr. Bedard.

That completes my line of questioning, Mr. Chairman. My Learned Friend, Ms. Everard, will start another line after the break.

THE CHAIRPERSON: Very good. We'll have a short break. Thank you.

--- Upon recessing at 2:35 p.m.
--- Upon resuming at 2:53 p.m.

THE CHAIRPERSON: Ms. Everard, anytime you're ready.
MS. CANDACE EVERARD: Thank you, Mr. Chairman.

CONTINUED CROSS-EXAMINATION BY MS. CANDACE EVERARD:
MS. CANDACE EVERARD: Just following on some of the questions that Mr. Saranchuk posed earlier, can the Panel comment on the Corporation's overall impression and response to the Hum and Simpson Report presented by CAC/MSOS?
MR. DON PALMER: Yes. This one comes to me. And overall -- my overall impression is really that they have absolutely missed the mark. And I say that -- there's -- there's two (2) overriding concerns that I have with that report.
And the first one is with regard to investment risk and they have left it alone. It -- it's -- they've been virtually silent on it. The only mention that they made about it was that they had been adjusting or commenting on the adjustments that we had made to the - the first risk analysis and they -- they said well,

we've really only looked at the operational risk part, that particular adjustment is, therefore, not pertinent.

Now, I grant that they say not pertinent with regard to their own analysis, but that's the only mention that I see of investment risk and, to me as we sit with $2 billion in assets and have huge risk, for them to more or less ignore that, then -- I think that's a tremendous oversight.

The second major disagreement that I would have with the Hum/Simpson Report is their, I'll say, misunderstanding of the insurance business and the regulatory cycle of that business.

And they talk about our monopoly position and when we require a rate increase, the impression that I get is that we just go out and get it. They make reference to the Public Utilities Board, the implication that I read was that we have carte blanche to increase rates by anything up to 20 percent on an overall basis.

I'm thinking if this Corporation got itself into a position that we required a 20 percent rate increase, I suggest you might see a different panel on this side of the table and you might very well see a different panel on that side of the table, as well.

It's not a 20 percent overall cart blanche that we've got and to suggest that the PUB only monitors the rates, I think that's certainly understating the purpose of th Public Utilities Board.

Our rate increases cannot be instantaneous. We -- I talked at some length on Tuesday about forecasting lag, about regulatory lag, about the policy year effect; that all those things, when something bad happens, it probably takes about three (3) years for us to have any effect for compensatory action against that bad thing that happened.

So to say that an unexpected non-recurring event is something we can react instantaneously to; I think that's certainly understating.

There's also some comment within Hum/Simpson about smoothing our rates. And I have great respect for Doctors Hum and Simpson and some of the research that they have done, but clearly they're not actuaries.

When we have to abide by actuarial principles and actuarial standards and set rates on the basis of expected future costs; that largely precludes us from smoothing the rates.

And when we have something bad happen to us, what's done is done. I mean the only -- the only way that we can fully fund a past benefit is to have it come from RSR. The actuarial standards and principles preclude us from including that in an ongoing, going forward rate. So I think they've missed that point.

Sorry, there are some other points that they've made; in their evidence about how we treat outliers. And they've been a little coy in that I think, they say, well, you could adjust for it, you could -- and it depends what it is, if it's something that wouldn't be funded from the RSR you ignore it or you could give it some extra weighting.

But it's the outliers that we're really trying to protect ourselves against in the RSR. Clear and simple. It's that unexpected, unforeseen, probably large event that we really are trying to protect ourselves against.

And to look at only twelve (12) years data and the if you happen to have something really out of the ordinary, saying well, we've got to adjust our data accordingly. I think that's missing the point.

In the inflation scenario that -- that we've talked about again there is a huge leveraged effect and it almost seemed -- there was no mention of -- of those possible large increases in claims reserves and it was unclear to me if Professors Hum and Simpson really understood that those benefits have to be completely fully funded.

We can't do cashflow underwriting. We can't -- we are required to have full reserves to pay for all claims that are currently open. We don't have any choice.

We talked a bit about liquidity as well and -- and I was somewhat puzzled by the Hum/Simpson claim that this is primarily a liquidity issue and I -- quite frankly the only way that it could possibly be is if we were cashflow underwriting, if we were purely a cash business and didn't have reserves.

That -- that's to me the only way that that -- that claim would make any sense. And clearly, clearly we are not a cashflow business.

I guess those are essentially my comments. The -- it's mainly from my point a misunderstanding of the insurance function, of the insurance accounting function, and the actuarial function.

MR. KEVIN MCCULLOCH: Mr. Chairman, I don't want to delay Ms. Everard's cross-examination any further, but I did indicate prior to the break that we were reserving the -- the chance to comment on the last two (2) exhibits filed by Mr. Saranchuk.

THE CHAIRPERSON: The Ibbotson?

MR. KEVIN MCCULLOCH: Ibbotson and the -- the other study that was attached or the article and Mr.

Galenzoski has some brief comments to make on those two (2) items.

THE CHAIRPERSON: Please proceed, Mr. Galenzoski.

MR. BARRY GALENZOSKI: Thank you. First of all, I just want to make sure that the Board understands that the Corporation is certainly aware of equity risk premium as a subject matter. We just simply weren't aware of this particular author that was being quoted and that -- that was the difficulty we were having.

But when we look at the equity risk premium document that the Ibbotson Associates have produced and has been put forth as evidence I just want to draw your attention -- again I've briefly gone through this thing, very cursory look at it and I wanted to draw your attention just to a few quotes out of this particular report.

On the very first page in the middle of the page it says:

> "Since the expected equity risk premium must be estimated there is much controversy regarding how the estimation should be conducted."

The report then goes on to talk about on -

- on page 80 near the bottom:

"Our own empirical evidence suggests that the yearly difference between the stock market total return and the US Treasury Bond --"

THE CHAIRPERSON: Just a second, Mr. Galenzoski, I truly want to follow you.

MR. BARRY GALENZOSKI: Okay.

THE CHAIRPERSON: Page 80?

MR. BARRY GALENZOSKI: Page 80 --

THE CHAIRPERSON: Yes, I'm there.

MR. BARRY GALENZOSKI: Page 80, last paragraph.

"Our own empirical evidence suggests that the yearly difference between the stock market total return and the US Treasury Bond income return in any particular year is random. Graph 5.3 presented earlier [and we'll talk about that in a second] illustrates randomness of the realized equity risk premium."

And if you turn back to graph 5.3 which is found on page 78 and they do -- they do graph since 1925 through to 2005 the realized equity risk premium per year and you will see that is very random as they suggest in their report. It's -- it's moving up and down and all over the place.

THE CHAIRPERSON: Looks like an electrocardiogram to me.

MR. BARRY GALENZOSKI: On page 81 just after Table 5.3 they make the statement:

"The significance of this evidence is that the realized equity risk premium next year will not be dependent on the realized equity risk premium from this year."

And then they go on to say -- I'm just omitting the next few words and in the middle of the following sentence:

"It is virtually impossible to forecast next year's realized risk premium based on the premium of the previous year."

And then we go onto the document that's entitled "The Examination of the Equity Risk Premium Assumed by Canadian Pension Plan Sponsors" and I believe this was done up by Aon Consulting.

THE CHAIRPERSON: Exhibit 13.

MR. BARRY GALENZOSKI: Pardon me?

THE CHAIRPERSON: We gave it an Exhibit

13.

MR. BARRY GALENZOSKI: Exhibit 13. Okay.

On the very first page near the bottom it says:

"The paper concludes that although the expected return on assets may be achieved, there are several factors that suggest that the expected return assumptions are aggressively optimistic."

And if we turn to page 7 of that report, Table 3 shows rates of return over a ten (10) year periods on Canada's long bonds and derived ERP and you'll notice that per the period 1984 to '93 the derived ERP is negative 5.6 and that for the period 1994 to 2003 derived ERP is .10.

So relatively unstable and -- and not too positive, obviously.

THE CHAIRPERSON: The period of time, if I may interject, marked by a continual virtual decline in interest rates.

MR. BARRY GALENZOSKI: Okay. But we'll put this in perspective by going to page 8 and --

THE CHAIRPERSON: By the way, my comments shouldn't be made as a defence of the paper because I'm reading it for the first time just like you.

MR. BARRY GALENZOSKI: Thank you. I appreciate that. The -- so there's no negative bias then towards my comments then obviously.

THE CHAIRPERSON: We'll decide on that later.

MR. BARRY GALENZOSKI: I know you will.

In the -- in the beginning of the third paragraph on page 8 it says:

"In fact, none of the previous ten (10) year periods shown in Table 3 suggest to me economic and financial conditions similar to those expected to be experienced in the next ten (10) years."

And then we skip down a sentence or two (2) and it says:

"I think this decade..."

And they're referring to the current decade.

"... will be known as the decade of unpleasant surprises."

And it finishes this little review off on page 9 in the second last paragraph and this is starting within the -- the second sentence:

"It should be noted that in recent ten (10) year periods the ERP in Canada has been less than 1 percent."

And the very last sentence in that paragraph says:

"Some authors, such as Bernstein, forecast a negative ERP."

So the Corporation has, you know, and I'm getting outside of this evidence now and just talking about what MPI does, MPI does not use an ERP when it's at forecasting.

And if you're looking at a pension plan they would be encouraged to use that for several reasons. Number one (1), there's -- in many pension plans there's a significant shortfall of the assets compared to the liabilities and there's a -- there's a lot of pressure to use a higher discount factor in -- in valuing their liabilities going forward.

THE CHAIRPERSON: Depends on who it is and whether it's a joint sponsored pension plan or an employer sponsored plan as to whether --

MR. BARRY GALENZOSKI: Well, I'm talking about a defined benefit plan and that's what this document, I believe, is referring to, defined pension plan.

THE CHAIRPERSON: All I meant, Mr. Galenzoski, you were inferring there might be a pre-disposition one way or another. It largely depends, I think, on whether it's a jointly administered plan or employee administered plan.

MR. BARRY GALENZOSKI: That may be very true. If it's employee then is probably going to be a different -- depending on who's writing the cheques, I guess, makes the difference on that one.

So, you know, the view towards financing a long-range liability like a pension is a little bit different than the view with respect to financing a premium or setting a premium for an insurance product that's going to last for one (1) year, the next year that we're looking for.

And you can -- you can make some mistakes, I believe on -- on the longer term plan, for instance on a pension liability, because the payment stream is going to happen many years in the future and you have some opportunity to recover.

When you make the assumptions with respect to the pricing of your insurance product for the next year you do not have that opportunity to recover unless, of course, you can take that out of your rate stabilization reserve if you make a mistake on that.

So we have taken the approach of not estimating an equity risk premium on our equity portfolios; that is because of several reasons. Number one, we have, relatively speaking, not been investing in equities for that length of time that we have a long period of history.

And, number two, just because the recent evidence is, is that it's not always available. So what ends up happening in our situation is that if the, indeed, the equity risk premium does materialize in our portfolio and it does result in improved bottom line, that falls to the rate stabilization reserve and can be dealt with at that point in time.

THE CHAIRPERSON: So why do you invest in equities?

MR. BARRY GALENZOSKI: We invest in equities for the stated reasons I provided yesterday which is, number one, when we -- when we moved into the no-fault plan and we realized that we were going to have large accumulations of cash that needed to be invested and that we had liabilities that were inflation linked; we had to take a different approach then just investing 100 percent in bonds.

And when -- as we studied the subject, we wanted to get a -- we wanted to get a different risk profile with respect to our investments and there is some expectation and hope that you're going to get a lift with respect to the -- and equity risk premium that we're talking about, over the long term.

The problem is predicting it for rate setting purposes. And for rate setting purposes, we don't have that opportunity of coming back and saying, whoops we made a mistake and now we're going to have to ask for a little bit more, because that policy lasts for a very short period of time, twelve (12) months and then it's over; we're onto the next rate setting process.

So that's the reason we've chosen not to put an equity risk premium in at this stage.

THE CHAIRPERSON: Thank you, Mr. Galenzoski, I think that's a valuable commentary you've made that we will reflect on considerably. And we have got to commend you, too, (2) for your fast reading skills because they're evident the way you've managed to parse that document and find these sections. And I'm not being glib, it's very good.

MR. BARRY GALENZOSKI: I appreciate that. Thank you.

THE CHAIRPERSON: Ms. Everard...?

MS. CANDACE EVERARD: Thank you, Mr. Chairman.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Palmer, we're going to get into the rate-making model, but just before we go there, can you go back to AI-16 and, in particular, page 9?

(BRIEF PAUSE)

MR. DON PALMER: I have it.

MS. CANDACE EVERARD: Thank you. In Table 10 on the lower portion of the page, looking at the row relating to the 1995/1996 insurance year; it's reflected that there was in the far right column a 16.1 percent difference over the previous year or -- sorry, I guess, between forecast and actual.

Would that statistic be what you refer to as an outlier?

MR. DON PALMER: Definition of an outlier is somewhat subjective. If I can put a little more definition around that, I think two (2) standard deviations beyond the mean is probably a reasonable depiction.

That would be -- the standard deviation on the bottom of that table shows at 7.6 percent. This is over two (2) times that, so I would say that this would be an outlier.

MS. CANDACE EVERARD: Mr. Palmer, would you say that the reason for that 16.1 percent statistic was the lack of experience with PIPP at that particular time?

MR. DON PALMER: I would say that that was a contributing factor. Now, I will tell you that in retrospect the 1995/'96 year was a very bad year. It's probably the worse PIPP year that we've had.

We didn't know it at the time because we didn't have the experience. So, you couple the fact that we didn't have historical experience, didn't understand the plan as much as we do today, and had a very bad year that all those things contributed to that and if that's an outlier, then sure, I'll accept that.

MS. CANDACE EVERARD: And in your view, how should outliers be treated?

MR. DON PALMER: They're -- they're part of the experience, especially since the RSR is designed to protect against something like this.

Now, there's a -- there's a little -- within this, in answering your question -- your question I'm not -- I'm not accepting the fact that this type of risk analysis in -- in just comparing actual to expected is -- is valid for the purposes of RSR.

So in terms of how it should be treated, again, I'll temper that with saying probably this isn't the best treatment in -- in which to set the RSR in the first place.

And -- and if I can add -- add one (1) more comment on that, we have -- or I stated just before the break that our forecasting is improving as we understand things better, as we understand the plan better, but the accuracy of our forecast doesn't stop something bad from happening -- happening next year.

And I think that's the point. And for us to tie our RSR into the forecasting process rather than the insurance process, I think is misplaced.

MS. CANDACE EVERARD: And just to confirm, Mr. -- Mr. Palmer, the inflation adjustment that's reflected on the next page of AI-16 which is Table 11 is being proposed by the Corporation as an improvement to the risk analysis?

MR. DON PALMER: Yes, it is.

THE CHAIRPERSON: While they're pausing if I could go back to Mr. Galenzoski because I want to seize this opportunity for your comments, if I may.

Would it be fair for us to take from your comments that -- and I don't mean to say something that appears to be self-evident but I'll lay it out, that MPI is quite concerned as to their performance over the next premium year. The bias is against reliance on general experience over a longer period of time. There's a concern over the risk of a loss at any year that could be accounted for by a reliance on experience better than that forecast. Is that fair?

MR. BARRY GALENZOSKI: Yes, that would be fair, yeah.

THE CHAIRPERSON: You may want to think about this but is there anything, in particular, or, in general, in the Board's behaviour over past Orders that has been a factor in the development of this philosophy? You don't have to answer immediately.

MR. BARRY GALENZOSKI: We'll take a look at your words but -- and give you our reaction I guess tomorrow.

THE CHAIRPERSON: We have lots of time. Thank you.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Mr. Palmer, just -- just one (1) more question on page 10 of AI-16 and Table 11.

Under the column entitled, "Revised

Difference" for the 1995/'96 insurance year there's a dollar amount of I believe $93.9 million and can you just explain how that number was arrived at on this particular chart?

MR. DON PALMER: What we did is took the percentage variance in each year and then applied that to our current forecast so we have a total loss currently of -- forecast of $582 million.

The percent deviation that we saw in that particular year was 16.1 percent so we took 16.1 percent greater than the 582.12 and then the -- and the difference or 16.1 percent of the 582 is the 93.9 million.

MS. CANDACE EVERARD: And is it fair to include that figure as an outlier in the risk analysis or should it be adjusted to reflect the lack of experience at the time?

MR. DON PALMER: No, I think it's fair to include it and that particular year was a bad year. We -- we will -- we have -- have observed that for sure.

MS. CANDACE EVERARD: Okay. Turning then to the rate making model, I'd ask you to reference TI-2?

MR. DON PALMER: Is it in the book of documents?

MS. CANDACE EVERARD: No. It's not. So,

page 1 of TI-2, I understand, is a reflection of the use of the financial forecast model and how that gives rise to a construction of the required rate changes; is that correct?

MR. DON PALMER: Required -- required rate changes by major class. On an overall basis and by major class, yes.

MS. CANDACE EVERARD: Now, what I'm going to ask you to do, Mr. Palmer, is to go through the rows on this particular exhibit and provide a brief commentary on the nature and basis for each component and the unique handling of that component by major class? And I have a few specific questions on some of the rows and I'll just jump in when you get to those particular rows.

MR. DON PALMER: The first row is the expected unit counts for the '07/'08 policy year. And that's a forecast on the number of insured units that we will expect for each of those major classes.

The second row that is labelled "claims" is the expected claims cost per unit for each of those major classes. So, for instance, we expect in the '07/'08 policy year that private passenger vehicles will incur seven hundred and seventy-four dollars and twenty cents ($774.20) of claims cost per vehicle, contrasted with thirty-three dollars and five cents ($33.05) for trailer rates because it's -- it's a different risk.

MS. CANDACE EVERARD: And on -- on that line I did have a couple of specific questions.

Can you confirm that the numbers on the claims line reflect the results of the new loss transfer allocations?

MR. DON PALMER: Yes. I can confirm that.

MS. CANDACE EVERARD: And can you comment on whether there is any special treatment for catastrophic claims in the history reflected on that line?

MR. DON PALMER: Yes. Again, this is the expected cost of future claims. So it's been -- it's been taken into consideration. Yes.

MS. CANDACE EVERARD: And are there any other special adjustments on that line?

MR. DON PALMER: Not special adjustments, per se. Some of the techniques that we use to arrive at those numbers maybe you could term as a special adjustment. For instance, we have looked at serious losses and spread them out over a longer period of time then we did for non-serious losses.

So we -- because there are a small number of claims we have spread the catastrophic losses and looked at a ten (10) year average rather than a five (5) year average for the rest of the classes so that there isn't skewing of the data for some of the small classes.

MS. CANDACE EVERARD: If you could continue with the next line on claims expense and then I do have some specific questions on that line.

MR. DON PALMER: The claims expense is the amount that it takes to adjust the claims that come from overall and from each major class. And that's spread by -- on a pro rata basis based on the claims costs.

So if there are higher claims costs the assumption is that there will also be higher claims expenses.

MS. CANDACE EVERARD: Can you confirm that this is a flat percentage of claims not varying by major class?

MR. DON PALMER: I can confirm that.

MS. CANDACE EVERARD: And how do these figures allow for differences between major classes in the composition of claims by coverage?

MR. DON PALMER: It -- it's an average. For instance, if you look at trailer claims, virtually all physical damage claims, there would be no injury component in that particular one (1).

The claims would be fairly easy to adjust. There wouldn't be any long-term effect of adjusting those claims. Contrast that with a class like motorcycles, that has a very large injury component. Injury claims are more detailed, more time consuming to adjust, can be open for much longer periods of time.

So again that's built in on an average basis. We haven't -- we haven't looked at the individual composition of that, but it's again an average.

MS. CANDACE EVERARD: So it would be fair to say that some coverages tend to incur more adjusting expenses than other coverages?

MR. DON PALMER: Yes, that would be accurate.

MS. CANDACE EVERARD: And would it also be fair to say that coverages in the basic package are not uniform across the major classes?

MR. DON PALMER: That's also accurate, yes.

MS. CANDACE EVERARD: Thank you. If you could go on with road safety?

MR. DON PALMER: The next line is road safety, which is the cost of operating our road safety and loss prevention programs.

They are targeted to Highway Traffic Act vehicles. We don't have specific programming on trailers, for instance. So we have not allocated any of that road safety expense to trailers or ORV's.

We also have some specific programs, theft prevention programs that are aimed at private passenger vehicles, so there's an extra amount allocated to the private passenger vehicle; that's why they're allocation is a little higher than the other major classes. Overall within each major class, each component is done on a per vehicle basis.

The next line is operating expense. And that's the administrative expense other than the claims division for -- to operate the Corporation. That would be salaries, building expenses, and so on, and that's allocated on a per vehicle basis.

A few years ago the Board deemed that it probably was inequitable to charge that operating expense to trailers and off road vehicles. Although there is some actuarial soundness to that because we do have flat administration requirements, everybody gets a renewal and those type of things.

So there is a cost, it doesn't matter if you're - you're insuring a Cadillac or a 1978 Buick Skylark, the administration costs aren't different. So that's why it's on a flat per vehicle basis.

The problem and we see that cost about sixty dollars ($60) a vehicle. It probably didn't make any sense to have claims cost in the nineteen dollars ($19) a vehicle, as we see on ORV's and charge sixty bucks ($60) to administer it.

There was an inequity there. So the decision was made at that time to not charge the operating expense to trailers or off road vehicles.

MS. CANDACE EVERARD: But, you can -- you may have said this but just to confirm, that this particular line fully reflects the HTA or Highway Traffic Act unit basis for allocation?

MR. DON PALMER: That's correct. The next line is commission. We pay our brokers commission on a -- on the basis of premiums written. That's reflected in that line.

The next line is premium tax. We pay the Government of Manitoba 3 percent premium tax on all premiums written. We have divided that into premium tax paid on vehicle premiums and vehicle tax paid on driver premiums.

MS. CANDACE EVERARD: And just to confirm in the case of the Commission the -- and the -- the vehicle premium tax it's a fixed percentage of the premium that is at issue?

MR. DON PALMER: That's correct. And you'll also notice that the premium tax for drivers isn't included in -- in trailers or off-road vehicles because those vehicles do not require a driver -- a licenced driver.

The next two (2) lines are the Re-Insurance Premium for casualty and catastrophe. We're required to -- to rate on the basis of gross risk and to build into our rate some allowance for catastrophic claims.

The way that we have done that is because we protect ourselves through re-insurance that we have said that our re-insurance premium is a proxy for those catastrophic events so that's why we've put it in in this manner.

You'll --

MS. CANDACE EVERARD: Mr. -- Mr. Palmer, sorry, just to interrupt. If -- if re-insurance is included as a cost, then can you confirm that the claims are included net of re-insurance?

MR. DON PALMER: I can confirm that, yes.

MS. CANDACE EVERARD: And just a couple more specific questions on re-insurance confirming that there is a distinct treatment by major use?

MR. DON PALMER: Yes. The casualty

program is for large injury claims. Again if we look at trailers and off-road vehicles, trailers is -- is self-evident; there isn't a large -- a risk of injuries there.

On the off-road vehicles remember what this coverage is. It's third party liability capped at two hundred thousand dollars ($200,000), so again there's no risk of that being catastrophic and that's why there's no premium included for that line.

The next line is Re-insurance for Catastrophes and that's -- our major catastrophe or catastrophic peril would be hail. And motorcycles do not have comprehensive coverages so the -- the re-insurance premium is not charged to motorcycles because it's not covered under the basic compulsory program.

MS. CANDACE EVERARD: And so what you've just described between the two (2) lines relating to re-insurance, the one being casualty and the other being catastrophe is the distinct treatment between those two (2) categories?

MR. DON PALMER: That's correct. The next line is Fleet Rebates. We have a fleet rebate program that's available to fleets that are more than ten (10) vehicles in that at this particular time and probably as long as I can remember there are more dollars spent -- paid out in rebates than in surcharges so there is an off balance there. So we have to collect the money to pay for that off balance. We have charged that on a per-vehicle basis to all categories that have fleet eligibility.

MS. CANDACE EVERARD: And -- and if I'm right those are the private passenger, commercial, and public classes?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And the Corporation reflects in this document a flat amount to each of those classes?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And are fleets equally common in these three (3) major uses?

MR. DON PALMER: Probably not. There would be a higher incidence of fleets in the commercial and public than there would be in the private.

The next line is the Anti-Theft Discount. And this -- this shows actually as a -- an offset to premium. You can probably draw a line between fleet rebates and anti-theft discounts.

Everything above that line that I've gone up through so far is a -- is a cost. And everything going down is a revenue offset. The anti-theft discount essentially is the money that flows in from the immobilizer incentive fund to -- to pay for immobilizers and that's only for private passenger vehicles, so, that's the only class that gets credited with that.

MS. CANDACE EVERARD: So it would be fair to say that the anti-theft discount figure reflected there is an off balance cost of the premium discounts being offered?

MR. DON PALMER: That's correct.

MR. LEN EVANS: Excuse me, I wonder if I could interject?

I'd like to go back to the line of catastrophe. What is the definition of catastrophe? I know you use as an example hailstorms; is that the amount of money -- if one (1) vehicle, let's say, is hurt by hail that's not deemed to be catastrophe. So it would have to be a financial amount. So what is the cut-off?

MR. BARRY GALENZOSKI: That's an accumulation of losses coming out of one (1) event that would exceed our retention on our -- on our re-insurance program. So a catastrophe in that case would be anything over a $10 million loss today.

MR. LEN EVANS: I see. I was just thinking we had a catastrophe called a tornado near Gull Lake and so forth but I imagine it was just a few vehicles affected, so that wouldn't be defined as a -- as a catastrophe for insurance purposes?

MR. BARRY GALENZOSKI: Not for this insurance company. Maybe for --

MR. LEN EVANS: Yeah. Some may --

MR. BARRY GALENZOSKI: -- Wawanesa.

MR. LEN EVANS: Somebody out there has had a catastrophe payment. Okay. Thanks.

MR. DON PALMER: The next is driver premium and this is -- we do have a premium that's charged to all Manitoba drivers on their driver's license that includes a basic premium as well as surcharges for accidents and for demerits.

CONTINUED BY MS. CANDACE EVERARD:

MS. CANDACE EVERARD: Can you indicate what is the foundation for the level of the average driver premium?

MR. DON PALMER: The driver premium is set at forty-five dollars ($45) less five dollars ($5) per merit.

MS. CANDACE EVERARD: And how do we know that the split between the driver premium and the vehicle premium is optimal?

MR. DON PALMER: We don't. That has been -- been said. We haven't earmarked any coverage specifically for the driver's premium. That is an amount that was set as a compromise through the -- in the Corporation and through this Board that that is an adequate amount that we believe should be charged drivers.

We feel that there are drivers that don't own vehicles and there should be some premium amount but whether it should be fifty dollars and forty-six cents ($50.46) and not sixty (60) or not thirty (30) I guess, to use Mr. Saranchuk's terminology, I would say that that's management judgment.

The next line is service fees. We have -- the major -- major one included in that would be financing of insurance premiums that we do get revenue from people taking time payments and that's largely what that is. There are a few other things included in there, but that would be the bulk.

The next two (2) lines are investment income and, as I indicated before, we do get -- rely on investment income to offset our premium rates. And we have calculated as a percentage of premium. And, again, separated that between driver premium and vehicle premium.

You add all those up with the expenses minus the offsets and it comes up with the required rate, raw.

We have -- we have to balance everything to the overall requirement. And because of some of the allocations of claims and whatnot, if you just add up all the pieces you don't get the total. And so I have required rate balance and that's just so -- the sum of all the parts equal the overall requirement.

So that's why the -- for the required rate balanced is the same on an overall basis, but different on the major classes.

The next line is what the current '06/'07 rate is because our ultimate goal is to calculate a percent change required. So we have to start what are they -- what are they paying today?

We have what's called major class drift, I guess, maybe next year we can call this upgrade just to be consistent with the terminology that's used in the financial forecast, but it's the same thing.

MS. CANDACE EVERARD: That was going to be my question, is whether this drift is similar to the vehicle upgrade factor?

MR. DON PALMER: I would say, the same. The next -- the next line is --

MS. CANDACE EVERARD: Sorry, just before you go to the next line, I just had one (1) more question about the major class drift. Can you describe the basis on which the drift assumptions are established to vary by major class?

MR. DON PALMER: What we have done, is we have looked at the historical drift over the last year and pro-rated that into the future. Now, the reason you'll see that that number is drift of 7.1 percent, compared to our 3 percent assumption that was used in the financial forecast.

This drift occurs over time. And this is the amount -- this average rate is taken from our rate model that was -- as at a point in time, the end of November of last year, we take a snapshot of our vehicle file, then we apply all the '06/'07 rating rules to it and come up with an average rate.

But, the vehicle population is at last November. We have to project this into the average policy date that will be in effect in '07/'08, which is I think it's two (2) years and two (2) months if memory serves me correctly.

So this is the projection of the 3 percent over a two (2) year period and that's why it's 7 percent, just over two (2) years of drift.

Once we apply that drift to the current average rate, we come to what the rate would be in

'07/'08, if we didn't make any rate changes.

We then compare that to the required rate balanced, to come up with our overall required change, with the assumption at that point in time, that all the major classes are fully credible, meaning that we can fully rely on the experience, on the past historical experience that would reflect future experience.

MS. CANDACE EVERARD: So is what you're saying that the line which refers to the required change, measures the change from the current rate after the drift adjustment to the required rate?

MR. DON PALMER: That's correct. The next line is somewhat of a throw back, applied for change. We have, in past years, rounded that requirement. If we got -- if that came out at .6 percent we may say, well, we'll call it zero and adjust everything accordingly.

We haven't done that this year. We've said the indicator is minus 2.6 so we're going to apply for minus 2.6.

The next line credibility is the weight that we put on for past experience. It's a measure of how much we can believe the data. So when you have a very large class like private passenger we say there's enough vehicles in there that we virtually 100 percent believe the data that's -- that's in there.

For smaller classes like the public class we say that there's enough data that we believe in that -- in that historical data 64 percent. We do have a credibility formula that we have imbedded in TI-20 that has been discussed at length at -- at past hearings. I'm not sure that you want to go through that now.

MS. CANDACE EVERARD: So is the size of the class then the basis for the assigned credibilities or are there other factors in addition to the size?

MR. DON PALMER: It's the size of a class, yes. We credibility weight the overall requirement with -- with the requirement in each major class and come up with the credibility-weighted change.

MS. CANDACE EVERARD: So would it be fair to say that the credibility-weighted change recognizes the reduced reliability of the smaller volume major uses?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: And then that the balance of credibility goes to the overall change?

MR. DON PALMER: That's also correct. To come up with the credibility-weighted required rate again because of some of the math involved the sum of the parts doesn't always come to the whole so we -- we balance it, again, to make sure we get the total revenue requirement and then compare that number with the '07/'08 average rate without rate change to come up with our bottom line required rate change.

MS. CANDACE EVERARD: Thank you. I'll now shift into a different area. If I could direct your attention to SM 6.3 this is an issue that Mr. Saranchuk touched on in the overview but we'll just go into a little bit of detail.

(BRIEF PAUSE)

MS. CANDACE EVERARD: In particular, if you could look at SM-6.3 page 2 which has a -- a table at the bottom and as well page 8 which has a table and I'd ask you to compare the financial forecast indications by major class and overall from the table on page 2 with the corresponding proposed revenue adjustment in the upper table on page 8.

MR. DON PALMER: Sorry. You want me to compare just the financials on page 2 with the amount on page 8?

MS. CANDACE EVERARD: Yeah, the -- compare the financial forecast indications by major class and overall from the table on page 2 with the corresponding proposed revenue adjustments in the upper table on page 8.

MR. DON PALMER: The indicator for private passenger major class from the financial indicator from TI-2 was minus 4.4 percent and on the -- the actual revenue that we're -- we're requesting is minus 3 percent.

On commercial we've got an indicator of plus 2.4. We're applying for plus 5.4. For the public class we are applying for minus 6 -- or indicate a minus 6.3; we're applying for minus 2.4. On motorcycles we have an indicator of 13.7; we're applying for 8.4

On trailers we have an indicator of minus 17; we are applying for minus 14.1. On off-road vehicles we have an indicator of minus 24.5; we are applying for zero and I'll have to come back to that one. And on an overall basis we are indicated minus 2.6 and we are applying for minus 2.6.

As far as the difference -- the reason for the differences is that we have capping rules. We went through an analysis of these a couple of days ago on AI-12 and the differences and what happens when you do all the capping rules along the way.

So, that accounts for the difference between amounts shown as we indicated and amounts shown for the applied for. The exception to that is on off-road vehicles because of the additional coverage. We are adding to the coverage of off road vehicles. We're not sure exactly the effect of what that insurance will cost so we've chosen to freeze the rates for off-road vehicles this year.

MS. CANDACE EVERARD: So just to confirm, in addition to the caps that you referenced a moment ago, what factors and considerations contribute to the differences between the indicated and proposed revenue adjustments? And are there any that are specific to a major class?

MR. DON PALMER: They're the caps and -- capping is the major cause of that and the requirement to always balance to the total revenue requirement.

We have, in some cases, utilized the capping rules that have historically been used by the Board. In some cases, like for mopeds, we have put our own cap, so to speak, on. We have, for application purposes, superceded the 20 percent and put in our own cap on that for the amount that we have chosen to apply for.

MS. CANDACE EVERARD: Thank you. Moving then to some questions on mopeds, motor scooter and motorcycle rates and the -- the general references for the first two (2) questions relating to mopeds and motor scooters are at your pre-filed testimony, Mr. Palmer, as well as the response to question 52C posed by the Board in the first round which is not in the book of documents.

And my question, firstly, with respect to moped rates, is that if the increase this year in moped rates were limited -- or capped at 20 percent per year what would the financial implications be for the year of the application?

MR. DON PALMER: It means the rest of the rates would be a little higher because it is a relatively small class and has low premiums. It wouldn't be a significant amount but it would -- the requirement would still flow through to other vehicles.

MS. CANDACE EVERARD: Thank you. And conversely or inversely, if the decrease to motor scooter rates were limited or capped to 20 percent per year what would the financial implications be in the year of the application?

MR. DON PALMER: Again, theoretically, the rest of the rates would -- would be decreased. But, remember that the number of scooters is about seventy (70) so there is virtually no revenue change that would come from that particular change.

MS. CANDACE EVERARD: With respect to motorcycles, if I could direct your attention to SM

4.3.B.3, which is at page 12. And, in particular, the table on that page, if you could give some history regarding the rate line adjustment process and the phasing in that is continuing this year?

MR. DON PALMER: The costs per vehicle are -- are determined per rate group. And so that the -- the premium within each group -- within each rate group optimally should balance the risk that is presented by that rate group.

So in private passenger vehicles, for instance, higher rate groups generally have higher damage ability, that's how CLEAR works, so, have higher premium costs.

For motorcycles, the vast majority of their cost is based on injury claims, PIPP claims. And there is not a difference in PIPP claims amongst the different rate groups.

It doesn't matter if you're -- get injured on a thousand dollar ($1,000) motorcycle or a forty thousand dollar ($40,000) motorcycle, you're injured, and there doesn't seem to be distinction between the quantum of the injuries based on the value of the bike.

When we went -- historically there has been a fairly large difference in premiums, based on those rate groups that was in odds with the fact that most of the costs, injured costs, really don't depend on rate groups, so, we had an inequity there.

Now, several years ago when we were looking at very, very large required indicated rate increases for motorcycles, in the area of 100 percent required increases; it didn't really matter that the low valued ones needed 150 percent and the higher valued ones needed 80 percent increase.

They were all very deficient. So we moved them up in concert because we were capped at the 15 percent experience increases. Once we got to a certain level - and this happened maybe three (3) years ago - it got to the point where the high value motorcycles were paying their share and the low valued motorcycles were not.

So at that point in time, we have endeavoured to increase the lower valued rate groups more significantly and leave the higher ones alone. So if you can visualize a rate line that slopes upwards with the rate being low rate for the low valued motorcycles and a high rate for the high value, we're tipping that rate line, pivoting it from the top, so to speak, to bring the lower rate groups up and leave the higher rate groups alone.

MS. CANDACE EVERARD: And Mr. Palmer,

it's that adjustment that's reflected at the table on page 12 of SM4.3?

MR. DON PALMER: That's correct.

MS. CANDACE EVERARD: If I can now refer you to question 54 asked by the Board in the first round, which is not in the book of documents, and just ask you to review the question and answer for the record.

(BRIEF PAUSE)

MR. DON PALMER: I have it.

MS. CANDACE EVERARD: Can you review the response for the record, please?

MR. DON PALMER: The response is:

"Assuming that current target differentials remain in effect at a maximum 20 percent increase for vehicle, the increases by insurance year end rate group would be as follows: For 2008 rate group 0 with have a 12.6 percent increase; rate group 1 would have a 3.2 percent increase; and rate group 2 and above would have a 0 percent increase. For the following year, 2009, rate group 0

would see a 5.2 percent increase; and
rate group 1 and 2 and above would see
0. And in 2010 the rate group 0 would
see a 1.3 percent increase and the
other rate groups would see 0."

By that time the transition to the new rate line is complete.

MS. CANDACE EVERARD: Is the Corporation aware of any new initiatives undertaken by the Insurance Bureau of Canada with respect to the rate group tables for motorcycles and if so, can someone elaborate on those initiatives and the Corporation's plans in that regard?

MR. DON PALMER: There have been no new initiatives by the Insurance Bureau of Canada for motorcycle rates.

MS. CANDACE EVERARD: Next, can someone provide a summary of the progress that's been made on the definition of sport bike classification?

MR. DON PALMER: We have gone through our sport bike definitions, our list of vehicles that were defined as sport bikes and with the assistance of members of the CMMG have done a complete study and identified -- I don't remember the exact number but I think a hundred and forty (140) different models that were formerly classified as sport bikes that we are now putting into our motorcycle "Other" category; remove them from the sport bike category to -- and they're not -- or so they're not subject to sport bike rates.

So that -- that has been completed.

MS. CANDACE EVERARD: So can you then provide an overview or a summary of the approach that's being used for rating sport bikes as opposed to other motorcycles and is there a differential there?

MR. DON PALMER: Yes. Yes, there is. What -- what we've done -- now that we've redefined the classification, we have included this sport bike as a separate category when we calculate the -- the rates and from that, treat it the same way as we would any other different insurance use and we have calculated the rates accordingly based on that.

And there are much larger rate -- rate increases indicated for sport bikes. We have judgmentally dampened them and have applied for a greater increase in sport bikes than we have in other types of motorcycles.

MS. CANDACE EVERARD: I'll just have a couple of questions then on loss transfer with reference to the Order of the Board last year 97/05 and if you could, please, characterize what the impact has been of the loss transfer change pursuant to that Order and the implementation of the -- or how the implementation of the new cost attribution rules has been.

MR. DON PALMER: The main effect was to lower the required rate increase for motorcycles, increase the required rate increase for commercial vehicles and the other ones were largely unchanged.

As far as implementation we -- we did write a -- a program, an algorithm to -- to re-state our -- our data for rate-making purpose. We -- we haven't changed our data, our claims data base, that remains as it did before, but we have restated all the claims in our four (4) rate-making purposes with some challenges.

As I had identified last year, data was -- the -- the cost allocation methodology that was ordered by the Public Utilities Board was one that we hadn't really contemplated when we built our databases, so, there was a -- a fair amount of data cleaning that was required, a lot of manual effort to look at claims and a lot of testing that was done.

We did ask for our internal audit department to come in and -- and test all our claims costs to make sure that the allocation was done correctly.

We had identified some places within the data that, within the strictest context of the Board

Order, there wasn't sufficient data within the claim file to actually -- or within the electronic file to allocate it according to the Board Order.

We have had a couple of fixes to our database in order to accomplish that. As we were looking at the data one thing that we found, there was -- it was pointed out a couple of years ago that there seemed to be a very large change in the number of single vehicle accidents on motorcycles from 1999 to 2000 when we implemented our current claims administration system.

What we have found is that some of the coding that was done prior to the implementation of CARS was -- was incorrect and we have adjusted that data accordingly.

But overall, the data, that we now have as our rate-making data, I think, fully reflects the Order of 97/05.

MS. CANDACE EVERARD: Thank you, Mr. Palmer. I just have one (1) further question on this issue.

The Corporation has indicated that it would consider extending the loss transfer order to all costs and there's reference in AI-21, which is the PIPP cost allocation study, that the Corporation would be updating the Board.

So could someone just provide a status on that issue?

MR. DON PALMER: Currently, we haven't undergone that study or -- or that consideration. I can tell you that, based on the amount of effort that was required for the injury claims, there's probably ten (10) times as many collision files. I can tell you that it would be a monumental task to go through the same effort that we went through on our injury claims for collision claims.

I can also tell you that one of the conclusions that we had in our -- in our report for the last loss transfer hearing some eighteen (18) months ago, was if we were to implement loss transfer on a, sort of, a piecemeal basis there would be major inequities.

We don't have loss -- rate groups on a loss transfer basis for collision costs. So, given that IBC is not looking at re-calculating or re-stating their rate group tables, I think that that's problematic.

So, right now -- we haven't undergone the study. It's pending and there's no definite timetable as to when that would be completed.

MS. CANDACE EVERARD: Mr. Chairman, I'd be embarking on a new area if we were to continue, so, I'd ask for your guidance as to whether it's your intention that I do that or whether you want to break for the day.

THE CHAIRPERSON: I think we'll embark again tomorrow. Thank you very much, Ms. Everard. Thank you all.

(WITNESS PANEL RETIRES)

--- Upon adjourning at 4:11 p.m.

Certified Correct,

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Wendy Warnock, Ms.