

January 11, 2012

TOWARDS A NEW ERA FOR ECONOMICAL:

DEMUTUALIZATION PROGRESS REPORT XI

We have just begun a new year that should be one of the most significant in the 140-year history of Economical: we expect that mutual policyholders will vote on the Company's demutualization proposal in 2012. While we await the finalization of demutualization regulations and monitor financial markets, your Board of Directors, and its Special Committee responsible for oversight of the demutualization process, will continue to provide you with regular reports like this about Economical's progress.

Development of demutualization regulations: We continue to do all we can to move our demutualization forward but, ultimately, the timing is in the hands of the Federal government. The Department of Finance has responsibility for developing regulations for the demutualization of Federal property and casualty mutual insurance companies. We cannot proceed without those regulations. As you read in our last progress report, the development of draft regulations is taking longer than we had hoped and expected. We continue to have constructive discussions with the Department of Finance as it strives to meet its commitment to create regulations for demutualization of P&C mutual insurance companies that, in the Department's view, enhance efficiency and competition, ensure the safety and soundness of the industry, and provide fair and equitable treatment for policyholders. We also continue to hope that draft regulations will be issued for final public comment within the next few months.

We believe at least part of the reason for the delay is that the Department received a significant number of submissions in response to its request for public comment on P&C demutualization last summer. While these submissions have not been made public by Ottawa, some have been released by those who submitted comments. Not all of them agree with Economical's fundamental position that the mutual policyholders are the true owners of mutual insurance companies and therefore should be the decision-makers on demutualization and the recipients of the benefits of demutualization.

Other commentators have suggested alternatives that we believe are seriously flawed from the point of view of the law, good public policy, and the best interests of Economical. For example, others have argued that:

No Property & Casualty demutualizations should be allowed.

Economical's Position: This would keep mutual P&C companies at a disadvantage to non-mutual competitors who, among other things, have access to capital markets to fund growth. Mutual P&Cs lack that vital access and could risk being left behind by competitors who have it and can use it to continue to gain size and scale in the Canadian market. Furthermore, we do not believe there is any valid policy reason why mutual P&C companies should be treated differently from mutual life companies which were allowed to demutualize in the 1990s.

P&C demutualizations should be limited in the amount of benefits from demutualization that can be distributed – some amount should be held back from mutual policyholders.

Economical's Position: We do not see a way in which the Company could demutualize and not distribute all the benefits from such a step. The very nature of demutualization involves the Company's common shares being distributed, whether through a sponsored demutualization or Initial Public Offering, at fair market value. The distribution of shares provides the financial benefit to the legal owners of the Company – the mutual policyholders.

All policyholders – not only mutual policyholders – should share in the distribution of the benefits from demutualization. There should be a broad distribution among all policyholders.

Economical's Position: It is clear that mutual policyholders are the only stakeholders with ownership rights and are, therefore, the only group eligible to participate in the distribution of the benefits from demutualization. Confiscating the benefits of mutual policyholders, as owners, in order to pay other policyholders who are not is likely to be judged as a clear infringement of the mutual policyholders' property rights and may be unconstitutional. In the case of the mutual life companies, only voting policyholders received benefits. That precedent is appropriate for P&C companies as well.

Distribution of demutualization benefits should include not only mutual policyholders but also any policyholders who were eligible and could have been mutual policyholders had they chosen to do so.

Economical's Position: As well as being extremely difficult to determine who might be eligible to be a mutual policyholder, this is essentially unfair to those who actually became mutual policyholders. A parallel would be insisting that the proceeds of a takeover offer for a public company be distributed to investors who *might* have been shareholders at the time of the offer, but were not. Both scenarios are illogical. Only the current mutual policyholders are the owners of the Company and therefore eligible to participate in the distribution of demutualization benefits.

Demutualization should be subject to approval through a vote of all policyholders, either as a single group or by different classes, and not just a vote by the mutual policyholders alone.

Economical's Position: Only mutual policyholders are entitled to vote on such Company matters. It would be inconsistent with existing legal rights to give non-mutual policyholders the right to control the outcome of a vote that should affect only mutual policyholders. Unless they were offered some form of compensation to which they are not legally entitled, there would be no incentive for non-mutual policyholders to vote in favour of demutualization, despite the advantages for the Company and the benefits for mutual policyholders. This scenario could result in one group or the other blocking the vote on demutualization which would not be in the best interests of the Company or its policyholders.

You can find a more detailed discussion of Economical's views on the direction of the draft regulations in the Company's own submission to the Department of Finance. It is available at the Company's website: www.economicalinsurance.com. Mutual policyholders can also request a printed copy by calling 519-570-8500 ex 42358 or by e-mail at getthefacts@teig.com.

From the beginning, Economical has been clear and consistent on its position on what is needed in the demutualization regulations. We remain focused on advocating that position and encouraging the development of regulations that can be implemented effectively.

Corporate progress on the demutualization plan: Meanwhile, Economical continues to do whatever it can to prepare while we wait for those regulations to be issued.

- As you know by now, we are working on a dual track process. Economical's demutualization will be completed either through an Initial Public Offering or through a transaction involving one or more financial sponsors. The ultimate choice between these alternatives is dependent on the implications of the demutualization regulations and the economic environment in the marketplace once we are ready to complete our demutualization. Once regulations are in place and the regulatory approval process is under way, we will choose our track based on the Board's assessment of the best interests of the Company and its stakeholders. Conditions in the financial markets for an Initial Public Offering remain uncertain at this time, but we do see some signs of emerging stability ahead and we continue to prepare actively. At the same time, we have completed a further round of management meetings with qualified third parties who have been selected to submit proposals for a sponsored demutualization.
- Economical and its advisors are continuing to work on other important issues, such as potential tax treatment and refining the suggested criteria for the allocation of demutualization benefits to mutual policyholders. We emphasize that these are "suggested criteria": Economical can recommend allocation of demutualization benefits, but those recommendations will be subject to review and approval by our regulators.
- Your Board and your President and Chief Executive Officer, Karen Gavan, are also taking steps to strengthen Economical for the long term. This month, for example, the Company announced the appointment of six new senior executives who have either been given new responsibilities or who are bringing significant expertise and experience to Economical from other companies.
- Economical continues to operate effectively, despite what was generally recognized as a very challenging year for the global insurance industry. We expect to release our results for 2011 in February.

Please be assured that we are doing everything we can do to develop a final and detailed demutualization proposal for you to consider and vote on at a Special Meeting of Mutual Policyholders. We hope to hold such a meeting within six months of receiving the final demutualization regulations we are all waiting for from the Department of Finance. We will keep you informed with these regular Progress Reports and invite you to contact us or our CEO, Karen Gavan, at karen.gavan@teig.com if you have any questions.

Sincerely,



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