AUTOMOBILE INSURANCE RATE BOARD

PROFIT REVIEW SESSIONS

Before Board Panel:

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Harry Gough - Vice-Chair
Ted Zubulake - Board Member
William Moore - Board Member
Harry Gough, QC - Board Member
Lewis Klar, QC - Board Member
Merle Taylor, CMA - Board Member
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Susan Steeves - Board Member
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David Marshall - Board Member

HELD AT:

McDougall Centre
Calgary, Alberta
November 10th, 2006
Day 3 of 3

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Jack Donahue	)Board Counsel
David Simpson (np)	)Facility Association
Norma Nielson (np)	)
David Chan (np)	)
Diane Brickner (np)	)Peace Hills Insurance
Jamie Hotte (np)	)
Melvin Yellowbird (np)	)
Grant Miner (np)	)Aviva Canada
Chris Townsend (np)	)
Steve Whitelaw (np)	)Dominion of Canada
Doug Hogan (np)	)General Insurance
	)Company
Frank Bomben (np)	)Co-operators General
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Saskia Matheson	(np)	)
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Don Fox	(np)	)
Bill Premdas	(np)	)
Derek Tupling		)Allstate
Ajay Pahwa		)
Doug Young		)TD Newcrest
Joel Baker		)MSA Research

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THE CHAIRPERSON: All right. Derek, you're going to introduce this morning?

PRESENTATION BY ALLSTATE:

MR. DEREK TUPLING: Yes, I am, sir. Thank you very much, and I'd first like to begin by thanking the Board for providing the Allstate Canada group of companies with the opportunity to be here today, to participate in these Hearings and to provide our perspective and some input into this very important discussion and topic.

THE CHAIRPERSON: You've been a bear for punishment. You've been here since the start. You were here --

MR. DEREK TUPLING: Observing intently, yes.

THE CHAIRPERSON: -- and never left.

MR. DEREK TUPLING: Yes. My name is Derek Tupling and I'm the manager of external affairs of the Allstate Canada Group of Companies and I'm joined here today by Ajay Pahwa who is our Vice President and Chief Risk Officer.

Our presentation is broken up into two (2) components. I'm going to just provide some overview and some perspective in terms of the organization and then Ajay will move into the more technical aspect of it in terms of ROE and providing some of our suggestions and recommendations.

So, just to begin, then. The Allstate Canada Group of Companies is a -- is a multi-channel producer and distributor of home and auto insurance across Canada. We have community-based agents, we have a broker representatives, we sell directly on line and also through our customer contact centre at 1-800-ALLSTATE.

The Allstate Canada Group of Companies comprises three (3) different and separate companies. The first and obvious one is Allstate Insurance Company of Canada. We have fifty-three (53) agents across Alberta and we're the twentieth largest insurer in the province with over $60 million in direct written premium last year.

Pembridge Insurance Company. We have twelve (12) brokers across Alberta and we had $2.8 million in direct written premium last year, in 2005.

And Pafco Insurance Company which is a -- a non-standard company. It's an alternative market for high risk drivers; hasn't had the opportunity to be introduced yet in Alberta although we are obviously looking for an opportunity to do so down the line.

From our perspective, we believe that the insurance industry was healthier and more competitive last year and more stable in 2005.

Our feeling is that rates, and certainly in our case, rates did continue to fall voluntarily in most cases, and there were more new products and services that were introduced right across the country. I think it's important to -- to note that consumers are benefiting from these changes and from reforms that have happened, not just here in Alberta but right across the country.

One of our -- one of our -- a key message is and one of the things we're striving to work towards as we work today and then move into the future is to mitigate this roller coaster ride of rate fluctuation. The situation that we incurred as an industry in 2001 and 2002, quite frankly from our perspective, was unacceptable and we take obviously some responsibility for that.

And going forward, we want to -- we don't want to go back to that type of situation. So we're actively looking internally to see what more we can do for our customers, and obviously working with governments and boards, such as yourself, to make sure that -- that we're delivering an affordable and high quality insurance product to consumers.

One of the other points I'd like to make as well is that, as I said, while ensuring that consumers are charged a reasonable and appropriate premium, it's equally important to ensure that companies do have the flexibility to operate and to -- to operate in a competitive market.

I think that's one of the other pieces that -- that we feel is important as well. And we're seeing that, too.

Moving on. As far as the background goes, it's been alluded to in the past by IBC or in previous hear -- or previous presentations here the last couple of days by IBC and others that over the past twenty-seven (27) years there have been no fewer than four (4) distinct earning cycles which have generated rate fluctuation and an ROE return fluctuation up and down.

But we know that the latest cycle which began in 1998 yielded the lowest return for the insurance industry over any previous period of time.

It's no secret -- it's no secret that the insurance industry is cyclical. We've illustrated that or tried to illustrate that; others -- other organizations have done that as well. And that cyclical nature has put increasing costs -- results in increasing costs and -- and pressures put on the system.

I think the past six (6) years, especially for us or for our organization, provides an excellent snapshot of that up and down motion and the pressures that both consumers and insurers face.

And so at that point what I'd like to do is now turn it over to Ajay and he'll take you over some of this perspective from our organization over the past six (6) years and then move into where we're -- where we see the industry going in the future.

MR. AJAY PAHWA: Good morning. I thought I'd take a few minutes to talk about Allstate's financial results for the past few years.

Beginning in 2000, there were serious concerns as to whether companies were willing to put their capital at risk in such an unstable environment.

For example, during that time, ACG's ROE was 5.5 percent, some ten (10) points below what our shareholders -- shareholders were expecting on their return. In 2001, it dropped further by 10 percent -- ten (10) points to a return of minus 4 1/1 percent and then in 2002, the ROE fell again to the lowest point in the Company history to minus 9.6 percent.

To put it another way, for every one

dollar ($1) collected in premium 2001, a dollar ten ($1.10) incurred in claims and expense was paid. In 2002, this grew to a dollar thirteen ($1.13). Allstate was on the verge of going out of business in Canada, but once Allstate hit bottom the only place to go was up.

The long road back was not a smooth one for consumers or insurers. The insurance environment in 2001 and 2002 produced much higher, much tighter underwriting criteria and forced companies to limit exposure in an effort to recover and achieve the reforms in markets all across Canada.

2003 provide -- to be the beginning of a turnaround as Allstate ROE bounced back to 14.2 percent. 2004 and '5 also produced a healthy return -- healthy ROE return of 30 percent and 32.9 percent, respectively.

However, a few years' of mod -- a few years' of moderate success does not erase a decade of instability and sub-par financial results. Despite the positive recovery in the past couple of year -- couple of years, Allstate's average ROE in the past six (6) years was a modest 11.4 percent.

More importantly, I'd like to stress that the returns earned by ACG in the past two (2) years are not sustainable. Just as the competitive market drove ROE up, it will drive ROE down as well.

By comparison, ACG's average ROE between 2001 and 2005 was 12.6 percent. And as a comparison, at the same time the banks were earning 13.8 percent, RBC at 16 1/2 percent and Loblaws at 17.6 percent.

Over the same time period the ROE for the entire industry was only at 10.3 percent. When ROE's fluctuate, so do -- so too do rates.

In 2002, when Allstate's ROE was at its lowest point, our auto rates were at their peak. It was noted during the annual -- annual adjustment hearings that between 2000 and 2004, Allstate auto rates in Alberta increased on average by approximately 12 percent. As ROE improved over the course of 2003, '4 and '5, auto rates have fallen dramatically in all of Alberta and right across Canada.

This chart illustrates how rate increases were needed during the 2000/2004, while at the same time our ROE was at the all time low of minus 9.6 percent which is here, so it's the twelfth, as we're going through.

As our ROE returned to levels demanded by our shareholders, rates have dropped by 6 percent in 2004, a further 15 percent in 2005, another 2 percent in 2006.

The financial results outlined for ACG

illustrate how volatile and unpredictable the insurance industry can be. More specifically, it provides a foundation which supports Allstate's position on the question of an appropriate target level of ROE.

Every company is unique. No two (2) insurance companies are exactly the same. There are a number of factors that set companies apart. For example: the type of insurer, mutual versus stock; the products that are offered, personal lines only versus commercial and personal; geographical distribution; concentration risk appetite; use of re-insurance; customer service and claims handling; are just primary examples of what differentiates one (1) insurer from another.

These factors are an integral component of an organization's effort to attract consumers by delivering a high quality product and to achieve an ROE that shareholders demand as a result of the risk of the operation.

Thus no one (1) single target or range will meet the expectations of every insurer.

The unique nature of the insurance product creates an inherent risk and volatility for insurers as the cost for any one (1) policy won't be known for many years ahead. This -- there may not be any losses or there might be a loss or a claim worth millions of dollars.

There are many techniques and methods used to estimate what -- the cost with accuracy, but even with sophisticated techniques there are a considerable amount of volatility. Companies require flexibility to respond to situations based on the nature of their operation and the best interests of their customers.

Determining insurance rate is a prospective and complex process which is as equally as prospective and complex a process of determining insurance company's ROE.

Moreover, there are numerous methodologies used by insurers to determine the ROE that they're required to operate and maintain and attract capital. No single rate or range is appropriate for every insurer.

It is Allstate's -- ACG's position that the industry-wide ROE average or range will drastically reduce a customer's ability to choose an insurer, it'll stifle competition between companies, and potentially drive companies out of the Alberta market.

Therefore and respectfully, the Allstate Canada Group strongly advocate that insurance industry-wide ROE average a range not be implemented in Alberta.

The rate determination model used by Allstate is a discounted cashflow approach. This -- the

DCF method takes several factors and values and discounts them to a common time and period to determine the appropriate premium levels. The DCF method is commonly used by insurers. While it's the preferred method for Allstate it's not likely the method used by every insurer.

There are six (6) components in our model which are premium to surplus ration, investment returns, tax rates, losses, underwriting expense, and claims expense.

Firstly, premium to surplus ratio is subjective and is dependent on the level of risk that comprises the company's portfolio. The higher the surplus ratio, the less capital used to support the underlying business.

However, it is important to note that a company's entire surplus is available if necessary to support the insurance operation in every province in which they do business.

It's not as simple as allocating a portion of the company's surplus to Alberta because it doesn't lead -- doesn't limit the company's exposure to that amount. If loss and loss expenses exceed premium investment income, the entire capital of the company is at risk to settle customer claims, no matter what line of business it is in or where it happens.

This is what the insurance business is all about. Whether it's a snowstorm in Southern Ontario, ice storm in Quebec, hurricane in Nova Scotia, or heavy rainfall in Edmonton, ACG surplus is available to respond regardless of where is happens.

If companies were limited -- limited to earning -- a specific return in one (1) province, it would significantly hamper an insurer's ability to fulfill its commitment to its customers. Insurers need to have the flexibility to earn a reasonable rate of return in every province in order for there to be where customers need them the most.

The second component is investment returns. These are returns generated by funds supplied by policyholders as well as shareholders.

The third component is losses. These are the most difficult to estimate due to the uncertainty of the -- and the volatility.

Fourthly, loss expenses are also need to be considered, as well as underwriting expenses which are broken down into variable and fixed.

And finally tax rates, which are used to convert returns to an after tax basis.

These are the six (6) components that

Allstate uses and considers in determining the overall rate level needed by the Company to achieve the target profit.

From the discounted cashflow model -- is used to convert the results of a premium.

Each individual company must show in the development of their rate level that they have utilized an appropriate method based on its own operations and capital requirements. Therefore, a reasonable approach for the Board would be to enable individual companies to use accepted methodology to determine expected returns which meet the specific needs of the individual companies on their operations.

To gain a better understanding, I thought I'd provide a simple example of calculations involved and the inputs.

So these are the inputs that we're using here as our simple example here. Premium to surplus ratio, one point five (1.5) to one (1), after tax ROE of sixteen point nine three (16.93).

Now that is the actual return that our shareholders are expecting from us. This is based on the Fama/French 3 Factor model which is essentially using the capital model, which was discussed in detail the last couple of days here.

Allstate has a complete document showing the derivation of the sixteen point nine three (16.93) and I'd be pleased to provide that if the Board so needs to. The whole derivation is available.

We've got, just again as a variable, loss cost estimated at a hundred dollars ($100); variable expense, twenty-five dollar ($25), function of premium; fixed expense of ten dollars ($10); loss adjustment expense of 10 percent; risk rate at 5 percent; market rate of seven and a half (7 1/2) and the present value factor of nine point (9.) -- point nine two five (.925)

With all these inputs, it deals -- gives you this cashflow model which looks a little daunting, I agree, but it's really simply all we're trying to do is, we're trying on the left side of the equation, looking at the premiums received, add the returns we're expecting on investment on equity, subtract losses and expense, and equate the right side of the formula to the after tax return on equity of the sixteen point nine three (16.93).

All this factor is doing -- it's just grossing it back up to make it a pre-tax basis.

So, the idea is to solve for 'P' in this equation here. Going through the algebra and the math, the premium becomes a hundred and sixty-nine dollars ($169). And once you have that, with all the inputs, it equates to a loss ratio of 60 percent; expense ratio of 31 percent; combined ratio of ninety-one (91) which leads to an underwriting margin of 9 percent.

I realise this is a simple example, but I just thought I would walk you through some of the inputs and how they're being derived in our model.

Another question asked by the Board was what was the impact of the impending change in the insurance financial reporting.

Effective January 1st, 2007 insurance companies are required to record their assets at market value rather than historically record them at amortized or book value. This was -- essentially convert all unrealized capital gains or losses into realized capital gains or losses.

Insurers will be required to designate all investment into three (3) buckets: held to maturity, available for sale, and held for trading.

For time wise I know you guys have heard of this in the last couple of days of various buckets and how they are defined, so I just want to say that at ACG we're still reviewing what option best fits our -- our business model. But based on our initial reviews, regardless of what option is selected, our equity position is going to increase due to converting our unrealized gains to realized gains.

So, how should these issues be handled in the context of the overall regulation of automobile insurance and ratemaking?

The competitive market place can be allowed to operate to the advantage of consumers in Alberta -- sorry, what, yeah -- right, in Alberta without an ROE target level or range.

Over the past couple of years, increased competition has benefited Alberta drivers with lower rates and greater choice in the market. For example, last year alone Allstate and Pembridge made some eighteen (18) changes to their respective automobile insurance product, including new discounts and positive changes to the underwriting criteria, in an effort to make it more attractive to consumers.

In addition, a number of enhancements were also made to the property line products, as well as improvements to the speciality line products such as motorcycles and snowmobiles.

Introducing an ROE target level or range would hamper the insurer's ability to introduce measures such as these that obviously benefit consumers and thus provide the consumer with less choice in the marketplace. Not only do these move -- illustrate the competitiveness that exist in Alberta, but they're also a strong indication of ACG's commitment to servicing consumers in the Alberta market.

Consumers deserve the freedom and flexibility to find a coverage that is most appropriate for them and the most appropriate price. And insurers should have the flexibility to earn the right to be the insured choice for the consumers.

To add context, I thought it would be helpful to, in my discussion, to talk about experience from another jurisdiction, namely New Jersey.

New Jersey regulators, for the last thirty (30) years tried to fix the insurance industry with regulation after regulation. This started in 1972 in which the rates were rolled back, no-fault insurance and strict price regulation were introduce.

This led to a downward, destructive spiral in which 2002 was the breaking point for the industry. At that point forty (40) insurers had exited the market, consumers spent a lot of time shopping for insurance, and all this created availability crisis for auto insurance in that state.

As a comparison, new Jersey had 47 percent fewer companies selling auto insurance than Illinois and one-third (1/3) fewer than New York and Pennsylvania.

Five (5) out of the six (6) largest insurers in the US were not selling insurance in New Jersey. Finally, in 2002 -- 2003, New Jersey's governor enacted a comprehensive package of reforms that enabled consumers choice and allowed competition back in the marketplace.

Some of the highlights and benefits of the reforms were excess profits. Before to -- before the reforms, insurance companies -- insurance companies were only allowed to earn 3.5 percent excess -- 3.5 percent profit based on premium written. However, with the reforms, this restriction was removed and now companies are able to earn an operating income based on what is needed to support their own capital.

Secondly, the reforms improved the prior -- prior rate approval process and increased an expedited rate approval limit from 3 percent to 7 percent. Underwriting rules and criteria was changed in that the take-all-comers rule was suspended if the individual company reached their target growth or cap growth as well as a take-all-comers rule was going to be phased out over five (5) years.

And, finally, new regulation allowed territorial rate revisions without territorial subsidies that had occurred in the past.

On a more personal note, after one (1) year of reform, Allstate had finally experienced a halt to its shrinking neighbourhood offices in New Jersey, also hired a hundred and twenty (120) new employees.

Allstate loss market share in New Jersey, but for all the right reason. Increased competition led to more choices and availability to the consumers.

In addition, the reforms also had these positive results: a 185 million was put back in the pockets of New Jersey drivers; new insurance company was created at Mercury General; AIG decided to -- decided to change its exit strategy from New Jersey; and Geiko, the fifth largest insurer, entered the market.

Back here customers will also play a very important role in determining the health and stability of the insurance system. With a wide array of companies competing for business, customers would naturally gravitate to those -- would naturally gravitate to those providing the service and products that they feel are good value.

There are many consumers who consciously protect themselves and understand what they expect from their insurance company and they have -- and willing to pay more -- more for better service, better relationships and better products.

The competition for capital is -- is global and is stiff. Handcuffing insurer's ability to attract capital by implementing an ROE target or range jeopardizes the health and stability of the marketplace that has been evolving in Alberta since 2003.

It is no secret that if equity investors do not see the potential to earn the required return on their investments, they will turn to an alternate investment with returns that are appropriate. As a result, the potential for companies leaving the market because of the lack of capital to support the operation becomes a very frightening possibility.

I trust the proceeding has provided the Board with some insight on how ACG calculates and arrives at a target ROE. While the method may be used by another organization, the factors that are used, the application and the outcome will be vastly different.

Imposing one (1) methodology or one (1) target on some sixty (60) insurers operating in Alberta contradicts the spirit in capital enterprise that has become synonymous with the province.

Therefore and respectively, the Allstate Canada Group strongly advocates that an industry-wide ROE average or range not be implemented in Alberta.

That's the end of our presentation and

we're happy to answer any questions and...

THE CHAIRPERSON: Yes.

QUESTIONS BY BOARD:

MR. LEWIS KLAR: I just have a question and a comment on this. The comment is that, you know, for two and half (2 1/2) days we've been hearing how the market works and competition works and regulation doesn't. But we've also been hearing how the market didn't work and that's why we have regulations. In other words, you've -- your own presentation indicates how volatile it was.

How do you reconcile those two (2) arguments, that the market works, but it wasn't working, and now is working, with regulation?

MR. DEREK TUPLING: I think when you -- I think when you look at some of the specific changes and some of the specific goals that were desired by the Government at the time that needed to be changed and some of the -- some of the issues that needed to be addressed, that regulation certainly does play an important role in -- in the system. And it has a role to play and we -- we appreciate that and we respect that, and we -- we look forward to working with regulators to -- to address those issues.

However, I think there are some -- some other aspects that allow the competitive market to operate in a system that benefits consumers. And there are just a couple of specific examples.

And this ROE issue or the issue of profit level would certainly be one (1) of them, where we feel that it's not as specific as introducing a cap on minor injuries or -- or addressing issues dealing with -- with -- compensating chiropractors or issues that -- that are that specific that can be addressed with regulation or with -- with legislation.

This is one (1) topic in particular where we believe and we feel that the competitive market can operate and that, you know, what works for -- what works for Allstate might not work for Dominion and might not work for ING and might not work for -- for other organizations and that consumers will see that down the line.

So those prices will -- will --

MR. LEWIS KLAR: That's not getting to my question. As Mr. Donahue said yesterday, we're not here to regulate the ROE of insurance -- of insurance companies. We're here to -- to consider the appropriate premium price every year during our annual review process.

MR. DEREK TUPLING: Hmm hmm.

MR. LEWIS KLAR: And one (1) component that we use and that is the underwriting profit.

MR. DEREK TUPLING: Hmm hmm.

MR. LEWIS KLAR: Now if you look at your six (6) factors if I can -- and perhaps you can help me understand this. Your six (6) factors in determining your premium every year are -- are premium to surplus ratio, investment returns, tax rates, underlying losses, and claims expenses.

We don't seem to include any premium -- any -- any underwriting profit -- any underwriting profit on that premium, is that correct?

Am I correct in -- in understanding it that way?

MR. AJAY PAHWA: Well that's -- we're working backwards. We're looking for a target ROE and it works backwards to determine the profit.

MR. LEWIS KLAR: Well let me is -- is -- are those six (6) components the six (6) components you use to set the premiums every year?

Is that what you were saying?

MR. AJAY PAHWA: Yes.

MR. LEWIS KLAR: And -- and --

MR. AJAY PAHWA: But they -- sorry, go

ahead.

MR. LEWIS KLAR: And in those six (6) components is there -- is there in there somewhere a -- a profit -- profit on that -- on -- not on your investments or on your surplus or on -- on what you do with the premiums once you -- once you get it and were -- you invest it for three (3) years or for a certain amount of years --

MR. DEREK TUPLING: Yeah.

MR. LEWIS KLAR: -- is there a profit on that premium that you include?

MR. AJAY PAHWA: Well, it's in there -- inherently in there. When you're looking at the ROE target, are you working backwards to determine what the appropriate premium would be. You're using the implied value when you're taking a discounted value of the cash flow, basically. So it's inherently built in there.

MR. LEWIS KLAR: Okay. Perhaps -- perhaps Ted will have to --

MR. TED ZUBULAKE: Maybe you show that -- you show that chart again, where you had the numbers there --

MR. AJAY PAHWA: That one there?

MR. TED ZUBULAKE: What you're saying is you -- based on those factors, those assumptions, that leads you, I think you said to a 9 percent underwriting margin.

MR. AJAY PAHWA: That -- for this example here, yes.

MR. TED ZUBULAKE: For that example. But -- but so that's -- that's -- that 9 percent is equivalent to the Board's current 5 percent.

MR. AJAY PAHWA: That's what I'm saying. But we're working -- we're not using the profit, we work backwards with the ROE assumptions and go through the model to determine. So it would be equivalent to that underwriting margin of 9 percent. That's -- that's what it comes down to.

But we don't have an explicit -- we don't say we want 9 percent or 5 percent. With the inputs that we used based on our ROE assumption, premium to surplus ratio and whatnot, that's what the bi-product of the results are.

THE CHAIRPERSON: Further questions?

MR. DAVID WHITE: I just got one (1) question. Outside of -- is has to deal with the all-comers rule. I guess the point is, the only thing I see that you think that should be regulated is controlling your costs when it comes to the caps. What other part -- you know, what other part do you see needs to be regulated?

Because we don't want to -- you know, don't regulate profits, don't regulate the all-comers rule, but thank you for doing the caps; but I don't see where you see any other role.

MR. DEREK TUPLING: I -- I'm not sure -- I'm not sure -- you're suggesting that based on -- you're suggesting that there's no other role for the regulator?

MR. DAVID WHITE: Well, just from your presentation it -- it just seems like the only role the regulator has in your mind is, in the interest of Albertans, is to provide the cap to limit expenses for companies.

MR. DEREK TUPLING: Well, I think -- I think the regulator plays an important role in providing information and education about the auto insurance product just as much as we do. We share that responsibility.

MR. DAVID WHITE: But that's -- but that's not really a true regulatory function. I mean, it's something we do but it's not a true regulate -- it's not something --

MR. DEREK TUPLING: No, no, absolutely not. But -- but there are specific -- like I said I think there are specific examples of goals that the

Government try to achieve -- that needed to achieve just as insurers needed to achieve when reforms were introduced, that -- that were specific that could be addressed in regulation or could be addressed in legislation.

A company's ability to operate in a competitive market might not necessarily be one of those specific issues that needs to be addressed in regulation or in legislation. That would be the point that we would --

MR. DAVID WHITE: The other comment I'd make too is I think, you know, the industry, I think they do a better job of educating consumers too because, you know, two (2) years of record profits now, every presenter has wanted us to increase the underwriting margin or something that way.

Perhaps you guys could do a little bit of the heavy lifting too in terms of educating consumers towards the ends that you're looking for, why you need profits, the insurance cycle, rather than sort of throwing it to us and saying we need this. But, you know, a little more cooperative venture would be helping?

MR. DEREK TUPLING: I -- I agree. I -- I agree with you wholeheartedly. And we -- and as I said just a minute ago, we share in that responsibility and we

-- and we do take that very seriously and we're obviously working in conjunction with the IBC trying to do our best to inform and educate our consumers about our product, what it is that they -- about our product and the services that we provide, and putting that into context, in terms of this is why we charge the premium that we do, this is the services that we provide.

And we -- we certainly are looking for opportunities to make sure that our consumers and our customers, more importantly, are educated and are informed about the product that they're purchasing from us.

THE CHAIRPERSON: Ted...?

MR. TED ZUBULAKE: First -- yes. I think the Board would appreciate a copy of the -- the documentation that arrives at that sixteen (16) -- that target profit or target rate of return on equity.

Again, for 2 1/2 days, the Board has heard a number of presenters like yourselves comment on the -- the issue of profit. However, the Board's mandate is very specific. Our -- our goal at these Hearings is -- is quite specific and that is what number basically comes after -- what number do we plug into that formula, the ratemaking formula that -- that the Board utilizes to come up with the industry-wide adjustment? What profit loading do we put in there?

And Allstate like other presenters has -- have come back and told the Board first, don't regulate -- first, don't regulate at all --

MR. DEREK TUPLING: Yeah.

MR. TED ZUBULAKE: -- secondly, don't regulate profits, which the Board isn't doing, and third, no one (1) single number is appropriate and fourth, you gone a step further, a range is inappropriate.

But we need a number. What do you suggest the Board use for that industry-wide adjustment?

MR. AJAY PAHWA: I'd like to echo what Dominion was saying yesterday; have a range -- or a limit there where -- or a value where if it becomes public to the -- public domain there it becomes an excessive rate. It becomes almost embarrassing to the public side.

So have a wide enough range or wide enough number to our ceiling where it gets to the point where it gets really embarrassing for an individual insurance company to be operating at that level.

MR. TED ZUBULAKE: Yeah. And --

MR. AJAY PAHWA: And -- and you operate at that level it'll be self adjusting with a free enterprise --

MR. TED ZUBULAKE: But that's -- that was my point. Now if the Board were to take that route --

MR. AJAY PAHWA: Yes.

MR. TED ZUBULAKE: -- you're saying you're confident enough in the -- in the competitive marketplace that companies will not all seek the highest possible rate, that they will work below that ceiling as you put it.

MR. AJAY PAHWA: In a competitive environment if everybody was doing it, you'll get more entrants coming in who would price it lower and then they'll just naturally gravitate to the more equilibrium price anyway.

But having said the way we're looking for it, it allows that flexibility when results go up and down, you have that range to --

MR. TED ZUBULAKE: Right. And -- but -- but you also understand the purpose of the indust -- of the -- we take a profit margin, put it into the industry -- to the ratemaking form, but come up with -- we come up with an industry-wide adjustment, okay?

MR. AJAY PAHWA: Yes.

MR. TED ZUBULAKE: Now -- so, I'm going to say -- let's suppose the Board plugs in a 15 or 12 percent ROE into that formula, it -- it's not saying that every company must operate at a 15 percent or at 12 percent or whatever the numbers are we -- it's -- if anything, it's kind of an average and the Board recognizes there are companies operating above that and below that.

So what is wrong with taking -- again, you're advocating a ceiling -- a high margin in that, what's wrong with something closer to the average?

MR. AJAY PAHWA: No, I think we have -- at the end of the day we like to be able to have no restriction which we think will not be able to operate --

MR. TED ZUBULAKE: Right. Right.

MR. AJAY PAHWA: -- at a closer level. And if it's excessive, with the new companies coming in, it will bring it down anyways, naturally. So it'll be a self- regulating and self-adjusting value anyway.

MR. TED ZUBULAKE: Okay. Thank you. One (1) last point. On -- on the -- the effect of the financial reporting changes --

MR. AJAY PAHWA: Yes.

MR. TED ZUBULAKE: -- in your example that we had on the board there a minute ago, you used -- and I realize it's an illustrative example, but you used a premium surplus ration of one point five (1.5). And -- and for arguments sake, let's suppose that -- that is the number that Allstate currently uses.

Will the -- will the new financial reporting requirements change your view of what that number should be for Allstate -- it -- given that one point five (1.5) is -- is your current number?

MR. AJAY PAHWA: Well first all, that one point five (1.5) isn't -- it was a typo. It should have been a one point three (1.3) but with the calculations were already done.

MR. TED ZUBULAKE: Okay. So whatever. But whatever that number is that Allstate's using now, will that number change going forward under the new financial reporting requirement?

MR. AJAY PAHWA: I don't think it'll drastically change. But at the end of the day after a few years it'll be -- results will almost at the same level where --

MR. TED ZUBULAKE: Right.

MR. AJAY PAHWA: -- between the realized and unrealized gains, will fall too --

MR. TED ZUBULAKE: Because I heard you say that you -- you thought that this would affect your equity.

MR. AJAY PAHWA: No, I'm saying the total equity, once we convert is as of January 2007, will naturally go up because the unrealized gains are being now --

MR. TED ZUBULAKE: But it's a -- a one (1) shot --

MR. AJAY PAHWA: Yeah, it's a one (1) time thing for 2007.

MR. TED ZUBULAKE: Okay. Thank you.

MR. AJAY PAHWA: Yes.

THE CHAIRPERSON: Further questions?

Well, thank you very much. I want to thank you. And as you know, we have this complicated process to go through and we'll be certainly looking at your submission like the others and coming up with some conclusion.

So thank you for your time. We look forward to hearing from you at the rate hearings later this year.

MR. AJAY PAHWA: Absolutely. Thank you.

MR. DEREK TUPLING: I appreciate it. Thank you.

THE CHAIRPERSON: Thank you. Five (5) minutes.

--- Upon recessing at 9:35 a.m.

--- Upon resuming at 9:45 a.m.

THE CHAIRPERSON: Good morning. You're all by yourself this morning.

MR. DOUG YOUNG: I am here all by myself and I hopefully --

THE CHAIRPERSON: You've had the as low as two (2) but I think you've capped it --

MR. DOUG YOUNG: Oh yeah. Joel will -- after me will be on his own too, so I -- I feel okay.

THE CHAIRPERSON: So would you introduce yourself and proceed?

PRESENTATION BY TD NEWCREST:

MR. DOUG YOUNG: Yes. My name is Doug Young and I'm from TD Newcrest. And the particulars of who I am and what I am and what I do is on the first slide and I'll delve a little bit more into detail in a few slides.

But I'd first like to again thank the Board for -- for asking me to come and present my views on -- on this topic. I think it's very interesting and fits right into what I do everyday when I'm looking at the property and casualty industry and the publicly traded prop -- property casualty insurers.

And just to be clear, obviously I'm coming at this from -- from an analyst perspective and not from

TD's insurance perspective. I know that -- that you do know that, but this is a very different approach that I'm coming at this because I do believe that TD Meloche Monnex was in here presenting as well.

So I'll take it to Slide 2, just a bit about background on TD Newcrest and -- and what it is. It's an institutional brokerage operation of TD Bank which focusses on the equity sales and trading.

Our clients are -- are primarily the institutions; there are large pension funds, mutual funds. And -- and we are the largest in terms of block trading for -- for our big clients and we do rank third in terms of overall research coverage by Brennon Woods (phonetic) which is an independent organization.

So just -- before I go through into my views on some of the specific topics that I'm sure that -- it sounds like a lot of people have been hammering home in the last few days, and I just thought I -- I'd go back in terms of what I do and provide some context of what some -- some of the items that our clients are focussed on and why maybe the views of our clients might matter. And I think the last presenter touched on -- touched on a few of them.

So for our -- for my particular role and I've been in this role for just over six (6) almost seven

(7) years now. It's getting longer and longer.

You know, we go in and we -- we look at an industry. We kind of build an understanding of an industry, how it works, how it -- how the companies compete, how the -- what are key drivers. You know, we devise our financial projections and -- and we make recommendations whether this is a good sector to invest in and what company is in that sector to invest.

And -- and what some of the items that our client -- our clients care about obviously is the growth in these sectors; is there a value opportunity, something the market is missing; are they earning a proper return on the invested capital; is there competitive advantages such as distributions, scale, ability to handle claims faster and so forth.

More so -- lately a lot of people are looking at different catalysts and so acquisitions would be one. The cycle and hardening and softening cycle are -- are another one.

And they also for us to properly measure the risks in these different industries and what those risks could mean for the sector and for the different companies.

And -- and I guess why the views of our -- our clients might matter, there's obviously -- they are a source of capital for the insurance companies. You know, the valuations and the views of the market do have an impact upon their stock prices and on the cost of capital. And the owners do have a say in the direction what -- what these businesses and these insurers take in terms of how much capital they deploy to different market places.

And just a -- to let you know as well, property casualty is one of the sectors that I -- that I do cover. I do cover a lot of few other sectors such as the life insurance, mutual fund sectors, publicly traded stockbrokers, stock exchanges, and a number of holding companies.

So I look at a number of different financial organizations. And why I think that's important to know is that our clients are not only looking at the property and casualty insurance sector as a place to invest, but they're also looking at property and casualty compared to a lot of different sectors.

And so they are competing for capital from -- for -- from a number of different -- different areas in the marketplace. And most of the companies we cover are Canadian companies but a lot of them do have US businesses; large US businesses as well.

So we -- when I was asked to come and

present, it took me a little while to figure out what -- what I was going to bring to the Board above -- beyond what I understand that -- that has come out of the last few days. And I'm sure you've seen so many graphs on -- on the cost of capital and depicting ROE's versus the cost of capital and to that I will add my own.

And I think you've heard more than a few textbook arguments around how to tabulate the true cost of equity capital and I'll keep my comments on that one brief.

Rather I decided to put my analyst cap on and present my views similar to how I would if -- you know, a client were to come in and talk to me about the sector and I think including the discussions of the risks in the sector. And one of the big risks that we always talk about is, is the regulatory environment.

And I outline in this slide exactly what we plan to cover today. We provide -- to go through just our measure of the industry ROE versus cost of capital. We're going to talk about the property and casualty cycle and -- and what -- how we look at it is there's been a destruction of value over the past ten (10) years, how we feel there's a potential for and there has been historically not -- not saying in Alberta, but in -- in many provinces and states there has been irrational regulatory intervention that has hurt the industry.

We -- we're going to address head-on the views on -- on capping industry profits and ROE's. I discuss what we believe are the potential pitfalls of not allowing insurers to earn the proper return and to provide from what our perspective is of the best outcome for I guess all constituents, consumers, the insurers, and the public.

So this again is my take at the ROE versus the cost of equity capital. And I know again, you've seen more than a few of these graphs in many different forms but we thought we'd take our crack at it too.

And what we're trying to show is how the industry ROE's compare to what we tabulated as a simplistic cost of equity capital from 1995 to present and on average the ROE's for the P&C sector, since '95, have been 9.9 percent. And I think even if we go back ten (10) to twenty (20) years, I don't think it deviates a great deal from that.

We also include what we view as a cost of equity capital for the industry over this timeframe and -- and how we derive this using a CAPM model, and the details are on the bottom right of the -- of the business or of the chart.

And we factor in the risks associated with the property and casualty market by inputting different betas in to give us a range. And -- and at the end of 2005 this range was 15 percent to 18.5 percent, and that's the cost of equity capital.

We don't want to get lost in the slide here. What we do believe is particularly important, is that over the time frame after deducting the cost of equity capital -- and you know, we have seen a destruction of -- of value. And what this tells us is that over the past 10 years the -- there's been risks that have been higher than -- that have been priced properly into the industry and -- and the prices that have been set.

So essentially in a nutshell the industry was not earning a sufficient return based on what we view as the sector risks.

So going to the property and casualty insurance cycle, and I think again this discussion was in with the -- with the last speaker as well, why has there been a destruction of value in this -- in this industry? And I think there's three (3) key ones that are very specific to the industry and then I think there's one that's outside of the industry control in our view.

The first is the increase competition which tends to rise as the capital levels increase and a companies attempt to put more capital to work. It's a -- and we've seen this historically and given the product differentiate -- differentiation is very difficult or historically hasn't been there specifically in the commercial side, typically the only way to -- to attract business is to -- to cut your pricing. So that's been one of the key ones and that's obviously within the -- within the insurer's control.

You now, we've also got higher investment returns. As interest rates increase or equity markets have gone up you've seen the insurers look for float to invest. And so we in turn have been willing to lower their prices because again, through that discussion -- one of the questions in the last time, was that they're willing to give up on the underwriting profit to get that float and to make it -- the returns more in the marketplace than the interest rate side.

Bad move if interest rates obviously make a market shift in the opposite direction.

And I think historically there has been different points in the industry where the industry has misread trends. And so these obviously knocks against the industry and things that we view as risks.

And the one that we view that -- that is outside of the industry's control obviously is -- is the potential for regulatory intervention, and this is a topic we're going to discuss in a few slides.

So for us with our analyst cap on, you know, the one (1) risk that we view is the biggest is the potential for the irrational regulatory intervention or constant changes in the rules that govern personal auto insurers.

And, you know, through the industry stats and through our contacts in the industry and people that we've met and talked to, you know, we can keep tabs on the competitive forces in the marketplace.

We can keep tabs on what the investment returns on -- are in. We can keep at least a decent tab on where frequency and severity are heading and what we don't know and what has historically have changed quite a bit is the rules that -- that have been put forth by the provincial regulators and how often these rules do get -- do get changed.

So for us, this is the number 1 risk that we look at when -- you know, as an unknown, when we look at this -- this sector. Just to be clear, we don't necessarily believe that regulation is -- is a bad thing, we just believe that over regulation and the constant change of the rules makes it very difficult for the industry to -- to earn an economic -- sorry, an economic return. And we believe this leads to uncertainty, cyclicality, and we believe under these scenarios, the industry and the insurer should be able to earn a higher rate of return on the capital deployed.

For us, obviously Ontario is the -- the key example that we always go back to. It's -- it's -- of what can happen when the industry misreads trends. And I -- yeah we'll -- I'll give you -- it's the insurers fault on that side. But more to -- more importantly for us, it's when industry guidelines continually change.

In the left graph we -- we include the loss ratios, direct written premiums, and the net written premium for the Ontario personal auto market.

And through the 1990's there were obviously three (3) changes implemented by FSCO that initially helped to lower loss ratios through the mid '90's. However the -- the type of no-fault insurance adopted allowed certain participants to learn how to work the system and to their benefit, and the lack of response to immediately address this eventually led to an increase in the loss ratios, and subsequently higher prices at the end of the '90's and the early 2000's.

And this, coupled with a failure of the facility association prices to -- to increase along with the industry prices, led to pretty dire straits for the industry and for consumers. And it was not until FSCO implemented changes through Bill 198 that we saw the loss ratios come down and prices fall. That's obviously one (1) example.

The other example, and it was mentioned in the last presentation, was -- was New Jersey. It's an extreme example but it is a real example, I think.

In 1972 no-fault insurance was introduced to combat the hardening conditions and rate rollbacks were implemented. This led to more than a few insurers leaving the state and the residual market was created to make sure all drivers could find coverage. And by the last 1980's the residual market was running at a pretty big loss which was obviously picked up by the industry.

And prices need to increase to offset these losses but the regulator pursued various forms of rate suppression. And insurers could either curb the amount of business they wrote or -- or left -- or leave altogether.

And in 1998 the auto insurance cost reduction Act pushed to contain the tort and medical cost inflation. The market obviously stabilized but insurers were forced to reduce prices and -- immediately, and the cost savings were to come in the future but it was unknown.

So I don't think I want to -- I don't want to get lost in -- in that particular example. I think the point here that I want to drive home, obviously from our perspective, is the property and casualty insurers already have to deal with some pretty big risks and assumptions which, you know, include not knowing what the cost of -- cost of what they are selling is going to be; what the litigation pressures could arise; the potential for unknown catastrophes, just to name a few.

But to add on top of this, having to operate under -- I guess under a rigid rules that may not adopt in a timely manner to adverse industry trends or -- or change too often, such that what rules they will be governed under in two (2) years out is unknown, add to the complex -- complexities of operating in this industry.

And I'm not trying to single out Ontario and New Jersey. There's other examples, but these were two (2) of the obvious ones that -- that come to mind.

So on Slide 9, there's no doubt that reforms implemented in October of 2004 in Alberta are having a positive impact. And as we show in this graph -- graph, the loss ratios, the direct written, the net written premiums have declined over the last few years.

However, as we've shown specifically in

the last slide, reforms can lead to short term improvements. But in our view the long-term outcome is still unknown, and especially given some of the events that are -- that are going on that we know of today which we'll -- we'll talk about in -- in the next slide.

Some of the concerns that -- and some of the developments that -- that we look at and we try to -- to track in terms of judging the -- the regulatory risk in the marketplace, and there's a few items, obviously the size of the -- of the rate grid which represents I believe roughly 20 percent of premiums and 15 percent of insured risks, and -- and how is the experience of this going to unfold as it matures?

And I also believe that the drivers that were not intended to be on the grid are getting on the grid. And so I think this is one (1) risk that we try to keep as best we can a tab on. We saw what happened with the Facility Association in Ontario and it's obviously one that we want to make sure that we're as -- as best we can, on top of.

There are constitutional challenges in Alberta and the Maritimes against minor injury caps and I think if -- if these were to succeed I think there would be some significant impacts for the industry and for the regulator, as well. We're obviously sitting here at the hearings for the -- in terms of looking at the profitability for the industry and -- and what the outcome will be. It'll -- it will be interesting to see for us and -- and the ongoing review of personal auto guidelines and -- and what's the outcome going to be?

So we're watching all of these very, very closely, but in our view these are -- are uncertainties that we must consider.

Going into the capping of profits or -- or the notion of capping profits in ROE's, I guess the -- the idea of setting percent of premiums or ROE's, for us we just -- we struggled with -- with the idea for some time of how we'd ever come up with a specific number. And this leads us to our conclusion of we just don't believe that there is a magic number for everybody in the industry and we believe there's a few reasons why.

Number 1. I mean, we're not sure how in an industry where the cost of goods sold are unknown, that you'd ever drive in an ROE cap or a range. I guess that's the first point I'd make.

And the second. We looked for other industries that had ROE caps and obviously the one is -- that comes to mind is utilities which are often subject to the ROE caps. And the problem we have here is that a property and casualty insurer, in our view, is not similar to a utility. And we sat down and chatted with our utility analyst before we came out.

And whereas the utility typically looks -- locks in the future revenues through long-term contracts and has a good handle on what the costs will be, you know, a property and casualty insurer sets prices annually, and as we've shown prices can change drastically and -- and the end claims expenses are unknown.

But we'd also argue that the risks for a property and casualty insurer are also greater, a result of the -- the previously mentioned points, but also from a litigation perspective and unknowns such as catastrophic and weather-related losses.

And lastly, I think utilities tend to be monopolies, whereas the property and casualty insurance market is very competitive. And this is a point that we'll talk to on the next slide.

So then we looked at the rest of our financial services companies in -- in the universes we look at, and none of which are -- I guess are subjected to profit or ROE caps and -- and operate in pretty competitive marketplaces. And these include the banks, the life insurers, and the mutual fund companies.

And -- and in now way are we saying they should be subjected to ROE caps or profit regulation, but this is the group that we judge the property and casualty insurance against when we're -- when we're looking at places for our clients to put their money.

And lastly, I guess, I look at the ROE's that the industry has produced over the last ten (10) years, twenty (20) years, and it's been 9.9 percent on average. And I guess it's -- why would you want to implement a cap on an industry that's obviously been -- been able to keep the ROE's under -- at fairly low levels.

Going to -- to Slide 12, the competitive pressures in our view should keep the -- should keep the ROE's in check. And -- and I guess from our perspective, why in such a competitive market does a profit or ROE cap need to exist is the question that we looked at.

And as we've shown in -- in this slide, there are ample personal auto insurance providers and half of the top ten (10) are mutual companies, which are less focussed let's say on maximizing ROE's and profits than maybe -- than a publicly traded insurance company; more focussed on maybe providing the necessary services and their policyholders -- and owners. You know, but we believe this group also will keep ROE's in check.

And we'll move onto the next slide, and

just talking about some of, in our view, what we believe some of the costs of not allowing insurers to earn a proper return on capital could be. And this is not a specific, just to the property and casualty insurance sector, but would be for any particular sector. In our view the risks are -- are pretty significant. I think they could stifle innovation.

And I -- and I look at the -- why would an industry want to bring you products to a market? Why would a company work hard to lower their costs and implement new technology, interface, or offer a differentiated product when they're unable to earn, I guess, a proper return on these investments.

And the second, more than a few insurers would likely pull out of the market if they weren't able to earn a -- a proper return. I think the service levels -- levels could suffer significantly and we saw that in New Jersey and ultimately we'd be left with a less competitive market in -- in our view. And I think this would lead to greater market instability.

In our view the extreme example -- we'll point back to New Jersey where between '93 and 2003 a significant number of insurers pulled out of that market. Availability was scarce and the poor customer service was viewed by some as good for the bottom line and I think that's a very challenging place to go to for an industry. Again, an extreme example but I think one that's very real and interesting to look at.

On the next slide we -- we provide an excerpt from an AM Best article, which we found very interesting and talked -- talked about the New Jersey market and in our view the takeaway was that while extreme, you know, we do believe the experience in New Jersey provides a real example of what happens when insurers are not allowed to earn a proper return or any return at all.

And again I think it's a very extreme example but one that -- that we tried to understand to a greater degree when we look at the industry.

And for us, you know, with our analyst cap on the -- the best outcome in our view, you know, we don't believe there is one (1) ROE that is suitable for the industry. We believe returns are best set by participants and we believe the competitive pressures will keep ROE's in check.

We like to see a market with a light regulatory touch. Again we are not against regulation by any stretch of the imagination where insurers with a competitive advantage are able to reap financial rewards and in turn this could lead to greater product innovation and so forth. And we believe this environment would lead to less uncertainty, greater market stability, and -- and a more stable pricing environment.

And the last one is our disclaimer that my legal department required me to put in. So that's my presentation. It's probably very short versus what you've heard over the last few days and I'll leave it at that and I'm not sure if there's any specific questions.

THE CHAIRPERSON: Okay, Doug, I'll ask if there are questions. Yes?

QUESTIONS BY BOARD:

MR. BILL MOORE: Doug, thank -- thank you for coming. Who or -- we don't have that many publicly traded companies here but who actually owns them, primarily insurance or primarily pension funds, endowments?

MR. DOUG YOUNG: It's a good question and if you look at ING, obviously the parent company still owns 70 percent --

MR. BILL MOORE: Hmm hmm.

MR. DOUG YOUNG: -- so 30 percent is publicly held. And there are some pretty significant institutional owners that are in there that have bought when -- when it did come to market. You know, what that exact percent is it's difficult to tabulate but I wouldn't be surprised to see half of that being big institutional money managers. I won't -- and I know a few of them that I do talk to that are -- are big -- big owners of the firm. I won't name names but they're very focussed on this industry.

And these are also institutional investors in Canada and in the US that have invested in these companies so it's more of a global investment community that is -- that is looking at these companies.

MR. BILL MOORE: So at that level of investor they get a pretty close scrutiny through people like you?

MR. DOUG YOUNG: Absolutely.

MR. BILL MOORE: To a large extent in your profession, your colleagues, your competitors, you, to a large extent, drive the prices of shares.

MR. DOUG YOUNG: Yeah, we -- the -- I -- I don't know if you saw yesterday but ING obviously reported their results and the stock did fall significantly and I think it's -- you know the concerns that we see from our clients and the people that are buying and selling stocks is what's happening in -- in the cycle and what's happening in -- in the regulatory environment in the personal auto side and -- and the big markets obviously being in Ontario and Alberta. Those would be the two (2) big, big concerns that are -- that are really front and centre in a lot of our clients' views.

And absolutely when there is uncertainty in the marketplaces and you see the stock drop, the cost of capital for these companies does increase.

MR. BILL MOORE: During the -- during the period of -- of value destruction as you -- as you more or less phrased it, did the total shareholders' returns in -- in those years also reflect the fact that -- that these companies were making less than their cost of capital?

MR. DOUG YOUNG: Well, it's tough -- it's tough to measure in Canada because really ING is fairly new to being a publicly traded company, Northbridge is fairly new to being a publicly traded company, and -- and Kingsway has been around for a lot longer but I wouldn't say that's really a company that's representative of -- of the Canadian property and casualty insurance market. So it's very difficult to plot out through the different cycles what happens to the stock prices in -- in Canada.

What we have done is we've looked at the US market because that -- there have been publicly traded companies for a longer period of time and absolutely you tend to see the stocks ebb and flow with the market cycle and you see the -- the valuation multiples ebb and flow with the market cycle to some degree.

You know, the market does realize that they're not going to pay top dollar when we're approaching the peak of the cycle so you're going to see a contraction of multiples and you -- and they're not going to pay bottom dollar for the -- for the companies when the cycle goes down so you'll see an expansion of the multiples, but generally you see -- speaking you will see a fluctuation in the stock price as we move our way through the -- through the different market environments.

MR. BILL MOORE: We had a presentation yesterday from a -- from a UK insurer and they -- they purport to have in place a very sophisticated capital -- capital allocation model that --

MR. DOUG YOUNG: Okay.

MR. BILL MOORE: -- will dictate where the capital is going to go by line of business and by geography. Would that -- would that be fairly typical of -- of a -- how -- how the large insurer or -- or even of -- of your clients when you're -- when you or they are trying to allocate where their capital are going are they becoming more and more sophisticated in that?

MR. DOUG YOUNG: Oh, absolutely and they're becoming more global too and so if you're seeing a -- you know something happened in Canada, they'll take their money and they'll -- they'll go into different marketplaces and -- whether it be into the coastal regions in the US where we're seeing prices go through the roof, you know, they'll take -- they'll try to invest or take advantage of a market-hardening condition such as that.

The -- again it's -- you know, because a lot of the capital in Canada is tied up by foreign insurers that are operating in -- in Canada and it's such a small part of lot of these foreign insurers' overall business it's sometimes I think maybe -- maybe it gets lost in -- in the wash in terms of allocating capital in and out to some degree because they are very small --

MR. BILL MOORE: Hmm hmm.

MR. DOUG YOUNG: -- operations but important, too. Don't get me wrong on that front, but -- but very small so...

MR. BILL MOORE: One (1) -- one (1) argument I've heard is that historically they were so small that the parent didn't pay much attention to them but -- but with a more -- a much more focussed effort on allocating capital more precisely --

MR. DOUG YOUNG: Hmm hmm.

MR. BILL MOORE: -- they probably aren't going to be ignored from now on.

MR. DOUG YOUNG: Absolutely. I think the times definitely have changed in five (5) -- ten (10) years ago and I'm no expert, I wasn't around five (5) to ten (10) years ago but I knew a lot of people that were and just the mentality behind the management teams that are running some of these companies and the requirements that are being imposed upon some of these management teams whether it be the publicly traded ones or even the private ones or the -- the ones that are foreign subsidiaries, I think there's more of a -- a focus on -- on maintaining stability and -- and being smart than maybe just going out and writing as much business as you possibly can.

That said, I think the market probably said that ten (10) years ago or five (5) years ago too so we'll see if it actually bears out.

MR. BILL MOORE: Thank you.

MR. LEWIS KLAR: You understand we're regulating only a -- a piece of the property and casualty insurance.

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: We're regulating third

party liability for bodily injury claims --

MR. DOUG YOUNG: Hmm hmm.

MR. LEWIS KLAR: -- and accident benefits. Now, I can understand why there could be a -- a large degree of unpredictable -- unpredictability, uncertainty in property and casualty in general, --

MR. DOUG YOUNG: Hmm hmm.

MR. LEWIS KLAR: -- catastrophic occurrences, floods, ice storms, Katrina, et cetera. But it seems to me and perhaps you can help me understand this, that in this segment that we are regulating it would seem to me fairly predictable risks. Firstly, risk assessment is -- is quite sophisticated in terms of assessing risks.

Secondly, the -- the frequency and severity of claims, bodily injury claims, can be fairly closely tracked on an annual basis. There's already a cap and I'm not talking about the government's cap; we're talking about a judicial cap --

MR. DOUG YOUNG: Hmm hmm.

MR. LEWIS KLAR: -- in Canada on non-pecuniary damages.

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: So there's a very small limit beyond pecuniary damages the courts can award.

There -- there's hardly any use of punitive damages in Canadian tort law and negligence claims. There's a very small use of juries.

And Canadian courts generally are quite conservative in damage awards --

MR. DOUG YOUNG: Absolutely.

MR. LEWIS KLAR: -- and assessments. So can --can we understand why I keep on hearing how risky and how uncertain the claims for third part bodily injury are in Canada?

How can they really -- how can they be so dramatically different on a year-to-year basis considering all these factors which I just mentioned? What is going to be the catastrophe that -- that turns a year into a --

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: -- into a major loss?

MR. DOUG YOUNG: Let's have a look at Ontario as a prime example and it's why I brought the -- this slide back up and -- and I think if you look at the Quebec model they -- you know, the -- the Government takes in that -- that side of -- of the insurance whereas the property and casualty or the property and physical damage is the one that's outsourced the -- to the -- to the insurers and the publicly traded insurers and so forth.

MR. LEWIS KLAR: But Quebec's a no-fault model?

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: So there's no -- so Quebec is an actually regulated system. There's no -- there's no uncertainty at all because --

MR. DOUG YOUNG: Hmm hmm.

MR. LEWIS KLAR: -- the -- the damages are paid according to a compensation scheme --

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: -- fixed just like Workers' Compensation?

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: Okay.

MR. DOUG YOUNG: I don't think -- I look at Ontario and I think it's -- it was -- it was one (1) of the biggest drivers of the problems that happened in Ontario at the end of the '90s was the bodily injury and the accident benefits side of the equation and part of that was because the way it was set up and because practitioners and different individuals that were part of the system were able to work the system to the detriment I think of the insurance industry.

And it caused and cost, I think, the rest of the -- the industry and consumers as well and obviously that has been curbed with Bill 198 and so that's a huge, huge benefit to that but historically speaking when I look at the industry, that was a -- that was a big risk for the industry.

MR. LEWIS KLAR: Well, you know, I don't want to get into the details. First there's -- there's -- as you know there's controversy about whether it was bodily injury claims which actually drove up insurance price and we know --

MR. DOUG YOUNG: Hmm hmm.

MR. LEWIS KLAR: -- we know the famous Ernst & Young study and --

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: -- and that. But, you know, my experience, I tell you, my experience with -- with Tort law and in the automobile accident field certainly doesn't -- doesn't convince me at all. I mean certainly because of the structure of our judicial system and the way --

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: -- they way our claims work here --

MR. DOUG YOUNG: Yeah.

MR. LEWIS KLAR: -- it doesn't -- it

doesn't convince me at all that there -- there's a high level of uncertainty, that there should be a high level of uncertainty, but that -- you know, I just wanted your opinion --

MR. DOUG YOUNG: Yeah. No, and -- and I --and you know it's funny. When I picked up the industry overall one (1) of the things that I praised Canada about versus the US was the -- the fact that -- the control on tort costs in Canada versus the US. It's very, very different and talking to let's say some of the insurance companies that have trucks that do long haul trucking insurance and they have it across Canada and the -- the business that goes into the US is very, very, very different risks. And so --

MR. LEWIS KLAR: And that -- and that's why perhaps these American examples which we hear -- we heard from the American academics, et cetera, from different states. I mean the systems are completely different in many respects and I -- I think people have to understand the conservativism and the -- and the constancy of the Canadian system.

MR. DOUG YOUNG: It's still a -- there is a cycle to it and that's what we look at and I think there is a component of that cycle; that's all those different components that we went through and I think that -- but you're right from -- from a tort perspective. But I -- I would also say I think that tort cost in the US is built into the premium and the prices that are set there, too. So it's -- yeah, no, I don't disagree with your point that the Canadian marketplace from a tort perspective is very -- more stable let's say than the US marketplace.

MR. LEWIS KLAR: In that cycle of insurance. I'm not talking about all insurance, just that segment which we regulate.

MR. DOUG YOUNG: Yeah.

MR. DAVID WHITE: I just had one (1) question. If you're ICC, medium-size company, that's auto insurance how would the provinces rate in terms of a good place to do business given the regulatory and economic environments?

MR. DOUG YOUNG: Well, I think that right now it's -- if I look at the changes that have been made, Ontario is -- is a really good marketplace to be in presently and -- and the industry has made a lot of changes and a lot of reforms that have worked positively for -- for the consumers and for the industry. I think that -- that would be one (1) point.

Now, and -- and the two (2) big markets, it's - you know is -- is Alberta and -- and Ontario that represents the lion's share of the personal auto market that can be written by private -- private companies in -- in Canada.

So -- and I don't -- you know, I look at the -- the environment that you have in Alberta and I would say it's a pretty good environment today because of the changes that have been made historically and the reforms that have been made historically so I would say there seems to be a little bit more uncertainty out in New Brunswick at this point in time. We'll see how things evolve there.

But that's how -- but that's kind of how I would look at it. Ontario and Alberta would be the two (2) ones -- provinces that I would look at and I think the market and -- and the reforms that have been put through are benefiting the industry and benefiting the consumers I think as well.

THE CHAIRPERSON: Ted?

MR. TED ZUBULAKE: Yes. You and -- you and others have shown that the kind of historical return on equity from P&C insurance has been around 10 percent going back --

MR. DOUG YOUNG: Hmm hmm.

MR. TED ZUBULAKE: -- ten (10), fifteen (15), twenty (20), thirty (30) years.

We've also heard from other presenters that -- about the -- the relatively recent increased equity or capital standards imposed by OSFI, the minimum capital -- minimum capital test which I -- I gather everything else being equal -- of course that never happens -- but everything else being equal should drive down returns because more equity capital has to be maintained.

MR. DOUG YOUNG: Yeah.

MR. TED ZUBULAKE: We've also heard from you and others that investors deciding where to allocate their capital are looking for returns -- double-digit returns -- 14, 15, 16, 17 percent.

So given the -- what the -- the expectations of investors, the ones that control the -- the capital and the -- the performance of the insurance industry, the P&C industry in the past plus the -- they're getting the new capital standards, why would anybody want to invest in a P&C insurance company?

MR. DOUG YOUNG: That's a very good question. MR. TED ZUBULAKE: I mean I -- I --

MR. DOUG YOUNG: And --

MR. TED ZUBULAKE: -- I guess I'm -- are these expectations unrealistic?

MR. DOUG YOUNG: Well, I guess I also

would say to you I think this is the average and I think there are some companies that stick out and some companies that outperform the industry and -- because not only do they have sale advantage but they have a competitive advantage whether it be distribution or there would be from an actuarial perspective and -- and so these are companies that don't operate I guess at 9.9 percent on average.

That's the average for the industry but there are companies out there that do a good job and make a proper return on that capital that's deployed.

MR. TED ZUBULAKE: That means for some companies 9.9 percent return is -- is quite fine, otherwise why would they be in business all these years and that's what I'm --

MR. DOUG YOUNG: Well, there would be --

MR. TED ZUBULAKE: -- struggling with.

MR. DOUG YOUNG: And there would be -- and there would be some that would operate below that.

MR. TED ZUBULAKE: And below that, yes.

MR. DOUG YOUNG: Absolutely.

MR. TED ZUBULAKE: Okay.

MR. DOUG YOUNG: And I think -- and I -- I can't speak for -- for the mutuals but I -- maybe that would be one that profit maximization isn't one of their particular goals and so maybe that would be one (1) sector or one (1) structure of a company that would write that business that would make a lower -- lower return whereas the other individual companies would want to get a higher return.

But no, it's -- it's one that I struggle with myself when I look at this industry and I look at that 9.9 percent and, you know, over -- through a cycle it's not that attractive.

MR. TED ZUBULAKE: Yeah. Thank you.

THE CHAIRPERSON: Well, Thank you, Doug, we appreciate you coming and I -- I heard you answer Bill to the effect that you influence the market value and I looked in my portfolio last night and I don't to keep you too long. I want you to get out and flog that market.

MR. DOUG YOUNG: I don't cover income trusts.

THE CHAIRPERSON: Thank you very much.

MR. DOUG YOUNG: Thank you.

THE CHAIRPERSON: Five (5) minutes.

--- Upon recessing at 10:21 a.m.

--- Upon resuming at 10:27 a.m.

THE CHAIRPERSON: All right. Are we

ready? Well, welcome. We're looking forward to hearing you presentation. You're the last of our three (3) days and I guess that the old saying the best comes last is I hope. So we're looking forward to your presentation.

PRESENTATION BY MSA RESEARCH:

MR. JOEL BAKER: I'm in the unenviable position of holding you back from your weekend, but I'll -- I'll do my best.

Good morning. My name is Joel Baker. I'm president and CEO of MSA Research Inc. of Toronto. I would like to thank the AIRB for inviting me to present our views on the Alberta auto insurance rate environment.

I'd like to preface my presentation by saying that unlike other presenters at these hearings I will not specifically be addressing the issue of appropriate target rates of return or the appropriate cost of capital for other insurers in Alberta. Instead I've been asked to focus my presentation on the perspective of rating agencies and our own views of the situation here.

First let's give you a bit of background on MSA. MSA is a Canadian independent analytical research firm that is focussed specifically on the Canadian insurance industry, focussed on the property, casualty, and life sectors.

I founded it in 2004. MSA supplies analytical software and financial reports to approximately 90 percent of Canada's P&C insurers and reinsurers based on market share. Our clients also include equity analysts, all banco and investment bankers, all major audit and actuarial firms, academics, regulators, governments, agents and brokers, and writing agencies. We also have the occasional consumer ordering material from us.

Our analytical databases contain detailed financial information on approximately 97 percent of Canada's -- of Canadian insurers, market weighted.

MSA was founded by myself in March of 2004. Prior to that I was the general manager of AM Best Canada Limited, AM Best's Canadian subsidiary, and before that I was general manager of Track Insurances Services Limited. AM Best purchased Track in '99 and renamed it AM Best Canada. AM Best eventually shut down its Canadian subsidiary in 2003 and after a few months I started up MSA.

Just a few ground rules on -- on what we're presenting here. Unless otherwise specified all the data comes from our databases. Unfortunately the regulatory statements that we rely on don't separate out commercial versus private auto so we have to look at both together and we also excluded Lloyd's data because that's primarily commercial.

And the results are presented on a calendar year basis, thus losses from any given period include development and prior periods.

An outline on our presentation. We'll talk about rating agency perspectives, the view from MSA, historical and recent results, the Alberta auto contributions as a percentage of non-government auto in Canada, so what Alberta's feeding, in terms of premiums and claims, into the auto environment in Canada, looking at the big groups as they're gaining share here and potential areas of concern for the AIRB, the -- the market conduct regulators, and the driving public.

I'll turn my attention now to the rating agency perspectives. MSA is not a rating agency but we've -- I've had -- I have rating agency experience myself and I -- we have partnership with Standard and Poor's; I've discussed this with them.

A significant number of Canadian insurers carry financial strength ratings from one (1) or both of the main rating agencies, AM Best and Standard and Poor's. The agencies assign two (2) types of ratings to the market, interactive ratings and public information or public data ratings.

Interactive ratings involve an in-depth review of an insurer's financial position, market position, and business profile. Interactive ratings also involve in-depth meetings with management.

Public data ratings on the other hand typically involve a quantitative external analysis of insurer's financials using only publicly available information.

I will restrict my discussion here to interactive ratings as I believe they are more reflective of rating agency views when they are provided robust access to information and management.

It is also very important to note that several large personal lines players in Canada are not currently rated by any company. The reason for this is that there's little demand for financial strength ratings from consumers of P&C insurance or from their brokers, little if any.

For the most part, insurers -- for most insurers Alberta Auto represents a small part of their overall portfolio. While performance of this book is important in the rating review in most cases deterioration in Alberta Auto will not, on its own, trigger rating downgrade on large national players and also agencies attempt to rate through the cycle. They don't rate one (1) year at a time. They look through the whole cycle and decide what rating can be maintained through the highs and lows of a cycle.

However, exposures to the uncertainties emanating from Alberta's other regime are certainly a concern for agencies, particularly for companies that are heavily exposed to this market. Only one (1) Alberta-based insurer is currently rated and the rating of that company reflects its overweight exposure to Alberta Auto.

When assigning ratings agencies traditionally support the ratings of the company's strengths while on the other hand they list a series of offsets explaining why a rating is not higher. In recent years the difficulties in various auto insurance markets have dominated the offset lists for personal lines and multi-line insurers.

As -- as I said earlier, Alberta Auto and so on would not be a reason for a downgrade for large national players, however, the uncertainties here qualify it to show up on the list of rates and offsets for rated personal lines players.

And here are a few quotes from the rating agencies themselves. I -- I asked Standard and Poor's to provide a quote and this is what they gave me:

"The Alberta Government's premium grid which was designed to bring about more affordable and -- and available auto insurance for young and inexperienced drivers does not reflect the economic reality for this driver class."

That's what Standard and Poor's provided. And the other following two (2) quotes come from AM Best press releases on ratings, and these are in the offset area.

The first one is:

"AM Best remains concerned about the effects that recent regulatory changes in the Alberta auto -- automobile insurance product will have upon the long-term profitability."

And the next one is a more general one:

"These rating strengths are partly offset by rate restrictions imposed by regulators on the automobile insurance product in most provinces of Canada."

So the typical type of offsets in the rating reviews.

And now I'll turn my attention to our own view from MSA. The current environment in Alberta is of some concern to MSA. We're particularly concerned about the sustainability of the grid cap and the cross-subsidisation in genders. The regime appears uncertain and unstable. Declining CAPM revenue while claim costs are less contained and non-grid risks are penalized while riskier drivers benefit from grid caps.

And the -- the standout flag for us is the unparallel size of the risk-sharing pools, particularly that one in the other grid risk pool. Both risk-sharing pools currently account for about 22 percent of premiums or 13.9 percent of private passenger vehicles. FAA expects us to decline slightly in the mid term, but I'm -- I'm uncertain about the longer term. We expect if -- if results deteriorate the RSP's will grow. And overpopulation of RSP's typically indicate unhealthy market conditions.

I kind of liken it to a scenario. If you look at -- think about five (5) boats in a stormy lake that are leaking, the people bailing them out, and the rain's coming down, that's a scenario I see with growing risk sharing pools. You're throwing it out into the water but it comes back in through the hole as -- as you get your -- as you get your participation.

The grid benefits inexperienced new drivers by capping their cost of insurance below what is economically warranted. Further, the grid not only caters to new drivers with clean records but also the risky drivers with records of at-fault accidents and convictions.

Insurers have been taking various approaches to dealing with the imbalance, following, just a few. They see -- perceive underpriced business in the pool. They attempt to offset underpriced business by gains on non-grid risks, optional coverages and, to the extent possible, in other lines of business, or they just reduce their exposures as much as possible if they find -- if they feel that the business is underpriced.

(BRIEF PAUSE)

MR. JOEL BAKER: Here I'd like to touch on AIRB's interest in determining what the appropriate target level of profitability for insurers should be. My observations are general in nature. My observations are general.

The ROE target -- cost of capital is very difficult to determine, as you've seen I'm sure in the past few days. The product is immature and experience as it's evolving is hard to price. And then there's a conflict between Prudential capital requirements -- and the lower levels the companies want to maintain to achieve higher returns.

I believe if -- if a target is set it should be a -- a -- viewed over a cycle and not annually. Investment use should be taken into account. And the other issues are capitalization levels and capital provider requirements vary by company types, mutuals versus stock or foreign-owned, or multi-line versus personal-line companies. And it's difficult to translate ROE targets to a loss ratio, combined ratio target.

Other areas of concern. Should the Charter challenge on a cap for pain and suffering claims go against the industry, we would expect some upheaval. The question is rather hypothetical and we'd expect appeals, but if the ruling went successfully against the cap on a retroactive basis previously closed claims would re-open and costs would climb dramatically. Results would be -- results would be impaired and the economic underpinning of the regime would be weakened further.

Some estimate that the claim costs would climb somewhere between twenty (20) and 30 percent. And there are charter challenges against similar caps in other provinces. If -- one would be concerned that if a cap was overruled in one province, that could spill over to others.

Whether ratings from rating agencies would be affected depends on many things, such as specific rulings and the costs and the allowable price adjusters and each insurer's specific financial position, but it would definitely be a negative.

I, like many others, have some concerns about the cross-subsidization nature of the grid. While the -- the model has successfully suppressed insurance costs, it has done so at the expense of other policyholders in a manner that, in our view, is not dissimilar to a tax.

I also question the long-term sustainability of the model, particularly if the RSP's grow and experience deteriorates as a consequence of claims inflation.

Open competition would, in my opinion, better serve the driving public, perhaps with some explicit government financial programs for the benefit of young claims-free drivers.

Now we'll turn to the slides depicting financial information. As you can see, Auto loss ratios in Alberta have come off the 2004 lows but still appear relatively tame to the introduction of the grid and the rate rollbacks. The only exception being personal accident and first party bodily injury claims. These appear to be at a historical high through six (6) months of 2006. You can see that in the -- the red line there.

I must caveat that by stating that personal accident only comprises a small portion of the auto premium, about 5 percent, and results of six (6) months across companies have all -- have been all over the map. The total however is high. We'll continue to monitor this going into year end.

I say the results appear tame but that is not to say that they will remain that way as the product matures.

QUESTIONS BY BOARD:

MR. TED ZUBULAKE: Excuse me, sir?

MR. JOEL BAKER: Yes.

MR. TED ZUBULAKE: Are these reported numbers or developed numbers or --

MR. JOEL BAKER: These are as reported, as I indicated in my --

MR. TED ZUBULAKE: Okay. And you seem to have something here -- these last points for the -- you have second half of 2006 on this.

MR. JOEL BAKER: Yes. Yes. We get the data from the companies.

MR. TED ZUBULAKE: But how is that

possible?

MR. JOEL BAKER: How is what possible?

MR. TED ZUBULAKE: Are we in 2007 yet? Did I miss the last three (3) months?

MR. JOEL BAKER: We're at --

MR. TED ZUBULAKE: You have the second half of 2006 data?

MR. JOEL BAKER: I have the six (6) months 2006 data.

MR. TED ZUBULAKE: The first six (6) months.

MR. JOEL BAKER: First six (6) months.

MR. TED ZUBULAKE: Well, I'm asking, it looks like you're at -- your points here go through the second half of the year.

MR. JOEL BAKER: We go through to six (6) months of 2006, through June 30th.

(BRIEF PAUSE)

MR. TED ZUBULAKE: Oh, these are quarters.

MR. JOEL BAKER: So we have 2005, 2006, first quarter of 2006, second quarter --

MR. TED ZUBULAKE: I am sorry. These are

quarters, right. Thank you.

CONTINUED BY MSA RESEARCH:

MR. JOEL BAKER: I'll go back. This slide shows -- this one here shows whether auto premiums generated in Alberta relative to all non-government auto premiums in Canada are in proportion to other claims generated in Alberta relative to other claims in Canada.

Wherever the blue line is above the dotted red line, Alberta was providing relatively more in the way of premiums than it was in claims. When the dotted line was above the blue line, Alberta was kicking out more in the way of claims than it was in premiums relative to Canadian market.

As you can see, between '93 and '95 Alberta was generating between thirteen (13) and 13.5 percent of auto premiums in Canada while generating slightly less than 13 percent of the claims. The situation reversed dramatically in '96 through '98 when Alberta generated dramatically less than its, quote-unquote, fair share of premiums relative to claims.

In the years '98 through 2000 premiums and claims were quite synchronized, diverging again in the years '99 to 2005. They seem now to be in sync again.

Adding this up over the years shows that it is a wash. I came into this thinking probably that given all the turmoil in Alberta, that Alberta was kicking out more claims than its fair share, but the results came back showing that it's actually a wash over -- over time.

Alberta drivers have not consistently overpaid or underpaid relative to other jurisdictions in Canada. The general upward trend in the graph is a reflection of the growth in the Alberta population and the economy relative to the rest of Canada in the period.

This slide shows the rather dramatic growth of the top five (5) players in the Alberta auto market. The results are on a consolidated basis, so the AVIVA group, the Cooperators group, TD and Meloche Monnex group, Wawanesa on it's own, and ING Canada. Some of this is the result of general industry consolidation but part of it is attributable to the reduced participation by other players in the market.

The top five (5) wrote about 45 percent of the business in 2000, while they now write close to 55 percent. In fact, the top four (4) write 50 percent now. The concentration of auto here is second only to that found in the Maritimes for provinces with private passenger auto regimes.

While the size and the scale of Alberta

economy is much larger than that in Newfoundland, PEI, Nova Scotia or New Brunswick -- sorry. While the size and scale of the Alberta economy is much large than that in Newfoundland, PEI and Nova Scotia, the Alberta -- the concentration here is higher. In New Brunswick the top five (5) groups command 46.5 percent of the market. We believe fragmentation is in decline.

This slide depicts the historical performance of the top five (5) groups as compared to that of the industry. The black line being the industry. As you can see, the results are quite varied with ING and TD outperforming the market in most years. And as shown earlier we're seeing a light ramp-up in loss ratios going into the first six (6) months of 2006.

This slide, which I believe is rather illustrative of the situation in Alberta, shows the top writers in the market. These are -- these seventeen (17) companies and groups write about 95 percent of the auto premiums in Alberta. The bars refer to the dollar amounts written, the right-hand axis, while the red line shows how much Alberta auto represented of each insurer's overall writings, all lines and all regions. The black bars are those of the top five (5) players.

What this chart shows is the -- the only large players to have a -- a real large stake in Alberta auto, representing more than 20 percent of their portfolio, was Wawanesa. The rest, although major players in the market, generate between 5 percent and 15 percent of their overall writings here, while the two (2) indigenous writers that we have data for, AMA and Peace Hills, are much more exposed to developments in Alberta.

Now I'm turning to potential areas of concern. We believe that the regime is currently at what is known as the honeymoon stage and that the profitability in that period following a radical form typically overstates the long-term profitability as market forces adjust to the new reality. Also, the early data is too green for effective or accurate actuarial forecasting.

So we're not totally -- we don't totally trust the numbers that are coming out of 2005 or mid-year 2006. We want to see a few more years of development before we can establish a -- an opinion on the profitability of the market.

Here are some potential areas for concern for the -- some more areas of concern. A reduction in competition or participation. If prospective risk-weighted returns are unattractive and are perceived as real regulatory risks and risks of participating in the RSP's are too high insurers will hesitate to come into the market or work to reduce their exposure there. 55 percent of the market is already controlled by the large five (5). Several insurers have reduced their participation or have effectively withdrawn.

Another area of concern is claims inflation. Claim inflation can arise from various sources, increased frequency, higher-end vehicles, increased cost of repairs, potential -- this is a potential, I -- I believe, is -- is serious -- the potential for less stringent claims handling for grid RSP business. If the company's throwing out the lion's share of its Alberta auto business into the pool, how much attention is it going to pay on the claims side versus if it was on its own books. And the potential for fraud.

Another area of concern is a downturn here will adversely affect the local carriers. They will feel the pain disproportionately. In the extreme but not farfetched scenarios their solvency or independence could be put at risk.

And that is the end of my presentation, but I'm open to questions.

THE CHAIRPERSON: Questions? No questions.

CONTINUED QUESTIONS BY BOARD:

MR. TED ZUBULAKE: I have --

THE CHAIRPERSON: You're up.

MR. TED ZUBULAKE: -- just one quick question.

The last speaker said that in his opinion the Ontario market environment is pretty good right now. Would you agree with that?

MR. JOEL BAKER: Yes. Yes.

MR. TED ZUBULAKE: Yes?

MR. JOEL BAKER: Yes.

MR. TED ZUBULAKE: That's what I wanted to know. Thank you.

MR. JOEL BAKER: I had a --

THE CHAIRPERSON: If there are no more questions --

MR. JOEL BAKER: -- I had an answer to the question that was asked earlier. I think I have an answer.

THE CHAIRPERSON: I think we wore your predecessor out with the questions.

MR. JOEL BAKER: There was a question about before the -- the reforms came into place the volatility was still there. That was a question earlier. I don't think the regulations -- lack of regulations would guarantee stability, just that the volatility can arise from various sources and regulations is one of them.

You can also have volatility when things are -- when costs are known you can still have volatility if pricing -- if you're one dollar ($1) below the cost consistently, you can end up depleting your capital over time even if it's stable, if you can't price at the appropriate level even if it's stable.

MR. LEWIS KLAR: My point was that one of the great things of the two and half (2 1/2) days was that we had sessions on economics and free market and -- and everything -- free market -- competition -- that sort of ignores the fact that the only reason -- in the first place when this province and other provinces would prefer not to regulate, the only reason that regulations come into effect -- produce unavailability.

So it was -- the theory of free market and how, if you have this free market it would work much better than regulations, but the reality is that it really ignores what actually happened, which is that it was the free market which drove jurisdictions into regulation.

MR. JOEL BAKER: Right. When we look at it as if you rode out that period stability might have returned anyway as -- these claims -- the costs went --

ramped up as a result of losses in previous years. Things overreact. I mean, companies overreact and the industry overreacts in -- in some cases or under-reacts and the soft markets end up being compensated by a few years of very high rates and then eventually might come down on it's own, and -- when it may have come down on its own anyway. That's my perspective of it. But you can't -- you can't -- I don't think free markets are a panacea, that they would eliminate volatility.

THE CHAIRPERSON: Well, thank you very much. We appreciate your time and effort, as I mentioned, I don't want to repeat myself over and over but it's a complicated process and we'll be looking at -- taking your presentation in full consideration.

Thank you very much.

The Board would retire to the other room. Ted has a few set up for us. When you're ready we'll retire to the other room, Ted.

--- Upon adjourning at 10:52 a.m.

Certified Correct,

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Sue Zaharie