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2 AUTOMOBILE INSURANCE RATE BOARD

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5 PROFIT REVIEW SESSIONS

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9 Before Board Panel:

10 Alfred H. Savage - Board Chairman

11 Harry Gough - Vice-Chair

12 Ted Zubulake - Board Member

13 William Moore - Board Member

14 Harry Gough, QC - Board Member

15 Lewis Klar, QC - Board Member

16 Merle Taylor, CMA - Board Member

17 David White - Board Member

18 Susan Steeves - Board Member

19 David Marshall - Board Member

20 HELD AT:

21 McDougall Centre

22 Calgary, Alberta

23 November 9th, 2006

24 Day 2 of 3

25

1 APPEARANCES

2	Jack Donahue		)Board Counsel
3	David Simpson	(np)	)Facility Association
4			
5	Norma Nielson	(np)	) self
6	David Chan	(np)	)
7			
8	Diane Brickner	(np)	)Peace Hills Insurance
9	Jamie Hotte	(np)	)
10	Melvin Yellowbird	(np)	)
11			
12	Grant Miner	(np)	)Aviva Canada
13	Chris Townsend	(np)	)
14			
15	Steve Whitelaw		)Dominion of Canada
16	Doug Hogan		)General Insurance
17			) Company
18			
19	Frank Bomben		)Co-operators General
20	Katie Suljak		)Insurance Company
21			
22	Chris Daniel		)TD Meloche Monnex
23	Rick Evans		)
24	Craig Alexander		)
25	Francois Faucher		)

1 APPEARANCES (Con't)

Line	Name		Representing
2	Jim Rivait	(np)	)IBC
3	Jane Voll	(np)	)
4	Grant Kelly	(np)	)
5	Richard Phillips	(np)	)
6	Sharon Tennyson	(np)	)
7	Richard Derrig	(np)	)
8	Richard Gauthier	(np)	)
9			
10	Shawn DeSantis		)Royal SunAlliance
11	Saskia Matheson		)
12	Thomas Little		)
13	Brad Hardie		)
14	Merle Taylor		)AIRB Consumer
15			)Representative
16			
17	Jetse de Vries		)ING
18	Martin Beaulieu		)
19	Don Fox		)
20	Bill Premdas		)
21			
22	Derek Tupling	(np)	)Allstate
23	Ajay Pahwa	(np)	)
24	Doug Young	(np)	)TD Newcrest
25	Joel Baker	(np)	)MSA Research

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1 --- Upon commencing at 8:31 a.m.
2
3 THE CHAIRPERSON: Bill, do you want to
4 introduce the Board? We did it yesterday but we'll go
5 through it today once.
6 MR. BILL MOORE: Certainly. I'm -- I'm
7 going to start with John Donahue who I almost forgot
8 yesterday. You of course know Al, our Chair and on my
9 immediate left, Lewis Klar the vice-chair. Harry --
10 Harry Gough -- it took me a while there. And David --
11 David White, Merle Taylor our consumer representative.
12 Susan Steeves, who is with me on the Board staff and Ted
13 Zubulake our actuary from New York, and Patti Grier whose
14 just joined us. Thank you.
15 THE CHAIRPERSON: Thank you, Bill.
16 MR. BILL MOORE: Sorry, Harry. One more
17 elder --
18 MS. PATTI GRIER: Dennis.
19 MR. BILL MOORE: -- elder moment there.
20 MR. DAVID WHITE: Oh, you missed Dennis.
21 THE CHAIRPERSON: You forgot our
22 superintendent.
23 MR. BILL MOORE: And our superintendent,
24 sorry, who just sat down.
25 THE CHAIRPERSON: You forgot --

1 MR. BILL MOORE: Dennis Gartner, sorry.
2 THE CHAIRPERSON: I'm just going to turn
3 it over to you to and introduce your group at this time.
4 MR. CHRIS DANIEL: It's Chris.
5 THE CHAIRPERSON: Good morning, Chris,
6 yeah. I know it is. I've seen you before.
7 We -- you've been here before.
8 MR. CHRIS DANIEL: Thank you. And you
9 invited me back here as well. Very nice of you.
10 THE CHAIRPERSON: We'll just proceed from
11 there.
12
13 PRESENTATION BY TD MELOCHE MONNEX:
14 MR. CHRIS DANIEL: Thanks very much, Al.
15 So first of all I'm going to introduce our people. But
16 just before I do that: I think we appreciate -- we
17 appreciate the opportunity of appearing before the Board.
18 We recognize the sensitivity and the relevance of this
19 very important topic of profit or return on equity.
20 So our presenters are in no particular
21 order, first of all myself which is Chris Daniel. I
22 think you all know me and my responsibilities. Craig
23 Alexander who's Vice President and Deputy Chief
24 Economist, and Craig is sitting to my immediate left, of
25 the TD Financial Group.

1 We also have Rick Evans, Senior Vice
2 President with the TD Group, responsible for claims for
3 Canada, again, just to my left. And to my immediate left
4 is Francois Faucher, who's Senior Vice President and
5 Chief Financial Officer for the TD Meloche Monnex Group.
6 These gentlemen will provide their
7 professional opinions on this topic, ensuring the
8 information is relevant to a sustainable and competitive
9 automobile insurance market in Alberta.
10 The Meloche Monnex Group being the largest
11 distributor of group insurance in Canada, representing
12 1.5 million clients or policyholders in 2006, bearing in
13 mind that our fiscal year runs to October 31st. And in
14 fact we've just finished our fiscal year.
15 We employ just over thirty-three hundred
16 (3,300) personnel using the direct response mode, which
17 is without intermediaries and with the lowest operating
18 costs. We utilize two (2) brand, TD Meloche Monnex which
19 is for professionals and alumni, and the TD Insurance
20 Home and Auto brand which is for select employee groups
21 as well as the direct market.
22 We have invested substantial resources in
23 Alberta to achieve the distinction of being the third
24 largest distributor of automobile insurance to the
25 Alberta public, now representing over two hundred

1 thousand (200,000) individual clients in Alberta.
2 In premium dollars, translated to roughly
3 $314 million dollars in 2006 for automobile insurance,
4 our client base having tripled since -- since 2001. We
5 now have over five hundred (500) personnel in Alberta and
6 we have achieved these results by providing a stable
7 competitive and a quality service to the Alberta market
8 in all kinds of conditions.
9 We will continue to provide valuable
10 advice and our opinions to the Government as we have in
11 the past. As a committed and corporate -- as a committed
12 corporate entity we cannot overstate the importance and
13 relevance of the information that our senior executives
14 will provide to you today on the topic of regulating the
15 return on equity.
16 So again, thank you for your time. I will
17 now turn the podium over to -- to Rick Evans, our Senior
18 Vice-President, responsible for claims of Canada. Thank
19 you.
20 MR. RICK EVANS: Thank you very much,
21 Chris, and good morning to everyone. The -- the notice
22 to the industry that the Board provided us with in
23 advance of these hearings asked us to respond to several
24 technical questions related to the profit provision and
25 how that is connected to return on equity, and also

1 related changes to financial reporting.
2 And a little later on our CFO, Francois
3 Faucher, will respond to those specific questions. But
4 we also thought that this would be a good time to take
5 the opportunity to look -- to talk about what I guess I
6 would call profit regulation in -- in a broader sense.
7 And we thought it would be valuable to --
8 to ask Craig Alexander to -- to come to Alberta to -- to
9 talk about profit regulation in a broad -- in a broad
10 sense, not just with respect to the insurance industry
11 but I think even in the more broad-- broader sense, and
12 try to make some connections and conclusions to -- to the
13 insurance industry.
14 I won't go through all of the -- the list
15 of discussion highlights but I think I'll just turn
16 things over to -- to Craig.
17 MR. CRAIG ALEXANDER: Thanks very much.
18 I -- I'd like to thank you for the opportunity to address
19 you today and what I'm going to do is I'm just going to
20 talk a little bit from an economist perspective about
21 this issue about price -- price regulation and -- and
22 profitability and ROE.
23 Upfront, I -- I want to be very honest
24 with you, I'm not an expert on auto insurance. I'm --
25 I'm an macroeconomic economist that's basically employed

1 by TD Bank Financial Group to do analysis of economic
2 trends. We do forecasts for the Bank. We help with risk
3 management and other factors like that.
4   Our -- our responsibility on the industry
5 side is we do look at industry trends and we look at
6 issues surrounding, you know, how Canadian corporations
7 are doing from a profits perspective, what does this mean
8 from a -- from a banking perspective, and so forth.
9   But I'm not a subject matter specialists
10 on -- on the details about auto insurance per se. And as
11 a result, my comments to you today are basically going to
12 be in a very generic sense. I'm going to talk about, you
13 know, in general issues surrounding profitability and ROE
14 and particularly in a regulated price environment.
15   Now as -- as I understand it, you know,
16 the mandate of this Board is to ensure accessible
17 affordable auto insurance in Alberta and with the
18 delivery coming from a healthy competitive marketplace.
19   And from a public policy point of view,
20 you know, it's a very noble objective. It's something
21 that's clearly in -- in the interests of Albertans. And
22 really the objective is to ensure that you come as close
23 as possible to achieving that ideal.
24   Now what's really interesting from my
25 perspective as an economist, when I think about that

1 mandate, the thing that strikes me immediately is that,
2 you know, from -- from a pure economist point of view, if
3 I went back to my first year economist sort of classroom
4 and I was talking to a group of students, I could draw
5 you an actual diagram of exactly what -- what the optimal
6 outcome is, right?
7 I mean, I could sit there and I could draw
8 a supply and demand curve, average cost curve, a marginal
9 cost curve and I could say, You know what, what you're
10 trying to do is you're trying to pick the price that
11 delivers the market clearing outcome, one where the
12 industry return -- receives what's called normal or -- or
13 fair economic profits.
14 And, you know, it's -- it's extremely
15 elegant from a -- from a theoretical point of view. The
16 problem is when you go from a theory to the practice,
17 when you go from the theory to the real world, all of a
18 sudden it becomes extraordinarily difficulty to actually
19 implement that -- that policy, because quite frankly, you
20 have limited amount of information to work with and
21 you're working with a lot of uncertainty with respect to
22 where the price should be; what the profitability of the
23 industry.
24 Like what -- like what -- what is the
25 equilibrium? What is the fair profits for the industry

1 to ensure that it remains vibrant and productive and
2 competitive so that you end up with the right outcome.
3 And what's interesting I think is that
4 from your -- and unless I'm misrep -- misunderstanding
5 things, your responsibility is on the pricing. But
6 obviously the pricing which affects accessibility and
7 afford ability also has an impact in terms of
8 competition.
9 So there's a lot of secondary affects
10 beyond, you know, just that -- that rate decision. And
11 that's where it becomes really complicated because you
12 have to understand all the nuances of what -- what
13 happens when you -- when you set the price and then, you
14 know, potentially if you decided to look at the
15 profitability.
16 And so in actual fact I -- I have a great
17 deal of sympathy for -- for your task because I think
18 it's an extraordinary difficult one, given the
19 information that you -- you have -- you have at hand to
20 make your decisions.
21 And -- and I want to spend a minute just
22 sort of going through like what the challenges are. As a
23 starting point, I mean it's critical that everyone
24 understands that all industries need a certain level of
25 profitability, right?

1 Profits -- profits are a good thing in the
2 sense that all businesses need them in order to invest --
3 have enough to invest in the business to have enough
4 capital available to ensure that the -- that the industry
5 functions properly.
6 Now from accounting point of view, you --
7 you start getting into measurement issues and the pop --
8 one of the most popular definitions of profitability is
9 return on equity.
10 I mean you could use other measures but
11 one of the most popular ones is -- is ROE and so I'm --
12 that's mainly what I'm going to focus on.
13 And when you think about ROE, when you
14 think about profitability, it's going to differ. The --
15 the equilibrium or the fair or natural profits are going
16 to differ depending on the characteristics of the
17 industry involved. So it's not a constant across
18 industries.
19 And the reason is that the -- the return
20 on equity has to reflect the risks that the businesses
21 are inherently taking. So just like you as personal
22 investors have a -- have a right to expect that an
23 investment that you make in a bond or a -- or a stock
24 over -- over a length of time is going to pay a higher
25 return than investing your money in a GIC because you're

1 taking a lot more risk as an investor.
2 Similarly individuals or institutions
3 providing capital to an -- an industry expect a certain
4 rate of return based on the risk that they're taking in
5 the first place, right? The higher the risk, the more
6 return that they're going to expect to compensate them.
7 Now when you think about auto insurance,
8 you would have to say that there are some unique
9 characteristics here that suggest that the risk profile
10 might not be the same as some -- some other industries.
11 And that in fact the risk profile could be a little
12 higher.
13 And that -- the -- the -- I mean there's a
14 lot of risks, right? There's reputational risk, there's
15 structural risk, there's financial risk and so --
16 associated with the return on the investments being made.
17 But the one that really stands out in my
18 mind is the -- is the uncertainty related to claims. And
19 in fact the auto insurance industry doesn't know what
20 their liabilities are going to be when they're actually
21 selling the product in the first place.
22 They -- they collect the premium, they'll
23 invest that money, but they won't know until many years
24 later what the liability is going to be. What the claims
25 are going to be. They don't actually know whether and,

1 you know, for a particular -- for a particular -- for a
2 particular policy whether there's going to be a few
3 claims or a lot of claims, whether they're going to be
4 small claims or large claims.
5 And so this is -- this is a very
6 structural risk in this industry. Another part of the
7 volatility out there, or risks out there, is the fact
8 that you do have an insurance -- a well demonstrated
9 insurance cycle.
10 You go through periods where claims are
11 very high and periods where claims are very low. And it
12 -- it's reminiscent of the business cycle for the economy
13 where you go through a recession, then you have a
14 recovery, then you have an expansion and variably
15 something goes wrong and the economy goes back into
16 recession.
17 And you know, at the moment it looks
18 business cycles for the economy are every ten (10) years.
19 You tend to have mid cycle slow downs every sort of four
20 (4) or five (5) or -- sorry, five (5) to six (6) years.
21 But you're going to get these sort of
22 fluctuations. And similarly in the insurance industry
23 you're going to have fluctuations as well. And the
24 really hard part is you're never going to call the -- the
25 turning points. You know, we're economic forecasters,

1 we're actually paid to try and call turning points in the
2 economy, but we find it extraordinarily difficult. It
3 gets so much easier -- like, once you're in the recession
4 and trying to make a prediction as to how you're going
5 grow out of it, right? We nine (9) times out of ten (10)
6 get the turning point completely wrong.
7 And similarly on the insurance side --
8 side of things, the volatility in the insurance market is
9 such that it's very hard to call the turning points.
10 So again, it basically comes back to
11 there's a lot of risks associated in -- in this
12 particular industry. And so you would argue that the ROE
13 on it probably should be higher than some industries that
14 maybe don't suffer through the same sort of degree or
15 risk.
16 But I'll be honest with you. We don't
17 know how big the risk premium should be. And -- and I
18 suspect having read some submissions that were presented
19 in other jurisdictions, that you're probably getting, you
20 know, in the presentations you're getting, you're
21 probably getting wide ranges on what people think is a
22 normal or reasonable equilibrium ROE, right?
23 Looking at some of the submissions that
24 I've seen in the past, you know, the number could be
25 anywhere from I don't know, 9 to 18 percent. And the

1 question that this raises is, you know, how useful is
2 this as a public policy tool, right?
3 If -- if this is your benchmark and the
4 benchmark is so unstable and there's such a high degree
5 of uncertainty related to where their equilibrium is.
6 You know, how do you use it as a tool to make sure that
7 you get your policy right?
8 And yet I know -- I -- I appreciate the
9 fact that at the end of the day, you actually have to set
10 a price, it's going to have an impact on profitability,
11 so it is natural to think if we said, you know, a premium
12 of this we're going to get this sort of profitability.
13 But what I'm -- what I'm saying is that
14 you have a very difficult task because at the end of the
15 day you're not going to be able to discern precisely what
16 the ROE really -- really should be.
17 So there is probably an equilibrium out
18 there. There probably is an appropriate ROE. But the
19 problem is that it's not observable, we don't know
20 exactly where it -- where it lies and it's probably not -
21 - it's probably not constant.
22 So from a theoretical point of view I can
23 -- again, I can draw you a chart and say all you've got
24 to guess is P-Star (phonetic), right, and yet this is not
25 going to be a very useful task.

1 Now in the absence of -- of good hard
2 analytical information where I can come and say to you,
3 you know, we've done, you know, this enormous amount of
4 research and we've come to the conclusion that this is
5 the appropriate ROE. You know, in the absence of that,
6 you know, there's a natural inclination to go and look at
7 historical data as a guide, right? And that's natural,
8 right?
9 If -- if you don't know what -- what the
10 outcome should be, maybe the past will give us some
11 insight. And if we look at the ROE in the P&C industry --
12 ow this data is from The Insurance Bureau of Canada and I
13 suspect you're probably sick and tired of seeing this
14 particular chart or you will be by the time of all these
15 presentations are done.
16 You'll see that over the last several
17 decades the average ROE has been around 10 1/2 percent.
18 However, there's a couple of observations here that --
19 that I really think need to be highlighted and that is,
20 look at the volatility in it, right? It goes all over
21 the place. There is dramatic swings. It goes from, you
22 know, generalizing, it goes anywhere from about 1 1/2
23 percent to about 19 percent.
24 And there are periods -- if you actually
25 look at that slide, you'll notice that there are more --

1 more time is spent below 10 percent than above 10
2 percent, right? In other words there's a large number of
3 years where you have single digit ROE and then you
4 suddenly get a huge pop and you get a few years where
5 it's extraordinarily high, and in fact it then averages
6 out to this 10 1/2.
7 And quite frankly from an industry point
8 of view it's important to understand the volatility is --
9 is terribly important from a -- from a financial well
10 being point of view.
11 Not that the industry likes volatility. I
12 mean, if we -- if you could get rid of it, it would be
13 ideal. But the bigger problem is that you really need
14 those high ROE years to pay for those years that sustain
15 -- those periods where you have a sustained low ROE,
16 right?
17 So in other words the average might be
18 around 10 1/2 percent, but if you were to actually use
19 that as some sort of guided target you would find that
20 there would be an awful lot of years where it's sort of
21 lower than that and then you'd have some really
22 excessively, you know, strong years.
23 But they're actually important. They're -
24 - they're absolutely crucial to the industry to make up
25 for the low years. And similarly, if we look at the next

1 slide in terms of the -- the rate of change, I mean this
2 is what struck me, right?
3 The change from any one year to the next
4 could be from nothing, like no change, to 10 percentage
5 points, right? That's huge. That's -- you know, so you
6 -- you have that ROE of ten (10) and then the next year
7 you have an ROE of twenty (20), and the next year you
8 have an ROE of ten (10) and the next year you have an ROE
9 of zero.
10 Like that's -- that's highly
11 characteristic of a very unstable trend. And if you
12 actually look at the average annual change, right,
13 positive or negative, the average annual change is 3
14 percentage points.
15 Okay. So again, you sort of think, well
16 the average is 10 1/2 percent but on, you know, any given
17 year, you know, from an annual average point of view the
18 standard deviation is well in actual fact it's somewhere
19 between seven and a half (7 1/2) and thirteen and a half
20 (13 1/2).
21 Well I'll tell you again, this goes back
22 to my -- my sympathy for the challenges you have because
23 if I actually went to TD Bank Financial Group and said,
24 Okay, from the point of view of managing your foreign
25 exchange risk, I want to tell you that, you know, quite

1 frankly you should basically manage your foreign exchange
2 risk on the assumption the Canadian dollar's going to be
3 somewhere between seventy-five (.75) and ninety-five
4 cents (.95), you know, I'd probably lose my job, right?
5 Because quite frankly, it's not a terribly useful range,
6 right?
7 And this -- this -- this highlights a lot
8 of the problems that you inherently have. The other
9 factor is and I'm going -- I'm going to apologize because
10 you probably read that very easily up on the slide. But
11 you have it I think in your books.
12 MR. CHRIS DANIEL: It's on page 12.
13 MR. CRAIG ALEXANDER: You actually have
14 some -- some data doing an industry comparison of -- of
15 ROE. Now, I will note that particularly if you're
16 familiar with the Insurance Bureau of Canada data, this -
17 - these numbers might look a little different because the
18 P&C Insurance numbers are a little different than the IBC
19 data.
20 And this is because the data's from
21 Statistics Canada and so it's, you know -- I -- I tried
22 to do my best to identify why there was the difference in
23 -- in the numbers. The trends are exactly the same, it's
24 just the absolute levels are a little different. And I
25 tried to understand why that was the case and I -- I

1 didn't come up with an adequate answer.

2 But I worked at Stats Can for five years

3 and I have a sort of -- I have two (2) suspicions.

4 Number 1 is it may be that the -- the P&C Industry

5 category for Stats Can isn't quite the same, you know,

6 there may be some different -- some -- because some

7 companies in this data they are in the IBC data.

8 The other alternative is maybe that Stats

9 Canada massaged the data a bit to make it comparable

10 between industries. One of the things I used to work on

11 when I was there was that because industries would report

12 inventories on like a first in, first out, last in, last

13 out, you know, all these different accounting procedures,

14 Stats Can would actually try to modify the data so that

15 everybody was on the same basis, right, in order to try

16 and make it so that you can compare across -- across

17 industries. So it may be that's also the reason why

18 we're seeing it slightly different.

19 And I also apologize because I would have

20 really liked to have had at least ten (10) years worth of

21 data. Because, quite frankly, I think that you really

22 need to like at these things over a business cycle. I

23 don't think you can actually look at it over a short time

24 horizon.

25 But the main point that I would draw your

1 attention to here is if you actually look at the P&C
2 Industry's performance, Number 1, you can see the ROE is
3 very unstable for everybody. Like it's -- it's shocking
4 how much this thing moves around for each industry from
5 year to year.
6 The second thing is, you'll see that the -
7 - although it's extremely high in '94, the average annual
8 rate over the '94 to -- or '99 to 2004 period, the P&C
9 Industry was actually below average. And in fact, was
10 sort of, you know, below the bank's and also below a lot
11 of -- of non -- a lot of non-financial companies as well.
12 So I -- I do recognize that there can be
13 public perceptions about, you know, the -- the premiums
14 being too high or there may be a perception about very
15 high profitability. But again, I think you need to look
16 at -- over -- over long periods of time whether you're
17 just picking up, you know, the peak, you know, the sort
18 of peak years, and then you're going to have a shift in
19 the claims cycle and you're going to find that the ROE
20 then comes back down again.
21 And so from an average annual point of
22 view maybe it's not, you know, maybe the trend isn't --
23 isn't that abnormal.
24 The other thing struck me when I looked at
25 this was that it seems like that the return On equity is

1 actually low from a risk point of view. And I know that
2 you're going to be having the TD Newcrest analyst come
3 and present to you tomorrow and quite frankly I haven't
4 had the opportunity to talk to Doug about this because my
5 characterization of it is that the -- the ROE is actually
6 abnormally low given the risk profile.
7 And if we go away from the Stats Can data
8 and we think about the ROE for the industry as a whole, I
9 mean the average has been 10 1/2 percent over the last
10 several decades.
11 But in actual fact it hasn't been much
12 higher. In fact it's been about -- it's only been
13 marginally above the return on equity for a lot of the
14 utilities, which don't -- the utilities don't face the
15 same sort of risks that you have in insurance.
16 So it seems to me that it could be the
17 case that not only is the ROE not, you know, the
18 equilibrium ROE not observable, it's probably a long run
19 con -- concept, right? It's probably not the fact that
20 you're going to see the -- the normal profits each year.
21 And more ominously, the issue is that the
22 past might have been presenting you with a misguided sort
23 of representation of where fair value might be. And to -
24 - to take it, you know, a non insurance example of this,
25 you know, what is fair value on the Canadian dollar?

1 Well, I'll tell you almost all of our
2 models say fair value is eighty-three cents (.83), right?
3 And they said it was eighty-three cents (.83) throughout
4 the 1990's and what did we end up with?
5 We had a currency that was down near
6 sixty-two cents (.62) at one point and we kept saying no,
7 no, no, this isn't fair value and you know, the market is
8 -- you know, the market's distorted and this -- you know,
9 things will change. And what do you know, the Canadian
10 dollar came rocketing back up and now we're sitting at,
11 you know, we then close -- sitting close to ninety cents
12 (.90), and now we're on the high side of fair value.
13 In fact, the equilibrium was only
14 experienced as we went rocketing through it, right? And
15 this is -- this is where I get a little concerned about
16 the ROE. The natural level, the natural equilibrium
17 level you probably never have for any length of time.
18 You're probably going to have periods above and periods
19 below, and the hope is that over time you get something
20 that's adequate.
21 Because if the industry doesn't have
22 sufficient -- a sufficient ROE, then you're going to end
23 up discovering that it becomes under-capitalized, that
24 competition -- you know, your accessibility becomes an
25 issue because businesses won't be attracted to basically

1 grow their operations, that you'll -- you'll create -- or
2 you'll have a situation where the industry becomes less
3 healthy.
4 The other thing I would -- I would note is
5 that when -- when we get to the topic of regulating ROE
6 or -- or having some sort of implicit idea as to, you
7 know, what it should be, I think it creates a real
8 serious optical problem, particularly from a public
9 policy point of view. And again, this comes back to my -
10 - my sympathy for the task that you have ahead of you,
11 because quite frankly I think you're going to end up in a
12 situation where you're never going to make everybody
13 happy, right?
14 If you -- if you have a situation where we
15 get a high ROE year, you're bound to get some -- some
16 attention from the public or from the media saying that,
17 you know, well premiums were obviously then set, you
18 know, too high.
19 And premiums should have been lower
20 because the ROE should have never been that high. And
21 similarly when you have a really low ROE year, you're
22 bound to have a situation where the industry comes and
23 pounds on the door and says, you know, We really need the
24 premiums higher because if you don't then we're going to
25 become under-capitalized and this is going to hurt our --

1 our viability.
2 And so at any given moment I suspect that
3 over time you're just going to consistently be bombarded
4 with requests to change your premiums. And the question
5 becomes how do you respond to those -- those pressures.
6 And one of the -- one of the things that
7 Don Drummond, our Chief Economist, and I have spent a lot
8 of time talking to Ottawa and the provinces about is one
9 of the inherent challenges in public policy, and that is
10 it always tends to work with a lag. And in actual fact
11 with all of the best interests at heart, public policy
12 changes can often result in sub -- you know, undesirable
13 outcomes.
14 And the reason is because you could
15 actually aggravate the volatility, you could actually
16 aggravate the -- the cycle. Let me give an example of
17 this.
18 Imagine a situation where the ROE is very
19 high and it's a year where claims happens to be low.
20 Maybe it's because the -- the highways have been widened
21 and so there's fewer accidents happening and the claims
22 go down because there's, you know, less -- less frequency
23 of -- of claims.
24 And that turns out to an aberration,
25 right? Because as population grows and there's more cars

1 on the road the accident rate just eventually gets back
2 to where it was before, as that extra lane doesn't do
3 what it was doing before. Like, I mean it's -- you get
4 back to the status quo.
5 Well, if you respond to a very high ROE
6 year or -- because of that short term sort of affect, you
7 could then lower the premium and then find out that in
8 actual fact the claims have gone up and so it turns out
9 that you have a low ROE year and then the premiums will
10 come down so you actually end up pushing the ROE lower
11 than it otherwise would of.
12 At which point then the industry comes and
13 knocks on the door and says, Please, please, please,
14 please raise it because we desperately need it to go the
15 other way. And so you could actually end up in a
16 situation where the policy ends up creating more
17 volatility.
18 And yet, you know, as I'm saying, it could
19 be a perfectly rational choice with all of the
20 information at hand, right? And each time it couldn't --
21 it could be absolutely compelling that we, you know, you
22 need to lower it now, and then it's going to be
23 absolutely compelling that you're going to have to raise
24 it the other direction.
25 And I think that's -- that I mean -- and

1 this isn't about auto -- this isn't just about auto
2 insurance, this is about any market oriented -- or, you
3 know, any -- any -- any market intervention sort of
4 policy that you can get into this sort of affect.
5 The other question I have, and this is a
6 very fundamental question about the impact of targeting
7 ROE, and that is about the incentives that you put in
8 place and how the market responds to those -- those
9 incentives.
10 Because at the end of the day, economics
11 really, really is about getting -- getting the incentives
12 right. I don't know how many of you are familiar with a
13 -- there's a book on the market right now, it's been
14 around for a while, it's a best selling book called,
15 Freakonomics.
16 And nine (9) times out of ten (10) people
17 will never even consider reading an economics book
18 because, you know, it's just -- it's going to be dry and
19 boring.
20 Well let me tell you, this book is -- is
21 extraordinarily good. I would highly recommend it to
22 you. It's very entertaining, very engaging, there's no
23 ideology in it. It's all about economics in terms of
24 incentives.
25 If you get the incentives right, what ends

1 up happening? If you get the incentives wrong what
2 happens? And how you can end up with unintended
3 consequences. And he has a great example in it about a
4 daycare.
5 And the -- and basically the problem this
6 daycare is having is that people are leaving -- aren't
7 picking up their kids on time. And so the daycare says,
8 you know, Well we can't leave the kids out in the street
9 so they have to have people stay late and -- and put in
10 longer hours, and it's costing the daycare money. And
11 they say, Well wait a second, this isn't appropriate. So
12 they decide they're going to put in place a fine.
13 So the deal is if you -- if you -- if you
14 don't pick up your kid on time, you know, 'X' number of
15 days, they're going to put a fine on you of close to four
16 hundred dollars ($400) for the month. It sounds pretty
17 stringent, right? Do that over a year, that's a lot of
18 money.
19 Well, what happens? You know, the number
20 of kids being left late at the daycare quadruples. And
21 so all of a sudden they're like at a complete loss.
22 Like, how could it be that, you know, we fine them and
23 more of them leave their child.
24 Well, the answer comes two-fold, right?
25 Number 1, is it turns out the fine was set at the wrong

1 level. Although it sounds punitively high, if you
2 actually do it on a per day basis it becomes actually,
3 you know, cheaper than most babysitters. So that -- so
4 that the -- the parents that were leaving kids there
5 don't change their behaviour because the penalty isn't
6 high enough.
7 But the one that got me more interested
8 was that the actual response, when they actually asked
9 the parents that were leaving their kids late, you know,
10 why they were doing so. And one of the -- you know, if
11 you actually sorted through the answers, one of the
12 outcomes that he finds is that the moral requirement to
13 pick up your child had disappeared.
14 In other words, by putting in place a
15 fine, the daycare was actually saying, you know, it's
16 acceptable to leave your child late. All you've got to
17 do is pay this fee and it's perfectly acceptable.
18 So whereas you had some parents that would
19 move heaven and earth to make sure that they were there
20 to pick up their child on time because it was, you know,
21 the right thing to do, by putting in place the fine,
22 they'd actually created an incentive to say, No, no, no,
23 actually it's okay, you just to pay this added -- added
24 amount of money.
25 And so this -- it's just an illustration

1 of the fact that you got to get the incentives right. So
2 when we think about a -- a target on ROE or a restriction
3 on ROE, think about some of the secondary effects.
4 Like we -- we focus on -- you target a
5 price and it's going to have an impact on profitability,
6 right, on ROE. Well, but there's an awful lot of other
7 things that impact ROE as well, right?
8 You can make money in good times and bad.
9 You can make -- you can make, you know, money either by
10 increasing your margins and selling more or you can make
11 money by cutting costs, boosting -- boosting efficiency
12 and becoming more productive, right?
13 So if you put in place a target on ROE I
14 get a little concerned that this could deter companies
15 from basically trying to become more efficient, more
16 productive, maximizing use of new technologies, new
17 processes. And that's where I get really concerned as an
18 economist, because probably the number 1 economic problem
19 I think we have in Canada is poor productivity growth,
20 right?
21 So I'm -- I'm -- I'm very -- and maybe --
22 maybe it's my pre -- predisposition that I look an issue
23 and then I start thinking about, what does it mean for
24 productivity.
25 But, you know, if you put in the target

1 for an individual company, you could end up with an
2 unintended consequence that, you know, it may be that the
3 industry level ROE isn't the appropriate one. And in
4 fact, you know, if we go back to where I started, the
5 risk -- the risk profile of a company will determine it's
6 ROE. Well, because the assets liabilities of -- of each
7 company are slightly different -- the ROE actually for
8 each company -- the appropriate one could actually be
9 different.
10 Then if you have a target at ROE, you'll
11 actually deter it, even the company was capable of
12 producing a higher ROE, you know, it won't because it'll
13 know that there's -- you know, this is what the
14 guidelines going to be, this is what the target is, this
15 is what the limit is.
16 So they may not be willing to -- to you
17 know, be as efficient, as productive, as competitive as
18 they could be.
19 Now one way around that is you could argue
20 that, well we won't -- you know, you don't -- you don't
21 put it on the company, you put it at the industry as a
22 whole. And I think that creates a bit of a fallacy
23 because at the end of the day you're still going to end
24 up in the same place.
25 Because if all of the companies are trying

1 to become more efficient, more productive, they're all
2 trying to introduce new technologies, and all of these
3 things are trying to boost their ROE to the extent that
4 they're actually successful the industry will get
5 penalized because their ROE goes up.
6 So as a consequence, you've got to be a
7 little careful about the -- the incentive -- the
8 incentive structure.
9 Now it may, you know, it's probably a lot
10 less stringent at the industry level than it is at the
11 firm level. But you could still end up back -- back
12 where you started at, that you don't have the same sort
13 of incentives from a market point of view.
14 So, you know, in conclusion, I mean let me
15 -- let me very clear. I mean, I'm an economist and
16 economists have a natural predilection towards, you
17 know, letting the market deal -- you know, come out with
18 the market outcome, right? Generally speaking, we -- we
19 believe that unless there are some really profound exter
20 -- externalities that you're fighting against, you should
21 basically let the market sort of come out with an
22 appropriate level, because at the end of the day that
23 will create the most sort of competitive efficient --
24 efficient marketplace.
25 But I can certainly understand that, you

1 know, from the point of view of once you've made the
2 decision that you're going to regulate prices, you need
3 to think about what the impact that might have on the
4 profitability of the industry.
5 But you also need to think about some of
6 the -- the challenges and my -- my suggestions are,
7 number 1, you know, you need to recognize that the ROE is
8 not con -- you know, the equilibrium ROE is not constant
9 over time; it is going to fluctuate. It depends what's
10 going on in the marketplace; structural changes, right?
11 If you have a rise in a litigation, if you
12 have an increase in fraud, if you have the increase in
13 traffic density and so forth, right, the risks associated
14 with the industry are going to rise and it will affect
15 the appropriate ROE. You're not going to know exactly
16 where the appropriate ROE is and this is why you're going
17 to get all these different -- different numbers being
18 thrown at you and probably the range of them is going to
19 be extraordinarily big.
20 And -- and quite frankly I can't tell you,
21 you know, quite frankly I don't think that there is a
22 single number that's right. And I think that that's why
23 I think you're probably going to hear more and more
24 people talking about, you know, well, in the absence of
25 knowing the right number, you know, use a range or

1 something like that.
2 My -- my suggestion is don't -- just don't
3 be rigid and dogmatic about it when you look at ROE,
4 right? View it as being sort of a long run concept and
5 keep in mind that it is going to go all over the place
6 from one year to the next.
7 And so, try not to be too over reactive if
8 you get a few high years and don't be over reactive on
9 the downside as well. You want to try and make the -- I
10 mean at the end of the day, you're taking -- you're
11 making, you know, the best guess you can. And you know,
12 quite frankly, you know, we should all be honest about
13 it, it is going to be a guess, right?
14 You're going to guess at what -- it's
15 going to be an educated guess, it's going to be the best
16 guess you can possibly make, but I think it's going to be
17 a very, very difficult thing to -- to implement.
18 And -- and you also need to think about
19 the secondary -- a lot of the secondary affects. Like
20 don't think of it just in terms of, you know, a simple
21 rule; you stick in this premium, you end up with this
22 ROE. You need to think about all the secondary
23 implications in terms of, you know, how is this going
24 affect availability, accessibility, competition, how is
25 this going to impact, you know, the -- the attraction for

1 -- for -- for investors to put capital in the industry
2 and keep it healthy, and at the same time defending the
3 interests of your constituents which is your central
4 mandate.
5 So with that, I'll thank you for your time
6 and attention and I'll pass things over to the next
7 speaker.
8 MR. FRANCOIS FAUCHER: Thank you, Craig.
9 Hi everyone. Before I start I would like to say that I'm
10 extremely pleased to be here. It's my first time having
11 the opportunity to talk a rating board.
12 I've been associated with Meloche Monnex
13 since 1995 where the company...
14
15 (BRIEF PAUSE)
16
17 MR. FRANCOIS FAUCHER: I was associated
18 with Meloche Monnex since 1995 where the Company was
19 very, very small, if I may say. And I was closely
20 involved in all the investments we made here in the
21 province; both in terms of growing organically to the
22 potential of groups and so forth, but most importantly,
23 in terms of deploying the capital required to do
24 acquisitions.
25 As you know we -- we did two (2)

1 acquisitions for Canada Life Casualty Liberty Mutual.
2 And -- and for us it was important to understand the
3 criteria and obviously the characteristic of the Alberta
4 market. And -- and when Alain Thibeault, our CEO, and
5 Rick came to me with this challenge that the Board has, I
6 was -- my first reaction was -- was a concern about
7 future capital deployment in terms of we are an active
8 participant in the capital deployment strategy at TD
9 Bank.
10 And, obviously, having a potential
11 limitation in terms of our ROE and our -- also potential
12 opportunities to increase the -- the profitability with
13 respect to generating synergies and when we do
14 acquisitions, I was really concerned. And I fully
15 support the fact that -- what Craig just referred to,
16 just about. So but, you know, I -- my initial, I would
17 say, comment that I would be concerned of the future
18 opportunities for Meloche Monnex, for -- for the Alberta
19 market.
20 So my role here today is go through more
21 the technical aspect of the presentation. You've asked
22 us to comment on the reconciliation model with respect to
23 how do we reconcile the ROE versus a profit provision.
24 First of all, most -- the important point
25 is to review two (2) major assumptions. First of all,

1 the premium to surplus ratio is -- is key to all
2 provision or ROE that we have to establish. As a general
3 rule, we need to follow the minimum capital test of OSFI.
4 As you know, we are a regulated -- regulated
5 organization.
6 The rule today is we need to have a side -
7 - a ratio of 150 percent, which was actually the rule in
8 terms of -- of capital. But OSFI requires each insurer
9 to establish a margin with the risk profile of each
10 organization.
11 So currently -- that's why we're stating
12 that currently OSFI is requiring between one sixty-five
13 (165) and one eighty (180). It could be more than one
14 eighty (180) depending on the risk profile and the
15 historical results of each organization, but we're
16 submitting a ratio of between one sixty-five (165) and
17 one eighty (180) of the assets required to sustain the
18 business. So this is -- this is the general rule of
19 thumb.
20 So this is converted into a ratio overall
21 of -- roughly of two (2) to one (1). So 200 percent.
22 So a ratio of two (2) to one (1) in terms of we need one
23 dollar ($1) of capital for every two dollars ($2) of --
24 of premium. But this is for all lines combined, all
25 coverages and all products; both auto and -- and home

1 business.

2 So specifically what we recommend is to
3 allocate, by line of business, a -- a P and S, or a
4 premium to surplus ratio. So we did some internal
5 studies. We've -- we've also read some studies that were
6 -- that were done, either in Canada and outside Canada.
7 So I'm not providing all the details today, but we could
8 look at them at another moment, but we are recommending a
9 ratio of 150 percent for basic coverage because this
10 coverage is -- is exposed to more volatility.

11 As Craig just alluded before, in terms of
12 the volatility with respect to the reserves or the claims
13 cost which are known three (3) or four (4) or five (5)
14 years after -- after the fact, the ultimate net cost is
15 known only -- only later. There's also timing of
16 payments, and also the current minor injury cap challenge
17 that you are aware of is creating uncertainty around --
18 around the ultimate cost.

19 So that's why the recommendation is -- is
20 having 150 percent for basic coverage. And, in other
21 words, for optional coverage it means that it will be
22 higher than 200 percent to have an overall coverage of --
23 of two hundred (200).

24 So this is the -- the recommendation that
25 Meloche Monnex is -- is providing to the -- to the Board.

1 The second assumption, with respect to
2 investment income. Investment income for insurers are --
3 come from two (2) sources. First of all, it's coming
4 from the policyholder funds that we retain in order to --
5 in order to pay out, in due course, the claims, where
6 it's -- what we call, it's our fiduciary role in order to
7 keep this money and to invest it in a risk-free
8 environment.
9 Second, we have -- we're getting
10 investment income from our capital. So, first of all,
11 our -- our business is not -- it's not an investment
12 business. So we need to manage the capital, assuming
13 that we don't have any excess capital. So we -- we have
14 the capital to sustain the risk of our business, plus the
15 fund that we're retaining for our policyholders.
16 Our view, and we're working closely with
17 TD Bank, it's a risk-free environment. So -- so what we
18 do is that in order to -- to manage the assets versus the
19 liability cost, we use a perfect duration match. So we
20 don't want to be exposed to any risk -- interest risk
21 volatility. So -- so that's the -- the number one
22 assumption, if I may -- if I may say.
23 And also with respect to capital, we --
24 the duration is -- is looked upon having a more short to
25 mid-term orientation. So that's the sole reason why we

1 are recommending to the Board using an interest rate in
2 line with a three (3) year government bonds rate, which
3 is currently at 4 percent. Because we, again, we're not
4 assuming that we are an investment business and we want
5 to run into a risk-free environment.
6 And we -- one could say that currently P&C
7 insurers get more than 4 percent, but our view on -- on
8 that is that they carry excess capital, where they're in
9 a position to take more risk. But our view is that if
10 you take more risk or if you invest for example in common
11 shares, you need to put aside more -- aside more capital,
12 but it's -- because it's more risky. So we feel that the
13 net cost of this would be close to 4 percent.
14 So that's the recommendation we're
15 providing to the Board, using a 4 percent investment rate
16 of return on the -- our investment portfolio.
17 Moving along, converting ROE into
18 underwriting provision and also the profit provision. So
19 a few points here.
20 The ROE is based on investment and
21 underwriting revenue. So it's the insurance margin that
22 we're getting on our -- on our premium plus investment
23 incomes coming from two (2) sources; first, policyholder
24 funds and, second, the capital.
25 So we need to quantify investment income

1 coming from these -- these two (2) sources. This is an
2 important aspect. And cash to be invested comes from
3 timing difference between collection of premiums.
4 Obviously, we collect the premium in the first year of
5 the -- on the year of the policy and -- but we pay the
6 claims longer -- in the longer term; three (3) or four
7 (4) years down the road.
8 So we provided in the submission a
9 detailed model, that I'm not presenting today, in the
10 matter of time constraint, but it's really what we need
11 to -- to take away here.
12 Slide number 16 is a -- it's a high-level
13 model, just to illustrate, with respect to the current
14 framework, what is all there. Meaning that currently,
15 under my -- my own reading, I saw that there is a profit
16 provision of five dollars ($5) which is used currently in
17 order that -- would translate into a target ROE.
18 I just -- I thought it was important for
19 us to present -- present the reconciliation under the
20 assumption we are proposing. First of all, using a 150
21 percent P&S, premium to surplus ratio, and also using an
22 investment rate return of 4 percent.
23 Unfortunately, there's a typo here in the
24 graph. I'll -- I'll explain to you just a bit later. So
25 --but premiums, out of the one dollar ($1) premiums that

1 you're getting, we need sixty-seven dollars ($67) of
2 capital for basic coverage.
3 So the target ROE, assuming we -- we want
4 5 percent profit provision, is 8 percent. So this would
5 be the REO sustaining a profit provision of -- of five
6 dollars ($5). And I'll continue.
7 So target profit prem -- after tax, it
8 means that we need to, out of the sixty-seven dollars
9 ($67) of capital we have, times -- it's not 18, it's 8
10 percent, so it's sixty-seven (67) times eight (8), makes
11 -- we need a profit net of tax of five dollars ($5).
12 If you translate that into pre-tax, so you
13 take five (5) divided by one (1) minus 33 percent, it's
14 eight dollars ($8). And within the eight dollars ($8) we
15 -- we're cap -- we're earning investment income on the
16 capital we have. So you take eight (8) minus the three
17 (3) -- that's the last before line -- so my eight (8)
18 minus three (3), you derive to the five (5).
19 So what we're trying to illustrate here is
20 that using a five dollar ($5) profit provision currently
21 provides a -- in my opinion, an inadequate target ROE of
22 8 percent, which barely -- barely -- accounts for our
23 cost of capital adjusted for the risk that we're getting.
24 So it's really -- it's barely making it. So we're not
25 generating any -- any earnings with respect to the risk

1 that we're exposed, as -- Craig just alluded before.
2 So I thought it was important for us in a
3 -- like, overall managers to highlight our view in terms
4 of the current profit provision that is used by the
5 Board.
6 Last topic, next two (2) slides. You also
7 have asked us to comment on the new financial reporting
8 standards that P&C insurers will be subject to very soon.
9 So the new economic standard, like thirty-eight fifty-
10 five (3855), it's simply to align us to the US standards.
11 And it's -- the goal is to recognize the fair value on
12 the balance sheet and ultimately in the income statement.
13 There are three (3) options offered to
14 insurers. First option, health to maturity, fair value
15 option, and available for sale. You have all the details
16 in the submission. There are three (3) options that each
17 insurer can -- can choose, if I may say.
18 So MMI's position, since we are here and,
19 as Chris said earlier, it's October 31st, so we were kind
20 of the first to come to the plate and had to do our
21 selection. So what we selected is an -- an hybrid model.
22 So we selected for our assets backing liabilities with
23 respect to our fiduciary role, so we selected a fair
24 value option versus the capital, which derives an
25 available for sale option.

1 Why have we done that? It's really --
2 simply is to focus on limiting earnings volatility.
3 Because if we would had -- had selected another option,
4 there would have been a lot of volatility because,
5 simply, all the variation in the interest rate in our --
6 in our portfolio would have gone into our -- our equity
7 versus all the variation for reserves. Because, as you
8 know, our claims have to be discounted with interest
9 rates which are prevailing in the market.
10 So there would have been a lot of
11 volatility, which we want to avoid, making sure that we
12 understand, you know, the ultimate results in order for
13 us to do better pricing on our products. So this is --
14 this was really the -- the reason why we selected this
15 hybrid model. And this was accepted by -- by OSFI.
16 And also the fact that we have a thorough
17 approach of duration matching will limit volatility,
18 because we match closely, as I said earlier, our assets
19 versus our liabilities. So, really, the focus is on
20 limiting the volatility.
21 With respect to industry, the selection by
22 other insurers will come on January 1st, 2007. I don't
23 know what our competitors will do, but it could generate
24 some volatility because, depending on what their choice
25 will be, but also we know for a fact that they're --

1 they're not as, probably, thorough as we are in terms of
2 managing the -- the duration of the portfolio. So they
3 manage more the interest -- interest risk that was
4 adjusted due to develop, before.
5 So this -- this, in my mind, is -- could
6 be a concern to -- to the Board in terms of expected
7 volatility for other insurers. But I think -- but with
8 respect to our selection, it -- there would be somewhat
9 of volatility but with a lesser extent. So this is --
10 MR. CHRIS DANIEL: Thank you.
11 MR. FRANCOIS FAUCHER: -- my report, Mr.
12 Daniel.
13 MR. CHRIS DANIEL: Thank you, Francois.
14 Rick...?
15 MR. RICK EVANS: Thank you, Francois and
16 Chris. As we've gone through this exercise we have sort
17 of drawn a few broad conclusions. And it's really more
18 of a step back from, you know, the ROE profit level
19 reconciliation question to, sort of raising -- raising
20 the question on -- another question on the following
21 premise.
22 And that is that stability, availability
23 and affordability of insurance, auto insurance in
24 Alberta, has -- has improved due -- due to the hard work
25 of many stakeholders in the process over the last few

1 years. So the question, I think, is: What remains to be
2 done? What can be done to make the -- to make the
3 marketplace better?
4 And the question and conclusion that we've
5 come to is, what can be done to foster competition and to
6 ensure that there is a dynamic and competitive
7 marketplace in Alberta? Because at the end of the day
8 that is what will help to keep the -- the move with
9 regards to stability and -- and affordability moving
10 forward. So our specific conclusions are really in
11 reference to the question of a -- a competitive and
12 dynamic marketplace.
13 So we -- we think that -- that the Board
14 should consider looking at the actual process and timing
15 of -- of rate adjustments, and maybe raise the question
16 of whether or not the annual review process creates what
17 I would call an artificial market constraint. And I
18 think that, from -- from our point of view, we think that
19 we and other players in the industry are sometimes
20 operating in the dark in terms of the uncertainty of what
21 can happen in the process.
22 You know, in all jurisdictions that we
23 operate in there's some kind of an approval process for
24 rates and -- and that's fine and -- and that's probably
25 good for public policy. But the once-a-year process does

1 keep us in the dark and it sort of doesn't allow the
2 market to be as dynamic as it could be.
3 And so if you look at other jurisdictions
4 where there -- where there are processes in place where
5 companies are continuing coming to rate boards during the
6 course of the year for rate approvals, there's a more
7 dynamic market mechanism, because at -- at the heart of
8 everything insurance companies are competitive. And
9 perhaps this actually slows things down in terms of when
10 costs are declining in the marketplace. Maybe -- maybe
11 rates aren't declining as fast as they might in -- in a
12 more open environment.
13 Secondly, we think that, as has been
14 argued earlier, that if ROE is a reference point, either
15 directly or indirectly, a wide range of ROE's should be
16 accepted because it's just a practical thing to do and it
17 results in the right kind of incentives, that Craig
18 mentioned earlier.
19 It -- it results in incentives for good
20 financial performance; that's good for shareholders and
21 that's good for market stability. And it's also good for
22 consumers because if there is an incentive to improve
23 performance in a competitive environment, not all of that
24 benefit is passed onto shareholders because it's in the
25 nature of competition that if there is a profitable

1 environment companies try to achieve higher market share.
2 Finally, I think that there's probably
3 more that could be done to foster competition in terms of
4 -- of helping consumers to understand what's available in
5 the marketplace. And in other jurisdictions, and -- and
6 I'll use FSCO as the example in Ontario, quite a bit of
7 work has been done in terms of providing consumer
8 information, downloadable brochures on -- on their
9 website. In fact, there's actually a tutorial for
10 consumers on auto insurance rates.
11 And the truth is, average premiums in any
12 jurisdiction can be lower if -- if consumers are educated
13 in terms of how to look after their own interest and --
14 and how to shop intelligently for insurance products.
15 So finally our recommendations are -- but
16 the regulations that have been introduced since 2003 have
17 been -- have been effective and perhaps there's more that
18 can be done in terms of improving competition. We think
19 that the best outcome for drivers are found where there's
20 a well balanced governance framework for the marketplace
21 that is combined with open competition that insures
22 availability and choice for consumers. And finally, if
23 an ROE assumption is used in conjunction with industry
24 rate adjustments, the current profit provision in our
25 opinion is -- is to low.

1 So that's -- that's it for -- for our
2 presentation and thank you for your attention. I think
3 we're pushing the edge in terms of time, Mr. Chairman.
4 THE CHAIRPERSON: I think we have some
5 questions at this end of the table.
6
7 QUESTIONS BY BOARD:
8 MR. LEWIS KLAR: I have some, probably
9 for Craig. I'm quite concerned about this volatility
10 issue and I just want to focus on that just for a second.
11 I assume the volatility launches from a
12 surplus -- is it -- does that include things like flood,
13 fire -- are we just talking about that chart? Is that
14 just automobile insurance that you're talking about?
15 MR. CRAIG ALEXANDER: I think it's the --
16 property management would be insurers as a whole so it's
17 not -- it's not just autos.
18 MR. LEWIS KLAR: So --
19 MR. CRAIG ALEXANDER: But I -- but I
20 suspect that the answer for autos is exactly -- is
21 exactly the same. I mean the -- that -- that the
22 conclusion would be, it doesn't actually matter what --
23 what part of the P&C business you're talking about, I
24 would expect you would see broad based volatility period.
25 MR. LEWIS KLAR: Right. Now explain to

1 me this, basic regulation on an annual basis can actually
2 -- can actually reduce volatility. Basically --
3 basically in every year the Board meets and it looks at
4 all the factors which go into pricing your premium
5 including claims, frequency, severity, return on
6 investment, expenses, et cetera, and appropriate profit.
7 And based on that actuarial assessment a
8 premium is set, so that your volatility shows -- like
9 some years it's 20 percent, some, you know, some years
10 it's 1 percent but over a long period of time it's 10.5
11 percent.
12 MR. CRAIG ALEXANDER: Hmm hmm.
13 MR. LEWIS KLAR: But if you do it on an
14 annual basis and you look at each factor on an annual
15 basis and are able to adjust it on an annual basis,
16 shouldn't that, in theory, reduce the swings?
17 In other words isn't the reason for this
18 volatility an unregulated market, that is a situation
19 they're not able to adjust or -- or they only know
20 several years later? But -- so -- so that's important to
21 me to understand whether or not this whole process --
22 MR. CRAIG ALEXANDER: The answer -- the
23 answer is, if you get absolutely everything right, if you
24 make an accurate prediction for all of the different
25 components, you can absolutely create a reduction in

1 volatility.
2 MR. LEWIS KLAR: Okay. Now where --
3 MR. CRAIG ALEXANDER: But -- but the
4 point would be that you have imperfect information,
5 you're going to have to make assumptions about what's
6 going to happen in the future. And while I have a lot of
7 confidence in, you know, my -- my economic forecast, I
8 also recognizes the fact that -- that the crystal ball
9 often gets cloud -- cloudy and cracked.
10 MR. LEWIS KLAR: Right. But we're not
11 doing anything different than insurance companies are
12 doing. They're also predicting.
13 MR. CRAIG ALEXANDER: Absolutely.
14 MR. LEWIS KLAR: Okay. So our
15 assessment, it's not as if we're dealing in a world of
16 uncertainty and the insurance companies are dealing in a
17 world of certainty, we're all dealing with the same
18 information and same predictions.
19 MR. CRAIG ALEXANDER: Absolutely.
20 MR. LEWIS KLAR: So --
21 MR. CRAIG ALEXANDER: All -- all I was
22 trying to raise was just the risk. I'm not saying that
23 it -- it will happen. I'm not saying -- and as you -- as
24 you pointed out quite legitimately, the issue is if you
25 let the market behave the way the market will behave,

1 right, if you didn't have any market interference you
2 would end up with a volatile outcome anyway, because
3 you're going to end up having, you know, claim cycles and
4 you're going to have investment cycles.
5 MR. LEWIS KLAR: Well yes, the proof that
6 is your chart.
7 MR. CRAIG ALEXANDER: Right. You're
8 going to -- well keep in mind that a large, you know,
9 there -- there are -- there's a number of -- you know, a
10 large number of jurisdictions have had regulation in --
11 in that environment, so you might be able to credit some
12 of the volatility; I would argue probably a very small
13 part. Like I mean, I'm not even sure -- you -- there's
14 no way you would ever be able to say that because of
15 regulation we've had this impact.
16 But you'll never actually be able to -- to
17 assess 'X' post --
18 MR. LEWIS KLAR: Right.
19 MR. CRAIG ALEXANDER: -- you know,
20 whether you've -- you've actually increased or decreased
21 the volatility per se.
22 But all I'm saying is that it works on
23 both sides. You -- you could, you know, if you get
24 everything right, you could lower the volatility in the
25 industry. If you get it wrong you could actually end up

1 adding to the volatility in the industry.
2 MR. LEWIS KLAR: Well, my point -- my
3 point is no one's ever going to get it right
4 MR. CRAIG ALEXANDER: Yeah.
5 MR. LEWIS KLAR: And by -- but -- but
6 whether we're going wrong or how wrong we're going,
7 should be evident every year. I mean, we've only been in
8 operation two (2) years but after a period of five (5)
9 years, six (6) years and -- you know, I've been hearing
10 about this sort of that these ROE's now are because of
11 five (5) years ago and so on and so forth, and we don't
12 know what's going to happen five (5) years from now.
13 But the longer regulation stays in effect,
14 you do -- you do start -- the chickens do, you know,
15 start coming home to roost and you do -- do start seeing
16 the results of previous decisions. And -- and any errors
17 and there will be errors because everyone will make them
18 can --
19 MR. CRAIG ALEXANDER: Hmm hmm.
20 MR. LEWIS KLAR: -- be corrected
21 sensitively and annually as opposed to waiting to see --
22 waiting for these crises. Is that not true?
23 MR. CRAIG ALEXANDER: The -- the more --
24 the longer you do it, I would assume the better you get
25 at it.

1 MR. LEWIS KLAR: Correct.
2 MR. CRAIG ALEXANDER: So, you know, I
3 agree with that. I also suspect that the -- the members
4 of the Board though will have a bit of turnover over
5 time, and so to some extent the people that are
6 influencing the decisions, like won't have the same --
7 you know, it isn't the ten (10) years from you that
8 you're going to have the -- the knowledge of the -- of
9 the same people here. I mean I could be wrong, but I'm
10 assuming that there will be some sort of turnover.
11 I -- I hear your point and I absolutely
12 agree that if you actually get everything right, no
13 question about it, you could reduce the volatility in the
14 marketplace.
15 All I'm saying is that there's a chance
16 that with all the information that you have, with the
17 absolute best intentions, with -- with, you know, as much
18 information and with the best judgment you have and all
19 the skills at your disposal, there's still a -- you know
20 a chance that -- that you get it wrong. And when you get
21 it wrong you could actually add to the volatility.
22 And you're absolutely right, the market
23 will do this as well and every business goes through this
24 process, right? TD Bank Financial Group puts together a
25 corporate plan, you know. Twelve (12) months later we

1 find out what our results are and then we have to go back
2 and defend, you know, did we get -- were we on plan, were
3 we above plan, were we below plan, right?
4 I -- and again, I don't have any issue
5 about the idea of -- of trying to defend public interest
6 and trying to have accessible affordable auto insurance.
7 I mean, again, as a public policy oriented economist, I
8 can absolutely appreciate the goal, right? All I'm
9 trying to make you aware of is the risks.
10 And what I would suggest is that I don't
11 think that after one (1) -- one (1) more year you
12 actually have enough information necessarily. Like when
13 -- when you said that may -- probably -- I agree with
14 absolutely everything you said up until the point when
15 you said, you know, like one (1) year later we'll know
16 whether we made the right or the wrong decision.
17 And quite frankly, I'm not convinced that
18 you do. I think you -- you only know many years after
19 the fact whether you actually made the right or wrong
20 decision.
21 MR. LEWIS KLAR: I didn't -- I didn't
22 mean to say one (1) year --
23 MR. CRAIG ALEXANDER: Yeah.
24 MR. LEWIS KLAR: -- for the previous
25 year. But we'll know -- as we go along, we'll know where

1 we're going.
2 MR. CRAIG ALEXANDER: Sure, sure.
3 THE CHAIRPERSON: Dennis, you had a
4 question.
5 MR. DENNIS GARTNER: To followup to that
6 for -- for Craig as well.
7 Craig, I'd like your comments on a few
8 points that I'd like to make and you can tell me if this
9 is a pipe dream or whether they actually make some sense.
10 I'm -- I'm an observer of the industry as
11 well. I've not made my -- my living as a part of this
12 industry. I've been in it -- been it for about five (5)
13 years now trying to regulate it, but I certainly am not a
14 technical expert in any sense of the word.
15 There have been some changes though that
16 I've observed that may make some significant differences
17 to that insurance cycle.
18 MR. CRAIG ALEXANDER: Hmm hmm.
19 MR. DENNIS GARTNER: Number 1, is the
20 reform to general damages that essentially has occurred
21 across count -- across the country. That was a big part
22 of the claims costs.
23 MR. CRAIG ALEXANDER: Hmm hmm.
24 MR. DENNIS GARTNER: And my observations
25 were that that was the most difficult part to really

1 predict. It's a lot easier to predict the costs that an
2 insurance company are going to pay in this province
3 anyway for death. We know that there's going to be about
4 four hundred (400) of them and we know how much each one
5 costs. We know how many serious catastrophic injuries
6 the insurance industry's going to have to deal with; that
7 -- that's fairly predictable.
8 But the big unpredictable costs were these
9 minor injuries that just, one after the other, after the
10 other, after the other, and some cost a lot and some
11 didn't cost that much and it just was almost the luck of
12 the draw.
13 MR. CRAIG ALEXANDER: Hmm hmm.
14 MR. DENNIS GARTNER: So I thought well we
15 have some predictability there that we didn't have
16 before.
17 MR. CRAIG ALEXANDER: Hmm hmm.
18 MR. DENNIS GARTNER: I think we have some
19 predictability at least in this province on -- on health
20 costs that we didn't have before, because of the minor
21 injury standards or protocols that we put in and -- and
22 caps on -- on fees, regulation of -- of healthcare
23 providers, et cetera. That -- that just wasn't there
24 before.
25 And so Section B, over time, I think will

1 become more predictable. The outcomes will become more
2 predictable.
3 We made a variety of changes to the
4 product in the hope that there would be more stability
5 and predictability. So --
6 MR. CRAIG ALEXANDER: Hmm hmm.
7 MR. DENNIS GARTNER: -- so that's one (1)
8 I think factor that -- that wasn't there five (5) years
9 ago.
10 Secondly, there has been a lot of
11 sophistication in -- in the industry, in my view.
12 They're not -- ROE, right now, is high. Profits are --
13 are good.
14 MR. CRAIG ALEXANDER: Hmm hmm.
15 MR. DENNIS GARTNER: And industry is not
16 beating each others brains out to go after -- after
17 premium dollar. They're being much more judicial than
18 they have been in the past. Underwriting profit
19 standards -- underwriting standards I think seem to be
20 more important than -- than they have been in the past.
21 MR. CRAIG ALEXANDER: Hmm hmm.
22 MR. DENNIS GARTNER: Industry is
23 disciplined. Concentration in the industry, at least in
24 auto in this province, has been significant. Right now
25 we have the four (4) largest companies writing about 50

1 percent of the auto product in this province; that --
2 that didn't exist before.
3 Those large companies writing these large
4 volumes are sophisticated companies. They're looking at
5 -- at long term. They're not the creamers who come in
6 and say well we'll make a million bucks this year and
7 take off as soon as that cycle goes down.
8 The challenge that -- that you spoke about
9 with respect to the minor injury regulation and that
10 significant reduction and volatility, and the -- and --
11 and the -- full of volume or total amount of -- of claims
12 costs that came through -- through that minor injury
13 regulation, yes, there's a challenge to it. But I don't
14 think this province or any other province really has any
15 intention of going to the bad old days if we lose that
16 challenge.
17 I think the -- the Government's cross is
18 planned, but not only in Alberta. Appreciate the
19 stability that we have now. As -- as you said, Rick, the
20 reforms seem to be producing the objectives that we had.
21 And -- and there will be other ways of bringing or
22 maintaining the stability in this market if -- if that
23 one turns out to be unconstitutional.
24 So I thought -- I thought there has been
25 some -- some -- maybe it's a pipe dream, but I'm hoping

1 there's major structural changes here that are -- that
2 are going to make things a lot more predictable than they
3 have been in the past.
4 MR. CRAIG ALEXANDER: You -- you made me
5 a lot of good points, and I think that one (1) of the
6 things that will be interesting to observe as we go
7 forward is whether we actually see a decline -- like, a
8 structural decline in the amount of volatility that --
9 that's present in the marketplace.
10 When you -- when you look at the -- the
11 actual data, it -- it does suggest that maybe over the
12 last fifteen (15) years there has been a small reduction
13 in -- in the standard deviation, but not a dramatic one.
14 So it may be that you're absolutely right
15 that as we go forward it could be that because the
16 industry's getting better at predicting future claims and
17 better able of managing the risks that, you know, the ROE
18 does come down. And -- and that's why when I said in the
19 -- in the presentation that the -- the concept of a -- of
20 an industry equilibrium ROE isn't constant, right?
21 There can be structural changes. And the
22 structural changes can come on both sides. Like, it
23 could be that the industry gets better about managing the
24 risk. It also could be the case that because of climate
25 change and more erratic weather systems and, you know,

1 more ice, hail storms, that you end up with, you know,
2 things that you can't forecast.
3 But I mean, like -- like all I'm saying is
4 the distribution of -- like it could be that the ROE does
5 -- it could be that the -- the risk that the industry is
6 facing diminishes to the extent that the equilibrium ROE
7 drops.
8 The problem is we don't actually as I
9 start -- as I said, we don't even know what the risk
10 premium should be. So we don't actually even know where
11 the equilibrium should be. So if it goes down by a
12 percentage point, we don't where, you know, it -- what
13 it's gone down to because we don't actually know where
14 the original starting point was.
15 MR. DENNIS GARTNER : Maybe ask Rick to
16 add to that.
17 MR. RICK EVANS: Yeah. My -- my only
18 additional observation is I think that there actually has
19 been great work done with the reforms and that -- that
20 they have been largely effective.
21 But one (1) observation that I would have
22 is that when you look at the market cycles and the
23 volatility of the market cycles, it usually is a reform
24 like, or change to the product, or other -- some other
25 kind of legal or regulatory change at the lower part of

1 the cycle that actually helps the industry to -- to
2 rebound.
3 So from the point of view of where we're
4 sitting today, I think that much has been done to -- to
5 limit the volatility. But if history teaches us
6 anything, it -- it often times returns and one of the
7 drivers usually is -- is bodily injury claims.
8 So I think -- I think the -- there's good
9 news in the work that's been done but having been in the
10 industry for almost thirty (30) years, I -- I've seen
11 volatility re -- reappear from time to time.
12 MR. DENNIS GARTNER: Well that's right,
13 Rick, but I --
14 MR. RICK EVANS: Yeah.
15 MR. DENNIS GARTNER: -- the point I'm
16 making is we have a -- tool now which -- which limits
17 bodily injury claims to a certain degree and --
18 MR. RICK EVANS: Yeah.
19 MR. DENNIS GARTNER: -- we know that's
20 under challenge. But I think it's not only the industry
21 that recognizes that that part of the claim dollar needs
22 to be both predictable and stable.
23 And so we're -- we're watching and
24 thinking of alternatives too.
25 MR. RICK EVANS: Yeah.

1 MR. DENNIS GARTNER: And so -- so maybe
2 you'll -- maybe we'll be able to maintain that stability
3 whereas before nobody seemed to really be paying any
4 attention to it.
5 MR. RICK EVANS: Right.
6 MR. CRAIG ALEXANDER: It also -- it also
7 could be that the shock or something comes from a
8 completely unanticipated area --
9 MR. DENNIS GARTNER: Absolutely.
10 MR. CRAIG ALEXANDER: -- right? Like I
11 mean one of the things that I've been just completely
12 amazed by is -- I mean we spend a lot of time looking at
13 the Albertan economy and you look at the rapid movement
14 of people coming into the -- the rapid movement of people
15 coming into the province; you see the dramatic, you know,
16 changes in the -- in the housing sector; you see the
17 urbanization that's going on.
18 Now, you look at Calgary and I'm just
19 amazed by -- you go back in August and there was only six
20 (6) unsold condos in all of Calgary and then in July
21 there was only six (6) unsold condos and in June there
22 was only six (6) unsold condos. And I suspect it's the
23 same six (6) units, right?
24 And so what's happening is you're going to
25 end up with an increased density of population. Your --

1 your urban centres are going to expand. I think you're
2 going to get a lot more density of growing up through the
3 Edmonton/Calgary corridor.
4 I think, you know, Alberta's going to
5 continue to grow at an extraordinarily rapid pace and so
6 you're going to end up with, you know, for the auto
7 service -- insurance industry I think you're going to see
8 extraordinarily strong demands for products -- growth and
9 product -- for a demand for products and services.
10 And so, you know, we -- we don't know --
11 you know -- that's going to create it's own set of
12 strains. It's just different sorts of risks.
13 MR. CHRIS DANIEL: And while we -- you
14 know, we agree and we think the growth is fabulous, very
15 positive for -- for someone like ourselves, it also
16 presents a lot of constraints, staffing for instance.
17 We're going through a tremendous challenge in retaining
18 and hiring new staff. And what does that end up doing,
19 it ends up costing us a lot more money.
20 And in fact, this year alone we -- we did
21 a midterm adjustment and we're going to do another
22 midterm adjustment in January, just in order to keep our
23 staff. And that represents 5 percent, which is huge,
24 just to keep our staff.
25 So we know that while there's great

1 opportunities, there's also great challenges on the other
2 side too. And you look at the administrative costs, look
3 at just space alone and what's happened in Calgary. You
4 know, from the twenty-five dollar ($25) to a forty dollar
5 ($40) square foot. You look at all of these factors that
6 factor into our expenses. So just to -- while we're very
7 positive on that -- sorry, go ahead.
8 THE CHAIRPERSON: Ted...?
9 MR. TED ZUBULAKE: In your written
10 submission as respect to issue number 1, you had two (2)
11 recommendations. One is that there should not be a
12 profit provision or ROE reference point in ratemaking and
13 secondly, if the Board sets a target ROE, it should be a
14 range rather than a fixed number. But as you know, the
15 Board's mandate is to annually set an industry-wide rate
16 adjustment; a -- a single number.
17 How does the idea of a range of ROE's fit
18 into that mandate? How can -- how can the Board work
19 with a range of ROE's if it has to select a single
20 industry-wide rate adjustment? Doesn't it not need a
21 single reference point for that ratemaking process?
22 MR. RICK EVANS: Yeah, I think that's --
23 that is a real issue and a real problem. And our
24 recommendation would be that the Board seek to have the
25 mandate amended so that -- so that a range could be --

1 could be appropriate.
2 MR. TED ZUBULAKE: What -- what about the
3 idea of a -- a single reference point but perhaps working
4 with a range in terms of reviewing Section 6 filings?
5 MR. RICK EVANS: I'm not sure that I can
6 answer that question.
7 MR. TED ZUBULAKE: Yeah, the Section 6
8 filings would be filings made by companies that want an
9 exemption or waiver from the industry-wide adjustment,
10 basically.
11 MR. RICK EVANS: Yeah.
12 MR. CHRIS DANIEL: It still creates an
13 uncertainty when actuaries are forecasting.
14 MR. TED ZUBULAKE: No, but -- okay. But
15 we have a -- we have a system in place here, I -- I don't
16 think the mandate's going to be changed soon. Can you
17 provide any other assistance or recommendation to the
18 Board as how to work within the current framework with
19 respect to the profit margin?
20 MR. CHRIS ALEXANDER: I said if we don't
21 -- I want my colleagues to correct me if I'm wrong, but I
22 think the simple answer is, I think you -- you probably
23 do need to think when you're setting the premium, what --
24 what you expect the outcome will be in terms of the
25 impact on ROE.

1 Just don't be surprised when the industry
2 ROE is dramatically different than what you're assumption
3 was.
4 MR. TED ZUBULAKE: That's not the issue.
5 The issue is we need -- we need to select an ROE. The
6 Board needs to select an ROE, a reference point if you
7 will, to include in the -- the analysis in order to
8 arrive at a -- a great change, an industry-wide
9 adjustment. The Board needs a single number. Whatever
10 happen -- you're right --
11 MR. RICK EVANS: Yeah.
12 MR. TED ZUBULAKE: -- the actual outcome
13 maybe -- will likely be different than what it goes in --
14 what the expectation is, but nevertheless it needs an
15 expectation.
16 MR. RICK EVANS: But, my suggestion would
17 be in the absolute absence of being able to have the --
18 the mandate adjusted, that if a number has to be selected
19 it should be selected at the high end of the theoretical
20 range and then let the marketplace compete within that
21 boundary.
22 MR. TED ZUBULAKE: And one (1) last
23 question. We -- we saw from the -- the chart that over
24 the last twenty (20) or thirty (30) years the -- the
25 average ROE for the industry, P&C, was about 10/10 1/2

1 percent.
2 Why is that not an appropriate reference
3 point to use for the industry-wide adjustment?
4 MR. RICK EVANS: I think the problem is
5 that if that is used as a reference point, then what
6 happens over time with those years when the industry is
7 not able to achieve that -- that target number? I mean,
8 in the dynamic marketplace over time, there are good
9 years and there are -- and there are bad years. And so
10 the -- the -- there needs to be some long term prospect
11 for consistent ROE's.
12 MR. TED ZUBULAKE: But the point is, the
13 long term average has been about, let's call it 10
14 percent --
15 MR. RICK EVANS: Yeah.
16 MR. TED ZUBULAKE: -- we -- the Board
17 knows fully well that every year it's not going to come
18 out exactly at 10 percent, but why not then use that long
19 term average as the average profit margin or return on
20 equity for the --
21 MR. FRANCOIS FAUCHER: My -- my view on
22 that is that we're looking three (3) years, like,
23 backwards. I think we need to look ahead.
24 MR. TED ZUBULAKE: Right.
25 MR. FRANCOIS FAUCHER: I think the

1 condition -- the current sophistication of all the
2 modelling and the capital location is quite different.
3 We are better -- better organized at -- certainly at
4 Meloche, at the Bank, and also competitors.
5 So really now the -- the appetite and
6 investors are -- are different. We have a better way of
7 -- even though there are uncertainties in evaluating the
8 risk and so forth, then that generates the fact that if
9 one say that, for P&C insurer the risk is higher, so we
10 need to look ahead naturally because it was thirty (30) -
11 - thirty (30) years ago it was like 10 percent.
12 MR. TED ZUBULAKE: Okay. Yeah, I see.
13 MR. FRANCOIS FAUCHER: Moving ahead it's
14 quite different. And we see capital going out of North
15 America, going to Europe and Asia and so forth and I
16 think that we need to -- we're not battling capital in
17 terms of -- only in North America we're --
18 MR. TED ZUBULAKE: So this -- so this is
19 my -- so -- so this is something -- 10 percent may have
20 been okay in the past. Now things --
21 MR. FRANCOIS FAUCHER: Yeah.
22 MR. TED ZUBULAKE: -- have changed and
23 investors' appetites have changed. 10 percent is no
24 longer --
25 MR. FRANCOIS FAUCHER: yeah. There are

1 better means to evaluate their risk and we see -- we
2 strongly believe that P&C, the 10 percent isn't -- is not
3 sufficient because of the volatility and I think we said
4 since -- since the beginning.
5 MR. TED ZUBULAKE: Okay.
6 MR. RICK EVANS: And in addition, the
7 question has to be raised whether or not that historical
8 10 percent return would have been achieved had there been
9 a 10 percent reference point over time.
10 THE CHAIRPERSON: Chris, thank you very
11 much --
12 MR. CHRIS DANIEL: Thank you.
13 THE CHAIRPERSON: -- for your
14 presentation. And we agree with you, we have a lot of
15 work ahead of us and we'll take it under serious
16 consideration with the others and we'll do our best.
17 MR. CHRIS DANIEL: Thank you very much.
18 MR. FRANCOIS FAUCHER: Thank you.
19 THE CHAIRPERSON: Five (5) minutes. Five
20 minutes.
21
22 --- Upon recessing at 10:21 a.m.
23 --- Upon resuming at 10:28 a.m.
24
25 THE CHAIRPERSON: All right, we'll

1 proceed. I'll let you go ahead and introduce your staff
2 or your people.
3
4 PRESENTATION BY ROYAL SUNALLIANCE:
5 MR. SHAWN DESANTIS: Thank you for giving
6 this opportunity to share our thoughts with you. My --
7 my name is Shawn Desantis, I'm Vice-President of Personal
8 Insurance at Royal SunAlliance.
9 And today over the next thirty (30)
10 minutes we'll be representing Royal SunAlliance plus the
11 sister company of ours, Unifund, that operates in the
12 Province of Alberta.
13 I'd like to introduce the people that will
14 be joining me. To my right is Saskia Matheson. She'll
15 be our technical product person and she works at Royal
16 SunAlliance.
17 And then we've invited two (2) external
18 individuals from the Bank of Montreal to join us. And
19 these two (2) individuals will speak from an independent
20 perspective their thoughts on what other industries are
21 looking at from a return of equity.
22 At this point in time in the Canadian mar
23 -- or in the Alberta marketplace Royal SunAlliance and
24 our sister company repre -- is around the number 5th to
25 the 6th largest automobile insurance writer. So we have

1 a lot invested in the Province and we have a strong
2 desire to -- to influence in a positive fashion, the
3 direction the committee takes.
4 I'm going to start the presentation and
5 give you an overview of our business in Canada and the
6 global market and particularly how it rates -- impacts,
7 capital allocation and therefore leads into the required
8 return on equity.
9 Saskia, is then going to speak
10 specifically on the Return on Equity and how it impacts
11 pricing. And then as I mentioned, the Bank of Montreal
12 executives are going to talk to, specifically, other
13 industries and their thoughts on a predictable ROE for
14 the Alberta marketplace.
15 As one of the largest insurance companies
16 in the Canadian marketplace, and we look how we've
17 expanded over the last number of years, we have grown
18 dramatically in the Province of Alberta.
19 Our sister company, Unifund, has done a
20 number of acquisitions in the Province of Alberta to
21 allow us to move to a significant player in this Alberta
22 marketplace.
23 We have over three hundred (300) people
24 employed in the Province of Alberta and that's growing
25 everyday. This is a very strong market for us, an

1 important market for us.
2 As we talk about profit levels you will
3 get a sense that we have a very strong view on ensuring
4 that we create a very healthy industry here, a stable
5 industry and a good industry for the customers and the
6 citizens of Alberta.
7 The graph on the slide and you've seen
8 this probably in a number of different slides over the
9 last number of days, speaks to the volatility in our
10 industry. And it is important to recognize that, as we
11 go about deciding what the profit level should be, where
12 the historic volatility has been, and where the future
13 volatility is going.
14 In this province we've had product reform.
15 And Dennis made some good points. There's some very
16 positive aspects to the product reform and there's also
17 some challenges with the product reform.
18 We have an all-comers rule that we
19 introduced. We have a risk sharing pool that we
20 introduced. And we need to manage those two aspects of
21 the product reform, because as we look forward we see
22 those two aspects impacting volatility of the Alberta
23 results.
24 If you look at a national perspective, and
25 this is a national perspective you're seeing. Five (5)

1 out of the last seven (7) years our ROE has been under 10
2 percent as an industry. And you can see where Royal's is
3 in there as well.
4 This under 10 percent, if it continues or
5 if it -- at that point in time it definitely impacted to
6 capital in the marketplace and we saw it in Alberta where
7 it was difficult for individuals to buy insurance. Now
8 when we look at the ROE, over the last couple of years in
9 the industry, it is strong and it's a very stable
10 marketplace.
11 The industry is more sophisticated. The
12 industry is working hard to be disciplined and allowing
13 companies to manage their portfolios to reduce the
14 volatility will be important.
15 You know, the question was asked about the
16 volatility and -- and can we do something to prevent it,
17 perhaps on an annual basis. I will assure you that in
18 our organization, we have executives and numbers of
19 actuaries, people in our product department, looking at
20 volatility on a monthly basis, and we work hard to find a
21 way to manage that volatility. Volatility is impacted
22 both by market dynamics, regulatory boards, and action in
23 maintaining what's right for the consumer.
24 So volatility is the biggest challenge our
25 industry faces. And I also make the comment, as we study

1 back on actions that have been taken in historically,
2 there have been other boards and other industry groups
3 that have changed product and over a period of time there
4 continues to be a weakening in that product which results
5 in readjustments.
6 So managing volatility is the biggest
7 challenge our industry faces and I would suggest that the
8 volatility in our industry, although is in a better
9 position, we shouldn't expect that the insurance cycle
10 will stop or cease in the years going forward.
11 We are a global company and we operate in
12 -- in twenty-seven (27) countries across the globe. Our
13 capital therefore is looked at from a global perspective.
14 We use a very sophisticated capitalling model, that
15 Saskia will share with you some of the information on
16 that.
17 So in the Alberta marketplace, as we
18 invest here and the money and the capital that we invest
19 here, it's judged globally. And so as we decide today
20 what the -- what appropriate return on equity is, I
21 encourage the Board to keep in mind that the capital here
22 is competing for capital not only in Canada but across
23 the globe.
24 And as we continue to invest in this
25 province, we have a lot at stake to ensuring we're

1 getting the appropriate returns. Our company trades in
2 the London Stock Exchange and it has a demand of
3 shareholders.
4 And as we all know shareholders have a
5 number of different options to put their capital in
6 place. And therefore when we look at the type of returns
7 that we need to get, we look at a number of comparable
8 companies -- industries, to ensure that we're getting
9 appropriate level of shareholder support.
10 If you kind of look at it from a capital
11 management perspective -- and just to put it into a
12 global context, our -- our capital competes from a global
13 perspective and a global market. So for us as a company
14 to get capital to support our business we need to ensure
15 that we're producing the appropriate returns from a
16 global perspective.
17 It then goes to the next step, with our
18 shareholders; so individuals that are buying our shares.
19 And they require certain ROE expectation. And so then it
20 goes into the Canadian marketplace and those two (2)
21 issues drive the type of returns that we need to get for
22 our business in Canada.
23 And to break it down even further, from
24 the Canadian marketplace it then falls into the Alberta
25 marketplace. And we look at -- we allocate capital

1 across Canada and compared to other jurisdictions, be it
2 Ontario, be it Quebec or be it New Brunswick, which one
3 allows us to drive the proper return on equity we need to
4 meet our shareholders' expectations.
5 We feel comfortable with our investment in
6 Alberta. We feel that over the last number of years that
7 Alberta has served us well and we believe that it'll
8 continue to serve us well.
9 Our goal is to suggest -- to recommend an
10 ROE that allows a healthy competitive environment and
11 that it allows fair returns for companies, and probably
12 the most important things, it's fair pricing for
13 Albertans.
14 You will see throughout our presentation
15 our recommendation for an ROE is somewhere between 12 and
16 14 percent. And this is clearly based on global markets,
17 what our shareholders feel is -- is worth having the
18 capital in the Alberta marketplace, and also what we
19 believe will drive fair pricing for Alberta consumers.
20 Saskia...?
21 MS. SASKIA MATHESON: Thanks. This
22 rather -- this rather busy slide is an illustration of
23 the methodology that's used within Royal SunAlliance
24 worldwide on an allocation of capital.
25 And not to go through the details, but to

1 make I guess the illustration that with more modern
2 capital modelling within companies each one of the
3 jurisdictions in which we operate, now almost operates
4 like a small capital market itself.
5 So when I say I want to expand in Alberta,
6 offer new products, bring in new pricing, whatever the
7 case may be, I'm actually having to go back to the model
8 and say, is this a better investment of Royal's money
9 than expansion of -- in the Chilean market for some other
10 line.
11 And so this model which has -- an
12 actuarial team in the UK's been working on for a number
13 of years, keeps me honest in my approach of where the
14 best investments are of the Company's capital and of its
15 resources over time.
16 So whereas I think we've -- we've seen the
17 point, and certainly earlier in the day, of individuals
18 saying, we're more sophisticated than we used to be.
19 We're actually, at Royal SunAlliance, am living through
20 the consequences of that sophistication very much, on at
21 least in annual and often quarterly basis in terms of
22 making plans for where we're going to grow or expand or
23 put it on the back burner for now, because we're not
24 getting the kind of results that we can get somewhere
25 else.

1 When we go from that model and I -- in our
2 submission, we gave to you in response to the Board's
3 question about a request for calculation techniques to --
4 to turn ROE into a profit provision within rate. And we
5 shared with you a formula from our actuarial department
6 which is how they then take these targets and build them
7 into pricing. And I'm sure that Mr. Zubulake can tell
8 you that he probably has formulas similar or somewhat the
9 same that he himself uses.
10 The point today is not to talk about that
11 formula and the details of that formula. I'm not an
12 actuary and I'm not in a position to be able to comment
13 on the specific choices of sub variables.
14 But I live with the consequences of that
15 formula because if you take a look at how it breaks down
16 into real everyday language, which is the way I have to
17 deal with that formula, there are portions of our return
18 on equity that come out of the investment of these
19 capital on the side; there are tax implications.
20 But in terms of setting the price, we're
21 talking about that first big bucket on -- on this slide
22 which is the return from insurance operations. So I
23 can't control the tax environment, I can't control that
24 piece of it, but I look at the pricing.
25 So I'm looking at what am I getting out of

1 insurance operations in order to achieve that target
2 return on equity that is -- that is set or that is -- is
3 the goal to start with.
4 And I'd just like to make -- not on the
5 formula but on some principles behind the use of the
6 formula that we feel are very critical in the job of
7 setting or the -- the rate level or the target rate level
8 and profit provision within the industry, that in
9 ratemaking, and we say this often and -- and the con --
10 what it actually means is sometimes different, it's a
11 perspective exercise.
12 So when we look at the rating for this for
13 -- for policies in 2006, we are actually looking at not
14 only the claims that will occur on those policies going
15 forward, but taking that premium money and investing it.
16 It's the premium money coming in in 2006 that we're
17 looking at investing.
18 We do hold investments of premium income
19 that came in, in 2004 or 2000, and -- and -- but the
20 investment on that income is attributed to the ratemaking
21 for the individuals who bought policies in those years.
22 And so when we look at what is the
23 appropriate yield rate, what bonds should we look at, and
24 I know these items have been at discussion at previous
25 Board hearings, we don't look at, and we would recommend

1 the Board not look at, what the historical return on the
2 investment portion of this equation has been, but on what
3 a company will receive by prudent investment of this
4 year's policyholders' money going forward, because that
5 should always be collapsed back into this year's premium.
6 If we blew it last year or the year before
7 and that investment didn't happen or losses accrued that
8 we were not anticipating, when we make the rates, and we
9 recommend this approach for the Board as well, we don't
10 try and balance those losses or those profits in this
11 year. We do each year independently.
12 And that's a critical aspect of turning
13 that target return on equity into a rate level that is
14 right and fair for the individuals purchasing and the
15 companies doing business in that timeframe.
16 The last item, and again on turning that
17 Return on Equity into a pricing provision within the
18 rates is to remember that we are talking about Alberta
19 automobile rates, personal automobile rates. It would be
20 inappropriate to look at investment portfolios of general
21 insurance companies but keep a mix of policies or a mix
22 of business across both personal and commercial.
23 As we mentioned, a bit part of the formula
24 of determining -- turning that ROE into a target loss
25 ratio that we price to, is to say how long will we have

1 that policyholder money available, how will it be
2 invested?
3 If I'm running a commercial general
4 liability operation, I've got that money in investments
5 for a much longer period of time because it's going to
6 take much longer for those claims to come to fruition or
7 to be dealt with.
8 In the personal automobile, we have a set
9 framework of time, that we know pretty much the majority
10 of claims are -- are going to be paid, how long do we
11 need to hang onto that money. And therefore when we talk
12 about the bond yield or what period of time we should
13 look at the bond yield, it's in reference to when will we
14 need the money to pay the claims of the individuals whose
15 premium dollars we're hanging onto for that very reason.
16 And that again is a very -- we would urge
17 the Board to, on that level, make sure that it's each
18 year independently that we're looking at investments on
19 that premium dollar that is specific to personal
20 automobile and that is conservative in its approach,
21 because that money needs to be liquid and it needs to be
22 available to pay the claims of those individuals who have
23 -- who have claims during that time.
24 If a company balances its portfolio in a
25 different way, they're doing it from money available from

1 other lines of business.
2 And on that note I don't want to take up
3 longer of our time, I'd like to turn over the floor to
4 our colleagues from the Bank of Montreal.
5 MR. BRAD HARDIE: Thank you, Saskia. Mr.
6 Chairman, I do have hard copies of our PowerPoint
7 presentation. Should I hand those out?
8 THE CHAIRPERSON: If it's easier to
9 follow.
10 MR. BRAD HARDIE: There's about ten (10)
11 copies there. There's enough for the people we have.
12
13 (BRIEF PAUSE)
14
15
16 THE CHAIRPERSON: Thank you. It's see
17 Bank of Montreal. We've had other banks --
18 MR. BRAD HARDIE: Appreciate the equal
19 air time, Mr. Chairman.
20 Mr. Chairman and members of the Panel,
21 good morning and I thank you for the opportunity to
22 present to you today. I know it's in the package, but
23 briefly, my name is Brad Hardie. I've working in the
24 financial services industry for twenty (20) years in
25 various capacities including fifteen (15) years in the

1 investment banking industry.
2 I have a Bachelor of Commerce degree from
3 the University of Toronto and I'm also a chartered
4 accountant, and I'm currently a managing director and
5 head of our financial institution's investment banking
6 group at BMO Capital Markets which is a member of the BMO
7 Financial Group.
8 And with me today is Tom Little. He is
9 the Director in the financial institutions group --
10 investment banking group of BMO Capital Markets. He has
11 working in the investment banking industry for seven (7)
12 years; previously practised as a litigation lawyer in a
13 major Canadian law firm. He has a Bachelor of Arts
14 degree, a Bachelor of Laws degree, an MBA from the
15 University of Western Ontario.
16 Just very briefly to, in terms of BMO
17 Capital Markets, we are an investment bank. I'm sure
18 most of the Panel is familiar with investment banking --
19 banks do. But just to emphasize, we're involved in all
20 facets of the capital markets. The services we provide
21 can be broken down briefly into two areas.
22 One being capital raising and all forms of
23 capital, both equity, debt and corporate lending. The
24 other large service we provide is advice to corporations
25 and governments, principally in and around buying and

1 selling companies which is known as mergers and
2 acquisitions.
3 But it's important to note that both these
4 services typically involve assessing and quantifying cost
5 of capital or return on equity for our clients with
6 respect to the services we provide.
7 So if we just go to -- we are on Slide 1.
8 In terms of our remarks today we're speaking directly to
9 one (1) point which is your desire to seek input on an
10 appropriate target level of ROE for automobile insurance
11 written in Alberta.
12 And as I said, our focus is on -- on
13 investors and trying to understand what investors do, so
14 our comments are -- are in the realm of the stock market.
15 There are obvious billions of dollars at play in the
16 property and casualty insurance industry around the
17 world.
18 And what we're trying to do is look at
19 investor behaviours and move away from some of the
20 volatility charts you've seen based on generally accepted
21 accounting principles in looking at volatility. But
22 let's look at the actual dollars that are at play and
23 what are investors doing. They're earning return through
24 capital gains and through dividends and -- and how are
25 they -- how are they assessing this industry, how are

1 they looking at this industry, how do they expect to be
2 rewarded by putting dollars to work in that industry.
3 So that's our frame of mind and that's
4 where -- where our comments we'll rely on this morning.
5 So we have looked at observable data in
6 the equity capital markets and looked at North American
7 property and casualty insurance companies. This does
8 mean there are some limitations. We have extended the --
9 the data set beyond Canada. It would be nice to strictly
10 limit it to Canada. In fact it would be wonderful if we
11 could limit it to Alberta public companies simply
12 operating in the automobile space. That's not possible.
13 But we think lessons can be learned by
14 looking at the broader -- the broader market. Canada is
15 a small P&C market. There are four (4) publicly traded
16 P&C companies in Canada working in various areas of the
17 property and casualty insurance industry. Tom will speak
18 directly to some of those -- those comp.
19 And for a number of reasons we don't think
20 we can limit ourselves just to those four (4) companies
21 and that's why we broadened it into a North American
22 perspective.
23 The other thing to keep in mind is these
24 companies are multi-product line, multi-geographic; i.e.
25 global companies in many cases. And again, we should

1 keep that in mind when trying to take away lessons from
2 those broader data set into -- into just the Alberta
3 market.
4 Turning to Slide 2. In terms of our
5 methodology we've adopted the capital asset pricing
6 model. And again very briefly, the capital asset pricing
7 model was developed over fifty years ago. The -- it's
8 now used widely in the industry, certainly in the
9 investment banking industry, by most -- most North
10 American corporations, their M&A department use CAPM, and
11 it has been recognized by the Canadian courts. So it's a
12 well accepted model.
13 It is reproduced on -- on Slide 2 for you.
14 It's a -- it looks fairly simple. It really involves two
15 components.
16 1. Rewarding investors for the time
17 value of money which is represented by the risk free
18 rate.
19 And the other is looking at the specific
20 risk of a particular asset or an asset class in respect
21 of the stock market in general. So what we're trying to
22 quantify is the relative risk of a particular stock or a
23 particular industry relative to the market.
24 Investors can make a choice, they can
25 invest in this industry or that stock or they can invest

1 in the broader -- on the broader market and the return
2 dynamic will be -- will be very different. But I think
3 it would be very enlightening in terms of investor
4 behaviour and expectations when we look through and look
5 at each of the elements of the model.
6 So right now, I'd like to pass it over to
7 Tom who will walk us through each of the individual
8 components and then I assume we'll take some questions at
9 the end.
10 MR. THOMAS LITTLE: Thanks, Brad. Ladies
11 and gentlemen of the Board, what I'm going to propose is
12 that I take you through just 4 or 5 slides which
13 illustrate the component parts of the CAPM model and then
14 on the last page we will arrive at an observable range
15 for the cost of equity based on the empirical data that
16 we have analysed.
17 So the first component of CAPM is the risk
18 free rate, which as Brad mentioned compensates investors
19 for placing money into a risk free investment for a
20 specified period.
21 By convention, we use the long term or
22 thirty (30) year Government of Canada bond as the best
23 indicator of the risk free rate. And to put this in
24 context for you, we have show on the left hand side of
25 this slide, the risk free rate or the Government of

1 Canada bond going back to 1986, and you will see in that
2 period that the yield has been as high as 11.57 percent
3 and recently as low as 4.02 percent.
4 When you consider various periods since
5 1986, you'll see that the twenty (20) year average is 7.3
6 percent, a five (5) year average, 5.03 percent, a 3 year
7 average 4.67 percent.
8 And when you look at more recent history
9 on the right hand side of the page you'll see that the
10 Government of Canada bond, in the last 12 months, has
11 fluctuated between a high of 4.66 percent in late June to
12 a low of 4.02 percent back in December of 2005.
13 The CAPM model uses the risk free rate at
14 a specific date, today's date. And at the time we
15 prepared this analysis the rate was 4.24 percent and you
16 can see where we're right down at the low end of the
17 historical range.
18 The next component on slide 4 is beta.
19 Beta is a measure of a stock's volatility in relation to
20 the market. Beta of one (1) means that a stock's
21 volatility is perfectly correlated with the movement of
22 the broader market. A Beta of less than one (1) means
23 the stock is less volatile. More than one (1) means the
24 stock is more volatile.
25 The chart we've shown here is a large

1 sample of public companies in the US on the top half of
2 the table, and the four (4) public companies in Canada on
3 the bottom half of the table all operating in the P&C
4 insurance sector.
5 You'll see if you look at the raw levered
6 beta column, that the beta's range from a high of one
7 point four (1.4) for W.R. Berkely to a low of point four
8 (.4) for Northbridge.
9 The next column over is a column that we
10 call R-Squared. And R-Squared is a statistical
11 measurement that measures the degree to which a stock's
12 volatility or its risk is explained by the beta.
13 So the higher the R-Squared the more
14 predictive the power of the beta to measure a stock's
15 volatility. And when you look at that column of R-
16 Squared you'll see that the high is point three seven
17 (.37) again for W.R. Berkely, a low of point zero four
18 (.04).
19 And in our analysis we would say that any
20 R-Square below point two zero (.20) becomes less
21 statistically significant in accepting the raw levered
22 beta as a predictive measure of a stock's volatility.
23 In other words, when you have a high R-
24 Squared the beta is meaningful. When you have a very low
25 R-Squared and I would direct you to the three (3)

1 Canadian companies -- actually the four (4) Canadian
2 companies who all have very low R-Squared. What that
3 tells us is that the beta for those companies is not a
4 good predictor in isolation of the volatility of that
5 particular stock.
6 So at the bottom of the page, you can see
7 there that when we look at this group as a whole, the
8 overall average beta is point nine one (.91), the median
9 is point eight eight (.88) and when we take a market
10 weighted beta it's point nine five (.95).
11 That beta then gets applied to the market
12 risk premium through the exercise of multiplication. And
13 on page 5 we've shown the market risk premium which is in
14 effect the excess return that the stock market provides
15 over the risk free rate over a long period.
16 And this excess return or risk premium
17 compensates investors for accepting a higher risk. And
18 as you'll see in this chart their market risk premium
19 over the last 20 years is very constant.
20 And at the moment and according to
21 Ibbotson, which is a widely accepted source which does
22 all the arithmetic calculation for the -- for the market
23 risk premium over time, the market risk premium in 2005
24 is 5 percent. And that by convention is the market risk
25 premium that we use in estimating cost of equity.

1 On page 6 you'll see a table that explains
2 the size premium. And we have applied a size premium in
3 our analysis because when we look at all of the companies
4 operating in the Alberta P&C insurance market and we look
5 at the average book value of equity of those companies,
6 and that list is appended to the last page of our written
7 submission, we find that the average book value of equity
8 is approximately $302 million.
9 And to that book value of equity we've
10 applied a price to book value, multiple of one point five
11 zero (1.50) at the midpoint, to get an illustrative
12 market capitalization for these companies as if they were
13 publicly traded.
14 And then we've adjusted that value of $453
15 million from Canadian dollars into US dollars and we
16 arrive at an implied public market capitalization of $400
17 million. And according to analysis conducted by
18 Ibbotson, companies with market capitalization of less
19 than $600 million US require an additional return on
20 equity.
21 Investors demand more because of the
22 inherent volatility and increased risk of smaller
23 businesses.
24 And that premium, according to Ibbotson,
25 is 3.95 percent.

1 So, when you take those component parts
2 and add them together as we've done on page 7, you'll see
3 that the only variable here in the table is the beta.
4 And the beta is specific to each individual stock, at the
5 low end point four (.4), at the high end, one point four
6 (1.4).
7 The risk free rate is four point two four
8 (4.24), the market risk premium of five (5) and the size
9 premium of three point nine five (3.95) produces a range
10 of 10.19 to 15.19 percent.
11 And we would be more comfortable guiding
12 the Board to a range between twelve point five nine
13 (12.59) and twelve point nine three (12.93) using either
14 the median, the average or the weighted average beta,
15 which we think is more statistically relevant for the
16 purposes of the Board.
17 And finally, on the last page we've
18 provided a sensitivity analysis. And across the top
19 we've used a beta ranging from point eight (.8) to one
20 point two (1.2) and down the left hand side of the table,
21 a risk free rate from point -- three point seven five
22 (3.75) to four point seven five (4.75). And what you'll
23 see in the shaded area of the table is that using a beta
24 of between point nine (.9) and one point one (1.1) the
25 resulting cost of equity is somewhere in the range of

1 12.2 to 14.2 percent.
2 In terms of the actual sensitivity to beta
3 and risk free rate, for every increase of point one (.1)
4 in a beta, the cost of equity increases fifty (50) basis
5 points or one half (1/2) of 1 percent. And for every
6 increase in the risk free rate of fifty (50) basis
7 points, again the cost of equity increases by fifty (50)
8 basis points or one half (1/2) of 1 percent.
9 So, that concludes the analysis of cost of
10 equity in our presentation and now I'll turn it back to -
11 - to Saskia.
12 MR. SHAWN DESANTIS: Mr. Chairman, thank
13 you for your time. I -- just in conclusion, then we'll
14 open the floor to questions.
15 You know, our goal at Royal SunAlliance is
16 to have a healthy Alberta marketplace where it's good for
17 consumers, good for shareholders and good for companies.
18 And so even as we talk about a recommended ROE, you know,
19 you've heard from our colleagues from the Bank of
20 Montreal and you heard our thoughts around somewhere
21 around 12 to 14 percent and, from our perspective, it's
22 important that we make the right decision in order to
23 keep capital in the Alberta marketplace.
24 Thank you. And now we'll open the floor
25 up to questions.

1 THE CHAIRPERSON: Thank you. Questions
2 at this end?
3
4 QUESTIONS BY BOARD:
5 MR. LEWIS KLAR: How does your
6 recommended ROE square with the information that -- that
7 we've received that the long term has been 10.5 percent?
8 Why would there be this -- this disconnect
9 between what it actually has been for thirty (30) years
10 and what you think it should be?
11 MR. BRAD HARDIE: Maybe I can start with
12 one (1) comment. You know, one (1) observation to make
13 would be the -- the 10 percent average you saw, as I
14 understand it, is a -- an accounting term. It's looking
15 at accounting that income relative to -- to book values
16 based on historical financial statements.
17 Our analysis is actually looking at
18 equities, actually looking at -- at stock market prices.
19 You would anticipate there would be some correlation. I
20 don't know whether or not there have been studies on --
21 on linking those two (2) but we looking at -- we are
22 looking at two (2) different sources of data. And
23 whether or not those should -- should match up or be the
24 same or be just -- very different certain times of -- of
25 a certain industry cycle or period, I can't -- I can't

1 speak to that.
2 But they are originating from very
3 different perspectives and data sources.
4 MR. LEWIS KLAR: Yeah, well, it seems to
5 me -- maybe you can answer this, then.
6 Well wouldn't -- what do you think that --
7 what would be more relevant to us would be the ROE for
8 the specific industry over the last thirty (30) years as
9 opposed to your analysis as applied to the stock market
10 prices of these companies?
11 MR. BRAD HARDIE: Well, the orientation
12 was, at the end of the day, it's people with skin in the
13 game who make the decisions with respect to allocating
14 capital to the industry.
15 So we should be looking at the people who
16 actually have dollars invested and how they're reacting
17 to the volatility and to the multitude of regulatory
18 environments, the multitude of particular weather or
19 claims patterns. All of that is obviously being baked to
20 investors' minds.
21 MR. LEWIS KLAR: Hmm hmm.
22 MR. BRAD HARDIE: We're not seeing stocks
23 go up and down by 20 or 30 percent every year as the
24 industry goes up and down.
25 Investors are -- have a much longer term

1 view on the attractiveness and stability of the industry
2 and that's what we're trying to get behind in terms of --
3 in terms of this particular analysis.
4 MR. LEWIS KLAR: Okay.
5 MR. SHAWN DESANTIS: I'd just add a
6 comment to that, is that, you know, I think it was
7 mentioned in the earlier presentation, too, as the global
8 markets get more much sophisticated with capital
9 allocation, that 10 1/2 percent number, there is more
10 pressure globally to produce a number which is getting
11 into a bunch of different jurisdictions across the globe.
12 So, historically that number might have
13 served the industry well. Going forward, I think, as was
14 articulated, that number is in a different range.
15 THE CHAIRPERSON: Any further questions
16 down here? Questions from this end?
17 MR. BILL MOORE: Maybe -- maybe just a
18 question about your UK actuaries and the model which
19 attempts to allocate most efficiently.
20 I presume the model would also tell you or
21 -- pardon, would tell them to tell you that you must
22 withdraw your capital from a given market.
23 Is it -- or is a retrospective model as
24 well as prospective?
25 MS. SASKIA MATHESON: We use it on a

1 prospective basis.
2 MR. BILL MOORE: Hmm hmm.
3 MS. SASKIA MATHESON: Using it on a
4 retrospective basis is more a matter of testing the
5 validity of the model --
6 MR. BILL MOORE: Hmm hmm.
7 MS. SASKIA MATHESON: -- ie. did the
8 model predict the right answer? Using it retrospectively
9 to see, gee, we should have taken the capital out is one
10 of those exercises that should only be done with a --
11 with a heavy heart.
12 You don't want to just look back and say,
13 we shouldn't have been in that market. We -- so we use
14 it retrospectively to say, did the model predict the
15 right number --
16 MR. BILL MOORE: Hmm hmm.
17 MS. SASKIA MATHESON: -- and then we use
18 it prospectively for allocation of capital. It does --
19 although it has some volatility in it, obviously, it
20 attempts to make the best use of capital throughout
21 multiple jurisdictions. And it -- it does -- it will
22 tell us that generally the decisions out of it are, stand
23 fast, don't put more money in and we'll -- when the
24 number gets bad then we'll talk about it --
25 MR. BILL MOORE: Withdrawing?

1 MS. SASKIA MATHESON: Yes.
2 MR. BILL MOORE: Do you then keep -- keep
3 nominal books as to what your profitability and your
4 capital allocation is by line, by province?
5 MS. SASKIA MATHESON: We -- using that
6 formula, that --
7 MR. BILL MOORE: Hmm hmm.
8 MS. SASKIA MATHESON: -- as I say, that
9 heavy actuarial formula that was in our written
10 submission, we create target loss ratios for each line of
11 business --
12 MR. BILL MOORE: Hmm hmm.
13 MS. SASKIA MATHESON: -- each coverage in
14 each jurisdiction.
15 So I have, in the end, a target loss ratio
16 for liability cover in automobile in Alberta.
17 MR. BILL MOORE: Yeah.
18 MS. SASKIA MATHESON: I have a different
19 target loss ratio for that for liability in New
20 Brunswick, in Ontario, and different coverages within
21 Alberta. So, I will price each line separately.
22 MR. BILL MOORE: And I would think most
23 of your major competitors are -- are that sophisticated
24 in -- in knowing what their true ROE's are by line, by --
25 MS. SASKIA MATHESON: I would certainly

1 assume so, yes.
2 MR. BILL MOORE: Yes.
3 MS. SASKIA MATHESON: Yes.
4 MR. BILL MOORE: But that's not published
5 anywhere even -- even on a confidential basis. So one of
6 the -- one of the concerns I think that the Board has is
7 that we know what's happening on all lines basis for
8 Canada as a whole, but we don't know anything else.
9 We don't really know what's happening in
10 Alberta.
11 MS. SASKIA MATHESON: Probably the
12 closest you would have would be, and I think we've had
13 this discussion somewhat before at previous hearings --
14 MR. BILL MOORE: Hmm hmm.
15 MS. SASKIA MATHESON: -- is the IBC data,
16 you're right. But company data by line on that basis is
17 not -- is not published.
18 MR. BILL MOORE: How do you think the
19 industry would react if we -- if -- if we asked that a
20 survey be created that pull this information together,
21 obviously on a confidential basis? But --
22 MS. SASKIA MATHESON: I certainly
23 couldn't answer for how the industry would react.
24 MR. BILL MOORE: Hmm hmm.
25 MS. SASKIA MATHESON: I think that

1 certainly more information is better. I think that we've
2 have recent discussions about things like the expense
3 ratio and what the information is that goes behind that.
4 And obviously, when you're making an
5 industry conclusion based on voluntary information given
6 by a few companies, that's not the best information. So
7 that needs to be better. I think a lot of work is being
8 done --
9 MR. BILL MOORE: Hmm hmm.
10 MS. SASKIA MATHESON: -- to make that
11 information better.
12 MR. BILL MOORE: Hmm hmm.
13 MS. SASKIA MATHESON: The better the
14 information that one has about results by line, obviously
15 the better the outcome will be.
16 We still do remain however -- competitive
17 market, and so in the same way that we're always happy to
18 share within our rate filings a lot of information that
19 we would prefer to not share with our competitors, I
20 think the same holds true for a lot of this information.
21 We're generally more than happy to share
22 with the Board. We just don't want to share with the guy
23 down the street who's trying to price us out of a
24 particular market.
25 MR. BILL MOORE: No, and -- and very much

1 under -- or we very much understand that. So, thank you
2 very much.
3 THE CHAIRPERSON: Any further questions
4 this end? Questions...? Ted...?
5 MR. TED ZUBULAKE: Just one (1). The 12
6 or 13 percent target ROE, after tax ROE, that you're
7 recommending, with all things being equal, require the
8 Board to increase rates, that would increase the profit
9 margin that's currently in the industry-wide adjustment
10 formula, if you will.
11 How do you reconcile that with the, you
12 know, the record profits that the -- or the high profits
13 that the insurance industry is reporting over the last
14 couple of years and so far, the first half of 2006 as
15 well; the fact that the -- again the industry is
16 reporting high profits, and yet in a sense saying that
17 the rates were too low?
18 MS. SASKIA MATHESON: And, Ted, this is
19 obviously the discussion we've also had --
20 MR. TED ZUBULAKE: Yeah.
21 MS. SASKIA MATHESON: -- at previous
22 hearings which is that those results are financial
23 results.
24 And I think one of the points we made was
25 that each year needs to be priced independently. So, I'm

1 looking at the data now for what's -- for what has been
2 happening historically on a loss basis, and I'm
3 projecting forward to what I'm going to need to pay those
4 claims over the next two (2) years, two and a half (2
5 1/2) years is the normal cycle, for -- for an automobile
6 claim payment.
7 The results that you are seeing in the
8 industry are financial results that are part and parcel
9 of the premium income investment strategy, whatever the
10 bond yields, were for a number of previous years.
11 They are also generally national in the
12 same -- the same limitation, in judging those results on
13 a, what's happening in Alberta automobile, the same
14 limitation applies to taking the profitability results
15 for the industry as a whole across the country and making
16 conclusions about what the price should be for Alberta
17 automobile.
18 MR. SHAWN DESANTIS: There's something
19 I'd like to add to that. The -- the -- if -- if we want
20 to reduce the volatility in the industry then I believe
21 as leaders of the industry then we need to allow
22 companies to potentially take some rate increases, and it
23 might be minor increases.
24 If we do not achieve that, then in a year
25 from now, the discussion with the Board will be

1 significantly different, or eighteen (18) months from
2 now, which creates this volatility.
3 I think managing the changing results and
4 the environments will reduce the volatility. And I
5 think, you know, the goals of what we're trying to
6 achieve in all markets across Canada is reducing
7 volatility.
8 And by -- what we're looking at today, our
9 current results, and saying we don't need rates. I think
10 we're making the same decision we made as leaders in the
11 industry numerous times throughout the cycle and it will
12 catch up with us.
13 MR. TED ZUBULAKE: Would you agree that -
14 - just quickly, I'll put a tail on that, that the -- to a
15 large extent the -- the results, the profitable results,
16 being reported by the industry in these last couple of
17 years are basically a realization that the -- they over-
18 estimated the losses from prior years.
19 That -- that -- had -- the industry had
20 perfect knowledge of what the claim costs would be,
21 actually we would have -- if we show that chart of ROE's
22 up on the board again, we would see higher ROE's several
23 years ago and lower ROE's today?
24 MR. SHAWN DESANTIS: There is some --
25 some benefit in the results today from prior year runoff.

1 MR. TED ZUBULAKE: Yeah.
2 MR. SHAWN DESANTIS: And -- and, you
3 know, I think that's kind of builds around my comment
4 that what we're seeing today, even though we've done a
5 lot of work on reform, positive work on reform, what
6 we're seeing today is some issues that are going to be
7 occurring in the Alberta market place in six (6) to
8 twelve (12) months that we need to manage correctly so we
9 don't end up into crisis mode which we ended up into a
10 number of years ago.
11 MR. TED ZUBULAKE: Thank you.
12 THE CHAIRPERSON: Thanks, Ted.
13 MS. MERLE TAYLOR: Thank you for the
14 presentation. It was very clear and helpful. I just had
15 one (1) question, and I appreciate you've shown
16 different, like the sensitivity analysis on the -- the
17 risk free rate as to what the assumptions are.
18 But some other presenters have used a risk
19 free rate for a three (3) month term or something like
20 that whereas you've used a thirty (30) year, and I wonder
21 what your reason for using the longer term would be?
22 MR. THOMAS LITTLE: It is a convention
23 that we use the long term thirty (30) year Government of
24 Canada Bond. There are really three (3) reasons for
25 that.

1 The first is that there is a very low
2 probability that the Government of Canada will default,
3 so that's why we use a Government bond as opposed to any
4 other.
5 The thirty (30) year bond as opposed to
6 any other shorter term bond best captures, in the long
7 term, future inflation risk of investors because of the
8 duration of the bond.
9 And, thirdly, there is less volatility and
10 the long term bond yield is less subject to short term
11 interest rate and other market variations.
12 So for those three (3) reasons that's why
13 we follow the convention of using a thirty (30) year bond
14 yield.
15 MS. SASKIA MATHESON: If I might just add
16 to that. having heard the other presenters this morning,
17 there may be a -- a disconnect between when we are
18 looking at how much investment should be built into the
19 pricing going forward. We would use a three (3) year
20 bond based on the fact that's how long we need to hang on
21 to premium income. The thirty (30) year period that the
22 gentlemen from the Bank of Montreal are using is in
23 evaluating capital on the overall.
24 The two (2) are different outcomes. One
25 is a specific pricing exercise where we look at the three

1 (3) years. And this is a let's look at what stocks have
2 given or what the industry has returned over time on a
3 thirty (30) year basis.
4 And that may be the different periods of
5 time you're talking about.
6 MS. MERLE TAYLOR: Okay, thank you.
7 THE CHAIRPERSON: Thank you. And I'll
8 thank you, Shawn, for your presentation. We appreciate
9 it very much. And, as you know, we have a very
10 complicated decision to make here and it'll take us some
11 time because we have to get into our rate setting later
12 in the year.
13 So we thank you for your input and we'll
14 weigh it with the best of our judgment.
15 MR. SHAWN DESANTIS: Thank you very much.
16 MR. BRAD HARDIE: Thank you.
17 THE CHAIRPERSON: Thank you.
18
19 (BRIEF PAUSE)
20
21 THE CHAIRPERSON: Five (5) minutes. Five
22 minutes.
23
24 --- Upon recessing at 11:14 a.m.
25 --- Upon resuming at 11:20 a.m.

1 THE CHAIRPERSON: I'll let you proceed
2 with your introductions then.
3
4 PRESENTATION BY CO-OPERATORS:
5 MR. FRANK BOMBEN: Thank you, Mr. Chair.
6 I appreciate the opportunity to make our presentation
7 today. What I'm going to do is a very brief presentation
8 about who we are as an organization.
9 First of all, let me introduce myself.
10 I'm Frank Bomben. I'm the manager of Government
11 relations at the Co-operators and with me is Katie
12 Suljak, Vice-President Actuarial Services.
13 I'll do a very brief description of the
14 Co-operators in general and our operations in Alberta.
15 And Katie will walk through the -- the presentation in
16 terms of appropriate target ROE, appropriate values for
17 the components of reconciliation between profit provision
18 and ROE and the impact of the impending changes in
19 insurance financial reporting.
20 First of all, who -- who we are. Now, the
21 Co-operators is a group of Canadian companies focussing
22 on insurance.
23 We are co-operative. Our member owners
24 are thirty-three (33) co-operatives; credit unions and
25 like minded organizations. And if you count all the

1 members of the members of our organization, we represent
2 about 4.5 million Canadian citizens across the Country.
3 Just to give you a brief description. In
4 Alberta, our member owners in Alberta include Credit
5 Union central in Alberta, Lilydale Co-operative, United
6 Farmers of Alberta and Wild Rose Agriculture producers.
7 And you'll see on the slide here just the
8 scope of our -- of our business. We have ninety-nine
9 (99) agents in Alberta; roughly, just under four hundred
10 (400) employees. And you can see the number of vehicles
11 that are insured in Alberta. And our philanthropy -- or
12 since 2000 roughly, I think nine hundred thousand
13 (900,000) contribute to a number of charities.
14 And this next slide is just a -- I won't
15 go through all of them, but this is sort of a list of
16 some of the beneficiaries of our corporate donations over
17 the years.
18 In terms of our -- our guiding principles
19 -- and they're the same ones that -- that you have as a
20 Board.
21 The Co-Operators' approach in terms of the
22 auto product, not just in Alberta, but right across the
23 country, relies on security. We believe that all of our
24 clients have the right to have the appropriate level of
25 protection.

1 Affordability. We believe that our
2 clients should -- should be able to have an affordable
3 product.
4 Availability. There should be
5 accessibility right across the Country, let alone each
6 individual province. And we believe that the product
7 should be well understood by our clients.
8 That out of the way, I'll let Katie take -
9 - take you through our presentation.
10 MS. KATIE SULJAK: I'd like to start by
11 saying that I'm not an expert on capital adequacy pricing
12 models. I know that you've heard from some today as well
13 as yesterday.
14 What I do want to talk to you about is the
15 Co-operators expected return on equity. We believe that
16 a range of ROE targets is appropriate for the industry.
17 For the Co-operators we target a 12
18 percent return on equity. And that's the target that we
19 use for all products and in all provinces. And this is
20 the target that's been set for the Company and approved
21 by our Board.
22 This -- we believe this is a reasonable
23 target for us and it balances our need to ensure
24 affordable rates for our clients as well as enough
25 profitability to satisfy the requirements set by OSFI to

1 maintain a minimum capital adequacy ratio, as well as the
2 expectation of the various rating agencies such as AM
3 Best and Standard & Poor's, and also allows us to grow
4 our business as well. And this target level needs to be
5 achieved on a long term basis.
6 And due to the nature of insurances, as
7 you know, there will be years when we won't achieve that
8 -- that target ROE. So that means in other years we need
9 to be able to achieve a greater ROE than our target.
10 There was a question that was asked in an
11 earlier presentation about if we price our products
12 annually or look at our indications every year, that we
13 should have lower volatility in our results. So I just
14 wanted to comment on that if I can.
15 When we look at our -- at historical
16 experience this year, we probably know that what -- what
17 our experience was 5 years ago. But what we're trying to
18 do is price what the product is going to cost us next
19 year. And we won't know that for another number of
20 years, just because of the uncertainty in the insurance
21 environment; the challenge to the cap on pain and
22 suffering for minor injuries has been mentioned a couple
23 of times today.
24 If that's successful that won't affect
25 just the cost for next year, it will actually affect the

1 cost of claims that have already occurred; that there
2 will be re-opening of claims that we've already settled
3 and it will cost us more historically. And we'll see
4 those results in future financial results.
5 The industry has also been faced with a
6 couple of class action suits. We don't know what will --
7 what kind of challenges will come to us in the future but
8 we expect that there will be some and those are hard to
9 plan for and we don't price for them right now. But when
10 they occur they will result in more volatility in our
11 results.
12 So I just wanted to talk just briefly
13 about what a 12 percent ROE means to our customer. When
14 we do our pricing we determine what an appropriate profit
15 margin is in our premium.
16 And to get that 12 percent ROE that
17 translates into about one point two cents (1.2) per
18 dollar of premium that's allocated to profit. And when
19 you look at -- in addition to that, out of every dollar
20 of premium we pay about 73.3 percent for claims costs and
21 claims handling.
22 So this chart shows you the breakdown of -
23 - of the premium dollar and where the money goes. As I -
24 - as I said more than -- than 73 percent of the premium
25 dollars are paid out for claims and claims handling.

1 We also have variable and fixed expenses;
2 variable expenses of 12 percent, fixed expenses about 13
3 1/2 and the rest 1.2 percent is our profit margin. The
4 reason it's so low is because of the investment income
5 that we do earn on the premium -- because we hold it
6 until we have to make our claims and expense payments.
7 So 12 percent ROE means about at 1.2 percent margin on
8 premium or profit.
9 For determining our rate indications we
10 use a loss ratio approach which I know is different from
11 what the Board uses. But to do that, we determine a
12 permissible loss ratio, the loss ratio that will allow us
13 to achieve our 12 percent Return on Equity.
14 And a number of assumptions are made to
15 determine that. One is our expenses, the variable and
16 fixed expenses. And we look at our historical experience
17 and any changes that we know that are coming to -- to
18 incorporate those.
19 We look at the payment patterns of our
20 claims by coverage in order to recognize the investment
21 income that we'll earn on premium. We make an investment
22 yield assumption about what sort of returns we'll receive
23 on that premium and that we need to use the returns that
24 we will earn in the future on those premium dollars.
25 We can't use historical investment returns

1 because we can't invest tomorrow's dollars at yesterday's
2 returns. And we also make a premium to surplus ration
3 assumption. In our case it's two (2) to one (1) for
4 automobile.
5 And we also provided a formula with our
6 written submission that shows you how we go from our ROE
7 assumption and these other assumptions to our profit
8 margins.
9 The last item that I just want to briefly
10 talk about is the changes coming in financial -- for
11 financial reporting effective January 1st. Companies
12 will not be restating prior years experience based on the
13 new reporting requirements, which means it's going to be
14 difficult to compare historical results with future
15 results. What -- another thing you'll see is that
16 there will be multiple net income numbers shown in our
17 financial statements. There will be net income, there'll
18 also be an item called 'other comprehensive income plus
19 total comprehensive income', and having those different
20 income numbers is going to cause some confusion.
21 Some other impacts. There will be
22 increased volatility in our returns. We thought they
23 were volatile before, they're going to be more volatile
24 in the future. Part of that volatility will be on the
25 policy liabilities due to the changes in the yield -- the

1 portfolio yield that we use to discount our liabilities.
2 There'll be more volatility in that return; historically
3 it's been fairly stable.
4 Having that number more volatile means
5 that our liabilities will -- will go and down depending
6 on what the market yield is for our investments.
7 There'll also be greater volatility in the
8 company's income due to changes in the market value of
9 assets. So unrealized gains will show up either in net
10 income or total comprehensive income depending on how a
11 company classifies its assets.
12 So it will be more -- depending if -- for
13 companies that classify their assets differently, it will
14 be difficult to compare across companies their -- their
15 net income.
16 The first presenter today indicated that
17 they are going to be using a hybrid model held for
18 trading and available for sale. We will be using
19 available for sale as our -- the way it will be allo --
20 valuing our assets, which means that our net income will
21 be net income due to unrealized gains, will show up in
22 other comprehensive income.
23 For them it will be split between the two
24 (2) types of income. So it's going to be more difficult
25 for you to know how companies' returns compare from one

1 to the other.
2 So our presentation was quite brief, but
3 we welcome any questions that you have.
4 THE CHAIRPERSON: I appreciate that this
5 morning because I was running behind schedule and we
6 certainly have heard from a lot of -- so do I have
7 questions? Any down here?
8
9 QUESTIONS BY BOARD:
10 MR. BILL MOORE: From a financial
11 economics perspective I think we would submit that now
12 that everybody's marking the market it'll be a lot easier
13 to compare companies but that's a different topic.
14 MS. KATIE SULJAK: But -- well it depends
15 on what type of assets companies have as well where there
16 -- whether they --
17 MR. BILL MOORE: But you've been hiding
18 the results for years with carrying things in book and
19 smoothing this stuff. Anyway, that's not my question.
20 Your 1.2 percent, your profit margin or
21 you're suggested profit margin, as you're aware when the
22 Board sets the industry average premium, we're including
23 a 5 percent profit margin. And -- and the -- or the main
24 purpose of these sessions is that too high or is it too
25 low?

1 Now I don't think you're suggesting we
2 should lower that to 1.2 but that needs to be explained.
3 MS. KATIE SULJAK: No. The 5 percent I
4 believe doesn't include investment income --
5 MR. BILL MOORE: Yeah.
6 MS. KATIE SULJAK: -- or -- our number --
7 we take the 1.2 percent plus any investment income and
8 that -- the combined of those two is -- is our total
9 return.
10 MR. BILL MOORE: It will be helpful to
11 know what that combined number was.
12 MS. KATIE SULJAK: Well we -- the 5
13 percent that the Board is using, we believe is too low.
14 It results in lower than 12 percent ROE so we would say
15 it should be higher than that.
16 MR. BILL MOORE: But you don't have a --
17 a conversion number for us?
18 MS. KATIE SULJAK: Well, I think that the
19 number needs to be more in the -- I would say 8 -- 8
20 percent range.
21 MR. BILL MOORE: Okay. Thank you.
22 THE CHAIRPERSON: Ted...?
23 MR. TED ZUBULAKE: I just have a point.
24 But you also said you use a two (2) to one (1) leverage
25 ratio.

1 MS. KATIE SULJAK: Yes.
2 MR. TED ZUBULAKE: It seems to me that
3 the five (5) isn't too far off the mark that the Board is
4 using to achieve your twelve (12). Eight (8) sounds like
5 it would be -- you would end up over 12 percent return.
6 MS. KATIE SULJAK: Well the 12 percent
7 it's at and after tax return.
8 MR. TED ZUBULAKE: Yeah, I know. I
9 understand that. But -- anyway I -- I -- but your
10 position is that the five (5) is too low.
11 THE CHAIRPERSON: Any further questions?
12 Well, thank you very much. We appreciate
13 your presentation. And, as I've said to others, we have
14 a complicated decision to make and we'll take all the
15 presentations we have under consideration, and we thank
16 you for making it.
17 MS. KATIE SULJAK: Thank you.
18 THE CHAIRPERSON: Thank you.
19 MR. FRANK BOMBEN: Thank you, sir.
20
21 (BRIEF PAUSE)
22
23 THE CHAIRPERSON: All right. May I have
24 your attention please. Our next presenter is our
25 consumers representative. Merle has a very difficult

1 role. She's a member of the Board and she represents the
2 consumers on her board and has what I would indicate as
3 an independent role on our Board in many ways. She is a
4 representative to our Board but a Member of the Board and
5 she has to make yearly presentations to us, and we're
6 loaded with all kinds of complicated questions for her.
7 Merle, you're up.
8
9 PRESENTATION BY MS. MERLE TAYLOR:
10 MS. MERLE TAYLOR: I've already told
11 David not to ask me what beta factor I've used.
12 Yes. As you -- thank you, Mr. Chair. You
13 know, as a Member sitting on the Board I guess when we
14 have discussions I -- I do reflect my own personal views
15 and then I -- and then when I sit here and present, then
16 I'm -- what I'm trying to reflect to you is what
17 consumers are telling me, what I've garnered from my
18 discussions and -- and how I think any decisions that are
19 made by the Board would be perceived by consumers.
20 So there may sometimes be a difference
21 between what I might personally think and what the
22 consumers think. But I try very hard to be objective in
23 terms of thinking of the people that I've met through my
24 various meetings and hearings and the letters and phone
25 calls, e-mails, that I -- I get at different times from

1 consumers.

2 And my process this year, I did, you know,

3 meet with consumers around the province in the Spring.

4 And at that point in time the -- the insurance industry

5 had just reported profits of 20.2 percent for the

6 previous year.

7 And there were certainly consumers that

8 were upset about it, you know. They felt that that rate

9 was on their back, that they were paying high premiums,

10 what they felt were high premiums, and the insurance

11 companies were making big profits on them.

12 Another -- so that I reflect on what

13 consumers told me in the Spring. I also keep in touch

14 with consumer representatives in the Maritimes, and we

15 got together just about ten (10) days ago and, you know,

16 we sort of trade stories in terms of what's happening in

17 other parts of Canada as well. So that's informative.

18 And, of course, they've had hearings on

19 profits in the Maritime Provinces and so they were able

20 to give m a bit of insight in terms of what some of the

21 thinking was in -- in their jurisdictions.

22 And, you know, in knowing that I had to

23 present to the Board I did some of my own research as

24 best I could. And my qualifications, I -- I have a BA in

25 Economics and I'm a CMA. So I'm -- and I've -- I was a

1 previous executive in Alberta Finance, but I left in
2 1982. And I've run my own management consulting firm for
3 the last twenty-five (25) years.
4 So I'm -- I'm an informed consumer
5 representative, although I don't by any stretch present
6 myself as having actuarial qualifications or -- so I
7 understand things at some level but I'm not -- I'm not
8 trying to present here an expert opinion.
9 So when I talk to consumers, I think that
10 I could generalize as to what their concerns are, and one
11 of the first is certainty. And we saw about two (2) or
12 three (3) years ago, when there was a hard market that
13 suddenly premiums were increasing by 20 to 30 percent and
14 that's when consumers start to get upset.
15 The majority of consumers have got -- are
16 salaried people. They predict how much income they're
17 going to have in a year. They've got budgets. They need
18 to have some predictability in terms of what their costs
19 are going to be and a big jump in their premiums causes
20 them difficulty with their personal finances.
21 Another concern that consumers have got is
22 that this is a mandatory product. And you can debate
23 that. You've always got the choice, you don't have to
24 drive. And in some cities, in some provinces, that's
25 more of an option than in others. In Alberta we've got a

1 resource-based economy and a lot of the people that are
2 working, in order for them to work they really have to
3 have a vehicle.
4 So it's -- in some sense is more of a
5 mandatory product in Alberta than it might be in a place
6 like Toronto, where, you know, you could feasibly get
7 around without -- without using a vehicle. And so given
8 that it's a -- a mandatory product the view of consumers
9 is that the profit on that mandatory product should be
10 modest. And so that, as I say, they -- they do react
11 when the insurance industry reports profits of 20.2
12 percent.
13 Another concern of consumers, and a number
14 of people have mentioned this, is availability. And that
15 was another big problem two (2) to three (3) years ago,
16 when consumers simply couldn't get insurance from
17 standard carriers.
18 And so that's the counterbalance to it, is
19 that we have to have a competitive healthy insurance
20 industry. If the Board makes decisions that are too
21 hard, then at some point there will be insurers that will
22 leave town. They'll just say, We just can't make enough
23 money on the product here, we're not going to offer
24 automobile insurance in Alberta.
25 And certainly, you know, talking to my

1 counterpart in New Brunswick, it was a different issue.
2 It wasn't related to profit, it was related to the rating
3 of territories.
4 But in New Brunswick the Rate Board came
5 down with decisions that were too hard on insurers and
6 they refused, virtually, to provide insurance to that
7 part of northern New Brunswick, which they felt was rated
8 too low.
9 So that can happen if the decision are too
10 hard. We know there has to be some allowance for a
11 healthy industry.
12 The complexity of the issue and the -- the
13 Rate Board is asked to rule on a level of allowable
14 profit for mandatory auto insurance and yet it's very
15 difficult to dissect the portion that we're regulating on
16 and what the profits are for that particular segment.
17 Just, should we -- here, this little
18 chart. This is the total P&C industry; the premium
19 revenue for Canada, which is 34.7 billion. And the great
20 big -- what colour would I call that -- lavender portion
21 is the rest of Canada, our ROC. And the other one that's
22 segmented is Alberta, for the property and casualty
23 industry.
24 And out of that chunk -- now I can use
25 this little laser here and see how this works.

1 That piece is the third party liability
2 accident benefits portion for Alberta, which is 1.2
3 billion out of thirty-four point seven (34.7). So that's
4 3 percent out of the -- the total piece.
5 So while the insurance industry is
6 reporting a return of 20 percent for all lines in Canada,
7 we're only regulating 3 percent of that total pie. The
8 other pieces, we've got optional automobile insurance,
9 which is this piece, which is .7 billion. And then the -
10 - then there's commercial, which is this light blue
11 piece. And then property insurance for Alberta is the
12 other chunk here.
13 And so in trying to figure out what the
14 profit provision should be on our little 3 percent
15 portion there, we don't really know. Is mandatory
16 insurance subsidising commercial auto? Is property
17 insurance subsidising mandatory auto? Are Alberta's
18 rates high compared to the rest of Canada or is the rest
19 of Canada subsidising Alberta? It's very difficult to
20 come to any kind of assertation as to -- to what that
21 reality is.
22 So -- and this is sort of my simplistic
23 understanding of profit versus return on equity. And the
24 underwriting profit is premium revenues minus the accrued
25 third-party liability claims and accident benefits, minus

1 an allocated administrative costs and income tax. And --
2 and then, of course, as other presenters have explained,
3 the premiums are collected in advance of providing the
4 service.
5 And for some, if you don't actually have
6 an accident in the year, then you won't actually receive
7 anything back. You'll just pay your premium and -- and
8 that money is available to pay for claims for the other
9 more unlucky people that had an accident in that year.
10 And so there is a pool of funds that then
11 the insurers invest in -- in appropriate ways because
12 they've got the money in advance providing the product.
13 And so the investment income on those premiums is an
14 important component of -- of the return on -- to come to
15 the return on equity.
16 So in giving the Rate Board some food for
17 thought as far as consumers are concerned, I would like
18 to just identify some principles and some -- provide some
19 benchmark data which will help to guide the decisions.
20 And I think first there's -- there's two
21 (2) main principles. And the first, I think that
22 mandatory products should have a modest profit, that
23 we're only dealing with a small portion, we're dealing
24 with third-party liability accident benefits. And that,
25 as I've described, is really a mandatary product.

1 The consumer doesn't have any choice, as
2 opposed to other lines that -- that insurers provide.
3 You know, there's commercial, there's property insurance.
4 There is some more discretion in terms of whether
5 consumers need to purchase those products.
6 Another difficult question is optional
7 coverage, because Alberta is different than some other
8 provinces in that we don't regulate optional coverage;
9 recently in the Maritimes they do.
10 And data that's been recently presented by
11 our actuaries, Mercer Oliver Wyman did an analysis of the
12 -- the optional coverage in Alberta, and the results of
13 the analysis that they did indicated that optional
14 coverage in Alberta, the premiums are 20 to 25 percent in
15 excess of what's required to cover costs and have an
16 adequate level of profit.
17 That's when, as a consumer rep, I have to
18 sit back and think, Holy crow. So there's -- market
19 forces, to my mind, are not working right now to benefit
20 the consumer. What it would appear is that rates on the
21 optional coverage, on the collision, have been held and
22 haven't been reduced to make up for any foregone profits
23 on the mandatory insurance, which of course we have been
24 -- been regulating.
25 So -- and, you know, in terms of how

1 optional is the optional coverage, you know, if you
2 purchase a new vehicle and you need to get financing, you
3 can't get financing unless you carry collision coverage,
4 so that makes it not optional if you're buying a new
5 vehicle.
6 And if you have any kind of new vehicle at
7 all, if you're thinking that there's a possibility that
8 you might get in an at-fault accident, the majority of
9 people really couldn't afford to pay the bill if they
10 suddenly had to pay a twenty thousand dollar ($20,000)
11 hit to repair their vehicle.
12 So they would view again that the optional
13 coverage isn't very optional. The only way it's optional
14 is if you drive a -- a beat-up old car and just carry the
15 -- the mandatory insurance. So that's -- that's a
16 concern to consumers, I'm -- or it will be once they find
17 out.
18 At the same -- counterbalancing the fact
19 that I think that the profits need to be kept to a
20 reasonable level is that the profit level needs to be
21 adequate. And, you know, I'm aware that there's OSFI
22 requirements in terms of the reserves that insurers need
23 to keep.
24 And -- and also, as I mentioned, I mean,
25 there's a risk that if you're too hard on the -- the

1 profit level, that there may be an inability or an
2 unwillingness to provide the product in Alberta. And
3 then I -- I think too there -- there is a risk too that
4 if it's held too low for too long, that then the
5 certainty factor can be -- can come into play as well, in
6 that you could then see a big jump in rates some years
7 down the road.
8 Okay. Now, benchmark data. And I think
9 that a lot of these figures have come out in some way,
10 shape or form over the last day and a half, but I -- I've
11 just kind of picked them out from different sources.
12 And first the risk-free rate which
13 translates to a return on equity of somewhere around 7 to
14 8 percent. So the risk-free rate is about 4 percent.
15 And I -- I think it would be a fair comment that the --
16 the insurance business is a riskier business or is --
17 deserves to get a return that is higher than the risk-
18 free rate. There's obviously risk associated with the
19 product, with investing in it, and so that's one (1)
20 benchmark figure.
21 The average ROE over the past thirty (30)
22 years presented by IBC has been 8 to 11.2 percent. And I
23 think that data has been presented by several presenters
24 over the last couple of days.
25 In 2005 the return on equity for insurance

1 companies is 20.2 percent and in 2006, nineteen point six
2 (19.6). Very healthy profits.
3 Utility companies, the regulated ROE is at
4 8.9 percent. I've seen some other numbers that I have
5 actually, the EUB decision, and my number is 8.9 percent.
6 And again I think that it would be an acceptable
7 conclusion that the insurance business is a riskier
8 venture than utility companies. So this is a regulated
9 industry and they've established a rate of 8.9 percent in
10 Alberta.
11 Newfoundland ruled on their profit
12 provision as being 10 percent. Dr. Kalaman (phonetic), a
13 professor from University of Western Ontario, presented
14 to both the Newfoundland Board and the New Brunswick
15 Board, and his recommendation was a return on equity of
16 8.5 to 9.5 percent. And, you know, that's a
17 substantially different number than what we heard
18 yesterday from the expert presenters that presented with
19 IBC.
20 Now, again, I -- I'm not in a position to
21 challenge the -- the academic papers, but as I understand
22 it one of the significant difference of Kalaman's
23 research was that he based his on Canadian data as
24 opposed to American data.
25 Another benchmark figure; the stock market

1 has had an average of 10 percent return on equity over
2 the last fifty (50) years. And various experts have been
3 recommending a return on equity somewhere between 9
4 percent and 16 percent, or yesterday IBC presented 17
5 percent.
6 The last point I've got here is what's the
7 dollar impact on consumers? And this is actually kind of
8 interesting, in that for 1 percentage point difference in
9 profit, the difference on the mandatory premium for a
10 consumer is six dollars ($6). And, you know, that isn't
11 a lot of money, right?
12 It's -- Bill Moore can translate that to
13 lattes. I told him we have to use a Tim Hortons for the
14 consumers side representative.
15 So it's an important question for the Rate
16 Board and for the insurance industry to come to a
17 methodology that's acceptable for determining the -- the
18 profit provision and coming to a rate that consumers will
19 perceive to be acceptable and reasonable given the
20 market, but at the same point it's not going to be this
21 huge gigantic dollar impact on premiums, would be what I
22 understand.
23 So my recommendations. I think that
24 guidelines -- as a general consideration the return on
25 equity should be higher than the risk-free rate and

1 should be higher than the return on equity on utilities.
2 However, given the information that's come forward as far
3 as the rates on optional coverages, the profits that are
4 being made on that and the reported profits of the
5 insurance industry, consumers would not support any
6 increase in the allowable profit levels at this time.
7 The -- the rates on optional coverage
8 indicate that market forces in Alberta are not working
9 for the consumer. And the other consideration or the
10 other recommendation is that any adjustment to allowable
11 profit should take into account the profits that are made
12 -- made on -- on optional coverage.
13 So I think that we have to -- even though
14 we're not regulating the optional coverage, that that has
15 to be something that weighs into the decision of the --
16 of the Board when we make our determination as to what's
17 allowable at this point in time.
18 So in conclusion, with the recommendations
19 that I have made, are the consumer concerns addressed?
20 Certainty. With the profits the insurance
21 industry's making right now I don't see any indication
22 that there would be substantial premium increases
23 required in the next foreseeable future.
24 Reasonable profits on a mandatory product.
25 Not recommending any increase. And I think that

1 consumers can -- should expect that the profits on a
2 mandatory product should be on the low end rather than
3 the high end.
4 And availability. I don't think we've got
5 any indication that there's such a hard market in Alberta
6 at this point in time that the industry is going to stop
7 providing the profits. I don't think that that is going
8 to be a concern to consumers. That's it. Any questions?
9 THE CHAIRPERSON: Thank you, Merle.
10 Questions...?
11
12 QUESTIONS BY BOARD:
13 MR. LEWIS KLAR: You were talking about
14 your communication with consumers at the meetings that
15 things -- that you have had over the past couple of
16 years.
17 Did you do any special communications in
18 preparation for the prompt hearings or were you really
19 referring to the meetings that you were having for the
20 right level, sort of the, I don't know --
21 MS. MERLE TAYLOR: Well, when I met with
22 them in the Spring it had already been announced that
23 there were going to be profit hearings in the fall. And
24 so just in terms of being practical I knew I wasn't going
25 to do a tour of the province again.

1 So I raised the question with consumers
2 and with brokers at that time as to, you know, what and -
3 - and to be honest with the consumers I didn't have to
4 ask the question; they brought it forward themselves,
5 that the level of profit was a concern to them.
6 MR. LEWIS KLAR: So that on their mind?
7 MS. MERLE TAYLOR: Yes, yes.
8 MR. LEWIS KLAR: And did --
9 MS. MERLE TAYLOR: Of course it's the
10 people that would come to the meetings, too. You know,
11 they're often more well read, informed and -- and they
12 had a burr under their saddle, you know, that -- and the
13 profit level was something that was of concern to them.
14 MR. TED ZUBULAKE: But -- but on this
15 point we -- we've heard in response to questions the
16 Board asked they've always presented it as reconcile at -
17 - reconciled to the fact that they have -- are achieving
18 high profits this year, last year, and the year before,
19 with the need to increase rates or increase the profit
20 margin in the boards industry-wide adjustment.
21 Does not the consumer understand that or -
22 - you -- you say that the consumer is reacting to the
23 high profits reported by the insurance companies, but
24 that's just this year, last year, the year before. Are
25 they not looking at or considering the long-term

1 profitability results of the industry? They can't grasp
2 the --
3 MS. MERLE TAYLOR: Well, you know, it is
4 -- it is a challenge for the Board, isn't it?
5 MR. LEWIS KLAR: Yeah.
6 MS. MERLE TAYLOR: Because, I mean, I
7 appreciate the viewpoint that you've got to be -- you
8 can't always be looking in your rearview mirror. And me,
9 I'm -- I'm accountant so I'm always guilty of that; look
10 at the past to determine the future --
11 MR. LEWIS KLAR: Yeah.
12 MS. MERLE TAYLOR: -- and that isn't
13 always appropriate. And well, consumers read the
14 headlines and they --
15 MR. LEWIS KLAR: Yeah, yeah. That's --
16 that's a --
17 MS. MERLE TAYLOR: -- they're not
18 thinking about the business. And they -- they also
19 totally don't understand -- and you know I think that
20 that -- the slide where I showed a small slice of the
21 industry we're actually regulating, you know, consumers
22 don't understand that. They -- they're just thinking the
23 insurance industry profits, my premiums and that's it.
24 MR. LEWIS KLAR: Yeah.
25 MS. MERLE TAYLOR: And lots of them

1 wanted to talk about property insurance, too. You know,
2 that was a concern to them as well; not understanding our
3 role and the fact that we don't regulate property
4 insurance. Or add some small business people too, wanted
5 to talk about commercial insurance.
6 So, you know, they're -- to think that the
7 consumers understand where we fit in and where the
8 insurance industry fits in, you know you've got to kind
9 of do a whole educational piece to really make that
10 understood.
11 MR. DAVID WHITE: It's a challenge for
12 the Board but I think it's also a challenge of the public
13 relations ability of the insurance companies to make the
14 point that, you know, to educate the consumer as well as
15 to why they need the profits. Just an observation.
16 MS. MERLE TAYLOR: Yeah.
17 THE CHAIRPERSON: Further questions?
18 Well, thank you very much, Merle. Now you can come back
19 and go to work.
20 That'll end our morning session. We'll be
21 ready back at one o'clock. Thank you.
22
23 --- Upon recessing at 11:59 a.m.
24 --- Upon resuming at 1:00 p.m.
25

1 THE CHAIRPERSON: Well, welcome, Dominion
2 of Canada. We're looking forward to your presentation
3 and I think I'll just leave it to you to introduce
4 yourself to the Board and we'll be glad to hear your
5 presentation.
6
7 PRESENTATION BY DOMINION OF CANADA:
8 MR. STEVE WHITELAW: Thank you, Mr.
9 Chairman. When I was here in the Spring with my colleague
10 Shanz Binyear (phonetic) you invited us back for this
11 Hearing so I've taken you up on your offer and I've
12 brought my colleague Mr. Doug Hogan with me. He is
13 Senior Vice President and Chief Financial Officer of the
14 Dominion.
15 My name is Steve Whitelaw. I'm Vice
16 President, Product Development. We thank you for the
17 opportunity to be here today.
18 I am going to give you a little bit of a
19 detailed picture about the Dominion just to set some of
20 our comments in the context, and we'll offer some
21 thoughts with respect to the appropriate level of ROE,
22 and then my colleague Mr. Hogan will carry on with the
23 remainder of the presentation.
24 We are as you know 100 percent Canadian
25 owned and operate only in Canada. As a result the

1 management decisions made by our executive management
2 team, our frontline people and our Board of Directors are
3 made by Canadians who understand the Canadian marketplace
4 and understand the -- the products that we're selling.
5 Our shareholder measures our performance
6 over the course of a cycle as opposed to any -- any
7 shorter term measure quarterly or annually. We are
8 evaluated by our performance over the cycle. This is --
9 this affords us the luxury of meeting the expectations of
10 our shareholders and our policyholders through
11 consistency, stability, and transparency.
12 Consumers in Alberta should experience
13 competitive, stable prices over time. Price volatility
14 has practically nothing to do with ROE pricing
15 assumptions and everything to do with claims costs and
16 investment income.
17 We feel that competition fostered through
18 the allowance of company-specific pricing assumptions
19 best serve the consumer in the long term. When profits
20 reach above average levels in a competitive marketplace
21 prices stabilize and often decline.
22 Therefore we encourage the Board to
23 continue their good work and to remain focussed on the
24 integrity of the automobile insurance product to ensure
25 claims costs are controlled. And we suggest that the

1 Board not set a profit target or cap but permit each
2 insurer to select its own ROE assumptions for its own
3 unique circumstances.
4 There is a -- there is no practical need
5 for establishing a target or maximum ROE, mainly because
6 the assumed ROE does not necessarily translate to the ROE
7 that is actually achieved and as a result this acts as a
8 poor tool to manage price volatility.
9 The industry has generated a reasonable
10 but not excessive average ROE through the last twenty-
11 eight (28) years, as you've heard before I think the
12 number is in the order of 10 or 10 1/2 percent, and
13 during each of the four (4) cycles during that period.
14 And you've seen this picture before.
15 A couple of things I'd like to just
16 reinforce on this. The average ROE of 10 percent is
17 clearly not excessive. The insurance cycle is
18 continuing. There's -- periods of higher returns are
19 required to offset the periods of lower returns and it
20 was only a few short years ago that we were at record low
21 returns.
22 I've indicated the average ROE's through
23 the last four (4) cycles on the chart and I'm going to
24 just add to that with Dominion's own experience, just to
25 further make the point that a target ROE or an average

1 ROE doesn't match to every company's circumstance.
2 In the first cycle through '78 to '83 --
3 we have data actually from '80 to '83, but our return on
4 equity was 12.7 percent compared to the eleven point two
5 (11.2). In the second cycle noted, our ROE was three
6 point four (3.4) compared to the nine point nine (9.9)
7 for the industry.
8 In '87 to '96 our ROE was twenty point
9 seven (20.7) compared to the ten point six (10.6). And
10 from '97 to 2004 our ROE was nine point seven (9.7)
11 compared to the eight point six (8.6) demonstrated by the
12 industry.
13 Overall that yielded a -- a return for
14 Dominion of 14.5 percent; that being the twenty-four (24)
15 year average from '80 to '94.
16 And again just to reinforce that point, in
17 the last full cycle the Dominion produced a combined of
18 one-o-four point three (104.3) and after tax net income
19 of 5 percent. And that translated to an ROE of nine
20 point seven (9.7).
21 Of note this nine point seven (9.7) was
22 achieved -- that -- that was achieved was less than what
23 we had indicated as our target ROE in our filings.
24 MR. DOUG HOGAN: Thank you, Steve.
25 Hello, everyone. If the Board is happy with and accepts

1 our first recommendation that we just left we could
2 actually end our presentation here and that would be
3 great. But just in case not I have a few comments on
4 some of the other items that were raised in you seeking
5 some input.
6 The next item is with respect to the
7 reconciliation or the appropriate values, I think were --
8 were the words used, of the items that reconcile ROE to
9 the so-called profit provision.
10 And when I use the term 'profit
11 provision', rightly or wrongly, I'm assuming it's the
12 after tax net income divided by net earned premium. And
13 I'm not sure if it was before tax or after tax that is --
14 that the Board is thinking in terms of. But just to be
15 clear I'm thinking on the after tax basis which ROE also
16 is after tax.
17 So the first point we want to do or want
18 to make here is to...
19
20 (BRIEF PAUSE)
21
22 MR. DOUG HOGAN: The first point we want
23 to make is simply a reminder of the many factors that go
24 into both the ROE and the profit provision. And many of
25 these assumptions if you -- as you probably heard too

1 many times already, are difficult to predict. We have
2 historical data but when we're pricing, we're pricing
3 this year's product coming up and we have to project and
4 look ahead to these many assumptions.
5 And again just to emphasize, the boxes on
6 this slide are intended to somewhat categorize the
7 different pricing inputs into several areas of a
8 company's operation.
9 So, for example, the operating style of
10 the companies differ greatly. There's distribution
11 differences. There's different investment strategies.
12 The reinsurance strategies are different among companies.
13 And if a broker intermediated companies they have
14 commissions to deal with and direct writers have their
15 own workforce costs.
16 And all of these pricing inputs differ by
17 company and they reflect different responses to -- to the
18 business.
19 Similarly, the way that claims are managed
20 by companies are also different. Claims costs themselves
21 differ due to many external factors. We've heard many of
22 them. We had traffic congestion, the legal environment,
23 trends in -- in the cost of vehicles, et cetera. And
24 different books of business attract different claims and
25 -- and these differences vary by company.

1 And then how a company will settle claims;
2 some may have bias to settle quickly with less questions
3 asked and others may take a more rigorous approach, for
4 example.
5 When all of these inputs are determined,
6 as best one can try to do in -- in the actuarial element
7 of pricing, at the end of the day the ROE and the profit
8 provision which both containing all of these inputs are
9 linked together by the level of capital that is assumed.
10 So in answering the question, what are the
11 key reconciling elements between ROE and the profit
12 provision, the simple answer or the -- and the main
13 answer is that it's the capital level or the leverage
14 that a -- an insurer runs with. And that leverage is
15 normally expressed in the premium to surplus ratio; the
16 level of premium dollars for every dollar of capital.
17 So with that context here are our comments
18 on deriving a profit provision and what to do with it.
19 The first bullet on this slide simply brings the two (2)
20 provisions -- or the two (2) ratios together. The profit
21 provision can be calculated by taking ROE and dividing it
22 by that leverage factor, the premium to surplus ratio.
23 So to summarize what that all means, it
24 means that in taking a company's ROE to a profit
25 provision we have to assume how much capital that entity

1 is carrying. And as we'll make the point a little later
2 as well, that differs by company as do all the other
3 factors.
4 Just by way of illustration, what I've
5 done here is I've put the last eight (8) years or the
6 last cycle's worth, which is eight (8) years of income
7 statements and balance sheets from the Dominion of
8 Canada, and I've averaged the income statements for those
9 eight (8) years in the dollars, and averaged the balance
10 sheets and the equity dollars, and provided, as a result
11 of that, a weighted average of the Dominion's ROE, and
12 the profit provision that equates to this ROE, just for
13 illustration.
14 So in the first column these are the
15 average dollars for eight (8) years, going back. And the
16 average capital and surplus of all eight (8) years added
17 up, divided by eight (8), is 360 million. And compared
18 to the top line, the gross premiums earned, that gives
19 you a premium to surplus ratio of about two (2).
20 So during that eight (8) year period
21 Dominion carried one dollar ($1) of capital, on average,
22 for every two dollars ($2) of premium that we wrote. And
23 as a -- another key factor is that the net income average
24 for that same eight (8) year period was 35 million. And
25 35 million divided into the average equity for the period

1 gives you an average -- weighted average ROE of 9.7
2 percent.
3 When you go to the right column it's all
4 the same information, now divided by gross premiums
5 earned, such that the bottom number, the net income
6 number, is that five cents (.05) was earned by Dominion
7 on the -- on the one dollar ($1) of premiums on average,
8 written during that eight (8) year period. And so using
9 an after tax assumption for the profit provision,
10 Dominion's 9.7 percent ROE equates to a five cent (.05)
11 profit provision or 5 percent.
12 A couple of comments on this. First of
13 all, the reason that the ROE of nine seven (97) equates
14 to five cents (.05) is because of the capital that
15 Dominion carried. We carried capital of roughly two (2)
16 to one (1). Right now as with most of the industry our
17 capital level is much higher than that and our ratio is
18 much lower, and earlier on in that period we were
19 carrying less capital. And there were external factors
20 for that. There were investment factors.
21 Lately, admittedly, there are retained --
22 there are higher retained earnings which are accounting
23 for a higher level of capital.
24 All to say that it is in our view
25 dangerously simplistic to assume a level of capital in

1 order to tie the ROE assumption to how many cents on the
2 dollar that profit provision needs to be. And so we
3 express concern with that. We've shown you the example
4 historically in Dominion's case. It would differ for all
5 of the last four (4) cycles we've been in.
6 This would differ greatly by company as
7 well and -- and for the industry itself. I don't have
8 industry data on this basis.
9 But we'd be very concerned that with
10 different choices of invested capital you're going to get
11 a different number and I'm not sure that difference is
12 meaningful for setting a pricing assumption.
13 A couple of other things to point out, if
14 you look on the right column and look at every cent or
15 every premium dollar, notice that the underwriting income
16 number is a loss. We lost four cents (.04) on -- on an
17 underwriting basis only, no investment income yet, for
18 every dollar ($1) premium that we wrote for that eight
19 (8) year period. And this is -- these are Canada-wide
20 results for Dominion.
21 And so the -- the other important thing to
22 recognize as an -- as a value that you're trying to come
23 up with an appropriate level for, is the investment
24 return, because during this period there were very
25 volatile investment results and probably historically

1 high investment results. Although the early 2000's did
2 provide a big correction
3 And so for every dollar of premium,
4 Dominion experienced eleven cents (.11) of normal
5 investment return, that's dividends and interest, and --
6 and gains and capital gains and losses. I'm not sure off
7 the top of my head what the breakdown is. It's probably
8 about two-thirds (2/3's) dividend and interest regular
9 investment income, and about one-third (1/3) from gains.
10 And that third is a bit of a high number.
11 And we're not looking forward at the
12 moment to quite so high returns in the current
13 environment. And then we have our tax rate down to five
14 cents (.05).
15 So to conclude from that illustration, our
16 recommendation to the Board would be similar to our first
17 recommendation, to not set -- despite hearing what the
18 mandate of the Board is, but to resist setting a profit
19 provision that is anyway constraining of what otherwise
20 will occur in the market, and rather to focus, as Steve
21 said, on the product side of the equation, the -- the
22 claims costs which is the single largest determinate of
23 the fluctuations and of the -- the variability in profit
24 between companies and over time.
25 It's not the answer -- it's not exactly

1 answering your question which was: What should the
2 numbers be? Our recommendation though is to let the
3 market produce the numbers, let companies assume their
4 own values in their pricing assumption and observe what
5 the market will do, and review and watch for outliers.
6 But just to take a -- a tangent for a
7 moment or -- or drill down a little bit more, since
8 capital is the key element that links the ROE assumptions
9 to the profit provisions assumptions, let me make a few
10 comments about capital in Canada.
11 As you're no doubt aware most insurers'
12 solvency and capital levels are regulated by the Federal
13 regulator, the Office of the Superintendent of Financial
14 Institutions of Canada, through their minimum capital
15 tests, the MCT. And in our view it's a very -- their
16 overall regulation is rigorous and is one of the -- meets
17 one of the highest standards in the world.
18 There have been studies done. The IBC
19 commissioned one and noted that the Canadian requirements
20 for solvency are among the highest in most of the -- in
21 western countries in the world that -- that have a
22 similar insurance product.
23 And therefore there should be I guess
24 respect in the pricing that that is the environment that
25 we are in. We have to maintain sufficient capital.

1 This capital is fully in support and
2 available for the drivers in Alberta, as in other
3 provinces in which a company may write, and a return on
4 that capital is -- is sought. But my main point is that
5 the capital levels in Canada, despite the modelling,
6 despite the tests, despite all of the math, are largely
7 dictated by the Federal regulator.
8 Companies would tend to provide -- would
9 tend to want to put up less capital to earn the same net
10 income and have a higher return and that's a -- the
11 shareholder's always seeking less capital in -- in a
12 venture and the regulator is seeking more capital. And
13 we -- we believe that over time that provides an
14 equilibrium between those two (2) stakeholders'
15 interests.
16 I'm going to skip through the next couple
17 of slides now because I don't think anyone deserves as
18 much punishment as -- as you seem to have to go through
19 in these hearings, and hear from accountants and
20 actuaries. Me being an accountant, so I -- I guess I can
21 say that.
22 But just -- if you are interested in
23 taking a look at how much capital a company provides in
24 support of Alberta auto. I believe you can do some very
25 easy adjustments to the minimum capital test that we all

1 have -- the Federally regulated entities have to use.
2 And several of those components can use data such as
3 unpaid claims, unearned premiums, and this data is
4 segregated in the annual filings to OSFI by province and
5 by line of business, more or less.
6 And we can use that data for -- for those
7 elements where it is segregated and do an MCT, if you
8 will, for Alberta Auto. And for the data elements, not -
9 - not to go into them and bore you with that, but for the
10 data elements that we can't easily attribute to a
11 province or to a line of business we would simply take
12 the pro rata share that Alberta Auto is on some basis,
13 whether it's premiums or whether it's the liabilities or
14 whatever it is.
15 And in particular, the capital that is
16 available for the company overall, should be -- an
17 allocation on -- on some reasonable basis can be made to
18 Alberta -- Alberta Auto, so that we -- we can estimate
19 capital available to Alberta, Alberta capital required,
20 and have an MCT ratio just for the Alberta book of
21 business; the auto book of business.
22 So if -- that's one (1) suggestion if you
23 are pursuing in more detail a way of looking at how much
24 capital is allocated to Alberta auto.
25 I don't think companies do that, by the

1 way, in the normal course but it's an easy way to do it
2 and -- and that slide just says what I just said.
3 So to conclude, with respect to capital
4 and the other components and answering your question,
5 what -- what are the appropriate values and reconciling
6 between ROE and profit provision, our main response is we
7 -- we request that you would not set so-called
8 appropriate values, but rather let companies assume their
9 values as they look forward for the next year in setting
10 their prices, and let the invisible hand of the market
11 govern over time what those values are.
12 And with respect to the third question, in
13 converting the ROE to an underwriting profit provision,
14 we've essentially covered that. And I would -- I would
15 like to recommend that instead of setting values that the
16 Board would review the values, review them in the
17 filings.
18 For example, in -- in our materials that
19 we submitted, we provided the permissible loss ratio
20 calculation that our actuary uses. And I think it is a
21 very standard approach with many companies which shows
22 most of the elements that we're talking about here
23 starting with the various input assumptions: what's
24 investment return going to be; what's my capital level
25 going to be; what -- what's my expense load going to be;

1 what's my target profit needing to be? And by putting
2 all of those together we -- we determine the price that
3 we are pursuing.
4 Now, we can take all of that same data and
5 create a user-friendly, hopefully, form or format that --
6 that would accompany the filings; different from the
7 format that I understand is now in place and with a
8 little more detail. And that would allow the Board and
9 its staff to review these various assumptions and look
10 for outliers and understand why a company is so far
11 different this year versus last year or to the peer
12 group, and take more of a -- a review approach to making
13 sure that Albertan drivers are -- are being served with
14 reasonable pricing assumptions.
15 Lastly, this one's closer to home for me
16 being an accountant but let me give you relief by saying
17 this is my shortest item to make comments on. And you've
18 heard some good -- good input on this already, in my
19 view.
20 The -- first of all I agree with others
21 that we don't exactly know what's going to happen because
22 there is optionality in this accounting standard, which
23 is -- which is not really a good thing for most
24 accounting standards. But companies do have choices on
25 how certain investments will be treated in the income

1 statement, in particular. And so we don't know for sure.
2 My guess and the approach that the
3 Dominion plans to take is to follow what most US insurers
4 do because they've been under these accounting rules,
5 essentially the same rules, for about ten (10) years.
6 And what is -- the -- the results of all of this when you
7 boil it down, is that there is now a new second income
8 statement. And that new second income statement will
9 largely embody the unrealized gains and losses and
10 movements, paper gains and losses in investments, for the
11 most part, certain other aspects, but in our industry
12 mostly investments.
13 And based on my guess on what selections
14 companies will make, again subject to what it -- remains
15 to be seen, but certainly in our case our net income as
16 it is today will largely be unchanged but -- and there
17 will be this new second bottom line.
18 So this is not -- this is not accounting's
19 finest moment. But we now have two (2) bottom lines and
20 to compare companies between each other you need to look
21 at the second bottom line which has everything in it
22 because the choices a company can make are which bottom
23 line certain changes are going to flow through.
24 So if -- if we stick to just the -- the
25 first level of net income which will still be called net

1 income, comparability is -- is going to decrease,
2 variability may increase on that level, and companies
3 will not be comparable for that net income.
4 And you will need to look at the second
5 bottom line. And the unfortunate part of looking at the
6 second bottom line is that it will include of paper gains
7 and losses that haven't happened yet. They've happened
8 on the market but the company hasn't actually taken those
9 profits or losses for real as yet.
10 So our expectation of what's going to
11 happen is that over time ROE isn't going to change
12 because the new accounting rules simply change the timing
13 of when you recognize certain investment gains and
14 losses.
15 So, over time it's not really an issue as
16 long as you're looking at the second bottom line. But
17 you will have to suffer through increased volatility in
18 the accounting results, all else being the same, thanks
19 to this new standard. And for that, that's very
20 unfortunate.
21 But again, consistent with the input of
22 other presenters, we really urge the Board to take a long
23 term view on the return on equity and the profit
24 provision, not a short term one (1) year approach. And
25 therefore this new accounting standard over time after a

1 little bit of noise and volatility, ROE's will, over
2 time, average to essentially what they otherwise would
3 have been.
4 I'm not sure if that was entirely helpful,
5 but that's how we see it.
6 Anyways, that ends our comments that we
7 were planning to make and we'd be happy to answer any
8 questions.
9 THE CHAIRPERSON: Thank you. Ted, or
10 this end of the table?
11
12 QUESTIONS BY BOARD:
13 MR. TED ZUBULAKE: Yes. First, just to -
14 - for the record, the -- the calculation -- the table
15 you've presented showing Dominion's average return on
16 equity, 1997 to 2004, you showed in that second column
17 that the net income equated to 5 percent of premium.
18 MR. DOUG HOGAN: Right.
19 MR. TED ZUBULAKE: I just, for the record
20 again, that 5 percent while it's the same number that the
21 Board is using in its -- in its rate adjustments, it's
22 just a coincidence? Those are apples and oranges?
23 MR. DOUG HOGAN: Absolutely.
24 MR. TED ZUBULAKE: Okay.
25 MR. DOUG HOGAN: Yes, thank you. I

1 forgot to mention that. Thank you.
2 MR. TED ZUBULAKE: Yeah. Thank you for
3 the suggestion of what to do with the MCT. I'd like to
4 try to get an Alberta capital -- level of -- capital
5 level, we'll take a look at that.
6 Have you done that analysis?
7 MR. DOUG HOGAN: It would be very easy to
8 do.
9 MR. TED ZUBULAKE: Yeah.
10 MR. DOUG HOGAN: I haven't actually done
11 it, but --
12 MR. TED ZUBULAKE: Okay, but we will --
13 and lastly, you recommend the Board not set a profit
14 provision. I'm going to ask the same question we've asked
15 other presenters.
16 MR. DOUG HOGAN: Right.
17 MR. TED ZUBULAKE: Of course, the fact is
18 the Board has to set something, select a profit provision
19 in order to determine the industry-wide adjustment --
20 MR. DOUG HOGAN: Hmm hmm.
21 MR. TED ZUBULAKE: -- unless you have
22 something else in mind. But given that, what do you
23 suggest the Board do?
24 MR. DOUG HOGAN: And I'm being totally
25 serious. I would urge you to make it as high as you can

1 to allow, you know, consistent with our recommendation,
2 the market to operate.
3 Because, in our view, we don't have a
4 problem with ROE in the industry or, I should say, I
5 don't believe the consumer does. 10 1/5 percent compared
6 to banks and other industries in Canada is certainly not
7 excessive.
8 And we recognize that 20 percent right now
9 is sensitive.
10 MR. TED ZUBULAKE: Hmm hmm.
11 MR. DOUG HOGAN: But I guess what we
12 would ask for is a ceiling that would limit offensive,
13 whatever that is, and I don't know what that answer is --
14 certainly, you know, it's always a balance between the
15 different stakeholders; shareholders here, investing
16 capital, providing protection to drivers, all of their
17 capital is at risk; and on the other hand, consumers
18 getting a fair deal.
19 So, our view would be, we don't have a
20 number for you on that but if there is a number that the
21 Board could agree is offensive, such that, you know, it
22 would be embarrassing for the Board -- for it to be
23 publicly known that the Board approve an ROE of X, that
24 would be our recommended number.
25 And, I believe the actual number will end

1 up continuing to be much less than that.
2 MR. TED ZUBULAKE: Yeah.
3 MR. DOUG HOGAN: Our rate filings in
4 Alberta in the last ten (10) years, I think, I think all
5 but one (1) year we pursued 12 1/2 percent. And in the
6 last cycle we did not achieve that, the market took care
7 of that for us.
8 MR. TED ZUBULAKE: And one (1) last
9 question. I think, as you know, the Board actually in
10 the industry-wide adjustment, doesn't talk in terms of
11 ROE, it uses a percent of premium. Of course, everybody
12 else tries to convert that to an ROE.
13 MR. DOUG HOGAN: Yeah.
14 MR. TED ZUBULAKE: There were reasons for
15 doing that. One -- the major one being the Board didn't
16 want to get into an ROE kind of issue -- regulatory
17 issue.
18 Do you have any problems with a percent of
19 premium approach as opposed to starting with a target ROE
20 then converting it to a percent of premium?
21 Is there anything wrong that you see with
22 a percent of premium approach, given that the number is -
23 - you accept the number as reasonable --
24 MR. DOUG HOGAN: Well, theoretically I
25 would say that the profit provision is wrong because it's

1 a return on capital is what shareholders are looking for.
2 So, a percent of a premium dollar, that
3 percent is very different by line of business and by,
4 perhaps, by jurisdiction as well, for different risk
5 factor reasons. However, to be -- to try to be somewhat
6 helpful on a more practical basis, I think is -- if the
7 Board adopts a ceiling approach, then I think similarly
8 we could -- we could be happy with a ceiling that's high
9 enough but expressed as a profit provision.
10 MR. TED ZUBULAKE: Okay.
11 MR. DOUG HOGAN: And that would mean that
12 the cap -- there should be also in the range of capital
13 levels that companies would choose, that you would allow
14 room for a generous, i.e., a higher capital level; say
15 like a one (1) times, you know, every dollar of premium
16 is supported by a dollar of capital.
17 There are certain -- certain famous
18 western based companies that have capital levels right
19 around there.
20 MR. TED ZUBULAKE: Hmm hmm.
21 MR. DOUG HOGAN: And for them, and for
22 their policyholders, that's a great thing and they want
23 that.
24 MR. TED ZUBULAKE: Hmm hmm.
25 MR. DOUG HOGAN: And other shareholders

1 might want to put less capital --
2 MR. TED ZUBULAKE: Right.
3 MR. DOUG HOGAN: -- in the company. So
4 if you can allow a low premium to surplus ratio and a
5 high ROE ceiling that hits the offensive level, then --
6 and convert that to the --how many cents of premium
7 dollars, then I think that, practically, that would be
8 our suggestion.
9 MR. TED ZUBULAKE: Thank you.
10 THE CHAIRPERSON: Any further questions?
11 MR. BILL MOORE: One thing I don't think
12 the Board has heard much about in the last couple of days
13 is, who do these profits eventually accrue to?
14 And, going back to some of our discussions
15 earlier and ignoring your -- your largest shareholder for
16 the minute, but do you --
17 MR. DOUG HOGAN: All right.
18 MR. BILL MOORE: -- have a sense as to
19 who your shareholders are? Are they fat cat capitalists
20 or are they pension plans and RRSP's and individuals?
21 MR. DOUG HOGAN: Thank -- I'd like to
22 take the opportunity just to gloat a little bit, if I
23 could, on that point.
24 We are a majority controlled by one (1)
25 Canadian family through their ownership of our

1 shareholder. Our shareholder owns us a 100 percent;
2 that's EL Financial Corporation Limited. They're
3 publicly traded on the TSE -- TSX, sorry, and they own
4 they majority of those shares.
5 They're a very -- a very humble family.
6 Duncan Jackman, our chairman, and the chairman of EL, was
7 just reported in the Report on Business magazine as being
8 -- giving the second biggest bang for his CEO pay buck to
9 shareholders. He ranked number 2. And that is how much
10 profit does he -- how much return on the stock did he
11 generate for his pay and he had the second level.
12 He slipped from first place last year.
13 So, the Jackmans are very conservative, long term view
14 investors and they're committed to Canada and we only do
15 business in Canada.
16 The other shareholders, which is still a
17 very large component are essentially pension plans. And
18 to be a little bit facetious, perhaps, our shareholders
19 are families and retirees and active employees who are
20 saving for their retirement.
21 And I'm not aware, if we even have any US
22 shareholders in there. There may -- there might be a few
23 funds who are there. But -- but of what I know, our
24 shareholders are basically Mom and Dad here in Canada.
25 MR. BILL MOORE: Thank you.

1 THE CHAIRPERSON: Any further questions?
2 Well, thank you very much. We appreciate
3 it. As you pointed out we have a lot of work on our
4 hands and we have a lot of -- well, we don't know if we
5 have a lot of different opinions, but we certainly had a
6 lot of opinions so far. And we'll be taking those into
7 consideration and it'll take us some time to machinate
8 and, of course, we'll come down, by -- sure for next year
9 because we have a requirement by mandate to make a
10 decision.
11 So, thank you very much, and we'll
12 probably see you again, I'm sure.
13 MR. DOUG HOGAN: Thank you for the
14 invitation.
15 MR. STEVE WHITELAW: Thank you very much.
16 THE CHAIRPERSON: Five (5) minutes.
17
18 --- Upon recessing at 1:34 p.m.
19 --- Upon resuming at 1:39 p.m.
20
21 THE CHAIRPERSON: All right. This
22 afternoon I guess the last presentation we have is with
23 ING. And Jetse do you want to introduce your -- I got it
24 right? It's only taken about four (4) hearings.
25 Would you like to introduce your people.

1

2 PRESENTATION BY ING:

3 MR. JETSE DE VRIES: I would like to

4 introduce -- I would like to start saying that I'm very

5 happy that we're here again and there's a risk to

6 becoming repetitive in our messages but -- but we still

7 take that risk.

8 But thank you for allowing us to do a

9 little presentation. And, you know, I've been -- I still

10 feel like a new Albertan here because I -- I still have a

11 very heavy accent, that it's been only three (3) years

12 that -- that we moved from Spain to -- to Alberta.

13 One of the reasons that we moved was

14 actually the -- the economic climate in Alberta and we

15 thought that it's great to be -- to be in an area where -

16 - where there is still so much things to do and to play

17 an important role in that economy and -- and work in the

18 insurance sector which is, I think, an essential part of

19 the economy. And things are going well.

20 And ING is going well as well. And I

21 think ING and I myself love Alberta as well because

22 actually we -- we were just looking into the numbers of

23 ING in Alberta is now bigger in number of customers than

24 Ontario, for instance, which shows that -- that Alberta

25 is a very important part of ING Canada.

1 So, plenty of reason to -- to ask -- to
2 ask some things from you and -- as I am not an expert in
3 anything. We have three (3) people here who -- who will
4 do the most of the talking.
5 Bill Premdas you've -- you've met him in
6 the last rate board hearing. He's our VP for actuary
7 here in -- in West Canada.
8 Martin Beaulieu is the senior VP for
9 personal lines. He works from -- from Montreal.
10 And Don Fox is Managing Director of
11 investment banking of CIBC. And he -- he can talk as if
12 he were an investor who needs to allocate his capital
13 very well -- doesn't -- relatively independent party.
14 And I have a couple of slides but I'm not
15 sure how I can move them.
16
17 (BRIEF PAUSE)
18
19 MR. JETSE DE VRIES: Okay. So I think
20 the reasons...
21
22 (BRIEF PAUSE)
23
24 MR. JETSE DE VRIES: Well, one of the
25 things that ING loves about Alberta, as I said, is its

1 climate that has to do with innovation and knowledge
2 based progress.
3 When you read the web -- the website of
4 the Government we always talk about the Alberta advantage
5 and I think that works quite well for -- for ING. And we
6 really appreciate to do business here because there is
7 this entrepreneurial atmosphere and there's competition.
8 And competition is very important for ING because even in
9 our strategic objectives, we say that we would like to
10 beat the competition as our main objective for doing
11 business.
12 So -- so competition is important and --
13 and we try to -- to beat the competition, but by coming
14 up with more innovative products and setting a little bit
15 sharper price.
16 And I think the question for ING is to
17 which extent we can do that in Alberta as well?
18 We also see that on the website we -- we -
19 - the Government is committed to have less regulation to
20 enhance competition and that -- and we like the -- the
21 fact that the Government is fiscally responsible and that
22 it has eliminated any provincial debt which shows that
23 the province is actually an entrepreneur itself.
24 I think that there also something in the
25 website that it says that there's no -- that there's --

1 there's -- there isn't any need for -- for regulations of
2 profits or ROE's and I think that we will mainly focus on
3 ROE in our discussion. But, of course, profit margins
4 are closely linked to that.
5 And one of the things that we -- that we
6 found very interesting was a part on the -- on the -- on
7 regulations of profits in a totally other industry which
8 is the -- the rental industry; rental prices of -- of
9 house in the housing market.
10 And I would like to quote something that
11 the government has says that:
12 "Experience shows that the rent
13 controls are harmful to the rental
14 housing market over the long term.
15 Rent controls discourage development of
16 new rental housing and fewer units are
17 available for rent. Some landlords
18 reduce maintenance of property or
19 provide fewer services as a method of
20 reducing operating costs, therefore
21 buildings start deteriorating."
22 So that's our own government here in
23 Alberta that says if you -- if you regulate profits,
24 things will -- will suffer. Service will suffer. Supply
25 of products will suffer. And we are slightly afraid that

1 it will happen or that it's already happening in the
2 insurance industry as well.
3 And, of course, our main -- main thinking
4 is that if you ask an investor what is important for him
5 or her, then it's -- it's just a hope that you will get a
6 great return on your investment.
7 I think that even if you would invest your
8 own money then it's always great to see that after some
9 time, like here in Alberta your house -- in the housing
10 market that your -- the value of your investment went up
11 by 30 or 40 percent.
12 If you don't -- if you're not allowed to
13 even have that hope then -- then I think then you take
14 away an essential element of -- in thinking of -- of
15 investors.
16 And ING -- ING is -- is a big corporation.
17 ING Canada is quoted from the Stock Exchange in Toronto,
18 so our owners are -- are pension holders, families, small
19 and big investors, also still a very big investor in
20 Holland called ING Group. But they basically all have
21 the same interest in the well being of this company, ING
22 Canada, and especially in Alberta where we are so big.
23 So, the purpose of our presentation is to
24 show what our investors or shareholders think about --
25 about what needs to be done in Alberta. Also to tell you

1 how they allocate their -- their capital and what we find
2 important to -- to make good money.
3 And I think that there's a -- as a general
4 comment we believe that that's having the freedom to
5 compete and not to have high limits of -- of ROE would --
6 or to have high limits of ROE would be in the interests
7 of everybody.
8 It's, of course, in the interest of the
9 investors. But we hope to show you that it's -- that
10 it's predominantly also in the interest of the consumers
11 of the Albertans, to get good products and to get good --
12 good premium rates that are the result of good
13 competition.
14 So, that as an introduction, let me first
15 present Martin Beaulieu who wants to talk about the cost
16 of equity for automobile insurers operating in Alberta.
17 And he will base his presentation on academic piece of
18 work prepared by Dr. Abdul Rahman who was unable to
19 attend today but who did the same presentation for New
20 Brunswick some time ago.
21 Martin...?
22 MR. MARTIN BEAULIEU: Well, good
23 afternoon, everyone. I will first, as Jetse is saying,
24 highlight a few of the conclusions of Dr. Rahman's paper
25 estimating the cost of capital for Canadian P&C insurers

1 that have been prepared for a similar exercise in New
2 Brunswick. The conclusions of -- of that study are still
3 relevant for -- for the Alberta context.
4 So, Dr. Rahman' report is based on state
5 of the art methodology proposed by Cummins and Phillips
6 which you have already heard from yesterday in the IBC
7 presentations. And their methodology modifies the
8 traditional CAPM model to incorporate the infrequent
9 trading and evaluation based on lines of business.
10 And the main conclusion of that study is
11 that the ROE should range between 12.4 percent and 16.6
12 percent and which is in line with the recommendations
13 that you've heard from IBC yesterday.
14 His report also discusses the economic
15 questions as to whether consumers will receive the most
16 advantage price offer insurance proposition if prices
17 were regulated by way of setting ROE rather than if they
18 were set by market forces.
19 The presumption of price regulation is
20 that the market equilibrium price will be too high for
21 consumers to bear. Hence the necessity to regulate price
22 is usually lower than the market equilibrium price.
23 This leads to obviously consequences. And
24 while not experienced yet in Alberta as we have seen
25 already in some US jurisdictions, that there have been --

1 that there have been consequences in -- in going too far
2 in that direction.
3 So Dr. Rahman then goes on to explain that
4 a fair market determined rate of return on equity will
5 lead to more choices as firms compete on product
6 innovation and value added feature; he cautions, using an
7 average feature of overall firm risk as a biassed
8 estimate of the risk of any one (1) line of business
9 would occur.
10 A recommendation is given that if the
11 Board insists on regulating ROE for the basic automobile
12 business, two (2) underlying principles must be adhered
13 to. And these are estimating the ROE for auto insurers
14 based on line of business approach and the second one is
15 -- is that ROE is subject to sources of volatility that
16 emanate from changes in the risk free rate and market
17 risk premium. And the rational approach is to permit
18 auto insurers to operate within a range for a given time
19 period.
20 The fact that your Board is trying to
21 determine an appropriate ROE formula shouldn't mean that
22 you need to cast a number in -- in stone. Competition
23 does control this and you need to adapt to market
24 conditions and could assess on a company by company
25 basis.

1 Let me now turn my discussion towards ING.
2 I would like to explain what is expected of ING and the
3 goals we tell the investment community we strive to
4 achieve.
5 And not all the insurance companies have
6 the same business model or shareholder expectations.
7 At ING we strive to create a sustainable
8 superior performance gap as measured by ROE relative to
9 the Canadian P&C industry of not less than five hundred
10 (500) basis points. And the reason for that is that we
11 compete for capital on markets with other sectors of the
12 economy. And the other sectors of financial services
13 have delivered depending on the sector between 14 and 20
14 percent ROE's over time.
15 The historical ROE of the P&C industry
16 when we look at it between -- in the last ten (10),
17 twenty (20) or thirty (30) years, whatever we look at in
18 terms of period, has been ranging around 10 percent,
19 which in insufficient to -- to satisfy the expectations
20 of the capital markets when we compete with these other
21 sectors that have delivered higher returns.
22 So, this is why our goal is to out-perform
23 and in the industry that we're in that does not provide
24 adequate returns for our -- for our shareholders.
25 The second goal is to exceed the annual

1 organic growth rate and direct written premium of the
2 Canadian P&C industry by at least three hundred (300)
3 points, three hundred (300) basis points. And again, the
4 reason why we want to out-perform by three hundred (300)
5 basis points in terms of growth, is that historic annual
6 growth rates of the industry that have been between 3 and
7 5 percent is too low to create the value we're trying to
8 create for our shareholders.
9 And it is these goals that our investors
10 hold us accountable to and also which drive our desire to
11 compete aggressively for Albertans share of wallet.
12 At ING we have a commitment to reinvest a
13 significant portion of our profits in order to continue
14 to improve our service levels and ease of doing business
15 for our customers and distribution partners. And also we
16 want to increase the value to our customers through
17 product innovation and differentiation.
18 So, creating value for our shareholder
19 requires that we would grow. And to grow we -- we have
20 to reinvest a portion of our profits and that's -- that's
21 a factor that lowers ROE over time.
22 So, as a general rule, in a free market
23 system, the objective of regulators must be to ensure
24 that the effective working of the market ensures a high
25 level of competition in an environment where -- which

1 respects consumer rights and appropriate commercial
2 practices.
3 First -- fierce competition is generally
4 understood correctly in my view to be the most effective
5 guardian of the public interest. Such competition
6 encourages product innovation, improved customer service
7 as well as lower prices.
8 In fact, over time such competition will
9 tend to reduce returns on equity for investors as a
10 higher share of the economic value must be offered to
11 customers to attract their business.
12 Again, in the last -- in the last -- in
13 the past, returns have been around 10 percent for -- for
14 the Canadian P&C industry where returns in general have
15 not been regulated. So what we're trying -- I think what
16 you have to assess if we are in a new world where
17 conditions have changed and if -- if profits are suddenly
18 going to exceed historical profits.
19 We know that we are in a cycle -- in a
20 cyclical business and that the current profits are -- are
21 higher than -- than what they have been in average.
22 So this is your -- your mandate to
23 estimate what is -- what will be the future if we're in
24 that new economy where the 20 percent range ROE's will be
25 the ones or -- or if the market forces will bring that

1 back down to -- to historical averages.
2 So given the risk profile of -- of our
3 business and the returns that we observe in -- in other
4 sectors of financial services, this is evidence that the
5 competition is the best regulator of ROE's.
6 And what encourages fierce competition is
7 the potential for higher returns. And I -- I would
8 underline here potential because we have not observed
9 very high returns in the past but what has kept people or
10 -- or shareholders investing their capital in -- in the
11 Canadian P & C insurances is that they have the hope that
12 there would be higher -- that they would earn these
13 higher returns.
14 So this is why we feel so strongly about
15 the importance of the decision the Board makes on this
16 topic you have invited us to discuss today.
17 Last year the Autorite des Marches
18 Financiers in Quebec published its annual report on the
19 performance of the automobile industry in that province.
20 It reported that the industry was functioning well with
21 high levels of competition ensuring affordability and
22 accessibility for consumers.
23 I think it is fair to say that the
24 insurance crisis that has affected our province here in
25 Alberta did not touch Quebec. I would suggest that --

1 that you as a Board look at the practices that are --
2 that have been applied by the Quebec regulators that
3 there might be -- there might be items in there for you.
4 No ROE limits or no take-all-comers rules
5 have been imposed there and no limits on underwriting
6 segmentation and no requirements for any risk rate filing
7 approval process. So these are factors that we think
8 have contributed to competition in -- in Quebec.
9 Earlier you have heard from IBC which
10 included evidence of other jurisdictions where too much
11 regulation actually had a negative impact to competition;
12 higher costs and less service available to consumers. So
13 Massachusetts and New Jersey are very good case studies.
14 It's also of interest to know that when
15 New Jersey introduced new reforms in 2003 to encourage
16 more competition by lifting regulation, suddenly
17 seventeen (17) new entrants have moved into New Jersey
18 marketplace to compete for -- for a share of that market.
19 In Alberta we do not need to look far back
20 into the past to see this type of -- of behaviour from
21 the insurers of partially limiting their -- their
22 writings in the province. When -- when we look at the
23 early year 2000 we -- we have seen clear evidence that
24 when returns were not adequate for the marketplace, many
25 competitors chose methods to reduce or restrict their

1 automobile writings in the province.

2 Market did not exist during that last
3 crisis and that was a good thing. And what I again we
4 think has kept them in is -- is the hope that the returns
5 would come back and that they will be able to -- to
6 recoup some of the losses that they -- that they had
7 made.

8 So this is concluding my -- my section and
9 I will turn it back to -- to Jetse.

10 MR. JETSE DE VRIES: Okay. Thank you
11 very much. Thank you. I would like to invite Mr. Don
12 Fox to -- to speak. Don is a former Albertan. He -- he
13 had made the choice to move to Toronto probably because
14 his personal ROE's are higher there than here but maybe
15 you will come back, Don.

16 Don is a Managing Director and head of
17 Financial Institutions at CIBC World Markets. He has
18 over sixteen (16) years of experience in advising
19 financial services organizations on financing, M&A
20 transactions and strategic considerations.

21 He is therefore knowledgeable about what
22 appropriately levels of returns that financial markets
23 would look for in a company. So, Don?

24 MR. DON FOX: Thank you. It is actually
25 a great pleasure for me to be back in Calgary. It was my

1 home, as Jetse said, for 9 years. And if you'll allow me
2 a slight digression, my first full time job was in the
3 Norsen (phonetic) Tower. Across the street when this
4 building was still a school and the kids went out at
5 recess everyday. So it's kind of interesting to come in
6 for the first time.
7 What I'd like to -- to highlight for you
8 today or -- or summarize for you today is the way in
9 which our business would look at the cost of capital or
10 an insurance company operating in Alberta. That's not to
11 say that's how you should go about setting rates, that's
12 a -- perhaps a different question. But I think it's
13 constructive to look at what investors would look at for
14 rates of return and how they would assess that.
15 In our -- you've heard before from other
16 presenters I believe, about the capital asset pricing
17 model. And that is the basis upon which our business does
18 its work in valuing companies and evaluating the rates or
19 return that are appropriate.
20 And so I'll just highlight for you some of
21 the key things here. As I say it's -- the capital asset
22 pricing model is used universally in the investment
23 banking and investment industry by capital markets
24 practitioners.
25 It's based, as I'm sure you've heard

1 before on the risk free rate. There is a risk premium
2 that's added to that. And the practice in our business
3 over the past few years has also been to include a size
4 premium for businesses that are below a certain --
5 certain level.
6 The inputs again, are long term Government
7 bonds which today are at near historical lows. The risk
8 premium is determined by a combination of things
9 including risk premium measured over time, as well as the
10 beta, which is a measure of a company's risk relative to
11 the general market risk.
12 Interestingly enough, the Canadian P&C
13 companies of which there aren't a large number, it is a
14 limited sample, but the Canadian P&C companies have betas
15 which are lower than the average market, and
16 substantially lower; and in fact are also lower than US
17 P&C companies.
18 The general theory, I think, is that over
19 time the beta will revert to the market mean which is a
20 beta of one (1). And that in fact is close to where the
21 P&C companies in the United States are. They have a beta
22 of about point nine five (.95) which is close to one (1).
23 As I said the -- the risk premia as well
24 as the size premia are measured over a long period of
25 time by an organization called Ibbotson Associates, which

1 is a well recognized source, and again, used universally
2 in our business for -- for that input.
3 So the results of the work that we would
4 do if you asked us, what is the cost of capital for a
5 nondescript average company operating in the automobile
6 insurance market in -- in Alberta, is that we would look
7 at rates of return ranging, and it's a wide range
8 admittedly, but rates of return ranging from 10 percent
9 to 19 percent.
10 That compares to the calculations which
11 would give rise to results of 10 percent to 15 percent
12 for US insurance companies. The underlying assumption
13 with respect to size of company operating in Alberta is
14 estimated to be a -- a market cap of 140 million to 325
15 million.
16 And we did that based on looking at the
17 list of companies that operate here and OSFI data that
18 provides the capital of those companies have, not just in
19 Alberta but -- but overall.
20 I think it's worthwhile to point out a
21 couple of things here. First of all, the -- the betas
22 that are derived, both in the US and in Canada, are betas
23 generally for, first of all publicly traded companies
24 obviously, but also companies that are relatively
25 diversified. Some are more focussed than others but all

1 of them have business other than Alberta automobile
2 business.
3 And it's likely that as you get to
4 individuals lines of business the conventional logic
5 would be that the risk for an individual type of business
6 would be greater than a broad range of businesses.
7 And again, the -- the calculations are
8 with respect to public companies who have ready access to
9 capital in the public markets. Those that don't have
10 access to capital in the public markets would generally
11 be looking to provide investors with higher returns
12 simply because private companies don't have the liquidity
13 and therefore investors in private companies would
14 generally require higher returns.
15 There's no way to actually calculate that
16 or put a number on that. But I just wanted to point out
17 those other matters for your consideration. And, I'll
18 turn it back.
19 MR. JETSE DE VRIES: Thank you. So just
20 before going to Bill to profit -- the profit provisions
21 and surplus ratios, I -- I think that we would like to
22 say two (2) things as a sort of conclusion of what Don
23 and Martin said.
24 I think -- we don't think that there's a
25 big need to regulate ROE and actually that it is

1 inconsistent with what Alberta itself says and what it
2 has proven to be a model of success. We don't think it's
3 in the public interest.
4 Actually if you look at the -- the current
5 Alberta market we see that there's not a lot of movement
6 in premium levels because everybody is waiting for you
7 guys to set -- to set the premium every year. So there's
8 -- there's uncertainty of what you will do will -- will
9 make the companies quite -- quite careful which is maybe
10 not -- not in the best public interest.
11 What we also see internally ourselves is
12 that we -- we wait with product innovation because we
13 don't know what impact it will have in a long run. And
14 if -- we don't know exactly what -- what kind of
15 commitment you can give us for the ROE levels.
16 And just to give you a couple of examples,
17 in other provinces we have developed new products, like
18 what we call the responsible driver guarantee where we
19 forgive and forget claims.
20 In Quebec we introduced the zero
21 deductible, if I -- I'm not mistaken, Martin. You can
22 argue whether that's good or a bad idea.
23 But we would not try to experiment too
24 much here in Alberta just because you're afraid that
25 something will happen with the regulations or with the --

1 with the rates in this market. And I think that's also
2 not -- not so good for the customers.
3 And we believe that the competitive market
4 will enhance accessibility. And if you look at -- at the
5 number of new comers in this market in the last couple of
6 years it's -- it's practically zero. There has been one
7 new company who's now entering the market and picking
8 certain segments in the market that they think is -- is
9 profitable. But the rest of the market is stuck with
10 what we had basically three (3) years ago.
11 So in those dynamics we feel that the
12 regulations and the -- and the rate setting by Government
13 has not stimulated a lot of innovation and new capital.
14 For the annual rate adjustment we
15 recommend an ROE of between 13 and 17 percent. We don't
16 want to -- to put one (1) number on it because we -- we
17 feel that the market is way too complex and its companies
18 are way too different from each other to -- to have one
19 (1) single number.
20 And again, insurance companies must create
21 value for the investors by generating a return greater
22 than their cost of capital and we'll talk later more
23 about that.
24 And finally, the adjustment should apply,
25 that's the recommendation we have, only to the grid

1 business because that's the business that -- that we've
2 always wanted to protect. We have had the reform which
3 has affected all Alberta drivers. In fact, when we
4 started the reform discussions we said that we had to
5 protect the -- the young drivers not necessarily the bad
6 drivers who are all on the grid now.
7 But the reforms have gone much further
8 than that and in fact all -- all drivers and all premium
9 rates for -- for that matter. So that is a in-between
10 summary.
11 And I'd like now to introduce Bill Premdas
12 to talk a little bit more about the surplus ratio.
13 MR. BILL PREMDAS: Thanks, Jetse. Good
14 afternoon. It's a pleasure to be here to present to you.
15 This is my second time appearing in front of the Board
16 and I'm just thinking for -- for you folks, you've -- are
17 into your second day of sittings, you're close to the end
18 of the day and you're thinking, Oh boy, here comes the
19 actuary.
20 What my colleagues have talked about for
21 the first part of our presentation was really what we
22 thought is the appropriate return on equity level. I'm
23 going to use my time to address a couple of the other
24 questions that you've asked for -- for comments on.
25 And that is: What are the components that

1 help you reconcile from the return on equity to a profit
2 provision? And -- and the Board has stated that you'd
3 like to stay with that methodology of coming up with a
4 profit provision.
5 So I'm going to talk a little about what
6 are the appropriate components and then I'll talk a
7 little bit about now that we know what those components
8 are, what do we think appropriate values for those --
9 those components are.
10 If I just think back to the first
11 actuarial report you had from your consulting actuary in
12 2005, Mercer came up with a 5 percent profit provision;
13 that was 5 percent of premium. They -- they took -- took
14 that 5 percent profit provision and they -- they said if
15 you use a two (2) to one (1) premia surplus ratio and
16 given a certain tax rate, this equates to a 10.1 percent
17 return on equity.
18 And I think we ended up here today to, you
19 know, discuss is that ten point one (10.1) -- you know,
20 obviously there's been some disagreement from the
21 industry if that is a true measure of what we think is
22 embedded in the rates, and then again what should be the
23 rate measure.
24 So -- and -- and the way that they take
25 this, you know, they've done a nice job. They said,

1 Here's historically how large the loss costs are and
2 they've projected that forward and said, You know, if it
3 was a hundred dollars ($100) in 2003 after reformat,
4 after all these changes, it's -- it's going to be a
5 different amount.
6 And then they said, Oh by the way, you
7 know, you insurers, you don't have to pay that amount out
8 right away, you're going to pay it over -- over time. So
9 they discounted that loss cost back and said, Here's how
10 much money you need to collect to pay out your claims.
11 And then they said, By the way, you have to pay some
12 expenses, and by the way there should be some profit.
13 So on my top line I just got the -- that's
14 how Mercer came up with premiums, is they took the loss
15 cost, they discounted it back, they added an expense
16 factor, they added a profit provision and then they came
17 up with -- with the rate.
18 Okay. This is actually how those numbers
19 are calculated. The numbers in blue I think are the
20 assumptions that were made by your consulting actuary. 5
21 percent profit provision, a leverage ratio of two (2) to
22 one (1), so that's your premium to surplus, the
23 investment yields that they used was 5.2 percent and a --
24 and a tax rate, that's the Alberta tax rate.
25 Then they say, Okay, I've got a hundred

1 dollars ($100) of premium. You know, and the question
2 was being asked, Well what return equity does that
3 generate?
4 So if you had the hundred dollars ($100)
5 of premium and you've got a two (2) to one (1) premium
6 surplus ratio it means you've got fifty dollars ($50) of
7 premium. No, I'm sorry, fifty dollars ($50) of surplus.
8 We know the operating profit is 5 percent
9 of your hundred dollars ($100) so you're going to get
10 five (5) bucks there, or at least you're planning for
11 five (5) bucks there. You -- you had to invest that
12 fifty dollars ($50) of surplus so while it's sitting
13 there supporting your policy you're going to earn -- earn
14 some investment income. At the 5.2 percent, you're going
15 to earn two dollars and sixty cents ($2.60). So that
16 five dollars ($5) and the two sixty (2.60) gives you
17 seven dollars and sixty cents ($7.60).
18 Now you say I've made some profit on that
19 -- on that fifty dollars ($50), oh but by way, I've got
20 to pay some taxes. At my tax rate of thirty-three point
21 six two (33.62) I'm going to pay two dollars and fifty-
22 six cents ($2.56) of taxes.
23 It leaves him with five dollars and four
24 cents ($5.04) of after tax profit. And the five dollars
25 and four cents ($5.04) compared to the fifty dollars

1 ($50), that's your 10.1 percent return on equity that --
2 that your consulting actuary came up with.
3 So, you know, today we're -- we're kind
4 of looking at it from another point of view, we're saying
5 if you -- if you change that return on equity from ten
6 point one (10.1) to some other number, what -- what do
7 you do with that?
8 You know, if you decide that the Return on
9 Equity should be fifteen (15) or seventeen (17) or, you
10 know, fifty (50), what does that mean in terms of profit
11 provision. I think that's one (1) of the questions the
12 Board was asking.
13 So -- so clearly what you need to do to
14 get from that -- to get from the bottom then slide up to
15 the top is -- is figure out what were the key pieces to
16 that. If you know your return on equity for example is
17 going to be 17 percent, and it's just a number I'm using
18 as an example, you need some other assumptions.
19 You still need to know what's your
20 leverage ratio, what's that premium to surplus ration.
21 And you still need to know what's your investment yield.
22 And you still to know what -- what's the tax rate.
23 So I want to talk a little bit about that
24 leverage ratio because that's the important one, or one
25 of the important components of how you get from your --

1 the return on equity that you may decide upon to have a -
2 - put into a profit provision. What -- what -- which is
3 what I think you wanted to do.
4 You need to choose not only return on
5 equity, you need to choose that premium to surplus ratio.
6 If -- if you look at companies in Canada over the last 8
7 years, the actual premium and surplus ratio they've been
8 operating at varies from one (1) to about one point four
9 (1.4). It averages out to about one point one (1.1) --
10 I think one point one six (1.16).
11 So that's the actual premium to surplus
12 ratio they've been operating at. Just -- just as return
13 on equity for your planning is looking forward, you need
14 to look forward too, for that premium to surplus ratio.
15 So just because companies have been operating at that
16 level it does not mean that's where you need to plan for.
17 So another way to look at it is to -- to
18 look at what would the Federal regulator require based
19 upon solvency. All -- all companies in Canada need to
20 meet solvency requirements and for most companies who are
21 Federally regulated, then they need to meet what's called
22 the -- the Minimum Capital Test or the MCT.
23 The MCT is a test that the Federal
24 regulator has developed that -- that tries to say, how
25 risky is the business you write? If your business is

1 very risky then I'm going to require you to hold more
2 capital. If your business is less risky then I don't
3 need you to hold so much capital.
4 And -- and, you know, so for example, if
5 you're writing long tail line -- liability lines which
6 are volatile and you don't know what the payouts are
7 going to be and what the changes in legislation could be,
8 then you'll probably need to hold more capital. If
9 you're writing, you know, physical damage only, that's
10 less volatile, it's less risky, you don't need to hold as
11 much capital.
12 So the Federal regulator has come up with
13 this Minimum Capital Test. It's an interesting test
14 because they don't actually tell you how to pass it.
15 They tell you that every company must at least score 150
16 percent, but they also say they expect each company to
17 maintain a threshold above that 150 percent.
18 And -- and it could vary. We think the
19 average is between 170 and 210 percent that you must
20 score at. And that's -- again the regulator meets with
21 the company and decides what do we think that threshold
22 should be.
23 So you're got to be at least one fifty
24 (150). If you fall down to one fifty (150) the regulator
25 certainly will be taking action. But they expect you to

1 be above that so between one seventy (170) and two
2 hundred and ten (210).
3 I -- I guess why I spent the time trying
4 to explain this is that that's really how we look at it.
5 We look at what do we need to -- how much capital do we
6 need to hold in order to pass the solvency test.
7 It -- it -- once you know how much capital
8 you're holding of course you can back out what's your
9 premium to surplus ration. In that a hundred and seventy
10 (170) to two hundred and ten (210) range that the
11 regulators seem to be asking for, that translates to a
12 premium surplus ration of about one point nine (1.9) to
13 one point five (1.5), you know, which is much different
14 than what companies are holding. Companies are -- I was
15 saying an average running about one point six (1.16) so
16 they're holding a lot more capital.
17 So you don't need to say it's -- need to
18 look at the actual. You can say I have some other
19 objective measure to understand how much capital should a
20 company bring automobile insurance in Alberta be expected
21 to put aside.
22 Okay. Now this -- this one point nine
23 (1.9) to one point five (1.5) that I'm talking about,
24 that's for all the business in Canada; that's, you now,
25 all lines of insurance in all provinces. But not every

1 business requires the same amount of capital, as we were
2 talking about before.
3 If you're -- if you're writing, you know,
4 short tail, very particular lines of business, you don't
5 need to hold as much capital. If you're writing longer
6 tail lines like liability, there's more volatility,
7 there's more uncertainty, it takes a longer time for
8 claims to develop, then -- then you need to hold more
9 capital.
10 So -- so what we did, and I didn't -- and
11 -- and I didn't put up all the spreadsheets where we
12 calculated this, but -- but we started with, you know,
13 the balance sheet and income statement for the industry
14 as a whole for 2005.
15 And we said when you look at the industry
16 the companies are holding that one point one six (1.16)
17 premium surplus ratio and their MCT ratio is two-forty
18 (240), they're way above what the Federal regulator
19 wants. So they've got more capital than what's actually
20 required.
21 So he said well let's adjust that down to
22 say a 17 percent return on equity and let -- let's adjust
23 it so that we can -- so we can say instead of holding
24 two-forty (240) as a minimum of capital ratio, what if we
25 were holding a hundred and ninety (190); that on average

1 is what companies should hold.
2 So that changes your premium surplus
3 ratio. Then we said that a hundred and ninety (190)
4 we've adjusted for is for the whole company. But let's
5 say we only want to look at the mandatory lines of
6 automobile insurance.
7 So still holding your minimum capital test
8 ratio at 190 percent at a 17 percent return on equity,
9 what premium surplus ratio do you get?
10 And -- and what falls out of the
11 calculation is you get a premium surplus ratio of one
12 point six seven (1.67). When you adjust that from --
13 just from down from automobile just down to mandatory,
14 you go through the same process and you say, at a 190 MCT
15 and a 17 percent return on Equity, what's the premium to
16 surplus ratio that we get for the industry today. And
17 that answer turns out to be one point three one (1.31).
18 So -- so we're starting with, here's what
19 the industry's at today; let's adjust it and say what do
20 they really to be at. And we're adjusting it down
21 further to say what do you need to be at if you only want
22 to write the mandatory lines of insurance.
23 And what comes out of that minimum capital
24 test calculation is that you should be at a premium to
25 surplus ratio of one point three (1.3).

1 So we started off saying, Here's how we
2 start --you know, Mercer started with their 5 percent
3 profit provision, their two (2) to one (1) surplus ratio,
4 and we worked the calculation down to see what the return
5 on equity was.
6 This slide just tries to do the opposite.
7 It says Once you have a return on equity, and we've
8 picked 17 percent, and once you have a leverage rate, a
9 premium to surplus ratio of one point three (1.3), use
10 the invest media that we've -- we've presented in
11 previous hearings, can you calculate what their profit
12 provision would be?
13 I've labelled the calculations, you know,
14 A, B, C, D. So that's the order you calculate these.
15 Don't -- don't think I'm going to go through them
16 individually with you, but you start at the bottom with
17 17 percent return equity.
18 So you know you had a hundred dollars
19 ($100) of premium, at one point three (1.3) of premium to
20 surplus, you had seventy-six dollars ($76) of premium.
21 Seventy-six dollars ($76) of premium, the
22 17 percent return, that means my after-tax profit was
23 twelve point nine eight (12.98). You back out the tax,
24 so you know what your pre-tax profit had to be. You know
25 what your investment income on that surplus you invested

1 was. So the rest has to be the operating profit. And
2 the operating profit turns out to be 15.4 percent of your
3 hundred dollars ($100).
4 And that's really what I -- what I wanted
5 to spend my time talking about, was how do you get from a
6 return equity and reasonable -- then you've got to select
7 a premium to surplus ratio, and how do you get to the
8 profit provision.
9 You know, and then -- then it occurred to
10 me that one (1) of the things that would be interesting
11 to measure was that if we use the assumptions that were
12 in that actuary report from 2005, how would we do on a
13 minimum capital test?
14 You know, how would an outside agency
15 who was saying, you know, What I care about is that you
16 can hold enough capital, are you going be solvent, that
17 you'll be able to answer th needs of all your
18 policyholders, pay those clams with some certainty, and
19 how would they look at it?
20 And I think that they wouldn't be very
21 pleased with the outcome because you end up with a -- a
22 MCT ratio of just -- just under 130 percent, it comes out
23 to one twenty-nine (129).
24 So that 130 percent, you know, we don't
25 know exactly what the regulator wants, say it's one fifty

1 (150) or above, that one thirty (130) is clearly below
2 what the -- the Federal Regulator requires for solvency.
3 So I suspect they would look at that and
4 say, you know, You need to do something because you don't
5 have enough capital to -- to safely answer the
6 requirements of your policyholders. So that 5 percent
7 profit provision that was embedded in the first rate
8 discussion really isn't sufficient to provide the
9 solvency that some of the regulators are asking for.
10 So I'll just -- if I could -- could
11 summarize there. We think that a premium to surplus
12 ratio of one point three (1.3) is the appropriate ratio
13 to use. And then if you happen to use the 17 percent
14 return on equity, as you heard my colleagues talking
15 about, you'll end up with a profit provision of 15.35
16 percent.
17 That's a lot for you guys. That's -- this
18 is what I do all day, I do math all day. I'm hoping that
19 that was clear enough. I'll be happy to answer your
20 questions.
21 Jetse, that covers my part of the
22 presentation, so far.
23 MR. JETSE DE VRIES: Thank you very much.
24 I will leave this slide on there maybe because that's the
25 -- that's the recommendation we have with the 17 percent

1 ROE, or we say it's hard to pinpoint to one (1) -- one
2 (1) number, but thirteen (13) to seventeen (17) we said,
3 and for seventeen (17) it's five (5) -- fifteen point
4 thirty-five (15.35) profit margin and a one point three
5 (1.3) premium to surplus ratio.
6 So thank you very much --
7 THE CHAIRPERSON: Thank you.
8 MR. JETSE DE VRIES: -- thank you,
9 Members of the Board.
10 THE CHAIRPERSON: Questions. There were
11 questions down here. Ted...?
12 MR. TED ZUBULAKE: Yes. First -- I've
13 lost my page here.
14
15 (BRIEF PAUSE)
16
17 THE CHAIRPERSON: While you're getting
18 ready, Ted -- Bill, did you have a question?
19 MR. TED ZUBULAKE: No, I'm ready. Can we
20 just sneak in first.
21 THE CHAIRPERSON: Okay. Yes.
22
23 QUESTIONS BY BOARD:
24 MR. TED ZUBULAKE: First, I guess this is
25 for Don. On the -- this is a clarification. On the

1 table you presented, on page 27, it showed the cost of
2 equity. We calculated that cost of equity range from, I
3 guess, 10.1 percent to 18.9 percent.
4 MR. DON FOX: Right.
5 MR. TED ZUBULAKE: Okay. Just pointing
6 out for the record that the -- the variation appears to
7 be entirely attributed to this size premium ?
8 MR. DON FOX: It's substantially
9 attributable to the size premium, that's correct.
10 MR. TED ZUBULAKE: Yes. And the
11 variation of the size premium in -- in turn is attributed
12 to a different -- looking at two (2) different
13 essentially averages.
14 MR. DON FOX: That's correct.
15 MR. TED ZUBULAKE: So this is a fairly
16 huge -- I think as you pointed out, very large variation
17 in -- in cost of capital or cost of equity numbers and
18 it's all driven by a different way of averaging a column
19 of numbers, basically.
20 What -- which of those two (2) approaches,
21 which of those two (2) types of averages do you believe
22 is the more appropriate?
23 MR. DON FOX: If I might answer a
24 question that you didn't quite ask --
25 MR. TED ZUBULAKE: Okay.

1 MR. DON FOX: -- to get to the same
2 point. I think what it highlights is the fact that
3 different companies, investors, looking at it from my
4 perspective, investors would expect a very wide range of
5 returns depending on the particular company that you're
6 looking at. So to me it -- it highlights the difficulty
7 in pinpointing --
8 MR. TED ZUBULAKE: Yes.
9 MR. DON FOX: -- one (1) number. And if
10 you made that size, average size wider, you'd end up with
11 even a slightly wider range of -- of expected ROE's.
12 But that -- that range covers off most of
13 the expectations within these possible results.
14 MR. TED ZUBULAKE: You would agree it is
15 a large range.
16 MR. DON FOX: It is, absolutely.
17 MR. TED ZUBULAKE: Yes.
18 MR. DON FOX: And in our business we
19 generally don't try to evaluate the appropriate return
20 for an industry. We're more -- generally more specific
21 and we're looking at specific companies and trying to
22 evaluate it on that basis.
23 MR. TED ZUBULAKE: And I guess a question
24 or a comment for Bill. We heard various presenters over
25 the last two (2) days now recommend or offer to the Board

1 for consideration various ROE's and various premium and
2 surplus ratios, and several of them suggested or
3 recommended the Board to, even the last presenter, to go
4 with kind of a ceiling approach. Pick the highest ROE,
5 acceptable ROE, and perhaps the lowest premium to surplus
6 ratio.
7 And I believe -- check our notes, but I
8 believe the 17 percent -- your example of a 17 percent
9 ROE is probably the highest ROE we've seen and you also
10 say it's the higher end of your range.
11 And the one point three (1.3) ratio I
12 think is fairly close to the lowest premium to surplus
13 ratio we've seen. So I view this, the 15.35 percent, as
14 kind of the high end or the optimal or the cap, the
15 maximum end on the resulting profit margin.
16 And I just want to point out to the Board,
17 or maybe you can help us here, how much of a premium
18 increase does that equate to in terms of going from a 5
19 percent profit margin to a 15.35 percent profit margin,
20 an average premium per policy increase, do you know?
21 I thought that the average mandatory
22 premium was around eight hundred dollars ($800). I may
23 be off. So I'm figuring it's 10 percent of eight hundred
24 (800), about eighty dollars ($80)?
25 MR. BILL PREMDAS: Our current mandatory

1 average premium is about five fifty-nine (559).
2 MR. TED ZUBULAKE: Five fifty-six (556)
3 on the --
4 MR. BILL PREMDAS: That's -- that's --
5 MR. TED ZUBULAKE: I believe you had said
6 six (6).
7 MR. BILL MOORE: Yeah. Yours -- yours
8 was six (6) last time.
9 MR. TED ZUBULAKE: Six (6). I'm sorry.
10 So 10 percent of six hundred (600), call it about a sixty
11 dollar ($60) increase. So just to put things in
12 perspective for Merle. One (1) point is six dollars ($6)
13 but ten (10) points is sixty dollars ($60). That's all
14 my question.
15 THE CHAIRPERSON: Yes...?
16 MR. JACK DONAHUE: I have a question
17 that's come up from your presentation and a lot of other
18 presentations we've heard on the last few days.
19 And arising, Ted has tried to, I think
20 several times explain that the mandate of this Board is
21 to annually set a benchmark base rate for the grid. And
22 in so doing, when they originally did that, they picked a
23 number of profit on premium rather than getting into an
24 ROE because the purpose of this Board was not to become
25 an utility-based Rate Board.

1 And so a premium of 5 percent was -- I
2 mean a proper -- number of 5 percent was picked.
3 I'm a little confused with all the
4 submissions that say you recommend the Government not
5 regulate ROE's or deal with profit. This Board can't do
6 their function without addressing that profit on the
7 premium.
8 So I'm just concerned in listening to
9 these, I'm thinking, are ING or other insurers concerned
10 that the purpose of these hearings are because the
11 Government are considering regulations to regulate ROE's
12 on auto insurance companies.
13 Is that what's, you know, the concern?
14 MR. MARTIN BEAULIEU: Well, it is unclear
15 in the -- in what we have heard or received what -- what
16 is actually going to be done with -- with that ROE that
17 you are -- are going to assess when one (1) area is -- is
18 certainly the annual adjustment where we see that you
19 have to use that -- that profit margin.
20 The other part that was uncertain was, was
21 it going to be used as well for deviations from -- from
22 the annual hearings or when the -- when we do -- is it
23 Section 6 -- 6 filings, or when we -- when we file our
24 auto term coverages, how it can be handled.
25 So maybe you can give us some -- some

1 light on --

2 MR. JACK DONAHUE: Yeah, Dennis addressed

3 this but I don't think it was there that we planned that

4 the Government or this Board or these hearings were

5 going to deal with the new regulations imposed and ROE

6 regulations on industry.

7 MR. MARTIN BEAULIEU: Hmm hmm.

8 MR. JACK DONAHUE: This is only to deal

9 with the annual adjustment. And in the first set of

10 hearings about 80 percent of the presentations all dealt

11 with ROE's and profit. And so I think on that point I

12 said, Look we're not dealing with ROE's, we're dealing

13 with profit on the premium.

14 And if the industry wants to discuss ROE's

15 and profit on premium, whether they're at the right

16 number, special hearings will be set up. It's not the

17 purpose of these hearings, not a much broader purpose to

18 sort of regulate ROE's on insurance company in this

19 province.

20 MR. MARTIN BEAULIEU: Yeah. And if I

21 may, each line of business should -- should contribute to

22 -- to our profit margin. And the -- the profit -- or our

23 returns then. The profit margin that is being set,

24 although it's not -- it's not regulating the ROE,

25 ultimately that's what it is -- that's one (1)

1 consequence of what it is doing.

2 Because the profit margin ends up being a
3 component of the ROE, and we're measured on -- on the ROE
4 basis. The markets are not recognizing a profit margin
5 or a line -- another line in our -- in our income
6 statement. They look at -- at the return on capital.

7 So that's why I think we translate that
8 profit margin that we understand you have to -- to select
9 for -- for the annual adjustment into a -- into an ROE
10 discussion.

11 MR. JACK DONAHUE: Well, I'm not sure.
12 Maybe I'll ask Ted or Dennis to answer this question but
13 I think the discussion has been brought up by the
14 industry is to compare to an ROE.

15 And I think the Government and this Board
16 talked about profit on premiums because they didn't want
17 to get into ROE's. That profit on premiums, I gather
18 from what we hear, every company would convert that
19 differently and it would be a different ROE. I'm sure
20 I'd remember that, we'd never get chance to review the
21 ROE regulation, generally.

22 MR. DENNIS GARTNER: Well, that was my
23 understanding. The hearings were organized by the Board
24 and not by the Government. The Government --

25 MR. TED ZUBULAKE: But I think the reason

1 why we're here is because there are some, many perhaps,
2 in the industry that feel that the 5 percent profit
3 margin is inadequate. And while we, the Board, talk in
4 terms of a percent of premium, and for good reason, as
5 this gentleman said, the companies, the investors talk in
6 terms of an ROE and they convert that to an ROE.
7 In order for them to determine if the 5
8 percent were assessed, the reason was for adequacy of the
9 5 percent premium margin, they have to convert it to an
10 ROE and stack it up against their standard, you know,
11 what they are trying to achieve.
12 So it's another issue, another language
13 issue, if you will, but there is investors, companies
14 talk in terms of ROE's. The consumers, the Board talk in
15 terms of a percent of profit. The only way to link the
16 two (2) is through this factor, that one point three
17 (1.3) premium to surplus ratio.
18 And that's why we're discussing ROE's and
19 premium to surplus ratios and that sort of thing, to try
20 to get a basis, is the 5 percent reasonable or not, and
21 we just, each separately, converting that into our own
22 metric that we are comfortable.
23 MR. JACK DONAHUE: Just the point I was
24 trying to make, Ted, that we've heard now at least three
25 (3), maybe four (4) presentations say, Don't regulate

1 ROE's. I don't think it was every our intent to regulate
2 ROE's.
3 THE CHAIRPERSON: No.
4 MR. JACK DONAHUE: Well --
5 MR. TED ZUBULAKE: That's part of the
6 problem. We are using a profit -- the Board is using a
7 profit margin in order to simply determine an annual
8 change.
9 MR. JACK DONAHUE: Exactly.
10 MR. TED ZUBULAKE: We're not setting
11 rates.
12 MR. JACK DONAHUE: Right.
13 MR. TED ZUBULAKE: We're not setting
14 profit margins for the -- for each and every company.
15 But we need something to plug into the formula to get a
16 rate change, and that's what we're here for. And, you
17 know --
18 THE CHAIRPERSON: I think you got --
19 MR. MARTIN BEAULIEU: And that's what --
20 what I think we -- we want to --
21 MR. TED ZUBULAKE: Yes.
22 MR. MARTIN BEAULIEU: -- to submit to you
23 for your consideration, that you -- you consider the
24 consequences on the ROE of what the profit margin is. In
25 the end I think we're -- we're all on the same line

1 there.
2 THE CHAIRPERSON: Bill, did you have a
3 question?
4 MR. BILL MOORE: Yes. I would agree or
5 maybe put it another way. If we set a profit provision
6 of 5 percent that results in a de facto ROE of some
7 number that we can't know exactly in advance. We can
8 know it in the past. But it's in that sense that it is
9 linked to ROE.
10 No. The Board certainly has no mandate to
11 change the way the regulations are written. And as Ted
12 said, from a practical perspective, we have to find out
13 some or determine some percent of premium that is
14 appropriate from both sides of the equation.
15 And yet, you know, you have obviously
16 said that five (5) is not enough.
17 Maybe one (1) request to Bill. Your
18 spreadsheet the MCAT limits to quote equivalent premium
19 to surplus ratios, they're based on the industry OSFI
20 data?
21 MR. BILL PREMDAS: Yes, it's OSFI data.
22 MR. BILL MOORE: Any chance we could see
23 those or is there anything proprietary in them?
24 MR. BILL PREMDAS: Oh, absolutely.
25 MR. BILL MOORE: I would appreciate that,

1 I haven't actually seen the calculations between the two
2 (2).
3 THE CHAIRPERSON: Any further questions?
4 MR. BILL MOORE: Maybe a quick question
5 to Mr. de Vries.
6 Your third quarter profits that you
7 announced this morning are down quite a bit from the
8 third quarter of '05.
9 Is that symptomatic of what's happening in
10 the industry or is that something unique to ING?
11 MR. JETSE DE VRIES: I think that the --
12 there was some early investors a little bit of a shock
13 when -- when they saw that profits went down by 22
14 percent, but if you take the time to look at the numbers
15 and see what -- what has happened over the years, then
16 our third quarter was still extremely --
17 MR. BILL MOORE: It was very good, but --
18 MR. JETSE DE VRIES: The only problem is
19 that -- that it's hard to maintain that same high level
20 of profitability. And having said that, there are
21 differences per jurisdiction in -- in performance of --
22 of --
23 THE CHAIRPERSON: Dennis, you had a
24 question?
25 MR. DENNIS GARTNER: Yes, but Martin was

1 going to comment too.
2 MR. MARTIN BEAULIEU: Yeah. Well,
3 premiums are still coming down across the country and --
4 and costs have started to come back up. So it's not -- I
5 think it was expected that at some point the results
6 would --
7 MR. BILL MOORE: I guess the real
8 question is, Are we at that point based on a one (1)
9 point sample here?
10 It's not a fair question. I'm sorry.
11 MR. MARTIN BEAULIEU: Yeah. If we knew
12 exactly where we are in the cycle we would much richer.
13 MR. DENNIS GARTNER: Two (2) questions.
14 The first one (1) to Bill.
15 Bill, on page 5 of your presentation you
16 discuss the report of the AMF and indicate that the
17 insurance business in Quebec is doing fine. I agree with
18 that.
19 I wonder why you made that comparison,
20 because the structure of the business is quite different.
21 SAAQ does all of the bodily injury insurance -- auto
22 insurance in Quebec. So all of the issues that we're
23 faced with in Alberta and the very reason for the reform
24 initiatives in the first place in Alberta simply never
25 existed in Quebec.

1 So I don't find much value in that
2 comparison, but I'm wondering if you'd say the same thing
3 about other provinces that had similar reforms but didn't
4 impose the grid, the all-comers rule, et cetera.
5 Could you compare Alberta to those
6 provinces?
7 MR. MARTIN BEAULIEU: Yeah. May I?
8 Because I made that -- that comment, so I'll --
9 MR. DENNIS GARTNER: Okay.
10 MR. MARTIN BEAULIEU: -- I'll comment.
11 So I -- I understand that -- that the structure of the
12 business is different and that in Quebec there's no
13 bodily injury involved in the private sector. But I
14 think what -- it's fair that the regulators would address
15 the product itself and -- and its structure of the
16 product.
17 I don't think that there is a need to
18 regulate price to regulate the -- to control the costs,
19 the cost side of the equation, which drives in the end
20 the price. So that's -- that's in that context that I
21 was making the comment about the regulation or less
22 regulation in Quebec.
23 MR. DENNIS GARTNER: But in this industry
24 when we were discussing the reforms in 2003 in this
25 province, very much were interested in regulating the

1 cost.
2 MR. MARTIN BEAULIEU: Hmm hmm.
3 MR. DENNIS GARTNER: We got not only
4 strong support but push from industry to regulate the
5 cost on AB. We got a strong push from the industry to
6 look at collateral benefits and that tax rule, as well as
7 the cap on general damages.
8 So I don't think your information is
9 accurate.
10 MR. MARTIN BEAULIEU: No. I mean, that's
11 -- that's what has been done, and I recognize that the
12 cost side was addressed. What I -- my comment was
13 related to the fact that we have addressed -- the cost
14 should have addressed the price issues and that there was
15 no need to regulate the price as well.
16 MR. DENNIS GARTNER: Okay.
17 MR. MARTIN BEAULIEU: So that -- that's
18 my comment.
19 MR. DENNIS GARTNER: And in other
20 provinces that have a cost structure or product similar
21 to Alberta and the price isn't regulated in the same way
22 although it's regulated, are those markets more
23 competitive than the Alberta market right now?
24 Is there innovation? Price reductions are
25 not seen in Alberta.

1 MR. MARTIN BEAULIEU: Well, until --
2 until recently that was the case in -- in a province like
3 New Brunswick. We were -- we had introduced a number of
4 new -- new products. The climate in the last few -- in
5 the last few weeks or few months has -- has made us a bit
6 more careful there, but we were seeing that.
7 In Ontario the climate has been pretty
8 good lately and -- and that's where we have introduced
9 our -- our responsible driver guarantee product and our
10 zero (0) deductible first.
11 MR. DENNIS GARTNER: Okay. Thank you.
12 MR. MARTIN BEAULIEU: So we see -- we see
13 that innovation.
14 MR. LEWIS KLAR: Yes. I was also going
15 to mention the Quebec thing because you mentioned I
16 think, I have your presentation, in some respects Quebec
17 is the most highly regulated province in Canada because
18 it's completely eliminated any possibility for victims of
19 automobile accidents to sue, you know, for damages. And
20 that's the most excessive regulation that any province
21 would adopt.
22 I assume your example on page six (6) of
23 your crash group policy and zero (0) deductible policy in
24 Quebec, that applies for property damage collision
25 because that's all that people require, right?

1 Now, we don't regulate that in Alberta.
2 But yet you haven't introduced it in Alberta because you
3 say it's a regulated market and that if it was un-
4 regulated, it might be introduced here. But that's not
5 regulated.
6 So why hasn't that been introduced here?
7 MR. JETSE DE VRIES: I think that's the
8 overall uncertainty of what's going to happen that is the
9 most important driver, if you want to do new things and
10 take risks. And, you know, you can argue what's -- about
11 the rate of regulations and maybe Quebec, for instance,
12 is more regulated than -- than Alberta, but at least it's
13 very stable.
14 And I think what the investors look -- are
15 looking for is stability and certainty that it will not
16 change. And I believe that -- and I'm not -- not
17 pointing at any -- anybody here in particular, but -- but
18 that we're still in a phase of the automobile reform
19 where we cannot speak of -- of stability.
20 We still have to have this kind of
21 sessions on profit margins that we translate into our ROE
22 and other -- other discussions, we still don't know if
23 there will be more regulations or not.
24 So I think that -- that sort of draws a
25 picture for an investor, whether he wants to take risks

1 or not. And every time we introduce a new product or do
2 something with the price, we're taking a risk.
3 THE CHAIRPERSON: Further questions?
4 Well, thank you very much. We appreciate
5 your presentation, Jetse.
6 MR. JETSE DE VRIES: Thank you very much.
7 THE CHAIRPERSON: You'll notice I got
8 Jetse right again. He corrected me last year twice. So
9 thank you very much and we appreciate it. You know, we
10 have a complicated process to go through and we'll be
11 working on it.
12 So, thank you. And that finishes our
13 Hearing for today, 9:00 tomorrow morning.
14
15 --- Upon adjourning at 2:45 p.m.
16
17
18 Certified Correct,
19
20
21 ____________________
22 Sue Zaharie
23
24
25