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8 August 2018

Darren Christle
Board Secretary
400 330 Portage Avenue
Winnipeg, MB R3C 0C4

Dear Mr. Christle:

Re: Manitoba Public Insurance – 2019 General Rate Application (2019 GRA)

Overview

Pursuant to s. 15 and 16 of the PUB *Rules of* Practice, CAC Manitoba is applying for an order compelling Manitoba Public Insurance to undertake the analysis requested in CAC Manitoba IR 84 f) and 85 g) on the grounds that:

- the information sought is relevant to the Public Utilities Board in its assessment of the Asset Liability Management Study as outlined under issue 21 of *Order 82-18* as it goes to overall credibility of the study and whether the analysis was biased by the choices made by MPI;
- MPI has failed to provide any response much less a full and adequate response to a relevant information request within the meaning of s. 15 and 15 of the *Rules of Practice*; and,
- it is more cost effective to have the information prepared by Mercer's for MPI than it is for the expert witness of CAC MB to attempt to replicate the analysis.

CAC Manitoba notes that the PUB has directed that August 10, 2018 be the date for hearing motions. Neither Mr. Williams or Ms Dilay will be in Winnipeg on August 10, 2018 for the hearing of this motion. However, Mr. Williams would be pleased to present his arguments via conference call.

Mr. Williams also observes that MPI has indicated in email correspondence today that while its motion for confidentiality has been made returnable for August 10, 2018 it is unlikely to be in a position to file its supporting affidavit on that date. In the event the PUB chooses to reschedule the oral argument, counsel for CAC MB are available on any other days other than August 13, 2018 or August 14, 2018. Alternatively, the Board may wish to consider the motion based on written submissions.

The Rules of Practice

Section 15 1) a) of *The Rules of* Practice imposes an obligation on MPI to provide full and adequate responses to information requests except in circumstances where it contends the information request is not relevant, the answer is not available or cannot be provided with reasonable effort, the information is confidential or where it relies on other grounds.[1]

1 *Rules of Practice*, s. 16.

The Information Request and the Reasons for Refusal

In information requests 84 f) and 85 g), CAC Manitoba asked Mercers to rerun its efficient frontier model under different assumptions. In refusing the information request, MPI does not appear to argue that the information request is not relevant. Rather MPI appears to rely on the suggestion that it would cost approximately $20,000 to respond to 84 f) and $10,000 to respond to 85 g).

MPI references an email exchange with CAC Manitoba in which it asked that the intervenor provide "evidence that Mercer's inflation forecast used in the ALM study was sufficiently inaccurate, or flawed in some way, so as to call into doubt the results of the ALM study" before it agreed to provide the informatio sought.

MPI does not reference an earlier email from CAC Manitoba in which detailed reasons were presented suggesting the information was relevant and material. MPI also does not reference a subsequent email from CAC Manitoba in which it was indicated that MPI and CAC MB would have to agree to disagree.

The Information Requested is Relevant and Material

The information sought will assist the PUB in its assessment of Issue 21 as set out in PUB Order 82-18:

> Asset Liability Management Study, including **review of all aspects of the Study recommendations** and implementation thereof, the basis for and evaluation of risk and return, **alternative portfolio compositions**, proposed portfolio segregation and **recommended composition of the investment portfolio(s)**, forecast investment performance and changes to the Investment Policy Statement." (emphasis added)

As the PUB will be aware the modelling of efficient frontiers for the purposes of investment decisions can be highly susceptible to key assumptions including assumptions relating to interest rates.

The purpose of the questions posed is to test the decisions made regarding key assumptions on which the ALM study is based. If the qualitative rationale to support a key decision (such as liability characteristics) is flawed, the value of the ALM study may come into question.

In this case, based on our review of the material, the ALM study is potentially vulnerable given the simplifying assumption about the nature of the liabilities (nominal vs real). Given this reality, it is important to understand the implications of that assumption.

The liability modeling "simplification" does not just impact the apparent attractiveness of Real Return Bonds as an asset class. It also impacts the return/risk relationships for all assets, and therefore the relative attractiveness of all asset classes - with particularly notable impacts on other real assets (i.e. real estate and infrastructure). Given the liability assumptions used in the ALM study, it appears that the model will "prefer" nominal bonds, and will tend to not prefer RRBs, real estate and infrastructure. That is a material outcome related to three asset classes.

If different liability assumptions were used, it is possible that alternative portfolio compositions would have been recommended. This is central to Issue 21 being examined by the PUB.

As noted above, IRs CAC 1-85(g) and 1-84(f), along with the other sub-parts to those IRs, are attempting to test whether the assumptions and constraints imposed in the Mercer's ALM study were appropriate. Specifically:

- Were **liabilities** modeled as accurately as possible (by including RRBs in the liability benchmark portfolio)? If not, this can make RRBs (as an asset class) look inferior to nominal bonds, which means the model will not like RRBs as much as nominal bonds. A more subtle but important point is that the liability modeling assumption makes other real asset classes (like real estate and infrastructure) look less attractive too, not just RRBs. The liability benchmark portfolio definition is fundamental to the whole analysis.
- Were **RRBs (as an asset class)** inappropriately excluded from consideration as an asset class to consider (constrained weight = 0%)? If so, this can bring into question the results of the ALM study.

In terms of issues relating to inflation, CAC Manitoba notes that inflation is not completely flat (some volatility) in the MPI projection models, and time horizon may be too short (5 years versus decades). However, this was not modeled, and models are very sensitive to assumptions.

A Response to IR 84 f) and 85 g) by Mercers is the most cost effective way to obtain reliable information

We note that CAC Manitoba and its consultants could do the analysis, using the first method of single period optimization to get efficient frontiers, for less than $10,000 by downloading an Excel optimization model from the web and using Mercer's capital market assumptions as inputs to the model. However, there are two difficulties with this option that would likely make it more efficient for MPI/Mercer's to conduct the analysis:

1. MPI and the PUB would likely want to check our calculations, and it is possible that Mercer's would decide to do the analysis themselves directly and compare the results; and
2. We cannot replicate the second method (multi-period scenarios), at least not without a lot more work/cost, and assumptions could differ from those that were actually used by Mercer under the Nominal approach. Based on our review of the material, the second method was likely the basis for the final decision (the first method being "preliminary" to start eliminating some asset classes and adding others to the study).

Conclusion

Thank you for your consideration of this motion.

Yours truly,

BYRON WILLIAMS
DIRECTOR

BW/vs