

Lombard
Canada®

2001 Annual Review

Annual Review



Lombard Canada

Company Executives

BYRON G. MESSIER
President & Chief Executive Officer

RICHARD N. PATINA
President, Commercial Lines

HENRY J. RODRIGUES
President, Personal Lines

MIKE STROFOLINO
President, 50EXCEL Division

ROBERT T. COUGHLIN
Senior Vice-President, Claims

KIM H. TAN
Senior Vice-President, Corporate & Business Development

FELICIA M. SALOMON
Senior Vice-President & General Counsel

M. JANE GARDNER
Senior Vice-President & Chief Financial Officer

KATHARINE M. ALLAN
Senior Vice-President & Chief Underwriting Officer

PETER HOWLING
Vice-President, Corporate Systems

RICHARD LAPIERRE
Regional Vice-President, Quebec Region

MARK LEBLANC
Regional Vice-President, Central Region

STEVE CADE
Regional Vice-President, Western Region

STAN KEEPING
Underwriting Director, Atlantic Region



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Profile



Lombard Canada Ltd. is a subsidiary of Fairfax Financial Holdings Limited. Fairfax is a Toronto based financial services holding company with operations in Canada, the United States, Europe and the Far East with consolidated net premiums written totalling C\$ 5.0 billion and total shareholders' equity of C\$ 3.3 billion.

Lombard Canada Ltd. is the holding company for Lombard General Insurance Company of Canada, Lombard Insurance Company and Zenith Insurance Company. Management of these companies through Lombard Canada Ltd. provides a group focus on profitability supported by disciplined underwriting, centralized expense control and technology advances. Lombard Canada® occupies a leadership position in the Canadian insurance market as a provider of commercial products to mainstream commercial lines risks and protection for homes and automobiles of a large number of Canadian families.

In addition, Lombard Canada Ltd. provides chief agency and management services to Tokio Marine & Fire Insurance Company Limited. This relationship has spanned over 50 years and we are proud of our commitment to and relationship with this internationally respected company.

Lombard Canada is one of the oldest insurance operations in Canada, the successor to the assets and history of a company that was granted a charter in 1782 and began underwriting policies in Halifax, Nova Scotia in 1804.

The Lombard Canada senior management team has extensive knowledge, experience and a proven track record. The companies are managed for long-term performance. Our strengths are sound underwriting and claims handling and strong relationships with business partners. Lombard has specialized expertise in adapting technology to further business goals. Our ability to capitalize on marketing opportunities, product design features and technological support distinguishes our services and enables us to respond to our customers' needs.

Strength & Stability

Lombard's strength is its people. With about 700 highly trained professionals in partnership with a network of over 200 independent brokers, Lombard is uniquely positioned and has the flexibility and focus to be the pre-eminent property and casualty insurer in Canada.

In addition to having access to innovative products and service excellence in underwriting and claims, our brokers and customers have the confidence that they are dealing with a Canadian-owned, financially stable and responsible organization.

In 2001, A.M. Best Company affirmed its A- (excellent) rating of all our insurance subsidiaries. Best's stated that the rating "reflects the group's consistent operating profitability, adequate capital position, conservative reserving practices and strong market position in Canada."

Highlights – 2001

- Gross premiums written were \$615.1 million.
- Lombard's assets exceed \$1 billion.
- Net losses after taxes amounted to \$29.4 million, compared to profit of \$8.3 million in 2000.
- Combined underwriting result, after affiliated reinsurance, was 119.8% compared to 105.2% in 2000. Before affiliated reinsurance, the 2001 combined ratio was 115.4% compared to 100.6% in 2000.
- Lombard's loss ratio deteriorated to 82.8% from 70.8% in 2000



A Message from Byron Messier, President and CEO



Since the acquisition of our operations by Fairfax Financial Holdings Limited in January of 1995, we have successfully accomplished our stated goal of sustained profitability through disciplined underwriting and pricing. We have transformed our organization into a service-oriented enterprise, providing excellence in sales and service through our brokers, front line underwriters and claims representatives.

We have an on-going commitment to employee development and training. In 2001, we re-instituted our trainee program and redesigned our compensation plan to align pay with performance and achievement of the company's goals.

We initiated a review of our underwriting and claims processes to ensure their vitality and responsiveness in a changing environment. As a result of this review, we restructured operations and positioned ourselves to take full advantage of what was perceived to be a hardening market. We made sure that the appropriate controls and drivers were in place so that our business would be profitable. We made a number of acquisitions that will be significant contributors to our longer term strategies.

However, in 2001 our combined ratio, the primary indicator of our performance, deteriorated to 119.8% on a legal entity basis and 115.4% before affiliated reinsurance. We sustained a loss after taxes of \$29.4 million. This is in comparison to a profit in 2000 of \$8.3 million.

A number of factors affected our results in 2001. The winter of 2000-2001 was one of the longest and coldest winters in Central and Eastern Canada, with record snowfalls. Weather conditions produced a higher number of large fire and automobile losses – which almost doubled from last year's level in the same period. As well, automobile claims costs escalated. In Commercial Lines,

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our results were affected by the settlement of old losses, discontinued lines and Crop/Hail losses. The market hardening that had been anticipated at the beginning of the year did not materialize to the extent expected.

All these factors dramatically affected our overall results and I am disappointed with the final numbers.

After a great deal of thought and discussion with many of our employees, I am satisfied that the strategies that we are pursuing remain valid and that we have the appropriate drivers in place to achieve our stated objective of 100% combined.

We are uniquely positioned to take advantage of the current business environment. We have the expertise of our employees, the commitment of our brokers, the products, the technology and the knowledge to once again outperform the industry. While we must improve our underwriting results, we cannot over-react. We have quality underwriters across Canada, the best broker force in the country and a strong core book of business.

The long-term strategies that we have put in place have already resulted in improvement in the performance of our personal lines, commercial lines and claims operations. We are seeing some real benefits that will positively impact our results in future years.

Future Outlook

We will be concentrating our efforts on quality underwriting and pricing. Our companies are adequately capitalized, efficiently operated and recognized as a responsible consistent market for commercial lines and personal lines products in Canada. We expect a positive impact from our recent acquisitions and restructuring. While there is a lot of hard work ahead of us, the future looks bright!

I would like to take this opportunity to thank all of our employees, brokers and business partners for their patience and support over the past year.



"WE HAVE TRANSFORMED OUR ORGANIZATION INTO A SERVICE-ORIENTED ENTERPRISE, PROVIDING EXCELLENCE IN SALES AND SERVICE THROUGH OUR BROKERS, FRONT LINE UNDERWRITERS AND CLAIMS REPRESENTATIVES."

Commercial Lines

RICK PATINA, *President - Commercial Lines*



Over the five-year period from 1996 to 2000, our Commercial Lines average combined ratio was 101.5%. Overall it is an excellent track record. Unfortunately, 2001 was a terrible year. We finished at a 112.9% combined ratio before affiliated reinsurance.

The deterioration in combined ratio was due to an increase in large fire losses in November and December, claims run-off for old automobile residual value programs, Crop /Hail losses and a loss of \$2 million on the World Trade Center attack.

However, there is some silver lining in this bad news.

The automobile residual value programs were cancelled previously. 2001 represented the last year of forty-eight month auto leases under the residual value programs.

Crop Hail business has traditionally been very profitable for Lombard. 2001 was the worst hail season in the last ten years in the Prairie Provinces. In 2002, we plan to increase Crop Hail rates significantly and reduce our writings in the more hail prone areas.

The \$2 million World Trade Center loss stemmed from our minor participation on a very high Property Surplus Excess Layer program.

All three of the above losses are non-recurring extraordinary items. Our underlying Commercial Lines book of business actually performed at a 103.9% combined ratio. Our overall net premiums increased by 27% over the year 2000.

With the current significant price increases we are achieving, cancellation of unprofitable programs and continued strict underwriting, we believe a 100% combined ratio in 2002 is achievable.

"WITH THE CURRENT SIGNIFICANT PRICE INCREASES ...WE BELIEVE A 100% COMBINED RATIO IN 2002 IS ACHIEVABLE."

Personal Lines

HENRY RODRIGUES, *President - Personal Lines*

The results in Personal Lines were very disappointing in 2001 with the combined ratio deteriorating by 18 points.

As outlined in Byron's message, we had a combination of bad weather, deteriorating auto environment (particularly with accident benefits coverage) risk selection challenges in both retail and group business (as we dealt with unprecedented growth) and very high severity. Since mid 2001, we have attacked the problem on a number of fronts:

- Aggressive price increases
- Termination of non-performing portfolios
- Redesign of our Group and P50 underwriting processes

These initiatives will lead to much improved results in 2002 and get us back to long-term profitability.

Retail Business

We signed up 9 new brokers in 2001, who transferred proven books of business that fit well with Lombard due to their strong underwriting culture.

The [Underwriting@Source](#) program continues to be a valuable tool in supporting brokers who have a quality orientation with the appropriate incentives.



Personal Lines ...CONTINUED



As well, in our continuing effort to make it easy to do business with Lombard, we have joined the CSIO portal project which will, when complete, provide our brokers with the capability to quote and issue with guaranteed amounts from multiple carriers, and issue a Lombard policy (if selected) without rekeying.

Group Programs

Lombard's Group programs continued to gain momentum with over \$21 million in new business premium written in 2001. The challenges continue to be good risk selection in a direct environment, and coping effectively with the pressures of quick growth.

Zenith Insurance/Privilege 50

In 2001, the focus of the P50 business unit was the smooth rollover of the CARP (Canada's Association for the Fifty-Plus) portfolio.

CARP will be the primary vehicle by which we grow our 50+ business in the future and we are working closely with CARP to ensure our mutual success.

"LOMBARD'S GROUP PROGRAMS CONTINUED TO GAIN MOMENTUM WITH OVER \$21 MILLION IN NEW BUSINESS PREMIUM WRITTEN IN 2001"

Claims BOB COUGHLIN, Senior Vice President - Claims

As I reported last year, 2000 was a time to take stock and carefully examine our overall claims process. 2001 on the other hand, was a year to implement and execute in order to achieve the identified "leakage" savings.

I'm pleased to report that our implementation plan has progressed smoothly and successfully. Not only was the original roll-out well received, but throughout 2001 clear "buy-in" by our claims staff was fully confirmed by our ongoing auditing program.

Not only have we seen a significant improvement in our day-to-day process, but I feel a new culture is developing where monitoring, benchmarking, round-tabling of files and vendor management have become core functions in our overall claims environment.

2001 was a difficult year for all of Lombard and our claims operation was no exception. Faced with ongoing negative developments in the legal environment, clear systemic failure of the no-fault benefit system in Ontario, and a large incidence of weather related claims in the winter months, our staff has faced many hurdles in their goal to achieve payment of a fair and equitable indemnity dollar.

I feel that they have more than answered the challenge and are well prepared for 2002.

What do I see new for 2002? Here are a few initiatives:

- continued centralization of our litigation processes.
- expansion of our enhanced claims procedures to all claims lines.
- additional focus on overall vendor management.
- enhanced communication with our brokers and key group accounts.

Will it be easy? Probably not. But I'm convinced we have the staff in place to more than achieve our goals.



"NOT ONLY HAVE WE SEEN A SIGNIFICANT IMPROVEMENT IN OUR DAY-TODAY PROCESS, BUT I FEEL A NEW CULTURE IS DEVELOPING...."

Financial Highlights



- Lombard continues to enjoy an 'A-' (excellent) rating from A.M. Best, North America's leading financial rating agency.
- Lombard reported a net loss after tax of \$29.4 million compared to net income of \$8.3 million in 2000. Both underwriting and investment income have deteriorated from last year.
- Our loss ratio increased this year to 82.8% from 70.8% in 2000.
- Our combined underwriting results, after affiliated reinsurance, were 119.8% compared to 105.2% in 2000. Before affiliated reinsurance, the 2001 combined ratio fell to 115.4% from 100.6% in 2000.
- Premium volume increased significantly this year. Gross premiums written grew by 22.6% to \$615.1 million while net premiums written increased by 22.5% to \$420.4 million.
- The actuarial valuation confirms that our companies continue to be strongly reserved for policy holder liabilities.



Consolidated Income Statement

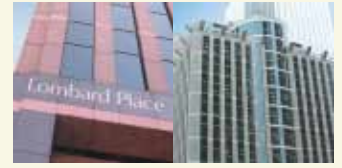
- for the years ending December 31, 2001, 2000, 1999, 1998 and 1997
- in thousands of Canadian Dollars
- all reinsurance is reflected in these financial statements

	2001	2000	1999	1998	1997
Gross Premiums Written	615,075	501,544	511,436	512,400	501,458
Net Premiums Written	420,448	343,322	350,084	381,180	363,282
Revenues:					
Net Premiums Earned	388,720	355,903	364,604	379,607	354,121
Net Investment Income	26,415	29,885	39,194	54,125	87,803
Total Revenues	415,135	385,788	403,798	433,732	441,924
Expenses:					
Claims and Adjustment Expenses	319,004	249,422	256,748	264,704	241,302
Commissions	66,158	54,685	63,161	64,434	59,491
Premium Taxes	18,774	17,038	16,993	16,827	16,051
Income Taxes	(21,147)	(5,289)	2,986	963	24,661
Other Expenses	61,795	61,654	55,708	64,743	62,586
Total Expenses	444,584	377,510	395,596	411,671	404,091
Net Income (Loss) After Taxes	(\$29,449)	\$ 8,278	\$ 8,202	\$ 22,061	\$ 37,833

Consolidated Balance Sheet

- as of December 31, 2001, 2000, 1999, 1998 and 1997
- in thousands of Canadian Dollars
- all reinsurance is reflected in these financial statements

	2001	2000	1999	1998	1997
Assets:					
Cash & Short-Term Investments	109,896	68,718	109,040	106,489	77,662
Stocks, Bonds & Real Estate	356,911	413,982	413,748	415,281	469,907
Premiums Receivable	147,066	119,888	124,312	138,380	139,250
Future Income Taxes	5,205	–	–	4,112	–
Reserves Recoverable from Reinsurers	385,679	346,319	349,090	323,997	315,235
Other Receivables & Other Assets	106,121	88,276	89,709	85,237	83,939
Total Assets	\$ 1,110,878	\$ 1,037,183	\$ 1,085,899	\$ 1,073,796	\$ 1,085,993
Liabilities:					
Unpaid Claims and Claims Expenses	636,145	583,662	599,022	593,086	564,283
Unearned Premium Reserve	291,645	242,531	250,672	249,543	248,189
Other Liabilities	58,769	62,222	65,336	68,500	69,391
Total Liabilities	986,559	888,415	915,030	911,129	881,863
Shareholder's Equity	124,319	148,768	170,869	162,667	204,130
Total Liabilities & Shareholder's Equity	\$ 1,110,878	\$ 1,037,183	\$ 1,085,899	\$ 1,073,796	\$ 1,085,993



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