

## MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE CORPORATION (MPI)  
GENERAL RATE APPLICATION FOR  
2015-2016 INSURANCE YEAR

Before Board Panel:

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

HELD AT:

Public Utilities Board  
400, 330 Portage Avenue  
Winnipeg, Manitoba  
October 29, 2014  
Pages 978 to 1207



“When You Talk - We Listen!”



1 APPEARANCES

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Certified of Transcript

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1 --- Upon commencing t 9:03 a.m.

2

3 MS. CANDACE GRAMMOND: Madam Chair, I  
4 just want to advise that Mr. Williams -- fine, that he  
5 might be late, and that we should just start without  
6 him.

7

8 (BRIEF PAUSE)

9

10 THE CHAIRPERSON: Good morning,  
11 everyone. We're ready to begin our -- I believe it's  
12 our fifth day of hearings for the GRA of the Manitoba  
13 Public Insurance Corporation and we're going to begin  
14 with cross-examination by Ms. Grammond.

15

16 MPI PANEL 2 RESUMED:

17

18 DAN GUIMOND, Previously Sworn

19 LUKE JOHNSTON, Previously Sworn

20 HEATHER REICHERT, Previously Sworn

21

22 CONTINUED CROSS-EXAMINATION BY MS. CANDACE GRAMMOND:

23 MS. CANDACE GRAMMOND: Thank you, Madam  
24 Chair. Mr. Johnston, I'm going to start out this  
25 morning with some questions in the actuarial areas, so

1 I think it'll be with you.

2                   The reference for the first line of  
3 questions is RSR.2, Appendix A, pages 83 and 84. So  
4 the first couple of questions you may not need to refer  
5 to those, but I will be going there so. And Diana has  
6 got page 83 up on the screen.

7                   So, Mr. Johnston, the first question is  
8 this. We've talked in the past about stochastic  
9 modelling. Can you remind us about that process as  
10 it's employed by the Corporation with respect to claims  
11 incurred?

12                   So what does it involve, and what do the  
13 results tell us at a high level?

14                   MR. LUKE JOHNSTON: Stochastic  
15 modelling is getting -- getting around like the  
16 distribution of outcomes, rather than just a point  
17 estimate. As you know, we -- we have to produce a  
18 fixed estimate for a rate indication.

19                   Ultimately we have to decide on our best  
20 estimate forecast, but the stochastic modelling piece  
21 gives you an idea of the potential variability of that  
22 best estimate. And as for a lot of the things we  
23 forecast, there's a lot of chance that occurs that are  
24 -- can impact our forecast, whether it's on claims, or  
25 equity returns, or interest rates, or whatever.

1 Particular to the claims stochastic  
2 modelling piece, we look at our actual claims history  
3 on a claim-by-claim basis. And without going into a  
4 ton of detail, we simulate claims on a month-by-month  
5 basis, and for each claim, we simulate the likelihood  
6 that that claim will have an injury, and then, you  
7 know, the cost of the injury, et cetera.

8 So, basically, it's a big model of the  
9 distribution of our -- of our losses based on our  
10 historical experience. Some -- for some things, we  
11 have a lot of experience. Like, collision, we have,  
12 you know, a hundred thousand plus claims a year for  
13 which to model. We would call that a -- a highly  
14 credible model. We have -- we have lots to go on.

15 For something like hail, it's -- it's a  
16 -- it's lot more uncertain. We've had a handful of  
17 major hailstorms. We have to make some less credible  
18 assumptions in some of those simulations, because we  
19 don't have as much to go on.

20 But what you see on -- on the screen and  
21 -- and if you scroll down a -- a little bit, in the top  
22 -- in the top table where it says, "Annual," the --  
23 that's the -- our stochastic model simulating -- the  
24 annual is the average claims incurred that are  
25 simulated from that model, and that's relatively

1 independent from our forecast. This is just saying,  
2 based on our history and how claims have occurred, this  
3 is, you know, what we see as the average. And then the  
4 cumulative sum of all those years is at the bottom of -  
5 - of that first table, the last row.

6                   When you go to the table below, that is  
7 the percentile distribution of all our simulations.  
8 And what that means is, for -- if we were to order all  
9 of -- so say we were to simulate a thousand years of --  
10 of data, and so, like, for the 2014/'15 year, we were  
11 to say, Put it in the model, and just by random chance,  
12 what could '14/'15 look like, you know, by -- if -- if  
13 we simulated the -- the year a thousand times?

14                   And what the bottom table is saying is,  
15 in that first column, if we were to order them from  
16 highest to lowest, 2 1/2 percent of our outcomes would  
17 fall at -- at \$582 million or less and all the way up  
18 to 97 1/2 percent would fall at \$680 million or less.  
19 And what that's telling you is between those -- you  
20 know, between those two (2) outcomes, chance alone can  
21 swing our numbers plus or minus 50 million without --  
22 you know, without any -- any -- not errors, but any --  
23 any misforecasts or anything, just pure chance  
24 occurrence. I think that's probably the best I can do  
25 there.

1 MS. CANDACE GRAMMOND: That's what I  
2 was expecting and more. So going back just for a  
3 minute to the stochastic modelling process, can you  
4 tell us whether there have been any improvements or  
5 changes to that work compared with what was done last  
6 year?

7

8 (BRIEF PAUSE)

9

10 MR. LUKE JOHNSTON: There -- there were  
11 no major changes, but I am going to check to see if  
12 there are any minor changes that... There -- there  
13 were definitely no significant changes to what we've --  
14 what we've done. But, of course, we're always trying  
15 to improve this model. So if -- so we use statistical  
16 software to -- to determine what -- you know, what the  
17 best model is, for example, and every year we'd  
18 reconfirm those assumptions.

19 So we have definitely improved our  
20 assumptions where we can, but I don't think we've made  
21 any significant changes to the -- or I know we haven't  
22 made any significant changes to the methodology, but  
23 I'll -- I'll confirm if there's been any minor tweaks.

24 MS. CANDACE GRAMMOND: Thank you. And  
25 I think we were wondering more about specific -- or,

1 pardon me, significant improvement. So if you're  
2 confident that there aren't any significant ones, then  
3 that -- that answers our question, so thank you.

4 MR. LUKE JOHNSTON: I am.

5 MS. CANDACE GRAMMOND: Mr. Johnston,  
6 you referred to the top table on the screen, which is  
7 on page 83, and you told us about the line item called  
8 "Annual" and the line item called "Cumulative."

9 Can you tell us how these amounts shown  
10 just in the top chart relate to the amounts shown as  
11 net claims incurred in Pro Forma 1?

12 MR. LUKE JOHNSTON: So that -- that's a  
13 very good question. So this -- this model is just  
14 simulating claims before any kind of discounting or,  
15 like, interest rate impacts. It's just forecasting the  
16 -- the undiscounted ultimate value, so to speak. So  
17 it's leaving aside all this uncertainty on the interest  
18 rate piece, and we talk about that particular risk  
19 separately in various places in the rate app and in the  
20 DCAT report. So these are just the actual claims  
21 costs.

22 The -- the annual numbers that you see  
23 in there undiscounted will be relatively close to  
24 what's in our rate application, but we haven't --  
25 they're not necessarily the same. Like we ran the

1 model as is. There are other reason -- like when we  
2 forecast, there are other assumptions that go into  
3 those forecasts other than just what the -- the  
4 stochastic model will -- will come up with, right.  
5 There might be a particular view on collision severity,  
6 or -- or things like that. I think that was  
7 everything.

8 MS. CANDACE GRAMMOND: Thank you. Now,  
9 tell me about the relationship between the amounts in  
10 the top table, so still just with that one, relative to  
11 the amounts shown as net claims incurred in the DCAT  
12 base scenario, if that's at all different from the  
13 answer that you just gave relative to the pro forma  
14 income statement.

15

16 (BRIEF PAUSE)

17

18 MR. LUKE JOHNSTON: So the same -- the  
19 same -- basically the same thing I just said. The DCAT  
20 scenario will -- these are again just ultimate costs  
21 before any discounting occurs. So the DCAT scenario  
22 will, of course, have the interest rate impacts, but it  
23 -- it utilizes this model. So in the -- what we call  
24 the high loss ratio scenario in the DCAT report  
25 utilizes this model -- let me just backtrack.

1                   The base scenario, which I think you  
2 asked about, utilizes the forecasting that we do in the  
3 claims incurred section of the rate app, and that's all  
4 justified in that section. As I mentioned, these  
5 results will be very similar, but net -- not  
6 necessarily identical, to those numbers. But this  
7 information is used as the basis to simulate that  
8 variability around your forecast in the DCAT report. I  
9 hope that answers -- yeah.

10                   MS. CANDACE GRAMMOND: Thank you. Yes,  
11 that's -- that's good. Thank you, Mr. Johnston. So  
12 now turning to the second table that we see on the  
13 screen, the longer one that you commented on a bit  
14 earlier explaining to us generally what's set out here,  
15 I do have a couple of specific questions.

16                   Would it be correct to say that the row  
17 marked as the 50th percentile, so about in the middle  
18 of the table, reflects the estimated level of  
19 cumulative ultimate losses at which actual outcomes are  
20 equally likely to be higher or lower?

21                   MR. LUKE JOHNSTON: Yes.

22                   MS. CANDACE GRAMMOND: And how does  
23 this median point estimate compare to the best estimate  
24 mean, or average, arising from the stochastic  
25 modelling? Like higher or lower, and by about how

1 much?

2

3

(BRIEF PAUSE)

4

5 MR. LUKE JOHNSTON: So if you look at  
6 the -- the annual -- in the top table, the base  
7 forecast, you'll see in the first cell it says 634  
8 million.

9

MS. CANDACE GRAMMOND: Yep.

10

MR. LUKE JOHNSTON: And in the -- in  
11 the bottom table, the 50th percentile is 622 million.  
12 So in this case, our base forecast is actually about 12  
13 million higher than the 50th percentile from the  
14 stochastic model.

15

And there's -- there's -- without going  
16 into the detail of every coverage, there are reasons  
17 why our base forecast is higher. A -- a couple just  
18 off the top of my head I can think of, recent hail  
19 experience has been very poor, and typically averaging  
20 20 to 30 million a year over the last five (5) years.

21

Our forecast has a more pessimistic hail  
22 assumption, while our stochastic model uses the entire  
23 history of our hail experience, and it's a little more  
24 optimistic. And -- and again, we just kind of put in  
25 our historical data and we let the model come up with

1 the distribution.

2                   So that's one (1) reason. And then, you  
3 know, other things, like if we have perhaps a more  
4 pessimistic outlook on collision in the forecast and we  
5 put the trend higher than the trend has historically  
6 been, that -- that would be also another reason.

7                   MS. CANDACE GRAMMOND: Thank you.  
8 Diana, can I get you to scroll down to page 84 and the  
9 first table there? Yeah. Thank you. So that top  
10 table on page 84 is entitled "Cumulative Simulated  
11 Ultimate Losses Minus Base Forecast for All Basic  
12 Coverages."

13                   Mr. Johnston, can you describe the  
14 information shown in this table?

15

16                   (BRIEF PAUSE)

17

18                   MR. LUKE JOHNSTON: So this is the  
19 complete table of -- I -- I talked about that one (1)  
20 point where the base forecast and the simulation  
21 results were -- were different. So if you look at the  
22 -- at the 50th percentile in '14/'15, you see that 11.7  
23 million, roughly. This is now the sum difference  
24 between the base and our simulated results for all  
25 future years.

1 MS. CANDACE GRAMMOND: Okay. So would  
2 it be fair to say that the base forecast of claims  
3 incurred appears to track most closely to the 75th  
4 percentile of the simulated results?

5

6 (BRIEF PAUSE)

7

8 MR. LUKE JOHNSTON: Just one (1)  
9 moment. I want to look at something.

10

11 (BRIEF PAUSE)

12

13 MR. LUKE JOHNSTON: Yes, that's correct  
14 in terms of this graphic, but the majority of that  
15 difference is generated purely from the hail forecasts.  
16 So if you go to page 78 of that same document, you'll  
17 see down at the bottom table of that page -- if you  
18 look at that 50th percentile row, you'll notice that,  
19 you know, those numbers look not exactly, but  
20 relatively similar to the deviations that you saw on  
21 the overall basis.

22

23 And per my previous comment, our hail  
24 forecast is definitely more pessimistic than our ten  
25 (10) year average hail, for example. If -- if you --  
we can go there if we need to, but the last five (5)

1 years of hail have continually hit us in the \$20 to \$30  
2 million range when we used to put out a forecast of 5  
3 or 6 million a year.

4                   So what -- what's been happening is not  
5 that we're getting this -- this big hundred million  
6 dollar storm that we're worried about. We're getting,  
7 essentially, kind of nickel and dimed with these little  
8 storms that cost 3 million here, 5 million there, and  
9 they have no reinsurance coverage because it's not a  
10 per-incident basis.

11                   So that table shows you that the -- the  
12 stochastic model again is taking just a longer -- a  
13 longer-term view in the forecast. It's trying to  
14 recognize recent history. And -- and we would talk to  
15 reinsurers about this regularly. They say that the  
16 frequency of storms everywhere has been increasing.  
17 And I'm not in a position to speculate whether that's  
18 climate change or anything like that. But I do know  
19 that my five (5) year average is 20 plus million more  
20 than it used to be, so that -- that's something we felt  
21 the need to put in the -- in the rating -- in the -- in  
22 the rates.

23                   MS. CANDACE GRAMMOND: Thank you, Mr.  
24 Johnston. My next question is this. Subject to check,  
25 if you wish, at last year's GRA, the comparable table

1 to the one on page 84, the last one that I had asked  
2 you about, showed that the base forecast of claims  
3 incurred tracked most closely to the 50th percentile of  
4 simulated results.

5 Can you confirm to what you would  
6 attribute this apparent upward shift with the simulated  
7 distribution of possible claims incurred outcome? And  
8 I don't know if you have -- if you've already provided  
9 that explanation relative to the hail, or if there's  
10 any other information you can provide.

11 MR. LUKE JOHNSTON: No, that's --  
12 that's a -- a good question. I -- it's -- the hail  
13 forecast that I just talked about is clearly one (1) of  
14 the main differences, but rather than speculate, we're  
15 -- we're looking at any other minor changes that were  
16 made. And I can just undertake to confirm what caused  
17 the difference between what we did last year versus --  
18 versus this year, okay?

19 MS. CANDACE GRAMMOND: Thank you. Got  
20 that? Okay.

21

22 --- UNDERTAKING NO. 26: MPI to explain the cause of  
23 the changes to the forecast  
24 between last year and the  
25 current year

1

2 CONTINUED BY MS. CANDACE GRAMMOND:

3

MS. CANDACE GRAMMOND: So, Mr.

4

Johnston, can you confirm that the GRA forecast of

5

claims incurred is still a best estimate?

6

MR. LUKE JOHNSTON: Yes, I can.

7

MS. CANDACE GRAMMOND: Thank you.

8

Okay, I'm going to go, then, to some questions with

9

respect to the actuarial standards. And I'll refer you

10

to PUB(MPI)1-42. I don't know that we need to spend a

11

lot of time on it, but you may want to have reference

12

to it.

13

14

(BRIEF PAUSE)

15

16

MS. CANDACE GRAMMOND: In that IR which

17

is now on the screen, it was asked if it is still the

18

Corporation's view that the pure actuarial-based method

19

is inconsistent with the Corporation's not -- nonprofit

20

mandate reportedly because the method does not

21

recognize investment income on retained earnings as an

22

offset to premium. And the Corporation's response to

23

the IR was, in essence, affirmative.

24

You with me so far?

25

MR. LUKE JOHNSTON: Yes, I am.

1 MS. CANDACE GRAMMOND: Do you agree  
2 with the Corporation's position in this regard, and  
3 why?

4

5 (BRIEF PAUSE)

6

7 MR. LUKE JOHNSTON: Okay, so per the  
8 response, we have filed evidence that shows how, if we  
9 had calculated rates on a pure actuarial-based method,  
10 that the actual break-even or zero profit rate --  
11 indicated rate change would be 7.6 percent.

12 So what -- what we're doing when -- when  
13 we say, Per pure actuarial-based method, we're  
14 literally taking only the policies that we're issuing  
15 for the 2015/'16 rating year, and we're forecasting out  
16 all the associated costs and revenues only for those  
17 policies. And then we're base -- we're saying, What  
18 premium do we need today on a present-value basis to  
19 cover all future costs?

20 So if you think of, like, a net present  
21 value calculation that you might do for a project or  
22 som -- or something, you have inflows, outflows.  
23 You're saying how much is needed today. And if we set  
24 it at zero percent profit, we get 7.6 percent.

25 In -- not in this response, but -- or,

1 actually, it is in this response. The cited quote in  
2 1992, the actuary at the time noted that, if we want to  
3 break even in the fiscal period, which is what we've  
4 come to understand as break-even for MPI, this method  
5 isn't going to -- going to work.

6                   This definition of 'break-even' isn't  
7 going to work because there's other revenues flowing  
8 into fiscal year net income, such as, you know,  
9 investment income on retained earnings, other impacts  
10 that might not have anything to do with '15/'16  
11 policies, but they might flow in from other adjustments  
12 that were made.

13                   And the goal was to create fiscal year  
14 net income to be break-even, or at least that was the  
15 understanding at the time, and that's what we've been  
16 doing for two (2) decades.

17                   So when -- when we produce the  
18 actuarially based rate -- rates, we did it just saying,  
19 What is break-even on that basis? And then we said,  
20 Well, what if we adjusted the rates such that we'd  
21 achieve the -- the current definition of 'break-even'  
22 that we use today?

23                   And that would offset that seven point  
24 six (7.6) to the -- the two point four (2.4) we have.  
25 And the rates calculated under both methods, like once

1 we made that adjustment, were almost identical.

2                   So it's -- the -- the way we -- the way  
3 we calculate rates in our current methodology is not  
4 100 percent pure actuarial standards. And -- but what  
5 we did show is that there's literally no difference in  
6 the indicated rates once you make this adjustment to  
7 get to our definition of 'break-even'.

8                   MR. REGIS GOSSELIN:    Could you repeat  
9 the def -- your definition of 'break-even', please?

10                   MR. LUKE JOHNSTON:    So the definition  
11 of 'break-even' that I -- that we use here in -- for at  
12 least two (2) decades and what -- and what I've done  
13 when I've set rates is that whole brea -- the average  
14 net income over the two (2) fiscal years that was the  
15 rating period needs to be zero.

16                   And we will cal -- well, we're -- like  
17 in previous discussions with Mr. Pelly through Ms.  
18 Grammond, we do all our rate setting on an actuarial  
19 basis. But at the end of the day, we've got to adjust  
20 -- offset the premiums to meet that mandate of break-  
21 even.

22                   So it's that -- that step that's  
23 different than what would happen if, you know, an  
24 actuary in the private sector would say, This  
25 particular group of policies, we want to make 10

1 percent profit. And on this group on the policies, and  
2 this group only, we -- you know, we do that net present  
3 value calculation. We put in a 10 percent load, and we  
4 contract that particular group of policies to see if  
5 they -- if they were profitable or -- or not.

6                   That's -- that's different than -- than  
7 what we do here. We're constantly adjusting every year  
8 to make sure annual fiscal year net income is zero, and  
9 that's worked for us. It's not that it's a -- it's a  
10 bad method. It works in this setting, and -- and it's  
11 given us very good rate stability for, you know,  
12 fifteen (15) to twenty (20) years.

13                   MR. REGIS GOSSELIN: Using your  
14 definition of 'break-even', you know, you're -- what  
15 we're typically seeing is the first year of the two (2)  
16 year period often is a negative and the second year is  
17 a positive, you know, so to arrive at a -- a break-even  
18 based on those two (2) values.

19                   And the effect of the positive relative  
20 to the negative, like what's happening with the  
21 positive that causes it to be higher? Is it -- is it  
22 the effect of volume and upgrades that's causing that -  
23 - you know, that -- there -- there usually is a  
24 difference of -- you know, it depends on the year, but  
25 2 million to 3 million negative, positive, something

1 like that.

2 But anyways, what's the effect that's  
3 causing that second year to be higher than the first  
4 year, all things being equal?

5 MR. LUKE JOHNSTON: Well, it's -- it's  
6 definitely highly dependent on the assumptions used in  
7 our forecast. So if -- if interest rates are assumed  
8 to rise over the period and it becomes increasingly  
9 favourable, that would be one -- one (1) reason. If --  
10 the opposite would be true if they were declining. I -  
11 - I don't know that I've seen a declining interest rate  
12 forecast yet in my history over the rating period, but  
13 that -- that's one (1) -- one (1) reason.

14 Another reason is, as we talked about  
15 yesterday, we have that volume factor which we forecast  
16 in the 1 1/2 to 2 percent a year range, and that  
17 upgrade factor which is around 2 1/2 percent. So with  
18 those two (2) items, if you get 4 -- 4 1/2 percent  
19 premium growth naturally without doing anything, if  
20 that trend is higher than what you're trending your  
21 costs, you're going to make money on the net income.

22 So to the extent that historically  
23 that's been true, we would need to adjust rates down to  
24 -- so -- so we don't -- so rates don't go faster than  
25 the cost base. But in this year's rate app, there's a

1 couple instances where that's definitely not true.

2 Like collision we're struggling with, right.

3                   So historically -- I talked a little bit  
4 about our PIPP forecast, and ten (10) years ago we  
5 weren't expecting this but basically over the last  
6 decade claims have been flat. So that's an example  
7 where we have a forecast growing, you know, less than  
8 inflation. And if -- if we assume that it will keep  
9 growing that way and premiums will naturally grow with  
10 the 4 to 4 1/2 percent, then we should hopefully see  
11 rate decreases, or -- or zero. But to the extent that  
12 that's not true, we -- we don't. Is that -- is that  
13 helpful? Yeah.

14                   MS. CANDACE GRAMMOND: Thank you.

15                   MR. REGIS GOSSELIN: But there would --  
16 there -- there are no actuarial factors that would  
17 influence the outcomes for the -- the coming year  
18 versus the -- the second year out?

19                   MR. LUKE JOHNSTON: The only other  
20 piece is when you put in a rate change, it just -- you  
21 just get only half of it in that first year because of  
22 staggered renewals. So if you -- you know, you --  
23 yeah, so you put in the 1 percent. You expect to get  
24 an extra 8 million. Well, the first year you only earn  
25 four (4) of it, and that -- that's another reason.

1 That's a more obvious reason than the ones I just  
2 mentioned, actually.

3

4 CONTINUED BY MS. CANDACE GRAMMOND:

5 MS. CANDACE GRAMMOND: Mr. Johnston,  
6 I'm going to ask you to refer to PUB/MPI I-46. Diana,  
7 if you could -- we'll just get it up, and then...

8 So the Corporation was asked to provide  
9 a restated version of the major classification required  
10 rate changes derivation exhibit, which includes a  
11 profit provision that recognizes as a premium offset  
12 the contribution of the expected investment return on  
13 the assets supporting Basic total equity. And we -- we  
14 have that information in the response.

15 Can you indicate what the Corporation  
16 was trying to achieve with respect to the information  
17 set out here and the steps taken with respect to  
18 investment income?

19 MR. LUKE JOHNSTON: We do have -- we do  
20 have a follow-up to this question too, but the -- the  
21 question was getting to this point where we do generate  
22 investment income, or revenue, from sources such as  
23 retained earnings or other assets that are not  
24 specifically supporting policies we're issuing in  
25 2015/'16.

1                   So we were trying to assess what  
2 additional income you would get from that, and how it  
3 would affect the -- the rate change. And -- and at the  
4 bottom -- I'll -- I'll get the -- the follow-up  
5 question shortly, but at the bottom we mention that we  
6 would get an extra 3.7 million, and that would lower  
7 our actuarial rate decrease by only about half a  
8 percent. The -- which is maybe a little bit  
9 surprising. It was surprising to me when I first  
10 looked at it.

11                   But if -- if you -- we haven't put in  
12 the undertaking yet, but when we do our actuarially  
13 based rates, we are pick -- and we might get to this --  
14 we -- we are picking a fixed discount rate to calculate  
15 the present value based on our fix -- a fixed income  
16 average yield. And we talked about what happens to our  
17 rate indication if we were to just leave our current  
18 interest rate level flat. And, again, we don't have  
19 the undertaking yet, but we said we might be looking at  
20 5, 6, 7, percent rate increase. And that becomes a lot  
21 more consistent with this actuarially based rate  
22 increase that we're showing to be 7 plus percent.

23                   What -- what's happening in our actual  
24 pro forma forecast is we are -- we're getting these big  
25 benefits from interest rates flowing through, and that

1 brings that rate indication down from 6, 7 percent to -  
2 - to 2.4, as -- as filed. But we're -- we also get  
3 higher returns from other asset categories, such as  
4 equities and, I think, real estate infrastructure, that  
5 are not contemplated when we do the actuarial rate  
6 setting, so that's -- that's another difference.

7 MS. CANDACE GRAMMOND: Thank you. So  
8 we're on I-46 here. And then there was a follow-up,  
9 which is II-17, for your reference. But I had asked  
10 you earlier about PUB/MPI I-42. And isn't it the case  
11 that what the Corporation was -- was attempting in I-46  
12 that we just looked at is exactly what the Corporation  
13 said in I-42 the actual mer -- actuarial method  
14 couldn't accomplish?

15 Can you help us with that?

16 MR. LUKE JOHNSTON: Yes, my response  
17 was that there's -- that particular question we just  
18 looked at, there is definitely investment income being  
19 earned and flowing into the fiscal year from -- from  
20 retained earnings or any excess assets you might have  
21 over and above those needs to support '15/'16 policies.

22 But the reality is, is that anything  
23 that flows through fiscal year net income, we're going  
24 to adjust rates to make that fiscal year net income  
25 break even. So whether it's rising interest rates, new

1 equity forecasts, whatever -- whatever it is, our rate-  
2 setting methodology will -- will ensure that MPI breaks  
3 even.

4                   So that -- if the question -- I -- is  
5 whether it's just this kind of -- this excess, you  
6 know, retained earnings that we have, and that's the  
7 only reason that the rate change would be different,  
8 then -- then you're -- you're correct, that's not the  
9 only reason. It's the -- it's that and the other  
10 reasons I just mentioned.

11                   MS. CANDACE GRAMMOND:     Just one (1)  
12 moment, Madam Chair.

13

14   (BRIEF PAUSE)

15

16                   MS. CANDACE GRAMMOND:     Thank you. Mr.  
17 Johnston, can you tell us about what the matching  
18 principle is inherent to the conventional manner in  
19 which Basic rates have been regulated?

20

21   (BRIEF PAUSE)

22

23                   MR. LUKE JOHNSTON:     I'm not -- I'm not  
24 sure I understand the matching principle. I -- I know  
25 it's probably Brian asking. But if you could ask him

1 to clarify, that would be helpful.

2 MS. CANDACE GRAMMOND: He can hear you.

3

4 (BRIEF PAUSE)

5

6 MR. LUKE JOHNSTON: Does he mean the  
7 matching of the proposed premium chan -- like, the  
8 policy premium with the costs of those policies?

9 MS. CANDACE GRAMMOND: What -- what  
10 we're driving at is the notion of matching accounting  
11 revenues with accounting expenses or outflows  
12 forecasted over a two (2) year period commencing when  
13 the new rates would first take effect.

14 MR. LUKE JOHNSTON: The -- okay, I  
15 think I know what you're getting at. I'll -- I'll try  
16 to respond. Again, all our rates are calculated up to  
17 the final ind -- indication, we believe in accordance  
18 to accepted actuarial practice.

19 But when we get to the end step, we know  
20 that we have to adjust, to -- to your point, the fiscal  
21 year average accounting net income, that basis. And  
22 that's where it changes from a pure actuarially based  
23 method to meeting the particular mandate of -- that we  
24 have in this province.

25 And so the difficulty I had last year

1 and possibly year before is -- with saying that our  
2 rate -- rating methodology is actuarially sound is --  
3 is that particular point. And that's all we tried to  
4 do this year is to say, Yes, we can calculate it to be  
5 actuarially sound.

6 It's not an overly difficult exercise  
7 since we do almost the whole thing that way anyways.  
8 But the rate indication will be different because of  
9 that accounting treatment or how -- or how we -- how we  
10 determine break-even here.

11 MS. CANDACE GRAMMOND: Okay. Now, can  
12 you tell me -- or have -- can you confirm that in the  
13 conventional approach, Basic rates are set to produce  
14 the usual break-even result that we've talked about  
15 over the test year and the year following?

16 MR. LUKE JOHNSTON: If the question is,  
17 Are the rates calculated to achieve break-even net  
18 income on that, the usually accounting year basis, then  
19 correct.

20 MS. CANDACE GRAMMOND: Okay. Now, can  
21 you tell us what is the matching principle inherent to  
22 the development of rate indications in accordance with  
23 accepted actuarial practice in Canada?

24 MR. LUKE JOHNSTON: This goes back to  
25 the looking only at those policies that'll be issued,

1 looking at all the claims costs that are expected over  
2 the life of those -- those policies only, the  
3 associated expenses, commissions, all -- all the usual  
4 pieces that we put into rates, calculating the present-  
5 day costs of all the costs and -- and inflows, and  
6 determine what premium we need today to cover all those  
7 future costs on a present-value basis.

8                   That method is not worried about what  
9 fiscal year net income is and how -- what -- everything  
10 that might flow into that. That's just looking at  
11 those policies and saying what -- you know, What do we  
12 need to -- to make whatever profit margin we want to  
13 cover all the -- the expen -- the costs and inflows and  
14 outflows?

15                   MS. CANDACE GRAMMOND: So it would be  
16 fair to say that these two (2) matching principles are  
17 different and produce different outcomes?

18                   MR. LUKE JOHNSTON: In terms of the  
19 meaning of 'break-even', absolutely. The -- as you see  
20 on this response, seven point six (7.6) rate in --  
21 increase is very different than -- than two point four  
22 (2.4). When adjusted to be the same -- on the same  
23 basis, we find that the -- the overall -- sorry, the --  
24 the rates by class were almost identical.

25                   But to your point, yes, two (2) -- two

1 (2) different indications. And -- and they will not be  
2 the same. You know, they're never going to be  
3 identical for the reasons we've discussed.

4 MS. CANDACE GRAMMOND: Okay. But the  
5 7.6 percent that you reference doesn't include the  
6 investment income earned on retained earnings.

7 That's right?

8 MR. LUKE JOHNSTON: That's correct.

9 MS. CANDACE GRAMMOND: Okay. So, Mr.  
10 Johnston, you've told us about the 7.6 percent  
11 increase, which is the estimate of the overall required  
12 change in average rate level estimated in accordance  
13 with accepted actuarial practice in Canada.

14 And you can confirm that this result can  
15 be compared with the 2.4 percent indicated rate  
16 increase on which the GRA is based?

17 MR. LUKE JOHNSTON: I'm not sure what  
18 you mean by 'compared', but we can definitely show how  
19 both -- both rate indications were derived.

20 MS. CANDACE GRAMMOND: Okay. And  
21 without focussing on the amount of the difference  
22 between the two point four (2.4) and the seven point  
23 six (7.6), but focussing on the fact that there is a  
24 difference between those two (2) numbers, what does  
25 that tell us?

1 MR. LUKE JOHNSTON: There's -- well,  
2 there's definitely different assumptions that go into  
3 the two (2), and the easiest example I could give would  
4 be interest rates. We do on -- per actuarial  
5 standards, I -- I'm not going to get the wording  
6 exactly right, but we select a discount rate that's  
7 consistent with the duration of the claims supporting  
8 those policies.

9 So we have -- we use the average  
10 discount rate of our fixed-income portfolio, and that  
11 rate is fixed at the date that the rates are indicated,  
12 or at least it was in our analysis, that we determined  
13 that to be reasonable. That alone creates a big  
14 difference because we -- as we have discussed, we have  
15 a rising interest rate forecast over our rating period,  
16 and that creates significant positive net income which  
17 is not included in, you know, that -- that additional  
18 favourable net income is not contemplated in the seven  
19 point six (7.6).

20 And then per my other point, we also  
21 have an assumption of favourable returns on other asset  
22 categories that are quite a -- well, significantly  
23 higher right now than we're assuming on the fixed  
24 income side. So the -- the fiscal year accounting  
25 basis will include the assumed seven point three (7.3),

1 I believe -- 7.3 percent a year return on equities.

2 That's not contemplated on the actuarial method.

3 Those are two (2) examples that would  
4 probably account for most of that difference.

5

6 (BRIEF PAUSE)

7

8 MS. CANDACE GRAMMOND: Would you agree  
9 that rising interest rates generally don't need to be  
10 contemplated in the 7.6 percent estimate except to the  
11 extent that interest rates might increase between now  
12 and the beginning of the next fiscal year?

13 MR. LUKE JOHNSTON: I would agree with  
14 that. That's what we've assumed in our analysis, that  
15 -- at that particular point in time when it's  
16 calculated that -- that you calculate the appropriate  
17 discount rate at that time, and -- and, right, you  
18 wouldn't constantly change it over -- over the period.  
19 That was, again, our understanding of how -- how it  
20 should be done.

21 MS. CANDACE GRAMMOND: Thank you. Now,  
22 considering that these two (2) estimates, the two point  
23 four (2.4) and the seven point six (7.6), are  
24 different, would you agree in principle that the  
25 conventionally estimated rate indication must be

1 charging either more or less to the cohort of policies  
2 issued in the year than is actually required to cover  
3 the costs expected to rise from those policies?

4 MR. LUKE JOHNSTON: Can you repeat  
5 that, just so I get it right?

6 MS. CANDACE GRAMMOND: Sure. So given  
7 the fact that we have the two point four (2.4) on the  
8 one hand and the seven point six (7.6) on the other,  
9 would you agree in -- with the principle that the  
10 conventionally estimated rate indication -- so the two  
11 point four (2.4) -- must be charging either more or  
12 less to the cohort of policies issued in a year than is  
13 actually required to cover the cost expected to arise  
14 from those policies?

15 MR. LUKE JOHNSTON: Yes. Yeah. The  
16 difference for -- you know, the reason for the  
17 difference you're seeing is -- is making that point.  
18 But -- here -- here's an example, I guess.

19 Like we -- I'll go back to the -- to the  
20 no growth interest rate scenario that we're going to  
21 file, and we haven't produced it yet but we're -- we  
22 said we expect this 5-, 6-, 7-percent-type indication.

23 If we set rates on the 2.4 percent  
24 break-even methodology that we use and interest rates  
25 do not increase at all over the rating period, rates

1 will clearly be deficient based on how we -- we've set  
2 them. And we'll post a prem -- continue to post a  
3 premium deficiency, or even have a bigger one, because  
4 you've assumed in -- in your -- like our -- in our  
5 break-even that we're going to get this increase, and  
6 we don't. So we don't, right.

7           If the -- if the opposite was true and  
8 we got much bigger interest rate swings or increases  
9 than we were expecting, then clearly, the assumption we  
10 used in the actuarial-based methodology would be a lot  
11 lower than reality, and even our -- even our 2.4 would  
12 be -- would be high, and we'd get favourable outcomes  
13 and -- and that would -- and it'd be all -- it would be  
14 -- both would be overstating, but we're somewhere -- my  
15 -- my view is that we're -- we're somewhere in the  
16 middle of the two (2).

17           It's probably unrealistic to assume that  
18 interest rates are going to decline even further over  
19 the forecast period. If they stayed flat, we're  
20 talking about something in the 7 percent type range.  
21 If they increase exactly per our original GRA forecast,  
22 2.4 percent should be sufficient for break-even.  
23 Anywhere in between, then the appropriate rate is  
24 somewhere in between those two (2) -- two (2) extremes.  
25

1 MS. CANDACE GRAMMOND: So it all, in  
2 essence, comes down to the underlying matching  
3 principle being different between the two (2)  
4 approaches, as we've discussed?

5 MR. LUKE JOHNSTON: Yes. And it does,  
6 the matching, but also the course that the assumptions  
7 used in the two (2) ana -- analyses are -- are  
8 different, as well.

9 MS. CANDACE GRAMMOND: Just back to the  
10 matching principles, would you say that it's a matter  
11 of public policy which principle should prevail?

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: And this is for  
16 rate-setting purposes.

17 MR. LUKE JOHNSTON: Yes, sorry. We --  
18 the -- the Corporation, in -- in terms of the policy  
19 used to determine break-even, we are definitely in  
20 agreement with the current policy going back to the  
21 discussions from 1992, where it was essentially agreed  
22 to -- to move to that basis.

23 And again, to res -- to reiterate, the -  
24 - this method has shown to -- to serve us well over two  
25 (2) decades in terms of that -- in terms of rate

1 stability and our -- and our break-even mandate. And  
2 we take -- again, we take break-even to mean what it  
3 currently means for rate-setting purposes. And until -  
4 - if the -- you know, until the Board indicates  
5 otherwise, we'd continue to support using that -- using  
6 that method.

7                   But the -- I understand the Board's  
8 interest in having this pure actuarial -- actuarial  
9 rate calculation, and it's definitely good for  
10 information purposes. And again, we've shown that we  
11 can -- the -- it's not that our rates are not being  
12 calculated on an actuarially sound basis. We just have  
13 a different methodology for determining what is break-  
14 even.

15                   MS. CANDACE GRAMMOND: Thank you. So  
16 we touched earlier on PUB/MPI I-46 and I had referenced  
17 the fact that there was a followup question to that in  
18 the Second Round, which was PUB/MPI II-17. So we'll  
19 maybe go to that. And just before I -- while Diana's  
20 bringing that up -- okay, perfect. So now we've got  
21 that up.

22                   And Diana, if you could just scroll down  
23 a little bit?

24

25

(BRIEF PAUSE)

1 MS. CANDACE GRAMMOND: Yeah, to the  
2 table.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: Perfect. Just  
7 at the -- just underneath the table, we see in the  
8 brackets reference to the estimated rate indication  
9 derived from accepted actuarial practice being refined  
10 to six point one (6.1) from the seven point six (7.6)  
11 that we spoke about earlier.

12 Do you agree that this estimate  
13 recognizes the investment income on retained earnings  
14 as an offset to premiums?

15

16 (BRIEF PAUSE)

17

18 MR. LUKE JOHNSTON: Yes, we agree -- we  
19 split -- we further split the investment portfolio out  
20 to more properly, for lack of a better word, account  
21 for the additional investment income that would not be  
22 related to the assets supporting those policies.

23 And so you can see we -- we split out  
24 equity and any other liabilities that aren't supporting  
25 the '15/'16 policies. And that gave us a -- a larger

1 offset. It doesn't bring us to two point four (2.4),  
2 but the impact was 12 million and a rate decrease of  
3 one point five (1.5) from our seven point six (7.6)  
4 indication.

5 MS. CANDACE GRAMMOND: So, Mr.  
6 Johnston, you've just referred to the 12.1 million  
7 that's referenced in this table. Can you maybe just  
8 walk us through what we see in this table and the  
9 derivation of that twelve point one (12.1)?

10

11 (BRIEF PAUSE)

12

13 MR. LUKE JOHNSTON: I'm not supposed to  
14 touch the mic. Sorry.

15 So what we're doing here is we're trying  
16 to -- at the -- in the top portion of this table, we're  
17 splitting out the liabilities related to -- sorry, the  
18 assets that are support -- other than the -- the  
19 amounts supporting to the claim liabilities and the  
20 rate indications.

21 So there's -- that's that 300 million.  
22 And then the total equity in our Basic program is -- is  
23 there as well. So there's -- there's liabilities that  
24 we have in terms of the 2015/'16 rates that we're  
25 setting. What we're doing here is we're pulling out

1 the assets that are related to, you know, kind of  
2 everything else, right?

3 And when you go down to -- just below  
4 that greyish area, investment income, so there's the  
5 inve -- the thirty-two (32) and the forty-nine (49) are  
6 the investment income from anything other than the  
7 fixed income portfolio supporting those claims. And  
8 the -- 'C' is the assumed average investment income.

9

10 (BRIEF PAUSE)

11

12 MR. LUKE JOHNSTON: I'm actually going  
13 to suggest I take this as an undertaking. I'm not --  
14 I'm talking with my back row, and I'm having under --  
15 trouble understanding one (1) -- one (1) particular  
16 piece of it. So I'd rather give you the proper answer  
17 than -- than ramble.

18 MS. CANDACE GRAMMOND: That's fine.  
19 We'll -- just one (1) moment. That's fine. So the  
20 undertaking is to basically describe and explain the  
21 information reflected in this table at PUB/MPI II-17.

22 MR. LUKE JOHNSTON: Yes, thanks.

23

24 --- UNDERTAKING NO. 27: MPI to describe and explain  
25 the information reflected

1 in this table at PUB/MPI  
2 II-17.

3

4 CONTINUED BY MS. CANDACE GRAMMOND:

5 MS. CANDACE GRAMMOND: I do have a  
6 couple more specific questions on the table, so what  
7 I'd be inclined to do is ask them now. If you can  
8 answer them, great. If not, we can tack it onto the  
9 undertaking. Would that work for you?

10 MR. LUKE JOHNSTON: I -- I'd prefer  
11 that we file the undertaking and then you ask them, but  
12 I could probably give --

13 MS. CANDACE GRAMMOND: But that --

14 MR. LUKE JOHNSTON: -- a more informed  
15 answer there.

16 MS. CANDACE GRAMMOND: That's fine.

17 MR. LUKE JOHNSTON: Yeah.

18 MS. CANDACE GRAMMOND: It's just a  
19 matter of timing. So I'll just make myself a note to  
20 that effect.

21 MR. LUKE JOHNSTON: Yes. Thanks.

22 MS. CANDACE GRAMMOND: Before we leave  
23 the topic of the actuarial standards, do you have  
24 knowledge of the basis on which the Saskatchewan Auto  
25 Fund and ICBC file their rate applications?

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: Is the question  
4 whether SGI and ICBC file their rates in accordance  
5 with accepted actuarial practice?

6 MS. CANDACE GRAMMOND: Yes, that's the  
7 question.

8 MR. LUKE JOHNSTON: It is my  
9 understanding that they do. What -- I don't know for  
10 certain if they have any other special policy  
11 considerations or adjustments that go into their final  
12 decision on how they set rates, but I do know that  
13 their actuaries sign off on rates indicating that  
14 they're per accepted actuarial practice.

15 MS. CANDACE GRAMMOND: And just for  
16 clarity, it's not just the rate application, but it's  
17 the rate indications that they put forward are pursuant  
18 to accepted actuarial practice?

19 MR. LUKE JOHNSTON: Correct.

20 MS. CANDACE GRAMMOND: Thank you. I'm  
21 going to move, then, to some questions with respect to  
22 the external actuary's report from February of 2014.  
23 So for reference, this is AI.7, Appendix E. I'm  
24 actually first going to ask, Diana, that you pull up --  
25 and, sorry, this is the valuation report -- ask that

1 you pull up PUB/MPI II-15 as a starter.

2

3 (BRIEF PAUSE)

4

5 MS. CANDACE GRAMMOND: Thank you. And  
6 if we scroll down to the response section? A little  
7 bit farther.

8

9 (BRIEF PAUSE)

10

11 MS. CANDACE GRAMMOND: Just one (1)  
12 moment. I'm going to check my copy. I'm not seeing  
13 what I want.

14

15 (BRIEF PAUSE)

16

17 MS. CANDACE GRAMMOND: Sorry, Madam  
18 Chair, just one (1) moment.

19

20 (BRIEF PAUSE)

21

22 MS. CANDACE GRAMMOND: In the response  
23 to (b), so if we can just scroll up a bit, there's  
24 reference to, in essence, reserving issues on income  
25 replacement claims. And, as well, at this response,

1 there's reference to other injury claims management  
2 issues relating to claims duration and the percentage  
3 of maximum entitlement received by claimants on income  
4 replacement claims.

5 Can you describe the nature of these  
6 claims handling issues?

7 MR. LUKE JOHNSTON: Yes, I can. So I  
8 did talk a little bit about this previously. When --  
9 obviously, I'm not working in the injury claims  
10 division. But what actuaries do is essentially look at  
11 the pattern of how claims are reported and paid and  
12 settled. And -- and when we do our review, if we see  
13 these patterns change in any way, we have concern,  
14 because our estimates are essentially tied heav --  
15 heavily to historical claims patterns.

16 So in -- when we put our new injury  
17 claims management system in in September 2010, the  
18 first year, there were various issues relating to --  
19 you know, we put in new automated reserving. We talked  
20 about having the -- an issue with double reserving, in  
21 some cases.

22 We had case managers using this new  
23 system, and their priority always has to be customer  
24 service, to pay people's income replacement. And, you  
25 know, getting the actuarial reserve in on the exact day

1 that I want it might not be their top -- top priority  
2 when they're trying to learn a new system and make sure  
3 claimants are paid.

4           So in the first year, we looked at that  
5 on the actuarial side. We said, There seems to be some  
6 issues with case reserving, payments seem to be up in  
7 some places, but we're going to put that year aside and  
8 say, you know what, this is probably an implementation  
9 issue. Clearly, this isn't something that I'm going to  
10 set all of our future forecasts on, knowing that we put  
11 a new system in. We'll let the injury claims know of  
12 our concerns and we'll assume that we should go back to  
13 normal patterns in -- in the future.

14           When we got to 2012, we did our report,  
15 and the issues were persisting, particularly the case  
16 reser -- under-reserving on the case reserve side, and  
17 our payment levels are actually higher, so we had  
18 conflicting information. Paid losses were increasing,  
19 which, in the actuary's mind, indicates that maybe  
20 exposure is higher. Maybe we understated our -- our  
21 estimates.

22           On the other side, you had case managers  
23 having lower than usual case estimates, which would  
24 indicate that maybe things are lower, so a very  
25 conflicting issue for the actuarial department.

1                   So we worked with injury claims  
2 management and we pulled a lot more information on the  
3 types of claims that were open, how long they were open  
4 for, and that's what I mean by 'duration', and we --  
5 and -- and along -- along with other case management  
6 issues such as, you know, reducing entitlement.  
7 There's -- there's various ways you can reduce  
8 entitlement, such as getting people back to, you know,  
9 work, or there's CPP disability. There's other things  
10 that we do that can reduce MPI's exposure.

11                   We noticed definitely that in some  
12 cases, there was increasing duration on some IRI --  
13 types of IRI claims, meaning that they were staying  
14 open longer than they used to. So from my perspective,  
15 that's very concerning, because that means exposure has  
16 increased.

17                   So we -- in -- in the March 2013, we had  
18 the injury division do a complete review of every  
19 single injury claim, make sure that reserving  
20 guidelines were followed, and also all the other  
21 aspects of case reserving.

22                   You know, are we reducing entitlement as  
23 -- as much as we can? Are we, you know, meeting other  
24 benchmarks and guidelines that they use for getting  
25 people back to work? And we put a plan in place to --

1 to essentially start benchmarking experience based on  
2 pre-system targets.

3                   So as you know, the -- the review  
4 actually resulted in an increase in case reserves a lot  
5 larger than -- than I had con -- contemplated in -- in  
6 looking at the data. And -- and that's -- again,  
7 that's related to that -- that lag. We didn't -- we  
8 didn't expect that we'd see increases in some of the  
9 older years, but we did.

10                   But, yeah, I can tell you now that we're  
11 -- we have a process in place for essentially mo --  
12 monthly benchmarking and tracking of -- of all aspects  
13 of -- of the injury case management process to ensure  
14 that we actually meet and eventually beat benchmarks.

15                   But, yeah, I think that's -- that's all  
16 I can say on that.

17                   MS. CANDACE GRAMMOND: Can you tell us  
18 what the impact of all of this has been on reported  
19 incurred and reported paid claims experience for  
20 Accident Benefits - Weekly Indemnity?

21                   MR. LUKE JOHNSTON: Well, whenever  
22 there is issues with claim duration pay -- payable  
23 increase, so we saw paid increase during that period.  
24 And I believe that's well documented. I don't have to  
25 reference that.

1                   In the -- in the immediate term, case  
2 reserves were being under-reported. So the reported  
3 incurred was down, which is again deceiving because  
4 paid was higher. The actuarial response to that is to  
5 add IBNR to ensure that you have, you know, the right  
6 estimate there of costs, whether the case managers have  
7 put it in or not.

8                   So that -- in terms of that particular  
9 year, my expectation was that we had the right incurred  
10 number there because of course I'm assuming that I  
11 added the right amount of IBNR to cover this particular  
12 issue.

13                   When they did their reserve review, of  
14 course they added more, so incurred was higher than we  
15 thought in -- in the year of the review.

16                   Going forward, our expectation is that  
17 this particular issue is very much under control now.  
18 And of course the expectation of the -- of the BI-3  
19 system that -- that's the name of the system -- the  
20 expectation in the -- in the -- going forward is that  
21 we'll actually beat benchmarks. It just took a few  
22 years to -- to get to that point.

23                   MS. CANDACE GRAMMOND: Thank you. I'm  
24 going to ask you to go then to the actuary -- the  
25 external actuary's valuation report at AI.7, Appendix

1 E. And we're going to start on page 5.

2

3

(BRIEF PAUSE)

4

5 MS. CANDACE GRAMMOND: So this table  
6 relates to Accident Benefits - Weekly Indemnity. Mr.  
7 Johnston, can you explain what we see on the screen, I  
8 guess starting with the top table?

9 MR. LUKE JOHNSTON: Okay. So this is  
10 our October 31st, 2013, actuarial report. We do this  
11 report in October because there's no way we'd have time  
12 to do it at the -- the full analysis at the end of the  
13 year with, you know, a couple-week crunch to get the  
14 year-end numbers. So we do a report in October. And  
15 then we up -- we just update it in February if there's  
16 any big changes.

17 MS. CANDACE GRAMMOND: Sorry, Mr.  
18 Johnston, I just want to stop you. Did you say 2013?

19 MR. LUKE JOHNSTON: Per the -- the top,  
20 this is -- this is a report we do as of October 31st,  
21 2013, but it's the basis for all the assumptions that  
22 we use for year-end, February 2014.

23 MS. CANDACE GRAMMOND: 2014.

24 MR. LUKE JOHNSTON: Yeah, yeah.

25 MS. CANDACE GRAMMOND: Okay. Okay,

1 sorry to interrupt you.

2 MR. LUKE JOHNSTON: No problem. The --  
3 this table is looking at the reported losses, so this  
4 would be the paid plus the case reserves that case  
5 managers add. And what's on the top row is -- is  
6 months of development. So what that -- what that means  
7 is basically how much time has passed in that  
8 particular year.

9 So on the left column you have,  
10 "Insurance year." And this is essentially when the --  
11 when the accident occurred. So an accident occurred --  
12 for -- for accidents that occurred in 2006, for  
13 example, eight (8) months in, we had 23.5 million of  
14 reported losses, if you see that on -- in the table.

15 And for that same year, 2006, by twelve  
16 (12) months in, we had 40 million -- 40.154 million  
17 reported. Twenty (20) months in, that was fifty-seven  
18 seven-four-two (57.742). And -- and I don't know if  
19 everyone's following that, but that's what we call  
20 development, and so when I talk about patterns that we  
21 rely on, when we look at a year like 2013, where you  
22 see eight (8) months in, we have 14 -- only \$14 million  
23 reported, well, obv -- obviously, I can't just say, Oh,  
24 you know, it's a good year. We only got \$14 million  
25 reported, right? There -- if you look out in the

1 future, you can see that what -- what's in that eight  
2 (8) months is kind of hovering, you know, 15 -- 14, 15  
3 to 20 million, but it ends up growing to be 50, 60, 70  
4 million once you get sixty-eight (68), eighty (80)  
5 months out in the future.

6 MS. CANDACE GRAMMOND: And --

7 MR. LUKE JOHNSTON: And the reason that  
8 happens is because in the short-term, we -- claims come  
9 in, with the exception of the really badly injured  
10 people where we know that they're going to be lifetime  
11 claims, we're obviously trying to get people back to  
12 work. Our case reserves aren't as high.

13 Once you get a couple years in, even on  
14 the serious claims, you start understanding what their  
15 real exposure is, so you start posting the reserves for  
16 lifetime benefits, whether that's inc -- income  
17 replacement for life or personal care for life, so the  
18 reserves go up.

19 And then as even more time passes, you  
20 realize, okay, well, this chronic pain claim isn't  
21 going to go away. It's time to post lifetime reserves,  
22 et cetera, and the -- and the values increase further.  
23 But that's hopefully a decent summary.

24 MS. CANDACE GRAMMOND: Thank you. And  
25 -- and just for the record, I appreciate what we have

1 up on the screen, but the table actually extends  
2 further to what would be our right onto another page  
3 that shows even months further into the future beyond  
4 what's here?

5 MR. LUKE JOHNSTON: Yes. And you can  
6 appreciate, you know, the -- the difficulty with  
7 estimating a year like 2013, right, because we're --  
8 we're posting -- the actuary's job is to post the  
9 ultimate liability required on those 2013 claims, and I  
10 don't have much information at eight (8) months.

11 So the -- clearly, the risk of being  
12 wrong is much greater in the short for the -- you know,  
13 for these earlier years than once you're five (5) or  
14 six (6) years out, where you have a lot more data. But  
15 we have methods to -- to account for that, and I won't  
16 talk about them now, but, yeah.

17 MS. CANDACE GRAMMOND: Thank you.  
18 Diana, if you could scroll down to the middle table?  
19 So -- thank you. So this, what we see, and again,  
20 keeping in mind that it extends, this block, as I  
21 understand it, is historical incurred development  
22 factors.

23 Is that right?

24 MR. LUKE JOHNSTON: That's correct.

25 MS. CANDACE GRAMMOND: And can you

1 describe for us, going back to the claims handling  
2 issues that you had mentioned in response to that IR,  
3 tell us what effect those issues had on the data that's  
4 reflected here, so directionally and the extent to  
5 which there was an effect?

6 MR. LUKE JOHNSTON: So these factors,  
7 they're -- they're really just ratios. So when it says  
8 twelve dash twenty (12-20), it -- it means what were  
9 your losses at twenty (20) months compared to your  
10 losses at twelve (12) months? So if you look at that  
11 twelve dash twenty (12-20) row, and you go down to the  
12 -- the bottom one, it says one point three-four-eight-  
13 six (1.3486).

14 So what we knew at twenty (20) months  
15 divided by what we knew at twelve (12) basically was  
16 one (1) -- a ratio of one point three-four (1.34), 34  
17 percent higher. And if you look at the -- the history,  
18 you can see in that particular column that we always  
19 get a pretty big growth rate between twelve (12) and  
20 twenty (20) months, because you're -- you're always --  
21 it's pretty consistently that case managers are adding  
22 reserves there.

23 If you look at the bottom diagonal, so  
24 to speak, so what I mean -- the -- the last number on  
25 each of these columns, those would reflect -- those

1 ratios would include all the impacts from the reserve  
2 review that was done in March 2013, and you can see in  
3 a lot of cases, this -- these latest numbers are bigger  
4 than normal.

5                   So if you go to twenty-four dash thirty-  
6 two (24-32), in that column, you go right to the  
7 bottom, it says one point three-six-eight-eight  
8 (1.3688). Well, you can see historically, we've never  
9 seen a growth in losses anything close to one point  
10 three-six-eight-eight (1.3688). And that's because  
11 when they did the review, they added -- they caught up  
12 to that lag, so to speak, and added more -- more case  
13 reserves.

14                   Similarly, if you go the thirty-six (36)  
15 to forty-four (44), you see that big number at the  
16 bottom, one three three (133) -- one point three-three-  
17 two-nine (1.3329), again significantly larger than  
18 normal. Continuing along the bottom, those -- all  
19 those kind of numbers are larger than what we normally  
20 see.

21                   So we're not -- we're definitely not  
22 going to rely on that information to predict the  
23 future. We're going to assume those are outliers, and  
24 -- and assume that now that everything is -- the lag  
25 has been -- we've caught up to our lag, that we're

1 going to revert back to what we'd call a normal  
2 development. So we're -- by no means we're assuming  
3 that will continue.

4 MS. CANDACE GRAMMOND: Thank you, Mr.  
5 Johnston. Diana, I'm going to ask you to scroll down a  
6 little bit towards the bottom of the page. We see  
7 there a line item, Mr. Johnston, called, "Selection  
8 factors." Can you discuss the basis of the selection  
9 for those selection -- or, sorry, selected factors  
10 identifying in each where any changes were made  
11 relative to the fiscal year prior?

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: And, sorry, Mr.  
16 Johnston, just before you answer, I should specify.  
17 It's the prior fiscal year end. I should have added  
18 that word.

19 MR. LUKE JOHNSTON: Yeah, we do have a  
20 response, I believe, to this in -- somewhere, and --  
21 and the back row is looking it up. But in -- just the  
22 -- well, at the bottom, you see these sel -- selected  
23 ultimates, selected factors. I'll talk about those.

24 Above that, though, you see that we  
25 calculate a bunch of different averages, and this would

1 -- is just an easy way for anyone reviewing to see how  
2 the experience might have changed over time. If all  
3 these average -- like -- so you see latest nine (9)  
4 years, latest six (6) years. We have something called  
5 middle four (4) of six (6), so that would exclude the  
6 high and the low number.

7           The actuary would prefer that all these  
8 averages equal the exact same thing. That would be a  
9 very consistent predictable development. They don't  
10 always, but if you look at the line, "Selected  
11 factors," the selected factors are based on the  
12 averages that you see above, and a selection has to be  
13 made. Sometimes it's easier to do than when -- when  
14 the data's really consistent. Sometimes, the aver --  
15 you know, it's a little bit more difficult.

16           There's a -- a few cases where they've  
17 changed. If you go to -- it's hard to see at the top  
18 of the table there, but 36 to 44 column. You'll --  
19 there, we'll see selected -- February 13, there's one  
20 point o-three (1.03) selected. Factor this year is one  
21 point o-four (1.04).

22           If you look at the averages above, you  
23 know, we have the six (6) year average being one point  
24 o-one-five (1.015), the three (3) year, which obviously  
25 includes a outlier is higher.

1                   You know, and there's other recent  
2 experience that, if you look up into the chart, you can  
3 see, prior to last year, there was a one point o-three-  
4 seven (1.037) and a one point o-six (1.06), a one point  
5 o-five (1.05). We decided to increase it to a one  
6 point o-four (1.04).

7                   That's the kind of assumptions that we  
8 have to make for every coverage, every -- you know,  
9 every development period in this report. And we try  
10 not to just continually change these all the time. We  
11 want some stability, but if -- if there's enough  
12 evidence, we -- we will tweak them.

13                   I don't think I need to go through every  
14 one of them, but that -- generally, all -- what I can  
15 say is the averages or recent information is used to  
16 pick the aver -- pick the assumptions, with the  
17 exception of some outliers that we exclude.

18                   MS. CANDACE GRAMMOND: Thank you.  
19 Okay. Diana, I'm going to ask you to go down to page  
20 6, which should be the next page in the document. And  
21 for the panel, I can indicate I just have a few more  
22 questions in this section. So we can just finish them  
23 and then maybe take the break before I go on to  
24 something else.

25                   Scroll down if you could. So this would

1 be the second half of what we were just looking at.

2 Can you -- can you keep going down?

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: This is going to  
7 be difficult, but I -- I am actually going to ask you  
8 to go back to the last page, sorry.

9 The -- I -- I want to ask a question  
10 about data that appears on page 6, but the line items  
11 that tell us what we're looking at -- yeah, right there  
12 -- are on page 5.

13 So we have across the bottom, Mr.  
14 Johnston, one (1) of the line items. And I believe --  
15 as I say, it's hard to look at this on a split screen,  
16 but my question relates to the selection of the tail  
17 development factor. And I -- I do have the number  
18 noted. It's one point zero-three-five-six (1.0356),  
19 which, as I say, appears on the next page.

20 Can you give us some commentary about  
21 the selection of the tail development factor? And it  
22 should be the second last line in the second last  
23 column that is on the next page.

24 MR. LUKE JOHNSTON: Yes. What -- once  
25 a claim -- and I -- income replacement claim becomes

1 more than ten (10) years old, we essentially take the  
2 reserving piece out of the case manager's hands, and  
3 the actuarial department does the -- the reserving on  
4 what we call tabular reserving basis, which is really  
5 the same thing that the case managers are -- are doing.

6           They have -- we supply calculators for  
7 them to do lifetime reserves, but once it's ten (10)  
8 years old and it's open, we just say, What are you  
9 entitled to for income replacement? And we're going to  
10 pay that for life. It's not -- we're not going to  
11 assume any kind of recovery any more at this point.

12           Case management can still occur, but  
13 from an actuarial basis, we're life-ing it out, and  
14 that -- and our experience shows that that's generally  
15 a good assumption.

16           The question that we're never going to  
17 know with certainty on our program is whether our life  
18 tables are totally accurate. And when I mean life  
19 tables, just how long people are going to live.

20           Every claimant -- if -- if you're a  
21 Great-West Life actuary selling life insurance to male  
22 non-smokers, you can have a -- probably a pretty good  
23 prediction of average life expectancy. Our claimants  
24 are not like typical life -- life insurance customers;  
25 they're a mixed bag of everything. Some are brain

1 injured. Some are quadriplegic. Some we're not even  
2 sure what's wrong, right, like. So how -- how long are  
3 they going to live on average?

4 We think we have a pretty good table in  
5 place; it's done well. But what we do is we say, at  
6 the very end of that long table, I don't know if you  
7 need to go to it, we use our tabular re -- we -- every  
8 year we update our estimates, and we compare that to  
9 how the actual experience is played out. And if you --  
10 maybe you could scroll to page 6. Oh, you're on page  
11 6.

12 MS. CANDACE GRAMMOND: Yeah.

13 MR. LUKE JOHNSTON: Okay, good. If you  
14 go just, actually, to the top of that table -- the top  
15 of that page, pardon me, you'll see that we're getting  
16 more data out in the -- from -- about the PIPP program  
17 out in the tail, as we call it, so the tail being,  
18 like, the kind of only the serious claims and how their  
19 experience is kind of running ten (10), twenty (20)  
20 years out in the future.

21 Two hundred and twenty-four (224) months  
22 is how old our 1994/'95 loss year was at the day of  
23 this report. So that's not a lot of information on how  
24 claims behave twenty (20) years after they're open.  
25 But what we do is, once we get at least five (5) data

1 points from a particular development period, we  
2 incorporate that into our tail factor selection. And  
3 we are, essentially, gradually modifying our life  
4 expectancy assumptions based on actual data that comes  
5 in.

6 Right now, without going into the  
7 technical part of the calculation, we're showing that  
8 we need a factor of that one point o-three-five-six  
9 (1.0356) to cover expected development from, basically,  
10 twenty (20) years and after. And again, that's purely  
11 just based on assuming that all the claims will get  
12 lifetime benefits.

13 MS. CANDACE GRAMMOND: And, Mr.  
14 Johnston, would you agree that the uncertainty with  
15 respect to the ultimate cost of claims is a source of  
16 risk for the Corporation?

17 MR. LUKE JOHNSTON: Yes, it is.

18 MS. CANDACE GRAMMOND: Okay, thank you.  
19 Diana, I'm going to ask you to go page 10 of the  
20 document that we're in. So this table, Mr. Johnston,  
21 is entitled, "Development of the Bornhuetter-Ferguson  
22 Initial Expenses" -- "Expected Loss Ratio."

23 If you -- can you just scroll down a  
24 little bit, Diana?

25

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: My question, Mr.  
4 Johnston, relates to the 1 percent annual loss trend  
5 assumption that we see. And I'm just struggling to  
6 actually see. Oh, it's there. It's just in the middle  
7 of the page in the bold where it says, "Selected  
8 Trend."

9 So with respect to that 1 percent, can  
10 you confirm that that is the annual loss trend  
11 assumption that's used in this analysis for the  
12 coverage reflected in this document?

13

14 (BRIEF PAUSE)

15

16 MR. LUKE JOHNSTON: Yes, that's  
17 correct. And that's consistent with what I've ment --  
18 I discussed before, that PIPP, particularly income  
19 replacement weekly indemnity, has a very favourable  
20 trend. Over our history, claims have been flat, and  
21 this particular trend being only 1 percent.

22 MS. CANDACE GRAMMOND: Thank you. And  
23 can you confirm that the Bornhuetter-Ferguson analysis  
24 result, whether for incurred or paid claims, is  
25 selected for the ten (10) most recent accident years?

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: Yes, we use -- in  
4 the first three (3) years, we use the higher of the  
5 paid or incurred Bornhuetter-Ferguson indication, and  
6 then after that we used the incurred BF method, I'll  
7 call it for simplicity.

8 MS. CANDACE GRAMMOND: Yeah, less of a  
9 tongue twister that way, for sure. So we see here in  
10 the middle of the screen reference to the trend and  
11 losses based on exponential regression of .89 percent,  
12 and then the selected trend at the 1 percent. I take  
13 it that that was a rounding up --

14 MR. LUKE JOHNSTON: Correct.

15 MS. CANDACE GRAMMOND: -- from the  
16 point eight nine (.89) to the 1 percent. And can you  
17 just indicate why that would be something that's  
18 rounded up, or rounded off at all?

19

20 (BRIEF PAUSE)

21

22 MS. CANDACE GRAMMOND: In other words --

23 MR. LUKE JOHNSTON: Yeah.

24 MS. CANDACE GRAMMOND: -- why not just  
25 use the point eight nine (.89)?

1 MR. LUKE JOHNSTON: Yeah. It goes back  
2 a -- a little ways, but the thinking is that by  
3 rounding to half a percent -- sorry, .25 percent, you  
4 get a little bit of stability in there. Perhaps just  
5 some noise around the real. If -- you know, if the  
6 real trend is around one (1) -- you know, if you get  
7 point eight-five (.85) one year, and one point o-two  
8 (1.02) the next year, like why keep modifying and  
9 getting slightly different numbers? Just keep it in  
10 these quarter point intervals, and you get a little bit  
11 more stability. It's not -- it's not a -- a massive  
12 material impact, but it's something.

13 MS. CANDACE GRAMMOND: Just a couple  
14 more questions on this point, and then we can take the  
15 morning break. Diana, if you could go to PUB/MPI I-40?  
16 And in particular, the attachment at (g) to the  
17 response? Perfect.

18 So, Mr. Johnston, can you describe what  
19 we're seeing in this chart?

20

21 (BRIEF PAUSE)

22

23 MS. CANDACE GRAMMOND: Sorry, Mr. Pelly  
24 has just reminded me this is a graph, not a chart.  
25 That's why he's the actuary.

1 MR. LUKE JOHNSTON: Yeah. I'm willing  
2 to accept either -- either definition.

3 MS. CANDACE GRAMMOND: Thanks.

4 MR. LUKE JOHNSTON: That's essentially  
5 the -- what we were just discussing in terms of the  
6 development of that -- that trend, which I believe is  
7 point eight-nine (.89). So you see the historical  
8 estimated ultimate class for accident benefits weekly  
9 indemnity by accident year. It's definitely not a  
10 straight line, but we call that -- we -- we'd call that  
11 -- you know, the fit indicates it's around 1 percent,  
12 point eight-nine (.89), as indicated.

13 What -- what happens with the -- the  
14 indexed PIPP coverages is occasionally, you might have  
15 a really bad serious loss year, like 2006. You see  
16 that number really bumps off the page. And I remember  
17 at the time -- you know, you always -- there's always  
18 concern. It's like, Oh no, is this some new trend or  
19 whatever.

20 But there's always going to be  
21 variability in this coverage, and sometimes you'll have  
22 -- you know, some -- unfortunately, sometimes it's the  
23 difference between a lot of people dying versus a lot  
24 of people surviving and becoming serious losses, and  
25 costs -- it costs the Corporation a lot more in -- for

1 an -- a -- a serious loss than a death.

2 MS. CANDACE GRAMMOND: Okay. So just  
3 to be clear, what does this graph indicate is the  
4 fitted annual loss trend?

5 MR. LUKE JOHNSTON: That's the -- I --  
6 I believe zero point eight-nine (0.89) that you  
7 referenced on the previous page.

8 MS. CANDACE GRAMMOND: That was rounded  
9 to the 1 percent in the other document?

10 MR. LUKE JOHNSTON: Correct, yeah. And  
11 if we were to plot like the equivalent of say 1  
12 percent, it would be probably almost hard to  
13 differentiate between the lines, but it'd be slightly  
14 different.

15 MS. CANDACE GRAMMOND: Okay. And how  
16 would you characterize the statistical significance or  
17 the quality of fit for this regression?

18 MR. LUKE JOHNSTON: Well, the indicated  
19 fit is -- is low. That's the -- that number, R-  
20 squared, zero point one-three (0.13). So collision,  
21 for example, would look very much like a straight line  
22 with the exception of last year probably.

23 But in terms of -- I kind of -- if this  
24 line wasn't on this graph and -- and someone was kind  
25 of just eyeballing and saying where would be a good

1 going-forward kind of assumption for -- for this  
2 coverage, I think this line that's produced would be a  
3 fairly reasonable estimate for that. And that's --  
4 that's what we're trying to go on.

5                   Like I said, there -- there is a lot of  
6 variability, so the fit won't be great. But this line  
7 I think does a good job of splitting out the highs and  
8 lows. And -- and if you were to project it forward, I  
9 think -- at least I know I would be comfortable with  
10 going on a forecast on that basis.

11                   MS. CANDACE GRAMMOND: Okay. So does  
12 that R-squared equal zero point one-three-three-six  
13 (0.1336) that you reference tell us something?

14                   MR. LUKE JOHNSTON: It tells us that  
15 the fit would be considered not -- not very good. If -  
16 - if we had a history that was all completely on a  
17 straight line, that would be an R-squared of one (1),  
18 perfect fit.

19                   And for some -- for -- for coverage like  
20 this, you're not going to get a very good fit. But I  
21 imagine collision is probably, I don't know, close to  
22 point nine (.9) or something. Don't quote me on that  
23 one, but very high compared to this coverage.

24                   MS. CANDACE GRAMMOND: Okay. And why  
25 was this regression model adopted as opposed to an

1 alternative method?

2 MR. LUKE JOHNSTON: Again, because  
3 you're looking for -- for Weekly Indemnity, my view is  
4 that a long-term view is required so you don't start  
5 making inappropriate assumptions just because you had a  
6 good few years or a bad few years.

7 This -- this methodology of fitting the  
8 data I think is -- is the best -- the best way to  
9 produce stable outcomes. You can see at certain points  
10 in our history, maybe 2001 to 2005 range, maybe there  
11 was pressure to lower our forecasts, right, because the  
12 results were so good for a -- for a few years. But it  
13 -- it has peaks and valleys, and -- and I don't know of  
14 a -- you know, of a method that's going to produce a  
15 much better outcome than this one.

16 MS. CANDACE GRAMMOND: Okay. But your  
17 evidence is, though, that this isn't a particularly  
18 strong fit with the -- the point one (.1) compared to  
19 the point nine (.9) that you referenced for collision.

20 MR. LUKE JOHNSTON: That's true, but I  
21 -- I can't force the data to be a good fit. Like  
22 either -- you know, there's not -- you know, there's  
23 not some other model that just going to, you know, fit  
24 perfectly with this history. This is the variability  
25 you get with the -- with the PIPP program.

1           Like I said, you know, sometimes you get  
2 a high serious loss year, sometimes you get a low one.  
3 But again, it's all in terms of these fits, in terms of  
4 how we set rates by like having that longer-term view  
5 when you have something with a poor -- a poor fit.

6           So, you know, just to backtrack a little  
7 bit, when we're looking at something like collision,  
8 you have hundreds of thousands of claims a year. And  
9 if there's a trend in the recent years, you're probably  
10 going to want to focus on that because you have a lot  
11 of data and a lot of predictability, kind of  
12 credibility to make that forecast.

13           For -- for this particular coverage, I  
14 think it's evident that short-term information is not  
15 going to be very accurate in predicting the future. So  
16 we take a long-term view on this, and -- and in -- in  
17 rate setting, we also take a long-term view to keep  
18 rates stable.

19           MS. CANDACE GRAMMOND:   Okay. Now, what  
20 we're seeing here is a mostly downward pattern over the  
21 last six (6) years reflected. Does that raise any  
22 concern for you with respect to using an upward trend  
23 assumption?

24           MR. LUKE JOHNSTON:   It -- it doesn't  
25 because, really, going back to -- if -- you know, a

1 discussion of -- of the -- of the fit, right? If -- if  
2 by nature, this data is highly variable, then a -- a  
3 long-term view is required. And -- and for that point,  
4 that's exactly what I think we don't want to do, is  
5 start looking at a few years -- you know, like, if, the  
6 -- you know, you roll the dice four (4) times and you  
7 get a one (1) each time, is it time to start  
8 forecasting ones (1s)? Like, it -- like, so I see it  
9 more in that sense.

10 But definitely, if -- if there's other  
11 factors that we think the nature of -- of weekly  
12 indemnity claims are changing, then that would be  
13 something we'd con -- we'd consider. But at this time,  
14 we don't have any reason to think that there's a big  
15 change in -- in this -- in this trend history.

16 MS. CANDACE GRAMMOND: Okay. And the  
17 last question on this. In dollar terms, about how  
18 sensitive are the unpa -- undiscounted, unpaid  
19 valuation results to the selection of a non-zero trend  
20 for this coverage? And feel free to give us an  
21 undertaking, if you so wish.

22 MR. LUKE JOHNSTON: Yeah, I just wanted  
23 to see if we answered that, but we can do that. And I  
24 think the undertaking is to show the impact of  
25 selecting a zero trend, or -- or what is --

1 MS. CANDACE GRAMMOND: Yeah.

2 MR. LUKE JOHNSTON: -- or point -- zero  
3 point eight-nine (0.89) trend?

4 MS. CANDACE GRAMMOND: My notes reflect  
5 a non-zero trend, so, yeah.

6 MR. LUKE JOHNSTON: Okay, so may --  
7 maybe it's not -- maybe we're -- I'm being too specific  
8 --

9 MS. CANDACE GRAMMOND: -- I think I'll  
10 ask my colleague to clarify.

11 MR. LUKE JOHNSTON: Yeah.

12 MS. CANDACE GRAMMOND: We want to make  
13 sure we get it right. So in dollar terms, how  
14 sensitive are the undiscounted, unpaid valuation result  
15 to the selection of a non-zero trend for this coverage,  
16 which would be the difference between the .89 percent  
17 as assumed and choosing zero? Make sense?

18 MR. LUKE JOHNSTON: Yes, except our  
19 results will have a selected trend of one (1), but  
20 we'll give you the results at zero and compare them to  
21 what we have. And -- and that'll give you the  
22 sensitivity. And we can -- we can do that by putting  
23 zero in there --

24 MS. CANDACE GRAMMOND: Yeah.

25 MR. LUKE JOHNSTON: -- and showing the

1 results, yeah.

2 MS. CANDACE GRAMMOND: I think actually  
3 we do want the 1 percent, yeah, the sensitivity  
4 measurement between the .89 and the 1 percent.

5 MR. LUKE JOHNSTON: Okay. Yes, we can  
6 do that.

7 MS. CANDACE GRAMMOND: Sorry, I -- I  
8 apologize, there was a slight mis --

9 MR. LUKE JOHNSTON: Yeah. No problem.  
10 We can do that.

11 MS. CANDACE GRAMMOND: Oh, sorry. It's  
12 the sensitivity between zero and one (1), not the .89  
13 and one (1).

14 MR. LUKE JOHNSTON: That was my -- that  
15 was my guess, yeah.

16 MS. CANDACE GRAMMOND: Okay, thank you.  
17 So that was my guess.

18 MR. LUKE JOHNSTON: But, yeah -- yeah,  
19 we got it.

20 MS. CANDACE GRAMMOND: Okay, thank you,  
21 Mr. Johnston. So --

22 THE COURT REPORTER: Sorry, we had  
23 better get that verified.

24 MS. CANDACE GRAMMOND: Okay. So the  
25 dollar impact in term -- to reflect sensitivity between

1 the selection of the 1 percent factor and zero.

2 MR. LUKE JOHNSTON: Yes, we can do  
3 that. Okay.

4

5 --- UNDERTAKING NO. 28: MPI to provide the dollar  
6 impact to reflect  
7 sensitivity between the  
8 selection of the 1 percent  
9 factor and zero

10

11 MS. CANDACE GRAMMOND: Thank you.

12 Madam Chair, I apologize, that took a bit longer. But  
13 I will move to a new area when we return from the  
14 break.

15 THE CHAIRPERSON: Okay, thank you very  
16 much. We'll take a break for fifteen (15) minutes.  
17 Thank you.

18

19 --- Upon recessing at 10:50 a.m.

20 --- Upon resuming at 11:08 a.m.

21

22 THE CHAIRPERSON: Okay, thank you.  
23 We'll begin again. You have an undertaking, Mr.  
24 Johnston?

25 MR. LUKE JOHNSTON: Maybe someone could

1 help me with the undertaking number. But the first  
2 response relates to my explanation of PUB II-17. You  
3 could bring that up, PUB II-17.

4

5

(BRIEF PAUSE)

6

7 MR. LUKE JOHNSTON: And page 2, please.  
8 Okay. Apologies for rambling a bit on this one.  
9 Clearly, this isn't something that we ever have to do,  
10 and we -- we did it this year because we're trying to  
11 have a better understanding of this -- how this  
12 additional equity or retained earnings benefits rates  
13 relative to actuarial standards.

14 So in the table what we have on the top  
15 is we looked at the amount of liabilities that aren't  
16 related to rates or claims. So we -- everything other  
17 than unearned premiums and -- and unpaid claims. And  
18 so you get the number 300 something million.

19 Those other liabilities would include  
20 something like the pension plan, for example, which  
21 wouldn't be, of course, related to -- to the -- the  
22 claims piece. Total equity is our total equity in,  
23 like, the retained earnings section of our Basic line  
24 of business, so like our -- our additional funds. So  
25 there's those -- those two (2) numbers there. So you

1 have the liabilities aren't supporting the claims and  
2 the -- kind of the retained earnings total equity of  
3 the Corporation, so those two (2) pieces.

4           Going to the next section, we said, What  
5 investment income do we earn on assets other than the  
6 fixed income portfolio? And -- and that's on the  
7 assumption that the entire fixed income portfolio was  
8 matched to cover claims liabilities. We then said, So  
9 what -- what -- the assumption we're now making is  
10 we're saying that 32 million and 49 million in those --  
11 that line there is the investment income associated  
12 with the numbers at the top table, the -- the other  
13 liabilities and the total equity. We earn that much  
14 investment income on those assets.

15           We took that percentage and said, If we  
16 apply that percentage to our total equity balance, that  
17 would be the equivalent of earning about 9 million and  
18 14 million investment income from our total equity, and  
19 the average of those is the 12 million that you see  
20 there. And -- and that's how we -- that's how we came  
21 up with how much does -- investment income is produced  
22 from our total equity balance. Okay?

23           MS. CANDACE GRAMMOND: Thank you. I'll  
24 review your comments now with Mr. Pelly, and we may or  
25 may not have more questions on this later on, but we'll

1 -- we'll take a look at that. Thank you.

2 MR. LUKE JOHNSTON: And I have another  
3 response, as well. This is in regards to the actuarial  
4 report. That Appendix E, page 10. Okay.

5

6 (BRIEF PAUSE)

7

8 MR. LUKE JOHNSTON: Is that reference  
9 good enough, or do you need...

10

11 (BRIEF PAUSE)

12

13 MR. LUKE JOHNSTON: Maybe we don't even  
14 -- actually don't even need the -- the sheet, but the  
15 question was, if we changed our trend from 1 percent to  
16 zero, what would the impact be? And we literally  
17 changed it in the back row, and it changed our  
18 ultimates by 2.6 million. So that's the sensitivity of  
19 that particular assumption.

20

21 (BRIEF PAUSE)

22

23 MR. LUKE JOHNSTON: So, yeah, 2.6 million  
24 in total on our undiscounted ultimate estimates for  
25 this coverage.

1 CONTINUED BY MS. CANDACE GRAMMOND:

2 MS. CANDACE GRAMMOND: Thank you. I  
3 actually would like to ask you a couple of follow-up  
4 questions on PUB/MPI II-17, the answer -- or the  
5 additional information that you had just provided. So  
6 maybe, Diana, if we can go back to that? We'll just  
7 clean that up, and then we'll go to Ms. Neville and --  
8 and then I'll move to another area.

9 So with respect to this, this is an  
10 excerpt of PUB/MPI II-17, we see the investment income  
11 information reflected varying fairly significantly from  
12 year to year.

13 Can you comment on why that level of  
14 investment income is varying in that way, and whether  
15 that's in part caused by the accounting treatment of  
16 the investment income?

17

18 (BRIEF PAUSE)

19

20 MR. LUKE JOHNSTON: I believe -- I  
21 believe there's a portfolio rebalancing in that '16/'17  
22 year, but I'd -- I'd prefer to undertake to get that  
23 without having to go through -- I don't want to have to  
24 go through all the investment income schedules right --  
25 while you wait.

1 MS. CANDACE GRAMMOND: Sure. That will  
2 be fine. And can you comment on why these are the two  
3 (2) forecast years that are most relevant for the  
4 purposes of picking the assumption?

5 MR. LUKE JOHNSTON: Well, this is  
6 definitely -- we developed this for the purposes of  
7 trying to approximate the -- the benefit of -- that  
8 total equity provides. So we've used -- we've used  
9 this as an example for the -- the rating -- you know,  
10 the rating period that we use and taken the average.  
11 The idea is that this would be the average earning  
12 period of the policies in effect for '15/'16. And if  
13 we isolated it to just one (1) year, it would be closer  
14 to the ten (10) than if we moved to the '16/'17 year  
15 it'd be closer to fourteen (14), but -- yeah. We --  
16 for -- with the staggered renewals and earnings we  
17 thought this was appropriate.

18 MS. CANDACE GRAMMOND: Okay. Would you  
19 consider simply using the average total return  
20 assumption for the relevant investment asset classes  
21 expected over the period that premiums are assumed to  
22 be written?

23

24

(BRIEF PAUSE)

25

1 MR. LUKE JOHNSTON: I -- I have not  
2 done that but on the face of that, that doesn't sound  
3 like an unreasonable assumption. It's something we --  
4 that we could look at. I -- I'd be surprised if we got  
5 a drastically different outcome but it seems  
6 reasonable. This is the method we -- we use to  
7 approximate it.

8 MS. CANDACE GRAMMOND: Okay. Maybe  
9 just something to consider. Thank you. Would you be  
10 able to provide an undertaking to show what the result  
11 of that analysis might be?

12 MR. LUKE JOHNSTON: Yes, we can. If --  
13 if you could have -- if you could maybe read in the  
14 actual undertaking just to make sure we got it right?

15 MS. CANDACE GRAMMOND: Sure. So the  
16 basis for the question was why the two (2) years are  
17 being utilized for the purposes of picking the  
18 assumption, and I guess what the difference would be in  
19 the dollar amounts if you used the average total return  
20 assumption for the relevant investment asset classes  
21 expected over the period that premiums are assumed to  
22 be written. Good?

23 MR. LUKE JOHNSTON: That's good,  
24 thanks.

25 MS. CANDACE GRAMMOND: Thank you.

1  
2 --- UNDERTAKING NO. 29: MPI to provide reasoning as  
3 to why the two (2) years  
4 are being utilized for the  
5 purposes of picking the  
6 assumption, and what the  
7 difference would be in the  
8 dollar amounts if you used  
9 the average total return  
10 assumption for the relevant  
11 investment asset classes  
12 expected over the period  
13 that premiums are assumed  
14 to be written

15  
16 (BRIEF PAUSE)

17  
18 MS. ANITA NEVILLE: Mr. Johnston, just  
19 a couple of questions. One (1) a broad one, and I'm  
20 not sure whether it's fair to ask or whether you can  
21 answer, but you talked frequently about the assumptions  
22 that you make and you change them. When you are  
23 revising assumptions, changing assumptions, what's the  
24 process that you're using on the assumptions? That's  
25 my first question.

1                   And my second question is, you indicated  
2 that the claims are much higher. I can't remember  
3 which graph it was on. Is the nature of the claims  
4 changing now, or is it the same? Can you see a pattern  
5 in claims and a different kind of claim coming up? And  
6 what I'm thinking of perhaps a claim that's even harder  
7 to quantify potentially over the long term.

8                   MR. LUKE JOHNSTON:   Okay. Very good  
9 questions, thanks. So assumptions that -- as you know,  
10 the rate app is completely prospective so every  
11 forecast we make has assumptions. And we are -- in --  
12 in my work I'm relying as much as I can on historical  
13 data to support the assumptions that I'm using. Where  
14 it gets difficult in some cases is -- is when we were  
15 discussing sometimes the -- the trends change and  
16 judgment is -- is required.

17                   And often at these hearings, we're  
18 talking about some of those grey areas. I don't think  
19 -- I -- I don't rarely -- I -- I rarely get asked  
20 about, you know, it's been 5 percent a year for the  
21 last five (5) years. Why are you picking five (5),  
22 right?

23                   It's more, this assumption looks, you  
24 know, maybe not completely consistent with the history.  
25 What made you pick that? And sometimes it's business

1 considerations or it's my own judgment in terms of, you  
2 know, talking with the business or the recent history  
3 or how I feel is the best way to produce a best  
4 estimate but create rate stability.

5                   So like -- like the -- that graph we  
6 showed where the claims were all over the place, I  
7 think --

8                   MS. ANITA NEVILLE: Are you the -- are  
9 you the one that -- that revises the assum -- the  
10 assumptions or makes the assumptions, or do you do it  
11 in concert with others? Do you do it based on not just  
12 your internal materials, but outside reading and --

13                   MR. LUKE JOHNSTON: Yes. No, very good  
14 question. The -- there are committees, and so we have  
15 -- we were just called the forecasting committee now.  
16 We used to have the claims and the rep, but the idea of  
17 those is to bring in the business.

18                   I can't make assumptions on the PIPP  
19 program without the business. And so we discuss, you  
20 know, what's happening, you know, what -- like -- like  
21 one (1) -- one (1) thing in our rate app is -- that we  
22 discuss is the -- the trend on serious losses seems to  
23 be almost non-existent, flat, even -- even including  
24 severity cost growth.

25                   So, you know, what -- what's changing in

1 that field? Like -- like a lot of these things that  
2 you don't know what impact they have, like seatbelts or  
3 air bags or drinking and driving commercials. And  
4 maybe those are some of the things that have allowed us  
5 to keep a flat serious loss forecast.

6 But that's, yes, very much in -- in  
7 consul -- consultation with the business to understand  
8 what's going on before I just plunk an assumption in  
9 there based on a five-year average or something like  
10 that.

11 And we do -- I -- I do talk regularly  
12 with chief actuaries at SGI and ICBC. I don't want to  
13 go on the record with a bunch of SGI information, but  
14 they -- their program is very similar to ours, and they  
15 experience a lot of the same types of trends and  
16 issues. So that -- those discussions are helpful.

17 ICBC a few years ago came to us and  
18 asked if we were seeing decreases in injury frequency  
19 as well, and we told them that it's -- it was flat, but  
20 not decreasing. And -- and I know they went forward  
21 with a fairly favourable injury frequency forecast, and  
22 it kind of backfired on them, to be honest.

23 So -- so, yeah, we do -- we do that as  
24 well.

25 MS. ANITA NEVILLE: What about the

1 changing nature of the claims? Is there a change? You  
2 had talked about the increased claims. Are they -- are  
3 they changing in nature?

4 MR. LUKE JOHNSTON: There's -- we've  
5 heard lots about physical damage, and Mr. Guimond can -  
6 - can probably discuss those topics better than -- than  
7 I can. Not probably. He can.

8 So when we look at something like  
9 collision, there's the different aspects, right? The  
10 frequency, the severity. On the frequency side, we see  
11 a lot of consistency. People continue to crash into  
12 each other at the same rates. So in that regard, we --  
13 we haven't -- we don't see any change right now, and  
14 it's essentially a status quo type forecast. In terms  
15 of how the -- the types of claims on that -- on that  
16 end are changing, we've heard some evidence about that,  
17 and I won't -- I won't get into that piece.

18 On the injury side, PIPP -- PIPP has,  
19 especially on the -- on the payment and claims duration  
20 side, been -- been very consistent over time. And  
21 that's why we use the historical data so much.

22 But, as mentioned, we seem to be getting  
23 real favourable trends on -- on the bigger claims, and  
24 hopefully that means, you know, people are changing  
25 their behaviours a little bit in terms of some of the

1 extremely risky behaviour that happened. A -- a lot of  
2 serious losses involve drinking and driving and -- and  
3 the such, so we -- we monitor that. That's one (1) of  
4 the reasons this -- this graph that's on the screen  
5 right now is -- is relatively flat.

6 But, yeah, to -- to your point, I --  
7 it's hard for me to -- like, an injury case manager  
8 could maybe give you a little better information on  
9 terms of how -- how they feel about, you know, a  
10 particular type.

11 MS. ANITA NEVILLE: I guess what I was  
12 really asking is whether you're seeing an increase in  
13 PTSD given the increased public discussion about it.

14 MR. LUKE JOHNSTON: That's not  
15 something I can answer. Yeah, I -- I can't answer  
16 that. I -- we could inquire with the business, but I --  
17 - I -- myself, I -- I don't know the details of that.

18 MS. ANITA NEVILLE: Good. Thank you.

19

20 (BRIEF PAUSE)

21

22 MR. DAN GUIMOND: I can say -- I can  
23 say that we do see more of it, and it's coming more in  
24 the reports that I read personally. So, yes, the  
25 posttraumatic stress disorder is manifesting itself

1 more in the claims that we're seeing.

2                   And, also, technology is having a big  
3 difference in terms of -- of life expectancy. We can  
4 see in our customers, in our -- our -- people that we  
5 thought we would -- would have passed away by now are  
6 not. Techno -- medicine's making a big difference.  
7 We're living longer.

8                   And, also, technology is also changing  
9 the -- the lives of our customers. Like, for example,  
10 I can see in some of the reports that I read, just to  
11 give you a flare of it, a -- a traumatic brain injury,  
12 for example, is somebody who can maybe cope by  
13 themselves at home, but they -- they don't know they  
14 should eat, so, for example, you can have a -- a gizmo  
15 -- a technological gizmo that buzz them, and through  
16 association, they know it's time to eat.

17                   So we -- so technology is -- is changing  
18 how claims are being managed and how they're -- how our  
19 customers, in terms of being able to maybe do more  
20 things on their own, be able to be more integrated into  
21 society. We're also taking some steps -- for example,  
22 we're very concerned about the availability of -- of  
23 people who need 7/24 care. So we're doing a pilot in  
24 Brandon right now for a -- for a house for a traumatic  
25 brain injury to be able to -- to make sure that instead

1 of -- like, there'll be four (4) people in that house.  
2 Instead of having four (4) 7/24 crews, you'll get one  
3 (1) for four (4) people.

4                   So we're trying to do things like that  
5 to make sure that we have the proper care for our  
6 customers, because what we're starting to see with the  
7 plan, since it was implemented in 1994, people who take  
8 care of the kids that were injured, like, right,  
9 they're -- they're getting old. Some of them are  
10 passing away. They can't take care of the children  
11 anymore. Some of them, families break apart.  
12 Sometimes it's the grandparent that takes care of it,  
13 and they're passing away right now.

14                   So we're -- we have to take proactive  
15 action to -- to help our customers out. So that gives  
16 you an idea of -- of how things are changing.

17                   MS. ANITA NEVILLE: Thank you. Thank  
18 you very much.

19                   MS. CANDACE GRAMMOND: Thank you.

20                   MR. REGIS GOSSELIN: Mr. Johnston, you  
21 -- you indicated that the PIPP experience in  
22 Saskatchewan -- or the PIPP program in Saskatchewan is  
23 very similar to ours in Manitoba. And you indicated  
24 that the PIPP forecast is showing stabilities --  
25 stability over time.

1                   Are they having the same experience as  
2 Saskatchewan?

3                   MR. LUKE JOHNSTON:    Yes, they actually  
4 -- unrelated to the hearings, they -- they contacted me  
5 recently and said, Are you also experiencing this? And  
6 I -- I said, Yes, we're basically -- we've basically  
7 been flat, injury claim counts for seven (7) to eight  
8 (8) years, yeah.

9                   MR. REGIS GOSSELIN:    Okay. And you  
10 indicated this morning that, you know, the collision  
11 forecast, you're struggling more with that one. So is  
12 it stemming from incidents, or is it stemming from the  
13 kind -- the kind of trends we're -- we've been talking  
14 about up to now, which is, you know, the higher cost of  
15 repairs and the -- the fragility of some of the -- some  
16 of the vehicles and so on?

17                  MR. LUKE JOHNSTON:    From a statistical  
18 standpoint, we -- what we do on the frequency side is  
19 we look on a month-by-month basis, because, as you can  
20 imagine, there's a lot of variability in, like,  
21 January, so -- like, with frequency, right, depending  
22 on if it snows all month.

23                  But it's -- it's kind of a good news/bad  
24 news situation. In -- in recent summers where this --  
25 the frequency is very stable, we've seen some

1 favourable frequency experience relative to history.

2 And by 'frequency', I mean claims per unit.

3                   On the other end, we've seen three (3)  
4 of the last four (4) winters have been abnormal in the  
5 -- abnormally bad frequency in the winter.

6                   But I put most of my weight on what --  
7 the summer tells me more like this is like when it's  
8 clean driving and the -- the trends seem to be holding  
9 there, so I -- in this rate app we've gone with like a  
10 long-term review of frequency, essentially discounting  
11 the -- the last few winters as being abnormal. So the  
12 -- the frequency forecast is essentially unchanged.  
13 The whole difference that you're seeing is in severity.

14                   MR. REGIS GOSSELIN: Now, the -- the --  
15 at the CARR conference that I attended, there -- there  
16 was -- you know, we heard from some of the Ontario  
17 evidence of -- of significant fraud being committed,  
18 and -- and in -- significant increase in claims losses.  
19 I guess I'm trying to understand...

20

21                   (BRIEF PAUSE)

22

23                   MR. REGIS GOSSELIN: So -- Ontario. So  
24 we heard at the -- at the CARR conference that Ontario  
25 was experiencing significant claims losses due to

1 fraud. And I guess I'm -- I'm wondering, and it's  
2 probably a question more for Mr. Guimond but, you know,  
3 at what point -- how would you pick it up in Manitoba?

4 I mean, you would probably -- I would  
5 imagine you would pick it up a lot sooner in Manitoba  
6 than you would in Ontario, but I -- would you pick it  
7 up through the work you're doing or through the work  
8 that -- that's being done at the claims adjuster level?  
9 How -- how would you pick it up?

10 MR. DAN GUIMOND: Right now we -- we  
11 pick it up by how our special investigation unit works  
12 with our adjusters and case managers, both on the  
13 physical side and the BI side. The -- and we believe  
14 that we've reached a point -- a saturation point in  
15 terms of what can be done in terms of human beings.

16 But we do believe that we can pick up  
17 more fraud through analytics, and you'll see in one (1)  
18 of our initiatives we're implementing analytics. And  
19 we believe that we, through the analytics -- and  
20 analytics, just for people -- just to be clear about  
21 that, it's how you can do data mining on the back end.

22 And there's two (2) things that happen  
23 with analytics that are advantageous to the -- the  
24 Corporation. One (1) is that you're able to put your  
25 investigators on the cases that has a much higher

1 probability of fraud. So -- so you can focus the  
2 people right away on -- on the right claims that are --  
3 are suspicious.

4           The other thing that you can do -- so  
5 that means that a return on -- on an employee, if -- if  
6 you mean in salary, because they can focus on ten (10)  
7 cases that you know is high probability so you might  
8 get eight (8) out of the ten (10) versus somebody  
9 trying to go through twenty (20) and get five (5),  
10 right, so you'll get more.

11           The other thing that happens is that --  
12 through analytics is that you're able to identify --  
13 identify the fraud before the payment on the claim  
14 occurs, so you're not -- you're also saving money on  
15 collections because the money never got paid in the  
16 first place because you're able to build it in a lot  
17 faster in terms of detection.

18           So we believe that we're able to -- our  
19 business case right now, what we're putting in, be able  
20 to get at least another million to a million and a half  
21 in fraud minimum.

22

23 CONTINUED BY MS. CANDACE GRAMMOND:

24           MS. CANDACE GRAMMOND: Mr. Johnston, I  
25 just wanted to ask you a follow-up question on the --

1 the back and forth with Board member Neville. She was  
2 asking you about how the assumptions are done and  
3 whether you discuss them with others, and you talked  
4 about the committee.

5 In terms of implementation of whether  
6 it's assumption or your actuarial judgment, is there a  
7 reporting process that you go through or do you just  
8 decide those things and implement them?

9 MR. LUKE JOHNSTON: Is -- is -- in  
10 terms of reporting process, do you mean as a reporting  
11 process to our management and the board?

12 MS. CANDACE GRAMMOND: Yeah, like do  
13 you have to go to either management or the board of  
14 directors and say, Here are the -- the elements of  
15 judgment that I want to exercise and they have to look  
16 at it, or do you just implement your judgment and tell  
17 them, This is what we're doing? I just don't have a  
18 sense of how you fit in with that hierarchy.

19 MR. LUKE JOHNSTON: Yeah. No, we -- so  
20 the -- the committee meets, and -- and it's often  
21 pretty clear which assumptions are more difficult to  
22 make. Collision this year would have been a good  
23 example. So the committee does all their work. Makes  
24 a presentation to management. Definitely highlights  
25 the -- in a general sense goes through all the

1 assumptions. This is a -- often -- depending on the  
2 nature of the -- the forecast, this could be a three  
3 (3) to five (5), six (6) hour meeting. That's  
4 basically a presentation done by all the -- you know,  
5 myself and all the relevant business people and -- and,  
6 you know, investments and everything.

7                   In -- in the case of this -- I'll give  
8 you an example with collision. In the case of this  
9 last year, we made a preliminary presentation to say,  
10 You know, here's our kind of first look at this  
11 forecast. Collision, you know, let's -- what's going  
12 on with this? How are we -- you know, why is it up 10  
13 percent?

14                   The business does a full detailed  
15 analysis which is in the rate app showing all the  
16 components of it. And then there's discussions in  
17 terms of, you know, what -- what will we -- what should  
18 we select as a trend for this coverage?

19                   You know, I -- I would comment, you  
20 know, from an actuarial standpoint, here's the  
21 historical data and the -- and the -- you know, the  
22 fits and everything. The business would talk about the  
23 technology and -- and what they're seeing. And  
24 ultimately, we have to decide on something. And --  
25 and, you know, management would be made -- made aware

1 of the sensitivity of those assumptions.

2                   And then one that -- once that  
3 decision's made, like the -- our management's okay with  
4 the particular forecast, that goes to the board as  
5 well, the same process, maybe like a little less  
6 detailed, but the same idea. And once it's approved at  
7 that level, that kind of gives me the okay to go do the  
8 rates.

9                   Like, so, okay, it's two point four  
10 (2.4). Okay. Go. Prior to that, I don't touch any of  
11 the rates until we get that kind of official  
12 confirmation.

13                   MS. CANDACE GRAMMOND: And who sits on  
14 the committee? Is it -- is it -- are there people from  
15 management or --

16                   MR. LUKE JOHNSTON: On the forecasting  
17 committees? Yeah, it would be like the -- like from  
18 the injury claims management division, it's the -- the  
19 executive director of injury claims. And they'll  
20 typically bring, you know, like some number cruncher  
21 workers.

22                   But, yeah, of course we also have people  
23 on the PD side, a corporate controller, investment  
24 manager and analysts. The -- all the committees  
25 combined, I'm sure the number's, you know, into the

1 twenty (20) to thirty (30) people involved.

2 We've kind of split apart in some  
3 aspects. Like the investment people don't need to sit  
4 through three (3) hours of physical damage discussions,  
5 but that -- other -- but probably about twenty (20),  
6 thirty (30) people in total.

7 MS. CANDACE GRAMMOND: Okay. Okay.  
8 Thank you. I'm going to go then to some questions on  
9 interest rate risk. And I know we had some evidence  
10 last week with Mr. Guimond on that and his view that  
11 it's a big concern for the Corporation.

12 And one (1) of the comments that was  
13 made -- and I'm -- I'm happy to hear from whoever wants  
14 to answer this, but I just want to get a better  
15 understanding. There was some evidence last week that  
16 the current approach used by the Board with respect to  
17 interest rate risk was pushing that risk onto the  
18 ratepayers.

19 And I just want to get a better  
20 understanding of what that comment means.

21 MR. DAN GUIMOND: The point that I'm  
22 trying to make to the best of my abilities is that if  
23 we continue to build into our forecast model that we're  
24 going to get revenue from interest rate that will never  
25 materialize, the amount that we're going to be before

1 you year over year will just keep growing and growing  
2 and growing.

3           And that's why it was so important this  
4 year to make the point how maybe you can be between two  
5 point four (2.4) and seven (7). So it'll catch up with  
6 time, and then what we're creating is a bubble into the  
7 future.

8           And that's what I mean by pushing that  
9 interest rate risk to the ratepayers because it'll  
10 catch up with us, and then the rate increase just gets  
11 to be very significant year over year. So last year we  
12 were at one point eight (1.8). It got reduced. Now  
13 we're at three point (3.) -- well, two point four  
14 (2.4). Could be as high as four point two (4.2), I  
15 believe, depending on the assumptions.

16           And -- and then if we change the  
17 interest rate assumption, if we don't use the one from  
18 the Board, could be as high as seven (7). So now  
19 you're saying, Okay, now, that's getting concerning to  
20 me, right? Because what's going to happen is it's  
21 going to catch up with us, and then -- and then it just  
22 -- it just explodes on you type of thing. And then you  
23 -- you could be in rate shock.

24           So -- so I -- I think it's important to  
25 manage that right -- right away.

1 MS. CANDACE GRAMMOND: Thank you.

2 MR. REGIS GOSSELIN: I wonder, could  
3 you -- and probably this is a good question from --  
4 from Ms. Reichert. The moving parts within interest  
5 rated forecasts that influence the result, could you --  
6 could you walk me through that? I'm -- I'm trying to  
7 figure that out -- piece out.

8 So, for example, you know, a -- a  
9 decline in interest rates will -- will trigger a  
10 capital gains increase on the bonds, the -- the  
11 marketable bonds. But the -- the effect of that,  
12 though, is that when you -- when you take money and  
13 invest in the bond -- take cash that you have available  
14 and -- and buy some more bonds, you're buying those  
15 bonds at a lower interest rate than you were -- you  
16 were expecting to -- to buy.

17 Is that -- that what's going on? I  
18 mean, I'm trying to figure out what's going on. What -  
19 - what would cause the wide variation -- what are the  
20 parts that are causing a wide variation in -- in the  
21 financial outcomes because of a change in the interest  
22 rates?

23 MS. HEATHER REICHERT: So in a  
24 declining interest rate environment, as -- as you just  
25 said, the marketable bonds, they decrease in value.

1 Each month when we're doing our financial statements,  
2 we have -- we -- for marketable bonds, we have to  
3 account for them at that -- at that point what their  
4 market value is.

5                   So every month, the -- the value of our  
6 bonds are converted into what the marketable rate for  
7 those bonds are at that month. So we don't have to  
8 necessarily have sold the bond to be recognizing the  
9 fact that it has decreased in value, and so at the time  
10 that we do sell them, we will be getting a -- a capital  
11 loss on that bond.

12                   The other aspect is -- is, during the  
13 year, if interest rates are, in fact, declining, and we  
14 are buying bonds in order to match with our  
15 liabilities, we are buying them with a lower coupon  
16 rate than what we may have forecasted. So then there's  
17 the impact of the actual coupon rate on the bonds  
18 themselves and getting less income than what we would  
19 have anticipated.

20                   The other aspect of the decreasing  
21 interest rate environment is that we have to determine  
22 the discount rate for our claims liabilities on the  
23 basis of what we're seeing as the weighted average  
24 interest rate on our bond portfolio, being both the  
25 MUSH bonds and the marketable bonds.

1                   So as the marketable bonds are  
2 decreasing in their interest -- in the -- is -- in the  
3 intre -- decreasing interest rate environment, then the  
4 discount rate for our bonds also is decreasing, which  
5 means that we have got to -- which -- for the  
6 liabilities. I'm sorry, not the bonds, for the  
7 liabilities.

8                   So the discount rate for the liabilities  
9 is decreasing, which means that the claims expense tha  
10 -- that we're reflecting increases. We have to hold  
11 more money at lower interest rates in order to have  
12 sufficient funds to pay off those claims in the future,  
13 so it's the combination of those -- all of those  
14 factors.

15                   MR. REGIS GOSSELIN:   Okay, but I'm more  
16 concerned about the near-term impact, you know, the --  
17 the two (2) year time horizon that are used to  
18 establish rates now. A -- a variation in interest  
19 rates downward, like we're seeing, has an impact over  
20 the two (2) year timeframe. And that impact over the  
21 two (2) year timeframe is related to the returns that  
22 you get from the investments that you make during that  
23 timeframe?

24                   MS. HEATHER REICHERT:   Yes, and  
25 whatever bonds we're holding during that timeframe,

1 because they are revalued every month, every year at  
2 what the then current market value is for those bonds.  
3 So it may be bonds that we have purchased five (5)  
4 years ago that are marketable that we haven't sold.  
5 But if the market rate for bonds is going down, we have  
6 to revalue those bonds that we hold, and we are losing  
7 -- losing capital.

8 Well, sorry. Yeah. Sorry, those -- the  
9 -- when the rates are going down, those bonds are --  
10 are -- I'm sorry, I was -- I was reversing it.

11 Overall, when the rates are going down, the net impact  
12 to us is negative, because the bonds -- the bonds  
13 themselves will increase in value, but that's offset by  
14 the decreasing claims that I was referring to. So the  
15 net of that, in a decreasing interest rate environment,  
16 it's a negative net -- a -- a negative net impact to  
17 the organization. Regardless of if we are buying and  
18 selling bonds or just holding them, marketable bonds  
19 are revalued every -- every month in our financial  
20 reporting.

21 MR. REGIS GOSSELIN: But -- but the --  
22 but the impact on the income statement during that  
23 short-term horizon is relatively modest.

24 MS. HEATHER REICHERT: I'll let -- I'll  
25 let Mr. Johnston continue.

1 MR. LUKE JOHNSTON: Yeah. No, it'll be  
2 helpful when we do provide the undertaking to the flat,  
3 because we can really isolate for you what's changed,  
4 and so whether it's coupon interest, claims. And  
5 that'll -- that'll be helpful, for sure.

6 The -- and just to add -- one (1) piece  
7 that wasn't mentioned is this whole idea of the premium  
8 deficiency. So we're in a very unique situation right  
9 now where we continue to have bank forecasts that are  
10 go -- assuming complete recovery.

11 So we keep setting rates on that basis,  
12 right? Like, we keep saying, Oh, that'll happen. And  
13 then, if it -- if it doesn't because of this premium  
14 deficiency like we have right now, because it -- the  
15 rates were banking on that, essentially, to happen and  
16 it doesn't, the effect of that is we could keep coming  
17 to these -- let -- let's say the fore -- the rates stay  
18 the same and the -- the forecasts keep doing the same  
19 thing.

20 We'll keep coming here, telling you that  
21 we lost a bunch of money in -- in reality, but the  
22 rates don't need that big of a hike because, don't  
23 worry, interest rates are going to rise, right?

24 And -- and so it's an RSR issue. It  
25 just -- it can just keep draining and draining and

1 draining, and we never bump that rate requirement up,  
2 because we continue to wait for these interest rates to  
3 come.

4

5 CONTINUED BY MS. CANDACE GRAMMOND:

6 MS. CANDACE GRAMMOND: Thank you. Just  
7 -- and I'm going to go into some questions on duration  
8 matching. But just before I do that, can you confirm -  
9 - and I -- I assume this is Mr. Johnston, although it  
10 may be anybody.

11 When we talk about changes in interest  
12 rates, whether they're unanticipated or whatever, and  
13 the impact of those interest rates causes a negative  
14 impact to the bottom line and hence the RSR, do we  
15 agree that that's one (1) of the purposes that the RSR  
16 is there?

17 Like, is interest rate impact one (1) of  
18 the impacts that the RSR is there to cushion is what  
19 I'm asking?

20 MR. LUKE JOHNSTON: Yes, it is. And  
21 when we -- the benefit of the DCAT approach is the DCAT  
22 will adjust to the risk level that you're -- that  
23 you're take -- to the risk that you're taking.

24 So if you are making a significant --  
25 not bet, but a forecast of significant favourable

1 outcomes, the DCAT will say, Well, oh, here's the risk  
2 of that not coming true, right? And so if, you know,  
3 if we were perhaps at a higher interest rate  
4 environment, the risk of being wrong might be less, and  
5 the DCAT indication would -- would fall as well.

6                   Similarly, I -- you're going to talk  
7 about duration matching too, but in terms of risk  
8 mitigation techniques and -- and the such, that would  
9 also have an impact on the DCAT indication.

10

11                   (BRIEF PAUSE)

12

13                   MS. CANDACE GRAMMOND: Madam Chairman,  
14 I'm noting the time. I know it's a bit earlier than  
15 we'd normally break. I'm happy to start with these  
16 questions, but I know I'm not going to finish the  
17 subject before 12:00.

18                   So I'm -- I'm in your hands whether you  
19 want to break now and just come back in an hour, or  
20 whether you want me to go till 12:00 and then just stop  
21 in the middle of the topic. It's -- I'm -- I'm fine  
22 either way.

23

24                   (BRIEF PAUSE)

25

1 THE CHAIRPERSON: I'm getting mixed --  
2 from either end. I'll make a decision. I think --  
3 think we'll stop for lunch now, and then you can just  
4 do a clean --

5 MS. CANDACE GRAMMOND: So we'll maybe  
6 come back at 12:50?

7

8 --- Upon recessing at 11:48 a.m.

9 --- Upon resuming at 12:54 p.m.

10

11 THE CHAIRPERSON: Okay. Welcome back.  
12 Hope you had a good lunch. We're going to continue  
13 with our proceedings, and we'll continue with Ms.  
14 Grammond.

15 MS. CANDACE GRAMMOND: Thank you.  
16 Madam Chair. Just before I resume the cross-  
17 examination, I just wanted to do a bit of housekeeping  
18 and update for all of the parties. And this is on the  
19 issue of the scenarios within MPI's DCAT and the --  
20 what we're calling the pass-the-pen initiative  
21 involving Mr. Pelly.

22 So Mr. Pelly's been doing some review  
23 and analysis, and he's come up with a document that  
24 reflect his thoughts and -- and right now, we're  
25 calling it an undertaking, but that may or may not be

1 really what it is. It's basically a request of MPI to  
2 do certain review and provide certain information.  
3 It's -- it is in two (2) phases, that's his  
4 anticipation that that's how this would unfold.

5                   So I just wanted to say on the record  
6 that I'm going to be circulating this document later  
7 today, like after the proceedings, when I'm able to do  
8 so. It is marked 'draft', and the reason for that is  
9 although it's been approved by the panel and prepared  
10 by Mr. Pelly, it's for input by MPI and CAC, and  
11 whoever else may want to have input into it.

12                   And then we'll also have some  
13 discussions about the timing and how exactly this will  
14 fit into this GRA process, because this is somewhat of  
15 a new way. So we'll need to give some thought to that,  
16 and we'll definitely be open for discussion about that,  
17 as well. So you will all be getting an email, and all  
18 the Intervenors will be getting an email from me later  
19 today with this document.

20                   Mr. Williams looks like he wants to say  
21 something.

22                   MR. BYRON WILLIAMS: We'll just reserve  
23 comment on this process. Our -- our client was acutely  
24 uncomfortable with it when it was presented, and the  
25 pecu --peculiar position it may put the Board actuary

1 in. And so we'll -- once we review this draft, we may  
2 have some additional com -- comments.

3 MS. CANDACE GRAMMOND: And I can also  
4 indicate that certainly, this is a new approach, but in  
5 the interests of making sure that everything is  
6 transparent and so forth, and to ensure that anything  
7 Mr. Pelly is saying is through the regular channels and  
8 on the record, we are proceeding in the way that I've  
9 described.

10

11 CONTINUED BY MS. CANDACE GRAMMOND:

12 MS. CANDACE GRAMMOND: Okay. So I'm  
13 going to have some questions, then, on duration  
14 matching. I'm going to ask that we go to the  
15 investment income section of the filing and the  
16 executive summary, which is found at the beginning of  
17 that section. So bottom of page 7 of the investment  
18 income summary.

19

20 (BRIEF PAUSE)

21

22 MS. CANDACE GRAMMOND: And, sorry, just  
23 one (1) other thing, Mr. Williams. We are -- and I  
24 think I said this, we are looking for Intervenor input  
25 on this document, as well.

1 MR. BYRON WILLIAMS: Our questions will  
2 more likely be -- well, I'll just reserve my comments  
3 till later.

4 MS. CANDACE GRAMMOND: Fair, and I'm  
5 not asking you to answer, but I just want to be sure  
6 that it's clear that we are seeking input.

7

8 CONTINUED BY MS. CANDACE GRAMMOND:

9 MS. CANDACE GRAMMOND: Okay. So we've  
10 got the investment income document up on the screen.  
11 If we can go down to the bottom of page 7?

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: Yes. So we see  
16 a paragraph here with respect to duration matching. So  
17 this is part of the evidence that the Corporation has  
18 filed. The Corporation says it:

19 "Has a duration matching program that  
20 offsets the impact of rising interest  
21 rates on investment income with a  
22 decrease in claims incurred. Since  
23 the forecasted duration gap between  
24 fixed income and claims is a -- a  
25 negative one (1) year in this year's

1 application, the Corporation benefits  
2 from a rising interest rate forecast.  
3 Over the rating years, the average  
4 impact of the interest rate forecast  
5 on investment income is a negative 28  
6 million, which is offset by the  
7 forty-five point five (45.5) negative  
8 million decrease, obviously, in  
9 claims incurred."

10 So I -- I'm just going to stop there. I  
11 -- I assume this is you, Ms. Reichert, although if it -  
12 - if it's you, Mr. Johnston, feel free to -- to jump  
13 in.

14 First of all, I've read that in  
15 correctly?

16 MS. HEATHER REICHERT: Yes. Yes, you  
17 have.

18 MS. CANDACE GRAMMOND: So the -- the  
19 difference, then -- and the -- the paragraphs goes on  
20 to say:

21 "Therefore, the average rating year  
22 net impact of the interest rate  
23 forecast is a positive 17 1/2 million  
24 on Basic net income."

25 So that's that difference between the

1 twenty-eight (28) and the forty five and a half (45  
2 1/2). Is that right?

3 MS. HEATHER REICHERT: Correct.

4 MS. CANDACE GRAMMOND: And this 17 1/2  
5 million, as is indicated at the -- the end of that  
6 paragraph, equates to roughly 2 percent in rates?

7 MS. HEATHER REICHERT: Correct.

8 MS. CANDACE GRAMMOND: And as the  
9 Corporation is saying in that last sentence, if the  
10 interest rate forecast doesn't materialize, there's a  
11 risk of about 2 percent, which is that 16, 17 million.  
12 There -- in other words, there'll be a hole in the  
13 revenue if interest rate forecast does not materialize?

14 MS. HEATHER REICHERT: Yes, that's  
15 correct.

16 MS. CANDACE GRAMMOND: Now, if we  
17 scroll to the next -- the top of the next page, we have  
18 some further information on this that I'm going to come  
19 to. In the part from the earlier page that I read in  
20 with the one (1) year gap reference, that was reduced  
21 in this year's filing from a two (2) year gap.

22 Do I have that right?

23 MS. HEATHER REICHERT: Yes, that's  
24 correct.

25 MS. CANDACE GRAMMOND: And when we talk

1 about the gap, just so that we're all clear, this is  
2 the gap between the fixed income investments and the  
3 claims liabilities.

4 Is that right?

5 MS. HEATHER REICHERT: It is the gap  
6 within -- between the duration of the fixed income  
7 assets and the duration of the claims liabilities, yes.

8 MS. CANDACE GRAMMOND: Thank you.  
9 Yeah, I -- I -- thank you for clarifying that. Now,  
10 what we see here on page 8, and I'm looking at the  
11 second paragraph under the heading, "Duration  
12 matching," we see the Corporation saying in the first  
13 sentence that its interest rate risk is managed by  
14 maintaining the fixed income duration within a  
15 bandwidth, et cetera.

16 And then in the next sentence it says,  
17 "In order to reduce the interest rate risk, the rate  
18 setting forecast," et cetera, et cetera, talks about  
19 the change from two (2) year to -- two (2) years to one  
20 (1) year.

21 So is the Corporation saying here that  
22 with this change that's been implemented, that is from  
23 the two (2) years to the one (1) year, that the  
24 Corporation is -- has managed or has reduced its  
25 interest rate risk?

1 MS. HEATHER REICHERT: What we are  
2 saying in that specific paragraph is that we have  
3 reduced our interest rate risk. We have not eliminated  
4 our interest rate risk. So if we were still at a plus  
5 -- or pardon me, if we were still at a minus two (2)  
6 duration gap, then this difference -- this -- this  
7 positive difference that we are seeing, because of  
8 increasing interest rate forecasts and the potential  
9 negative impact to us should that not occur, would be  
10 higher than the minus seventeen point five (17.5) -- or  
11 the seventeen point five (17.5) on the previous page.

12 So because we're at a minus one (1) year  
13 instead of a minus two (2) year, we have mitigated the  
14 risk of interest rates not increasing somewhat but not  
15 entirely.

16 MS. CANDACE GRAMMOND: And in terms of  
17 the dollars with respect to this change -- in term --  
18 that's okay. In terms of the dollars with the change  
19 from two (2) years to one (1) year, is it correct that  
20 the investment income for Basic was about \$5 million  
21 higher at the two (2) year duration gap?

22

23 (BRIEF PAUSE)

24

25 MS. HEATHER REICHERT: Sorry. We would

1 have to take that as an undertaking to determine what  
2 the difference would be had it remained a minus two  
3 (2). So I'm not sure the -- your reference to the 5  
4 million difference, if that was in an IR or -- or  
5 something, but...

6 MR. REGIS GOSSELIN: But if the -- if -  
7 - if your -- a 1 percent -- if the change in interest  
8 rates could yield \$17 1/2 million, your one (1) year --  
9 your -- your matching is off by one (1) year. Then if  
10 you had to go to 2 percent, it'd be 34 million,  
11 wouldn't it?

12 MR. LUKE JOHNSTON: The -- the impacts  
13 referenced would be from all -- all aspects of our  
14 forecast. So, for example, if -- if we got additional  
15 interest rate or -- or coupon income or anything from a  
16 higher interest rate forecast, that may impact things  
17 as well. But --

18 MR. REGIS GOSSELIN: And so -- so it  
19 would -- would be an oversimplification to doubt --  
20 double the amount?

21

22 (BRIEF PAUSE)

23

24 MR. LUKE JOHNSTON: Yeah. It wouldn't  
25 -- it wouldn't be a proportional adjustment. It would

1 definitely be larger, but we'll -- we'll take that as  
2 an undertaking.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: Okay. The court  
7 reporter is asking that we clarify the undertaking. So  
8 I'll state it and you can confirm.

9 The at -- the question was to -- whether  
10 the impact on investment income from the shift to --  
11 from a two (2) year duration gap to a one (1) year  
12 duration gap was a \$5 million number. And Ms. Reichert  
13 said she wasn't sure that that was the number. Provide  
14 an undertaking with the -- the number.

15 Is that fair to say?

16 MS. HEATHER REICHERT: Maybe I can  
17 state the undertaking in just a -- a different way.

18 MS. CANDACE GRAMMOND: Sure.

19 MS. HEATHER REICHERT: So what I think  
20 we can do is determine if we were holding our assets at  
21 a two (2) year lower duration than the claims, that we  
22 would determine what that net positive impact would be  
23 to our net income, and then compare it to what it is at  
24 minus one (1) duration.

25 MS. CANDACE GRAMMOND: Yes, that's

1 right.

2

3 --- UNDERTAKING NO. 30: MPI to determine net  
4 positive impact to net  
5 income based on holding  
6 assets at a two (2) year  
7 lower duration than claims,  
8 and compare it to what it  
9 is at minus one (1)  
10 duration

11

12 CONTINUED BY MS. CANDACE GRAMMOND:

13 MS. CANDACE GRAMMOND: And when was the  
14 one (1) year duration gap put in place?

15 MS. HEATHER REICHERT: The investment  
16 committee working group looked at -- we -- we -- in the  
17 order last year, but even before the order from the  
18 Public Utility Board, we undertook to look at our  
19 duration matching. We knew that that was something  
20 that was interesting -- or of interest to us as well as  
21 to the PUB.

22 So we had undertaken looking at duration  
23 matching, and determined that, while we engaged a  
24 consultant to do the asset liability management study,  
25 that while we were waiting for the results of that in

1 order to determine exactly, you know, what we might do  
2 to properly mitigate our interest rate risk, that in  
3 the interim, we would take the step to lower the  
4 duration, because we knew that the higher the duration,  
5 the more risk that we were taking on.

6                   So we did that paper. The investment  
7 committee working group met and discussed the viability  
8 of going down to a minus one (1) year duration, and we  
9 implemented that during the year and instructed --  
10 working with the department of finance, gave them until  
11 the beginning of August -- end of August -- gave them  
12 till the end of August in order to be able to, on a --  
13 a reasonable transition basis, move us from a minus two  
14 (2) year gap to a minus one (1) year gap.

15                   So we determined it earlier in our  
16 fiscal year and gave them until the end of August to  
17 actually implement the minus one (1) year duration.

18                   MS. CANDACE GRAMMOND: So the second  
19 quarter results that are on file in this proceeding and  
20 that we've had some evidence on reflects that change?

21                   MS. HEATHER REICHERT: Yes. At the end  
22 of August, which is the end of our second quarter, we  
23 were at that point within a minus one (1) year duration  
24 bandwidth between our assets, our fixed income assets,  
25 and our claims liability.

1 MS. CANDACE GRAMMOND: Thank you.

2 Okay. I'm going to go, then, to Attachment B at the  
3 investment income section of the filing. This is the  
4 duration matching paper.

5

6 (BRIEF PAUSE)

7

8 MS. CANDACE GRAMMOND: Thank you.

9 And Diana, if you can just scroll down a little bit?  
10 Yeah, so that's good. We're under the -- I'm looking  
11 under the heading of "1. Background on interest rate  
12 risk."

13 We see at the paragraph at the very  
14 bottom of the screen -- at the very bottom of the  
15 screen, we see PricewaterhouseCoopers's definition of  
16 interest rate risk, which I -- I won't read in. We can  
17 all see it.

18 Can you advise of whether MPI adopts  
19 that definition?

20

21 (BRIEF PAUSE)

22

23 MS. HEATHER REICHERT: Yes, that -- I -  
24 - I would agree with that definition of interest rate  
25 risk.

1 MS. CANDACE GRAMMOND: Okay. If we can  
2 scroll down, Diana, to page 3? So -- and just a little  
3 bit more, if you could. So this is where -- and this  
4 may help you with the undertaking that we were just  
5 talking about.

6 But this table, as I understand it,  
7 reflects a comparison between the negative two (2)  
8 duration gap and the negative one (1) duration gap, and  
9 it would appear that the dollar impact of the shift per  
10 the far right-hand column from that minus two (2) to  
11 minus one (1) was about 5 million in terms of a  
12 reduction in Basic net income.

13 MS. HEATHER REICHERT: Yes, that is  
14 what that table shows, but it's important that you  
15 understand right above the table where it says:

16 "This scenario assumes that the  
17 government of Canada ten (10) year  
18 bond yield increased by 1 percent  
19 from 3 percent to 4 percent in one  
20 (1) year."

21 So while this table with those  
22 assumptions does show a difference of 5 million between  
23 a minus one (1) year gap and a minus two (2) year gap,  
24 the undertaking we will do will be based on what the  
25 current forecasted interest rates are for the

1 government of Canada ten (10) year bonds and what we  
2 have underlying our rate model.

3 MS. CANDACE GRAMMOND: That's helpful.  
4 Thank you.

5

6 (BRIEF PAUSE)

7

8 MS. CANDACE GRAMMOND: Ms. Reichert, is  
9 it fair to say that the information on the screen in  
10 terms of the differences in the various options for the  
11 duration gap reflect the information that the  
12 Corporation would have used to make its decision to  
13 shift from negative two (2) to negative one (1)?

14 MS. HEATHER REICHERT: In -- in  
15 relative terms, yes. So this was done to show that  
16 there is, in fact, a positive impact to net income by  
17 lowering the duration. So, yes, this -- this was the  
18 information that was used to take the interim step to  
19 lower the duration gap from minus two (2) to minus one  
20 (1).

21 MS. CANDACE GRAMMOND: And I -- I think  
22 you said, "Positive impact," but it would be negative,  
23 right? Because the income is going down from forty-two  
24 (42) to thirty-seven (37)? Or do I have that wrong?

25 MS. HEATHER REICHERT: Sorry. It's --

1 it's -- from my perspective, it's a positive impact  
2 because it's reducing the risk of the high interest  
3 rates not occurring by only having a minus one (1) gap  
4 as opposed to a minus two (2) gap. Yes, it does reduce  
5 our overall -- it reduces our overall net income, but  
6 in doing that, it's reducing the downside risk of the  
7 interest rates not coming in at the forecasted amounts.

8 MS. CANDACE GRAMMOND: Okay. Thank  
9 you. Diana, if we can just scroll down a little bit to  
10 page 4? There's a table there -- yeah, under the  
11 heading of, "Falling Interest Rate Scenario." It's  
12 okay.

13 So this is where we have the scenario as  
14 reflected just under the heading that assumes that  
15 interest rates decrease by 1 percent from three (3) to  
16 two (2), and the difference between the negative two  
17 (2) to negative one (1) as we spoke about earlier was  
18 estimated to be about 16 million.

19 And we see that difference between the  
20 fifty-seven point two (57.2) in the chart, and the  
21 forty point seven (40.7) in the middle column of the  
22 chart?

23 MS. HEATHER REICHERT: Correct.

24

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(BRIEF PAUSE)

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MS. CANDACE GRAMMOND: So this table

confirms that declining interest rates cause increased

losses. Is that right?

(BRIEF PAUSE)

MS. HEATHER REICHERT: This table, what

it's -- it's confirming that if interest rates are

decreasing and you go down from a minus two (2) year

duration to a minus one (1) year duration, that there's

a positive impact to our net income situation.

So under a minus two (2) year bandwidth,

if you look, we would lose 57.2 million. If we're at a

minus one (1) year of bandwidth, we'd only lose 40.7

million. So, in fact, it is an overall improvement.

So in a declining interest rate scenario, having a

lower duration is more beneficial.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: So I understand

that the Corporation's interest rate forecast is based

on a four (4) year rolling average of interest rates.

Is -- is that right?

1 MS. HEATHER REICHERT: No, it's not  
2 based on a four (4) year rolling. It's based on the  
3 five (5) major banks' forecast of the -- the ten (10)  
4 year bond and Global Insights. So it's based on the  
5 average of their forecasts for the next five (5) years.

6 MS. CANDACE GRAMMOND: Okay. Thank you  
7 for clarifying that.

8 MR. REGIS GOSSELIN: But it's quarter  
9 by quarter, right?

10 MS. HEATHER REICHERT: Yes. Like, we -  
11 - we break it down quarter by quarter, yes.

12 MR. REGIS GOSSELIN: Now, this document  
13 refers to two (2) interest rate methodologies. It  
14 talks about the ten (10) year bonds and it talks about  
15 the standard bank forecast, and -- and I'm -- I'm  
16 getting confused between the two (2).

17 So if you look, for example, on page --  
18 if you go back to page 7 of the -- not the appendix  
19 document, but of the -- of the -- the earlier document  
20 that we were just looking at. So if you look at page 7  
21 it's talking about -- impacted forecasted interest rate  
22 is showing Government of Canada ten (10) year bond rate  
23 forecast. So these losses are driven by the  
24 Government of Canada.

25 If you go to the next page, then we're

1 into -- keep on going, interest meth -- methodology.  
2 Then we're talking about the risk -- five (5) major  
3 banks and then global insight forecast, so using two  
4 (2) interest rate methodologies, and I'm wondering --  
5 I'm getting confused between the two (2).

6 And I...

7 MS. HEATHER REICHERT: So we -- we're  
8 using the bank forecast for the Government of Canada  
9 ten (10) year bond rate.

10

11 CONTINUED BY MS. CANDACE GRAMMOND:

12 MS. CANDACE GRAMMOND: Now, there was  
13 some evidence given last week with respect to the  
14 potential implementation of cashflow matching. And I'm  
15 going to have some more questions on the review that's  
16 underway and -- and so forth, but just talking sort of  
17 in broad principles for the moment.

18 Did we hear the Corporation correctly  
19 that it may consider delaying the implementation of cas  
20 -- cashflow matching as a risk mitigation strategy  
21 until after interest rates have gone up to take  
22 advantage of a potential opportunity for gains?

23 MS. HEATHER REICHERT: I believe you're  
24 referring to Mr. Guimond's testimony during the first  
25 week. So we are in the process of doing our asset

1 liability management study. We are looking through  
2 that study at what the best method to mitigate our risk  
3 as it relates to interest rates would be.

4           As we've talked about I think given  
5 these just last couple of questions, if in fact  
6 interest rates do start to increase, the Corporation  
7 does benefit from the fact that, if we have a minus one  
8 (1) duration between the assets and the liabilities,  
9 and the interest rates are increasing, there is a net  
10 benefit to our bottom line.

11           Now, the whole question is: If we see  
12 those interest rates going up, we have to make a  
13 decision on whether or not we try to capture some of  
14 that benefit into our net income, or whether or not the  
15 risk of interest rates going up a bit and then dropping  
16 more is significant enough for us to say, No, we should  
17 be matching more -- more precisely sooner.

18           So it really is a decision that, when we  
19 get all the information in front of us on what the best  
20 matching strategy might be and what's happening with  
21 interest rates at the time that we have all that  
22 information, determining whether or not it's  
23 appropriate to delay somewhat in order to get the  
24 benefit depending on our assessment of the risk at that  
25 point in time of whether they're going to go up or if

1 they're going to stay flat or if they might be going  
2 down.

3                   If we see that they're staying flat and  
4 they're going to be going down, then as CFO, I am going  
5 to definitely be saying, No, this is unacceptable risk  
6 to the Corporation, and we need to be more closely  
7 matching as soon as possible.

8                   So it will be a determination based at  
9 that point in time when we have all the information in  
10 front of us.

11                   MS. CANDACE GRAMMOND:    And if I  
12 understand correctly the work that's being done right  
13 now under the ALM study, that's going to take some  
14 time, right?  And we heard from Mr. Guimond about that  
15 last week.

16                   So while that's ongoing and there's the  
17 phase 1 and the phase 2, the Corporation has  
18 implemented this shift in the duration gap as sort of a  
19 -- my phrase -- stopgap until the outcome of the ALM  
20 study is known, we -- you have a bit more information  
21 on how interest rates are developing, and then you can  
22 do the analysis and make the call that you were just  
23 describing?

24                   MS. HEATHER REICHERT:    Correct.  It was  
25 an interim measure to mitigate the risk because we did

1 not see the interest rates going up. So by lowering  
2 that duration gap, we are not -- the impact -- the  
3 negative impact to us of the interest rate not going up  
4 is not as severe as it would have been if we'd kept it  
5 at the minus two (2) that we were at last year.

6 MS. CANDACE GRAMMOND: And no matter  
7 what interest rates do, does the Corporation want to  
8 mitigate interest rate risk, or does it want to  
9 continue to look for opportunities to take advantage of  
10 interest rate shifts?

11 MS. HEATHER REICHERT: As an insurance  
12 company, first and foremost we want to be able to  
13 mitigate our risk. And to the extent that we can  
14 mitigate our risk while potentially looking at  
15 opportunities to increase our net income, then we try  
16 to do that.

17 But first and foremost, as I said  
18 yesterday, as an insurance company, it's about  
19 mitigating the risk. As it relates to our investments,  
20 first and foremost, is to pay off our liabilities, and  
21 then it's to achieve yield. So it's a combination of  
22 all of those things that we look at.

23 MS. CANDACE GRAMMOND: Thank you. Just  
24 one (1) moment, Madam Chair.

25

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: So I -- I think  
4 I understand your evidence, Ms. Reichert. And coming  
5 back to the issue of the point in time in the future  
6 when you have feedback from Aon under this ALM study  
7 and -- and you are faced with the decision whether you  
8 implement something, whatever may be recommended,  
9 immediately or whether you wait to see what's going to  
10 happen with rates, is it not possible, though, that the  
11 Corporation would be in the same position then that it  
12 is today, that the banks keep saying the interest rates  
13 are going to go up but they haven't?

14 And, if so, do you have any sense of how  
15 you might proceed?

16 MS. HEATHER REICHERT: So the banks are  
17 definitely one (1) vehicle to look at what -- what  
18 might be going to happen with interest rates. At that  
19 point in time, we would also be looking at what has  
20 most recently occurred with interest rates.

21 So today, as we have talked, interest  
22 rates are not going up, but if they do start to go up  
23 then we'll be talking with the Department of Finance  
24 and their professionals. We have our CFAs at MPI. And  
25 be looking at what everybody is saying in addition to

1 the banks on what might be happening with interest  
2 rates.

3                   So it won't just be the banks. It will  
4 be our own judgment. It will be what's happened in the  
5 most recent past. And it will be, you know, what the -  
6 - the chair of the Bank of Canada is saying from his  
7 perspective is going to happen with interest rates. So  
8 it will be all of those things combined to -- to help  
9 us make the decision at that point.

10                   MS. CANDACE GRAMMOND: At this point,  
11 though, there aren't other interest rate forecasts that  
12 the Corporation is using besides the banks and Global,  
13 as you mentioned?

14                   MS. HEATHER REICHERT: No, there isn't.  
15 That's right. We are just using the five (5) banks and  
16 Global Insights, and I wasn't referring specifically to  
17 other forecasts per se other than what Mr. Guimond has  
18 -- had spoken to last week about the Bank of Canada.

19                   I'm talking about generally what's  
20 happening in the most recent past, as well as what  
21 generally the feeling is with our bond managers and  
22 others on what's going to happen with interest rates.  
23 So not -- not professional interest rate forecasters.  
24 That's not what I intended to say.

25                   MS. CANDACE GRAMMOND: I -- I think

1 from what we're hearing of your evidence, you are  
2 saying that mitigating risk should be one of the first  
3 priorities for the Corporation.

4 MS. HEATHER REICHERT: Yes, I believe  
5 that is what I said. Insurance companies, mitigating  
6 risk is one of the, if not the, top priority.

7 MS. CANDACE GRAMMOND: Okay. I'm going  
8 to ask a few more questions on this topic. Is it the  
9 case that if cash flow matching reduces interest rate  
10 risk, it will also reduce -- reduce capital targets?

11

12 (BRIEF PAUSE)

13

14 MR. LUKE JOHNSTON: If -- yes, there is  
15 a portion of -- it -- you know, relative to a flat  
16 interest rate environment versus an increasing one,  
17 there is a portion of difference that can be mitigated  
18 through cash flow matching, or -- or closer duration  
19 matching, and there's a portion that cannot.

20 So, one thing that we're going to do in  
21 this undertaking where we have the flat interest rates  
22 is break down all the impacts and make it a little bit  
23 more clearer what can be mitigated to a large extent  
24 through cash flow or improved duration matching, and  
25 what cannot. Because I think we don't want anyone here

1 to think that the entire difference between this two  
2 point four (2.4) and 7 percent we were taking about  
3 could just be mitigated by putting in cash flow  
4 matching tomorrow. That's definitely not the case.

5 But there's a portion of it and -- yes,  
6 if risk reduces, the DCAT target would reduce as well.

7 MS. CANDACE GRAMMOND: Okay. And thank  
8 you because you've answered one of my questions that  
9 was coming down the way.

10 That at -- at the end of the day if the  
11 Corporation gets advice from Aon to manage interest  
12 rate risk in an effective way, that that would have  
13 some impact, and potentially a substantial impact, on  
14 the current DCAT.

15 MR. LUKE JOHNSTON: There -- yeah,  
16 there will be an impact; whether it's substantial isn't  
17 clear because there are other risk factors that are  
18 part of that report, and as long as we continue to be  
19 in equity and we continue to have claims, it -- you  
20 know, a different version of the scenario will  
21 essentially rise to the top.

22 But as you know, right now our worst-  
23 case scenario is this combined scenario, and all else  
24 equal in that scenario if we lowered our interest rate  
25 risk it would go down. But we haven't tested, you

1 know, a duration matching version of that -- that  
2 model, yeah.

3 MS. CANDACE GRAMMOND: And, Mr.  
4 Johnston, I think you said a couple of moments ago that  
5 cashflow matching, you know, will not eliminate  
6 interest rate risk. Would you agree that it would  
7 substantially mitigate interest rate risk?

8

9 (BRIEF PAUSE)

10

11 MR. LUKE JOHNSTON: There'd definitely  
12 be a reduction in risk. The substantial part depends  
13 on what type of interest rate changes we're talking  
14 about and -- and the such, so I don't -- I don't know  
15 if I want to clarify this as substantial. But we've  
16 seen some of the -- the charts that you've -- you've  
17 seen where we've tested the plus or minus 1 percent  
18 swings. And we've talked about 5 million and 16  
19 million numbers and -- and such. Those are big  
20 impacts.

21 So if that supports the definition of  
22 'substantial', then that's the kind of ranges we might  
23 be talking about.

24 MS. CANDACE GRAMMOND: Thank you. I  
25 wanted to ask you a couple of questions about some

1 content in the audited -- or sorry, annual financial  
2 statement of the Corporation for the last year-end.  
3 And this is, I believe, part of the document that was  
4 the answer to pre-ask 3, I think it was.

5 We had asked that a copy of the document  
6 be filed. And I think in the answer, the Corporation  
7 directed us to a link for it. And I'm -- I'm not sure  
8 that it was found in the original filing.

9

10 (BRIEF PAUSE)

11

12 MS. CANDACE GRAMMOND: I'm not sure  
13 that it's the same document that's on the screen. I  
14 think what Mr. Cathcart and I were just discussing is  
15 that the excerpt that I have in my hand is something  
16 that he obtained from the Corporation's website. And,  
17 actually, although we had intended that this be  
18 provided under pre-ask 3, that link took us to a  
19 different document. I think the difference is the  
20 audited versus not audited financial statement.

21 So I'm -- I'm going to read an excerpt  
22 to you. I -- we can put this on the overhead if that  
23 would help, but I -- I do need to read from it.

24 MR. BYRON WILLIAMS: Ms. Grammond, if I  
25 might interrupt. Diana could probably Google it if

1 it's on the MPI website, as -- as well.

2

3 CONTINUED BY MS. CANDACE GRAMMOND:

4 MS. CANDACE GRAMMOND: Mr. Cathcart I

5 think might be able to just send her the document.

6 Okay. Okay, well -- you know what, give us a moment.

7 We'll sort this out so that we're all looking at the

8 same thing. I do have a couple other questions on the

9 -- the duration matching topic.

10 So we've spoken about the -- the first

11 phase of the study that's ongoing. And the

12 Corporation's awaiting some -- oh, wow, she's amazing.

13 Yeah, that's awesome. Okay, I'll just -- I'll just

14 finish this, and then I'll come right back to the

15 document on the screen.

16 So we know what the first phase is

17 doing. The second phase of this study would then be to

18 recommend an appropriate allo -- asset allocation mix

19 for the Corporation?

20 MS. HEATHER REICHERT: Correct.

21 MS. CANDACE GRAMMOND: And as Mr.

22 Guimond told us last week, Phase 1 is on track to be

23 completed by the end of 2014.

24 The Corporation doesn't have any

25 preliminary findings or conclusions yet?

1 MS. HEATHER REICHERT: That's correct.

2 MS. CANDACE GRAMMOND: And that the  
3 Phase 1 findings will be shared with the Board in next  
4 year's filing. I guess the question that I have just  
5 as a follow-up to that is has the Corporation given any  
6 consideration to the format or the process that might  
7 be followed? Because there is going to be, obviously,  
8 a link between Phase 1 and Phase 2.

9 And our question is whether the Board  
10 would have any opportunity for a discussion with the  
11 Corporation between the two (2) phases or whether the  
12 Corporation is going to proceed, and then intending to  
13 report back to the Board at the next GRA?

14 MS. HEATHER REICHERT: It -- it is our  
15 intention to review all of the Phase 1 information and  
16 -- and, in effect, get Phase 2 information, and then  
17 look to see how we are going to implement on whatever  
18 recommendations would be within that report.

19 So it -- it is our intent to -- to make  
20 management decisions on the basis of that information  
21 and then reflect that in next year's rate application.

22 MS. CANDACE GRAMMOND: Thank you.

23 Diana, if you could go down to page 39 of the document  
24 that you've got up on the screen.

25

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: So in this  
4 section called "Interest Rate Risk," at the third  
5 paragraph, the one that's just at the bottom of the  
6 screen right now, as at February 28th, 2014, the  
7 Corporation has given some information about the impact  
8 of interest rate changes on the income portfolio,  
9 right? And in particular, the impact of a hundred  
10 (100) basis point shift, both increase and decrease.

11 Are you with me?

12 MS. HEATHER REICHERT: Yes, I am. Yes,  
13 I am.

14 MS. CANDACE GRAMMOND: So Corporation  
15 says a hundred (100) basis point increase would result  
16 in a decrease of the fixed-income portfolio of  
17 approximately 67.3 million, whereas a hundred (100)  
18 basis point decrease would result in an increase in the  
19 fair value of the same -- of approximately 78.9  
20 million.

21 So my question is: What would the  
22 impact of a hundred (100) basis point increase or  
23 decrease be on claims liabilities?

24 MR. LUKE JOHNSTON: We can do that as  
25 an undertaking for the -- the same point in time and

1 day they used for those numbers.

2 MS. CANDACE GRAMMOND: Thank you.

3

4 --- UNDERTAKING NO. 31: MPI to provide impact of  
5 one hundred (100) basis  
6 point increase or decrease  
7 on claims liabilities as of  
8 February 28th, 2014

9

10 CONTINUED BY MS. CANDACE GRAMMOND:

11 MS. CANDACE GRAMMOND: And is there a  
12 particular reason why that converse impact wouldn't be  
13 shown here? Like it -- it seems like part of the  
14 impact is referenced, but not all of it.

15 MR. LUKE JOHNSTON: Actually, I thought  
16 the -- the same thing, and I was expected to scroll  
17 down and see the impact. But, yeah, you're right, it's  
18 -- it's not there.

19 There is -- with interest rates so low,  
20 there is a point where our -- our claims discount rate  
21 with provisions actually hits zero because it can't  
22 even fall any farther because say -- for example, say  
23 it's 3 percent. We assume 2 percent inflation, which  
24 drops it to one (1), and then we have a provision for  
25 interest rates which is one (1). So -- but we'll --

1 we'll do that as an undertaking.

2 MS. CANDACE GRAMMOND: Thank you. Just  
3 one (1) other question on this.

4 THE COURT REPORTER: Is that -- sorry.  
5 Is that the same undertaking --

6 MS. CANDACE GRAMMOND: Yes.

7 THE COURT REPORTER: -- or a new one?  
8 Okay.

9

10 CONTINUED BY MS. CANDACE GRAMMOND:

11 MS. CANDACE GRAMMOND: The last  
12 paragraph at the bottom of the screen, and it's --  
13 which is the last paragraph in that section, it is  
14 stated that there could be an impact -- or, sorry,  
15 fluctuations in interest rates would have an impact on  
16 unpaid claims.

17 But then it says:

18 "The duration of the fixed-income  
19 portfolio approximates the duration  
20 of the unpaid claims liability.  
21 Therefore, any change in interest  
22 rates related to these investments is  
23 largely mitigated by an offsetting  
24 impact on the unpaid claims  
25 liability."

1                   This seems different than what we've  
2 been discussing so far on this issue. So I would ask  
3 someone from the panel to comment on this difference.

4                   MS. HEATHER REICHERT: That statement  
5 is a very generalized statement. I'm -- I'm trying to  
6 -- to recall. My -- my understanding is we're required  
7 to put in a comment as it relates to the claims  
8 liability. Obviously, we are not required by the  
9 accounting standards to actually have disclosed the  
10 amount of the impact to the liabilities.

11                   And I would say that this comment would  
12 be made relative to the fact that we considered, from a  
13 -- from an accounting perspective, we consider it to be  
14 considerably matched, the duration of plus or minus two  
15 (2) years to be relatively matched from the accounting  
16 perspective, and that the difference was likely deemed  
17 not to be a material difference for the purposes of the  
18 year-end financial statements.

19                   That's what I believe -- that's why I  
20 believe that comment is made in the way that it's made.  
21 It's not made from the standpoint of a rate-setting  
22 risk or an interest -- what we've been talking about in  
23 the last while.

24                   MS. CANDACE GRAMMOND: So you're  
25 saying, from a rate-setting perspective, while the

1 Corporation views this as -- as a huge issue for  
2 financial statement reporting purposes, which is a  
3 different yardstick, not so much?

4 MS. HEATHER REICHERT: That would be my  
5 -- my take of the situation, yes.

6

7 (BRIEF PAUSE)

8

9 MS. CANDACE GRAMMOND: I -- I guess  
10 maybe just one (1) more question on that, Ms. Reichert.  
11 You're -- you're saying that the -- the two (2)  
12 viewpoints are -- are different and with different  
13 purposes. But wouldn't the readers of the financial  
14 statements, whoever they may be, conclude from this  
15 statement that -- that interest rate risk isn't a  
16 significant issue for the Corporation?

17 MS. HEATHER REICHERT: Possibly. But  
18 as you can see, the -- the financial statements  
19 themselves are quite extensive. So taken in its  
20 entirety, they would look at all of the results and  
21 what the impact deemed from this interest rate issue is  
22 to the overall reported financial results for this  
23 particular year, again, I -- I'm suggesting was not  
24 considered to be significant from the financial  
25 reporting aspect.

1 MS. CANDACE GRAMMOND: Thank you. I'm  
2 going to move, then, to some questions regarding the  
3 RSR. So we -- we've had some evidence, obviously,  
4 already on this point. The purpose of the RSR has been  
5 stated in these proceedings. We know what the Board  
6 established range is in the current fiscal year. We've  
7 talked about balance in the RSR as of the end of the  
8 last year end, right, which is around a hundred  
9 million. We talked, I think, yesterday about the fact  
10 that that's gone up as of the end of August. And you  
11 had pointed out that it's a good time of year.

12 So let's look at -- on Tab 6 of the  
13 Board's book of documents. This is Pro Forma 3, which  
14 is the statement of retained earnings.

15

16 (BRIEF PAUSE)

17

18 MS. CANDACE GRAMMOND: So we see here  
19 as at the date of filing the rate application, the  
20 Corporation is projecting by the end of the current  
21 fiscal year, so Feb -- February of 2015, balance in the  
22 RSR of just under 62 million, which is, of course,  
23 about 20 million under the Board's current minimum.

24 Is that right?

25 MS. HEATHER REICHERT: Yes.

1 MS. CANDACE GRAMMOND: And pursuant to  
2 the annual report of the Corporation, and specifically  
3 for Basic, which reflects total equity, this -- the  
4 document on the screen is retained earnings, Basic's  
5 total equity as of the end of the last fiscal year was  
6 about 170 million, so that hundred million in the RSR  
7 plus about 70 million of AOCI?

8 MS. HEATHER REICHERT: Sorry, you're --  
9 are you referring to something on this page?

10 MS. CANDACE GRAMMOND: No.

11 MS. HEATHER REICHERT: No, you're  
12 referring to another document?

13 MS. CANDACE GRAMMOND: The annual  
14 report.

15 MS. HEATHER REICHERT: To the Basic,  
16 the Autopac annual report?

17 MS. CANDACE GRAMMOND: Yes.

18 MS. HEATHER REICHERT: Okay. Subject  
19 to check.

20 MS. CANDACE GRAMMOND: Okay.

21

22 (BRIEF PAUSE)

23

24 MS. CANDACE GRAMMOND: Now, I think you  
25 -- you told me yesterday, Ms. Reichert, that in the

1 forecast for the Corporation through the outlook  
2 period, and we can use the document on the screen as an  
3 example, the Corporation has forecasted an ongoing 1  
4 percent RSR rebuilding fee through that period?

5 MS. HEATHER REICHERT: Yes.

6 MS. CANDACE GRAMMOND: But for the  
7 purposes of the application as filed, the Corporation's  
8 only asking for 1 percent for the year of the  
9 application, the 2015/'16 year, and isn't asking for  
10 something beyond that period of time at this stage?

11 MS. HEATHER REICHERT: Correct. It's  
12 my understanding that when we do ask for an RSR  
13 rebuilding fee, that that is in place for the year of  
14 the application, and that we -- the normal course is to  
15 reapply for that in subsequent years.

16 MS. CANDACE GRAMMOND: Thank you. Now,  
17 we know that in the past, there was a time where the  
18 Corporation had asked for an RSR rebuilding fee. This  
19 is bef -- certainly before your time and before mine,  
20 as well.

21 Do you have any of that historical  
22 context, because I -- I believe that it was a 2 percent  
23 fee that was asked for at that time? So do you have,  
24 or could you provide information relative to what was  
25 in the RSR at that time? What the target was supposed

1 to be? What the rate indication was? That kind of  
2 thing.

3 MS. HEATHER REICHERT: I am -- I am  
4 sure that we could go back to documents from that time  
5 period and be able to provide what the -- at that time,  
6 the RSR was. What -- I know at that time that we were  
7 not preparing a -- a DCAT report, so -- but I'm sure  
8 that we can go back and determine what, in fact, the  
9 range of the RSR was based on what the Public Utility  
10 Board was ordering at that time.

11 Did you want me to do that as an  
12 undertaking, and to...

13 MS. CANDACE GRAMMOND: Yeah. If -- if  
14 you could advise of what -- so what was in the RSR at  
15 that time? So in terms of what the balance was. What  
16 the target was, and I appreciate there was no DCAT, but  
17 there would have been some kind of a target. What the  
18 rate indication was, and I believe that at that time,  
19 the Corporation put forward a -- a multi-year plan of  
20 sorts. Like, it proposed, like, 2 percent, 2 percent  
21 one (1), or something to that effect. Ms. Kalinowsky  
22 will remember the details.

23 MS. HEATHER REICHERT: Yes, we will do  
24 that. We will take that undertaking.

25

1 --- UNDERTAKING NO. 32: MPI to provide what was in  
2 the RSR and to provide  
3 historical context when MPI  
4 last asked for an RSR  
5 rebuilding fee

7 (BRIEF PAUSE)

9 CONTINUED BY MS. CANDACE GRAMMOND:

10 MS. CANDACE GRAMMOND: Okay. Now, from  
11 the filing, and I -- I do have the specific reference  
12 if you want to refer to it, it appears that the RSR  
13 rebuilding fee is a loading on vehicle premium. Is  
14 that right? And is driver premium also proposed to  
15 contribute to replenishing the RSR?

16 MR. LUKE JOHNSTON: It was only on --  
17 on vehicle premium.

18 MS. CANDACE GRAMMOND: And was any  
19 consideration given to including the rebuilding fee on  
20 driver premium?

21 MR. LUKE JOHNSTON: Generally, when  
22 we're asking for rate changes, it's on the vehicle side  
23 only. If we have a prop -- a proposal on the driver  
24 safety rating scale, it's kind of a separate exercise.  
25 It'd have to be looked at differently.

1                   The other piece is that 1 percent on  
2 some of those driver scale numbers is fractional, like,  
3 pennies types of thing. So even on -- on some of the  
4 rates, a 1 percent RSR fee doesn't even round to a  
5 dollar. So when you start asking for a 1 percent fee  
6 on a twenty dollar (\$20) driver premium, like, what  
7 exactly is your new rate? And it just rounds down to  
8 twenty (20), so we decided just to leave that one  
9 alone.

10                   MS. CANDACE GRAMMOND: You would agree,  
11 though, that motorists who only pay a driver premium,  
12 so don't have a vehicle in their name, will also  
13 benefit from there being an adequate balance in the  
14 RSR?

15                   MR. LUKE JOHNSTON: I agree with that.

16                   MS. CANDACE GRAMMOND: And I -- I  
17 suppose based on your earlier answer that it would be  
18 the Corporation's view that whatever potential inequity  
19 this might create is not particularly significant in  
20 dollar amounts.

21

22   (BRIEF PAUSE)

23

24                   MR. LUKE JOHNSTON: I apologize. Could  
25 you just repeat that question?

1 MS. CANDACE GRAMMOND: Sure. So if the  
2 proposed fee is just on vehicle premiums, that means  
3 the drivers aren't paying it, those that are just  
4 drivers and don't have a vehicle in their name, and I  
5 appreciate what you said about materiality and amount,  
6 but it would seem that if those that are drivers only  
7 would be getting some benefit from the RSR having an  
8 adequate balance, then if they're getting a benefit and  
9 not paying into it, there seems to be an inequity  
10 there.

11 But what I'm asking is, if that's the  
12 case, perhaps it's not a significant issue or a  
13 significant inequity because of the dollar amounts?

14 MR. LUKE JOHNSTON: Yes. If we're --  
15 if we're talking 35 to \$40 million in driver premiums,  
16 we're looking at -- if we could figure out a way to  
17 somehow get 1 percent out of that group and charge  
18 whole dollar amounts, we're talking three (3) or four  
19 hundred thousand dollars (\$400,000) from extra, so it -  
20 - I would call that an insignificant amount, yeah.

21 MS. CANDACE GRAMMOND: In relative  
22 terms?

23 MR. LUKE JOHNSTON: Pardon me?

24 MS. CANDACE GRAMMOND: In relative  
25 terms?

1 MR. LUKE JOHNSTON: Yeah. Like,  
2 relative to my salary, that would be a lot, yeah.

3 MS. CANDACE GRAMMOND: Okay. So, Ms.  
4 Reichert, we spoke a minute ago about a potential  
5 application for a 1 percent surcharge in the future,  
6 and that's something that the Corporation will  
7 obviously assess.

8 Will -- if the RSR surcharge that's  
9 currently being applied for is granted, would the  
10 Corporation track that balance or track what is  
11 collected under that fee as a separate line item?

12 MS. HEATHER REICHERT: I -- I'm not  
13 sure. Are you asking whether or not we would track it  
14 as a separate line item on our financial statements or  
15 internally? So I'll answer it: Internally? Yes, we  
16 would be able to determine how much we collected from  
17 premiums that was attributed to the 1 percent RSR, so  
18 we would do that.

19 From a financial reporting purpose, I  
20 would look back to see what -- how we had handled it in  
21 the past, but I don't believe we would need to or have  
22 a reason to disclose it separately on the financial  
23 statements. What you would see is, if all forecasts,  
24 all assumptions came to fruition, you would see a net  
25 loss next year of six million three hundred and thirty-

1 seven (6,337,000) that included 1 percent RSR for  
2 whatever premiums that we collected in -- in that year.

3

4

(BRIEF PAUSE)

5

6 MS. HEATHER REICHERT: Sorry, I'll just  
7 add to that. If -- if it was the desire of the Public  
8 Utility Board that when we come back next year to show  
9 how much was received as a result of the 1 percent, we  
10 can definitely show that within our financial model and  
11 within our pro forma statements.

12

MS. CANDACE GRAMMOND: The panel will  
13 obviously have to consider that. I'm advised that, in  
14 the past, it was tracked separately. And I suspect  
15 that would be something that the Board might want to  
16 see, but, again, that's obviously their decision.

17

The other question that we have is if  
18 the rebuilding fee is granted and motorists get their  
19 renewal, what is this going to look like? Like, how --  
20 how does the Corporation envision the renewal form that  
21 motorists get in terms of rate increase versus the 1  
22 percent, if that's how this ends up?

23

MS. HEATHER REICHERT: I am told, and I  
24 understand, that on their renewal notice, they will  
25 know what amount of the premium that they're paying is

1 with respect to the RSR rebuilding fee.

2 MR. LUKE JOHNSTON: And -- and we did  
3 perform the calculations completely separately. So the  
4 -- we have a rate file that's just two point four  
5 (2.4), the usual PUB methodology, and then a completely  
6 separate file that's just the fee amount, so it's --  
7 there -- there are two (2) separate rate tables, so  
8 that can be shown.

9 MS. CANDACE GRAMMOND: Thank you.

10 MR. REGIS GOSSELIN: I'm still way back  
11 in the -- in this whole issue of duration matching and  
12 so on. And I'm trying to -- you know, I think at the  
13 heart of this debate, you know, I reme -- I reca --  
14 recall last year that, you know, the -- the fact that  
15 the adjustments that were made by MPI had the impact of  
16 -- of -- that were proposed to be made by MPI had the  
17 impact of establishing rates that would have otherwise  
18 been higher.

19 In other words, you -- you were being  
20 conservative on your rate forecast, and thereby that  
21 would trigger -- if -- if the -- the Board bought into  
22 that, the Board would -- would trigger a higher rate  
23 than would otherwise have been the case.

24 And so, you know, it -- it -- I think,  
25 looking at it very dispassionately, ratepayers are

1 concerned about rates they have to pay. They're not  
2 concerned about rates that they could potentially pay  
3 in the future. They're -- they're worried about rates  
4 they have to pay more immediately.

5                   So if you're conservative in your rate  
6 forecasting methodology, it has the impact of otherwise  
7 increasing rates that have to be paid by ratepayers.  
8 If -- if you turn out to -- to have a gain in interest,  
9 then what -- what happens is, in the future, you're  
10 going to have -- you're going to avoid rate increases  
11 sometime in the future because you've won on your -- on  
12 the -- you've won by virtue of the fact that the --  
13 that interest rates are higher than you were  
14 forecasting, so there's a gain.

15                   So you've gained, you've avoided a  
16 future rate increase. Meanwhile, the ratepayers and  
17 the Board as well, and I think probably your board of  
18 directors as well, is concerned about the rates that  
19 have got to be paid now by ratepayers, money that's  
20 coming out of ratepayers' pocket today or in the coming  
21 months.

22                   So -- so what's happened now is that,  
23 because you're -- you're mismatched in terms of -- of  
24 your duration, you've in fact amplified the impact of  
25 rates on the downward side. You know, you've actually

1 -- if you had been neutral in term -- if -- if you had  
2 been neutral in terms of your -- your asset and  
3 liability situation, rates could have done down. But  
4 in effect the mismatch has caused an amplification of  
5 the impact of the decline in rates.

6                   So -- and I -- and I guess the question  
7 is: We're going to gain, you know, if -- if, for  
8 example, we're conservative on the rate setting and  
9 rates go up, you're mismatched, you amplify the gains  
10 that you get on the upward side, you avoid rate  
11 increase -- rate increases in the future. But what's  
12 happened now is, because of the mismatch, rates have  
13 gone down, amplified the loss, higher rates are  
14 required.

15                   So it boils down to what do we prefer.  
16 Like, do we prefer to have rates coming out of -- of  
17 ratepayers' pockets minimized right now, or do we  
18 prefer having them minimized sometime in the future?

19                   So it's -- it's -- I mean, I -- I can  
20 understand why you'd be willing to position yourself to  
21 get some of the gains that will ultimately happen in  
22 markets when rates go up. I mean, they can't keep on  
23 going down like they have for such a long time. At  
24 some point they're going to -- the market's going to  
25 change. We thought it was going to change earlier in

1 the year, but it didn't.

2                   So the -- so we're somewhat in some ways  
3 still faced with the same dilemma, the same -- the same  
4 rate-setting dilemma, though. Go ahead.

5                   MS. HEATHER REICHERT: If I could,  
6 Diana, could you pull up from the overview section page  
7 27, that water graph that we referred to before? So  
8 underlying our rate application this year, we are  
9 forecasting interest rates to increase as the banks are  
10 saying they are going to.

11                   And if we -- so on this waterfall graph,  
12 if you look at the very first green box that says minus  
13 2.14 percent, if we were not forecasting the interest  
14 rates to increase in the manner that we are, we would  
15 in fact have asked for a 2 percent higher rate increase  
16 this year. Instead of two point four (2.4), we would  
17 have asked for four point four (4.4).

18                   So we are in fact in this application  
19 keeping that rate increase lower than what we're  
20 actually comfortable in saying that is going to be  
21 adequate because we have the 2.14 percent benefit of  
22 what we're forecasting our interest rates to be.

23                   If we were more closely matched -- so --  
24 so last -- maybe I'll say it the other way. Last year  
25 when we came here, if we had been at a minus two (2)

1 duration mismatch, the -- and had used the standard  
2 method of forecasting interest rates as we are doing  
3 today, I don't have the exact number, but it would have  
4 been a bigger positive effect on last year's rates. So  
5 in other words, the 1.8 percent that we asked for last  
6 year would have been something less. So -- did I say  
7 that the right away? I gave you all these ups and  
8 downs.

9                   But I guess maybe more importantly I --  
10 I hear your comment being, Do we charge people a  
11 reasonable rate today in order to prevent having to  
12 charge them a much higher rate in the future? And this  
13 gets back to Mr. Guimond's testimony on -- last week  
14 where depending on what happens with the interest rates  
15 and -- and what we are expecting to happen on those  
16 interest rates, there can be quite a bit of volatility.

17                   So we aren't intentionally trying to  
18 overcharge anyone as it relates to the interest rates.  
19 What we're trying to do is manage to have the least  
20 amount of volatility in the rates going forward. And  
21 Mr. Guimond showed the -- the four (4) -- four (4)  
22 quarter graph of the survey of our customers who  
23 indicate that what they want is, yes, to pay the lowest  
24 possible rates, but they want to know that the rates  
25 that they're paying today are not going to be

1 significantly different tomorrow, which we are taking -  
2 - that they want us to manage this in such a way that  
3 we are not increasing the risk to them of -- of --  
4 because of what interest rates are doing having to  
5 charge them considerably more next year because the  
6 market doesn't increase, or it doesn't do what -- what  
7 everyone was expecting it to do.

8 Does that help?

9 MR. REGIS GOSSELIN: I -- I think we're  
10 saying the same thing. I think that we're just  
11 addressing it from different perspectives. I mean,  
12 you're -- you're addressing it from the perspective of  
13 a loyal foot soldier to MPI. We're trying to balance  
14 the interests of MPI and the ratepayer. So it's --  
15 it's trying to find the right balance.

16 But clearly, you know, based on the  
17 results that you've shown -- and the nearby evidence on  
18 interest rates, there's an issue that has to be  
19 addressed from a rate perspective. There's no question  
20 about that, so.

21 MR. DAN GUIMOND: Yeah. I just -- I  
22 just -- I'm -- I'm so pleased to hear what you just  
23 said about the dilemma that's being faced. And this is  
24 why the MPI team wanted to architect this rate app in a  
25 manner that -- you know, we can put things behind, like

1 the DCAT. Make a decision on that, and so on.

2                   And it -- it goes back maybe last week  
3 to what -- the suggestion that I was making but I  
4 didn't want to vary the rate app because you're going  
5 to see that right now it's at least 3.6 percent, like  
6 the pre-ask, and you'll see with all the different  
7 scenarios it could be a lot higher.

8                   But like you're saying, eventually you  
9 know they're going to go up. So that's the dilemma  
10 because then the money starts to come in. So with --  
11 with putting the DCAT behind and MPI being able to  
12 rebuild the -- the RSR, if -- if you approve the GRA  
13 the way it's constructed, right, and I think you even  
14 alluded that to, the two point four (2.4) once it -- if  
15 you put it into the -- into the Basic rates, it -- it  
16 plugs the hole. It might not plug the whole thing, but  
17 it plugs the hole.

18                   But the 1 percent, you know, the way  
19 it's architected it doesn't put you in -- your back to  
20 a corner. You can use that 1 percent because every  
21 year you have the opportunity to decide, Okay, now at -  
22 - at least I have 3.4 percent coming in for that year.  
23 And then next year you can decide, Well, okay, like  
24 what am I going to do? And you can evaluate every  
25 year.

1                   But what I'm saying is that to your  
2 point you haven't built it in the Basic rate so that  
3 when your -- a year later -- you see what I mean? Like  
4 you're -- you -- it -- it finds a way for you as a  
5 regulator -- the way we -- the way we submit our -- our  
6 general rate app to be able to -- you know, assuming  
7 that you approve the -- the three point four (3.4), at  
8 least we have the -- the three point four (3.4), but  
9 what we think is at least three point six (3.6) and  
10 maybe even higher.

11                   But you -- you've eliminated the risk of  
12 the transfer to the ratepayers because they'll see  
13 three point four (3.4) next year, and then every year  
14 you can make an assessment. Okay, like -- you know,  
15 and -- and decide how far you want to go built right  
16 into the rates, and how you can maybe use that RSR  
17 percentage to buy yourself some time until we get to  
18 2018 or 2019 when it really starts to -- to go up.

19                   So it's -- it's -- that's what I was  
20 thinking about. We need to work together to mitigate  
21 the risk, and put some -- some options on the table for  
22 you so that you don't -- you feel comfortable with your  
23 decision while mitigating the risk.

24                   So this proposal that we have, or this  
25 GRA that we're asking you to approve, it -- it -- to me

1 it -- it's a way -- it's an option that we're putting  
2 on the table for the regulator to not create a big  
3 bubble down the road, but at least you're -- at least,  
4 at the same time, like, to your point, you know, that  
5 you're probably concerned.

6                   Like you say, Well, if I put it all in  
7 the Basic rate -- let's say you put three point six  
8 (3.6) in the Basic rate. And then you say, Okay, in  
9 two (2) years, they start to go up, and here you are,  
10 money coming in. But if you use a combination of the -  
11 - like, the 2.4 and the 1 percent, and you do that  
12 every year, you -- you kind of have the best of both  
13 worlds to buy time.

14

15   (BRIEF PAUSE)

16

17 CONTINUED BY MS. CANDACE GRAMMOND:

18                   MS. CANDACE GRAMMOND: Thank you. Just  
19 further to that, the exchange and the -- the last few  
20 minutes and the discussion about timing and -- and  
21 rates and so forth. Just to confirm, we do all agree,  
22 though, that rates should be set on a best estimate  
23 basis, which includes the interest rate forecast?

24                   MS. HEATHER REICHERT: Yes, we do,  
25 neither conservative nor unconservative.

1 MS. CANDACE GRAMMOND: Right. Because  
2 that approach promotes fairness in the rates and limits  
3 any intergenerational inequity.

4 Would you agree?

5 MS. HEATHER REICHERT: Yeah. That's a  
6 fair statement.

7 MS. CANDACE GRAMMOND: Thank you. I  
8 just had a follow-up question, as well. Mr. Johnston,  
9 on the exchange that you and I had, I was asking you  
10 about whether the RSR rebuilding fee was on vehicle  
11 premium or vehicle and driver premium, and we talked  
12 about the significance of that.

13 But just in terms of the numbers, I'm  
14 reminded that, pursuant to Pro Forma 1, the total  
15 driver premium written for current fiscal year,  
16 2014/'15, is about 47 million. So is it really 30 to  
17 40 million of that that are drivers that have no  
18 vehicles? It seems like a lot. So I just want to know  
19 if I understood that correctly or -- or not.

20 MR. LUKE JOHNSTON: The -- the driver  
21 premium amounts are the total collected for every -- on  
22 everyone's driver's licence. So, like, that -- you  
23 have to have a driver's licence if you have a vehicle  
24 or -- or not.

25 MS. CANDACE GRAMMOND: Sure. So -- so

1 overall, the Corporation's collecting 47 million in  
2 driver premium. What I was trying to get at before  
3 when you said the 30 to 40 million, were those drivers  
4 that don't have a vehicle? It just seems like a lot to  
5 me if 30 to 40 million out of \$47 million are people  
6 that don't have cars, but I -- I'm not sure now if I  
7 understood you correctly or not.

8 MR. LUKE JOHNSTON: You're -- you're  
9 right, I apologize. So you're -- that total is  
10 everyone, like, every driver. Off the top of my head,  
11 I don't know what the subset of that number is. There  
12 are drivers that don't have vehicles registered. So,  
13 you know, like, say it was half or less of that, it --  
14 it would be half of that amount, and then an even small  
15 fractional amount if we were to apply 1 percent to that  
16 number.

17 MS. CANDACE GRAMMOND: Would -- would  
18 you have a fairly easy way of giving us that split, who  
19 -- who has vehicles and who doesn't out of the roughly  
20 47 million in driver premium?

21 MR. LUKE JOHNSTON: Yeah, we -- we can  
22 take that as an undertaking. That's a -- just a query  
23 from our data warehouse.

24 MS. CANDACE GRAMMOND: Perfect. That's  
25 clearly stated?

1 THE COURT REPORTER: Yeah.

2 MS. CANDACE GRAMMOND: Okay.

3

4 --- UNDERTAKING NO. 33: MPI to provide the split of  
5 who has vehicles and who  
6 doesn't out of the roughly  
7 47 million in driver  
8 premium

9

10 CONTINUED BY MS. CANDACE GRAMMOND:

11 MS. CANDACE GRAMMOND: Excellent.

12 Okay, so I'm going to move, then, into some questions  
13 on the DCAT. And before we go to the -- the DCAT  
14 report, I believe that in Mr. Cheng's report, on his  
15 external review of the latest DCAT, he indicates that  
16 his scope included a review of the adequacy of  
17 procedures, systems, and the work of others relied on  
18 by the chief actuary.

19 Does that sound about right?

20

21 (BRIEF PAUSE)

22

23 MR. LUKE JOHNSTON: That does sound  
24 right, subject to check. I'm just going to find my  
25 report.

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: Thank you. And  
4 Mr. Cheng's report reflects his conclusion that he  
5 detected no material issues in the DCAT?

6 MR. LUKE JOHNSTON: As a summary  
7 statement, yes.

8 MS. CANDACE GRAMMOND: Can you tell us  
9 what information was shared with Mr. Cheng to allow him  
10 to reach that conclusion?

11

12 (BRIEF PAUSE)

13

14 MR. LUKE JOHNSTON: For this year's  
15 report, my recollection is that he just received the  
16 DCAT report in its entirety with all the exhibits. I  
17 don't believe in this particular year he requested  
18 additional information about, you know, our assets or  
19 anything, for example. Remember that Mr. Cheng also  
20 does our policy liability review so, yeah, he has  
21 access to a -- a lot of information as well that he  
22 wouldn't have if he was solely doing just our DCAT peer  
23 review.

24 MS. CANDACE GRAMMOND: Just a moment,  
25 Madam Chair.

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: Would Mr. Cheng  
4 have had reference to the prior DCAT, which was the  
5 first one (1) based on the new financial model?

6 MR. LUKE JOHNSTON: Yes, Mr. Cheng did  
7 the peer review of the previous DCAT, so he would have  
8 also looked at that one, and understood the  
9 conclusions.

10 MS. CANDACE GRAMMOND: Okay. So we  
11 know that he had the document. Do we know whether he  
12 would have gone back and reviewed it in the context of  
13 reviewing the current DCAT?

14 MR. LUKE JOHNSTON: I didn't have those  
15 discussions with him, so I can't really say if -- if he  
16 did that, or not.

17 MS. CANDACE GRAMMOND: Okay.

18

19 (BRIEF PAUSE)

20

21 MS. CANDACE GRAMMOND: Okay. I'm going  
22 to ask then, Diana, if we can pull up the -- the DCAT.  
23 This is at RSR.2 of the filing. If -- if we can go to  
24 page 26?

25

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: Just one (1)  
4 moment, Madam Chair.

5

6 (BRIEF PAUSE)

7

8 MS. CANDACE GRAMMOND: Diana, if you  
9 could just scroll up a little bit, or down -- I guess  
10 down. Scroll down. A little more.

11

12 (BRIEF PAUSE)

13

14 MS. CANDACE GRAMMOND: Okay. So we've  
15 got a series of tables here on page 26. You can  
16 confirm that the Corporation's proposed minimum RSR  
17 target level is 194 million, and that that's based on  
18 the combined scenario result in 2018/'19?

19 MR. LUKE JOHNSTON: Yes. This -- this  
20 -- yes. This isn't the easiest table to see why that  
21 is, because these are the absolute amounts, not the --  
22 the change from the base forecast. But what you've  
23 said is correct.

24 MS. CANDACE GRAMMOND: Okay. And, as  
25 well, MPI's proposed minimum total equity target is 213

1 million, also based on the combined scenario result, in  
2 this case, for 2017/'18.

3 MR. LUKE JOHNSTON: Correct.

4 MS. CANDACE GRAMMOND: And can you tell  
5 us a little bit about why, in the Corporation's view,  
6 it's appropriate to propose a minimum target level for  
7 adoption today based on a capital level forecasted for  
8 three (3) or four (4) years from now?

9

10 (BRIEF PAUSE)

11

12 MR. LUKE JOHNSTON: Well, what we're  
13 doing in -- in the scenarios is -- is, in -- in my  
14 opinion, most appropriate for this process, because  
15 we're looking at our forecasts -- our base forecasts  
16 today and saying, What type of swings can we have in  
17 terms of adverse outcomes over the forecast period for  
18 which we're setting rates.

19 So this is exactly what it does. We --  
20 we actually don't even have the impact touch the  
21 '14/'15 year. So when you look at these tables, you'll  
22 notice that the numbers are all the same. The adverse  
23 scenario is assumed to impact the '15/'16 year and  
24 thereafter. And what we're measuring is the  
25 differences between our base forecast over that period

1 versus what the adverse scenario does.

2 And on that basis, we believe that, in  
3 terms of the risk for the '15/'16 rates, that that's --  
4 that's the most reasonable method to do that.

5 MS. CANDACE GRAMMOND: You would agree  
6 that the Basic investment portfolio and actuarial  
7 liabilities would typically be expected to be larger at  
8 the future time, three (3) or four (3) years from now,  
9 than they are today?

10 MR. LUKE JOHNSTON: I would agree. And  
11 I would also say that that is contemplated completely  
12 in -- in our base forecasts, and also in terms of how  
13 the adverse scenarios affect us at particular points in  
14 time in the future.

15

16 (BRIEF PAUSE)

17

18 MS. CANDACE GRAMMOND: Just one (1)  
19 moment, Madam Chair.

20 MR. LUKE JOHNSTON: Just as an example  
21 to make that more clear, if -- let's say we're looking  
22 at a stock market crash or -- or something like that,  
23 or even just a decline in the stock market. We're not  
24 shocking today's portfolio or the -- the year-end  
25 '13/'14 portfolio. We're shocking the hypothetical

1 portfolio that we have forecasted in this rate app for  
2 the '15/'16 year. So it -- it reflects the balances at  
3 that time, not -- not, you know, last year's financial  
4 statements.

5 MS. CANDACE GRAMMOND: Okay. Wouldn't  
6 it be the case, though, that if Basic had the target  
7 level of RSR or total equity, as the case may be,  
8 today, the supporting assets would be expected to  
9 contribute to growth to that capital level before the  
10 modelled adverse event happened three (3) or four (4)  
11 years from now?

12 MR. LUKE JOHNSTON: Again, I don't know  
13 what else to say other than that any assumed growth is  
14 included in the base forecast, which we're, you know,  
15 calculating the scenarios off of, and any another  
16 assumptions that are -- you know, like, for example,  
17 premium growth or returns on investment, they're all  
18 included in the models being used. We're just -- all  
19 we're -- all we're doing is adversely impacting those  
20 scenarios in the future.

21 So, yeah, I'm -- I'm not -- I'm not sure  
22 what else to say other than -- than all the -- the  
23 financial model is intended to give is a realistic as  
24 possible projection of our future financial position.

25 MS. CANDACE GRAMMOND: Okay. Thank

1 you. Now, Mr. Johnston, you and I had a discussion  
2 just a few moments ago in the context of the cashflow  
3 matching, about what the adoption of cash -- cashflow  
4 matching may impact in terms of Basic's sensitivity to  
5 interest rate risk.

6                   Given your comments on that in terms of  
7 the mitigation of that risk or potential mitigation of  
8 that risk, can you comment on whether that would be a  
9 motivator for MPI to adopt cashflow matching for Basic?

10                   MR. LUKE JOHNSTON: Like the other --  
11 well, not all of the risks. Some -- some of the risks  
12 we have are almost impossible to avoid. We're -- if we  
13 have a bad winter and we have more collisions, that's  
14 not really a risk that -- you know, we're not going to  
15 buy some kind of reinsurance to prote -- that's -- we  
16 got to absorb that risk for our insurance company.

17                   Same thing with equities. If that's a  
18 choice we make to go into in that asset category, we  
19 want a capital level that's appropriate to absorb that  
20 risk.

21                   So interest rates is no different. If  
22 we have a particular appetite for risk and that's  
23 deemed acceptable for the Corporation and -- and the  
24 Board, the DCAT will reflect the risk level that you've  
25 taken.

1                   So if you mitigate interest rates with  
2 an improved cashflow matching methodology, you -- your  
3 risk levels should go down. If you get out of equity  
4 market completely, your risk level will go down. That  
5 is -- is really the -- the main benefit of the DCAT  
6 method as opposed to some other method that's just like  
7 a constant premium target or something.

8                   We could -- you know, like, let's say we  
9 did a whole bunch of significant risk mitica --  
10 mitigation exercises and the DCAT went down. Our  
11 current methodology would just stay the same, right?  
12 Like, the percentage of premium would -- wouldn't --  
13 wouldn't react to that at all.

14                   MS. CANDACE GRAMMOND: So to summarize  
15 that, the Corporation, you would expect, would be  
16 motivated to adopt cashflow matching for the reasons  
17 identified?

18                   MR. LUKE JOHNSTON: This -- this one's  
19 a -- a little tricky, because say you -- if you do an  
20 asset and liability management study, you're going to  
21 essentially be given a risk profile, and the  
22 Corporation has to decide where they want to sit on  
23 that spectrum.

24                   You could move to an extremely low risk  
25 position and miss out, essentially, on -- it -- say,

1 you know, get out of equities completely and miss out  
2 on those gains, you know. We could change our interest  
3 rate policy. They all have impacts, right?

4 So when we do the ALM, we'll have to  
5 decide where we want to sit on that spectrum. We're --  
6 we're likely not going to be on the lowest possible  
7 risk, you know, threshold on that table, because the --  
8 the consequences of doing that would be very costly to  
9 ratepayers in terms of having to increase their rates.

10 We'll have to select a risk level that's  
11 appropriate or that -- that we believe appropriate, and  
12 the Board will see that. But the -- the outcome from  
13 that is always going to be a DCAT that reflects the  
14 particular risk level that you've taken.

15 So I don't want to just make an -- a  
16 general statement that's saying, Absolutely, we'd want  
17 to completely eliminate every ounce of interest rate  
18 risk that we have, because there might be costs to that  
19 which I -- you know, that's going to be assessed in the  
20 ALM, and we'll pick what we think is best for MPI.

21 MS. CANDACE GRAMMOND: And I -- I  
22 appreciate your comment about not wanting to commit to  
23 something now. And I appreciate that the study's  
24 ongoing and -- but I just want to be clear that I -- I  
25 wasn't intending to direct the question to eliminating

1 interest rate risk as opposed to mitigating it.

2                   So I -- I would assume that you would go  
3 with me on the -- on a yes to the mitigation question  
4 if we leave aside elimination.

5                   MR. LUKE JOHNSTON: Again, I have to be  
6 careful, because if you mitigate interest rate risk,  
7 you take away the benefits that are being projected on  
8 your rates as well. So there's a cost to that. Risk  
9 mitigation may reduce the DCAT indication but raise the  
10 rate indication, and there's a balance between those  
11 two (2).

12                   So if you're getting a favourable  
13 benefit of -- of duration or not duration matching in  
14 the -- in the rates, say -- say it's 10 million, you  
15 take that away, the rates need to sup -- you know,  
16 support that by increasing. And that's likely  
17 perpetual, but you get to lower your -- your DCAT  
18 target.

19                   So which one is preferred? I don't want  
20 to speak prior to the -- the ALM results. The  
21 Corporation will have to take a position on that.

22                   MS. CANDACE GRAMMOND: Okay. But --  
23 and -- and I -- I appreciate what you're saying about  
24 both sides of that issue. But there's also a cost to  
25 ratepayers to fund the RSR to a higher level to protect

1 against the risk, right? So isn't that balancing  
2 always going to be there?

3 MR. LUKE JOHNSTON: Absolutely. I --  
4 yeah. There's -- that's the other side of -- of -- the  
5 -- the opposite of the rate piece, right? If you don't  
6 get it in the rates and it doesn't work out, you've got  
7 to get it in the RSR.

8 Is the RSR big enough to cover the risks  
9 that you're willing to accept? That's what the DCAT  
10 will -- will do. If you lower risk, it'll -- it'll  
11 lower and you should have less variable outcomes, yeah.

12 MS. CANDACE GRAMMOND: Okay. Thank  
13 you. The Board had asked a question of the Corporation  
14 at PUB/MPI II-42. Maybe we could pull that up? And  
15 then I -- I have a few more questions on this section  
16 that I think I can get through before we take our  
17 afternoon break.

18 So PUB/MPI II-42 is up on the screen.  
19 And if we look at the response -- if, Diana, you could  
20 just scroll a bit? We see a -- a variety of scenarios  
21 here.

22 Mr. Johnston, can you comment on this  
23 response and what insights we see here into  
24 substantially eliminating or mitigating interest rate  
25 risk for Basic?

1 MR. LUKE JOHNSTON: Well, what we see  
2 here is a scenario that assumes the interest rate  
3 forecast is per the base forecast. So the interest  
4 rate forecast materializes perfectly as forecasted, and  
5 it only looks at the combined risk of equity returns  
6 and claims incurred over the forecast period. So it's  
7 kind of an interest rate neutral scenario.

8 What we have to be really careful with  
9 is again this assumption that you can mitigate all  
10 interest rate risk just by cash flow matching. You  
11 cannot. And when -- again, when we provide this  
12 scenario that shows flat interest rates that the  
13 scenario -- the undertaking, we can show -- explain the  
14 -- some of the differences in terms of what can be  
15 mitigated and what can't.

16 So again, the -- one of the -- one of  
17 the easier examples is the actual coupons that the  
18 bonds pay will be higher if you get much higher  
19 interest rates versus if you get lower ones. Like,  
20 there's actual interest payments as opposed to just  
21 changes in the market values.

22 So there's --there's another piece  
23 there, and there's also other issues such as the  
24 premium deficiency et cetera, but we'll outline --  
25 outline those in our response to that undertaking.

1 MS. CANDACE GRAMMOND: And can you tell  
2 me before consideration of management and regulatory  
3 action, what does this alternative combined scenario  
4 indicate should be the minimum RSR level, and the  
5 minimum total equity level?

6 MR. LUKE JOHNSTON: I'll have to  
7 undertake to do that, because the -- the numbers here  
8 are just the absolute numbers. I need to see the --  
9 the deviation from our base forecasts, and so we'll  
10 undertake to do that. And again, as you mentioned,  
11 there's no management action in these scenarios, so I  
12 wouldn't want the -- the Board to think that -- that  
13 that is necessarily the number. We would still have to  
14 include plausible management regulatory action in the  
15 results. But we'll undertake to do that.

16 MS. CANDACE GRAMMOND: Okay. Undertake  
17 to provide a version that includes management and  
18 regulatory action, as well?

19 MR. LUKE JOHNSTON: We can do that, as  
20 well. So how about we -- we say we will -- I'll --  
21 I'll provide a table that shows the differences from  
22 the base first for this to get an extent -- give the  
23 Board an idea of how much it can change. And then what  
24 we do in the DCAT is we essentially pick the worst  
25 scenario at the one (1) in forty (40) year level, and

1 we put forward management action assumptions in there,  
2 and so we'll provide that output for you.

3 MS. CANDACE GRAMMOND: Thank you.

4

5 --- UNDERTAKING NO. 34: MPI to provide a table that  
6 shows the deviation from  
7 the base forecast, then in  
8 the DCAT, pick the worst  
9 scenario at the one (1) in  
10 forty (40) year level, and  
11 put forward management  
12 action assumptions

13

14 CONTINUED BY MS. CANDACE GRAMMOND:

15 MS. CANDACE GRAMMOND: Now, I'm going  
16 to be getting into some questions with respect to the  
17 MCT, and before we get into the -- the 100 percent  
18 ratio for the -- the total equity range upper limit,  
19 you can confirm that the MCT, or minimum capital test,  
20 is prescribed by the Office of the Superintendent of  
21 Financial Institutions of Canada, otherwise known as  
22 OSFI?

23 MR. LUKE JOHNSTON: Yes.

24 MS. CANDACE GRAMMOND: And I understand  
25 that changes to the MCT are scheduled to take effect in

1 2015. You're aware of that?

2 MR. LUKE JOHNSTON: That's my  
3 understanding, yes.

4 MS. CANDACE GRAMMOND: And are you able  
5 to provide a -- at a high level, a description of how  
6 the MCT is to change in 2015?

7 MR. LUKE JOHNSTON: At this time, I --  
8 I can't. But we can -- we can undertake to do that if  
9 necessary.

10 MS. CANDACE GRAMMOND: Okay. Can you  
11 give an indication of the direction or order of  
12 magnitude of the impact of the 2015 changes on the MCT  
13 ratio of 42 percent as at last year end, or is that not  
14 realistic at this time?

15 MR. LUKE JOHNSTON: I -- I cannot.  
16 Yeah, our MCT is based on the latest information that -  
17 - that we had. And it's -- I can -- if there's an  
18 undertaking required, I can work with our corporate  
19 controller who does the -- whose area does the MCT  
20 calculation. But I'm not -- I don't want to go on  
21 record stating what I think the outcome will be of the  
22 '15 -- 2015 changes.

23 MS. CANDACE GRAMMOND: Yeah, Mr.  
24 Johnston, if you could give that undertaking, we would  
25 take that, so to advise of a -- a description at a high

1 level of how the MCT is changing in 2015, and then  
2 indicate the direction and order of magnitude to the  
3 extent that you're able of the impact of those changes  
4 on the Corporation's MCT ratio as at February 28, 2014.

5 MR. LUKE JOHNSTON: We will attempt to  
6 do that. I don't want to put my accounting group in a  
7 box. I'm hoping that they are able to do that for you  
8 and that we can get the information necessary to do  
9 that. We will make our best efforts to do so.

10 MS. CANDACE GRAMMOND: Thank you.

11

12 --- UNDERTAKING NO. 35: MPI to provide a  
13 description at a high level  
14 of how the MCT is changing  
15 in 2015, indicating  
16 direction and order of  
17 magnitude of the impact of  
18 those changes on the  
19 Corporation's MCT ratio as  
20 at February 28, 2014

21

22 MS. CANDACE GRAMMOND: Madam Chair,  
23 maybe we could take the afternoon break now.

24 MR. REGIS GOSSELIN: Oh, you know, just  
25 to ma -- to make sure that, you know, we don't do a lot

1 of work here. If -- if it represents a significant  
2 challenge, my sense is that, you know, give us the  
3 significant changes and which of the changes have the  
4 most material impact on the MCT for MPI.

5 So, you know, we're a long way from  
6 being anywhere close to having enough reserves to  
7 consider the -- what's the right number for the MCT.  
8 But we got to have some sense of where -- where the  
9 direction's going on MCT.

10 MR. LUKE JOHNSTON: Thank you for that.

11 THE CHAIRPERSON: Okay. Thank you, Mr.  
12 Johnston. We will take our fifteen (15) minute break  
13 now and return at a quarter to 3:00. Thank you.

14 MR. BYRON WILLIAMS: Madam Chair...?

15 THE CHAIRPERSON: Yes, Mr. Williams?

16 MR. BYRON WILLIAMS: I believe My  
17 Friend, Ms. Grammond, had a document that wasn't on the  
18 record that Diana miraculously googled. And so I'm  
19 wondering if that's going to be made an exhibit.

20 MS. CANDACE GRAMMOND: Yeah, I suppose  
21 we should make it an exhibit. I don't know what the  
22 next exhibit number is, but... Eleven. So, yeah, I  
23 mean, it -- it does tie in with Pre-Ask 3. But just to  
24 cover the -- the bases, I'm fine with that document  
25 being MP -- or PUB Exhibit 11. Thank you, Mr.

1 Williams.

2 THE CHAIRPERSON: Okay, thank you.

3

4 --- Upon recessing at 2:31 p.m.

5 --- Upon resuming at 2:55 p.m.

6

7 THE CHAIRPERSON: Welcome back. We'll

8 continue with our proceedings at this time, and I'll

9 call upon Ms. Grammond to continue with her cross-

10 examination.

11

12 CONTINUED BY MS. CANDACE GRAMMOND:

13 MS. CANDACE GRAMMOND: Thank you, Madam

14 Chair. So, Mr. Johnston, I just want to follow up on

15 the last exchange that we had before the break relative

16 to the undertaking that was provided. So I -- and I'm

17 -- I have some questions about the MCT ratio, but I --

18 I think I'm going to start with the following.

19 I think we're struggling with the

20 Corporation's reasons for the hundred percent proposed

21 MCT. And I'm not talking about the usage of MCT for

22 the total upper equity. I'm talking about the

23 selection of the hundred percent. And so I -- I have

24 some questions on that, and I'll -- I'll come to those.

25 But will not Basic's MCT ratio change

1 due to the 2015 changes to the MCT even if Basic  
2 remains exactly the same?

3

4 (BRIEF PAUSE)

5

6 MR. LUKE JOHNSTON: I'm just going to  
7 quote the Corporation's response from PUB I-125 where  
8 we state:

9 "Given the 2015 draft MCT guidelines  
10 are only a draft at this point in  
11 time and there is no prevailing set  
12 guidance on their application, any  
13 analysis would not be complete and  
14 potentially not illustrative of the  
15 potential impact. In addition, any  
16 changes to the MCT guideline will not  
17 impact the reasonableness of the  
18 financial projections or actuarial  
19 modelling used to determine rates  
20 effective March 1st, 2015."

21 MS. CANDACE GRAMMOND: And I appreciate  
22 that, but would you agree, though, if Basic's MCT ratio  
23 comes down due to the changes being implemented, then  
24 the 100 percent target would become a stronger target  
25 in 2015 than it was in 2014?

1 MR. LUKE JOHNSTON: Again, I don't want  
2 to comment on potential changes, but the Corporation's  
3 position was that -- that we don't have any reason to  
4 believe that this target used by OSFI would somehow  
5 become less credible or invalidate our current approach  
6 because they continue to make improvements to that  
7 methodology.

8 It's a -- it's not a -- it's definitely  
9 not an arbitrary methodology, by any means. So we're  
10 asking for 100 percent MCT as the upper target because  
11 we believe that's the -- essentially the pure  
12 application of that methodology.

13 What it means to take a 50 percent MCT,  
14 for example, isn't clear, at least in my mind. And  
15 then we also stated various other reasons about, you  
16 know, comparable and -- and objective -- objective and  
17 -- and such. But that's -- that's our position.

18

19 (BRIEF PAUSE)

20

21 MR. LUKE JOHNSTON: If -- if you're  
22 asking if MPI is going to continue to be comfortable  
23 with the MCT should 100 percent MCT next year be lower,  
24 my expectation would be yes. But of course we'll  
25 update the MCT, provide the Board with the information.

1 MS. CANDACE GRAMMOND: Yeah. And --  
2 and I appreciate that. That's not really what I was  
3 getting at, and maybe I'll make one (1) more attempt on  
4 this at this stage, but really just that if -- in the  
5 context of this GRA, the Corporation's proposing 100  
6 percent as its -- as the MCT ratio.

7 And we know that the test is changing  
8 next year, and I appreciate that you've given me an  
9 undertaking on that. But if the test changes, then the  
10 100 percent being proposed now and for -- utilized in  
11 2014 won't be the same in 2015 in relative terms.  
12 That's really all I'm asking.

13 MR. LUKE JOHNSTON: I apologize. The -  
14 - at every fiscal year end, I assume our financial  
15 position will be different. And we'll update the MCT  
16 and it will be a different number. And what we've put  
17 on record is that we're quite comfortable using the  
18 actual MCT result as our upper target rather than  
19 projecting what it will be two (2) or three (3) years  
20 from now.

21 Even -- like, we do attempt to do that  
22 in the models the best that we can, but we understand  
23 in this process that it would be good to have our  
24 actual MCT results based on the latest guide --  
25 guideline as an upper target.

1                   And -- and again, it's just -- it's just  
2 that. We're not particularly worried about the  
3 implications of some future MCT guideline for the  
4 targets we're proposing today.

5                   MS. CANDACE GRAMMOND:    Okay. Now, I  
6 know when you read in the response to the IR, you had  
7 referenced that the guidelines were in draft. I  
8 believe that they've now been finalized.

9                   Are you aware of that?

10                  MR. LUKE JOHNSTON:    I am not at this  
11 point, but again, I will consult with our accounting  
12 area and we'll get you an undertaking the best that we  
13 can. We could do that.

14                  MS. CANDACE GRAMMOND:    I don't know if  
15 we need an undertaking. If you're not aware of the  
16 draft being finalized, that's -- that's probably fine.  
17 I know we're agreed that there are going to be some  
18 changes coming in 2015, so --

19                  MR. LUKE JOHNSTON:    Sorry, the  
20 undertaking in terms of what the -- now I guess not  
21 draft changes are, and -- and --

22                  MS. CANDACE GRAMMOND:    Yeah --

23                  MR. LUKE JOHNSTON:    -- whether we can  
24 quantify those impacts?

25                  MS. CANDACE GRAMMOND:    Yes. Yeah --

1 MR. LUKE JOHNSTON: Okay.

2 MS. CANDACE GRAMMOND: -- no, we'll --  
3 we'll keep that undertaking in place. Okay. So  
4 delving into the -- the MCT issue a little bit more but  
5 shifting the focus, pursuant to the filing I understand  
6 that the MCT ratio that resulted from the analysis that  
7 the Corporation did was about 42 percent as at February  
8 28th of 2014.

9 Is that right?

10 MR. LUKE JOHNSTON: Yes.

11 MS. CANDACE GRAMMOND: And the total  
12 capital available in that instance, which is the  
13 numerator of the MCT ratio, was decreased by about 35  
14 million identified as assets with a capital requirement  
15 of 100 percent.

16 Is that right?

17 MR. LUKE JOHNSTON: Yes.

18 MS. CANDACE GRAMMOND: Can you comment  
19 on the nature of the asset giving rise to this MCT  
20 penalty?

21

22 (BRIEF PAUSE)

23

24 MR. LUKE JOHNSTON: The -- the sources  
25 of that \$35 million adjustment are actually in PUB I-

1 20, the -- page 2. So I can --

2 MS. CANDACE GRAMMOND: Diana, maybe you  
3 could just bring that up, if you don't mind, PUB I-20,  
4 page 2?

5

6 (BRIEF PAUSE)

7

8 MS. CANDACE GRAMMOND: Sorry, you said  
9 page 2, Mr. Johnston, or have I given -- have I  
10 repeated the wrong reference? This doesn't --

11 MR. LUKE JOHNSTON: PUB I-120.

12 MS. CANDACE GRAMMOND: I-120, I'm  
13 sorry, Diana, I said the wrong thing.

14

15 (BRIEF PAUSE)

16

17 MR. LUKE JOHNSTON: That there.

18 MS. CANDACE GRAMMOND: Yeah, okay.

19 MR. LUKE JOHNSTON: So the -- the  
20 sources are outlined but -- yeah, page 2. If that's  
21 not the right -- yeah.

22

23 (BRIEF PAUSE)

24

25 MR. LUKE JOHNSTON: Yeah. Yeah, you

1 can stop now.

2 MS. CANDACE GRAMMOND: Okay.

3 MR. LUKE JOHNSTON: So -- so in terms  
4 of how those amounts are calculated, I'm not able to  
5 give a description right now. I would need to get more  
6 details to -- to explain the numbers on that -- on that  
7 page. I can come back and -- and do that, but from --  
8 from here I -- I need to get more detail.

9 MS. CANDACE GRAMMOND: Okay. We'll --  
10 we'll just hold that for a moment. I'm not going to  
11 specifically ask for an undertaking. You can confirm  
12 though that the MCT penalty is about ten (10)  
13 percentage points, reducing the ratio from about 52  
14 percent to about 42 percent?

15 MR. LUKE JOHNSTON: Yeah, approximate  
16 basis, yes.

17 MS. CANDACE GRAMMOND: Okay. And can  
18 you advise why the DCAT's forecasted MCT ratios do not  
19 include any assets with a capital requirement of 100  
20 percent?

21

22 (BRIEF PAUSE)

23

24 MR. LUKE JOHNSTON: We do answer -- I  
25 believe we answer that question in PUB I-121. I don't

1 know if I want to read in the whole answer. It's  
2 fairly long, but --

3 MS. CANDACE GRAMMOND: Okay, well,  
4 thank you for providing the reference. We can maybe  
5 pull it up and you can answer as you see fit.

6

7 (BRIEF PAUSE)

8

9 MR. LUKE JOHNSTON: So again, it's a  
10 fairly lengthy answer, but we state in the second  
11 paragraph:

12 "The difference of the assets with  
13 the capital requirement of 100  
14 percent is as a result of  
15 interpretation of the guidelines.  
16 There are certain aspects of the MCT  
17 that are subject to interpretation  
18 where OSFI would provide final  
19 guidance on the interpretation.  
20 However, as the Corporation does not  
21 have a relationship with OSFI, the  
22 Corporation completes the  
23 interpretation."

24

25 (BRIEF PAUSE)

1 MR. LUKE JOHNSTON: So I don't know if  
2 it's necessary to read -- read the rest of that, but my  
3 -- yeah, my position right here is I would need to --  
4 this is something I would need to go back to the office  
5 to talk about with the accounting department.

6 MS. CANDACE GRAMMOND: Sure. I mean,  
7 we'd be happy to take an undertaking on that. So it's  
8 to advise of why the DCAT's forecasted MCT ratios do  
9 not include any assets with a capital requirement of  
10 100 percent. And that would be some further commentary  
11 beyond this IR.

12 And I can maybe ask a follow-up  
13 question. So, sorry, first of all, you're agreeable to  
14 that undertaking?

15 MR. LUKE JOHNSTON: Yes.

16 MS. CANDACE GRAMMOND: Okay.

17

18 --- UNDERTAKING NO. 36: MPI to advise why the  
19 DCAT's forecasted MCT  
20 ratios do not include any  
21 assets with a capital  
22 requirement of 100 percent

23

24 CONTINUED BY MS. CANDACE GRAMMOND:

25 MS. CANDACE GRAMMOND: The follow-up

1 question would be: When the February 28th, 2014,  
2 calculation was done, you came up with a value for the  
3 assets with 100 percent capital requirement. So I'm  
4 assuming -- are we agreed on that?

5 MR. LUKE JOHNSTON: Agreed.

6 MS. CANDACE GRAMMOND: So why not for  
7 the future forecasts?

8 MR. LUKE JOHNSTON: I agree. It's a  
9 valid question. That's -- I'll undertake to do that.

10 MS. CANDACE GRAMMOND: Okay. Great.  
11 Thank you.

12 THE COURT REPORTER: Is that a new  
13 undertaking?

14 MS. CANDACE GRAMMOND: No. It's the  
15 same one.

16 MR. REGIS GOSSELIN: Mr. Johnston, do  
17 you know why ICBC would be adhering to the MCT?

18 MR. LUKE JOHNSTON: Sorry, can you  
19 repeat that?

20 MR. REGIS GOSSELIN: Do you know why  
21 ICBC would be going with the MCT as the -- as the  
22 reserve level? Is it because they're fed -- federally  
23 regulated?

24 MR. LUKE JOHNSTON: As -- yeah. As --  
25 no. As -- SGI also uses it, ICBC. And from -- from --

1 I'm not going to again speak for them, and -- but I  
2 believe it's because of the -- you know, it's a  
3 standard test and it's objective and it's comparable.

4           And all the -- the -- it's -- we can --  
5 what I -- what I like about our approach is we -- we  
6 use the DCAT to propose the minimum. And that's --  
7 this is -- this is the made in Manitoba, you know, MPI-  
8 specific capital target that we're trying to  
9 collaborate on, et cetera.

10           We need a range, though. We could pick  
11 an arbitrary range above the DCAT just by picking a  
12 number, or we could use something that would aid the  
13 Board further in terms of understanding how the  
14 Corporation's capital sits relative to this test, other  
15 insurers.

16           It's -- regardless of what the Board  
17 decides on this, it's very useful information to, you  
18 know, see how we compare to SGI or private sector. So  
19 in that regard, we think it's -- it's important.

20           MR. REGIS GOSSELIN: I just -- my -- my  
21 understanding was one (1) of the reasons that SGI was  
22 using that MCT is because they have some insurance  
23 operations which are federally regulated. And I know  
24 they did dispose of one (1) corporation that they had  
25 in PEI, but they even -- and -- and I -- so I'm not

1 sure what the future is for M -- for Saskatchewan  
2 Government Insurance.

3 I'm just wonder if ICBC was faced with a  
4 similar issue, being federally regulated for part of  
5 their operations.

6 MR. LUKE JOHNSTON: I can -- I can look  
7 into that. My understanding, though, is that, for  
8 their Basic programs, they wouldn't need to follow that  
9 -- this -- OSFI rules. But I can -- I can confirm  
10 that, yeah. Sure.

11 THE COURT REPORTER: Is that an  
12 undertaking?

13 MR. LUKE JOHNSTON: Yes.

14 THE COURT REPORTER: Can you specify  
15 the undertaking?

16 MR. LUKE JOHNSTON: The -- I guess the  
17 undertaking would be to confirm whether SGI and ICBC  
18 are required to use the MCT for their capital  
19 requirements on their Basic programs, or whether that's  
20 something that they chose to do or the regulator asked  
21 them to do. Is that fair?

22

23 --- UNDERTAKING NO. 37: MPI to confirm whether SGI  
24 and ICBC are required to  
25 use the MCT for their

1 capital requirements on  
2 their Basic programs, or  
3 whether that's something  
4 that they chose to do or  
5 the regulator asked them to  
6 do

7

8 CONTINUED BY MS. CANDACE GRAMMOND:

9 MS. CANDACE GRAMMOND: Mr. Johnston, we  
10 have in the filing, and I can provide the reference if  
11 it would help you, but there's reference to a zero  
12 dollar provision for interest rate risk in the capital  
13 required in the 2013/'14 MCT.

14 And -- and my question is whether you  
15 can provide a work-up of the -- that -- how it came to  
16 be a zero dollar provision. So if -- if you can answer  
17 that, great. If you would like the reference and to  
18 have it brought up, we can certainly do that.

19 MR. LUKE JOHNSTON: Yeah, if you could  
20 provide the reference that you're looking at, I'll  
21 start with that.

22 MS. CANDACE GRAMMOND: Sure. So it's  
23 RSR.3, page 2.

24

25

(BRIEF PAUSE)

1 MS. CANDACE GRAMMOND: We might just  
2 need to scroll a bit more.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: Is this -- can  
7 we just scroll to see the -- the page number at the  
8 bottom of the page?

9 MR. LUKE JOHNSTON: We can include this  
10 in the undertaking that we're already doing in terms of  
11 assets with the capital requirement of 100 percent, if  
12 we --

13 MS. CANDACE GRAMMOND: Okay.

14 MR. LUKE JOHNSTON: -- want to lump  
15 this in there, explain -- to also explain the interest  
16 rate risk calculation, we can do that.

17 MS. CANDACE GRAMMOND: Perfect.

18 MR. LUKE JOHNSTON: Yeah.

19 MS. CANDACE GRAMMOND: Okay. Thank  
20 you. That covers that off. So getting into, then a  
21 discussion about the proposal on the hundred percent  
22 MCT ratio, what I understand is that the Corporation is  
23 proposing that this measure be used a definition for  
24 the upper limit for a range of Basic total equity as  
25 opposed to the upper limit of the RSR.

1 Is that right?

2 MR. LUKE JOHNSTON: Correct.

3 MS. CANDACE GRAMMOND: And to put a  
4 dollar amount on this, again, pursuant to the filing,  
5 the Corporation is proposing an upper limit for a range  
6 of Basic total equity of about 325 million.

7 Is that right?

8 MR. LUKE JOHNSTON: Yes.

9 MS. CANDACE GRAMMOND: So then the  
10 working range for Basic total equity is proposed to be  
11 between 213 million and 325 million?

12 MR. LUKE JOHNSTON: That's correct.

13 MS. CANDACE GRAMMOND: Now, in the  
14 filing, and this is on page 11 of RSR.1...

15

16 (BRIEF PAUSE)

17

18 MS. CANDACE GRAMMOND: Page 11 of  
19 RSR.1, it's stated that -- we may just need to scroll a  
20 little bit. That -- that first bullet at the top of  
21 the page:

22 "By establishing the RSR upper target  
23 at a hundred percent MCT, the Board  
24 has an objective measure in place  
25 that is comparable to other

1                   automotive insurers, both public and  
2                   private in Canada."

3                   You can appreciate, though, that it's  
4 important for the PUB to establish for itself the  
5 reasonableness of the proposed hundred percent MCT  
6 ratio for Basic in Manitoba?

7                   MR. LUKE JOHNSTON: I -- I can  
8 appreciate that, yes.

9                   MS. CANDACE GRAMMOND: And I referenced  
10 earlier that we are -- have been considering the  
11 selection of the hundred percent. So let's leave aside  
12 the usage of MCT as a concept, but let's just focus on  
13 the selection of that hundred percent as opposed to  
14 some other percentage.

15                   Can you talk about what analysis the  
16 Corporation has undertaken in support of the use of  
17 that number?

18                   MR. LUKE JOHNSTON: There has --  
19 there's not been an analysis of MPI's -- for example,  
20 like, we didn't do modelling of our, you know,  
21 financial outcomes to say that 100 percent MCT is the  
22 optimal upper target, and even what is -- you know, in  
23 terms of what that even means.

24                   We -- like, on the -- on the DCAT, we've  
25 been working together to establish the assumptions and

1 -- and rules we want to use, you know, our risk  
2 tolerance, our management action, how the scenarios are  
3 created. It's more clear on the DCAT side exactly what  
4 is -- is being done, right, for MPI specific.

5           For the 100 percent MCT, it's -- the  
6 recommendation is -- the -- the key reason is that it  
7 is -- like a -- the objective target that -- that we've  
8 discussed, objective comparable, it's -- I -- I don't  
9 know how to interpret lower levels of MCT, so this is  
10 the minium capital required under that test. To modify  
11 that test to make it 70 percent MCT or such, I don't  
12 know what that really means for -- for the test.

13           And -- and what I mean is to make these  
14 judgmental adjustments to the -- you know, the basis of  
15 that test may invalidate the use of it, so to speak.  
16 What happens in -- in terms of how the private sector  
17 uses it, there's this -- there's this minimum amount,  
18 and then there's 150 percent supervisory target, and my  
19 understanding of that is that extra 50 percent is to  
20 cover all these operational economic -- like, you know,  
21 different types of risks that can't be quantified, so  
22 they put a safety load on top of that. And then  
23 insurers are expect -- expected to save even farther  
24 above the one fifty (150).

25           In -- in my view, 100 percent is the

1 pure application of the test, and we haven't -- you  
2 know, we haven't done analysis to show that that's the  
3 right number.

4 MS. CANDACE GRAMMOND: So are you  
5 equating the usage of a ratio less than a hundred -- so  
6 let's say seventy (70), just to use your example -- do  
7 you equate usage of that number as a modification to  
8 the test?

9 MR. LUKE JOHNSTON: No. Like any --  
10 any result that we have can be compared to what a  
11 hundred percent MCT is. That's -- there's no question  
12 about that. So our DCAT proposed minimum target, I  
13 believe, is the -- around 65 percent of the MCT, so it  
14 gives you a gauge of -- in terms of what we're  
15 recommending versus what the MCT is worth.

16 The -- the DCAT has always been  
17 presented as a minimum level, and again, this -- this  
18 upper target was -- was picked for the reasons that  
19 we've discussed. No -- no further analysis to somehow  
20 support that this was the perfect optimal number other  
21 than what we've presented in here.

22

23 (BRIEF PAUSE)

24

25 MS. CANDACE GRAMMOND: One moment.

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: So, Mr.  
4 Johnston, the Corporation is putting forward a DCAT  
5 based total equity range lower limit, the -- the two  
6 thirteen (213) -- the 213 million, based on the  
7 modelling of adverse scenarios at a certain level of  
8 likelihood.

9 Could the same principles apply -- be  
10 applied to define an upper limit as opposed to the use  
11 of MCT ratio as suggested by the Corp?

12 MR. LUKE JOHNSTON: So could the -- I  
13 believe the question is, Could the DCAT -- could you  
14 select a -- say a minimum risk tolerance and a maximum  
15 risk tolerance, and produce two (2) figures and use  
16 that as your range? Yes, you could do that.

17 MS. CANDACE GRAMMOND: Would you  
18 consider it to be reasonable to try to establish a  
19 probability level beyond which it would be considered  
20 excessive to expect Basic total equity to provide  
21 complete protection against adverse scenarios? So in  
22 other words, are there other possibilities?

23 MR. LUKE JOHNSTON: Do you have the  
24 question written down? Could you repeat it, please?

25 MS. CANDACE GRAMMOND: Yeah. Of course

1 I have it written down. And, yes, I can repeat it. So  
2 would it be reasonable to try to establish a  
3 probability level beyond which it would be considered  
4 excessive to expect Basic total equity to provide  
5 complete protection against adverse scenarios?

6 MR. LUKE JOHNSTON: Is -- is it  
7 possible? Yes. The -- we would like -- from -- from  
8 my perspective, from preparing a DCAT report I would  
9 like the probabilities that we're calculating to fall  
10 within accepted actuarial practice, which is generally  
11 the -- we're talking about one (1) in twenty (20) to  
12 one (1) in a hundred (100) type events.

13 We, of course, would be willing to  
14 collaborate with the Board, Mr. Pelly and CAC, to come  
15 up with those assumptions, but there -- there would  
16 have to be a discussion about, you know, the size, the  
17 -- you know, the size of that range sufficient to  
18 manage rate stability, et cetera.

19 But could that be done? Yes, I -- I do  
20 agree it could. I would continue again, though, to  
21 support that the MCT at least be produced and used for  
22 the Board's information. I -- I do think it is -- it -  
23 - you know, we -- we do a lot of work with this DCAT to  
24 make sure it's, you know, really a fair assessment of  
25 MPI's risk, and we're not taking more money from

1 ratepayers than -- than we have to. But I think it's  
2 always good to look in the context of the -- you know,  
3 an objective test, and even -- it -- it's also used by  
4 our other public insurers, too, so it's important that  
5 we always look at that number.

6 MS. CANDACE GRAMMOND: So let's say  
7 that we choose one (1) in two hundred (200) year  
8 events. Should Basic ratepayers be expected to fund  
9 the total equity account to fully protect against  
10 adverse events that are more remote in likelihood than  
11 that?

12 MR. LUKE JOHNSTON: Well, once you  
13 start getting -- this is a, I guess, another issue.  
14 One (1) in two hundred (200), in my opinion, seems  
15 excessive for a Basic program. But when you start  
16 getting out into those extremes, the -- clearly, the  
17 modeling -- modelling results become less and less  
18 credible. We start -- you know, what's the one (1) in  
19 400 million -- or sorry, one (1) in four hundred (400)  
20 year hailstorm or something, right?

21 So it's a lot easier to make statements  
22 about one (1) in forty (40) year things and one (1) in  
23 twenty (20) year, but that's getting a little bit out  
24 there. And I -- I would expect that the Board wouldn't  
25 be in support of a -- a one (1) in two hundred (200)

1 year coverage, if that's your question.

2 MS. CANDACE GRAMMOND: Did it again.  
3 Coming back to the DCAT for a moment, can you give us  
4 an idea of what probability level in the four (4) year  
5 combined scenario is consistent with a \$323 million  
6 total equity upper target through the MCT proposal  
7 that's been put forward?

8 MR. LUKE JOHNSTON: That's something I  
9 would have to look at. And I guess my -- a follow-up  
10 question to that would be is it before -- I'm assuming  
11 it's after a management action. I could give you the  
12 results with and without management action. We -- we  
13 get to 300 million plus impacts quite easily before we  
14 institute management action even at the one (1) in  
15 forty (40) year level.

16 And, you know, that's -- I -- I've  
17 talked with the Board about that a little bit. We have  
18 to understand that when the Corporation recommends, you  
19 know, rou -- you know, roughly \$200 million, that  
20 there's already significant action happening to bring  
21 that number down from 300-plus million impact down to  
22 the \$200 million impact. We put in the rate changes  
23 and the RSR fees, and -- and we got to be careful that  
24 the management action it -- itself is in rate shock,  
25 where, like, it has to be, right?

1           A -- if we talk about rate stability, we  
2 don't want to say, Well, we put in, like, 5 percent  
3 rate increases a year, and that was our answer to rate  
4 instability, right? Like, it doesn't make any sense.  
5 So -- so I can -- I can undertake to do that, if you  
6 like.

7           So the undertaking, I think, is are  
8 there scenarios that are equivalent to a 324 mil -- \$5  
9 million impact with management action, and what the  
10 probability of that is -- the probability level that  
11 is?

12           MS. CANDACE GRAMMOND: Yes. Basically,  
13 what we're trying to get at is how bad of an event  
14 would be needed to exhaust the proposed upper limit,  
15 the 325 million?

16           MR. LUKE JOHNSTON: Okay. I'll -- I'll  
17 report on both before and after management action on  
18 that -- on that question. I'll take that as an  
19 undertaking.

20           MS. CANDACE GRAMMOND: Thank you.

21

22 --- UNDERTAKING NO. 38: MPI to report if there are  
23 scenarios equivalent to a  
24 \$325 million impact, what  
25 the probability level of

1 that is, both before and  
2 after management action

3

4 CONTINUED BY MS. CANDACE GRAMMOND:

5 MS. CANDACE GRAMMOND: Next question,  
6 Mr. Johnston, with respect to this idea of setting the  
7 total equity balance as opposed to retained earnings  
8 balance, what would the Corporation's position be if  
9 the RSR were modelled on total equity, so what the  
10 Corporation is proposing at the top end? Would the  
11 Corporation consider any changes to rate setting, and  
12 that would be being bra -- based on breaking even on a  
13 comprehensive income basis rather than just on a net  
14 income basis?

15 Can you talk about any -- and it --  
16 maybe it's not you. Maybe this is for one (1) of your  
17 panel mates, but we'd like to -- to know the thoughts.  
18 And that -- sorry, I said comprehensive income. I  
19 should have said total comprehensive income.

20 MR. LUKE JOHNSTON: We haven't looked  
21 at that in any detail, nor do -- did we have any  
22 expectation coming into this that we would propose the  
23 changes to how we would calculate our -- our break-even  
24 rates. Again, we -- we think it's worked, and we think  
25 it -- the way we have it set up produces, you know,

1 more stable rate outcomes. So I -- I can't -- I can't  
2 say I've looked at that, and -- and nor -- I -- I want  
3 to have an understanding of what that would mean for  
4 rate stability and indications before I commented on  
5 that, but I haven't looked.

6 MS. CANDACE GRAMMOND: So the  
7 Corporation is not modelling that at this point?

8 MR. LUKE JOHNSTON: We are not.

9

10 (BRIEF PAUSE)

11

12 MS. CANDACE GRAMMOND: Mr. Johnston,  
13 just on that, it is correct, though, that the financial  
14 model currently models interest rate changes such that  
15 the Corporation does model other comprehensive income.

16 MR. LUKE JOHNSTON: Yes, the -- the  
17 information is available. So, like, the -- the balance  
18 of AOCI is projected over the forecast period. It's  
19 not that it's not there to utilize. We're just saying  
20 we haven't contemplated or assessed setting rates in  
21 that manner yet.

22 MS. CANDACE GRAMMOND: Would it be  
23 possible for the Corporation to provide its position on  
24 the question of changing the break-even objective from  
25 net income to total comprehensive income?

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: Yes, we can provide  
4 our position, or our recommendation on that. I'll --  
5 I'll go have a -- a better look and understanding of --  
6 of what the impacts of that are. I think -- like, I  
7 don't expect them to be really significant, because  
8 we're generally talking about unrealized equity gain  
9 losses, and then when you're talking about forecasts,  
10 you're usually forecasting something relatively stable,  
11 like 7 percent a year or something. So I -- I don't  
12 know that it has a huge -- it would have a huge impact,  
13 but we'll have a look, and come back with our position.

14 MS. CANDACE GRAMMOND: Thank you.

15

16 --- UNDERTAKING NO. 39: MPI to provide its position  
17 on the question of changing  
18 the break-even objective  
19 from net income to total  
20 comprehensive income

21

22 CONTINUED BY MS. CANDACE GRAMMOND:

23 MS. CANDACE GRAMMOND: Now, the -- can  
24 you give us an indication of how far back the  
25 Corporation's current financial model dates, as in when

1 was that model originated?

2 MR. LUKE JOHNSTON: Last year's GRA was  
3 the first time we used the new model, if that's your  
4 question.

5 MS. CANDACE GRAMMOND: Okay. And would  
6 you consider the model to still be under development,  
7 or would you consider it static?

8

9 (BRIEF PAUSE)

10

11 MR. LUKE JOHNSTON: We're -- we're  
12 definitely very satisfied, happy with the model output.  
13 But like anything, it'll get continuous improvements  
14 happening. One (1) example of something that's not in  
15 there right now is the premium deficiency calculation.  
16 We had to pull that out.

17 It's a complicated calculation. We'll  
18 have to make decisions about whether we want that  
19 included in the model or external to the model. But,  
20 yeah, the mod -- ever -- every year, of course, we'll  
21 look at what the model's doing, and if we can improve  
22 it, we will.

23 So 'static' is not the right word, for  
24 sure, but it's functioning, yes, stable results we're  
25 seeing from the model. And we're very happy with its

1 performance to date.

2 MS. CANDACE GRAMMOND: And what would  
3 you say is the most recent improvement to the model?

4

5 (BRIEF PAUSE)

6

7 MS. HEATHER REICHERT: Just give us a  
8 second, because I'm pretty sure that we filed that  
9 information. I'm just looking for the -- for the  
10 reference.

11 MS. CANDACE GRAMMOND: Thank you. And  
12 I may be able to assist by just saying we're -- we'll  
13 be satisfied with the most recent significant  
14 improvement, so something that's minor, you don't need  
15 to worry about.

16 MR. LUKE JOHNSTON: An example that we  
17 -- we've incorporated MCT into the model. It's -- I'm  
18 sure we'll continue to refine that. As I've -- I've  
19 just discussed, we've had some difficulties modelling  
20 everything in that test, so we can improve that.  
21 Balance sheets were added to support the DCAT and --  
22 and the regulatory process. So, a couple examples.

23 MS. CANDACE GRAMMOND: Thank you. And  
24 do you have, top of mind, any upcoming improvements or  
25 changes that you can tell us about?

1 MR. LUKE JOHNSTON: Premium deficiency  
2 calculation is one we're definitely looking at. It  
3 would -- it's nice to not have something external to  
4 the model, obviously. And of course, we believe that  
5 we -- we should have all the functionality needed to  
6 handle the ALM results. But whatever comes out of  
7 that, we'll make sure it's -- the model's working  
8 appropriately to handle if there's anything new out of  
9 -- out of that piece.

10 MS. CANDACE GRAMMOND: And have there  
11 been any changes to the model since the GRA was filed?

12 MS. HEATHER REICHERT: Oops. No, there  
13 has not.

14 MS. CANDACE GRAMMOND: And did the  
15 Corporation engage an outside service provider to build  
16 the model?

17 MS. HEATHER REICHERT: Yes, we did.

18 MS. CANDACE GRAMMOND: And can you tell  
19 us in broad terms what step that -- or what steps that  
20 service provider took to test the software pre --  
21 before presenting each phase to the Corporation?

22 MS. HEATHER REICHERT: Not in any great  
23 detail, from myself personally. I know that the -- in  
24 -- the company that did the financial model development  
25 for us worked with us closely. They -- they do the

1 financial modelling and training for all of the major  
2 banks. So they followed best practices within that  
3 industry for developing the financial model.

4           And then we -- so they would test it  
5 themselves. Then we would, on each of the phases that  
6 we received, take it internally, run through a bunch of  
7 different scenarios to ensure that we were getting the  
8 expected results that -- getting the results that we  
9 expected to get from the financial model.

10           We have documented that. That was  
11 included as part of our general rate application  
12 filing.

13           MS. CANDACE GRAMMOND: Thank you. Now,  
14 I appreciate that we had some evidence on this issue  
15 last week in terms of access to the model, and Mr.  
16 Guimond had mentioned the proprietary concerns with  
17 respect to it. Leaving those aside but noting them,  
18 are there any other practical barriers to providing  
19 access to the model?

20           MS. HEATHER REICHERT: I would say the  
21 most significant barrier to providing access to the  
22 model is that the model does not just contain the Basic  
23 line of in -- line of business financial information.  
24 It -- it is a corporate financial model and, because of  
25 that, is not something that we are prepared to -- to

1 provide and share with the Public Utility Board.

2 MS. CANDACE GRAMMOND: The Corporation  
3 would understand though that it is important that the  
4 PUB have confidence in the model as an important  
5 element of reaching conclusions on a variety of things,  
6 including use of the DCAT?

7 MS. HEATHER REICHERT: Absolutely. And  
8 it -- it is MPI's position that, based on the hundreds  
9 of scenarios that we have run through the model and at  
10 least a hundred probably that we have provided to the  
11 Public Utility Board, the manual that we provided, the  
12 walkthroughs that we have done on the model through the  
13 DCAT technical conferences, the fact that, to our  
14 knowledge, anyone that has looked at the output of the  
15 model has not identified any concerns or issues that  
16 the output is contrary to what they expect to see,  
17 based on all of that, it is -- it's my opinion that --  
18 that the Intervenors and the Public Utility Board  
19 advisors should have comfort that the model is working  
20 the way that the model needs to work and -- and that  
21 providing the actual model itself, which is proprietary  
22 and also includes the confidential information on the  
23 competitive lines, I don't believe that that would  
24 actually enhance to any great extent the comfort that  
25 the advisors should already have with the model.

1 MS. CANDACE GRAMMOND: Just one (1)  
2 last question with respect to the model. The costs  
3 that were incurred which we had some evidence on last  
4 week, those would have flowed, at least in part,  
5 through to Basic, I assume, through the cost allocation  
6 methodology?

7 MS. HEATHER REICHERT: Yes, the costs  
8 to develop the financial model would have gone through  
9 our operating expenses and would have been allocated on  
10 the basis of our allocation methodology. I cannot tell  
11 you in -- specifically how much or the dollar amount  
12 that would have actually been charged to -- to the  
13 Basic line of business, but there would be some  
14 portion, yes.

15 MS. CANDACE GRAMMOND: Thank you. Just  
16 a couple of really short topics. And then I'll have a  
17 few benchmarking questions before we stop the hearing  
18 for today. And the first topic relates to the DSR  
19 scale.

20 So if our math is right, the Corporation  
21 will have five (5) years of DSR experience available  
22 for analysis in next year's GRA. Does that sound about  
23 right?

24

25

(BRIEF PAUSE)

1 MR. LUKE JOHNSTON: Let me just count  
2 my fingers here.

3 MS. CANDACE GRAMMOND: Yeah, I -- I can  
4 tell you I -- we looked back at some of the documents  
5 from last year, and there was an IR, and then some oral  
6 evidence with respect to last year, being four (4)  
7 years, or -- so we just -- we added.

8 MR. LUKE JOHNSTON: So DSR, like our --  
9 our rating year, also has staggered renewals, right.  
10 So the '14/'15 year that we're in, the last policy  
11 would -- would end at the end of the '15/'16 year, so  
12 we'll be really close to having five (5) years. Like,  
13 some of the -- those policies won't be fully earned  
14 yet, if I did my math right, but, yes, pretty close to  
15 five (5) years.

16 MS. CANDACE GRAMMOND: And so would the  
17 Corporation file any kind of analysis on DSR with the  
18 Board next year, or, if not, when would it file some  
19 kind of an analysis?

20 MR. LUKE JOHNSTON: Analysis in respect  
21 to whether the DSR program is working or whether the --  
22 the rates should be changed or both?

23 MS. CANDACE GRAMMOND: Both.

24

25 (BRIEF PAUSE)

1 MR. LUKE JOHNSTON: Yes. So for next  
2 GRA, we can include a more detailed analysis of -- of  
3 DSR. I wouldn't expect the -- the Corporation to come  
4 forward with drastic changes to that scale. The  
5 starting point, in my opinion, would probably be to  
6 say, Okay, here's what we know, and, you know, how --  
7 is it working? Here's the -- the -- you know, the  
8 different costs and et cetera for different points on  
9 the DSR scale. And that would lead to some discussion.

10 Not having done the analysis yet, I -- I  
11 can't speculate on what that would look like.

12 MS. CANDACE GRAMMOND: What we're  
13 getting at is that once sufficient data's available,  
14 that the Corporation would conduct analysis and testing  
15 from a fairness and rating perspective.

16 I mean, when the DSR scale was put in,  
17 obviously there was a completely dif -- different  
18 system there before. So the PUB, at some point, wants  
19 to have that comfort that the -- what's on the DSR  
20 scale is actuarially sound.

21 MR. LUKE JOHNSTON: Yes, and we've --  
22 we've stated that we'd like to have at least five (5)  
23 years of data, which you've alluded to. What will come  
24 next is there'll be the raw data from DSR, which is  
25 factual, right? Like, this is what's actually

1 happened. The next step will be in terms of the  
2 policies that we want to put forward and how -- around  
3 the -- the DSR premiums.

4 In the actual DSR hearings, there was  
5 evidence presented that, you know, depending on, you  
6 know, how you wanted the -- the model to work, there --  
7 it could produce massive rate dislocation. So that con  
8 -- that discussion would have to be had again and  
9 policies developed on -- on how to move, and the  
10 appropriate split, and et -- et cetera.

11 So that -- all of that, I -- like, I am  
12 not prepared to discuss, but I understand I think  
13 that's what the Board's looking for on DSR.

14 MS. CANDACE GRAMMOND: Thank you. And  
15 can the Corporation give any sense at this stage of  
16 whether the DSR system has changed drivers' behaviour?  
17 Or is it -- would you say it's still too early to tell?

18 MR. LUKE JOHNSTON: Well, I -- I can  
19 say the -- the DSR model has produced very good results  
20 in terms of -- relative to our research. The -- the  
21 behaviour of drivers has been con -- very consistent  
22 with our expectations.

23 The -- there's some preliminary evidence  
24 that perhaps drivers on the demerit side have improved  
25 a little bit compared to what we would have modelled in

1 our research. That's -- that's very preliminary, but  
2 that would be a good sign.

3 Mixed in, though, we have these, you  
4 know, especially last year, it was three (3) really bad  
5 winters that would not have been characteristic of any  
6 of the research that we did. So it's -- it's a little  
7 tricky sometimes to -- to figure out how those relate.

8 But no. There's no compelling  
9 information right now to tell us that driver behaviour  
10 has changed drastically. For example, our collision  
11 frequency forecast is almost identical what it was pre-  
12 DSR. It would be nice if it wasn't, but there's a lot  
13 of other external factors that influence that, like a  
14 bad -- bad winter.

15 MS. CANDACE GRAMMOND: Thank you. I  
16 just have a couple of questions on IFRS. So, Ms.  
17 Reichert, I assume this is you. Have there been any  
18 internal developments on preparation for the adoption  
19 of IFRS-4, Phase 2?

20 MS. HEATHER REICHERT: No, there has  
21 not.

22 MS. CANDACE GRAMMOND: It is still  
23 contemplated, though, that the Corporation would be  
24 making elections pursuant to that change that could be  
25 important to rates?

1 MS. HEATHER REICHERT: Yes, but  
2 definitely down the road. The earliest effective date  
3 we understand for IFRS-4 is our year beginning March  
4 1st, 2019, I think. So that is for sure at least one  
5 (1) or two (2) general rate applications away, and they  
6 are still -- have not come out with definitive  
7 standards as it relates to the IFRS. It has not -- has  
8 not yet been finalized.

9 MS. CANDACE GRAMMOND: We had some  
10 discussion last year about the impact of IFRS, or  
11 rather, IAS, International Accounting Standard 19,  
12 which I gather has now been implemented. And can you  
13 tell us what, if any, impact that had on retained  
14 earnings within the Corporation?

15 MS. HEATHER REICHERT: IAS19 was with  
16 respect to employee benefits accounting, so the pension  
17 evaluations. So essentially, that particular standard  
18 required us to take any evaluation, gains, or losses  
19 from our pension and reflect them in AOCI. So what  
20 that did for the Corporation, because we had had  
21 pension evaluation losses in the prior year, it  
22 effectively increased the retained earnings  
23 specifically on Basic.

24 But it -- it increased our retained  
25 earnings on the Basic line of business, because those

1 losses no longer were included in the net income of  
2 that year, therefore net did -- did not then flow  
3 through to reduce the retained earnings, so when we  
4 restated, it increased our retained earnings for Basic.  
5 And I'm -- the number escapes me right now, but my  
6 recollection was it was around 9 or \$10 million that we  
7 increased the opening retained earnings for '13/'14  
8 because of that standard.

9 MS. CANDACE GRAMMOND: Thank you. I'm  
10 going to move, then, to some questions on benchmarking,  
11 and we'll finish out the day on that topic. I'm going  
12 to ask you to go to SM.2, page 9.

13

14 (BRIEF PAUSE)

15

16 MS. CANDACE GRAMMOND: So just while  
17 we're waiting for that, in last year's order, the Board  
18 had ordered the Corporation to provide a benchmarking  
19 framework with benchmarking indicators to which the  
20 Corporation intended to be held accountable. You  
21 recall that?

22 MS. HEATHER REICHERT: Yeah, I recall -  
23 - sorry, I recall wording of that nature within the  
24 last year's order.

25 MS. CANDACE GRAMMOND: And the

1 Corporation has acknowledged in the filing the  
2 importance of benchmarking, and I can give you the  
3 reference if you wish.

4 MS. HEATHER REICHERT: No, that --  
5 that's fine. Yes, we -- we do appreciate the  
6 importance of benchmarking as a -- as an operational  
7 management tool to -- to ensure that we're managing the  
8 Corporation in -- in an appropriate manner.

9 MS. CANDACE GRAMMOND: And what we have  
10 up on the screen -- if you can just scroll a bit,  
11 Diana? Thank you. The Corporation's identified four  
12 (4) major areas of corporate performance in the  
13 benchmarking framework. Operational efficiency, IT  
14 service delivery capability, serving Manitobans, and  
15 community impact.

16 That's right?

17 MS. HEATHER REICHERT: Correct.

18 MS. CANDACE GRAMMOND: And to boil it  
19 down a little bit further, operational efficiency is --  
20 is essentially what we see with the work that the Ward  
21 Group has done.

22 That's right?

23 MS. HEATHER REICHERT: Yes,  
24 essentially.

25 MS. CANDACE GRAMMOND: And the IT

1 service delivery capability is the Gartner Group?

2 MS. HEATHER REICHERT: Essentially,  
3 yes.

4 MS. CANDACE GRAMMOND: Just to talk  
5 about the Ward Group a little bit, what we've learned  
6 is that the Ward Group work compares the Corporation to  
7 other insurers, and we have a commentary starting on  
8 this topic on page 13 of the same section, SM.2. And  
9 in particular, the Ward Group compares the Corporation  
10 to three (3) benchmark groups.

11 Those are listed on page 16 of the  
12 filing. So maybe we can just bring that up? Just a  
13 little bit more. Yeah, there we go.

14 So we've got the Canadian Personal Auto  
15 Benchmark Group, the Canadian Benchmark Group, and the  
16 US Personal Auto Benchmark Group.

17 That's right?

18 MS. HEATHER REICHERT: Correct.

19 MS. CANDACE GRAMMOND: And we had asked  
20 an IR with respect to the composition of each of those  
21 groups, and learned that in the first group listed, the  
22 Canadian Personal Auto Benchmark Group, two (2) of the  
23 insurers of the nine (9) referenced are public  
24 insurers. And the same is true for the second group,  
25 the Canadian Benchmark Group, two (2) of the thirteen

1 (13) are public insurers.

2 That's consistent with your  
3 recollection?

4 MS. HEATHER REICHERT: Yes, that sounds  
5 reasonable.

6 MS. CANDACE GRAMMOND: It's -- just so  
7 you know, it's PUB/MPI I-63(d). We don't need to go  
8 there, Diana, but that's where that's found.

9 Now, the information from the Ward Group  
10 has been filed with the Board now for the last couple  
11 of years. I believe this is the third year that we  
12 have information from the Ward Group in the GRA?

13 MS. HEATHER REICHERT: Yes.

14 MS. CANDACE GRAMMOND: And the Ward  
15 Group analyzes the Corporation's performance on the  
16 basis of some specific metrics. If we go to page 19 of  
17 SM.2 we'll see a chart that shows the Corporation's  
18 performance with respect to those metrics.

19 The first one, total gross expenses as a  
20 percentage of gross written premium, reflects that the  
21 Corporation is under that reflected for the other  
22 groups?

23 MS. HEATHER REICHERT: Yes.

24 MS. CANDACE GRAMMOND: And just as an  
25 aside, does the Corporation have input into the metrics

1 by which it's compared by the Ward Group, or is that  
2 something that the Ward Group does?

3 MS. HEATHER REICHERT: That is  
4 something that the Ward Group does. They are -- they  
5 develop the respective ratios that you see in front of  
6 you and -- and work to determine what those ratios or  
7 dollar amounts are for each of their clients on as  
8 consistent a basis as -- as they can.

9 MS. CANDACE GRAMMOND: Okay. Now, in  
10 past years, the Board's received a document from Ward  
11 Group, and we don't have that this year. We have the  
12 filing but not the actual Ward Group document.

13 Can you comment on that a little bit,  
14 why we had that shift this year in terms of the  
15 documents provided?

16 MS. HEATHER REICHERT: If I'm not  
17 mistaken, in the past years, we didn't provide as  
18 robust analysis of the various benchmarking indicators  
19 that you see in front of you and provide as  
20 supplementary information in the last year, and  
21 possibly last two (2) years. What the Ward Group saw  
22 as like the most significant indicators for the  
23 Canadian Auto Group, and then gave us the comparisons  
24 to -- to the other -- the benchmark groups that you see  
25 in front of you.

1                   So, essentially, the information that  
2 had been provided before in a letter from the Ward  
3 Group is now fully provided, I would say, within this  
4 benchmarking section, as well as the additional section  
5 in Volume III.

6                   MS. CANDACE GRAMMOND:    AI.12.  Okay.  
7 Now, when the Ward group provides to the Corporation  
8 the results, if we can call it that, of how MPI  
9 compares with the various groups, does Ward Group  
10 provide any commentary or insights or does it just  
11 provide the outcome of the comparison?

12                  MS. HEATHER REICHERT:    It provides the  
13 outcome of the comparison.  And then they come and  
14 present to the management committee and talk about what  
15 they see from the various trends, what they see from  
16 our trends now that we have three (3) years and what  
17 they see happening at MPI relative to the other  
18 benchmark groups that -- that -- again, that you see in  
19 front of you.

20                  MS. CANDACE GRAMMOND:    Do they provide  
21 anything in writing when they give that presentation?

22                  MS. HEATHER REICHERT:    Nothing in  
23 writing, as I recall, on their assessment of what they  
24 see relative to the other benchmarks.  They just  
25 provide the -- the base numbers and indicators, if you

1 will. And then their presentation is a verbal  
2 presentation. But my recollection is that they don't  
3 provide written -- written commentary; it's provided in  
4 a verbal presentation to us.

5 MR. ALLAN MORIN: Would you -- would  
6 you happen to see individual benchmarks or is it  
7 cumulative? Like, would you see SGIs or ICBCs?

8 MS. HEATHER REICHERT: No, we would  
9 not.

10 MR. ALLAN MORIN: Okay.

11 MS. HEATHER REICHERT: What is provided  
12 to us is essentially what you see here, Canadian  
13 Personal Auto Group, Benchmark -- Canadian Benchmark  
14 Group, yeah.

15 MR. ALLAN MORIN: Thanks.

16

17 CONTINUED BY MS. CANDACE GRAMMOND:

18 MS. CANDACE GRAMMOND: On that note,  
19 SGI and ICBC, can the Ward Group be asked to conduct  
20 specific comparisons to those two (2) insurers, for  
21 obvious reasons, right, more similar business model to  
22 MPI than private?

23 MS. HEATHER REICHERT: So, yes, we can  
24 ask for specific comparisons to be made between us and  
25 say SGI or ICBC. But part of the Ward Group providing

1 us with that information is our commitment that we  
2 cannot share that in a -- in a public forum. So they -  
3 - they will provide it for our internal use only.

4 MS. CANDACE GRAMMOND: And...

5

6 (BRIEF PAUSE)

7

8 MS. CANDACE GRAMMOND: Has the  
9 Corporation ever had a conversation with Ward Group  
10 about filing on a confidential basis within this  
11 process?

12 MR. DAN GUIMOND: They -- we're --  
13 we're not allowed to -- we wouldn't be allowed to  
14 release the information in the public domain. It's  
15 confidential, and also it's not something that the  
16 other insurers were willing. And that -- that's --  
17 that's an issue as well, right, in terms of -- I mean,  
18 you have to respect what the other companies want made  
19 in the public arena or not.

20 MS. CANDACE GRAMMOND: Thank you. In  
21 the interests of time, I'm just going to move and ask  
22 you a few questions about the second aspect of the  
23 benchmarking, which is the IT piece and the -- where we  
24 -- the Corporation works with Gartner.

25 So as the Corporation has done in the

1 past, it filed this year the Gartner score card, which  
2 relates to IT spending. We do have that document in  
3 the Board's book of documents. It's at Tab 10. And we  
4 see, if we go to -- maybe just to the recommendations  
5 section, you'll see PDF page 4.

6 And I -- I apologize, by the way, if  
7 anyone's pages are -- some of them are turned the wrong  
8 way because I know mine are. So that was a small error  
9 on my office's part, and I apologize for that.

10 But if we can go to PDF page 4, we have  
11 the title 'Key Takeaways from Score Card Analysis'. I  
12 know it's not up on the screen, but I'm sure it's  
13 coming imminently. Does everybody have it? Yeah? I  
14 don't -- I don't want to leave anyone behind. Perfect.  
15 Thank you, Diana.

16 So on this particular document, we have  
17 a couple of observations and implications,  
18 recommendations. So if we just go, first of all, under  
19 'key observations', we see the second last item:

20 "Despite a 2.3 percent reduction in  
21 the IT to company FTE ratio, MPI  
22 spent 8 percent more on personnel and  
23 9 percent more on outsourcing, and  
24 used 12 percent more contractors than  
25 peers. These patterns are consistent

1 with the Ward benchmark findings for  
2 MPI."

3 Does the Corporation have any comment  
4 with respect to that item before we go to the next  
5 column?

6 MS. HEATHER REICHERT: No. That is  
7 what the document says.

8 MS. CANDACE GRAMMOND: Okay. Under the  
9 next column, 'implications and recommendations', the  
10 second item says:

11 "Therefore, it continues to be  
12 critical to make modernization and  
13 rationalization of IT an ongoing part  
14 of MPI's governance process and  
15 investment strategies. As the  
16 modernization effort ramps down,  
17 staffing plans should be developed to  
18 ensure a core of key skills remain  
19 in-house to reduce contractor  
20 dependance, increase staff  
21 satisfaction, and maintain costs."

22 Does the Corporation have any comments  
23 with respect to that item?

24 MS. HEATHER REICHERT: I guess I would  
25 just comment, referring back to discussions that we had

1 yesterday and -- and last week about operating  
2 expenses, the data processing costs, about our capital,  
3 and the fact that we believe that we have reached the  
4 peak, if you will, and are now at the point where we  
5 are starting to stabilize the expenditures in the IT  
6 area, like forecasting forward.

7                   So we are at the point that they're  
8 referencing here in their implications and  
9 recommendations, where we are looking at how we ensure  
10 that we've got the right stable base of IT resources  
11 in-house in order to continue to maintain. So we've  
12 come over that hump, if you will, of the twenty (20)  
13 year roof problem, and are into a -- moving into the  
14 phase of more of the maintenance as opposed to more of  
15 the new.

16                   MS. CANDACE GRAMMOND: Okay. Thank  
17 you. So I think I'll -- I'll end there for today. I  
18 do have more questions on benchmarking but I'm -- my  
19 plan is to turn the mic over to Mr. Williams on  
20 Tuesday. He can do his cross-examination on any Dr.  
21 Simpson related matters. If there's an opportunity  
22 later in the hearing for me to get back and ask some  
23 more questions about this, I will, but we'll perhaps  
24 play that by ear.

25                   So we reconvene Tuesday, November 4th,

1 with Mr. Williams on the mic.

2 THE CHAIRPERSON: Okay. Thank you, and  
3 -- and then we're still planning on having Mr. Simpson  
4 come 3:30 on the Wednesday and carry on into the  
5 evening, is that correct?

6 MR. BYRON WILLIAMS: He's totally  
7 looking forward to it.

8 THE CHAIRPERSON: Well, thank you.  
9 Have a good I guess sojourn for the last -- the next  
10 five (5) days, and we'll see you next Tuesday.

11

12 --- Upon recessing at 4:04 p.m.

13

14

15 Certified correct,

16

17

18 \_\_\_\_\_

19 Cheryl Lavigne, Ms.

20

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