



# Minimum Capital Test Review

## Final Report (Confidential – Internal)

Prepared for The Manitoba Public Insurance Corporation by MNP<sup>LLP</sup>  
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# Executive Summary

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## Background

The Minimum Capital Test (“MCT”) is a calculation that is required to be submitted to the Office of the Superintendent of Financial Institutions (“OSFI”) on an annual basis for all Federally Regulated Property and Casualty (“P&C”) insurers as stated in the Insurance Companies Act. The MCT calculation adheres to guidance outlined in OSFI’s MCT Guideline (“the Guideline”). The MCT determines the minimum capital/margin required at which property and casualty insurance companies must operate.

The Manitoba Public Insurance Corporation (“MPI”) is not a federally regulated financial institution and therefore is not required to submit the MCT to OSFI. MPI calculates the MCT as required by the Public Utilities Board (“PUB”) as part of information submitted in determining and monitoring MPI’s ongoing financial health, in addition to being used as part of premium rebate determination.

Typically, the MCT calculation is done for an organization as a whole, however, MPI prepares its calculation on a line of business basis. Fundamentally, the MCT Guideline uses a risk-based formula to determine the capital available and the capital required in relation to insurance operations as a gauge in determining the Corporation’s ability to satisfy future obligations.

At a minimum, OSFI requires federally regulated P&C insurers to maintain an MCT ratio of 100%. However, OSFI has established an industry-wide supervisory target capital ratio of 150%. This provides a cushion above the minimum requirement and facilitates OSFI’s early intervention process. P&C insurers are expected to establish their own internal target capital and maintain on-going capital above this target.

## Objective

MPI Senior Management requested MNP LLP (“MNP”) to independently conduct a review of the MPI MCT calculation to confirm that:

- The MCT calculation is performed in adherence with the Guideline, as issued by OSFI;
- Internal controls are in place regarding data entry and integrity for the MCT calculation.

## Risks

The following inherent risks were considered in planning for this audit:

- Data entry errors exist in the MCT calculation workbook,
- The Guideline has been inappropriately interpreted or not adhered to in producing the MCT calculation,
- Aggregate balances have not been appropriately allocated to subcategories in the MCT calculation or the appropriate line of business,

- Actuarial inputs into the workbook have not been calculated appropriately, and
- The MCT calculation has not been reviewed by an appropriate level of management.

## Scope

MNP reviewed and assessed:

- The Q2 2021 MCT calculation workbook; and
- The design and operating effectiveness of controls supporting the MCT calculation.

Data entered into the MCT calculation was not subject to audit procedures and therefore was assumed to be correct.

In the below comments we have not estimated the impact on any calculations which may or may not be significant to the overall MCT calculation.

## Limitations

The work performed did not constitute an audit, examination or a review in accordance with generally accepted auditing standards or attestation standards. We did not audit or otherwise verify the information supplied to us in connection with this engagement from whatever source.

Fraud is perpetrated with the intent to conceal and our procedures were not designed to detect fraud. This report is solely for the information of MPI. Any use that a third party makes of the report and any reliance or decisions made based on it are the responsibility of such third party. MNP accepts no liability or responsibility for any loss or damages suffered by any third party as a result of decisions made or actions taken based on the deliverables.

Our work is limited to the specific procedures and analyses described herein. Our report must be considered in its entirety by the reader. Selecting and relying on a specific portion of the analyses or factors considered by us in isolation may be misleading

## Conclusion

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Management performs the MCT calculation on a quarterly basis that generally appears to be in accordance with the Guideline, as issued by OSFI. MNP has noted the findings below from both a control and detailed calculation perspective. MNP has discussed these findings with management.

### *Control Findings*

Our review identified key control weaknesses resulting in significant deficiencies. Some controls related to this process are not adequately designed or operating as designed or there is a lapse in the control environment. We have summarized these findings and included our risk ranking of them (Low, Medium, High), beginning on page 6 of this report.

### *General Calculation Findings*

Our review identified areas of the detailed MCT calculation that require further consideration. A list of the findings has been presented, beginning on page 8 of this report.

### **Overall Recommendation**

Based on the assessment results summarized above, MPI should develop a plan to eliminate current control deficiencies noted in the MCT creation process, in addition to reviewing the detailed calculation findings noted and determine their impact on the MCT calculation. MPI has provided their proposed responses which has been included with our observations.

## Acknowledgment

We would like to express our appreciation for the cooperation and efforts made by MPI team members whose contributions assisted in ensuring a successful review. MPI team members provided MNP with unrestricted access to all activities, records, systems, and personnel necessary to conduct this review freely and objectively.

## Summary of Observations

### Risk Ranking and Assessment Criteria

The observations outlined in this report have been assessed based on a rating scale defined in this table:

Rating	Rating Description
H = High	The observation represents a control weakness, which could have or is having a major adverse effect on the ability to achieve process objectives. The observation requires immediate management action.
M = Medium	The observation represents a control weakness, which could have or is having an adverse effect on the ability to achieve process objectives. The observation requires management action within the short-to-intermediate term.
L = Low	The observation is not critical but should be addressed in the longer term to either improve internal controls or efficiency of the process.

### Control Observations and Recommendations

OBS #1. Detailed Review of MCT Calculation	High
<p><b>Observation</b></p> <p>The MCT calculation is prepared on a quarterly basis by the Assistant Manager, Financial Reporting and then sent to the Chief Financial Officer (“CFO”) for review and approval. The MCT calculation should be reviewed in a greater level of detail by a member of MPI management before the calculation is sent to the CFO. In addition, supporting documentation included in the MCT calculation workbook (e.g., data derived from the financial statements, support for actuarial calculations included etc.) was not organized in such a manner in some areas that would allow for an efficient review.</p> <p><b>Impacts</b></p> <p>Errors or omissions related to inputs into the MCT calculation can exist without the appropriate granularity of review and documentation trail supporting the inputted numbers.</p> <p><b>Recommendation</b></p> <p>MPI should revise the current review process for the MCT calculation. MPI should ensure the calculation is reviewed in detail including the validation of amounts to supporting documentation or reconciliations. To enhance the review process, a quarter-by-quarter analytical analysis and explanation of movement in the MCT percentages should be included in the workbook which would clearly explain the cause for any changes in the percentage calculated.</p>	

## Management Response

### Activities to be performed:

MPI will have two levels of review as management prepares the Capital Report and of the detailed P&C 1 calculation. Review to be completed by Manager Financial Reporting or the Corporate Controller. Management will complete a bottom-up review and then sign off, and an analytical analysis and explanation of movement in the MCT percentages will be added to our Capital Reporting to the Board which will be reviewed by Executive after review from Manager Financial Reporting/Corporate Controller where we will review and document movement in and clearly explain the cause for any changes in the percentage calculated.

OBS #2. MPI Actuaries are not Sufficiently Involved in the MCT Calculation Process

High

## Observation

Through discussions held with various members of MPI management team and as evidenced by errors found in the MCT calculation (see *Detailed MCT Calculation Observations* section of this report), it was noted that the involvement with MPI's actuarial Department was minimal (limited to a high-level review of the output percentage as opposed to detailed review of actuarially derived amounts) in regard to the creation and review of the MCT calculation. As such, areas of the MCT that require actuarial expertise are not being appropriately reviewed or considered by those with the relevant knowledge.

## Impacts

Errors or omissions related to actuarial driven numbers in the MCT calculation may occur.

## Recommendations

MPI should ensure that all actuarial related information in the MCT calculation is reviewed by MPI actuarial staff.

## Management Response

### Activities to be performed:

Capital Report as per described in point 1 above, will be reviewed with Chief Actuary and designate on a quarterly basis and all recommendations will be reviewed, and aligned to ensure Actuarial involvement/inputs in the MCT calculation with a sign off from our Actuarial Group documented on our Board site.

OBS #3. Irrelevant Information

Medium

## Observation

Certain information included in the MCT workbook was not relevant to the calculation or had not been appropriately updated. For example, there were instances noted where data had been entered in various tabs within the workbook that was incorrect in comparison to the quarterly financial statements. However, this data did not ultimately affect the MCT calculation percentage calculated.

### Impacts

Inaccurate and irrelevant information included in the workbook may lead to inefficient supervisory review, as well as increased difficulty in validating numbers to the general ledger and quarterly financial statements.

### Recommendations

MPI should review data included in the MCT workbook and ensure it is relevant to the MCT calculation itself. If the data is not relevant, it should be removed from the workbook.

### Management Response

#### Activities to be performed:

MPI has reviewed data included in the MCT workbook and there are worksheets that though are not required to be populated link through to other worksheets, and are hence required. MPI will note the finding, and will hide worksheets that are not required.

OBS #4. Detailed MCT Compilation Documentation Does Not Exist

Medium

### Observation

No formal documentation exists today as to how the MCT calculation is completed or the process as to how the MCT calculation is compiled.

### Impacts

Knowledge of how the MCT calculation is compiled may be lost if management currently involved in the creation of the calculation were to leave the Corporation.

### Recommendations

MPI should document a process flow narrative which notes the relevant controls and responsibilities at each step of the process, where relevant information comes from, and what managements assumptions are in any instances where the Guideline is not explicit. This would allow other staff to complete the calculation in the absence of regular staff, and ensure the calculation is completed consistently and may also assist in the detailed review process.

### Management Response

#### Activities to be performed:

MPI is creating a process narrative and workflow procedures for the MCT performance, and cross-training on same. There will be documentation on:

1. Process flow narrative which notes the relevant controls and responsibilities at each step of the process;
2. Origin of relevant information; and
3. Managements assumptions are in any instances where the Guideline is not explicit.



## Detailed MCT Calculation Observations

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In the below comments we have not calculated any potential impact on the quarterly MCT calculation.

### *Data/Calculations*

1. Tab 30.64 – Provision for adverse deviations are not currently being deducted from unpaid claims.
2. Tab 30.64 – Net unearned premium is being used instead of net premium liabilities excluding provision for adverse deviations.
3. Tab 30.66 – All foreign exchange has been included in “Other”. In the calculation, there are specific currencies noted where foreign exchange should be inputted, and not lumped all into “Other”.
4. Tab 30.66 – Owner occupied properties is included in the MCT calculation at cost – this should be at amortized cost.
5. Tab 30.71 – The cash balance being included in “Cash held on premises” may not meet the definition of “Cash held on premises” based on review of the Guideline. Therefore, this amount would be required to be included in “Cash other”.
6. Tab 30.71 – “Due from Other line of business” is an intercompany re-balancing account, however is included in receivables on this tab. This is a not a valid receivable with a third party, and should be removed from the calculation.
7. Tab 40.52 – The classification of private debt needs to be investigated further to ensure it’s current treatment is appropriate in this tab.
8. Tab 60.20 – No values are being recorded for the beginning period net unearned premiums, which could mean that any risk margin related to net earned premium may be understated.
9. Multiple tabs – Hardcoded numbers were noted in the calculation where reference to sources is not explained/documentated.

### *Process*

1. The calculation is performed on a line of business basis. This creates complexities in allocations that are not generally required in the MCT calculation. The MCT is generally calculated on a consolidated basis.
2. The MCT is forecasted to the end of the year as part of the most recent premium rebate determination. This is unusual in the insurance industry and may create problems if unexpected adverse claims experience develops after declaring a rebate.

### *Management Response*

Management has reviewed the above suggested observations made by MNP LLP and incorporated the points as management sees fit.