

**Pro-Text
by Dan Reith**

Let's talk Profits.

Every business, regardless of mission statement and operational goals, seeks to make a profit. As each year passes, management seeks to do better than the previous year. Profit, growth, and stability are the catch words and measures by which business evaluates its operations. Oddly enough, when those profits are for one's own business it's all good; but when those profits are earned for businesses which one often fails to totally understand, it's a bad thing. Well — get ready, as the insurance industry prepares to announce its operating results for 2005 and yes the bottom line is "profit".

Insurers have begun to announce individual profits and on March 15th industry earnings for 2005 will be posted. At this time last year, the Insurance Bureau of Canada (IBC) estimated an overall return on investment of approximately 20%. Taken into consideration that interest rates have been more favorable in 2005 and the return on capital has given insurers more dollars to invest, one can assume that earnings will meet or exceed 2004 numbers. However, return on investment is anticipated to be somewhat the same or slightly less than 2004. So, when looking at the industry results and the individual insurer's bottom lines, don't get too excited that the industry made money. What you need to consider is the actual underwriting results. When companies and the industry post their annual results, to a certain extent, the reality is skewed by the investment returns. A better measure of profitability is the underwriting results. If an insurer takes in more premium dollars than it pays out in claims, then underwriting is profitable. If the company pays out more in claims than it takes in premium dollars then it is not profitable; but the profits from investments can be added back to reduce the loss or create an artificial profit. Over the long term, an insurer can only offset its underwriting losses by investment profits for so long without drastic measures being taken. If not, the marketplace suffers as it did after 9/11 where sustained underwriting losses could no longer be offset by investment profits because there were no investment profits.

Contrary to what consumer advocates report, an insurance industry that makes profit is a good thing. A profitable insurance industry, like any industry, is healthy and stable when it is profitable. A quick glance at the airline industry is a clear indicator of what happens when profit is drained from a sector over a long period. Further, when the insurance industry is healthy, consumers benefit. Consumers benefit because sustained profitability allows for rate or premium stability and over the long term, premium reduction. All those who have purchased insurance over the past two years have experienced first-hand the benefits of a healthy industry and have seen insurance rates on both the personal and business side of the market stabilize and begin to decline over the past 12-18 months. In addition to rate stability and reduction a profitable industry allows for greater market capacity or availability as the marketplace becomes more competitive. This is evidenced by the increase in the number of providers of personal and business insurance.

From 2001-2003 many insurers withdrew from the marketplace, unable to write new business. Others removed themselves from insuring certain lines of business and it became common for many to have great difficulty in finding insurance. Often, when they did, it was at significant premiums. The tide has turned. Calls to IBC's Consumer Information Centre from Ontario residents complaining about their inability to find

automobile insurance are down 44% since 2003. Similar complaint calls from business unable to find liability insurance are also down by 48%. Clearly the industry is better able to respond and meet the needs of consumer, thanks to a return to profitability.

Let's put all this in perspective. The insurance industry is highly regulated by provincial and federal regulators. The industry by its very nature is risky and cyclical with earnings fluctuating year to year. In 2002 the industry posted its worst year on record with a return on equity (ROE) of less than 2%. That same year the banking industry in Canada saw a ROE of approximately 18% and Loblaws, as a single company, had a reported ROE of approximately 18%. Given the cyclical nature of the insurance business results need be considered over a longer period of time than just one (1) year. For example, from 2001 to the Q3 2005 (the latest period for which data is available) home care and business insurers made 7 cents of profit for every dollar they brought in from premiums and investments.

So what do these companies do with this profit? Much of it is paid out in claims. In 2004 Canadian insurers paid out over \$20 billion dollars in claims. In addition, they provided employment for more than 100,000 Canadians and the industry as a whole, through general and special taxes, is one of the largest commercial tax payers in the country. The stronger the industry, the more it contributes to the economy. For example:

- 41,500 Ontarians are employed in the industry (up 7% from 2003-2004)
- \$5.6 billion dollars invested in Ontario provincial and municipal government bonds (up 35% over 2003)
- \$1.9 billion dollars paid in taxes and levies to the Ontario government alone (up 11% 2003 to 2004)

Across Canada insurers also provide financial and volunteer support to more than 750 charitable organizations, ranging from local service groups, sport and youth organizations to national medical research foundations.

Taking it all into account and considering the impact the industry has on the economy it is not a bad thing that your insurance company made a profit last year. Going forward, you will be glad they did as your insurance rates remain stable and even decline. Don't forget the most important thing...when your insurer makes a profit you can know they have the funds to pay your claim when you make one.

For more information on the insurance industry contact your insurance provider or visit www.ibc.ca.

This column appears regularly in Business Beat and has been submitted by Dan Reith BA (Hons) CAIB, a principal of Reith and Associates Insurance and Financial Services, 462 Talbot Street, St. Thomas. Dan is also a Member of the Chamber's Board of Directors. Questions and comments on this column are welcomed by the writer and 631-3862 or via e-mail: info@reithandassociates.com