








Refund from Surplus

“To be or not to be”, or in this case “To Refund or not to Refund”, that is the question of the month and longer, as we flew through this year seeing growing profits. After an excellent year in 2020, who would have thought that we would be in this position eleven and half months later? What a great debate to have this year and hopefully in future years as well, because that means we have made a substantial profit. This is the kind of challenging decision we want to have.

First let’s test the process we set up.

The whole financial page is attached but here’s the current year indicators:

Considerations	2021 P
Is MCT over target	
Combined Ratio < 90%	
3 Year Combined < 95%	
5 Year Combined < 95%	
Premium Written to Surplus	
Strategic plan not impacted	
Investment Income	

As the policy says, these indicators above, all showing green, simply tells us we have the financial results that warrant a conversation about a refund from surplus.

Amount

If we are considering a refund, what would be a good number to look at? Here are the three year and five year financial numbers and the amount of underwriting profit in excess of the combined 95% ratio target. 2021 is included at projected amounts (\$7.5 million underwriting profit).

	3 Years	5 Years
Premium Written	101,369,980	156,057,609
Net Premium Earned	84,333,465	128,373,123
Net Premium Income	85,712,508	130,451,482
Net Claims Incurred	40,596,393	66,514,670
General Expenses	<u>35,139,157</u>	<u>54,512,365</u>
Total Expense & Claims	75,735,550	121,027,035
Underwriting income	9,976,958	9,424,447
Net Profit	13,466,045	14,211,863
Net Loss Ratio	47.4%	51.0%
Net Expense Ratio	41.0%	41.8%
Combined Ratio	88.4%	92.8%
Excess profit over the Combined Ratio target of 95%	\$ 5,691,333	\$ 2,901,873

What line(s) of business contributed to the profits?

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Automobile Loss Ratio	35.3%	44.9%	65.4%	43.1%	16.6%
Commercial Loss Ratio	24.1%	36.7%	-3.8%	22.7%	20.3%
Farm Loss Ratio	51.2%	37.0%	48.0%	40.8%	24.3%
Personal Loss Ratio	73.2%	61.4%	75.0%	78.4%	33.5%

	<u>3 Year</u>	<u>5 Year</u>
Automobile Loss Ratio	40.8%	40.6%
Commercial Loss Ratio	13.9%	19.6%
Farm Loss Ratio	37.2%	39.6%
Personal Loss Ratio	61.2%	63.3%

All of the 3 and five year profits came from auto, farm & commercial, but this year, a significant amount was due to residential.

How much would you give out and how would you apply it?

Let's say, for the sake of argument, you want to give a refund. I would suggest something straight forward:

	<u>2021</u>		
	<u>Written</u>	<u>Refund</u>	<u>%</u>
Automobile	8,192,770	819,277	10%
Commercial	4,470,141	447,014	10%
Farm	8,948,295	894,830	10%
Residential	<u>13,850,694</u>	<u>692,535</u>	5%
	35,461,900	2,853,655	

The above is based on premium written and it would actually be earned. The policy also has to be in-force on December 31st. All this means is the refund amount would be less than shown. The reduction would cover cheques and mailing costs. But the calculation can be done both ways. You could also provide a refund amount (ie. \$2.8 million) and then pro-rate that amount over the policies. It may mean 9.8% of your policy premium instead of a round number.

The amount of \$2.8 million relative to the underwriting profit of \$7.5 million projected or better \$8.3 million as at November, is a reasonable reduction. If we started this year thinking we were going to have an underwriting profit north of \$4 million, we would be very pleased.

It's also about half of the 5 year excess profit above our target.

What does a refund of 10% and 5% look like from an individual policyholder?

On average, it's about \$135 per policy with the highest refund being a whopping \$6,600. The total refund on a written basis is 2,986,783. If we made sure the smallest cheque a person receives is \$25 the cost goes up by \$15,000 or if we said everyone will get at least \$50, then it costs \$84,000 extra.

My analysis is on a per policy basis, so looking at my policies ...

Car ... \$261
House ... \$42
Boat ... \$21
Umbrella ... \$7
Total \$331

What happens if we make the decision and December falls apart?

Well, that would be unfortunate and highly unlikely given we are making the decision with only two weeks to go. However, what I believe you want to do is put parameters around any motion that would provide an automatic process. For instance, if you thought the example refund of \$2.8 million was right, what I would suggest is you draw a line in the sand at a lower amount such as \$1.8 million which is approximately 5% across the board.

You could then make a motion such as this....

The board approves a refund of surplus of 2.8 million dollars subject to achieving a minimum underwriting profit, after the refund has been taken into consideration, of \$4 million. In the event that the minimum underwriting profit is not achieved, the refund amount would be reduced such that the minimum is achieved. If the refund must be reduced below \$1.8 million dollars to achieve the minimum underwriting profit, then no refund shall be issued.

In the case of subscription policies, no refund will be given to any policy we are not the lead company on. In the case we are the lead company on the subscription policy, only the portion we retain as lead company shall be considered in the refund calculation.

The refund from surplus amount shall be allocated to all policies in-force at December 31st, 2021 and in good standing with their payments.

Each policy shall share equally based on the proportion the earned premium on their policy bears to the total earned premium of all policies used in the calculation.

Or (if you thought 10% and 5% for residential was a good idea)

Each policy shall share equally based on the proportion the earned premium on their policy bears to the total earned premium of all policies used in the calculation. In the case of residential policies, only 50% of the earned premium will be considered in the refund amount.

No policyholder shall receive less than a \$25 refund cheque amount.

What are the types of ways to tell people about it?

I see a letter going with the cheques from the Chair of the board explaining mutuality and discussing the extraordinary results that lead us to this historic decision.

Our paper advertisement of our annual meeting.

We would do some social media advertising/ website, again with mutuality being the message.

We are going to start working with a marketing company to promote our agents' channel and could use their help with the message of the refund.

So it comes back to do you want to or not.

We had a list of pros and cons as with any action there are typically both. It is a board decision and you represent the policyholders.

All I can say is I have reviewed this document and the general amounts mentioned in it with management and they felt comfortable in those numbers, especially targeting the minimum type underwriting mentioned. Last year end, there was only a couple of us in favour, but the sheer magnitude of the profit (so far) has brought them over to the understanding of why this year, it could be done. The messaging of the refund should be surrounding the extraordinary year we have had.

REFUND FROM SURPLUS DECISION

	2021 P	2020	2019	2018	2017	2016	2015	2014	2013	2012	10 Years	
Premium Written	35,461,900	34,298,836	31,609,244	28,308,177	26,379,452	24,939,452	23,536,216	22,394,344	21,749,901	21,131,104	269,808,626	
Net Premium Earned	29,751,381	28,658,598	25,923,486	23,237,081	20,802,577	19,661,762	18,480,627	17,618,893	17,221,175	16,587,260	217,942,840	
Net Premium Income	30,247,042	29,126,778	26,338,688	23,600,657	21,138,317	20,015,497	18,821,361	17,933,774	17,516,665	16,865,712	221,604,491	
Net Claims Incurred	9,800,564	14,923,947	15,871,882	13,627,317	12,290,960	9,786,374	10,713,497	9,019,845	10,565,135	6,866,689	113,466,210	51.2%
General Expenses	12,895,764	11,571,559	10,671,834	9,793,209	9,579,999	8,893,596	7,934,874	7,657,348	7,364,040	7,127,360	93,489,583	42.2%
Underwriting income	7,550,714	2,631,272	(205,028)	180,131	(732,642)	1,335,527	172,990	1,256,581	(412,510)	2,871,663	14,648,698	93.4%
Net Profit	6,679,286	4,480,554	2,306,205	(337,861)	1,083,679	2,231,748	877,618	2,724,354	763,273	3,203,413	24,012,269	
Surplus	44,319,651	37,640,365	33,159,811	30,853,606	31,191,467	30,107,788	27,876,040	26,998,422	24,274,068	23,510,795		
Ratios	2021 P	2020	2019	2018	2017	2016	2015	2014	2013	2012	10 Years	
Premium Growth	3.4%	8.5%	11.7%	7.3%	5.8%	6.0%	5.1%	3.0%	2.9%	4.3%	67.8%	
Net Loss Ratio	32.4%	51.2%	60.3%	57.7%	58.1%	48.9%	56.9%	50.3%	60.3%	40.7%	51.2%	
Net Expense Ratio	42.6%	39.7%	40.5%	41.5%	45.3%	44.4%	42.2%	42.7%	42.0%	42.3%	42.2%	
Surplus Growth	17.7%	13.5%	7.5%	-1.1%	3.6%	8.0%	3.3%	11.2%	3.2%	15.8%	88.5%	
Premium Written to Surplus	0.80	0.91	0.95	0.92	0.85	0.83	0.84	0.83	0.90	0.90	0.87	
Combined Ratio	75.0%	91.0%	100.8%	99.2%	103.5%	93.3%	99.1%	93.0%	102.4%	83.0%	93.4%	
3 Year Combined	88.4%	96.7%	101.1%	98.8%	98.7%	95.1%	98.1%	92.9%	96.4%	92.2%		
5 Year Combined	92.8%	97.3%	99.3%	97.8%	98.3%	94.3%	96.3%	94.5%	96.4%	94.6%		
Considerations	2021 P	2020	2019	2018	2017	2016	2015	2014	2013			
Is MCT over target	●	●	●	●	●	●	●	●	●			
Combined Ratio < 90%	●	●	●	●	●	●	●	●	●			
3 Year Combined < 95%	●	●	●	●	●	●	●	●	●			
5 Year Combined < 95%	●	●	●	●	●	●	●	●	●			
Premium Written to Surplus	●	●	●	●	●	●	●	●	●			
Strategic plan not impacted	●	●	●	●	●	●	●	●	●			
Investment Income	●	●	●	●	●	●	●	●	●			
Policy Class Contribution	2021 P	2020	2019	2018	2017	2016	2015	2014	2013			
A - Automobile Policy	16.6%	43.1%	65.4%	44.9%	35.3%	40.9%	45.8%	52.4%	104.3%			
C - Commercial Policy	20.3%	22.7%	-3.8%	36.7%	24.1%	56.2%	14.3%	100.2%	0.8%			
F - Farm Policy	24.3%	40.8%	48.0%	37.0%	51.2%	68.7%	14.9%	58.6%	103.0%			
P - Personal Residential Policy	33.5%	78.4%	75.0%	61.4%	73.2%	27.0%	58.1%	28.1%	91.0%			