MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE
2006 INSURANCE RATES

Before Board Panel:

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

HELD AT:

Public Utilities Board
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APPEARANCES

Walter Saranchuk	)Board Counsel
Candace Everard	)
Kevin McCulloch	)Manitoba Public Insurance
Raymond Oakes	)CMMG
Byron Williams	)CAC/MSOS
Nick Roberts	)Manitoba Used Car Dealers Association
Michael Mager (np)	)CAA
Pam Shaw	)
Margaret Scurfield (np)	)IBAM
Robert Dawson (np)	)CBA/MBA
Claudio Sousa (np)	)Scootering Manitoba
Richard Loiselle (np)	)

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--- Upon commencing at 9:08 a.m.

THE CHAIRPERSON: Good morning, everyone. Hope you enjoyed Thanksgiving.

Before we begin our second week of deliberations, we've been reflecting, and we have a few questions that we want to ask MPI, that they can take under advisement for a response later. But to provide them an opportunity to respond I thought it was better to let them know at this time.

I have six (6) questions basically. I'll go through them slowly.

The first one would be to please provide a complete list of the functions of DVL, with an indication as to the functions that relate to road safety and related insurance matters, and those that relate to the Province's income stream, arising out of DVL functions.

The second question is, please indicate if there are functions that are not scheduled or intended to be reviewed in the upcoming business process review.

It may be helpful to the Board to obtain the terms of reference or the scope of review pertaining to the review of the business process review.

The third thing, changing topics, was please provide an historical summary as of the end of each MPI fiscal year, back to inception, I imagine, it's as easy as anything else, listing the gross written premiums for basic in respect of fiscal years, the RSLR balance at the end of that fiscal year, and the net income or loss for basic in the subsequent fiscal year. We're interested in forecasting in this.

And the fourth question is, please provide for each of the last five (5) fiscal years, the net impact on the provision for unpaid claims of the annual actuarial review, and separately, the net adjustments arising out of the annual audit.

We're attempting to gain a fuller appreciation of the potential variability of results from year to year, forecast to forecast.

The fifth was please provide a preliminary assessment on the anticipated income of the Board's loss transfer decision on the actuarially indicated average premium for motorcycles, scooters, mopeds and dealer plate vehicles, i.e., whether MPI anticipates the decision when fully reflected, will increase, decrease or do nothing for the average premiums for these vehicle categories.

We understand that you're recasting an analysis of experience that's not finished. And we're only looking for an indication of direction if it's possible.

And finally, and yet another topic, please indicate MPI's assessments of its obligations arising -- obligations, if any, arising out of the Sustainable Development Act. We would find that helpful.

And now we'll switch to Mr. Williams, I believe your witness, Mr. Todd, is first up today?

MR. BYRON WILLIAMS: Yes, and we'll ask Mr. Barron perhaps to have him sworn.

THE CHAIRPERSON: Of course. Mr. Barron...?

JOHN TODD, Sworn

THE CHAIRPERSON: Thank you, Mr. Barron.

Mr. Williams...?

EXAMINATION-IN-CHIEF BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Mr. Chairman, Mr. Todd's testified before the Public Utilities Board on many occasions for a variety of utilities, but for some of the newer Members of the Board he -- I'm not sure that he has testified before them, so I'm just going to ask him -- Mr. Todd, to briefly outline your qualifications for the Board.

(VOIR DIRE COMMENCED)

MR. JOHN TODD: I think I've met all the gentlemen on the Panel before, they've met me, across the room.

Economic regulation has been my field for thirty (30) years. I established a consulting business in 1980, twenty-five (25) years ago.

Since 1990 in particular, most of my work has been with -- in relation to regulatory proceedings, such as this one (1), with work in natural gas, electricity, telecom and auto insurance. I think that the Public Utility Board of Manitoba has seen me in all four (4) of those capacities, including telecom, because this goes back to the days when telecom was regulated by this Board.

In total, I've been involved in about a hundred and seventy-five (175) proceedings, preparing evidence in about sixty-five (65).

Current clients include regulated utilities across Canada, BC, Terasen, and -- and ICBC, Ontario, Hydro 1, OBG, Enbridge, Union Gas and out in the East Coast NB Power, for example, as well as many other stakeholders in regulated industries; producers such as in Canada, regulators such as the Ontario Energy Board, and so on.

As Mr. Williams mentioned, I've given evidence before this proceeding, or this -- this Panel on a number of occasions. And in particular there were, I think it was three (3) times, that I gave evidence dealing with the RSR of MPI, first in 1998, in relation to the 1999 MPR -- MPI/GRA. Some of that evidence is recapped in my evidence filed in this proceeding, although that evidence basically summarized decisions of the Board over the years.

MR. BYRON WILLIAMS: Mr. Chairman, subject to any comments or objections raised by other parties, I'd ask that Mr. Todd be qualified as an expert in the theory and practice of economic regulation, noting his particular experience with issues related to the Rate Stabilization Reserve of MPI?

THE CHAIRPERSON: Mr. McCulloch, do you have any problems?

MR. KEVIN MCCULLOCH: No, Mr. Chairman.

THE CHAIRPERSON: Do any of the other Intervenors present have a problem? Very good, Mr. Williams.

(VOIR DIRE CONCLUDED)

EXAMINATION-IN-CHIEF BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Mr. Todd, I'd refer you to evidence dated September 12th, 2005, prepared on behalf of CAC/MSOS, titled, Comments of John Todd on MPI's Rate Stabil -- Rate Stabilization Reserve and Related Issue.

I take it you have that evidence, sir?

MR. JOHN TODD: Yes, I do.

MR. BYRON WILLIAMS: And can you confirm that the written material was prepared under your direction and control, and is accurate to the best of your knowledge and belief?

MR. JOHN TODD: Yes.

MR. BYRON WILLIAMS: Mr. Todd, I wonder if you can briefly summarize the highlights of that evidence for the benefit of the Board?

MR. JOHN TODD: I was asked to address four (4) issues, those are set out on page 3 of the evidence. Just to be sure everybody understands where I'm going I'll just read those -- the four (4) issues as they're stated.

"1. Comment on the methodology used to establish the RSR target for rate setting purposes.

2. Comment on the RSR target range

that would be consistent with the recommended methodology.

3. Comment on the appropriateness of using an appropriation of RSR funds to fund the Immobilizer Incentive Fund, the IIF.

And fourth, look at the appropriateness of including OFSI's MCT as a component in determining the appropriate target range for the RSR."

And, right away, I have to retract my comment because that's written as "OFSI" and obviously it should be written as "OSFI". My fingers are sometimes -- get mixed up.

These issues are policy issues. As policy issues there's not an analytic right or wrong answer. It's a matter of what's appropriate in the particular context and the decision you're making. And when I look at policy issues as an analyst my starting point is, what are you trying to accomplish?

And analytically you can say if you're trying to accomplish a particular goal here's the way you achieve that goal. The approaches are driven by the goals. And, therefore, all of my comments are premised on my understanding of the goals.

For that reason, I want to be clear -- make it clear to you what my understanding of the purposes of the RSR, the target range, the IIF and the MCT, what those purposes are and how they all fit together.

Starting with the purpose of the RSR, there appears to be no dispute over what the role of the RSR is all about. In the final section of my evidence which is Implications For the 2006 GRA Issues, starting at page 33, I quote MPI's statement for the purpose of the RSR which, in the current application, reads:

> "The basic insurance rate stabilization reserve relates to basic compulsory automobile insurance and is intended to protect motorists from rate increases made necessary by unexpected events and losses arising from non-recurring events or factors."

I agree with that and I believe all parties agree with that and that wording, or very close to that wording, has been used and has been the touchstone for many years.

In practical terms, what exactly does that mean? What exactly are we talking about? Let's be clear on that and certainly clear on my understanding of what that means.

In practical terms it means that the RSR is going to pre-collect from policyholders some money to put into reserve so that in the event of negative circumstances the company's response does not have to be a sudden and large rate increase, it can be a gradual recovery from an unfortunate event.

If we go right back to the beginning of this whole issue, to the ARC (phonetic) report, the wording was:

> "I also accept the advice that MPIC should accumulate the surplus in order to provide a cushion against massive rate shocks occasioned by unforeseen events."

Clearly the issue is not the ability of the company to carry on business. The issue is what you're going to do with rates. So, it's to mitigate the rate impact in response to unforeseen events.

Unforeseen events or variances from actual always mean that MPI is inadvertently overcharging or undercharging its policyholders. The point is, when you set rates the intention is that you will collect from customers exactly what the costs of claims and -- and the claims themselves, the cost of operations. The intention is to set rates to exactly recover those costs. Nobody's got perfect foresight, therefore the rates are not perfect.

If actual costs turn out to be higher than the revenues generated, that means you've under collected. Sorry, did I say that right. If the rates are higher than what the actual costs are you've over collected. If the rates are below what the actual costs are, then you've under collected.

Now, in other contexts, such as in natural gas and electricity, which you regulate, often what's done is you use a deferral account. Simply, say that there's something that we want to pass through exactly to customers, we don't have it forecast exactly, so we're going to take that variance. We're going to put it into the deferral account.

We're going to collect it from customers the next year or if there's an over collection we're going to give it back next year. It's a mechanism that is used in regular -- for regulatory purposes, to ensure that costs exactly equal revenues.

That could, in theory, be done for MPI. But when you go back and look at the history, if we had a deferral account, some of those variances are so large that you'd end up with huge rate impacts to dispose of those variances through a deferral account methodology.

The RSR is simply replacement for a deferral account which says, instead of waiting for something to happen, we're going to pre-collect some money from policy holders, put it into reserve, so that if we get hit with a bad year we don't have to come in with a 5 or 10 percent rate increase to pay for last year.

That's -- I mean that's all we're doing here, pre-collecting, so we can smooth rate impacts. So the RSR is a safety margin.

The policy issue is how quickly do you want to make up for cases where there's undercharging, and when I say undercharging, I mean it's totally inadvertent, it's simply that as it turns out in retrospect we should have been charging more, and as a result the company's suffered a loss in a year.

To cover that you're over collecting from customers deliberately, that's why you had an RSR surcharge for four (4) years, deliberate over collection from customers to put some money aside so you could treat them in a more gentle manner in the event of a poor year.

That RSR has also been built up in addition to through the surcharge, through good luck, conservatism, whatever -- whatever you may view it as, which has meant that the company has -- has current -- got more in revenue than it actually recovered. In effect, inadvertently it was over charging them for many years, and that over charging flowed into the RSR.

So, put simply, by analogy we could say the RSR is there because we're sitting with a double barrelled shotgun and we don't want to have to shoot both barrels. We want to be sure that we're in a position to just fire one (1) barrel, not two (2) in the event of a bad year.

The important part of that is also what it's not. It's not to ensure that MPI has the capability to meet its obligations to pay claims. It's not -- it's not similar to the private sector insurer, that cannot raise rates if it runs into a bad year because of competition. It's not there because there are customers, where if the company has a solvency problem, those customers will come to the insurer with claims and they won't get paid. That's what the private sector is all about -- private sector regulation is all about. That's what OSFI is all about.

It's saying there are people out there -- OSFI's saying, we're a regulator, we're protecting customers, we're protecting the people of Canada, so that when they make a claim they'll get paid. That's a very different issue than the issue you're dealing with. And so I understand the purpose of the RSR. Rename it, do it for a different purpose, a whole different approach may be appropriate. But that's not what the history of the RSR is.

Now, we don't just have an RSR, we have a target range, a top end and a bottom end. What's the purpose of having a target range. The target range sets trigger points. We have two (2) trigger points.

At the bottom end, we've a trigger point that says, here's the trigger that determines when we go to the customers with an RSR surcharge, when we're going to ask them, intentionally, for more dollars than the costs that are going to be incurred.

That's the cost for the bottom end of the target range.

The top end of the target range has a purpose as well. That's the point where you have a trigger for a surplus dividend.

Now, we've seen in the past, there's been years, when there's been a surcharge. There's been one (1) year where there's a surplus dividend. These are real, meaningful triggers, these are not concepts; that's the purpose of the target range.

So we want to set the target range

appropriately, given those purposes of the RSR in Manitoba.

How do we set it? This is when you get to the first question that I was specifically asked to address. Sorry for the long introduction.

First question was: what's the methodology? Well, that's the methodology of saying, how do we determine what those trigger points are?

The approach that has been approved by the Board quantifies the relevant risks, it says here's how many dollars that are reasonable to expect in terms of variances due to the unforeseen events that are being covered and we're deliberately setting a level of risk, 95 percent or 97.5 percent, a risk that relates to the probability that the RSR will go below zero (0).

Now, implicit in that, you're saying it's possible and it's permissible that the RSR will go below zero (0), even at 95.7 percent probability that you're safe, there's still a 2.5 percent chance you'll go below zero (0).

It's a very small chance, but there's a chance. The consequences of going below zero (0) is not that claims don't get paid. The consequence is a larger rate increase to get the company back above zero (0).

That is why you're willing to tolerate

some risk of going below zero (0), because what you're dealing with as a consequence, is a rate increase, not insolvency, not failure to pay claims.

And what this Board has looked at over the years, and what this Board has decided over the years, is the appropriate trade off between how much do you pre-collect from customers and put into the RSR both through deliberate and through the luck of the way yours turn out, how much do you pre-collect and put into reserve and hold in that reserve, in order to avoid future rate increases?

All you're doing is trading off earlier rate increases to give you smoothing versus late rate increases. It's all timing, including from a customer's perspective, they're willing to pay something for rate stability in the future, but are they prepared to pay an unlimited amount for that?

Is there some point which they say, I've paid enough for that?

So the policy issue you're facing is -- is what's the reasonable trade off in that pre-collection versus rate stability.

To do that, my view has been over the years, and the view of the Board has been over the years, you want to quantify it specifically.

And the specific rules, if you want, are laid out in the Decisions -- pre- Board Decisions over the years, which are summarized in my evidence and I won't go back through those.

So what about the target range? The target range is driven by those purposes. The target range using that specific quantitative methodology, says here's how low we're prepared to go and feel that we have sufficient cushion, even at the bottom end of the range, we have sufficient cushion in those reserves so that we're not going to have to introduce an excessive rate increase.

Or, if we do, the probability's low enough that we accept that probability as a reasonable amount to have as protection.

And at the upper range, it says at some trigger point at the top end of the range, we're saying it's time to take some of that over-collected dollars and return it to ratepayers.

How much is enough protection against future rate increases?

Now, I think the -- the Board has set out a method very clearly. And it has said, very clearly, to the company, if you think the dollars are wrong -- the target range is wrong, go back, do your quantification and give us an updated risk analysis.

The concept is, it's based on risk. If you think our numbers are wrong, bring in a new risk analysis show us the numbers are wrong and we'll consider it and we'll move the range up or down according to your new risk assessment, assuming the Board accepts that risk assessment.

Given the methodologies that have been approved by the Board which are consistent with the approach that I've recommended over the years, I did, as you saw in the evidence, a quick calculation producing round numbers that said if you take the old range of 50 to 80 million and increase it by inflation, as was an approach approved by the Board, it now, since the point in time that inflation adjustment was brought into play, in round numbers, we're talking a range of 55 to 90 million.

Again, I was just rounding their $5 million because there doesn't seem to be much point to being much more precise than that.

And, again, that, of course, is still subject to a new risk assessment in terms of my recommendation of what would be appropriate. And when I give a target range and simply saying applying the approved methodology here's what the numbers would come out to be.

In reviewing the transcript, I point out that I've interpreted inflation as being a CPI type of inflation. I think that others have interpreted that as perhaps the -- the increase in the scale of the company's business.

So obviously that number depends on -- on how you interpret the concept of inflation in the context of MPI and the RSR.

The third question related to the Immobilizer Incentive Fund. Had a little difficulty getting my head around what was being done here. I try to understand things through analogies. And I'll try to reduce it to -- to the way I got my head around it, for whatever it's worth to the Board.

It seems to me that essentially what the company's saying is they think it's appropriate to make an investment. They want to invest in the Immobilizer Incentive Fund. They're going to invest $40 million.

They're anticipating a payback for that of 80 million. If they're right, that's a good investment. Now, I'm not here to evaluate that as a -- as a -- as a good plan or not; that's not my expertise. I'm here to comment on the treatment of it and the linkage to the RSR.

So if it's an investment, say, well, investments are things like, say, investment in IT. You go and you put money into a computer system and sometimes you pay somebody to develop a new computer system and it doesn't work.

Similar to spending the 40 million in the Immobilizer Incentive Fund and instead of the payback being eighty (80) it's only twenty (20) or zero (0). I cannot recall any case where reserves were set aside to cover the downside of an IT investment. It's an investment just like any other investment.

The company -- the company invested in road safety and -- and loss prevention other -- other programs which sometimes required dollars up front where the benefit is seen down the road in the future. We don't set up reserves for that.

What do we set up reserves for? We set up reserves for things like pension reserves. You know, in effect, if you've got pension liabilities you may set that aside and it reduces retained earnings.

But a pension reserve, it's not an investment. It's an obligation. We have to pay out these pensions. It's an estimate but it's not something that you pay it out in the hope of getting -- getting a -- a return on that investment. It's just a liability.

So, you know, I look at it and I say, okay, the Immobilizer Incentive Fund may be a great thing to do as an investment and that's what it's being brought forward as. And I have difficulty getting my head around why you take some money out of the RSR to fund this, given that it's investment as opposed to a liability.

But at the same time I recognize it's a policy issue. Given the purpose of the IIF versus the purpose of the RSR, it seems to me the important thing is the IIF should not change the trigger points on the RF -- on the RSR. In other words, because the company went ahead with the IIF, it should not mean that a surcharge is introduced in 2008, but it wouldn't otherwise have been introduced.

That would mean that the funds were used for something unrelated to the RSR, and caused a surcharge, in effect change -- change your trigger point, and I can't see in terms of when I look at what the purpose of the RSR is for, I can't see why the IIF should change the targets and change the trigger points for the RSR.

So if the trigger points can be held whole, from the perspective of what I'm talking about, the RSR in this Proceeding, I don't care what the company does. Just don't introduce a surcharge because of the

IIF. And don't delay a dividend, because of the IIF. They're totally different things.

Turning to the MCT, which is often referred to as a solvency test, what's that really mean? What's the real purpose? Well, as I alluded to earlier, it's your -- we're talking about policy holders with a solvency test.

OSFI is not there as a regulator to protect shareholders in insurance companies that are shareholder owned. They're there to protect the people who have policies, the policy holders.

The purpose for their tests is to say we want to be sure that the companies that we regulate are able to pay the claims of the customers. Somebody doesn't pay for insurance, ends up getting nothing for it, simple as that.

The reason why MPI is not regulated by OSFI, cause it doesn't have to be, it's a Crown Corporation, it's a monopoly.

The chances of -- of it not paying on claims because of solvency issues, is essentially non-existent. The government that owns it would not allow that to happen.

So, is it appropriate to use the MCT as the trigger point for a surcharge, and to use that as a basis of trigger point for repayment, rebate to customers? No, it's not clear, you know, there's no linkage between that and the purpose of the RSR, it's a different purpose.

Now, if the purpose for reserves, and let's not call it an RSR, let's call it reserves. The purpose for reserves is something quite different, and other Crown Corporation auto insurance companies such as ICBC, have different purposes for their reserves, they take a different approach.

Other companies do not have trigger points for surcharges. Other companies do not have trigger points for rebates. Other companies are looking at the MCT, but not to decide when to impose a surcharge, they're looking at as -- looking at it as a discipline on the operation of the company, not for an RSR, for a different purpose.

Now, if MPI were in saying as a matter of policy, we want to have the purpose of reserves a totally different purpose, or the Government came in and said in future there's going to be a different purpose for MPI's reserves, it may be a -- it'd be appropriate to look at a test as appropriate for the different purpose.

My understanding of the purpose of MPI's RSR is that it is to establish trigger points for surcharges and rebates. For that purpose the methodology that the PUB has approved over the years, in my view, is a very good match.

Those are my comments on the four (4) areas and I'm open to any questions.

MR. LEN EVANS: Thank you, Mr. Todd for a very interesting presentation and I did read your report -- your study.

MR. JOHN TODD: I'm glad. Thank you.

MR. LEN EVANS: There is a -- there's another factor and just talking generally here and that's investment income. You talk about rates and stability of the company and so on, but in the case of MPI, at least, investment income is a very important factor in determining -- well, in determining the bottomline and in making decisions.

And I'm wondering if you'd like to comment on that?

MR. JOHN TODD: Yes. And that has been woven into the discussion of the RSR, not from the beginning but in the latter years, including years when I presented evidence on it.

The -- the value-at-risk approach was used to look at incorporating the risk related to the investment portfolio into the overall risk analysis because it's a variance which -- which can affect things.

And what the variance-at-risk analysis suggested was that if you look over a three (3) year period the risk was essentially zero. Now, within a year there's a risk.

What I don't know is how this Board would respond to a single year in which there was a very bad performance from a investment perspective. If, for example, there was a $50 million loss on investments in one (1) year, which is part of the normal fluctuations, would this Board impose a surcharge if it drove that that the -- the RSR below the lower end of the target range?

If that is the case, you should probably be using a one (1) year value-at-risk. My understanding, and certainly my take on why the three (3) year value-at-risk, which suggests essentially no risk at all, or two (2) is that because of the cycle of the hearing process by the time you get the results from one (1) year, go through a hearing in the subsequent year, get into a new rate year, you're talking at least two (2) years anyway before you respond.

Therefore, if you've had a hit -- a -- a Black Monday as some of us with the grey hair certainly have experienced, by the time you respond through the regulatory process you have seen a lot of recovery from that given the quantitative analytic assessment of value-at-risk -- of the impact on portfolios.

Therefore, what the -- what the PUB has done is it's -- it has said to the company, give us the risk analysis including your assessment of the risk related to your investment portfolio and we will take that into account.

It has said, we're not going to take that into account in exactly the same way as some of the other risks. It's not, sort of, a formulaic approach. It said give it to us information and we can take that into -- into account in determining what the appropriate target is at a given point in time.

And my understanding of the way they've applied that, as I say is -- is using the multi-year value-at-risk for the reasons I just mentioned. And so it is -- it is taken -- allowed to be taken into account and if there's a change in that risk the company has been invited to bring forward an updated value-at-risk analysis or -- or something else.

But it would be specifically related to the potential hit to the company. That has been complicated by some changes in GAP which are coming through. But as the company has said, those changes will have -- have the mark-to-market approach, but have no impact for rate setting purposes and so on. It will have no impact on net income. Therefore, that change, and I understand why from a policy perception it's been put aside.

So we're back to realized gains. Those are elements of judgment to be applied by the Board but I agree with the Board's decisions in the past that that information should be on the table when it sets the rate target for June.

Now, is that -- is that too wishy-washy an answer to the question? I mean, it's -- it's relevant, the Board has -- the Board has said it's relevant, but it's not formulaic.

MR. LEN EVANS: Just as a followup, speaking from a great deal of ignorance on my part, I still have a lot to learn about insurance rates, but I gather you're stating, categorically, that the minimum capital test, the MCT, just doesn't apply to a publicly-owned crown corporation which is almost guaranteed to continue to exist by the Government -- by the Provincial Government in this case.

And that it's just -- it gives you -- it gives you a long -- well, in this case it would give you a wider range or larger range as I understand it. That it's just simply not appropriate.

MR. JOHN TODD: Actually, I'm going to clarify that because it's not that I'm saying it's inappropriate for a crown corporation. I'm saying it's inappropriate for the purposes of MPI's RSR.

There -- there are other Crown Corporation insurance companies that are in a different position. For example, the driver in the way they look at reserves may be the competitive side of the business because of the way the company is structured and because of the competitive marketplace.

You know, as an example, ICBC does not have collision insurance as part of its basic. So the competitive market is very different. The competitive market is all the coverage on collision. It's an integrated company, it approaches things differently.

It does not have the trigger points for surcharges and other crown corporation insurers don't have -- have a formula for coming in with surcharges or rebates.

What we're looking at is a policy question in the context of MPI. So I'm only saying, in this context, given the purposes of the RSR, it doesn't fit. What we need is analysis of what is going to happen to rates.

We're not trying to drive rates that are -

- create a competitive level playing field. We're not trying to provide -- we're not trying to simulate a private sector company. We're not trying to give them costs which say we want you to price yourself like a private sector company.

And other Crown Companies, and let's go beyond insurance, some Crown Companies are specifically set up and specifically have a goal to operate like a private sector company, generate profits and return them to the coffers of the government. It's an investment that they made.

And directives come down from the government to the companies and to the regulators to say, set rates as if it's a private sector company. We don't want the lowest rates possible. We want them to generate money. We want them to be on a level playing field with competitors and we want them to generate profits to keep taxes down.

But that's a different purpose than the RSR. Again, I'm sorry for the long-winded answer but you need a clear distinction between the issue is not crown corporation the issue is the purpose of the RSR.

MR. LEN EVANS: Thank you. That's very useful. I don't know whether it's fair or not but I wonder if you could -- you mentioned ICBC, but what about

Saskatchewan Government Insurance; how do they compare with Manitoba?

I gather they continue to use the risk analysis approach, but I may be wrong. But I -- I suspect they operate a little more closely to MPI than does ICBC.

MR. JOHN TODD: And I have not looked at these companies in -- in detail for a comparison. My understanding of the -- in Saskatchewan is that there's -- there's a separation of the monopoly and the competitive sides, that is part of a larger entity which is a competitive insurer and that the MCT type approach, the whole OSFI type approach is applied to the competitive side, it's not applied to the basic monopoly side.

And so on the purely monopoly side it would be more analogous to MPI.

There's all -- in all of these jurisdictions, any time you have a crown corporation, and I'm sure you're familiar with it with Manitoba Hydro, and its subsidiaries like Manitoba, the policy, the politics of it, it's one (1) of the factors. And in each jurisdiction obviously it's different and therefore it is done differently, depending on Government policy.

Saskatchewan's is closer I think than --

than BC, from that political policy perspective, but
still different than Manitoba.

MR. LEN EVANS: Yes, and thank you. But briefly, are they using MCT or Risk Analysis?

MR. JOHN TODD: My understanding is they're using MCT for the competitive side only in Saskatchewan.

THE CHAIRPERSON: Thank you, Mr. Evans.

Mr. Todd, who stands behind the private insurance in ensuring claims pay out in case of an insurance company insolvency?

MR. JOHN TODD: In the case of a shareholder company, in a sense the shareholder, the owner stands behind it, but of course the -- the essence of an incorporated business is limited liability, and therefore beyond the equity invested in the company, nobody stands behind it.

THE CHAIRPERSON: If a chartered bank fails there's the Canadian Deposit Insurance Corporation, I just want to put on the record, you're saying that there's no such body stands behind P&C companies?

MR. JOHN TODD: As a -- no, I mean, as a -- as a backer of the company, there's nothing. In fact I'm not -- I'm not sure of the answer to that question, but I can check that.

THE CHAIRPERSON: The other -- another general question. You were talking about the Immobilizer Fund, and you'd accept that MPI's a not for profit corporation?

MR. JOHN TODD: Yes.

THE CHAIRPERSON: Under the CICA GAAP rules, I don't know what your experience is, but have you noted that many not for profits have a number of various segregations within their retained earnings?

MR. JOHN TODD: The -- first of all, I'm not an accountant, so any question I give is not an accountant's response to the question, and I just look at it in the regulatory context. And, yes, there can be -- there can be separations.

And it would be -- the question is, do you want -- should you have reserves for this particular item. I'm not saying it's wrong to have reserves. What I -- my -- my point was that if you set up a reserve, do you do it in a way that changes the trigger points for a surcharge?

I mean, my simple bottom line is they're accountable to the people of Manitoba. If a surcharge is required in two (2) years -- two (2) years down the road or three (3) years down the road or something like that, do you go to them and say, you're going to have to pay an extra 2 percent on your rates as a surcharge because we took $40 million and put it into the IIF?

It's a policy answer. I mean, I -- I can't say what's right or wrong there. And your policy decision on that is legitimate, whatever it is, because you are -- you are the ones that are accountable for making the policy decisions.

THE CHAIRPERSON: Thank you, Mr. Todd, we'll move now to MPI and Mr. McCulloch.

MR. KEVIN MCCULLOCH: Yes, Mr. Chairman, I can indicate at the outset that I'm ready to commence my cross-examination, but before I close it I'm going to need a brief recess in order to consult with my clients, as Mr. Dawson would say.

And I think that it'll probably be around the time when -- when the Board would be considering a break in any event, but just a heads up that I will need that -- that time.

THE CHAIRPERSON: That's fine, Mr. McCulloch, you'll have no problem with us.

CROSS-EXAMINATION BY MR. KEVIN MCCULLOCH:

MR. KEVIN MCCULLOCH: Mr. Todd, before getting into cross-examination, there's -- there's a couple of things I'd like to clear up from your direct evidence this morning.

First of all, you were quoting from your own evidence in which you deal with the findings of the Automobile Review Commission, which -- back in 1988, which we often refer to as the Kopstein Report, because it was headed by -- by Judge Robert Kopstein.

And I understood you, when reading from page 33 of your evidence, near the bottom line or near the bottom of the page, rather, when you're quoting from the ARC Report, you quoted saying:

> "I also accept the advice that MPIC should accumulate the surplus in order to provide cushion against massive rate shocks, occasioned by unforeseen losses."

And I understood, when you read that this morning, you used the word, or the words, "unforeseen events".

If, in fact, you did say "unforeseen events", am I correct in assuming that you meant to say, "unforeseen losses"?

MR. JOHN TODD: You are correct. I should have read what was in the -- yeah, the quote in the evidence.

MR. KEVIN MCCULLOCH: Thank you. The

other item that I wanted to -- to deal with, is you talked about the purpose for the RSR in ICBC, and I'm not sure whether they just call it retained earnings or -- or call it RSR, and I understood you to say that -- that the purpose of ICBC's RSR was different from the stated person -- purpose of MPI's RSR; is that correct?

MR. JOHN TODD: My understanding is that ICBC did use the term Rate Stabilization Reserve in the past. It does not -- it has not used that within the regulated context, as I'm sure you know.

ICBC first came under regulation two (2) years ago, and it's reserve and the -- an Act has been introduced in the past and partly enacted, setting up a new structure. And as far as I'm aware, in the new Act, there's nothing that creates an RSR equivalent to -- to Manitoba's.

MR. KEVIN MCCULLOCH: Yeah, really my question, Mr. Todd, was more aimed at whether they call it retained earnings or they call it RSR, I would suggest to you that the purpose of ICBC's retained earnings is almost identical to that of MPI and not at all different.

And in that regard, I would refer you to Tab 6 of Mr. Williams' documents. And if you look at the final page in Tab 6, under the heading of Retained Earnings, the statement in the annual report reads:

"Retained earnings are required to
provide the ability to absorb
unexpected, significant losses and to
maintain a stable rate environment for
ICBC's customers."

Do you agree with me, sir, that that's the stated purpose of ICBC's retained earnings?

MR. JOHN TODD: That's the stated purpose in the -- the document, yes.

MR. KEVIN MCCULLOCH: And would you also not agree with me that that is very close to the stated purpose for MPI's Rate Stabilization Reserve?

MR. JOHN TODD: Yes.

MR. KEVIN MCCULLOCH: Thank you. Now, could you refresh my memory, please, Mr. Todd, and when was the last time that you appeared as a witness before this Board as part of the MPI General Rate Application?

MR. JOHN TODD: I'd have to check the CV notes; three (3) years ago. Three (3) years ago, you've probably checked it and you can probably tell me.

MR. KEVIN MCCULLOCH: No, as a matter of fact I hadn't, that's why I was hoping you might remember. But --

MR. JOHN TODD: The years go by awfully fast, I must confess.

MR. KEVIN MCCULLOCH: So, you would say three (3) or four (4) years ago since you appeared as a witness?

MR. JOHN TODD: I appeared in '90 -- well, in '98 for the '99 case, in '99, in 2000, I think in 2001. So, just -- yeah, say four (4) years, give or take.

MR. KEVIN MCCULLOCH: Also in looking at the report that you've prepared and on which formed the basis of your evidence today, you indicated that you were going to address four (4) points and you've listed those to the Board and I'm not going to repeat that. But, you also indicated in your report that you were going to address these points largely by looking back at evidence from previous rate applications; is that correct?

MR. JOHN TODD: Primarily looking back at past decisions. Taking the decisions, in effect, as -- as precedents for what is being done.

MR. KEVIN MCCULLOCH: Right. And in fact, not that I count pages, but out of the thirty-seven (37) pages in your report, thirty-two (32) of them are spent reviewing previous history and previous Board rulings; that's correct, isn't it?

MR. JOHN TODD: It sounds like you did count pages. Yes.

MR. KEVIN MCCULLOCH: Now, I wondered, have you had an opportunity to review the evidence prefiled by Mr. Galenzoski at pages 4 and 5 when he talks about the risks that the Corporation sees as a basis for revisiting the RSR target?

MR. JOHN TODD: Yes. And those are set out in the introduction to my evidence on page 1.

MR. KEVIN MCCULLOCH: And do you take issue with the fact that these risks do exist for MPI?

MR. JOHN TODD: Well, if I have read the transcript of the evidence to date correctly, I think the company was -- and Mr. Galenzoski was -- was very clear that these are not new risks, but they are old risks where the quantity has changed; they've increased.

MR. KEVIN MCCULLOCH: Right. The --

MR. JOHN TODD: I think that's very clear. And I do not contest that they may well have and which is why I've indicated that the Board has invited the company in the past to bring forward a new risk analysis which provides the new quantities and so there's a mechanism for dealing with that in the existing approved methodology.

MR. KEVIN MCCULLOCH: So, you'd agree with me then that in his evidence Mr. Galenzoski is not bringing these items forward as new risks but is bringing them forward as a change in the magnitude of the risk; is that a fair assessment?

MR. JOHN TODD: Well, that's what he's on record as saying and I don't -- don't accept what he has to say about those risks. He didn't bring forward the quantification of them.

But that's -- that's what he's saying and I accept what he says.

MR. KEVIN MCCULLOCH: There are certainly in the evidence filed at page 4 and 5 calculation of what impact changes in these risks will have on the Corporation's bottomline; is that not correct?

MR. JOHN TODD: Well, that's precisely my point is that there's -- what -- my understanding of the company's evidence is that these are changes which have impacts which can be quantified and, therefore, they can be fully addressed in the existing methodology by bringing forward an updated risk analysis.

And if that is done, not only would the item by item impacts be quantified but the issues of co-relation, all the other issues around the quantification of risk can all be addressed in the same package to determine what the appropriate level of the RSR is.

It's totally consistent, what was foreseen, talking about foreseen and unforeseens, this issue was foreseen by the Board and it was part of their past decisions.

I don't see why the past decision aren't, therefore, being followed.

MR. KEVIN MCCULLOCH: Now, Mr. Todd, just to get it right and get it straight, I wasn't asking you whether you agreed with the Corporation's means of addressing the change in magnitude, I was asking you whether, on the record and the evidence provided by MPI they have demonstrated a change in the magnitude of the risk?

Staying away from the present for the -- for the way in which that's addressed.

MR. JOHN TODD: They have made a strong case that some of the individual risks have changed. They have not quantified what that means for the RSR target range using the approved RSR target range methodology, i.e., building in things like the co-relation and so on.

MR. KEVIN MCCULLOCH: Now, Mr. Todd, you're familiar, are you, with the MCT test or score that forms the basis of OSFI's direction to the P&C companies that it regulates?

MR. JOHN TODD: Familiar with, as in the context of being a regulatory economist and from my perspective, I mean not as an accountant and so on, but, yes, I have looked at it.

MR. KEVIN MCCULLOCH: And I understand that the MCT is a point in time calculation that produces a -- a figure that shows the minimum capital required for a company at that point in time?

MR. JOHN TODD: Yes, it's a calculation, and if you go to the OSFI website there's -- there's worksheets and the rules of how you'd go through the calculation and you'd run through a calculation at a point in time. Like it's analogous to a financial statement and end report at a point in time calculation.

MR. KEVIN MCCULLOCH: And based on the definition of MCT from OSFI' website, they describe the test as a guideline that outlines the capital framework using a risk based formula for minimum capital required, so it is a risk based formula, would you not agree?

MR. JOHN TODD: I agree, for its purpose it definitely is. That's -- that's what insurance is all about, you know, here for this purpose, in the case of OSFI for their purpose, it's all assessing risks. That's the business.

MR. KEVIN MCCULLOCH: And just -- and we'll be coming back to -- to MCT at a later point, but at this point I understand and would you agree with me, that there's been evidence before the Board that the OSFI standard requires 150 percent of the MCT score, as a minimum capital requirement; is that correct?

MR. JOHN TODD: That's correct.

MR. KEVIN MCCULLOCH: There's also been evidence before this Board that the industry average in the private P&C industry is 224 percent of MCT, would you dispute that?

MR. JOHN TODD: No, and I didn't do the exact calculations, but looking at the data on the OSFI site, that would appear to be all right.

MR. KEVIN MCCULLOCH: And I'm correct, am I not, in stating that all private P&C insurers in Canada are required to comply with the OSFI MCT test?

MR. JOHN TODD: That's correct.

MR. KEVIN MCCULLOCH: And some companies, I understand, carry even more than the industry average of 224 percent. I guess if -- if you've got an average it means that some are going to be higher and some are going to be lower; is that correct?

MR. JOHN TODD: I was about to say, from what I know about averages, that would have to be the case.

MR. KEVIN MCCULLOCH: Yeah. And in fact, just for interest, a company that Mr. Williams referred to in his cross-examination of the MPI Panel, Wawanesa Mutual Insurance Company, on their website, indicates that as of quarter four (4) of 2004, they held 370 percent MCT as a reserve, and in quarter two (2) 2005, they held 388.7 percent of their MCT score as a reserve.

Do you have any reason to dispute those figures?

MR. JOHN TODD: I would not dare dispute figures produced by legal counsel, from my side, and though it is -- has been pointed I believe that they are a mutual fund company, but not a shareholder owned company, which does affect the behaviour somewhat.

MR. KEVIN MCCULLOCH: Now, if all of the P&C companies, private P&C companies in Canada are applying the MCT standard, would you agree with me that that would qualify as best practices for the P&C industry?

MR. JOHN TODD: I would ask best practice for what? It's not a best practices for -- as a trigger point for applying a surcharge, because the rest of the sector cannot impose a surcharge, it's for a different purpose.

And I don't deny that, and in fact, I would -- I would wholeheartedly agree that for the -- the industry that are regulated by OSFI, operating in a competitive industry, that is you know, mandatory practice. I mean, I wouldn't even call it best practice, it's far beyond that, it's a mandatory practice, which makes it better than best.

MR. KEVIN MCCULLOCH: So if it's mandatory, your -- your evidence would be then that it's beyond the best practice?

MR. JOHN TODD: It's in the context of where it is used. It is a regulatory requirement that is a protection for the policyholder to ensure their claims get paid.

And they -- it has evolved over the years to provide increased protection as the federal regulator sees fit, just as they've evolved regulation of the banks and trust companies and so on, to protect depositors in those industries; that's their job.

But it doesn't mean -- doesn't mean that it is a correct approach for other purposes. It's a correct approach for those purposes.

MR. KEVIN MCCULLOCH: I don't recall asking you whether it was a correct approach. I was trying to get on the record, as I believe I now have, that this would certainly, at least, qualify as best practice in the PNC industry for private companies?

MR. JOHN TODD: Put with those words,

yes.

MR. KEVIN MCCULLOCH: I want to deal, for a few minutes here, with some comments that you made about trigger points and trigger points don't form a basis for setting RSR here at MPI or anywhere else, do they?

MR. JOHN TODD: No, I said those -- that's the implication of it. When you set -- the purpose of having a target range is you are defining -- in essence, you are defining two (2) trigger points.

MR. KEVIN MCCULLOCH: Yes, but the -- the -- the range is set to adequately reflect the risks that the company faces. The trigger points, one being the need for a surcharge and one being the need for a surplus dividend, merely flow logically from that range; isn't that correct?

(BRIEF PAUSE)

MR. JOHN TODD: It is -- I'm not quite sure of the distinction but, yes, it flows largely from that range. But what you're doing -- I mean, I'm a very practical person.

You know, I take a look and say, okay, this is not something esoteric. We're not setting up something that's purely conceptual.

We're setting up that has implications and when I design something that's practical, I look at what it's going to do.

If I'm going to design a light switch, and my original background's electrical engineering, what I'm going to think about is, does it turn the light on?

You know the consequences of this is -- is are we going to impose a surcharge at the right time? Are we going to give a rebate at the right time?

And that's the policy question that has to be addressed.

MR. KEVIN MCCULLOCH: But surely the first question is, is the reserve sufficient to protect policyholders from unexpected or unplanned losses and the fact that you have a range, by implication, the rebuild or the dividend will flow from that?

MR. JOHN TODD: In the absence of an RSR target range, the de facto would probably be zero (0), as the lower end of the range.

And it has been determined in history, going back twenty (20) years, that at zero (0) the response is too extreme.

Therefore we need something higher and all I'm saying to the Board is -- is that what we're doing when you're setting up the target range, defining the bottom end of it, is setting up at what point do we start going back to customers asking for more dollars?

You have to have that end purpose in mind when you define the method for calculating the target range. I don't think we're disagreeing; maybe there's some semantics -- semantical differences here, but.

MR. KEVIN MCCULLOCH: One other item I wanted to clear up, you were asked a question about what would happen if a private insurer went -- was insolvent and unable to pay claims.

Are you familiar with the organization, the Property and Casualty Insurance Compensation Corporation?

MR. JOHN TODD: I'm not familiar with the details of it. I've seen things kicked in the past. My understanding from OSFI is they have -- you go below the target range, they step in. Various consequences can result.

This particular mechanism, I don't know the details of it.

MR. KEVIN MCCULLOCH: Yeah, well then perhaps just for the record, I should read to you their mission statement, again, from their website. They say:

"The mission of the property and

casualty insurance compensation
corporation is to protect eligible
policyholders from undue financial loss
in the event that a member insurer
becomes insolvent."

So does that assist you in the question that was posed by one of the Panel Members as to what would happen if a P&C insurer was unable to meet the policy payments that were due or claims under its policies.

MR. JOHN TODD: In my understanding of that backing is industry funded and is -- is -- is private. And, therefore, the level of risks affect the funding of the Corporation and it all interplays as, shall we say, multiple mechanisms is my understanding of the way it works.

And that part of the protection is protection against claims on that body. Just as similar organizations exist for, well, deposit insurance is -- is federal. It's government backed. But for travel and so on, there are similar funds.

MR. KEVIN MCCULLOCH: Are you aware that all members of the P&C industry, all insurance companies involved in the P&C industry in Canada are required to be members of PACIC?

MR. JOHN TODD: Yeah, which means making contributions to protect the industry. Yes.

MR. KEVIN MCCULLOCH: I want to deal with the history, if I can, of the retained earnings calculation at MPI and it's dealt with in -- in your report. The first stage, as I understand it, dealt with the Autopac Review Commission, the Kopstein Report, back in 1988.

And the recommendation of that Commission was that MPI set up a reserve equal to 15 percent of premiums with action to be taken if that reserve falls below 10 percent which would trigger a re-bill or goes above 20 percent which would trigger a surplus dividend; is that your understanding of the Kopstein recommendation?

MR. JOHN TODD: Yeah, that's Recommendation 7.11. I -- I don't -- I don't recall and it's not part of the quote, that they said over 20 percent means there will be a rebate.

But that may have been the direction. They may have been silent on what would happen when they go to 20 percent.

MR. KEVIN MCCULLOCH: Right. They didn't use the word rebate, they used the phrase "action to be taken"; would that be more correct?

MR. JOHN TODD: Yes. I mean, my quote says "expected to take remedial action" is the exact wording.

MR. KEVIN MCCULLOCH: And if you're over the posted limit of your RSR "remedial action" in most instance would probably be a surplus dividend; wouldn't you agree?

MR. JOHN TODD: Well, in the case of the proceedings in recent years, there's been debate about whether it would be a surplus dividend or setting rates to not recover full costs. There's a number of mechanisms that could be used. They have different implications.

This Board has chosen, for good reasons, to go the route of a dividend rebate.

MR. KEVIN MCCULLOCH: Now, at the time, in 1988, are you aware of what the OSFI test for mandatory reserves was?

MR. JOHN TODD: I think that is in evidence somewhere but the detail escapes me. Certainly it was not the current standard.

MR. KEVIN MCCULLOCH: No. Could I suggest to you, sir, that in 1988 the required reserve level required by OSFI was 33 percent of premiums; does that jog your memory?

MR. JOHN TODD: Yes. In fact, I do recall reading that, I think it was a little before Thanksgiving dinner.

MR. KEVIN MCCULLOCH: And would you agree with me, sir, that what Judge Kopstein did was to take that 33 percent test and modify it to fit MPI's needs as he saw them in 1988 and his findings stated that MPI didn't need the 33 percent that the industry required, but rather he felt 15 percent would be sufficient?

MR. JOHN TODD: First of all, I don't know what he felt or how he came to his conclusion and my recollection of what I read from the company's evidence was that, in effect, that -- that's what he's done.

And, in retrospect, I would agree that those -- the numbers coincide with that. Whether that was his rationale, I have no idea.

MR. KEVIN MCCULLOCH: And you'd also agree with me, sir, that when Judge Kopstein was arriving at this recommendation back in 1988, MPI was not involved in the PIPP No Fault Injury Program, that only came into place in 1994; is that correct?

MR. JOHN TODD: Correct.

MR. KEVIN MCCULLOCH: And also, in 1988, the Corporation had no equity investments, all of its equity, or sorry, all of its investment portfolio was in bonds; is that correct?

MR. JOHN TODD: That's correct.

MR. KEVIN MCCULLOCH: The next step in the evolution seemed to move to a range based on unpaid claims, and I'm talking in about the -- the 1998 time frame.

Do you recall that as being one (1) of the proposals put forward by the Corporation as a means of calculating the appropriate RSR?

MR. JOHN TODD: Yes. And as you mentioned in the direction of this line of questioning that it's parallelling the evidence, what's laid out in my evidence.

MR. KEVIN MCCULLOCH: The third iteration was the risk analysis that you have talked about. And again, this was a forma -- formula rather, or a format that was introduced by the Corporation, included a -- a risk analysis, and a -- an investment analysis called the variation at risk, I believe, value at risk?

MR. JOHN TODD: Value risk, yes.

MR. KEVIN MCCULLOCH: Yeah. And --

MR. JOHN TODD: The value at risk was introduced perhaps in the third year of talking about the quantitative analysis, it was -- it evolved over a period of years, the -- the analysis, the risk analysis evolved over a period of years.

MR. KEVIN MCCULLOCH: And part of that evolution included significant challenges that you raised to approaches taken by MPI, for example, issues of perfect versus imperfect correlation and the confidence levels, these were all factors that were the subject of much evidence and -- and debate in those years; is that correct?

MR. JOHN TODD: I was simply pointing out to the company methods of risk analysis that it uses in its insurance business, in setting insurance rates. It does not add the risks that are faced by all those customers that come up with the aggregate risk for all its customers. There's collation issues in affect there.

I was just pointing out basic principles of statistical analysis. I don't know there's -- that there's huge fundamental -- there's difference in methodology, what we were just talking about is what is the correct application of statistical techniques in assessing risk.

MR. KEVIN MCCULLOCH: And there were also issues in those days as to whether operating expenses ought to be included in the calculation; isn't that correct?

MR. JOHN TODD: The way you refer to,

"those days," it sort of sounds like I must have had black hair back then, but it wasn't that long ago and we were both -- looked much like we look right now a few years ago.

MR. KEVIN MCCULLOCH: In any event, I think that's a yes, isn't it?

MR. JOHN TODD: Yeah.

MR. KEVIN MCCULLOCH: Now you're also aware, are you not, sir, that the MCT standard, the Minimal Capital Test introduced by OSFI was initially introduced in 2002, almost as a pilot or -- or as a test case, and was made mandatory in 2003; is -- is that correct?

MR. JOHN TODD: Yes. It was phased into affect, yes.

MR. KEVIN MCCULLOCH: And talking once again about the risk analysis and the value at risk, are you aware of any other insurer, either private or public, that uses that approach in establishing an RSR requirement?

MR. JOHN TODD: Well, first of all, other companies do not have Rate Stabilization Reserves, by and large. Most of the Rate Stabilization Reserves that I'm familiar with are with Crown Corporations, and they cut across industries.

I mean, obviously, it only -- it's only meaningful where you've got a monopoly and you can impose a surcharge, you know, impose higher rates where you can stabilize your rates, as opposed to go with the market price.

So you're talking a monopoly situation, plus regulators, they seem to apply to Crown Corporations, though conceptually there's no reason it would be limited to Crown Corporations.

So when you say nobody else does it, the only other auto insurance use of the RSR concept explicitly, is in the past ICBC and as a more limited sense with -- in Saskatchewan.

MR. KEVIN MCCULLOCH: Perhaps, sir, I should have asked you, were you aware of any insurer other than MPI, that used the risk analysis and the value at risk approach, to assess capital requirements?

MR. JOHN TODD: No.

MR. KEVIN MCCULLOCH: And it's quoted liberally throughout the first thirty-two (32) pages of your report, but would you agree with me, sir, that MPI's stated purpose for having a Rate Stabilization Reserve has not changed over the years?

MR. JOHN TODD: That's correct, it hasn't changed.

(BRIEF PAUSE)

MR. KEVIN MCCULLOCH: Would you also agree with me, Mr. Todd, that the Rate Stabilization Reserve is really only one (1) component of a Corporation's entire retained earnings?

(BRIEF PAUSE)

MR. JOHN TODD: It may be, depends on how the company defines it. My understanding is that MPI has essentially equated the two, but there are other examples in the past where there is a separate Rate Stabilization Reserve that has its own funding mechanism, has its -- has its purpose and other reserves may have other purposes.

MR. KEVIN MCCULLOCH: And there's evidence before this Board that in 1991, the Board of Directors of MPI approved the establishment of a catastrophe reserve out of retained earnings, separate and apart from the RSR.

Were you familiar with that?

MR. JOHN TODD: I read that evidence, yes.

(BRIEF PAUSE)

MR. KEVIN MCCULLOCH: You're also aware from the evidence that, for the past number of years, the Corporation has established the principle that the prime funding of the Rate Stabilization Reserve will come from surplus retained earnings of the extension and the SRE lines of business; are you aware of that?

MR. JOHN TODD: I'm aware of that statement. I'm not sure how we can know that in advance. I mean, certainly, the expectation would be that it would, because the expectation if the company is setting its rates correctly, is that there will be, on average, zero contribution from basic, because it should be breaking even.

So, by definition, all of the money that's building it should be coming from other sources.

Of course, we've seen in the past that it doesn't always equal zero and depending on what years you take, it may or may not.

So what will happen over some fixed period of time in the future is -- is uncertain, but unless there is a -- a tendency for conservatism within the company, I would have to agree that, by definition, the expectation is that most of the money will come from other sources.

MR. KEVIN MCCULLOCH: But more than by definition, are you aware that there has been evidence past, or brought rather, before this Board that the MPI Board of Directors has passed a Motion directing that any excess in retained earnings from the two (2) private, non-regulated lines of business will flow through to the Rate Stabilization Reserve?

MR. JOHN TODD: Yes, I'm aware of that.

MR. KEVIN MCCULLOCH: Now, I may have some -- I will have some other questions on the Immobilizer Fund, but you are aware that the Corporation has designated the Immobilizer Fund as -- this is the $40 million dollars, as a separate component of retained earnings and that's how it appears on the financial statements that have been provided to the Board?

MR. JOHN TODD: Yes. As I understand the -- the Board of Directors Motion which was passed unanimously, it was, I believe that Motion used the words, "appropriation from the RSR."

If you put all that aside and simply say there is a breaking down of the reserves into two (2) components, that's -- that's the end result, yes.

MR. KEVIN MCCULLOCH: So you're saying that the way the Board has structured it, there's a breaking down of retained earnings into two (2) reserves, the basic Rate Stabilization Reserve and the Immobilizer Fund?

MR. JOHN TODD: Yes. And I think -- I think there's -- there's two (2) issues that, in effect, are before the Board here. One is -- really three (3) issues. One is, is the Immobilizer incentive fund a good thing to do; as far as I'm concerned, from per -- my evidence assume yes because it's not my issue.

Second, is it appropriate to have a reserve for it? My comments in direct suggested I don't get it but maybe I'm just missing something.

And then the third issue is, if you are going to reserve for it, how is it funded? Do you, in effect, have an appropriation from the RSR which is a -- a lump of money which includes money that is there because of past contributions through a surcharge, through overpayments from customers as well as from transfers from extension and -- and SRE specifically as contributions to that RSR.

It is not -- it is not, for example, the result of a additional contribution from extension and SRE that is above and beyond the otherwise mandated contributions we made from those areas to the basic RSR.

That would have been a different way of

funding it. The company chose not to do it that way. It could have been just done through, like any other investment, through a capital -- treating it as an expenditure. They chose not to do it that way either.

MR. KEVIN MCCULLOCH: Speaking about the Immobilizer project, sir, are you familiar with the magnitude of the automobile theft problem in Manitoba, and particularly in Winnipeg?

MR. JOHN TODD: Through reading the company's evidence I'm familiar with -- with it, which is part of the justification for why this program is being undertaken. And, I mean, I have not assessed it. But on the surface, just having read over it, particularly given that it's going to cost 40 million to save 80 million, looks like a good business decision to me.

MR. KEVIN MCCULLOCH: So you'd agree then that the potential for long-term financial benefits to all ratepayers and including ratepayers of basic insurance is a strong possibility if the program is successful?

MR. JOHN TODD: Absolutely. Which brings us back to the discussion that I believe was between the Chairman and Mr. Galenzoski around, you know, are you being optimistic or pessimistic.

If you'll -- if that's the case why do we have a reserve? The concern is that it may not pay off because you won't get a high enough participation level. So a reserve is set up as -- as a way to, in effect, fund the failure to succeed and recover the cost of the program.

It seems to me that standard business practice would be, certainly if you were confident of your results, it would just be a capital investment like anything else. You spend today, you get benefits tomorrow. That goes in as a capital investment, not as a reserve.

And that was one of the points I made in -- in direct. It may all be well and good. We're just talking about different accounting techniques and as a regulatory person, not an accountant, I'm just, sort of, saying for regulatory purposes, which ultimately means for rate setting purposes; what makes sense to the Board?

MR. KEVIN MCCULLOCH: I want to move back to the question of MCT. In your report at page 37 you make the statement that:

> "The MCT is not a recognized method for determining the risk related to variances from forecast for a Crown Corporation."

Is that correct?

MR. JOHN TODD: That's correct.

MR. KEVIN MCCULLOCH: And you spoke a bit in your direct evidence about ICBC and I believe you indicated that that's a Corporation, an organization, that -- that you have done work for?

MR. JOHN TODD: That's correct. On financial allocation issues.

MR. KEVIN MCCULLOCH: And it's my understanding that not only does ICBC apply the MCT standard but they apply it differently to their competitive lines of business and their basic line of business; is that correct?

MR. JOHN TODD: That was the directive of their owner, the BC Government, yes.

MR. KEVIN MCCULLOCH: And the direction is that for the basic program, ICBC is to maintain a reserve or retained earnings, equal to 100 percent MCT; is that correct?

MR. JOHN TODD: That's Directive IC-2, yes.

MR. KEVIN MCCULLOCH: And the other directive of IC-2 is that for their competitive lines of business, they're to maintain reserves based on 200 percent of MCT?

MR. JOHN TODD: If I recall correctly,

200 percent is overall, and it's...

(BRIEF PAUSE)

MR. JOHN TODD: Okay, there's -- there's three (3) numbers, there's a -- there's a basic, competitive and which they call optional, and overall in reading that, yeah, it's two hundred (200) for the -- I guess my memory's wrong, it's two hundred (200) for the optional.

MR. KEVIN MCCULLOCH: Right, and the overall corporate is a 110 percent when you combine those two (2), allowing for the differences in the -- the size of the basic program and the extension program?

MR. JOHN TODD: Yes, but a weighted average of the two (2) does not come out to one ten (110), it's -- it's an overall if they vary, yeah.

MR. KEVIN MCCULLOCH: But those are their numbers?

MR. JOHN TODD: Those are the numbers, yes.

MR. KEVIN MCCULLOCH: Are you also familiar with the methodology by which the Manitoba Workers' Compensation Board sets its retained earnings?

MR. JOHN TODD: No, I'm not.

MR. KEVIN MCCULLOCH: Reading from the --

MR. BYRON WILLIAMS: Mr. McCulloch, if -- if he's not familiar, if you want to put it to him, that's fine. Sounds like you're giving some evidence here, so if you want to share it, I've been fairly lenient so far today, just share it with him and then -- then put it to him.

MR. KEVIN MCCULLOCH: I'm going to put it to him through a CMMG Response of 1-4.

CONTINUED BY MR. KEVIN MCCULLOCH:

MR. KEVIN MCCULLOCH: And perhaps we could provide you with a copy of that.

(BRIEF PAUSE)

THE CHAIRPERSON: This could take a minute I imagine, to copy and circulate. Maybe we could take our break now.

MR. KEVIN MCCULLOCH: Fine, Mr. Chairman.

THE CHAIRPERSON: Thank you.

--- Upon recessing at 10:37 a.m.

--- Upon resuming at 11:02 a.m.

THE CHAIRPERSON: Okay, Mr. McCulloch...?

MR. KEVIN MCCULLOCH: Yes, Mr. Chairman. Before I get back into the cross, and guided by a comment from Mr. Williams over the break, I did put a question to Mr. Todd about the PACIC mission statement based on a publication from their website and I wondered if -- if I might file that as an exhibit to clarify what was being said?

THE CHAIRPERSON: We'd find it helpful. Thank you.

MR. KEVIN MCCULLOCH: Thank you. I believe that would be MPI/PUB-21?

THE CHAIRPERSON: That's fine, subject to check.

--- EXHIBIT NO. MPI-22: PACIC mission statement.

MR. KEVIN MCCULLOCH: The other item that I wanted to put to Mr. Todd related to evidence before the Board in response to Information Request CMMG/MPI-I-4 and I have extra copies of that. That's already in as an exhibit, but for -- for reference in a few questions I'm going to put to Mr. Todd on that, I could distribute that to members as well.

THE CHAIRPERSON: Yes, please.

(BRIEF PAUSE)

THE CHAIRPERSON: Okay, we have it, Mr. McCulloch.

MR. KEVIN MCCULLOCH: Thank you, Mr. Chairman.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: Mr. Chairman, sorry to interrupt, Mr. McCulloch, just in conversation with Mr. Todd, in terms of his evidence we were just recalling an e-mail that apparently he got last night. And my computer crashed this morning, so I didn't receive it, but there are some -- some changes or errata in terms of his footnotes that will -- we don't have right before us.

We'll probably bring back to the Board's attention, so just so I don't forget, I've --

THE CHAIRPERSON: Very good.

MR. BYRON WILLIAMS: -- we've identified a few minor tech -- errors in the footnote.

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

CONTINUED BY MR. KEVIN MCCULLOCH:

MR. KEVIN MCCULLOCH: There goes three (3) pages of cross-examination on the footnotes, Mr. Chairman.

Mr. Todd, looking at the response to CMMG/MPI-I-4, and this is in the context of discussion that I had started with you before the break, on the position of Workers' Compensation Board.

That response indicates that the Workers' Compensation Board of Manitoba applies an OSFI formula, the minimum contributing capital and surplus requirements rules from OSFI to set its target for retained earnings and it shows that as of December of '04 WCB held a reserve -- a retained earnings rather, of $161.9 million and their premium revenue for the same time period was $177.9 million.

You'd agree with me that that is almost a 90 percent reserve to premium?

MR. JOHN TODD: That appears to be the case.

MR. KEVIN MCCULLOCH: And you'd agree with me that the Workers' Compensation Board is a Crown agency here in Manitoba that is not subject to OSFI regulation?

MR. JOHN TODD: I accept that.

MR. KEVIN MCCULLOCH: Moving on to --
THE CHAIRPERSON: Mr. McCulloch, just in balance to do with the WCB, are you aware whether Workers' Compensation has any reinsurance?
MR. KEVIN MCCULLOCH: Not that I'm aware of Mr. Chair.
THE CHAIRPERSON: Thank you.
MR. WALTER SARANCHUK: Also, just one other point, if I could make the observation, the last exhibit probably should be number 22.
THE CHAIRPERSON: Thank you, Mr. Saranchuk.
MR. WALTER SARANCHUK: I'm sorry. Because there was a reinsurance undertaking marked as 21, so I think the last one is 22.
MR. KEVIN MCCULLOCH: That's fine. Thank you, Mr. Chairman.

CONTINUED BY MR. KEVIN MCCULLOCH:
MR. KEVIN MCCULLOCH: Mr. Todd, going back to the MCT, I believe you're -- you're aware that the evidence before this Board is that the Corporation is, and through its Board of Directors, has set its retained earnings target at 100 percent of MCT?
MR. JOHN TODD: That's my understanding.

Yes.

MR. KEVIN MCCULLOCH: That's the RSR target, sorry. Now --

MR. JOHN TODD: There did seem to be some discussion around the difference between retained earnings and RSR but, essentially, the same thing as I understand it, was Mr. Galenzoski's words.

MR. KEVIN MCCULLOCH: Now, again from the information and the evidence that's been put on the record, the MCT is a test for calculating a company's minimum capital requirement; is that correct?

MR. JOHN TODD: Yes, the minimum capital test sets the minimum capital requirement from a regulatory perspective.

MR. KEVIN MCCULLOCH: And once the test has been applied to a particular company the regulator then sets -- or sorry, not before an individual company, but once the test has been promulgated, the regulator then sets the standard; is that correct?

And in this case the standard is 150 percent of MCT?

MR. JOHN TODD: The regulator sets the test. You know, on the website it lays out all the rules. It lays the standard, yes.

MR. KEVIN MCCULLOCH: But you'd agree

with me, sir, that there is a difference between the test and the standard that the regulator determines is the appropriate requirement?

MR. JOHN TODD: Yes, they are distinct.

MR. KEVIN MCCULLOCH: So there may be value in a test even though the organization is not bound by the standard set by the regulator?

MR. JOHN TODD: Yes.

MR. KEVIN MCCULLOCH: The other item, and the last item, I wanted to discuss with you was the comment I believe you made with respect to the Immobilizer Fund. And as I understood it you were suggesting that the Corporation could choose to treat this fund something like an investment in a computer system?

MR. JOHN TODD: I'd indicated agreement with some of the discussion in the transcript from earlier in the proceeding that a number of accounting treatments would have been possible and this particular one is what the company chose.

I did set out an analogy that, you know, a computer expenditure is -- is similar in the sense that, number 1, dollars would be spent this year, depending on what you're spending it on, the benefit to justify that expenditure would occur in later years, and there's some uncertainty as to what those benefits would be.

MR. KEVIN MCCULLOCH: But you'd agree with me, sir, that if you were dealing with an investment in a computer system, you would expect at the end of the day to have an asset as a result of that investment?

MR. JOHN TODD: You would expect to have an asset at the end of the day, but you would benefit -- the asset may have no actual commercial value. Firstly, un -- unfortunately, I suppose, I've been through a number of hearings where computer systems were being looked at, where they ended up with something that didn't work, and the computer system had no value and tens of millions of dollars were written off.

Secondly, many applications, the type of application I was referring to would be something which is company specific, so it would have no, you know, resale value or it's not an asset they could dispose of. The only value it has is the value of reduced costs in the operations of the companies. An updated billing system, for example, which would reduce costs.

So it's analogous in that way, in that you are investing in order to save, in that case operating costs, you know, here it's an investment which is in reducing claims costs.

MR. KEVIN MCCULLOCH: Then perhaps we

should use the analogy of an investment in a building, in that case you would have an investment, and once the investment was paid off, you would have an asset, a building?

MR. JOHN TODD: That would be different to both the computer system I was thinking of, and -- and the -- the IIF, in that if you have a building, yes, I agree, you'd have a physical asset which would be saleable, it would have a market value, as opposed to something which is hopefully reducing operating costs.

MR. KEVIN MCCULLOCH: Well, I appreciate your distinction that in -- in the investment in a computer system, you may not end up with an asset, but on the other hand we are dealing with a system, or a payment here, where there is no possibility of the Corporation ending up with an asset. The money is going out to people to buy an immobilizer to put in their car; isn't that correct?

MR. JOHN TODD: Yes, and but my -- my point was there are -- there are computer systems, which as I said, were designed for a particular company for them to use, where you make the investment knowing it's not going to have any -- any market value. You're -- you're doing it in order to save dollars. It's an investment in reducing your expenses, and that's the analogy I was trying to draw.

MR. KEVIN MCCULLOCH: Would you agree with me, sir, that the approach that the Corporation has taken to reporting from a financial point of view, reporting and handling the immobilizer fund, provides transparency and clarity to individuals reading the Corporation's financial statement?

MR. JOHN TODD: There is -- I -- well first of all, I think, as my comments around the IIF started off with is, I struggled to get my head around it, so it wasn't totally transparent for me to try to figure out the 40 million up front and what was being charged each year, and going back to the -- to the RSR, and so on and so forth.

What it does make transparent, it says we are planning to spend $40 million, if that's what you mean? You're saying here's -- here's what our program overall is, you know, it could have been said in a footnote, it's one (1) way to say, we're talking a $40 million program.

But the -- the financial statements going forward show how the $40 million will be drawn down, do they not?

MR. KEVIN MCCULLOCH: If I understand the accounting of it correctly, you are reducing the $40 million by expenditures to go, so it's sort of showing the -- the net that is outstanding, if you want. And I did think make the statement that says, you know, it's -- I'm having -- I was having trouble seeing why, that way, there's different accounting methodologies, you're fine as long as you're doing something according to GAAP then it's legitimate from an accounting perspective.

My main question to the Board was, should the IIF have an impact on the trigger points, in terms of when a surcharge comes in, would you -- would you want to end up going for surcharge, because you've got fewer dollars in the RSR, because those dollars got assigned to the IIF, especially if, this is investment and the money's coming back and it's all a matter of timing.

You know, it just seems, from an RSR perspective which is what I'm here about, it seemed, you know, I had trouble grasping why.

And I'm sure that, in final argument, the company will point exactly why and clarify my problems with that.

MR. KEVIN MCCULLOCH: Might I suggest to you, Mr. Todd, that the -- the way the Corporation has chosen to, in it's financial statements, account for this Immobilizer Fund, is analogous to the way in which the Board, years ago, directed the Corporation to show the rebuilding -- the RSR rebuilding premiums that were part of previous orders. The company was required to show that fund as a separate reporting line in the financial statements so that for transparency and clarity purposes, it was obvious to people how those funds were being accumulated for the RSR?

Wouldn't that be analogous to the way this Immobilizer Fund is being reported?

MR. JOHN TODD: I'm missing the analogy. You know, in that case what we're looking at was different sources of dollars for the purpose of the RSR. What I don't see here is the IIF having a purpose which is similar to the RSR.

Therefore I -- you know, to the extent that they're being mushed together, I don't get it. I mean, I would have thought greater clarity would be achieved by achieving -- maintaining greater separation from day 1, not taking the RSR and splitting it, but actually getting some separate funds.

But, as I say, it's a -- it's a judgment call, it's what's transparent and it's what the Board thinks makes sense, that matters.

The fact that I have trouble making sense of it, is not determinative of anything.

MR. KEVIN MCCULLOCH: Fine, I'll accept

that as your answer and that concludes my cross-examination, thank you.

THE CHAIRPERSON: Thank you, Mr. McCulloch. CMMG, Mr. Oakes...?

MR. RAYMOND OAKES: Thank you Mr. -- thank you, Mr. Chairman.

MR. WALTER SARANCHUK: Mr. Chairman, in terms of the order of cross-examination, I think it's Board Counsel.

THE CHAIRPERSON: Sorry?

MR. WALTER SARANCHUK: And then the Intervenors.

THE CHAIRPERSON: Okay. I'm -- Mr. Oakes, I think you can rest a bit longer there. Not to indicate that you're resting.

Mr. Saranchuk...?

CROSS-EXAMINATION BY MR. WALTER SARANCHUK:

MR. WALTER SARANCHUK: Thank you, sir.

In the first page of your documented evidence, Mr. Todd, you've referred to MPI's identification of various risk factors as considerations in increasing the required target RSR level; is that correct?

MR. JOHN TODD: That's correct.

MR. WALTER SARANCHUK: And those three (3) appear as bullet points on the first page of your document and without getting into them in detail, because they're there for all to read, but is it your evidence, sir, that whether individually or in their totality, these do not support a requested increase in the target RSR?

(BRIEF PAUSE)

MR. JOHN TODD: They do not, unless they are examined as part of an updated risk analysis which is the Board-approved methodology for addressing this kind of issue, an increase in the risk.

MR. WALTER SARANCHUK: So, effectively, what you're saying is there has to be closer examination through the risk analysis process?

MR. JOHN TODD: Exactly. Looking at the individual calculations piece by piece, does not tell you what the impact would be on the bottom line at risk analysis, and therefore the target range of the RSR.

'Cause it's -- you're going in the -- in the most simple terms, it's already been established by the Board that risks are not additive, so you can't just calculate these and add them on top of what we've got.

We don't know what the impact is without doing the full risk analysis.

MR. WALTER SARANCHUK: Thank you, sir. On page 8 of your documented evidence --

MR. JOHN TODD: Yes.

MR. WALTER SARANCHUK: You summarize the evidence you gave in 1999 relative to the purpose of the RSR and the differences and the consequences of the shortfall between a private and public insurer.

And, again, you have identified those there are two (2) bullet points there on that page. Can you elaborate on those differences, sir, and indicate whether you still agree that that is, indeed, the case?

In other words, do you agree with your prior evidence on that score?

MR. JOHN TODD: Firstly, yes, I do agree with my prior evidence from before. And the first bullet refers to a competitive private insurer. A shortfall can result in a company becoming insolvent and unable to increase its rates by enough to generate the funds needed to pay out the claims incurred.

So, the company would no longer be able to operate on a stand alone basis, is the point being made there. At which point somebody has to step in.

In the case of a monopoly public insurer, the case of MPI, because it is a monopoly, as I've seen in the past, its response to a difficult period is to raise its rates.

As it happens the mechanism used in this case was to impose an RSR surcharge. It can do that, it doesn't lose customers when it does that. It rebuilds reserves and it carries on with the fundamentals of its business uninterrupted.

MR. WALTER SARANCHUK: Thank you, sir.

At page 33 of your report, in the first paragraph you refer to the Automobile Review Commission Report and the appropriate RSR target and how it should be funding and how it should be used, you've indicated:

"Have been guided by a clear understanding of its purpose."

And then you indicate the three (3) purposes. For clarification, are the three (3) points your interpretation or are they from some other source?

MR. JOHN TODD: Those are not cited and quoted, those are -- that's my summary of my understanding.

MR. WALTER SARANCHUK: And can you comment on your view relative to each of them please?

In other words, as it relates to the stated RSR purpose?

MR. JOHN TODD: Those are almost mother and apple pie statements to me in terms of setting policy objectives. The RSR has a purpose, therefore, you would be setting the RSR target at a level that's adequate.

If you set it at a level that's more than adequate, then what you're doing is asking policyholders to contribute more dollars than necessary, which seems to be a pretty straightforward violation of a -- of a reasonable policy principle.

Clearly, it should be funded in a manner that's consistent with and furthers its purpose. Again, given the purpose you -- you fund it in a way -- you find your dollars in a way that's consistent with that purpose.

For example, you wouldn't want to fund it by imposing a 10 percent surcharge because the whole purpose is to stabilize rates. You wouldn't want to go from a zero surcharge to a 10 percent surcharge and create rate instability which would be contradicting the purpose.

And then it should be used in the manner consistent with its purpose. Saying -- so the dollars -- if -- if the reason why you've got policyholder money sitting in reserve is rate stabilization, I'm saying it should be used for rate stabilization.

As I say, it's sort of mother and apple pie logical implications, in my view, of the policy analysis.

MR. WALTER SARANCHUK: And at page 34 of your report, sir, you indicate two (2) bullet points as to what the RSR purpose is not. Now, are those your own opinions or are those from some other source?

MR. JOHN TODD: The words are mine. In each case, I provide an illustration of past Board decisions which, in my view, make the point that I'm stating, that they have made decisions which are consistent with that view of what they -- what is not, therefore.

So, for example, it's not to smooth rate increases in the face of forecast steep increases in costs. The Board makes specific decisions year after year, that when it's looking at risks, it's not looking at the rate of increase in costs, it's looking at variances from between the forecast and actual. So it's not to smooth increases.

The -- the Board has -- has directed that the RSR should not be used to enable the company to run a deficit on a forecast basis, it should be operating at break even, so that's all I'm saying here, which I think is fairly clear.

The purpose of the RSR is not -- it's the second bullet, is not to fund policies, programs or initiatives, other than unexpected losses. And again, that was an issue addressed a few years ago, and at least in one (1) particular case the Board indicated that the use should be limited to the RSR, although, in fact, I don't think it's the Board decision, I think the company changed its proposal in response to public issue. But that was endorsed in the Board Order.

MR. WALTER SARANCHUK: And further, on page 34, could you explain the methodology you used to determine your recommended RSR range, and could you also file your calculation by way of an undertaking?

MR. JOHN TODD: I will file -- I will file a calculation in support of that, I think what I did was -- given that we're dealing with round numbers, I took a 2 percent inflation rate, and I think I did my calculation in my head, so I can't file that, but I can reproduce it to get a ballpark for the increase to come up with the fifty-five (55) to ninety (90).

As I say, I was dealing with round numbers so I did not undertake a precise calculation.

MR. WALTER SARANCHUK: Would you suggest --

MR. JOHN TODD: What I did was used --

used inflation -- used CPI, a -- a rounded number for CPI to do the calculation, not to change, in the scale, the company's business.

MR. WALTER SARANCHUK: Is that a Manitoba specific CPI?

MR. JOHN TODD: No, I used a Canadian CPI. The differences are -- are small.

MR. WALTER SARANCHUK: Would you see any further refinements to your analysis?

MR. JOHN TODD: Well, I suppose -- I suppose one (1) could -- could use -- the Board could use a precise calculation. My point was, in terms of implementing the Board decision, it did not make sense to me that the Board decision would come up with the number like fifty three million five hundred and seventy-two thousand two hundred and sixty-five dollars ($53,572,265). You know, we're talking ranges, that's the way it's always been said in the past.

So the question is, and I'm just throwing this out to the Board as -- as indicative, probably fifty-five (55) is reflective of an inflationary increase at the bottom end of the range, and ninety (90) is roughly indicative of an increase in the top end of the range.

The Board may want to do a precise

calculation, inflating the old range for the years since it made that decision to include inflation, and come up with a calculation and take that number and use it precisely around it.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: So would this range then be in lieu of a risk analysis, or combined with a risk analysis?

MR. JOHN TODD: As I understand the -- the Board Order, and certainly my sense it would be reasonable, is that in the absence of an updated risk analysis you would use an inflationary increase as a -- as a way to avoid having to come in with the risk analysis every year, but to reflect the reality that -- that analysis -- that risks are changing from year to year, so it's -- it would be a proxy method, if you want.

Any time a risk analysis comes in, it would override that calculation, and simply say the target would be reset at the latest risk analysis numbers that are accepted by the Board.

MR. WALTER SARANCHUK: Given the risks that have been identified by the Corporation and the changes in their magnitude, is it your evidence that there ought to be a new risk analysis?

MR. JOHN TODD: Given -- given what the company has said about the impact of these changes, I would say, basically, show me, you know. Provide an analysis that -- that supports a change in the level.

The way -- the way the Board Order read, and I think it's appropriate is that the Company should have the opportunity to do that calculation; in effect, look at its risk analysis itself in -- on its own time outside of the hearing room. And if it determines that the impact is small, quantitatively, don't waste the Board's time with an updated risk analysis.

I wouldn't order them to do a risk analysis. We just know that they have the opportunity to do a risk analysis if they think it's going to have a significant impact.

They've chosen instead to come with a different approach.

MR. WALTER SARANCHUK: Which you maintain is inapplicable?

(BRIEF PAUSE)

MR. JOHN TODD: Well, for starters, the approach to -- going back to my initial comments, it's a policy question. If this Board says we want to use the MCT; other people are using it, Workers' Compensation are using it, we're going to do exactly what the Company said then by the Board's judgment, that makes it right, I accept that.

There's nothing -- I see no evidence that anything is wrong with the existing approved method that's been worked out over the years.

It measures exactly what you're trying to protect against in the case of MPI, with the RSR. The concerns the Company has put forward is that the risks have increased.

That, and what they're talking about, is the risk related to things that are recognized by the risk analysis. Therefore the logical response to that, is to say, let's come up with some new numbers using existing methodology.

Are we going to going through another five (5) year cycle with a new methodology, figuring out all of its tweaks, or are we going to take a methodology we've worked through for a number of years, and say we now have a methodology that's approved by the Board?

If you've got some increased risks, come in with the new numbers and we'll change the range, if justified.

I don't like doing unnecessary work, as my fifty-five (55) to eighty (80) said, you know, if you -- if you're going to end up with a round number, let's do a round calculation.

MR. WALTER SARANCHUK: Just in terms of the applicability -- the applicability of the MCT or the risk analysis, you've indicated that there's nothing wrong with the risk analysis.

Is there anything wrong with the MCT?

(BRIEF PAUSE)

MR. JOHN TODD: The MCT is -- has been developed for a very specific purpose which is not the purpose of the RSR.

That doesn't make it wrong, but if I was given a choice between a method that was developed for the specific purpose that I'm pursuing, or a method that was designed for some other purpose, my starting point would be the one that was designed for the express purpose that I'm using it for.

Now, by happenstance or by policy, perhaps the alternative is acceptable and in other jurisdictions, perhaps the real -- the real drivers of what's going on are different.

Perhaps it's pressure from the competitive market place that wants to see pressure and rates going up. Perhaps it's, as I mentioned, pressure to operate just like a private sector company and rates that reflect that.

Take a different -- different jurisdiction, different purposes and a different approach may be appropriate.

I'm taking my understanding of the approach here in Manitoba, which is to protect against large rate increases.

We have a mechanism that has been worked out through the years that at least at a level of principle the Company has always supported, even though it didn't support in a matter of detail; the quantitative approach. And we spent years working that out. We've got it, let's use it.

MR. WALTER SARANCHUK: Yes, and on page 36 of your report in the second boxed notation, if you will, you've indicated, quote:

"Adjusting for inflation for the four (4) years since the 2002 GRA, the appropriate RSR target range using round numbers could be set at $55 to $90 million for the 2006 rate year which commences March 1st, 2006." End of quote.

Why did you use the word 'could' as opposed to 'should'?

MR. JOHN TODD: Primarily because a full risk analysis could come up with totally different numbers and that would override.

MR. WALTER SARANCHUK: Thank you, sir.

At page 37 of your report you've stated that the:

"Immobilizer Fund should not be funded by drawing down the RSR."

But I take it that your evidence is that the initiative is a good one?

MR. JOHN TODD: I have no reason to object to the initiative. I -- I can't render an expert opinion on the initiative. I haven't looked at it from that perspective and that's not my expertise.

Based on the evidence the company is putting forward, as I indicated earlier, it looks, if, in fact, there's a potential for gaining 80 million for a $40 million investment that -- that sounds like a pretty good return. I'd -- I'd make that kind of investment in my business, I can tell you.

But I don't know whether that analysis

would stand up to scrutiny. That's another part of this hearing I -- I assume in terms of determining whether that is appropriate.

MR. WALTER SARANCHUK: So is it your main objection that the Corporation has allocated $40 million out of the RSR to fund that initiative?

MR. JOHN TODD: My message is -- there's two (2) parts to my message. 1 is, the proceeding with the IIF, from what I can tell, is in no way dependent upon funding it from the RSR.

If it is a cost-justified program you proceed with it and there's many different ways to account for it. Many different ways to notionally fund it. And that's where the computer system -- I mean, if you have a computer system that's going to save you money there's lots of ways -- you'll come up with -- you can come up with money to -- to pay for it. How you account for it is up to the accountants.

So, number 1, it's not necessary to do it this way.

Number 2, the primary impact of doing this seems to reduce the RSR and bring it down to a lower level that is less likely to trigger a refund.

I'm sure that's not the purpose. That's -- that's the -- the consequence. I don't understand, given the purpose of the IIF, which is essentially investment, I don't understand why the existence of that fund should be accounted for in a way that affects the -- either some future imposition of a surcharge or a rebate to customers because it's not related to the purpose of the RSR.

MR. WALTER SARANCHUK: Is there some specific funding arrangement that you had in mind?

MR. JOHN TODD: I -- I was asked to look at it from the perspective of its implication on the RSR. So, I guess I'm -- in effect, I'm saying, you know, I don't see it being -- why it's being done this way.

There are several -- probably several other ways to do it. What I've suggested is that -- and I think that as I read the transcript it's in everybody else's mind too, if you're investing $40 million from an $80 million return why would you need to have a reserve behind it when you don't have to have that for any other investment?

And I think the company's response is, because we could end up with no benefit from it and so we want to pre-allocate some dollars to cover off that risk. But, there doesn't have to be any reserve for it as investment.

Now, I caveat that comment with, I'm not the accountant. You could probably have ten (10) accounting methodologies put in front of you and the Board could choose whichever one they want.

The way I approach is from a policy perspective, what's the implication? And if the implication of this method is that it changes when the Board will have surcharges and rebates, that seems to raise questions about that particular method. There are lots of other ways of accounting for it that would be transparent, would let you see whether, in the long run, the company makes money or loses money on it.

If, in the end, they spend $40 million and only get $10 million of benefits, it's ultimately going to hit reserve for $30 million.

If they spend the forty (40) and they get $70 million in benefit, ultimately it's going to increase reserves by $30 million.

What this does is change the reserves in the interim, between when we start the program and when we finish the program, and therefore potentially affects the trigger points.

MR. WALTER SARANCHUK: You don't have to refer to this specifically, but just for reference purposes for the record. In the Corporation's response to question number 11, posed by the Public Utilities

Board in the Second Round of Interrogatories, the response with reference to the risk analysis included the following, sir. Quote:

> "The Risk Analysis Report was an early in house attempt to quantify operational and investment risk within basic automobile. The approach taken was unique to the Corporation, and as it was only applied to basic auto, could not be validated over a larger user community."

End of quote.

What is your comment relative to that response, sir?

MR. JOHN TODD: It is absolutely true that the concept of quantifying operational investment risks was brought forward by the company, initially. The mechanics of how that was done and ultimately approved by the Board, clearly was not their proposed methodology, there were changes made to that by the Board.

It -- so it was an in house attempt, got it going, but I think it was essentially a cooperative effort, if you wanted to -- if you want to call the Hearing process a cooperative process, then end up with a decision that it was a cooperative process between the company, Intervenors and the Board to come up with a methodology which was acceptable, unique to the Corporation. This is what I mean unique, I mean it's just -- it's basic risk analysis. I mean, insurance business is all about risk analysis because, you know, you insure against risks.

So the basic methodologies are the very core of what this company's all about, assessing risk.

So, yeah, on one (1) level perhaps it's unique, applying it this way, but the mathematics underlying it, the principles underlying the statistical methods underlying it, are what insurance and other risk analysis is all about. So that's not exactly unique.

Only applied to basic auto, not validated over a large user community, I'm not quite sure what they mean by that, if they mean others aren't using it to compare it to, that's true.

It's a -- it's a made in Manitoba solution. Personally I don't consider made in Manitoba solution to be wrong, because it's made in Manitoba. I think they come up with a good solution for the specific circumstances in Manitoba.

That doesn't mean I'd go and advocate everybody else adopt it, because they have different objectives. But it's a made in Manitoba solution, that's made for Manitoba Public Insurance.

MR. WALTER SARANCHUK: And with further reference to the Corporation's response to that Interrogatory, and they -- they indicated as follows, quote:

> "The MCT approach is the industry best practice in Canada. Accordingly, the MCT approach is more relevant to the Corporation in its RSR or capital requirement setting analysis."

End of quote.

I'd ask you, sir, to comment in terms of providing your views relative to what I just quoted to you. And then secondly, to indicate whether there are any aspects of the MCT that may be used as a tool for determining an appropriate target RSR.

MR. JOHN TODD: Okay, first of all with the best practice, I mean that -- discussed that with Mr. McCulloch earlier, when somebody says the best practice, they say best practice for what. You know, I've got daughters who -- who do track and field, they go out and they train.

The training you do for mid distance is different than the training you do for long distance, it's different than the training you do for short distance.

When you do a training program say, what are you trying to accomplish. Okay, we'll design the training program that meets what you're trying to accomplish.

Best practice is a very -- it's a phrase that has a lot of connotations about best practice means it's really good.

I'm not aware of the MCT being reviewed by the industry as -- as the best practice. It's a regulation, it's a requirement in a sense that makes the best practice, and it makes it above best practice. It's a mandatory practice.

But it's there for a particular purpose. Doesn't that -- that in itself does not say it's correct for the purpose we're talking about here, for the RSR.

The second part of the question was -- should have written it down.

MR. WALTER SARANCHUK: Are there any aspects of the MCT that may be utilized as a tool in determining the appropriate RSR target?

MR. JOHN TODD: The MCT, as I understand it, is, essentially, a risk analysis. A risk analysis being done for a different purpose.

And it may be quite legitimate to go

through the details of the MCT, there's -- there's worksheets and a lot of information on exactly how the calculation is done and if there are some lessons to be learned from the MCT that would be applicable to refining the risk analysis that's done and approved by this Board to be done for purposes of the RSR for MPI, sure, come in and suggest it.

That's -- that's what's happened over the years is that there's been discussion of the exact methodology being used for the risk analysis and, as my evidence shows, it was -- it was sort of refined when somebody said, well, here's a way to actually make it better.

I have not gone through it to look at it for aspects of the MCT which -- which could be adopted. I can't say there is anything there.

But there would be no harm in looking at it to see if there's lessons that are applicable in this made-for-Manitoba, made for MPI, solution to a particular problem.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: So your assessment is that it is a risk analysis and it could be applied in the circumstances?

If it were reviewed, for example, a little more extensively?

(BRIEF PAUSE)

MR. JOHN TODD: If -- if the Board were to look at the methodology, and in the Board's opinion it was an appropriate way to set trigger points for imposing a surcharge and rebates, and that it appropriate determines the level of reserves needed to stabilize rates, you know, the Board is, by definition, right.

But that would be subject to a detailed review of the mechanics of it, just the way we've done a detailed review of the mechanics of the existing risk analysis methodology.

There's, given that it's used for different purposes, my prior assumption is there's a lot of things in there that aren't relevant to stabilizing rates.

I mean, if -- if somebody asked me to design a test for stabilizing rates and design another test for addressing insolvency concerns, I'd assume I'd end up with two (2) different tests, not the same one.

It doesn't mean there can't be lessons to be learned, but my prior is there -- they're different tests, because they've different purposes.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: Now your recalculation, if you will, of the RSR target range as proposed by the Board, taking into account CPI's 55 million to $90 million, then we've asked you for whatever calculation you made on that score but not to get into anything actuarial on that score, just whatever you utilized -- the document that you submitted, if you don't mind.

But as you know, the Corporation's current and proposed target range is considerably higher. So bearing those factors in mind, can you provide the Board with your opinion as to what would be the appropriate strategy to deal with the apparent surplus RSR?

MR. JOHN TODD: Unless the Board decides to throw out its existing target range and methodology, or unless it decides to alter it, and right now it's not being asked to change it, it's being asked to throw it out and replace it with some -- with the -- something else; there's two (2) implications as far as my evidence would suggest.

One is, you take the RSR as it is, without taking out the $40 million for the Immobilizer Fund. Say, that's -- that's not an RSR issue that's dealt with separately and the company can account for it separately.

And, secondly, to the extent that the reserves are in excess of the currently applicable target range which is $90 million, by my rough calculation, the rest of it would become a refund to customers to bring it back down to that -- the high end of -- of the target range.

And that would be based on the reserves at the -- at the end of a fiscal year because the tradition has been you want to have those -- the reserves locked in, realized, they're not based on a forecast. So they're -- you know, this year or in the future there would be a refund to customers.

The Board could say, before we do that, given the concerns raised by the company, we would like to see an updated risk analysis, just to be -- so the Board could be conservative. That would be legitimate.

MR. WALTER SARANCHUK: And if you can't give the evidence at this particular time, perhaps then, by way of undertaking, can you provide the Board with an indication of what -- to what extent the RSR should be returned to the motorists and by what methodology?

For example, bearing in mind the last 16.6 percent dividend approach that was utilized; is that something that you would recommend be adopted again, or is there some other route, such as smoothing over of the return or something along that line?

So, assuming that you're going to provide us something in writing by way of an undertaking on both those counts, is there something that you can give us now to preface receipt of that document?

--- UNDERTAKING NO. 1: Mr. Todd to indicate to the Board to what extent the RSR should be returned to the motorists and by what methodology.

MR. JOHN TODD: Yes, I mean, the important part is the second part of how it might be done. There is an established method. I'm not aware of any complaints about how that went. The Board, Intervenors, the company went through a lot of discussion as to how it should be done and that approach was adopted because they wanted to keep it transparently separate from underlying rates.

All of the reasons for doing it the way it was done then would be equally applicable now, so why reinvent the wheel? You know, my recommendation would be, you've got a method that -- that was acceptable, it worked, use the same method.

The remaining question is, how much? Well, again, there -- there are principles which have been established through discussion, the Board's approved them. Take those same principles. Take the realized excess amount in the RSR and -- and return it to customers.

(BRIEF PAUSE)

MR. WALTER SARANCHUK: Those are my -- all my questions, Mr. Chairman.

THE CHAIRPERSON: Thank you, Mr. Saranchuk.

Well, Mr. Oakes, you've been patient. So your time has come. I'm wondering whether you want to begin now or, assuming that you've got quite a few minutes there of questions, wait until after lunch and we could come back a little bit earlier than we normally would?

MR. RAYMOND OAKES: That would make good sense, I think, Mr. Chairman.

THE CHAIRPERSON: Okay, would 1:15 be all right with everyone then? Very good.

--- Upon recessing at 11:55 a.m.
--- Upon resuming at 1:20 p.m.

THE CHAIRPERSON: Okay, everyone. Mr. Oakes wants to begin his questions of Mr. Todd. I appreciate it.

MR. BYRON WILLIAMS: Mr. Chairman, Byron Williams here. Just -- I apologize for the delay.

We had taken -- made two (2) undertakings to Board Counsel and because Mr. Todd is -- is leaving on a jet plane to Toronto, sometime today, we wanted to make sure that they were before the Board before he left, so we took a few extra minutes.

And I've provided them to Mr. Barron and I'll ask him to distribute them and certainly Mr. Todd is available to answer any questions regarding them, if it so pleases the Board.

THE CHAIRPERSON: Thank you, Mr. Williams.

(BRIEF PAUSE)

THE CHAIRPERSON: I don't think it matters, the order -- the way I have it right here. The undertaking that has to do with the proposing an outline for dealing with any amount in excess of the RSR target would be CAC/MSOS-11. And the second one which gives the details of Mr. Todd's calculation is number 12.

--- EXHIBIT NO. CAC/MSOS-11: Outline for dealing with any amount in excess of the RSR target.

--- EXHIBIT NO. CAC/MSOS-12: The details of Mr. Todd's calculation.

THE CHAIRPERSON: So, to remind everyone what we're doing now, is we're going through the various Intervenors, given them an opportunity to question Mr. Todd before he catches his plane.

Mr. Oakes...?

MR. RAYMOND OAKES: Thank you, Mr. Chairman. Given the amount of rest that I'd received this morning, I thought I would take it upon myself to circulate a previous Board Order, that being Board Order 703 in the Hydro hearings. And so I'd ask that that be marked as the next exhibit, please.

THE CHAIRPERSON: Do you have a number for CMMG exhibit? Two, Exhibit 2.

MR. RAYMOND OAKES: Thank you, Mr. Chairman.

--- EXHIBIT NO. CMMG-2: Board Order 703.

CROSS-EXAMINATION BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Mr. Todd, I'd provided you a copy of the Board Order 703 in the Hydro Act hearings just before the lunch break.

Do you recall the hearings in 2002 relating -- related to an information update regarding financial forecasts and methodologies in that hearing?

MR. JOHN TODD: I do recall it. I wouldn't use the adjective vividly, but I do recall it.

MR. RAYMOND OAKES: And you were a participant in those hearings as an expert witness; is that correct?

MR. JOHN TODD: That's correct.

MR. RAYMOND OAKES: I'm going to refer you, if I could, to the top of page 60 of that Board Order. And I'm going to read for you the Board's summary of the four (4) steps that should be taken, according to your position in those Hearings.

Number 1 would be determine which risks require reserves, namely unanticipated and therefore not built into the forecast.

Number 2, consider the magnitude and probability of that risk occurring, and recognize the relationship between the risks.

3, consider the tolerable rate increase, should the risks be realized.

And 4, ensure the risk analysis can justify the reserve position.

Were those -- was that your position in those Hearings?

MR. JOHN TODD: Yes.

MR. RAYMOND OAKES: And based upon the ruling of the Board at page 89 of that same series of excerpts from the Board Order, is it true that the Board essentially adopted your recommended approach as it relates to Hydro?

MR. JOHN TODD: Yes, I mean, urged to further examine their interrelationships. Yeah, I guess it endorsed the approach.

MR. RAYMOND OAKES: Okay. And with respect to the current Application before this Board, does it appear that MPI has demonstrated in its Application that they have considered the interrelationship of risks?

MR. JOHN TODD: Well, they have not submitted a risk analysis in the approved form, so they have not considered that with respect to the risks that have been identified as relevant to the RSR in the past. Arguably the MCT test looks at risks and there's some proper CICL (phonetic) techniques used in there for its purposes, but that's somewhat a different point.

MR. RAYMOND OAKES: Is it your understanding that the Corporation has not taken these four (4) steps and successfully demonstrated that they've quantified these four (4) components?

MR. JOHN TODD: Not in the current Proceeding.

MR. RAYMOND OAKES: From your perspective, considering the risk margins needed by MPI, should the Corporation as a whole be considered?

MR. JOHN TODD: Yes, that is part of the record of Board decisions that although it is focussed on basic as -- because it's a basic reserve and therefore it was focussed on basic, that it is also looked at in the context of the overall Corporation.

MR. RAYMOND OAKES: How about relative to the characteristics of the market for automobile insurance in Manitoba, in terms of competition?

Have you formed any opinions as to the characteristics of the market for automobile insurance?

MR. JOHN TODD: Sorry, have I formed any views of -- of it, or are you saying is that part of the risk analysis?

MR. RAYMOND OAKES: Have you yourself, sir?

MR. JOHN TODD: Well basic insurance is provided on a monopoly basis, so there is no competition for those -- that aspect of the insurance market. And given that it includes basic collision coverage, and the only thing that's competitive is extension, topping up that coverage in some sense and in certain categories there is, as I understand it, limited competition in that area, compared to what you'd find in most other jurisdictions.

MR. RAYMOND OAKES: Would you be able to say whether, for non-basic products, that MPI dominates the market in Manitoba?

MR. JOHN TODD: I don't know the -- the numbers on that. The numbers could speak to themselves better than I could.

MR. RAYMOND OAKES: Is it your opinion that MPI has some features of a monopoly in the extension business as well?

MR. JOHN TODD: The economic term would be it has the market power, which is not a monopoly but is not competition either. It's in between.

MR. RAYMOND OAKES: And would that market power then give MPI further ability to weather negative financial results?

MR. JOHN TODD: Market power and I -- I have no measures of how much market power MPI has. But assuming that that observation is correct conceptually then, yes, it would give it some -- some extra -- extra additional ability because market power applies the ability to -- to charge a higher price without losing customers.

So, assuming there's market power it would give them more strength to weather poor periods. Other companies could have other kinds of market power in adversity. There's a lot of -- when you get into the competitive market there are a lot of offsetting advantages and disadvantages.

A disadvantage that MPI has is its not diversified. So, it has greater exposure than a diversified -- diversified competitive company. When I say "diversified", diversified across product lines, diversified geographically. So, it has advantages and disadvantages in the competitive performance.

MR. RAYMOND OAKES: Mr. Todd, just looking at the Immobilizer Incentive Fund, you're aware that that particular initiative has no benefit to motorcyclists?

Are you aware of that, sir?

MR. JOHN TODD: I hadn't really thought through the implications. But, it's much harder to immobilize a motorcycle I think than a car. So, it makes sense to me although I can't verify it from the details of the program.

MR. RAYMOND OAKES: Are you familiar with the fact that motorcyclists will receive no discount in their insurance, much like the cars would, when they purchase the immobilizer?

MR. JOHN TODD: I accept that. I had not looked at that detail.

MR. RAYMOND OAKES: And are you familiar, sir, with the fact that motorcyclists, if they desire fire and theft, must purchase that coverage through an extension product?

MR. JOHN TODD: You mean must legally or must practically?

MR. RAYMOND OAKES: Practically.

MR. JOHN TODD: It's not available from other sources. I wasn't aware of that, but I can accept it.

MR. RAYMOND OAKES: And the retained earnings that have been appropriated for the IIF essentially are coming from extension premium revenue; is that correct?

MR. JOHN TODD: They are contributions to the RSR from the extension and SRE. Whether they will end up being the dominant source of funds is yet to be seen.

MR. RAYMOND OAKES: And given that motorcyclists have contributed, both through basic and through extension insurance to the building of the RSR they question as to whether it's fair or unfair. And discriminatory or not is really on of public policy; is that correct?

MR. JOHN TODD: That's a public policy issue. There's many issues of fairness which have to be judged by the Board. They can't be -- I can't draw conclusions from any analytic approach to it.

MR. RAYMOND OAKES: Thank you, Mr. Chairman. Those are my questions.

THE CHAIRPERSON: Thank you, Mr. Oakes. Mr. Roberts, do you have any questions of Mr. Todd?

MR. NICK ROBERTS: No, I don't, Mr. Chairman.

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

MS. PAM SHAW: No, CAA has no questions at this time.

THE CHAIRPERSON: Thank you.

Is Ms. Scurfield -- no.

Mr. Dawson...? Or anyone from Scootering Manitoba...?

Mr. Williams, do you have any return to Mr. Todd?

MR. BYRON WILLIAMS: No, I don't, Mr. Chairman. I did neglect to introduce Ms. Desorcy, but she, last I looked, is still back in the back row and she was there at some point in time this morning as well.

THE CHAIRPERSON: Well, then, thank you very much for your attendance, Mr. Todd.

MR. JOHN TODD: It's been a pleasure as always. Thank you, Mr. Chairman.

THE CHAIRPERSON: Thank you.

(WITNESS STANDS DOWN)

THE CHAIRPERSON: So, Mr. Oakes, we're back to you for the main cross-examination.

MR. RAYMOND OAKES: Thank you, Mr.

Chairman. At the same time I distributed the CMMG book of exhibits and I'd ask that they be marked as the next exhibit, so that, I assume, is CMMG Number 3?

THE CHAIRPERSON: Number 3.

--- EXHIBIT NO. CMMG-3: Book of Exhibits.

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

CROSS-EXAMINATION BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Thank you, Mr. Chairman. In reference to that material -- it's being pointed to me that the materials are back tabbed, in other words, if you're looking for the material that relates to number 1, you look before Tab 1 and sequentially in that fashion.

My questions start this afternoon with respect to identifying the level of the rate increases and I'd ask the Corporation, based on their response in Interrogatory CMMG 1-108 to confirm that, over the last ten (10) years, motorcycle rates have increased by 218.4 percent.

MR. DONALD PALMER: I'll confirm that.

MR. RAYMOND OAKES: And that would be the first -- there would be an indication in the filed exhibit materials, the attachment as enclosed?

MR. DONALD PALMER: It's CMMG 1-108 at the attachment 1, I guess.

MR. RAYMOND OAKES: That's correct. Are you in a position, then, to confirm the 218.4 percent increase over the last ten (10) years?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: Thank you for that. For 2006/07, the year applied for, the proposed average increase for motorcyclists is 12.7 percent, again on average?

MR. DONALD PALMER: That's for the motorcycle major class, yes.

MR. RAYMOND OAKES: And with respect to experience adjustments, as shown in Table AP.2, for motorcyclists it's 11 percent in territory 1, 13.73 percent in territory 2, 14.67 percent in territory 3 and some 9.08 in territory 4; is that correct, sir?

MR. DONALD PALMER: For the all-purpose motorcycle classifications, yes.

MR. RAYMOND OAKES: Thank you, sir. And I understand that, in addition, it's 15 percent increase for commuters and mopeds receiving an adjustment of an increase of 20 percent?

MR. DONALD PALMER: That's correct. The -- these are the experience adjustments which get rolled into the rate model, so the actual increases may be somewhat different depending on capping and whatnot.

MR. RAYMOND OAKES: Thank you for that. Based on the next Interrogatory 1-106, I'd ask you to confirm that the largest increase on a dollar basis for motorcyclists proposed for 2006/07 is three hundred and thirty dollars ($330) for sport bikes in territory 1, in rate group 1?

MR. DONALD PALMER: With engine size from 501 to 900 and -- or 501 and bigger cc's, yes.

MR. RAYMOND OAKES: Thank you. And based on the next Interrogatory 1-107, the largest increase on a percent basis for motorcycles proposed for 2006/07 is 20.18 percent for a touring motorcycle in territory 1 and 4 in rate group zero?

(BRIEF PAUSE)

MR. DONALD PALMER: Could you give me a reference for that, please?

MR. RAYMOND OAKES: We'll just do that in a second.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Perhaps we'll come back to that and provide the reference in a few moments.

MR. DONALD PALMER: If I can just add that we had capped all the increases at 20 percent, so there's probably several classifications in motorcycles, mopeds, that are in that 20 percent range, you know, plus or minus point one (.1) for rounding.

MR. RAYMOND OAKES: Just by way of comparison, I understand that the highest percent increase for any private passenger vehicle would be 12.99 percent and the reference for that being Table TI.53(b).

Can you confirm that, sir?

(BRIEF PAUSE)

MR. RAYMOND OAKES: The reference there would be three (3) pages from the back of that first tab of materials.

(BRIEF PAUSE)

MR. DONALD PALMER: I believe in our filed material we did have the list of -- of the top percentage ones. These are the ranges and -- and we -- I can't verify that this is necessarily an exhaustive list, so if I can take that as an undertaking, just the highest percent for a private passenger vehicle, I can do that.

MR. RAYMOND OAKES: That's fine, thank you.

--- UNDERTAKING NO. 18: Provide the highest percentage for a private passenger vehicle.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Our next topic deals with rate stability, and to that end we have the material that we'd like to file as the next exhibit, if we could; if I can enlist the good help of Mr. Barron?

--- EXHIBIT NO. CMMG-4: Cross-examination of Ms. McLaren by Mr. Byron Williams at the 2004 Rate Hearings.

MR. RAYMOND OAKES: And I take it that's CMMG number 4.

THE CHAIRPERSON: Number 4, Mr. Oakes, is an extract of a past hearing?

MR. RAYMOND OAKES: This is a cross-examination of Ms. McLaren at the 2004 rate hearings, cross-examination undertaken by Mr. Williams. Thank you, Mr. Chairman.

THE CHAIRPERSON: Okay, Mr. Oakes?

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Ms. McLaren, we've distributed the transcript relative to those hearings in cross-examination. Would you testify today that rate stability is still an important consideration in rate setting?

MS. MARILYN MCLAREN: Yes.

MR. RAYMOND OAKES: And the highlighted portion -- perhaps I can go up to line 23, the last paragraph in that section of the transcript, and it says:

"By the Corporation's Application of Clear Rate Groups, there's an inherent stability within that process. To simply treat the bonus/malice component in a different way would -- you know, the label the public would put on it would be publicly unacceptable. You

know, too, aggressively swinging up and
down for their mind set."

And that is one (1) way of defining the concern over rate stability; would you agree with that?

MS. MARILYN MCLAREN: I think this is referring to sort of trying to get a handle and -- and articulate the public acceptability in a language that they would use.

MR. RAYMOND OAKES: Okay. Thank you for that.

And rate stability, you've indicated, is still the goal of MPI?

MS. MARILYN MCLAREN: Rate stability is very important.

MR. RAYMOND OAKES: And given the sizes of the rate increases we've just talked about, are you, today, suggesting that the rates paid by motorcyclists meet the test of being stable?

MS. MARILYN MCLAREN: Stable and predictable, yes.

MR. RAYMOND OAKES: Certainly predictable, but a double digit increase means that they're not stable; wouldn't you agree with that?

MS. MARILYN MCLAREN: No. I think, given what Manitobans -- Manitoba motorcyclists understand about MPI rates, the rate making process, the fact that motorcycle rates have not been sufficient ever, in my memory, I think understanding the mechanism and the process used provides a consistent result year after year.

I think that would meet the test of both stability and predictability even though they are increasing each year.

MR. RAYMOND OAKES: Perhaps then we could look at CMMG Interrogatory 1-98 which has been tabbed in the materials and that's just immediately before Tab 2, the first production in that binder -- in that tab.

Do you have that?

MS. MARILYN MCLAREN: Yes.

MR. RAYMOND OAKES: And referring to that response, the rate -- rate adjustments has varied from some 36.67 percent in 2003 to 18.3 percent; do you see that there?

MS. MARILYN MCLAREN: The required adjustments, yes.

MR. RAYMOND OAKES: I know that the Board has asked MPI to provide its position relative to the effect of loss transfer; are you able to tell us, at this point, whether you would expect the loss transfer have a positive or a negative effect on motorcycle rates?

MR. DONALD PALMER: It's our expectation that the rate requirement, which is different than the actual rate charged, but the rate requirement should come down somewhat, yes.

MR. RAYMOND OAKES: Can you tell me why it came down this year, sir?

MR. DONALD PALMER: There's a -- there's a couple of reasons. The most important thing is that these are requirements that are cumulative. Last year we did get a 15 percent rate increase, so if we needed 35 percent last year and got fifteen (15), all else being equal, if there was no inflation -- inflation, that should mean that there's 20 percent left.

So we're pretty close to that. So this is, I think, in some ways verifies what our requirement was last year. There's a -- a couple of other situations. We do use the average of the last five (5) years of actual experience.

Last year, because of some unfavourable weather conditions, it's our belief, that we also had lower experience last year than in the previous years. So that would have an effect on it.

And, in addition, we're using ten (10) years of serious losses. The 94/95 year, which was a very bad one, came out of the experience so that will have a minimal effect as well. So all those things together would result in that.

But certainly the -- the main part of it is the requirement probably hasn't changed that much and we got 15 percent last year.

MR. RAYMOND OAKES: I'd ask you to consider, sir, whether it's the actual claims experience that is driving that reduction in the rate -- required rate. And I point you to CMMG 1-48 then, Interrogatory would be the reference.

It's not in the tabbed materials but it shows a 20.8 percent reduction in frequency between the year 2000 and 2004 and shows a 25.5 percent reduction in frequency in '04 over '03; are you familiar with those numbers, sir?

MR. DONALD PALMER: Could I get the reference again, please?

MR. RAYMOND OAKES: It's contained in Interrogatory 1-48 in the CMMG.

MR. DONALD PALMER: The experience that we saw in 2004/05, the last year, is lower than the other ones; that's -- you talk about a five (5) year decrease but most of that decrease is in the last year. And that was one of the factors that I mentioned as being one of the reasons that the rate requirement went up, so sure.

MR. RAYMOND OAKES: Okay.

How about the fact that in 2004 there was no serious losses and the reference for that was CMMG-1-101; would you agree with that?

MR. DONALD PALMER: Serious losses will have an impact on -- on rates, absolutely.

MR. RAYMOND OAKES: And you're confirming that the year 2004 saw no serious losses, no losses over half a million dollars ($500,000)?

(BRIEF PAUSE)

MR. DONALD PALMER: That's our experience -- experience, yes. It varies from year to year. I know that so far in '05/'06 I think there's four (4) or five (5) serious losses, so those are averaged out over a longer period of time, so to point at one year as being indicative of emerging experience, I think it's -- there is random fluctuation and our methodology reflects that.

MR. RAYMOND OAKES: And --

MS. MARILYN MCLAREN: Excuse me, if I could. I think, you know, the really important point here is that motorcycle category has had a few years in the last ten (10) or eleven (11) where there have -- a couple of years, anyway, where there have not been serious losses.

So that's not a real -- it's not emerging, it is random, to a certain extent.

What's really important here is that you lost what turned out to be the worst of the last eleven (11) years of experience with respect to motorcycle losses in general, and serious losses, in the 1994 year that fell out of the experience.

Now, I'm not sure that that's a really -- we had a fair bit of discussion about that. I think it's helpful for everyone to understand that, because you have a smaller pool, you have a preponderance of serious losses in the motorcycle pool compared to other vehicle classes.

We weren't sure that that was really the best approach to allow that year of data, of experience to really disappear, so to speak.

But when it came to the Corporation, as a whole, PIPP losses, as a whole, we looked at it and the recommendation from -- from the staff within the company is that there's no good argument to continue to expand that body of data beyond ten (10) years when it comes to serious losses for the PIPP program as a whole.

So when that was a recommendation coming forward, we then had to think about whether there was a reason to, sort of, come forward with an exception for the motorcycle class, and we decided not to.

So that's why that one (1) really bad year fell away. But it's certainly something that we expect will never be repeated.

So I think that, you know, the really important factors that have driven a significant reduction in the required rates for motorcycle are the three (3) that Mr. Palmer talked to you about.

But I think, given the conversation we've had over the years, and particularly your interest in the 1994 year and when it might leave the data set, it -- I think it was worth elaborating a little bit on that, 'cause it is now, in fact, gone.

MR. RAYMOND OAKES: I'm pleased to hear that, and there was a concern that it had been engineered to stay in for a lifetime. But it brings us to the -- the issue of credibility and would you agree, Ms. McLaren, if the credibility weighting assigned to motorcycles were reduced, then that would have resulted in a greater stability for rate changes?

(BRIEF PAUSE)

MR. DONALD PALMER: By definition, a

lower credibility weighting would mean that the rate indicator would be closer to the overall average.

MR. RAYMOND OAKES: So we're seeing less of a fluctuation than what we pointed to in CMMG-1-98 which saw the range of rate adjustments vary from 36.7 percent in 2003 to now 18.3 percent?

MR. DONALD PALMER: Given the last five (5) years, those numbers would have been less. I don't know that you -- they would be -- the bigger ones would still be bigger in relation to the smaller ones, so I don't know that that necessarily indicates stability.

MR. RAYMOND OAKES: I'm going to leave the area of rate stability and focus for a short while on growth and MPI expenses.

In terms of comparison to other public insurers, would it be fair to describe SGI as being the most similar to MPI in terms of coverages and administration of the insurance program?

MR. DONALD PALMER: If you're just looking at the insurance component, their no-fault plan, and since it's similar to MPI's, the make up of their business is quite different and the way they fund their auto fund from an expense point of view is quite different than MPI's.

MR. RAYMOND OAKES: They'd be similar in

the fact that all vehicles in Saskatchewan have first-party collision and comprehensive coverage, as well as third-party liability coverage?

MR. BARRY GALENZOSKI: Yes.

MR. RAYMOND OAKES: And motorcycles have first-party comprehensive coverage?

MR. BARRY GALENZOSKI: Yes.

MR. RAYMOND OAKES: And they have that under the basic plan in Manitoba?

MR. BARRY GALENZOSKI: That's correct.

MR. DONALD PALMER: There is no comprehensive coverage on motorcycles in Manitoba.

MR. RAYMOND OAKES: Okay, was --

MR. DONALD PALMER: In the compulsory program -- basic compulsory program.

MR. RAYMOND OAKES: Right, okay, I wasn't trying to trick Mr. Galenzoski there.

In Saskatchewan, I understand, that motorcycles do have the first-party comprehensive coverage included.

MR. DONALD PALMER: I'm not absolutely positive of that, but I'll take your word for it, again, subject to their deductible, which their -- for private passengers, their basic deductible is larger than in Manitoba. So...

(BRIEF PAUSE)

MR. RAYMOND OAKES: I'm going to turn to -- in the CMMG book of exhibits, the start of the material that prefaces the number 3. And you'll find, Mr. Palmer, a -- a production that we've prepared.

(BRIEF PAUSE)

MR. RAYMOND OAKES: I understand that this is an exhibit based on TI.7, showing the change in certain cost components from 2001. Do you recognize the numbers as being based on Exhibit TI.7, sir?

MR. BARRY GALENZOSKI: Unless this is a trick question, yes, they look similar.

MR. RAYMOND OAKES: And if we compare 2005 to 2001 for MPI, did the claims expenses in the index increase from one hundred (100) to one hundred and twenty-nine (129) as shown in the bold table under MPI?

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

MR. RAYMOND OAKES: And this would represent about a 29 percent increase in claims expenses over four (4) years, or approximately 7 percent per year?

MR. BARRY GALENZOSKI: Yes.

MR. RAYMOND OAKES: And for SGI, comparatively, as shown in the bold table for SGI, the increase was about 12 percent or about 3 percent per year, sir?

MR. BARRY GALENZOSKI: That's correct.

MR. RAYMOND OAKES: Looking at operating expenses, was the increase for -- the increase was from one hundred (100) to one hundred twenty point six (120.6), which would represent about a 21 percent increase?

MR. BARRY GALENZOSKI: For MPI, yes.

MR. RAYMOND OAKES: And so that would be approximately 5 percent per year?

MR. BARRY GALENZOSKI: Yes.

MR. RAYMOND OAKES: And the increase for SGI to 2005, can you indicate from that table what that was, sir?

MR. BARRY GALENZOSKI: It's a reduction by point one (.1).

MR. RAYMOND OAKES: And looking at the last bold table for ICBC, did actual claim and operating costs decline for that Corporation?

MR. BARRY GALENZOSKI: Yes, they did. Yes.

MR. RAYMOND OAKES: And referring the

next production in that binder, CMMG-2-3, the rate of premium taxes in Manitoba has increased since 2001?

MR. BARRY GALENZOSKI: No, the rate hasn't changed.

(BRIEF PAUSE)

MR. RAYMOND OAKES: And going back to the CMMG exhibit that we started with, for broker commission and premium taxes, what was the growth in BC from 2001 to 2004?

MR. BARRY GALENZOSKI: They're showing 3.8 percent.

MR. RAYMOND OAKES: And for Manitoba, sir?

MR. BARRY GALENZOSKI: We're showing 48.2 percent.

MR. RAYMOND OAKES: Okay. Looking at SGI and MPI, was the increase for Manitoba higher than Saskatchewan from 2001 to 2005?

MR. BARRY GALENZOSKI: Saskatchewan is showing for commissions and taxes 34.7 percent.

MR. RAYMOND OAKES: Would an important factor in the increase be that on the basic program MPI pays brokers on a percent of premium basis while for basic both ICBC and SGI pay brokers on a flat fee basis?

MR. BARRY GALENZOSKI: Yeah, I don't -- I don't know if I could -- I could say yes or no to either of those.

MR. RAYMOND OAKES: I wonder if you could provide that by way of undertaking, please?

(BRIEF PAUSE)

MR. KEVIN MCCULLOCH: We'll take it under advisement.

--- UNDERTAKING NO. 19: MPI to indicate the cause of the increase of broker commission and premium taxes in 2001.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Looking at Manitoba specifically, referring to the Table TI.17, Comparative Operating Expenses. Are commissions forecast almost double from 2001/02 to 2006/07 in that they're rising from nineteen million three hundred and sixty-five thousand (19,365,000) to thirty-four thousand six hundred and -- thirty-four million six hundred and thirty-nine

(34,639,000)?

MR. BARRY GALENZOSKI: Yes, that's not a doubling; that's an increase of just under 80 percent. However, there is some mitigating factors. The loss of the share cost is one of the big ones.

MR. RAYMOND OAKES: And how much would that be, sir?

MR. BARRY GALENZOSKI: Well, that would have accounted, out of that increase, that would have accounted for about $6 million and that would have increased over time. So, when you get to '06/'07 it probably would have been a little bit more than $6 million.

MR. RAYMOND OAKES: Without the cost sharing agreement then would it have increased from 19 million to, say, 28 million?

MR. BARRY GALENZOSKI: Yes, that's correct. That's based on the size of the premiums.

MR. RAYMOND OAKES: And so that would have been about a 50 percent increase?

MR. BARRY GALENZOSKI: Approximately.

MR. RAYMOND OAKES: Has MPI taken any steps to control that growth?

MR. BARRY GALENZOSKI: We're paying our commissions based on our contracted amounts with our brokers. That's also within -- that's also stated in regulation, the commission structure.

MR. RAYMOND OAKES: Turning over to page 2 of that tab of materials, it shows the effect of the greater increase than expenses for MPI compared to SGI and ICBC.

Looking at the bold column, second from the right, would you agree that approximately, between 2001/02 and 2004/05 it appears that costs have risen about $18 million more for MPI than -- than if -- than the costs grew at the same rate as SGI?

MR. BARRY GALENZOSKI: Assuming your calculations are correct that's what the number says.

MR. RAYMOND OAKES: And I'm looking at the far right of that top portion of the calculation showing percentage changed.

And would the savings be approximately 13 percent on claims expenses, 10 percent on operating expenses and 9 percent on commission and taxes if costs were the same as Saskatchewan?

MR. BARRY GALENZOSKI: Again, accepting your numbers. Yes.

MR. RAYMOND OAKES: Looking further down the second last column which shows ICBC, would the amount of the higher growth for MPI relative to ICBC be roughly

$50 million?

MR. BARRY GALENZOSKI: Again, assuming your numbers are correct, yes.

MR. RAYMOND OAKES: Referring to TI.2, the financial forecast method, if we took SGI to be more representative of cost level changes for motorcyclists, would a 13 percent decrease in claims expenses be about nineteen dollars ($19) and would that decrease the required rate by approximately nineteen dollars ($19)?

MR. DONALD PALMER: Subject to check. Sure.

MR. RAYMOND OAKES: And similar for operating expenses, a 10 percent decrease be about five dollars ($5) and that would decrease the required rate by about the same amount?

MR. DONALD PALMER: Again, subject to check. If any of these assumptions are lower then it'll be -- result in a lower answer. If any of them are higher, it'll result in a higher answer. Sure.

MR. RAYMOND OAKES: Okay. And so similarly, commissions and taxes, if you have a 9 percent decrease, that's about nine bucks ($9) off the motorcycle premium?

MR. DON PALMER: Different assumptions will yield different results, yes.

MR. RAYMOND OAKES: And overall, in terms if all of those rose -- if they rose at the same rate as the SGI experience, the saving to motorcyclists would be about thirty-three dollars ($33) per vehicle and re -- lower the required rate by 3 or 4 percent?

MR. DON PALMER: Again, without having gone through all the calculations, I'll take your word for it.

MR. RAYMOND OAKES: Just by way of undertaking, if the Corporation does any of those calculations and has different answers, would they undertake to advise us prior to final argument?

MR. DON PALMER: Sure.

MR. RAYMOND OAKES: Thank you for that.

--- UNDERTAKING NO. 20: MPI to provide any different answers and taxes it has concerning commissions and taxes.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Moving from that topic, then, to the Immobilizer Incentive Fund. And I ask the Corporation that since the last Application, would you agree that the Corporation has had very favourable financial results leading up to a building up of retained earnings?

MR. DON PALMER: Just for the previous year we've had very good financial results, primarily driven by a change in our financial provisions and some -- some improvement in investment income.

Years -- two (2) years prior to that, we had negative results.

MR. RAYMOND OAKES: Certainly last year, then, given all of those factors would you be able to say that premiums were more than sufficient last year?

MR. DON PALMER: No, again, I just went over the reasons why the change occurred. One was a change to financial provisions which affects prior year claims and then there was the gain on the investments which wasn't included from prior application.

MR. RAYMOND OAKES: But isn't it true, Mr. Galenzoski, that if you had very favourable results on the investments or on the IBNR's that you could then seek less premium from your consumer?

MR. BARRY GALENZOSKI: Absolutely not. It's a total fallacy. You're looking at a non-reoccurring event and therefore that can't be included in the base rate.

MR. RAYMOND OAKES: The last time that

the Corporation had the favourable financial results for the reasons that you indicated, were not part of those part of those monies rebated to all policy holders in the form of a surplus dividend?

MR. BARRY GALENZOSKI: You'll remember that when the surplus dividend was provided a few years ago, it was done based on an estimate of where the Corporation expected its financial results to be. And that in future, when we were going to do something along the surplus dividend line, it has to be based on monies that are audited and in the bank.

When we look back at the year the surplus discount was provided, which cost the Corporation around $81 million, the financial results that were predicted that based that amount of money being given back to the customers, did not materialize, resulting in a loss in that next year.

(BRIEF PAUSE)

MR. BARRY GALENZOSKI: And I think the other thing you'll recall is what happened is that the rates weren't changed. There was a discount to the given rate and so then that rate was the rate for the next year going forward. So, there was no change to the base rate.

MR. RAYMOND OAKES: Perhaps a simple question that will require another complex answer, but if the Corporation had it determined this year that it's RSR target were $100 million, would they be in a position that they would be, again, able to provide a surplus dividend?

MR. BARRY GALENZOSKI: If there was -- everything else was taken into account, the target was 100 million and it was funded to that tune and there was no Immobilizer Incentive Fund, then you would look back at the previous year. And I believe the number was about $135 million in Rate Stabilization Reserve, that would make $35 million eligible for surplus discount.

MR. RAYMOND OAKES: And the last time there was a surplus dividend it was paid out to motorcyclists as well; is that correct?

MR. BARRY GALENZOSKI: Yes, it was paid to everybody who was a basic policy holder.

MR. RAYMOND OAKES: The CMMG proposed CMMG Interrogatory 1-52, as shown in MPI's response to that Interrogatory, can you -- the Corporation confirm that no motorcyclists have been involved in a claim involving a stolen vehicle since 2001/02, and that's tabbed in the materials just before number 4, the first page?

MR. DONALD PALMER: That's what it says, yes.

MR. RAYMOND OAKES: And based on the response to CMMG Interrogatory 1-18, and the following Interrogatory, is it correct that motorcyclists do not receive a financial incentive to immobilize their vehicles?

MR. DONALD PALMER: That's correct.

MR. RAYMOND OAKES: So, can you tell me under the MPI proposal to -- to take funds, can you tell me what the benefit is to motorcyclists please?

MR. DONALD PALMER: First of all, the fact that it hasn't happened, our rates are done on a prospective basis, so that doesn't mean there is not -- not a danger to motorcyclists. So I think, on a going forward basis, having that hazard off the road is a benefit to all Manitobans.

MR. RAYMOND OAKES: It certainly hasn't been a danger to date?

MR. DONALD PALMER: Not -- not specifically to motorcycles. I think, as I believe you said in your opening statement, that motorcycle owners generally are owners of other vehicles as well. So again, the benefit goes to all Manitobans for that program.

MR. RAYMOND OAKES: Unless of course that motorcyclist has bought a new car that has an IBC approved immobilizer equipped at the factory, then you wouldn't get any rebate then either, would he?

MR. DONALD PALMER: He doesn't get the rebate, but certainly Manitobans -- Manitoba roads would be safe, and he would benefit from that.

MR. RAYMOND OAKES: Can you provide details on MPI's plans, if the target rate of 90 percent of vehicles in Winnipeg are not immobilizer equipped by 2009?

--- UNDERTAKING NO. 21: MPI to provide details about it's plan, if the target rate of 90 percent of vehicles in Winnipeg are not immobilizer equipped by 2009.

MR. BARRY GALENZOSKI: Yeah, there -- I think we talked about this with the Public Utility Board advisors when they were questioning, and what we said was that there's lots of things that we need to do before we get to the details about what will happen if we can't reach that 90 percent.

So, we're probably talking at least a year away before we're going to be talking in any more detail about that.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: What -- what proof will MPI be providing this Board with, with respect to its progress in reaching the 90 percent target?

MR. BARRY GALENZOSKI: Well, you can see the way we're accounting for it, there is transparency and clarity with respect to the take up on the program, we'll have the statistics that back up the -- the take up to the program, we'll be able to tell you the types of vehicles that have taken advantage of the program, and our success in -- in reaching our overall targets that we set for the program.

MR. RAYMOND OAKES: In that answer it sounds like it's possible that the IIF will require additional funding in the near future, depending on those results?

MR. BARRY GALENZOSKI: I don't know where you could have got that out of that answer because I wasn't talking about going past the $40 million, and I don't think that that's going to be happening.

MR. RAYMOND OAKES: Would you agree with Mr. Galenzoski that the impact of the Corporation's approach means that the costs of the immobilizer incentive are not part of the rate requirements?

MR. BARRY GALENZOSKI: They're not part of the rate requirements as specific within -- with respect to the base rate for any particular vehicle because it is being funded from retained earnings.

MR. RAYMOND OAKES: And this appropriation of retained earnings, is it discretionary, is it something that you can do for an unlimited number of corporate issues?

MR. BARRY GALENZOSKI: We got into a long discussion about that, possibly you weren't here when that occurred, but we can't foresee things that would happen that would cause us to do that at this stage.

MR. RAYMOND OAKES: Can you provide examples of other public insurers that have performed similar appropriations?

MR. BARRY GALENZOSKI: No, I can't. This is a very innovative program, it's addressing a very significant problem in Manitoba, and it is -- it is designed around that, and we haven't seen that occur anywhere else.

MR. RAYMOND OAKES: Not with any other P&C insurer either?

MR. BARRY GALENZOSKI: There wouldn't be

any other P&A insurer in the private sector that would be interested in doing anything that remotely looks like this.

MR. RAYMOND OAKES: Mr. Galenzoski, in page 5 of your prefiled information and is referenced in CMMG-2-25, the Interrogatory, can you explain more about the accounting standards that are related to appropriating reserves?

MR. BARRY GALENZOSKI: Yes. The Corporation believes that the accounting standards are -- are met with respect to generally accepted accounting principles for both the way we're putting the expenses through the income statement and then reimbursing the RSR through the IIF Fund, with the separate IIF fund being created out of retained earnings.

MR. RAYMOND OAKES: I want to ask Ms. McLaren some questions about MPI's risk profile.

Ms. McLaren, you would consider MPI a strong, well-run insurance company?

MS. MARILYN MCLAREN: Yes, I would.

MR. RAYMOND OAKES: And you'd consider -- you'd consider MPI to have produced consistent earnings performance over the last five (5) years?

MS. MARILYN MCLAREN: No, I wouldn't agree with that.

MR. RAYMOND OAKES: Okay. You'd consider that MPI's board of directors have defined roles and responsibilities and practices that meet or exceed what is necessary, given the nature, scope and complexity and risk profile of MPI?

MS. MARILYN MCLAREN: Yes, I would agree with that.

MR. RAYMOND OAKES: And the same with senior management?

MS. MARILYN MCLAREN: Yes.

MR. RAYMOND OAKES: And you'd consider MPI's mandate, organization, structure, resources, methodologies and practices related to risk management as meeting or exceeding what is necessary, given the nature, scope and complexity in risk profile of MPI?

MS. MARILYN MCLAREN: Yes.

MR. RAYMOND OAKES: So similarly for internal audit, it would meet those standards?

MS. MARILYN MCLAREN: Yes. I believe so.

MR. RAYMOND OAKES: And financial analyses as well that would meet or exceed what is necessary?

MS. MARILYN MCLAREN: Yes. That's true.

MR. RAYMOND OAKES: Compliance with applicable laws, regulations and guidelines, similarly?

MS. MARILYN MCLAREN: Yes.

MR. RAYMOND OAKES: That, to me, and I understand to OSFI as well, would indicate that MPI would be considered a very low risk, based on the OSFI risk assessment framework; are you aware of that standard?

MR. BARRY GALENZOSKI: I think that only looks a one (1) component; that looks at the management risk associated with a company. It doesn't look at the operational risk with respect to the insurance operations that we're conducting on an ongoing basis.

MR. RAYMOND OAKES: Would you agree with me that, on the management side then, in taking into account all of those factors, including the risk management, the internal audit, the compliance with applicable laws and the financial analysis, that all of those would result in MPI being considered a very low risk by the OSFI risk assessment framework?

MR. BARRY GALENZOSKI: Everyone's a very low risk until something goes wrong. And the fact that you've got good governance is -- is a good thing to have and it's going to probably help prevent things from going wrong.

But there are many things outside of our control, both from the investment side, the claims side, the reinsurance side, the major risk factors that the

Corporation has identified.

When you look at the way MCT is -- is calculated, it quantifies those types of risk. It doesn't provide a quantitative analysis with respect to governance.

MR. RAYMOND OAKES: I'm told that the risk assessment framework that we just discussed is one (1) of three (3) pillars of the OSFI overall assessment of risk; are you familiar with that, Mr. Galenzoski?

MR. BARRY GALENZOSKI: I'm -- I'm somewhat familiar with that. That -- that goes to, with respect, to any audits that they're doing on companies looking at how a company is performing.

We're -- we're limiting our -- our OSFI involvement to the minimum capital test, and that is more of a quantitative risk assessment analysis process.

MR. RAYMOND OAKES: Looking at the investment rate of return, Mr. Galenzoski, so I think you can keep your microphone on for the next short while, the rate of return as a percent of direct earned premiums that MPI used in calculating 2006/2007 rates; I understand that that was a rate of return of some 11.82 percent; would that be correct, sir?

MR. DONALD PALMER: That wouldn't be the rate of return. That would be percent of premiums written.

MR. RAYMOND OAKES: Right. A percent of direct earned premiums?

MR. DONALD PALMER: Sure.

MR. RAYMOND OAKES: And CMMG Interrogatory 2-28, which would be just preceding Tab 6, I'm sorry, just preceding immediately Tab 5 in the binder.

That Interrogatory 2-28 indicates that the five (5) year average return on investment is a percent of direct premiums earned, was 13.43 percent; is that correct, sir?

MR. DON PALMER: Yes, that's correct.

MR. RAYMOND OAKES: And the ten (10) year average was 14.89 percent?

MR. DON PALMER: No, 14.68.

MR. RAYMOND OAKES: I'm sorry. And if a higher selected return of 13 percent was used, would the required rate level for motorcycles decrease as shown in the response to CMMG-2-5, which is the...

(BRIEF PAUSE)

MR. RAYMOND OAKES: I'm sorry, the reference was 2-4 in the next exhibit.

MR. DON PALMER: Yes, I have it. A different assumption will yield a different result, yes.

MR. RAYMOND OAKES: And so comparing that with TI-2 the required rate would decrease from one thousand one hundred and fifteen dollars ninety-two cents ($1,115.92) to approximately one thousand ninety-nine dollars fifty-one cents ($1,099.51) or about a sixteen dollars ($16) reduction?

Would you agree with those calculations?

MR. DON PALMER: That's the rate requirement under those assumptions, yes.

MR. RAYMOND OAKES: And the required rate level for other vehicles would also decrease, approximately about seven dollars ($7)?

MR. DON PALMER: That's correct.

MR. RAYMOND OAKES: And if the rate of return used was 14 percent, the ten (10) year average in other words, would the amount of these decreases be about double that or we're talking about thirty-two dollars ($32) and fourteen dollars ($14) respectively?

(BRIEF PAUSE)

MR. DON PALMER: Approximately, sure.

(BRIEF PAUSE)

MR. RAYMOND OAKES: In terms of investment accounting, in the past we had heard testimony from the panel from time to time at MPI that there were similarities between MPI and Manitoba Workers' Compensation Board, particularly as it relates to the no-fault plan.

Do you recall some of that testimony in previous hearings?

MR. BARRY GALENZOSKI: I recall some of that testimony, yes. Not with respect to our investments though.

MR. RAYMOND OAKES: If you're going to characterize MPI's investments, would it be fair to say that most are held to pay for no-fault benefits?

MR. BARRY GALENZOSKI: There's -- that's getting to be the largest component of our reserves -- outstanding reserves, yes.

MR. RAYMOND OAKES: So the investments maintained by MPI are there for the same reason as they are for WCB?

MR. BARRY GALENZOSKI: No, there's some differences. For instance, some of those investments are held for other purposes, our pension liability is part of that, retained earnings is part of that.

There's a number of different pools of funds that make up our overall investment pool.

(BRIEF PAUSE)

MR. RAYMOND OAKES: There was two (2) Interrogatories, one was CMMG-1-29 and the other one was PUB-1-56(a) which talks about unrealized gains of $109.3 million.

Can you advise, Mr. Galenzoski, what the MPI policy for taking those unrealized capital gains might be?

MR. BARRY GALENZOSKI: Yes, we have some guidelines with respect to taking gains. For instance, on the bond portfolio we can -- we'll take gains if they're apparent and -- and reasonable to take under the guidelines that we've established.

We'll take up to $5 million without further consideration or study. And what we're talking about there is looking for opportunities where we can sell a particular bond and buy another investment, another bond, and not in the -- in the aggregate, in other words, taking the gain plus the downstream investment income, lose money in the deal, so that we would not deteriorate our -- our ongoing investment returns that we're going to have.

With respect to our -- our equities, we set a guideline there where we -- to -- to recognize the gains. We'll only start considering taking gains on that portfolio, both the Canadian and the US side, once we've exceeded 105 percent of the book value of those particular investments. And then those are -- we can consider taking some of those gains and over time we've done that, we've demonstrated that we do that.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Mr. Galenzoski, I'm looking at the 2004 Manitoba Workers Compensation Board Annual Report, that's tabbed in our materials, and I'm looking at page 4 of that, and it talks about the new standards, the change in accounting policy, the mark to market. And the highlighted portion of that reads:

"Under the new accounting policy financial assets of the investment portfolio are designated as available for sale and are carried at fair value, the amount of consideration that would be agreed upon in an arm's length transaction. Realized gains and losses are recognized as investment income in the year in which they occur. Unrealized gains and losses are recognized in other comprehensive income, until the financial asset is derecognized or becomes impaired, at which time the cumulative gain or loss recorded and other comprehensive income is reclassified to investment income in the statement of operations."

Is this the new standard that the Corporation is adopting in that respect?

MR. BARRY GALENZOSKI: It's the standard that the Corporation will adopt March 1, 2007.

MR. RAYMOND OAKES: And when you turn to the next page of that document, would you confirm that it indicates the WCB had an operating surplus of some $9,658,000?

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

MR. RAYMOND OAKES: And that operating surplus would include revenues much like MPI reports, that is premiums and investment income?

MR. BARRY GALENZOSKI: And any realized

gains on their investments.

(BRIEF PAUSE)

MR. RAYMOND OAKES: And at page 6, the following page, it talks about the investment portfolio, and the carrying value of investments. And the note 6, which is being provided on pages 6 and 7 of our exhibit, refer to investment income.

And on page 7, do you see the item denoted, reclassified gains from other comprehensive income?

MR. BARRY GALENZOSKI: No, I don't see that.

MR. RAYMOND OAKES: It would be halfway down page 7 on the left hand side under investment income, and it would show -- realize the investment gains of some $19,422,000 flowing through to the income statement and then to the operating surplus?

MR. BARRY GALENZOSKI: Yes, I see that.

MR. RAYMOND OAKES: Okay. And is that similar to realized capital gains that MPI takes from time to time, as shown in the materials before this Board, including CMMG-1-28?

MR. BARRY GALENZOSKI: Yes, it would be.

MR. RAYMOND OAKES: And if we turn to the last page of the material from the WCB Annual Report, referring to the two (2) tables, this shows the accounting for those unrealized gains?

MR. BARRY GALENZOSKI: Yes, it's two (2) new statements that'll be in the annual reports in the future, for -- for WCB in this case, and for MPI for the year ending February of 2008.

MR. RAYMOND OAKES: Okay.

MR. BARRY GALENZOSKI: And so just to confirm our understanding, this mark-to-market accounting would only have affect on the balance sheet, but it wouldn't affect the income statement?

MR. BARRY GALENZOSKI: It's not going to affect the income statement, and we've also talked about it not having impact on the retained earning targets or the RSR targets.

MR. RAYMOND OAKES: Referring to CMMG-2-47, is it correct that MUSH bonds are held to maturity?

MR. BARRY GALENZOSKI: That's our -- that's what's happened at MPI, yes.

MR. RAYMOND OAKES: Okay. And the amortized cost of these would be the same as their carrying value?

MR. BARRY GALENZOSKI: That's their fair

market and their book value are the same. Yes.

MR. RAYMOND OAKES: And then I understand that the percentage of the total MPI portfolio, in terms of the carrying value of the MUSH, would be about 23 percent?

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

MR. RAYMOND OAKES: Okay. And so the mark-to-market accounting, in summary, would have no effect on the reporting risk for this quarter of the MPI or for the MPI investment portfolio?

MR. BARRY GALENZOSKI: Not sure I understand that question.

MR. RAYMOND OAKES: The change to mark-to-market accounting, would it have any effect on the reporting risk for -- for the portfolio?

MR. BARRY GALENZOSKI: Not currently.

MR. RAYMOND OAKES: Mr. Galenzoski, one of the attachments in that same series of exhibits that we're working with is from the accounting standards board, Financial Instruments, Recognition and Measurement. And I'm referring to page -- should be tabbed as -- the bottom indicates page 4. The top should have a page 19; do you have that material, sir?

MR. BARRY GALENZOSKI: I have that -- I

have that, yes.

MR. RAYMOND OAKES: Okay. Referring to the CICA guidelines on recognizing financial instruments which are attached, can you read in the paragraph up to the end of point B and that would be item highlighted there as Point 05, starting with, "fair value"?

MR. BARRY GALENZOSKI: "Fair value is also the most relevant measure for other financial instruments. Therefore, this section requires that all non-derivative financial assets be measured at fair value with the exception of loans and receivables and held to maturity investments which should be measured at amortized cost, and investments in equity instruments that do not have a quoted market price in an active market which should be measured at cost, other than such instruments that are classified as held for trading."

MR. RAYMOND OAKES: And so the MUSH bonds would fall into the held to maturity investments described under Point A?

MR. BARRY GALENZOSKI: Yes, the Mush Bonds would fall under that.

MR. RAYMOND OAKES: Okay. In terms of another type of investment, venture capital investment, Mr. Galenzoski, given recent events at the Crocus Fund (phonetic) what steps has MPI implemented to reduce their potential risks in this venture investments?

MR. BARRY GALENZOSKI: Well, we haven't changed any of our processes. We don't believe that that's necessary. We have a small allocation to venture capital, that's basically 1 percent of our investment portfolio right now, that's being administered by the Department of Finance.

In other words, they're responsible for looking at the venture capital investment and making the decision as to the amount that they would want to put in there. We've put some practical limits on the amount that we would put into any one (1) particular venture capital equity investment.

And on that basis we feel reasonably comfortable with our equity -- or our exposure with respect to that segment of our investments.

MR. RAYMOND OAKES: I understand, Mr. Galenzoski, that one of the reasons that MPI has put forth as described in page 4 of your pre-filed testimony, that one of the reasons that MPI is seeking a higher RSR is it is needed due to higher investment income risk;

would that be correct?

MR. BARRY GALENZOSKI: Yes, that's part of it.

MR. RAYMOND OAKES: Can you tell us what active strategies the Corporation's put in place to reduce that risk?

MR. BARRY GALENZOSKI: Well, the Corporation does asset liability reviews. It looks at the optimal investment portfolio that it should have with respect to its liabilities that are contained on its balance sheet.

We've got specific goals with respect to the type of equity managers that we'll hire; the -- looking for diversification amongst the styles of the managers. The portfolio is structured for diversification overall from the asset mix that we -- we have.

We've hedged our foreign currency exposure with respect to our US investments; that's worked out very favourably for the Corporation. So, we've taken some reasonable steps to control the risk associated with the portfolio, but that doesn't eliminate the risk.

MR. RAYMOND OAKES: I understand that MPI has three (3) persons on staff that hold the Chartered Financial Analyst designation and you've talked about that last week in testimony.

Any of those steps that were related to risk management in terms of investment income risk, do they arise from the skills that those persons hold as CFA graduates?

MR. BARRY GALENZOSKI: Oh, partially. You know, we have a governance structure regarding our investment portfolio that considers risks on our portfolio from a number of different angles.

We do employ the professional tactics that are required to -- to make sure that we've considered the risk in the portfolio that we get the diversification that we think is necessary, but certainly the skill set brought to the table by our professional people on staff have been a big assist.

MR. RAYMOND OAKES: Okay. I'm going to refer you, if I might, to our Information Request 2-2 which is, I believe, it's three (3) or four (4) pages in to the next tab.

And if you have that, sir, then I'll ask you to refer to study session 12 of the CFA's Institutes study guide and there's a variety of sections related to investment risk management, including controlling interest rate risk with derivatives, risk management applications of forward and future strategies.

Section -- study session 13 goes on to talk about risk management application of option strategies, currency risk management which you just spoke of and risk management applications of swap strategies.

Has the Corporation taken the skills of the CFAs and incorporated any of these approaches to reduce investment risk?

MR. BARRY GALENZOSKI: Certainly. We eliminated our investments and swaps. We've got into hedging on our foreign currency. Again, we get into a number of different methodologies that we employ to -- to both assess risk and to try and reduce it, to some extent.

We have not taken all these steps, obviously, but certainly these are on -- on the table for discussion going forward as we move to different accounting guidelines.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Can you tell me, sir, is the biggest portion of the portfolio bonds?

MR. BARRY GALENZOSKI: Yes, approximately 75 percent is bonds.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Can you tell me, specifically in relation to those investments, have you taken any steps in controlling the interest rate risk with derivatives?

MR. BARRY GALENZOSKI: No, we have not.

(BRIEF PAUSE)

MR. RAYMOND OAKES: So the Corporation doesn't hedge in that respect, despite the fact you talked about the Corporation hedging the risk?

MR. BARRY GALENZOSKI: We hedge our foreign currency risk; there's a cost to doing that. There would be a cost to -- to hedge investment risks on bonds, also.

The Corporation has -- has chosen not to do that at this stage.

MR. RAYMOND OAKES: There's no prohibition in statute or regulation preventing the Corporation from hedging to reduce their investment risk?

MR. BARRY GALENZOSKI: Not that I'm aware of.

MR. RAYMOND OAKES: It's -- is -- to your knowledge, sir, is it prohibited by the MPI investment policy statement?

MR. BARRY GALENZOSKI: No, I don't believe it's prohibited there at all.

MR. RAYMOND OAKES: Do you know, sir, whether the Department of Finance hedges their investments in that respect?

MR. BARRY GALENZOSKI: I believe they hedge their foreign exposure on their debt, but I don't believe they hedge anything else.

That's -- remember, they're looking at debt, we're looking at investments; it's a little bit different.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Mr. Galenzoski, we talked briefly about mark-to-market accounting.

Would it be your position that that mark-to-market accounting increases the risk of the investment portfolio?

MR. BARRY GALENZOSKI: No, I don't believe it increases the risk of the portfolio. We had -- when we had -- when we were invested in equity swaps, that certainly increased the risk to the portfolio because we couldn't control the timing on -- on the results. And we had unfavourable results for a few years until we stopped investing in that type of equity investment.

But, no, I don't believe the other would have an impact.

MR. RAYMOND OAKES: So at most it would be a reporting issue?

MR. BARRY GALENZOSKI: Well, it's a reporting issue, but, you know, there is going to be potentially some downside for both the Corporation and -- and the Provincial Government with respect to reporting unfavourable results because of the balanced budget legislation and the summary budget requirements as they stand right now. That could have some impact on the Provincial finances going forward, but that's still to be determined, and we're working on that.

MR. RAYMOND OAKES: Mr. Chairman, I'm moving to the scintillating topic of actuarial reserves, and I know that it can be very fatiguing to be on the edge of your chair for this long. So I'm just wondering, did you want to take a break now, or some other time?

THE CHAIRPERSON: Now is a good time to take a break.

--- Upon recessing at 2:39 p.m.
--- Upon resuming at 2:59 p.m.

THE CHAIRPERSON: Mr. Oakes...?

MR. RAYMOND OAKES: I seem to be emptying the room, somewhat, Mr. Chairman. I hope that's not being directly reflective of my cross-examination skills. But, I'll press on in event.

THE CHAIRPERSON: It shouldn't have given everyone an opportunity to leave, Mr. Oakes.

MR. RAYMOND OAKES: Just for time tabling, I advised Board Counsel just during the break that I'm a little more than half way through, so I will require some time tomorrow, as well.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: And back to the scintillating topic, actuarial reserves, just so we're all on the same page, I'm in the tab just commencing prior to Tab number 8, so the materials filed immediately preceding that.

And I'm referring to CMMG Interrogatory 1-85, and I would ask the Corporation to confirm that if the loss development factors changed in the review of policy liabilities, then would the claims forecast also change?

(BRIEF PAUSE)

MR. DON PALMER: I think this goes on to an answer I've given quite a bit, and that's if assumptions change, the results will change.

MR. RAYMOND OAKES: So, just to confirm as well, then, the rates are based on the claims forecasts, so given those assumptions, a change in assumptions would result in a change of rates as well?

MR. DON PALMER: If you're talking loss development factors within the context of ratio of ultimate claims to reported claims, yes.

Given that the historical, ultimate claims costs are different, they would mean a different base for the forecast and, yes, the results would be different.

MR. RAYMOND OAKES: And again, you've just somewhat defined what loss development is, but just taking that one step further, if loss development changes so that the ultimate costs decrease, then the rate requirement also would decrease?

(BRIEF PAUSE)

MR. DON PALMER: That could be an effect. In forecasting, for instance, if you were forecasting some precipitous change in trend or something, you know, you could -- you could have the same forecasting come -- forecast coming from two (2) different sets of underlying data, depending what other assumptions you had.

But, in general, that would be true.

(BRIEF PAUSE)

MR. RAYMOND OAKES: In the material I want to refer you, Mr. Palmer, to Table AI.9, Exhibit 1, Sheet 1 of the policy liability review for February 28th, 2005 and ask you to confirm that the bulk of the incurred but not reported, which is, of course, the IBNR PIPP serious losses, are they followed by the PIPP weekly indemnity?

MR. DONALD PALMER: Yes. In this particular reporting of un-discounted IBNR that's -- that's true.

MR. RAYMOND OAKES: And the IBNR for these major groups are calculated on a discounted basis; is that correct?

MR. DONALD PALMER: The discounted amounts are shown in the section on that page under 2 which is all the various discounted months.

MR. RAYMOND OAKES: And how is the discount rate selected?

MR. DONALD PALMER: It's based on a -- for most of the PIPP benefits based on a real rate of return of 3 per -- 3 percent.

MR. RAYMOND OAKES: Is that rate adjusted for inflation?

MR. DONALD PALMER: It's the real rate. There's no inflation adjustment required.

MR. RAYMOND OAKES: Then for financial purposes the reserves are calculated at 2 percent and the difference becomes part of the provision for adverse deviation; is that correct?

MR. DONALD PALMER: Not quite. The discount is calculated 2 percent and the difference is the interest rate component of the provision for adverse deviation.

MR. RAYMOND OAKES: So, from a practical perspective it's 2 percent that's used to calculate the claims provisions?

MR. DONALD PALMER: No. I wouldn't agree with that. I -- I would say that the provision for adverse deviation is something distinct.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Mr. Palmer, would you say that the interest rate, PFAB, be part of the required capital in the MCT calculation?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: And if the discount rate selected was higher, would the IBNR increase or decrease?

MR. DONALD PALMER: If it's a higher interest rate it would be a decrease in the claims provision.

MR. RAYMOND OAKES: And then the required capital would be lower?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: If the discount rate selected in the review was higher; would this in turn decrease the level of claims forecast for these coverages?

MR. DONALD PALMER: The amount of -- the discounted amount of claims would change. Yes.

MR. RAYMOND OAKES: Change by --

MR. DONALD PALMER: Decrease.

MR. RAYMOND OAKES: -- decreasing. Thank you. And that would ultimately decrease the level of the rate requirement?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: Referring to the Interrogatory II-15 which follows in our binder, Appendix 2, page 1, is the discount rate used by MPI for valuing its pension liabilities the assumed rate of return on assets less the rate of inflation, some 3.75 percent?

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

MR. RAYMOND OAKES: That's higher than the rate used for the IBNR; is that correct?

MR. BARRY GALENZOSKI: Well, the IBNR is on a real rate of return. This is not on a real rate of return.

MR. RAYMOND OAKES: The number that we had asked you to confirm was 3.75 percent which was arrived at by deducting the 2 percent rate of inflation included in the rate of return from the 5.75 percent.

So would you like to change that answer?

MR. BARRY GALENZOSKI: Yes, based on three point seven-five (3.75), that is on a real rate of return.

MR. RAYMOND OAKES: And that's higher than the rate that you've used in the IBNR?

MR. BARRY GALENZOSKI: Yes, based on our

discussions with our actuary, the -- we have a different actuary for our pension liability, it's a different type of liability, and this was the appropriate numbers to be used for calculating that particular liability.

MR. RAYMOND OAKES: And if you'd have decided that that was the applicable rate that you should have been using for the IBNR, then the IBNR would be lower; is that correct?

MR. BARRY GALENZOSKI: The discount factor would be higher, resulting in a lower overall number.

MR. RAYMOND OAKES: Referring to CMMG-2-10, if we subtract the rate of return from the inflation rate, would that provide the real rate of return on the MPI investment portfolio?

MR. DONALD PALMER: On a historical basis, yes.

MR. RAYMOND OAKES: And speaking of a historical basis, if we look at that table in most years has MPI's real rate of return been higher than 2 percent in six (6) out of those seven (7) years?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: And subject to check, would you accept that the average real rate of return would have been about 5.45 percent?

MR. DONALD PALMER: I've checked it, that's right.

MR. RAYMOND OAKES: And if MPI had used this to calculate the IBNR, the IBNR would be lower?

MR. DONALD PALMER: Stop me if you've heard this before, different assumptions produce different rates.

MR. RAYMOND OAKES: And would -- those assumptions would result in lower rates?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: And the lower capital requirements in the MCT?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: And then referring to CMMG-1-34, is it correct that MPI does not include an equity risk premium in its forecast of investment returns?

MR. BARRY GALENZOSKI: That's correct.

MR. RAYMOND OAKES: Do you know, sir, what discount rate SGI or ICBC uses to discount its policy liabilities?

MR. BARRY GALENZOSKI: No, I do not.

MR. RAYMOND OAKES: Are you familiar, sir, with a member of the Canadian Institute of Actuaries by the name of William Weiland, I'm spelling that W-E-I-

L-A-N-D?

MR. DONALD PALMER: I'm familiar with Mr. Weiland, yes.

MR. RAYMOND OAKES: And I understand that he's a casualty actuary that is ICBC's consulting actuary?

MR. DONALD PALMER: Yes. He works for Eklund Partners, which is a firm that this Board is familiar with.

MR. RAYMOND OAKES: And are -- are you familiar, sir, with the fact that Mr. Weiland has used a 5 percent rate for discounting in BC?

(BRIEF PAUSE)

MR. DONALD PALMER: That's a discount rate that Mr. Weiland is using. I don't know that that's a real rate of return. The bulk of ICBC liabilities would be a third party liability, bodily injury, which are not subject to automatic indexing, so this could very likely not be a real rate of return.

MR. BARRY GALENZOSKI: I'd just like to bring one (1) thing to your attention, if I might, if you take a look at the Corporation's Annual Report for 2004.

(BRIEF PAUSE)

MR. BARRY GALENZOSKI: Pardon me, that's at AI-10.

(BRIEF PAUSE)

MR. RAYMOND OAKES: I have that, sir. Do you have a page reference.

MR. BARRY GALENZOSKI: And look at page 45. It's note number 7, it's at the top of page 45. And this talks about the provision for unpaid claims including adjustment expenses, is discounted using the following discount rates and we provide some information with respect to different discount rates that are used for different heads of damage with respect to our claims provisions. And you can see that it isn't all that the -- that the 3 percent real rate of return.

(BRIEF PAUSE)

MR. RAYMOND OAKES: You're speaking, sir, of the page 45, at the top there's a table, 2005 benefits and interest rate assumptions; is that correct?

MR. BARRY GALENZOSKI: That's correct.

(BRIEF PAUSE)

MR. RAYMOND OAKES: As our discussion commenced, we indicated that it was 3 percent per year.

MR. BARRY GALENZOSKI: That's for the PIPP and other, death and impairment benefits and it's -- on all other coverages, it's 5.7 percent by year, 5.35 percent and 5 percent thereafter.

So going back it reduces over time.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Mr. Galenzoski, would PIPP be the biggest chunk of the IBNR?

MR. BARRY GALENZOSKI: Yes, it would.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Moving now, Mr. Chairman, to some questions relative to the RSR and Mr. Galenzoski, from a historical point of view, was the last time this Board visited RSR in details, the hearings for the 2002/03 rates held in the fall of 2002, to your recollection?

MR. BARRY GALENZOSKI: That sounds right.

MR. RAYMOND OAKES: And I understood that that hearing followed the, of course, the -- the 2001/02 Application in which MPI found itself with an excessive amount of RSR which was returned to the ratepayers in the form of a surplus dividend; do you recall that as well, sir?

MR. BARRY GALENZOSKI: Yes, I do.

MR. RAYMOND OAKES: And my recollection is that dividend was approximately $75 million and every ratepayer received a dividend of approximately 16 percent; would that be correct?

MR. BARRY GALENZOSKI: Yes. Now keeping in mind what I put on the record earlier today that was based on our estimates where we thought we were going to be with respect to our financial results.

Those estimates proved to be wrong, and so we actually provided more of a discount than was -- than the Corporation could reasonably afford, based on its numbers that occurred after the fact.

(BRIEF PAUSE)

MR. RAYMOND OAKES: And I appreciate those comments. In the Board Order 179/01 at page 27, the required retained earnings using the MCT at the time of that ruling was approximately $127 million; does that sound right, sir?

MR. BARRY GALENZOSKI: Can you give me a reference to that, please?

(BRIEF PAUSE)

MR. RAYMOND OAKES: It's in our materials, just the first of which is an excerpt from Board Order 179/01 just preceding Tab 10 at the bottom of the page.

(BRIEF PAUSE)

MR. DONALD PALMER: Just to put a little bit of context, the MCT, in its final form, was enacted for the 2003 year. There was a couple of generations of MCT tests before that.

I'm not sure that, necessarily, this number is completely comparable to the current MCT test.

But that is the number that was stated in the document?

MR. RAYMOND OAKES: Mr. Palmer, just

following on your explanation. Is it possible that, by way of undertaking, you could file a summary of the changes of the MCT, since that time?

(BRIEF PAUSE)

MR. DONALD PALMER: I guess I should have kept my mouth shut.

I think we can find changes. I don't know if there's substantive changes or not.

--- UNDERTAKING NO. 22: MPI to file a summary of the changes of the MCT.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: And following the next page in our tabbed materials, page 51 of that same Board Order, in the middle paragraph.

Would you agree with me that at that time, the Public Utilities Board concluded that the MCT was of no direct relevance for establishing the Corporation's RSR target for rate setting purposes?

MR. BARRY GALENZOSKI: This was the beginning of our educational process and at that point they had that point of view, yes.

MR. RAYMOND OAKES: And in the conclusion in its order this Board set a target of 50 million to 80 million for the RSR; is that correct, sir?

MR. BARRY GALENZOSKI: I believe that's correct.

MR. RAYMOND OAKES: If we used that target, would the surplus RSR for 2006/07, excluding the IIF fund that's been appropriated, be about $62 million?

MR. BARRY GALENZOSKI: Well, if we're using the numbers that were actually booked as at the end of our last fiscal year, I believe that was about $135 million, so if you take $80 million away from that, it would be 55 million.

However, if you take Mr. Todd's number, that the 80 million is now 90 million, well then that changes the number by 10 million.

MR. RAYMOND OAKES: And how about the number for 2006/07 projected?

MR. BARRY GALENZOSKI: Well, we -- I think the policy is that we would not go on projected numbers, so those numbers wouldn't be relevant.

MR. RAYMOND OAKES: And if we left the IIF fund in the retained earnings, then the amount available would be?

MR. BARRY GALENZOSKI: Zero.

MR. RAYMOND OAKES: I'm sorry?

MR. BARRY GALENZOSKI: If you're taking the IIF fund separate and leaving that stand or -- or including it back in?

MR. RAYMOND OAKES: My question was about including it back into the amount?

MR. BARRY GALENZOSKI: Again, we'd have to use the numbers as of February of '04 -- of '05 and that IIF wasn't created at that point in time. So the numbers that I gave you previously would stand.

We'd have 135 million in -- in overall RSR and you take away either the 80 million or 90 million target number to come up with either 55 million or 45 million.

MR. RAYMOND OAKES: Thank you for that clarification. That 55 million surplus distribution would be about roughly 13 percent of projected premiums written in 2006/07?

MR. BARRY GALENZOSKI: I think it would be closer to 10 percent because you're looking at about a little over $6 million now for 1 percent of basic Autopac.

MR. RAYMOND OAKES: So that 10 percent, that's pretty similar to the proposed rate increase sought from the motorcyclists of some 12.7 percent?

MR. BARRY GALENZOSKI: Except the dollar amounts are different. Overall dollar amounts are different. We're not going to raise $55 million by -- from the motorcyclists.

MR. RAYMOND OAKES: The case would be, if there was a surplus dividend then, on average, motorcyclists would have no increase for 2006/07, in that scenario?

MR. BARRY GALENZOSKI: Agreed. Agreed. If it was applied on a pro rata basis, yes.

MR. RAYMOND OAKES: Mr. Galenzoski, when was the last time, in your tenure, that the Corporation had to draw down its RSR to meet financial needs?

MR. BARRY GALENZOSKI: Two (2) years ago.

(BRIEF PAUSE)

MR. BARRY GALENZOSKI: If you look at the statement that's attached just before Tab 10 in your own material you'll see the statement of basic insurance retained earnings. And it shows that for the fiscal year 02/03 ending February of '03, a basic loss $30 million, the year before that a loss $11.7 million. So that would have been the drawdown I was talking about.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Cumulatively they wouldn't have approached $80 million?

MR. BARRY GALENZOSKI: Well, just in those two (2) years we're looking at about $42 million. So that's a pretty big number.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Mr. Chairman, I have another exhibit. It relates to the DCAT and so, again, I would ask the good offices of the Board Secretary to assist us.

(BRIEF PAUSE)

THE CHAIRPERSON: It should be CMMG-5?

MR. RAYMOND OAKES: Yes, Mr. Chairman.

THE CHAIRPERSON: Any problems with that, Mr. McCulloch? It appears to be from your material.

MR. KEVIN MCCULLOCH: Yes, it does appear to be from our own material, Mr. Chairman.

THE CHAIRPERSON: Did you check, Mr. Oakes, exactly...

--- EXHIBIT NO. CMMG-5: DCAT material.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Mr. Galenzoski, the DCAT Report was shown in Section AI.19, that was from August of 2004; is that correct, sir?

(BRIEF PAUSE)

MR. BARRY GALENZOSKI: In AI.19, we now have two (2) D-CAT Reports, one (1) was dated August 23rd, 2004, and the last one (1) submitted was dated September 23rd, 2005.

MR. RAYMOND OAKES: Mr. Galenzoski, when we were here doing these Rate Hearings a year ago, you would have been aware of the -- at least the first of those two (2) reports when -- at the 2004 Hearings for 2005/06 rates; is that correct?

MR. BARRY GALENZOSKI: Yes, and I believe we filed that one (1) at that particular Hearing, just like we're filing the replacement of September 23rd, 2005 this year.

MR. RAYMOND OAKES: Are the minimum capital test numbers, in that report that we just referred to, the same ones as used for the MPI proposed new RSR target of $214 million?

MR. BARRY GALENZOSKI: Yes.

MR. RAYMOND OAKES: Referring to the response to CMMG Interrogatory 2-20, can you explain how Mr. Christie determined the model inputs 97.5 percent and 99 percent confidence limit on those scenarios?

MR. BARRY GALENZOSKI: Yes, I think he explains that in his report that 99 percent confidence level is what they would normally do for a private sector insurer, P&C insurer, but they're also doing it at the 97.5 percent level, because that's the confidence level that the Corporation has selected some time ago.

MR. RAYMOND OAKES: Are you aware of how he determined those exact amounts?

MR. BARRY GALENZOSKI: He would have done it through his calculations that he does to run the D-CAT.

MR. RAYMOND OAKES: You're not privy to those, sir?

MR. BARRY GALENZOSKI: Well I'm not -- you know, I wasn't sitting beside him when he did the calculations, but you know, the -- his base assumptions are in his report. The detailed calculations I haven't reviewed.

MR. DONALD PALMER: In MPI-220, in

adverse scenarios MPI experience is fitted to a normal distribution?

MR. RAYMOND OAKES: What seed value would that be, sir?

MR. DONALD PALMER: I'm sorry, I don't understand the question.

MR. RAYMOND OAKES: I'm asking you what the raw input to the model would be?

MR. DONALD PALMER: I believe that what you're looking for there is our financial business case going forward, so you would have used that as a base for starting the whole assumptions or his whole review.

MR. RAYMOND OAKES: Perhaps I'll ask another question. Did the Corporation verify the reliability of the results?

MR. DONALD PALMER: The Corporation reviewed the calculations to assure itself that the reports were accurate.

MR. RAYMOND OAKES: Is that available, sir?

MR. BARRY GALENZOSKI: Well it's the resulting report that you've got in front of you, we've -- we would get the report in its draft form, and then we would do some checks to ensure that the data that he used was accurate, and the final report is what you've got in front of you.

MR. RAYMOND OAKES: Looking at the -- the last or the late filed report, the 2005 DCAT report, in comparison with the predecessor, the August 2004 report, for the underlying assumptions of the base scenario, Mr. Christie decreased the direct premium growth assumption.

Can you provide us with an explanation of why this change was made?

MR. BARRY GALENZOSKI: We'd have been doing that based on our base business case going forward that we would provide them as a start to this process.

MR. RAYMOND OAKES: Which aspect of the business case?

MR. BARRY GALENZOSKI: Well there would be all aspects of it. The business case would detail what our premium expectations were, what are claims expectations are, investment returns, expenses.

All of that would be detailed in our business case going forward. Our multi-year forecast and he would use that in -- as his base assumptions going forward in this report.

MR. RAYMOND OAKES: You also changed the assumption with respect to ceded reinsurance premium growth.

Do you have an explanation of the reason for that change?

MR. BARRY GALENZOSKI: I believe -- I'm not sure exactly what change he made on that particular aspect of it, but we would have given him our views with respect to what we think was -- was reasonable with respect to going forward position.

In other words, you know, if you just take a straight percentage increase in that particular premium, going forward it gets to a number that's larger than the Corporation believes is going to be palatable with respect to placement of a program.

And so I believe he took some of that into account.

MR. RAYMOND OAKES: On page 18, Mr. Christie tests a scenario with one single very large catastrophic loss, being a hailstorm. In the previous report, Mr. Christie deployed the same scenario, but provided confidence limits for the analysis.

Can you explain the reason for this change?

(BRIEF PAUSE)

MR. BARRY GALENZOSKI: I'm not sure why he wouldn't have provided the confidence -- you're talking about the 97.5 and the 99 percent confidence intervals that he would have looked at?

MR. RAYMOND OAKES: That's correct.

MR. BARRY GALENZOSKI: Yes, I'm not sure why he wouldn't have provided that in this report.

MR. RAYMOND OAKES: Was Mr. Christie asked to prepare the results at a lower confidence limit, say 90 percent?

MR. BARRY GALENZOSKI: No.

MR. RAYMOND OAKES: Are you aware, sir, that Mr. Wailand the actuary we -- at Eckler (phonetic) that we spoke of that works with IBC prepares such an analysis relating to the ongoing debate relating to the MCT at ICBC?

MR. BARRY GALENZOSKI: Well that's a totally different debate that we're not privy to, and I don't know whether it's relevant to our discussions.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Referring to CMMG-1-102, CMMG copied the relevant sections of actuarial standards of practice.

I'm sure that Mr. Palmer's familiar with that, and would you agree that there's no dictated methodology for applying DCAT as there would be in a standard, scientific prodical and, for an example, like DNA testing.

Would you agree that there's no dictated methodology for applying the DCAT?

MR. DONALD PALMER: I don't think I would quite agree with that. There are certainly dictated guidelines.

It's not a recipe book, if that's what you're asking.

MR. RAYMOND OAKES: Would you agree with me that different actuaries doing a DCAT analysis could get different results?

MR. DONALD PALMER: Sure, I would agree with that.

MR. RAYMOND OAKES: And just building on the one (1) phrase that you had reduced to rote, would you agree that using different assumptions would yield different results?

MR. DONALD PALMER: No, I wouldn't agree. No, I'm kidding; yes, I would agree with that.

MR. RAYMOND OAKES: Okay. And in some cases, could those different approaches potentially indicate that MPI was in more than adequate financial condition?

MR. BARRY GALENZOSKI: I think that's again moving to an area of the evidence that isn't part of what we put together here.

We -- you know, you're providing you with the best estimates that we can get from our external actuaries. They indicate what they indicate and we put those forward.

I don't know if we want to sit here and speculate as to whether that could be better or worse than what we've got here.

I think if you look at the report that's provided, both from last year and this year, the actuaries conclusion is that our financial situation for basic is not satisfactory.

MR. RAYMOND OAKES: In the Interrogatory CMMG-II-22 can we conclude that the DFA that's talked about is a statistical approach in that it considers the statistical relationships?

MR. DONALD PALMER: I've been waiting to say this statement for the whole hearings that DFA is stochastic and DCAT is deterministic.

MR. RAYMOND OAKES: I'm glad I provided that opportunity. It probably means far more to you than it does to me. But that could go for a number of these questions.

MR. DONALD PALMER: Just a little actuarial humour.

MR. RAYMOND OAKES: The amount of the humour is taken note of. Carrying on in the same vein, I think, unfortunately. If one was to take the outputs of the DFA model and plug them into the MCT would you have a statistical base model of capital required compared to a non-statistical approach?

MR. DONALD PALMER: First of all, I'm not sure that I'm going to agree that DCAT is a non-statistical approach. It's not stochastic it doesn't use a statistical assumptions in -- to determine it.

So, if your DFA was constructed in such a way that MCT was one of the outputs of it, yes, you'd get a range of MCT results.

MR. RAYMOND OAKES: In terms of actuarial literature related to dynamic financial analysis and capital testing, sir, are you familiar with a paper from the Casualty Actuarial Society prepared by Mango and Mulvey (phonetic)?

MR. DONALD PALMER: I have to admit, I haven't read it. We did a quick -- quick search and that particular paper was presented in the Casualty Actuarial Society forum from 2000 which is a non-refereed journal. So it's there.

MR. RAYMOND OAKES: It's also present in the CMMG binder. And this is the material that precedes Tab 11 and it is tabbed at the top and I'd ask that if you can please turn to page 58, that's the numbers on the bottom of those pages.

It's on the top of the page it would be tabbed as 13; do you have that, sir?

MR. DONALD PALMER: I have it.

MR. RAYMOND OAKES: And are there other risk measures that could potentially be used such as the probability of ruin, the variance or standard deviation of the surplus, expected policyholder deficit, expected default loss rate on surplus?

And can I ask, has MPI applied any of those alternatives?

MR. DONALD PALMER: We had done some work years ago on probability of ruin. The -- you know, there's no reason that these particular risks couldn't be modelled.

MR. RAYMOND OAKES: The Corporation hasn't done that relative to this or any recent calculations?

MR. DONALD PALMER: No.

MR. RAYMOND OAKES: And just referring to page 60, two more down, tabbed at page 15 of our materials, there's a section entitled "risk measure standards".

Has MPI considered any of these alternate standards?

MR. BARRY GALENZOSKI: The alternate standard we've considered is MCT at 100 percent.

MR. DONALD PALMER: I don't know that just taking a quick look at this that this really outlines the standard in the strictest sense of an actuarial standard.

MR. RAYMOND OAKES: Moving on in the minimum capital test, Mr. Galenzoski, can you give us a very brief description of the minimum capital test?

I know that you provided that last week as well?

MR. BARRY GALENZOSKI: The minimum capital test is a risk-based approach sanctioned through OSFI and a requirement for all P&C insurers in Canada that are regulated by them, to determine level of capital required for these companies at MCT at a 100 percent, with the requirement to be at minimum of a 150 percent of that test.

MR. RAYMOND OAKES: Are you aware, sir, that I'm advised that the Minimum Capital Test at least partially flowed from an international convention known as Basil-1; are you familiar with that?

MR. BARRY GALENZOSKI: No, I'm not.

MR. RAYMOND OAKES: And are you -- I take it then, that you wouldn't be familiar with an updating of that now referred to as Basil-2?

MR. BARRY GALENZOSKI: Or even Basil-3, 4 or 5 --

MR. RAYMOND OAKES: Okay.

MR. BARRY GALENZOSKI: -- if they exist.

MR. RAYMOND OAKES: Would it be fair to say that the MCT test is driven by risk margin factors mandated by OSFI, similar?

MR. BARRY GALENZOSKI: Yes, it would be fair to say that.

MR. RAYMOND OAKES: Okay. One (1) time as I recall MPI used to use other approaches such as VAR, and a statistical operational risk assessment; is that correct?

MR. BARRY GALENZOSKI: That's correct, we used several versions of that.

MR. RAYMOND OAKES: Referring to comments on cross-examination, Mr. Galenzoski, made by you on cross-examination by this Board Counsel and Mr. Williams in 2004. And that's the second last page in that tab of materials following number 11 before number 12.

And it reads, your comments are in response to a question by Board Counsel, the question being:

"Yes. And in light of those last few answers, sir, I would refer you to page 2 of the report, namely the Executive Summary in the last paragraph, the penultimate sentence which says, quote, 'because MPI can establish MPI basic premium levels subject to PUB approval', and essentially in a monopoly situation, the levels of RSR that the OSFI test require are not necessarily appropriate for MPI basic, can you comment on that?"

Your answer was:

"Certainly, I -- we agree with that. We believe that it isn't necessary to be at the MCT minimum levels. That's a 150 percent, or necessarily even at the 100 percent level."

And then you go on to say you do agree with this statement.

Do you recall making those remarks and are those still true today, sir?

MR. BARRY GALENZOSKI: Well I don't recall making the remarks, but they are here in black and white, and I guess, as an explanation, the Corporation still believes that it doesn't have to be at the 150 percent MCT level. We have established a range of between 50 percent of the 100 percent MCT level at the lower end, and the top end being at a 100 percent MCT.

And so I think I would still stand behind this statement because it says that we didn't necessarily have to even be at the 100 percent level. In other words, if we were within our range, we were -- we were going to be relatively satisfied, particularly if we were near the top of that range, rather than the bottom.

MR. RAYMOND OAKES: MPI isn't subject to any of the OSFI rules; is that correct?

MR. BARRY GALENZOSKI: We're not regulated by OSFI.

MR. RAYMOND OAKES: Okay.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Is there some way for the benefit of those of us that don't have the level of involvement of working with all of these tests, where you can explain why the RSR under the MCT increased so dramatically from a $127 million in 2001 to 214 million for '04/'05?

MR. BARRY GALENZOSKI: Well I think part of that is Mr. Palmer's explanation that he -- the test that -- that previous time was not necessarily the same test. The -- the test today is -- if you'll look at the numbers that we provided last year, compared to this year, they actually decreased.

It -- it all depends on -- on what's happening, what's on your balance sheet with respect to your liabilities, what's your -- some of the off balance sheet items. For instance, in good times when investment gains, unrealized gains are -- are fairly significant, there's -- part of the MCT is to allow a 50 percent reduction of capital required, so that would have an impact on the number that comes out.

So, you have to look at the individual circumstances year over year as to what is driving the number and the formula that was being used at the time.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Is there any reconciliation of the change in those numbers that you could file before this Board?

MR. BARRY GALENZOSKI: No.

MR. RAYMOND OAKES: And why not, sir?

MR. BARRY GALENZOSKI: Well, number 1, you know, we may not have done a detailed calculation with respect to the number that come up with the 127.

I guess we, you know, we could look back at that, but I'm not sure that would be terribly helpful. There could be some changes in the formula, for instance, that could account for it, that it may not be able to determine.

MR. RAYMOND OAKES: You talked about some of the factors that may have been driving that massive increase in the -- between the two (2) numbers.

So I understand it, as claims provisions increase, does the rate required capital under the MCT increase?

MR. BARRY GALENZOSKI: Absolutely. Claims provisions are going up quite dramatically year over year. You know, well over $100 million a year in claims provisions, that's impacted by not just your -- your actual case reserves, but your financial provisions, the changes that are occurring there, plus or minus.

So claims would have a very major impact on -- on the overall test.

MR. RAYMOND OAKES: And are those claims

provisions, you say they've been increasing dramatically, are they likely to continue to increase dramatically?

MR. BARRY GALENZOSKI: Well, they're likely to increase for some many years to come and we've indicated that in the numbers we show going forward with respect to what we anticipate the MCT will look like, going forward.

MR. RAYMOND OAKES: So would it be your testimony today that you're going to be back before this Board in a number of years showing that the capital required under the MCT is increasing each year?

MR. BARRY GALENZOSKI: Yes.

(BRIEF PAUSE)

MR. RAYMOND OAKES: My next topic deals with rates and specifically, looking back the last couple of rate hearings, the rate prognosis for basic insurance for the overall vehicle pool were, at that time, from my recollection, that rates would continue to need to rise in the order of 2.5 percent or so for the next three (3) years.

Do you recall any statements to that effect in October 2003?

MR. BARRY GALENZOSKI: Yes, I believe

that the Corporation put forth a proposal like that which was rejected by the PUB.

(BRIEF PAUSE)

MR. RAYMOND OAKES: But if that was the rate prognosis that MPI had at that time, how do you reconcile that with the fact that the rates stay virtually unchanged for the vehicle pool for '05/'06 and that you're applying for no rate change in '06/'07?

MR. BARRY GALENZOSKI: And in fact had a rate decrease for this particular year and loss to share cost. All of that encompassed in that overall process, and the reason was, is that we were looking at a claims scenario that was quite significantly different than what we had anticipated originally.

That proved to be not a going forward position that was required and therefore the rate requirement that was initially indicated didn't materialize.

MR. RAYMOND OAKES: Another factor, I would assume, is that retained earnings increase from some 43 million to 182 million during that same period as referenced in TI-16, is that correct, sir?

MR. BARRY GALENZOSKI: Well that

happened. The only real impact that that has is that that makes more investment income available for -- to offset any rate requirement.

But that -- the very fact that there was an increase in -- in retained earnings for basic wouldn't necessarily impact rates, in fact, it wouldn't impact rates going forward at that point in time.

MR. RAYMOND OAKES: Now on the basic side, I assume that MPI has a 100 percent of the automobile insurance market in Manitoba; is that correct?

MR. BARRY GALENZOSKI: On the regulated part, yes.

MR. RAYMOND OAKES: And is there any information available to this Board about what the share would be on extension and SRE in terms of market share?

MR. BARRY GALENZOSKI: Not that we've put forward, but we would probably estimated that in the 90 percent range, around there.

MR. RAYMOND OAKES: Between ninety (90) and hundred (100), would that be fair?

MR. BARRY GALENZOSKI: No, ninety (90) and hundred (100) -- a hundred (100) is definitely not on, so --

MR. RAYMOND OAKES: Right.

MR. BARRY GALENZOSKI: -- I would say

closer to ninety (90) than hundred (100).

MR. RAYMOND OAKES: Okay. And are you in a position to advise how many active competitors there are in the market for products sold under extension?

MR. BARRY GALENZOSKI: No. Not offhand. There would probably be thirty (30) or forty (40) or more.

MR. RAYMOND OAKES: I'm talking specifically about Autopac extension?

MR. BARRY GALENZOSKI: Yes. And, you know, I'm -- I don't have specific information. I haven't reviewed anything recently on that. But there's a fairly active insurance community out there and I've got to expect that there would be thirty (30) or forty (40) competitors for optional insurance.

MR. RAYMOND OAKES: And would most of those be competing on SRE lines of business?

MR. BARRY GALENZOSKI: On both. They would both -- if they were set up to do business on SRE they're probably set up to do business on extension also.

MR. RAYMOND OAKES: For motorcyclists who want fire and theft coverage, would there be competitors in the Manitoba marketplace that you're aware of?

MR. BARRY GALENZOSKI: Not that I'm aware of. But I'm sure there are some. Whenever I buy my motorcycle insurance I buy it from MPI.

MR. RAYMOND OAKES: Good to have you on board. Moving to the topic of alternative risk measure, CMMG had provided an Interrogatory I-2 which asked that we confirm -- that you confirm that MPI is not subject to -- I'm sorry.

I'm sorry, I have the numbers wrong. CMMG II-11 which asked questions about the semi-variance and specifically:

"Does the semi-variance, as specified, measure the variation of outcomes that are adverse to the financial health of the Corporation while the calculation of variance measures the variation of outcomes that are both favourable and adverse."

If I want to boil down the answer, can I say, fairly, that simply put the semi-variance measures the risk of a bad financial outcome?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: And looking at the attachment to CMMG/MPI-I-7 which is the next Interrogatory in that tab that precedes number 14, is the semi-variance for the last ten (10) for actual claims incurred versus forecast about decimal 33 percent?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: And is this about one-half (1/2) of the variance of 64 percent?

MR. DONALD PALMER: Thirty-three (33) is almost half of sixty-four (64), yes.

MR. RAYMOND OAKES: In the last five (5) years has the semi-variance decreased to decimal 24 percent? I'm looking at the five (5) year semi-variance, the bottom --

MR. DONALD PALMER: The five (5) year semi-variance shows as point 24 percent, yes.

MR. RAYMOND OAKES: And that would be almost a third of the variance?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: So the overall risk of error in the claims forecast is much smaller than the Corporation's previously indicated since the variance was used in these measures?

MR. DONALD PALMER: I'm not sure that I agree with that quite how it was stated, no.

MR. RAYMOND OAKES: Well, if the semi-variance is lower in the last five (5) years than over the last ten (10) years, can you tell me whether MPI has improved in its forecasting?

MR. DONALD PALMER: I would just say that indicates the semi-variance is smaller. I don't know that that's necessarily a measure of our -- if its improved forecasting ability.

MR. RAYMOND OAKES: It means the risk is decreasing though, doesn't it?

MR. DONALD PALMER: The historical measure is less, yes.

MR. RAYMOND OAKES: So, overall, the risk of error in the claims forecast is much smaller than previously indicated since the variance was used in those measures?

MR. DONALD PALMER: No. Our -- our observed values are less. I wouldn't say that the risk is less.

MR. RAYMOND OAKES: I'm going to ask questions relative to ICBC, so the most informed member of the Panel with respect to ICBC's operations can hopefully answer some of these.

Can you describe their basic product of insurance, what I'm looking for specifically is confirmation for coverages such as collision and theft, which are not required.

The customer can choose to buy them from ICBC, or a number of competitors for those coverages?

MR. DONALD PALMER: The basic compulsory

package in British Columbia is confined to third party liability with a maximum of two hundred thousand dollars ($200,000) and also to some limited accident benefits coverage.

MR. RAYMOND OAKES: Okay. So some portion of ICBC sales, and I'd suggest to you, sir, that it's in excess of approximately half, are from the basic products, and the remaining other half would be made in a competitive market; would that be fair?

MR. DONALD PALMER: I don't know that -- exactly the split, it's something greater than half for basic, sure.

MR. RAYMOND OAKES: Okay. Consequently ICBC then would have a lot more competitive risk than MPI?

MR. DONALD PALMER: Yes.

MR. RAYMOND OAKES: Okay. In the last five (5) years, sir, I'm sure you've been made aware that there's suggestions that ICBC may be private -- privatized?

MR. DONALD PALMER: There have been rumblings to that affect, yes.

MR. RAYMOND OAKES: Okay. And certainly it would be a consideration for ICBC to apply MCT to IBC to make it -- to raise the capital targets?

MR. BARRY GALENZOSKI: No, I'm not so sure I would agree with that. Now there's been some recent pronouncements coming from their CEO, indicating that they're not going to be privatized. They put that one (1) to bed, it was in the last four (4) to six (6) weeks, so I don't think that that's a consideration.

They're -- when they're looking at their rate setting process, they've selected certain targets with respect to retained earnings for both their basic and optional side. They've separated those two (2).

With respect to the level of retained earnings that they have, they've now divided the -- the company on that basis, and they've set separate targets for retained earnings for each of the lines of business. A 100 percent of MCT for the basic, and 200 percent of MCT for their extension.

MR. RAYMOND OAKES: And so my question really was would apart -- and I appreciate your answer, but going back to the question, would applying MCT standards to ICBC make it easier to privatize, as it would be closer to compliance with OSFI regulations?

MR. DONALD PALMER: At a 100 percent I don't believe it would be for the basic compulsory part of that.

MR. BARRY GALENZOSKI: I'm not so sure

that they were ever contemplating privatizing the basic anyway. I think it was more their optional side, and putting them at 200 percent might make an argument for that, but that's not part of what we're comparing ourselves to.

MR. RAYMOND OAKES: Mr. Chairman, I'm moving to another technical discussion, the use of PFAD, I'm wondering if the Board has any clean up matters, or whether this might be an appropriate time to end for the day?

THE CHAIRPERSON: Thank you, Mr. Oakes, we'll look forward to you picking up again tomorrow morning. We have three (3) small items. Mr. Galenzoski, and Mr. Palmer I think probably could answer them.

Towards assisting us in better understanding the Application we've got three (3) short questions.

Mr. Galenzoski, when Mr. Oakes was reviewing the actuarial assumptions, it was indicated that the assumption for return on the investments was approximately 5 3/4 percent. And in reviewing MPI's current investment asset mix, last week we noted a sort of a split, eighty-five (85) to ninety (90) to fifteen (15) fixed income equity balance.

And furthermore, that we -- we are aware generally, I think we discussed that last week, that currently ten (10) year Canada Bonds yield less than 4 percent. That's to try to help you to understand where we're coming from with the question.

MPI has linked the current investment mix to among other factors, MPI's asset liability duration match. And we'd appreciate it if you could share the asset liability duration match schedule with us, because it might help us in understanding your current asset mix in references to asset mix comparability, whether the insurer's better. So I just leave that with you.

MR. BARRY GALENZOSKI: Well, the asset mix is spelled out in our investment policy statement which is provided in the material that we provided and we've also provided a lot of performance reports that would talk about the actual asset mix that we have.

THE CHAIRPERSON: What I'm talking about, though, Mr. Galenzoski, is the -- on one (1) hand there's duration of your various bonds and things like that, and you can assume that I suppose there's an infinite or immediate duration with respect to the equity portfolio.

On your liability side, you've got a tiny little bit of tort left and then you have, of course, the large PIPP portion and then you have your immediate, presumably collision and comprehensive, things of those matters.

So those liabilities would have different durations and I would -- you've mentioned the asset liability mix, so Im not trying to direct anything to you.

I'm wondering if you could help us. We're trying to understand your asset mix in comparison, for example, to this other one that's been placed before us, the WCB for example, which appears to be more in the line of 50/50 between equity and fixed income.

But if I could just leave it with you and you could ponder that.

The other two (2) questions again are the same nature of helping us understand something.

With respect to reinsurance, and dealing with reinsurers, are matters such as the MCT test and/or RSR levels discussed and, if so, is there any of those discussions that would be helpful if the Board were, at least, aware of?

MR. BARRY GALENZOSKI: We have discussions with respect to MCT and retained earnings, more pointed towards them than pointed towards us in respect to their financial viability and their credit ratings.

So I do require that our -- our

reinsurance broker provide us with the MCT scores on each of our reinsures that is based -- that files reports in Canada, and as well, we look at their credit ratings on a worldwide basis, so we know that for all of our reinsurers.

Now with respect to our own retained earning levels, that hasn't been a big factor in whether these companies want to do business with us and -- and I guess a case in point is that we've had negative retained earnings and they've done business with us just when we've had healthy retained earnings, with respect to our various lines of business.

So they're not -- they're not looking to do a credit check on MPI in the same basis that I'm looking to do a credit check on them and I think that's the long and short of the answer to that one.

Hopefully that will help you.

THE CHAIRPERSON: Yes, thank you, appreciate that.

The last one was sort of a short one was, with respect to the provision for adverse deviation, we note that the PAD is apparently basically doubled and over -- about four (4) years ago and we're wondering whether you explained the drivers of the main factors that -- and assumptions that are inherent in the increase?

In English, rather than in actuarial terms, if possible.

MR. DONALD PALMER: And we prefer to use the acronym PFAD rather than PAD.

There's -- there's three (3) components to the provision for adverse deviation. One is a -- a claims margin and the amount of margin is specified within the Canadian Institute Standard of Practice.

Depending on the line of business, typically a line -- a property line would have a lower claims margin. A -- a newer line of business or one with more volatility, such as PIPP, would have a higher provision for claims margin.

The second component is the interest rate margin and we talked about that with Mr. Oakes briefly, that the discount is calculated at an interest rate without margin and one with margin and again, the -- the amount of margin is specified within the standard of practice.

The third component of the PFAD is a reinsurance margin. We have that accounted for elsewhere on our balance sheets, so we don't actually formally use a reinsurance margin within our actuarial report.

THE CHAIRPERSON: So is it the growth of

PIPP since it was introduced and it hasn't quite matured yet to the point where more falling off than joining, the reason for the what you call exponential in one place?

MR. DONALD PALMER: That's correct, and I'm not sure -- a few years ago, and I don't know what you're comparing against, we -- we didn't have the interest rate margin as explicitly specified as we do now so that may -- we may not have included that within the reporting and the provision for adverse deviation as well.

THE CHAIRPERSON: So if you did start doing that, that would have an instantaneous effect, I take it?

MR. DONALD PALMER: Well, we have done that now. So the provisions for adverse deviation include both the interest rate margin component and the claims development component.

THE CHAIRPERSON: When you were talking about the claims margin, for example, there's not a lot of insurers in Canada that are operating PIPP to the degree that is being operated here.

Does that have any effect on the margin that's called for? Lack of experience, if you like, of the private insurer?

MR. DONALD PALMER: We're, through

consultation with the appointed actuary, we would be on the higher end of the margin.

THE CHAIRPERSON: And when you talk about the interest rate margin, and I'm just going back to it because I didn't completely grab the import of it, in this particular -- we know on the other side when interest rates rise when you hold a fixed bond portfolio the market value obviously falls.

Does it work to the opposite to some degree when it comes to the, I think you just call it, PFAD?

MR. DONALD PALMER: The -- the margin has the effect of lowering the effective interest rate. So the -- the liability is higher with a lower interest rate.

THE CHAIRPERSON: So, in other words, if interest rates fell it would hurt you on the investment side and help you with the size of the PFAD?

MR. DONALD PALMER: I don't know, necessarily, that the margin would change. Your -- your interest rate assumption would go up or down which would impact the -- the size of your liability.

Your calculation with the margin would change up and down but I'm not necessarily sure that the difference would change that much. It would be the margin itself that you would have to adjust in order to increase or decrease the PFAD.

THE CHAIRPERSON: I follow you. Okay, in short terms then, if the -- if interest rates climb two hundred (200) basis points it would hurt you on the asset side and, if you like, help you on the liabilities?

MR. DONALD PALMER: Not necessarily to the same degree. But, sure.

THE CHAIRPERSON: Thank you. We'll ponder all that.

MR. BARRY GALENZOSKI: Perhaps I can just provide some more clarification on the PFAD for you that's found at AI.10 in our annual report and on page 45, just below the two (2) charts that are showing there, and I can read it in, it says:

> "According to accepted actuarial practice the discounted reserve includes a provision for adverse deviation of 200.5 million, in 2004 that was 181.2 million, comprised of a claims development component of 118 million, 2004 that was 110.5 million, and an interest rate component of 82.5 million, 2004 70.7 million."

THE CHAIRPERSON: Thank you, Mr.

Galenzoski, that's quite helpful. So we'll shut down --

MR. KEVIN MCCULLOCH: Mr. Chairman, just before we shut down there was one undertaking that Mr. Palmer is now in a position to provide a verbal response to. I believe it had to do with the highest or lowest percentage rate change for passenger vehicles.

THE CHAIRPERSON: Mr. Palmer...?

MR. DONALD PALMER: Yes. The highest increase for passenger vehicles can be found in TI.3, Part 3.2A. There's three (3) vehicles that have a 23.81 percent increase. They're all all-purpose vehicles in Territory 4. The 1991 Chevrolet Lumina, the 1992 Chevrolet Lumina and the 1991 Mercury Grand Marquis LS are all going up 23.81 percent.

That's a combination of a couple of factors but all of those three (3) vehicles are moving from a rate group 3 to a rate group 4.

THE CHAIRPERSON: Thank you, Mr. Palmer. So we'll recommence tomorrow. Thank you.

--- Upon adjourning at 4:05 p.m.

Certified Correct,

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Carol Wilkinson