

Two hundred bucks more: The premium cost of public auto insurance

Introduction

It is commonplace to assert that public auto insurance is cheap. Research published by the Consumers' Association of Canada (CAC) has gained wide coverage in the media and is quoted by various interests on all sides of the political spectrum.¹ The public insurers all post premium comparisons on their web sites and in their annual reports that purport to show that public insurance is cheaper.

This *Alert* proves that such assertions are false. It is a myth that auto insurance in the public insurance provinces (British Columbia, Saskatchewan, Manitoba and Quebec) is relatively inexpensive.

In fact, the three western provinces with dominant public insurers are currently 11 percent more expensive than the private insurance provinces. Quebec, with a mixed system, is presently cheaper (by 11 percent). Next year, partly due to government-mandated premium rollbacks in other provinces, the four public insurance provinces will all be more expensive—by 18 percent relative to private sector provinces. And drivers in the three near-monopoly western provinces will collectively pay over \$200 more.



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Main Conclusions

- **The four public auto insurance provinces collectively have the highest average premiums in Canada.**
- **Next year, they will be 18 percent more expensive than private sector provinces if legislated rollbacks occur—and will take four of the top five highest premium slots.**
- **British Columbia in 2004 will be the most expensive (27 percent higher than the national average) and PEI and Nova Scotia the cheapest (at 36 percent and 33 percent below that average). Alberta will be the most expensive private insurance province—but just 1 percent over the national average.**
- **It is a myth that the public insurance provinces have cheap insurance. Appropriate measurement and assessment of hidden subsidies and inadequate financial reserves reveal the true picture.**

“A separate issue for the provinces with private insurance is the role of legislated freezes and rollbacks in reducing average premiums ... potentially dangerous policy if costs are not accordingly reduced, as it exposes insurers to insolvency risk and may lead to policies being withdrawn from the marketplace.”

And this is not all. Financial reserves in all of the public insurance provinces are too low to adequately cover potential insurance risks and the Quebec and Manitoba reserve positions are deteriorating. Thus, along with the push of cost pressures, average premiums in all four provinces will very likely continue to rise after 2004.

A separate issue for the provinces with private insurance is the role of legislated freezes and rollbacks in reducing average premiums. This is potentially dangerous policy if costs are not accordingly reduced, as it exposes insurers to insolvency risk and may lead to policies being withdrawn from the marketplace. Like the public insurance system, where state involvement is complete, partial market intervention using price controls can actually end up causing insurance to cost more. It is assumed here that the premium rollbacks can be supported by cost savings, something claimed by every government contemplating such changes.

For now, this *Alert* simply presents the basic facts on average premiums by province, leaving a discussion about explanations for the relative levels to future research. However, we do answer one question here: Why is it that the conclusions of this *Alert* are so at variance with received opinion?

First, other studies are hampered by comparisons of selected individual drivers that do not reflect the overall driving population. Since public insurers do not appropriately price risk into premiums,² a comparison of riskier drivers across the systems will, by definition, favour the public insurers. There are also important methodological issues in the various CAC studies that are discussed below.

Second, insurers sometimes present premium estimates using only basic insurance for private passenger cars, rather than including full coverage of optional or extension insurance, the commercial market, and smaller markets like those for trucks, motorcycles,

trailers and ATVs. Such partial comparisons underestimate the magnitude of premiums paid and, again, owing to public insurance policies, by definition understate the relative cost of basic insurance there.

Third, information is extremely difficult to obtain from the public insurers. Information requests to the three western public insurers have been regularly rebuffed, sometimes by regulatory order.³ This has the effect of diminishing the amount of comparative research on insurance costs by province, owing to the dominance of the Insurance Corporation of British Columbia (ICBC), Saskatchewan Government Insurance (SGI), and Manitoba Public Insurance Corporation (MPI) in their respective markets.⁴

The Results: Comparing Public and Private Premiums

Tables 1, 2, and 3 show the various premium calculations for last year, this year, and next year, along with an average of the four measures and a ranking from most expensive

Table 1: Premium Levels by Province – 2002

	<i>Per Capita</i>	<i>Per Driver</i>	<i>Per Vehicle</i>	<i>Per Insured</i>	<i>Average Premium</i>	<i>Rank</i>
BC	\$883	\$1,059	\$1,245	\$1,100	\$1,038	1
ON	\$729	\$832	\$1,019	\$1,041	\$864	2
MB	\$736	\$924	\$1,041	\$818	\$863	3
AB	\$812	\$866	\$861	\$882	\$850	4
NB	\$727	\$836	\$958	\$942	\$838	5
SK	\$736	\$850	\$818	\$696	\$781	6
PQ	\$603	\$796	\$853	\$1,023	\$779	7
NS	\$567	\$702	\$798	\$814	\$692	8
NF	\$495	\$638	\$826	\$870	\$661	9
PEI	\$580	\$592	\$819	\$736	\$650	10
Quebec					\$779	
Public ex Quebec					\$974	
Private ex Quebec					\$847	

Note: Per capita is age 16+; Policy is either insured vehicle or car-year equivalent; Constant \$2003

Source: IBC, ICBC, SGI, MPI, SAAQ, IGIF, OSFI, author's calculations

province (rated a 1) to cheapest (rated a 10).⁵

In terms of data reliability, the per capita calculation is the most solid. Licensed driver and registered vehicle numbers are next most reliable, based upon provincial data for drivers and a central Statistics Canada database for vehicles.

The insured vehicle or policy numbers are much less reliable, owing

to limited availability of insured drivers or vehicles data by province. The public insurance policy numbers are particularly puzzling, as all three western provinces self-report many more insured vehicles than registered vehicles: MPI has 27 percent more insured than registered, SGI has 18 percent more, and ICBC has 13 percent more. PEI also has a high proportion of insured to registered vehicles: 11

percent more. As a whole, these provinces count over 600,000 more policies than registered vehicles.

Some suggest that this is explained by excessively high out-of-province commercial fleet policies written in these provinces. However, a look at the proportion of total commercial policies written in the provinces with private insurance and Manitoba (the only public insurance province with sufficiently detailed data) shows that commercial premium proportions and growth rates are actually lower in the province with public insurance.

There are two key conclusions to draw from the tables.

First, premiums are rising this year for every province. This trend will be arrested only in private sector provinces in 2004, with legislated premium freezes and rollbacks, taking their combined average premium level back to 2001 levels. All of the public insurers will be more expensive next year.

Second, BC is always the most expensive province in which to insure an automobile, and PEI, Newfoundland and Labrador, and Nova Scotia are always the cheapest. Alberta will stay in the top tier and New Brunswick will move from relatively expensive to relatively inexpensive next year. The opposite will occur for Saskatchewan and Quebec. Manitoba will become the second most expensive province and Ontario will move down to mid-pack with a lower average premium.

The remainder of the paper discusses how the premium estimates are calculated and compares the results to other studies and other premium measures. The technical details may be of less interest to the general reader.

Table 2: Estimated Premium Levels by Province – 2003

	<i>Per Capita</i>	<i>Per Driver</i>	<i>Per Vehicle</i>	<i>Per Insured</i>	<i>Average Premium</i>	<i>Rank</i>
BC	\$900	\$1,081	\$1,271	\$1,123	\$1,059	1
ON	\$770	\$878	\$1,075	\$1,098	\$911	2
NB	\$780	\$887	\$1,016	\$1,000	\$892	3
AB	\$857	\$905	\$899	\$921	\$891	4
MB	\$751	\$925	\$1,042	\$818	\$869	5
PQ	\$621	\$812	\$870	\$1,044	\$797	6
SK	\$745	\$857	\$825	\$702	\$789	7
NS	\$607	\$747	\$849	\$866	\$737	8
NF	\$532	\$679	\$879	\$926	\$705	9
PEI	\$616	\$630	\$873	\$785	\$692	10
Quebec					\$797	
Public ex Quebec					\$991	
Private ex Quebec					\$893	

Note: Per capita is age 16+; Policy is either insured vehicle or car-year equivalent; Constant \$2003

Source: IBC, ICBC, SGI, MPI, SAAQ, IGIF, OSFI, author's calculations

Table 3: Projected Premium Levels by Province – 2004

	<i>Per Capita</i>	<i>Per Driver</i>	<i>Per Vehicle</i>	<i>Per Insured</i>	<i>Average Premium</i>	<i>Rank</i>
BC	\$906	\$1,091	\$1,282	\$1,133	\$1,068	1
MB	\$790	\$956	\$1,077	\$846	\$902	2
AB	\$826	\$862	\$856	\$878	\$852	3
PQ	\$648	\$841	\$901	\$1,081	\$827	4
SK	\$766	\$877	\$844	\$718	\$808	5
ON	\$666	\$757	\$928	\$948	\$787	6
NB	\$609	\$682	\$781	\$769	\$689	7
NF	\$523	\$661	\$855	\$901	\$687	8
NS	\$472	\$577	\$655	\$668	\$570	9
PEI	\$475	\$495	\$685	\$616	\$540	10
Quebec					\$827	
Public ex Quebec					\$1,005	
Private ex Quebec					\$783	

Note: Per capita is age 16+; Policy is either insured vehicle or car-year equivalent; Constant \$2003

Source: IBC, ICBC, SGI, MPI, SAAQ, IGIF, OSFI, author's calculations

Methodology

This *Alert* calculates average premiums by province by estimating total earned premiums (those attributed to insurance services within a given year) and then dividing by several relevant divisors: numbers of registered vehicles, population of driving age, numbers of licensed drivers, and numbers of insured vehicles or policies. The resulting rates are scaled to constant prices using provincial consumer price deflators.

All of the divisors have problems—owing mostly to data quality—but an average of the results, and ordinal rankings by province, should reduce the degree of inaccuracy in the estimated premiums. It should be noted that the resulting average is dimensionless, as it is calculated over different types of divisors.

Total earned premiums are adjusted for various factors in several provinces.

The BC numbers exclude the cost that ICBC incurs for non-insurance operating services, mostly due to licensing and compliance. BC premiums include the private sector optional market, estimated from rate filing submissions that declare an 87 percent market share for ICBC.⁶

Saskatchewan premiums include both Saskatchewan Auto Fund (basic insurance) and SGI Canada extension auto insurance policies. An estimate of the private sector optional market was unavailable there and this information gap will understate average premiums in that province. The Manitoba numbers suffer from the same absence of private sector optional market estimates and are also therefore understated.

Quebec premiums are a combination of driver licence and vehicle

plate revenues from the Société de l'assurance automobile du Québec (SAAQ) and private sector premiums tallied by the provincial regulatory body, l'inspecteur général des institutions financières (IGIF).

Premiums for the other provinces were obtained from the Insurance Bureau of Canada (IBC). They include private passenger totals, commercial vehicles, motorcycles, and miscellaneous premiums for all classes of vehicles.

Hidden Public Subsidies

The public auto insurance monopolies have several hidden cost advantages.

First, the institutions, as crown corporations, do not pay most taxes. This cost advantage means that taxpayers elsewhere in the provincial economy are paying higher taxes to compensate for this lost revenue. The main exception is the premium tax, levelled at rates between 3 percent and 5 percent by province.

I have added the cost of taxes (excluding premium tax) to total premiums for the public insurers using rates outlined in Chen and Mintz (2003). This likely understates the tax subsidy, as their study excluded payroll and property taxes. The tax rates are also somewhat lower than those found by the Council of Atlantic Premiers (2003) for the Atlantic provinces and the IBC (2003) for Canada as a whole.

Second, there is a potential subsidy item specific to Saskatchewan and Manitoba. Private insurers pay health levies to provincial governments to compensate for the costs of vehicle collisions in the public health system. These are typically in excess of 3 percent of total premiums by province. These costs are

published for ICBC and SAAQ—but it is not possible to find the information for either SGI or MPI in their various reports or in provincial public accounts or web-based health ministry documents. Health levy payments for Saskatchewan or Manitoba may occur—but if such payments are not part of their operating activities, then their premiums are understated in this *Alert*.

Third, private sector insurers are expected to hold reserves against insolvency and other financial risks. The federal Office of the Superintendent of Financial Institutions (OSFI) sets minimum capital requirements that must be adhered to at all times. The four public insurers are well below these levels, and so taxpayers at large are bearing insurance risk that appropriately belongs in the premium structure.

I have raised the public insurers' premiums by the cost of meeting these capital requirements. The cost is calculated using the reserves required to match the average for the entire Canadian property and casualty insurance industry, presently just over 12 percent of total assets. Actual public insurer reserves are subtracted from these required reserves, and the cost of holding the inadequate reserves is the deficient amount times the cost of capital.

That cost of capital is a weighted average of debt and equity returns. The debt portion is based on annually averaged ten-year Canada bond yields and the equity portion is that yield plus a beta-adjusted equity premium (beta equal to 1.2 times and the equity premium set at 4.5 percent). The weights are based on the present industry average debt-equity ratio of just under 50 percent.⁷

“Public insurer reserve ratios are less than half of the private sector average level, indicating that the government bodies are not held to the same standard as private sector companies.”

Public insurer reserve ratios are less than half of the private sector average level, indicating that the government bodies are not held to the same standard as private sector companies. Some say that government backing justifies them maintaining these inadequate safety margins—against this notion is the fact that many international private insurers are even larger than provincial governments and may have greater financial stability.

Looking at the separate public insurers, one sees that both Quebec and Manitoba have deteriorating reserve positions, with reserve ratios falling every year since 1999 and 2000, respectively. As well, on a forward-looking basis as discussed below, public sector reserves are likely to improve much less than in the private sector.

Projecting Premiums

Average premiums are estimated and projected for each province for 2003 and 2004.

The divisors for numbers of registered vehicles, numbers of licensed drivers, and numbers of insured vehicles or policies use three-year average growth rates for the projection. Population of driving age is more stable year-to-year and so last year's growth rate is used for the projection. Inflation for 2003 uses the Canadian annualized average to September, the latest data release, and an assumed rate of 1.5 percent for 2004.

Premiums for the private sector provinces use first half 2003 annualized results for the industry to calculate an average annual growth rate of almost 11 percent. Average premiums in 2004 are rolled back according to estimates of proportional savings from legislative changes available from public sources. Ontario premiums are expected to drop by 10 percent, New Brunswick's and Nova Scotia's by 20 percent each, PEI's by 19 percent, and Alberta's and Newfoundland and Labrador's are expected to remain frozen at existing levels.

Premiums are projected for public insurance provinces based on various sources. ICBC premiums are projected using basic insurance and non-insurance operating cost information in the organization's 2004 rate application to the provincial regulator. SGI premiums increase by 4.4 percent per year, equal to the five- and ten-year average growth rates excluding premium increases. MPI basic autopac premiums grow according to rate submission information given to the Public Utilities Board regulator and extension premiums are assumed to increase according to historical market shares. Quebec's SAAQ and private market premiums are assumed to grow at their three-year average growth rates.

Tax rates are assumed constant in the projection, though part of next year's premium increase in BC is a rise in the premium tax there.

Financial reserve subsidies are calculated based on liabilities that grow near 5.5 percent annually, a conservative assumption based on recent experience. Projected reserves are generated from rate filing information in BC, Saskatchewan, and Manitoba. SAAQ reserves are assumed to remain unchanged in nominal terms, a conservative assumption considering the deteriorating reserve position there.

Why Do Other Premium Sources Differ?

Statistics Canada

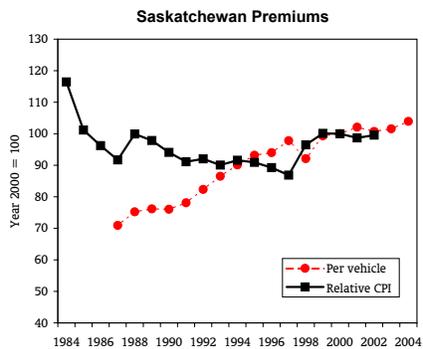
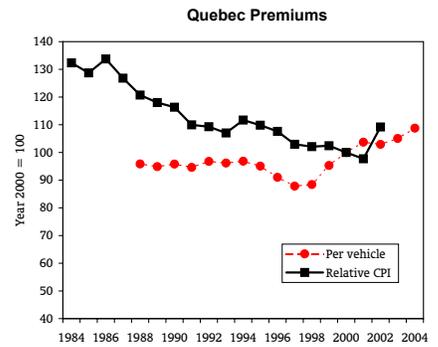
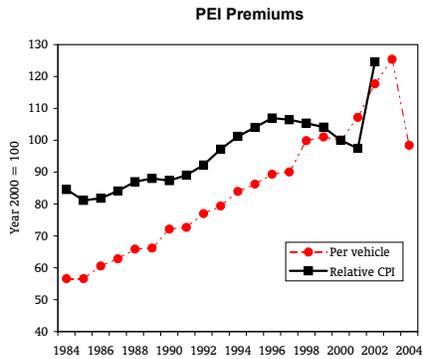
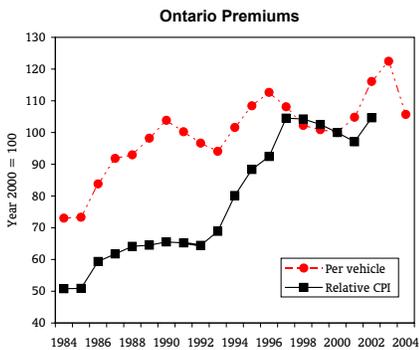
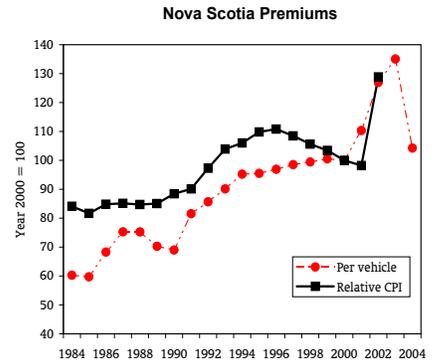
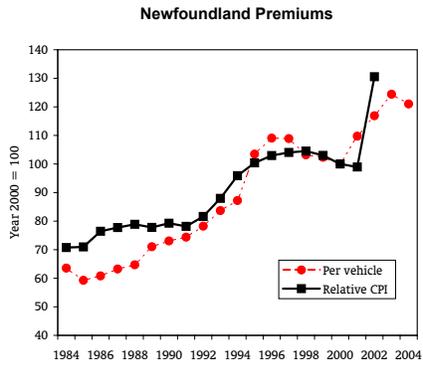
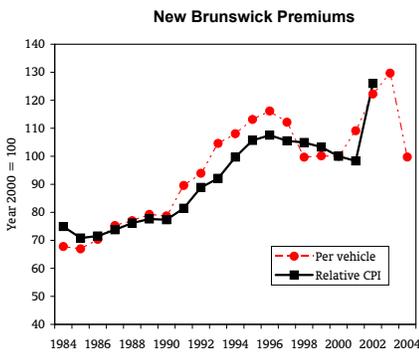
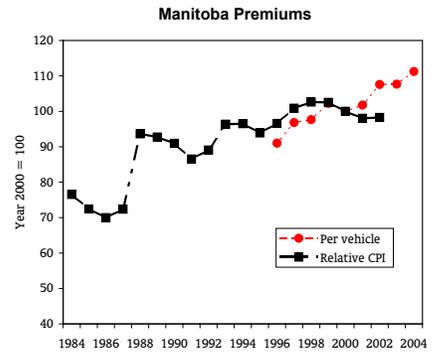
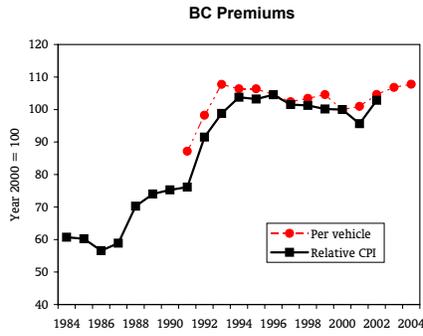
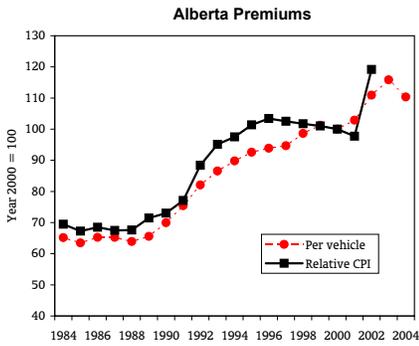
Auto premium prices are published by Statistics Canada. They are consumer prices, based on a fixed weight basket of expenditures and collected for specific models of automobiles over time. This may not be an accurate reflection of average premiums because vehicle and driver characteristics vary so widely and are not directly measured.

By comparison, the premiums from this *Alert* shown in Charts 1 through 10 are a combination of consumer and commercial market prices (though typically with over 85 percent of premiums spent on private passenger vehicles) and are averaged across the entire insurance market.

The charts compare the relative price of automobile insurance for specific models in each province (the premium index divided by overall provincial consumer prices) with the average premium per registered vehicle in constant dollars. These two concepts should theoretically correlate well over time.

The charts show that this is not necessarily so. Relative CPI prices are habitually underestimating average vehicle premiums over time,

Charts 1-10: Premiums by Province



except for Ontario where the opposite is true. As well, price changes in 2001 were underestimated in all provinces—and then those for 2002 were dramatically overestimated for Alberta, Quebec, and the Atlantic provinces. The CPI indices for Saskatchewan and Quebec indicate a drop in relative prices over time, while average vehicle premiums have actually increased somewhat.

It appears that using representative model prices, rather than average prices, produces these differences. Another factor may be expenditure shifts, as consumers opt for different amounts of optional coverage or upgrade to vehicles with higher insurance costs over time.

Council of Atlantic Premiers

The Council of Atlantic Premiers released a report in September that recommended against introducing public insurance in that region.⁸ Graph 15 of that report is a table of earned premiums per insured vehicle. It purports to show that public insurance premiums are \$522 (including \$38 in government costs) in BC, \$549 in Quebec, \$566 in Saskatchewan, and \$721 in Manitoba. Private sector province premiums range from \$731 in PEI at the bottom end to \$1,027 in Ontario at the top end. Thus, all public insurance provinces are cheaper than the private sector ones, and BC is the cheapest of all.

Although there is a caveat to the table, noting that the western public insurance province numbers could not be independently validated, it does leave a completely contrary impression to this *Alert*.

There are several reasons for this result.

First, BC and Quebec use only private passenger premiums in the

table, not total system premiums. Second, premiums for Ontario, Nova Scotia, and Newfoundland and Labrador are higher than the totals in this *Alert*. Third, as discussed above, the numbers of insured vehicles are greater than those registered for BC, Saskatchewan, and Manitoba. Fourth, the numbers of insured vehicles for the private sector provinces seem to be those for private passenger vehicles only. All of these factors overestimate private sector province average premiums and underestimate public insurance province average premiums.

Consumers' Association of Canada

Probably the worst example of inappropriate statistical usage comes from the CAC. Their latest report purports to show that average premiums in the private sector provinces, with the exception of PEI, vary between nearly \$1,800 and \$2,500 (for Ontario), while the public insurers vary between \$800 and \$1,100. Premiums in Toronto (the costliest city in the report) are seen to be almost four times higher than those in Brandon (the cheapest city).⁹

The study uses 10 rate quotes for 34 driver classes in 24 private sector province cities and one quote for each driver class in 17 public sector cities. A quick calculation yields over 8,700 quotes, not 7,000 as claimed in the report, but that is a minor criticism compared to the rest of the methodology.

There are two serious analytical mistakes in this and earlier CAC premium reports.

First, averages purport to represent total provincial and city results, while really just averaging a few rate quotes for a limited number of driver classes. The averages are equally weighted,

placing the 4.4 million persons in Toronto on an even footing with the 103,000 residents in Thunder Bay in the same province, or the 7,800 people in Lloydminster, Saskatchewan. Further, the rates are quoted, not transactional, and may not therefore represent true market conditions. Finally, fully half of the hypothetical drivers are in higher risk classes—a grossly disproportionate number. The higher premiums appropriately charged such drivers in private sector provinces biases their averages higher under this methodology.

Second, the sample is not at all representative. Thirty-four driver classes, with specific age, gender, driver record, driver experience, vehicle year, vehicle make and model, and vehicle use characteristics cannot possibly reflect the insurance holders of an entire city or province. Exactly half of the driver classes indicate past claims or convictions, well above the driver population share as a whole. Using Ontario as an example, at most only 11 percent of drivers would be represented in these driver classes, assuming that every driver of the same age, gender, and collision probability is included. Of course, only a very few drivers with these attributes drive the same vehicle or have the same experience or vehicle uses.

Finally, an average premium of just over \$2,500 in Ontario would imply total premiums there of over \$16 billion—more than the Canadian total—or a number for insurance policies that keeps one-third of vehicles idle in the province. Neither of these implied conclusions is anywhere close to being reasonable.

The CAC results should not be quoted beyond their very limited result of reflecting quotes for a

small subset of hypothetical driver classes. They do not measure average premiums in any valid sense beyond that.

Additional Comparisons

As a crosscheck on the work in this *Alert*, premium rates from two other official sources were examined.

The Canadian Survey of Household Spending (SHS) in 1999 shows the proportion of household spending on vehicle insurance premiums, registration fees, and licences by province. Total 1999 provincial premiums for private passenger vehicles in this *Alert* have been scaled by household income and are compared against the SHS proportions in Chart 11.¹⁰

There is a reasonable correspondence between the two measures. The notable exceptions are Saskatchewan (where the private passenger market share assumption may be inaccurate), PEI, and Newfoundland and Labrador. Part of the gap for the latter two can be accounted for in the unmeasured cost of government-provided regis-

tration fees and licenses. It seems that the premium estimates here are close to those from a limited survey of household expenditures.

The second comparison is with US average consumer expenditures on auto insurance, available from the Insurance Information Institute. Canadian average *earned* premiums in current prices from this *Alert* were \$837 in 2002 and are estimated to be \$896 in 2003. Using Statistics Canada's purchasing power deflator for personal consumption puts these premiums at US\$712 and US\$762, respectively.

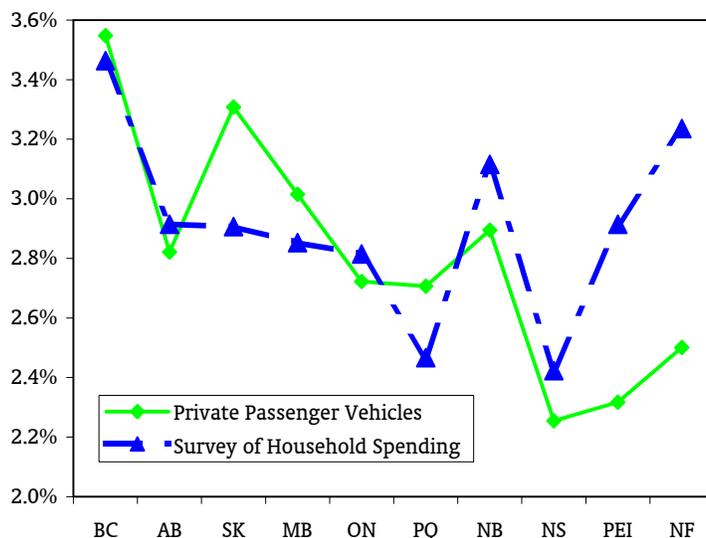
By comparison, the average US written premiums in those years are US\$781 and US\$847, respectively, roughly 9 percent more. Since Canadian *written* premiums are 5 percent higher than earned premiums, the gap is only 4 percent in each year. The close correspondence for average premiums in each country, both generated mostly by market forces, suggests that the estimates here are likely accurate.

Notes

- ¹ The CAC numbers were used in NDP election campaign literature in the recent Ontario election and were quoted by Lawrence Solomon in a *Financial Post* opinion/editorial on October 8, 2003. A table of CAC estimates of average provincial premiums appeared most recently in a *Globe and Mail* article on October 24, 2003.
- ² See "Public Auto Insurance: A Mortality Warning for Motorists," Fraser Institute, September 2003.
- ³ For example, the Insurance Council of Canada (now Insurance Bureau of Canada) was prevented by the Freedom of Information Commissioner for reasons related to "trade secrets" from obtaining information on insured vehicles, premiums, and claims in British Columbia in 1999. Kroll (2000), a study sponsored by the Joint Committee of the Law Society of Saskatchewan and the Canadian Bar Association, Saskatchewan Branch, noted that "we were denied access to all but certain public information relating to SGI Canada for reasons given that included keeping competitive sensitive information confidential."
- ⁴ The Quebec situation is somewhat different, with the government-owned Société de l'assurance automobile du Québec (SAAQ) comprising approximately 20 percent of the provincial auto insurance market.
- ⁵ The average uses half weightings for vehicle premiums and insured vehicle premiums because they essentially measure the same variable.
- ⁶ See ICBC 2004 Rates Application.
- ⁷ See Morin for derivations of various regulatory costs of capital and Booth (2001) for an estimate of the appropriate equity risk premium. The beta estimate and debt-equity ratio were taken from the current average for American publicly-listed property and casualty insurers.
- ⁸ See CAP (2003).
- ⁹ See *Globe and Mail*, "Auto Relief Too Little, Too Late?," October 24, 2003 and CAC (2003).
- ¹⁰ Such premiums are assumed to be 85 percent of total premiums in BC, Saskatchewan, and Manitoba, owing to absence of publicly available information in those provinces.

Chart 11

Household Spending on Premiums, 1999



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