

Annual 2002 Annual Review Review



LOMBARD INSURANCE COMPANY •
LOMBARD GENERAL INSURANCE COMPANY OF CANADA •
ZENITH INSURANCE COMPANY •

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

ANNE-MARIE VANIER

Senior Vice President & Chief Actuary

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 totaling (C\$) 6.3 billion and total shareholders' equity of (C\$) 3.5 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 General Insurance Company of Canada is the pre-eminent market for commercial insurance products distributed through select insurance brokers. Lombard Canada is an industry leader in developing new products and programs for the protection of the personal assets 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 700 highly trained professionals and a network of 200 independent brokers, Lombard is uniquely positioned for success in today's insurance marketplace and in the future.

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 2002, 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 – 2002

- Gross premiums written were \$770.9 million, an increase of 25% over 2001.
- Lombard's assets exceed \$1.3 billion.
- Net income after taxes amounted to \$14.1 million, compared to loss of a \$29.4 million in 2001.
- Combined underwriting result, after affiliated reinsurance, was 100.5% compared to 119.8% in 2001. Before affiliated reinsurance, the 2002 combined ratio was 99.2% compared to 115.4% in 2001.
- Lombard's loss ratio improved to 69.9% from 82.8% in 2001.
- Our expense ratio improved from 34.5% to 31.7%
- As of December 31, 2002, Lombard had capital and surplus of \$189.9 million.

A Message from Byron Messier, President and CEO

Last year I stated we had the appropriate strategies and drivers in place to achieve a sustainable objective of a 100% Combined Ratio.

I am pleased to report that, for the 2002 calendar year, we achieved our goal. We finished the year with a combined ratio of 99.2%. Direct Written Premiums grew by 25% to \$771-million with Net Written Premiums (before affiliated reinsurance) at \$691 million.

In addition, our Acquisition Costs fell almost 3 full points from 34.5% to 31.7%.

Most of this improvement and growth is attributable to proactive and aggressive underwriting and pricing measures taken in 2001 and 2002.

Our plan for 2003 is to aggressively grow our business through pricing initiatives and better the 99% Combined Ratio we achieved in 2002.

There is no question we are in the midst of a "hard" underwriting cycle. Industry Return on Equity for 2002 will be approximately 3% with little improvement expected for 2003. Canadian Industry Combined Ratios for 2002 will be in the 105-107% range, which is totally unacceptable. Return on Investment for 2003 will continue to disappoint. Consequently, we believe the "hard" market will last through 2003 and well into 2004.

With poor industry Returns on Equity, further consolidations of property and casualty insurers will occur. There will be reduced underwriting capacity, less capital, and pricing of all product lines will continue to significantly increase.

Lombard is very well positioned to take full advantage of this volatile marketplace. We have significantly out-performed the industry in 2002 and we are well capitalized.

We embrace 2003 with great enthusiasm. I believe we have the best trained insurance professionals in the industry and the highest quality of brokers in Canada. This along with our key strategies will ensure the long-term success of our company.

Our plan for 2003 is to aggressively grow our business through pricing initiatives and better the 99% Combined Ratio we achieved in 2002.

As in previous years I would like to take this opportunity to congratulate our employees and thank our brokers and business partners for their hard work and support over the past year. We look to the future with great optimism.

Commercial Lines

RICK PATINA, *President - Commercial Lines*

What a difference a year makes! As I mentioned last year, for the five years leading up to 2001, Lombard Commercial Lines enjoyed an average Combined Ratio of 101.5%. Although 2001 was bad, we knew it was significantly affected by specific non-recurring extraordinary items and we knew the underlying book of business was sound.

2002 has proven us right as we finished the year with a Commercial Lines Combined Ratio of 95.5% before affiliated reinsurance. 2002 saw the insurance market being hit hard by extremely poor ROE, capital constraints, consolidation of insurance carriers and overall reduced underwriting capacity. In the midst of this turmoil, Lombard was able to take advantage of market opportunities while also significantly increasing our pricing.

Those factors enabled us to achieve a 30% growth in Commercial Lines Direct Written Premiums in 2002 over 2001. We finished the year with \$521-million in Commercial Direct Written Premiums.

Each of our key initiatives performed extremely well.

Business Choice finished the year with \$130-million of business and an underwriting profit. We currently have 170 Business Choice installations with brokers who are using this Commercial Lines point-of-sale technology. Our Custom Marketing initiative also uses this point-of-sale technology to handle its business.

Custom Marketing also finished the year with an underwriting profit. This Commercial Group and Association business grew by 67% in 2002 to end at \$209-million of Direct Written Premiums. This area continues to be our fastest growing market segment.

Our Large Account Core CBP also performed well in 2002. We finished the year with \$182-million of Premium and an underwriting profit.

Our Special Operations business grew to \$85 million, up 52% from 2001. The Commercial Special Operations business consists of unique programs or lines of business requiring specialized underwriting. It involves classes of business such as Crop-Hail, Agri-Business, and Municipalities Insurance. The growth in this area was driven by significant price increases in existing programs as well as new business coming to Lombard due to overall capacity shortages in the marketplace.

We believe the Property and Casualty insurance market will remain hard in 2003. As a result, pricing will continue to increase and Lombard remains well positioned to take advantage of opportunities.

2002 has proven us right as we finished the year with a Commercial Lines Combined Ratio of 95.5% before affiliated reinsurance.

Personal Lines HENRY RODRIGUES, *President - Personal Lines*

The Personal Lines combined ratio improved by 11 points in 2002, but still fell disappointingly short of our goal of 99 percent combined.

To close the gap towards our target, throughout 2002 and continuing into 2003 we have taken several aggressive underwriting and pricing actions including:

- the termination of non-performing brokers and group portfolios;
- double-digit price increases across all lines and territories; and,
- tight expense control to bring our acquisition costs below 30 percent.

These actions are having an impact and we can now expect to achieve our goals in 2003.

Our strategy has continued to focus on account business and 70 percent of our Personal Lines portfolio is in the "Personal Choice" product category which has much better retention and profitability than monoline policies.

In Retail, we continue to write this account business through our carefully selected broker force which consists of only 60 brokers for all Canada. Our relationship with these select brokers has the "depth" and "breadth" to enable us to generate profitable business even through this difficult market.

In the 50+ segment of our business, we continue to experience unprecedented growth in the CARP (Canadian Association of Retired Persons) group which had a combined ratio of 98% in 2002.

In Group, we have refocused our efforts towards those segments that have the appropriate profitability profile, ie., Employer Groups and Professional Associations.

We are confident that the change in our group business strategy, together with the aggressive underwriting and pricing actions we have taken, will lead Personal Lines to results of 99% combined or better in 2003.

Our strategy has continued to focus on account business and 70 percent of our Personal Lines portfolio is in the "Personal Choice" product category which has much better retention and profitability than monoline policies.

Claims

BOB COUGHLIN, *Senior Vice President - Claims*

As I prepared to formalize these comments, I read and reflected on my thoughts in previous years and quickly realized the significant achievements we have made over that time.

Even with our return to profitability, the responsibilities of the claims staff remain constant. Our people, in their core competency, are continuously responsible for three key aspects of our Corporate health and welfare:

- (1) Service
- (2) Proper Evaluation
- (3) Reserving and Ultimate Fair Adjustment of our claims.

We have continued to move steadily forward in all aspects of these responsibilities and challenges.

A culture of the highest level of professionalism is developing within our operation, as reflected by our focus on continuous improvement in every phase of the claims process.

Armed with a strong committed staff, we are continually embarking on new initiatives in our quest for that improvement. Those initiatives in place for 2003 include:

- A commitment to lower our overall pending files.
- Revised relationships with our legal partners by the implementation of a File Banding system.
- Introduction of an Imaging System to parts of the claims process.
- An ever increasing emphasis on targeted training of our technical staff.

As I said last year, managing claims is always a challenge, but we have the people to make it happen.

Armed with a strong committed staff, we are continually embarking on new initiatives in our quest for that improvement.

Financial Highlights

- Lombard continues to enjoy an 'A-' (excellent) rating from A.M. Best, North America's leading financial rating agency for insurance companies.
- Lombard reported a net profit after tax of \$14.1 million compared to a net loss after tax of \$29.4 million in 2001. Investment income was relatively unchanged from last year. The turnaround is due to Lombard's improved combined ratio.
- Our combined underwriting results, after affiliated reinsurance, were 100.5% compared to 119.8% in 2001. Before affiliated reinsurance, the 2002 combined ratio improved to 99.2% from 115.4% in 2001.
- Our loss ratio decreased this year to 69.9% from 82.8% in 2001 (after affiliated reinsurance).
- Premium volume grew significantly this year. Gross premiums written were up by 25.3% to \$770.9 million while net premiums written increased by 23.2% to \$518.0 million.
- Capital and surplus grew from \$124.3 million at year end 2001 to \$189.9 million at December 31, 2002.
- Actuarial Valuations confirm that our companies continue to be strongly reserved for all policy holder liabilities.

Consolidated Income Statement

- for the years ending December 31, 2002, 2001, 2000, 1999 and 1998
- in thousands of Canadian Dollars
- all reinsurance is reflected in these financial statements

	2002	2001	2000	1999	1998
Gross Premiums Written	\$ 770,942	\$ 615,075	\$ 501,544	\$ 511,436	\$ 512,400
Net Premiums Written	518,024	420,448	343,322	350,084	381,180
Revenues:					
Net Premiums Earned	469,122	388,720	355,903	364,604	379,607
Net Investment Income	25,964	26,415	29,885	39,194	54,125
Total Revenues	495,086	415,135	385,788	403,798	433,732
Expenses:					
Claims and Adjustment Expenses	327,879	319,004	249,422	256,748	264,704
Commissions	56,934	66,158	54,685	63,161	64,434
Premium Taxes	22,777	18,774	17,038	16,993	16,827
Income Taxes	8,517	(21,147)	(5,289)	2,986	963
Other Expenses	64,928	61,795	61,654	55,708	64,743
Total Expenses	481,035	444,584	377,510	395,596	411,671
Net Income (Loss) After Taxes	\$ 14,051	\$ (29,449)	\$ 8,278	\$ 8,202	\$ 22,061

Consolidated Balance Sheet

- as of December 31, 2002, 2001, 2000, 1999 and 1998
- in thousands of Canadian Dollars
- all reinsurance is reflected in these financial statements

	2002	2001	2000	1999	1998
Assets:					
Cash & Short-Term Investments	\$ 86,343	\$ 109,896	\$ 68,718	\$ 109,040	\$ 106,489
Stocks, Bonds & Real Estate	479,771	356,911	413,982	413,748	415,281
Premiums Receivable	212,991	147,066	119,888	124,312	138,380
Future Income Taxes	15,028	5,205	–	–	4,112
Reserves Recoverable from Reinsurers	442,274	385,679	346,319	349,090	323,997
Other Receivables & Other Assets	130,767	106,121	88,276	89,709	85,237
Total Assets	\$ 1,367,174	\$ 1,110,878	\$ 1,037,183	\$ 1,085,899	\$ 1,073,796
Liabilities:					
Unpaid Claims and Claims Expenses	692,306	636,145	583,662	599,022	593,086
Unearned Premium Reserve	367,465	291,645	242,531	250,672	249,543
Other Liabilities	117,528	58,769	62,222	65,336	68,500
Total Liabilities	1,177,299	986,559	888,415	915,030	911,129
Shareholder's Equity	189,875	124,319	148,768	170,869	162,667
Total Liabilities & Shareholder's Equity	\$ 1,367,174	\$ 1,110,878	\$ 1,037,183	\$ 1,085,899	\$ 1,073,796



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