# Contents



## Financial Statements

# Directors and Officers

Seated, left to right: *Joe Facey,* First Vice-Chair, Director, Group 2 (2009); *Steve Smith,* President & C.E.O.; *Serge Gauthier,* Chair, Director, Group 8 (2009); *Bruce Williams,* Director, Eastern Canada (2009).

Standing, left to right: *Doug Crockett,* Director, Group 4 (2008); *Robert Forsythe,* Senior Vice-President; *Bruce Caughey,* Director, Group 7 (2009); *Barbara Bethune,* Director, Group 5 (2008); *John Leeson,* Director, Group 1 (2008); *Marie Byrne,* Recording Secretary/Office Manager; *Brian Downie,* Ontario Director-at-Large (2007); *Sheryl Janzen,* Director, Western Canada (2007); *Tom Smith,* Vice-President & C.F.O.; *Brian Bessey,* Second Vice-Chair, Group 3 (2007); *Michael O'Shea,* Past Chair, Canadian Director-at-Large (2008); *Dan Hill,* Director, Group 6 (2007).

# Five Year Financial Highlights

| | **2006** | 2005 | 2004 | 2003 | restated 2002 |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| Premiums Earned | **$ 157,317** | $ 149,354 | $ 152,891 | $ 139,633 | $ 100,979 |
| Commission Earned | **321** | 274 | 271 | 212 | 218 |
| | **157,638** | 149,628 | 153,162 | 139,845 | 101,197 |
| **Expenditures** | | | | | |
| Gross Claims Incurred | **136,884** | 133,878 | 111,044 | 112,832 | 77,324 |
| Reinsurance Recovery | **(16,987)** | (13,581) | (5,811) | (6,901) | (7,081) |
| Premiums Ceded | **19,608** | 18,859 | 18,686 | 16,645 | 16,235 |
| Commission Expense | **16,919** | 17,409 | 19,050 | 17,561 | 8,488 |
| Operating Expenses | **8,009** | 6,807 | 7,097 | 5,809 | 5,156 |
| | **164,433** | 163,372 | 150,066 | 145,946 | 100,122 |
| Underwriting Gain (Loss) | **(6,795)** | (13,744) | 3,096 | (6,101) | 1,075 |
| Investment Income | **26,215** | 44,170 | 20,318 | 10,655 | (90) |
| Refund of Premiums | **–** | – | – | – | (6,800) |
| Taxes | **3,495** | (5,813) | (4,010) | (385) | 1,764 |
| Net Earnings (Loss) for the Year | **$15,925** | $ 24,613 | $ 19,404 | $ 4,169 | $ (4,051) |
| **Surplus and Reserves** | **$ 190,819** | $ 174,894 | $ 150,281 | $ 130,877 | $ 126,708 |

# Operations and Staff

Seated, left to right: *Sue Perkons,* Statistical Coordinator; *Jackie Miller,* Loss Control Services; *George Mihailov,* Accounting; *Jeff Barnard,* Reinsurance Manager; *Tracey Schneider,* IS Department; *Arden MacIntyre,* Loss Control Services.

Standing, left to right: *Elaine Reaume,* Reinsurance; *Jane Williams,* Reinsurance; *Randy Drysdale,* Loss Control Services Manager; *Kathleen Seemann,* Office Services; *Shannon Simpson,* IS Department; *Jack Black,* IS Department Manager; *Carol Homer,* Administrative Offices; *Bob DeBrabandere,* Loss Control Services; *Sarah Hahn,* Office Services; *Sandra Wiseman,* Accounting; *Sid Dijkema,* Loss Control Services; *Sharon Godden,* IS Department; *Marilyn Paquette,* Human Resources.

Seated, left to right: *Krista Seiling,* Underwriting; *Krista Guia Pereira,* Claims; *Cynthia White,* Underwriting; *Laura Jessome,* Claims; *Maja Marosevic,* Claims; *Christine Meacher,* Claims.

Standing, left to right: *Helen Shea,* Claims; *Jeff Consitt,* Assistant Claims Manager; *Ursula Yetman,* Claims; *Hayley Williams,* Underwriting; *Jim Chandler,* Claims; *Angela Boost,* Underwriting; *Brad Shantz,* Claims; *Amanda Lantz,* Claims; *John Knill,* Underwriting Manager; *Erika Davidson,* Claims; *Susan McDonald,* Claims; *Jackie Brouwers,* Claims.

Absent: *Mary Ann Brenner,* Claims; *Bob Brenner,* Claims Manager; *Jessie Louks,* Claims; *Lisa Nevills,* Claims; *Richard Soehner,* Underwriting; *Peter Stolk,* Loss Control Services; *Bree Antunes,* Loss Control Services.

# CHAIRMAN'S MESSAGE



On behalf of the Board of Directors, it is a pleasure to present the 2006 Annual Financial Statement.

We are very pleased to report net earnings for the year of $15.9 million. This result was produced through marginal improvements in underwriting performance and the returns on our investment portfolio which includes gains that were realized during the period. Management reports will confirm that loss experience has improved slightly in property and general liability lines, while experience in our automobile portfolio declined during the period. The result was a net underwriting loss for the year.

Your Board of Directors has a well established and active process of establishing priorities that respond to the needs of our members. The foundation of our strategic planning process is our bi-annual series of member planning meetings which were held in July of this year. The member planning meeting process identifies opportunities and areas of concern and provides direction to the Board as we establish our strategic goals and objectives for the future. We want to thank those who attended for their enthusiastic participation.

Over the past year, we established a revised method of calculating Refund of Premiums and developed methods to ensure that the organization maintains an adequate surplus position for the future. A number of regional meetings were held across the country to communicate detailed information on both of these issues. Management continues to work on a number of important financial and operational issues and we will continue to maintain our focus on communications. During the year, we continued discussions with our members and the Ontario Mutual Insurance Association in examining the potential opportunities that a Joint Governance Structure may provide for our respective organizations. Your Board of Directors remains committed to enhancing oversight and governance of the organization by establishing Directors' commitment statements and through continuing education and training for Board members.

During 2006, Michael O'Shea, FMRP Canadian Director-at-Large, (Director, Usborne and Hibbert Mutual Fire Insurance Company, Exeter, Ontario) announced that he would be resigning from the Board following the completion of his term on the Executive Committee. We want to acknowledge the contributions and leadership that Michael has provided to the organization since his election in 1998. Michael served as Chairman of the Board and has played a key leadership role in the continued development of the organization.

FMRP continues to provide annual funding to the Farm Mutual Foundation, an organization founded to provide financial support for post secondary education for the children of the employees and Directors of our member companies and organizations. Distributions from the foundation have been well received by scholarship recipients which has generated a keen interest in the program and we look forward to supporting this very worthy initiative in the future.

It has been a privilege and pleasure to serve as the Chairman of FMRP over the last year. Through the continued cooperation and dedication of your Board of Directors and our professional management and staff, we will continue to succeed in developing the programs and services that "Empower our Members for Mutual Success".

We encourage you to attend and participate in our Annual General Meeting which will be held at the Sheraton Centre Hotel, Toronto, Ontario on Wednesday, March 28th, 2007.

Serge Gauthier

Chairman of the Board
Serge Gauthier

# REPORT TO THE MEMBERS

While we are pleased to be reporting net earnings of $15.9 million for the period, this result has been primarily driven by the continuing strong performance of our investment portfolio. Underwriting operations continue to struggle as a result of adverse development, particularly from both General Liability and Automobile lines of business. This seems to be reflective of the current soft market cycle and competitive retail premiums, as well as increases in loss severity on claims.

Our combined ratio of 104.9% for the year produced an overall underwriting loss of $6.8 million, however, our Investment Portfolio, now in excess of $450 million, generated a return of $26.2 million, for an ROE of 8.7%. The Surplus of the Corporation now stands at a very respectable $191 million. The increase in premiums and operating expenses reflect the stable growth of both our Class "A" membership base as well as the Class "C" business written in the United States. We are also pleased to report that we were able to garner significant rate increases in both the U.S and Canadian Crop businesses, which also generated a positive return in 2006.

Our overall Property portfolio produced acceptable results, with premiums assumed of $91.5 million. The Property Excess of Loss portfolio continues to under perform, with net claims exceeding net premiums by $.7 million on premiums assumed of $29.2 million for the period. We are, however, pleased to advise that claims frequency decreased during the year, and we continued to see a decline in the number of large individual risk losses which reinforces our commitment to our loss control and risk inspection activities. Our Catastrophe program performed very well for the year providing a positive contribution to our overall property results. We did not see any significant increase in Property Quota Share business, with the portfolio producing a small underwriting loss again this year.

Property results include our Class "C" business which is comprised of our participation in government sponsored Crop Insurance programs in Canada and participation in numerous Reinsurance programs for Mutual Insurance Companies in the United States. This year there was a significant improvement in the Canadian Crop programs, and, as indicated, we regained a significant portion of our market share of our portfolio of business in the United States.

Our General Liability portfolio continues to demonstrate volatility, with net claims exceeding net premiums by $8.9 million on premiums assumed of $20.1 million. A significant portion of this loss relates to development of prior years' losses and newly reported claims for prior periods. Outstanding loss reserves continue to be evaluated and significant adjustments to IBNR provisions have been made to accommodate for further adverse development. During the year we continued to refine our established procedures for establishing and adjusting retail rates on a group basis and we will continue our efforts to improve our financial performance of this line of business in the future.

Our Automobile portfolio continues to be a positive performer this year, with net premiums exceeding net claims by $3.7 million on premiums assumed of $45.6 million. Continuing trends in the reduction in claims frequency and severity, together with positive developments in our reserves for prior periods, were the contributing factors.

During the year we continued our focus on enhancing member services and strengthening our partnerships with our Class "A" membership base by increasing property risk capacity, implementing new programs for commercial insurance binding authority and by adding enhanced machinery breakdown cover. Our most significant efforts continue to be on our property line of business stressing Risk Management, Loss Control and Insurance to Value.

While this year did not generate the global catastrophic loss activity of the prior two years, the International Reinsurance market continues to struggle with global capacity and market availability. Again this year there was significant pressure to increase rates, however, our longstanding relationships with our reinsurance partners and our excellent loss experience will serve to minimize these increases.

# Management Statement on Responsibility for Financial Reporting

The accompanying financial statements of Farm Mutual Reinsurance Plan Inc. are the responsibility of management and have been prepared in conformity with accounting principles generally accepted in Canada, and include some amounts based upon management's best estimates and judgments.

In meeting its responsibility for the reliability of financial information, management maintains and relies on a comprehensive system of internal control including organizational and procedural controls and internal accounting controls.

The Board of Directors is responsible for approving the financial statements. It establishes an Audit Committee, comprised of directors who are not employees of the Corporation who meet with management and external auditors, who have unrestricted access and the opportunity to have private meetings with the Audit Committee, to review the financial statements. The Audit Committee then submits its report to the Board of Directors prior to its approval of the financial statements.

The members' auditors, BDO Dunwoody LLP, conduct an independent audit of the financial statements and report to the members thereon.

The Financial Services Commission of Ontario makes an annual examination and inquiry into the affairs of the Corporation as deemed necessary to ensure that the Corporation is in sound financial condition and in compliance with the provisions of the Ontario Insurance Act.

G.S. (Steve) Smith
*President* and C.E.O.

T. Smith
*Vice-President and*
*Chief Financial Officer*

Cambridge, Ontario
February 13, 2007

# AUDITORS' REPORT

To the Members of Farm Mutual Reinsurance Plan Inc.

We have audited the balance sheet of Farm Mutual Reinsurance Plan Inc. as at December 31, 2006 and the statements of earnings and surplus and cash flows for the year then ended. These financial statements are the responsibility of the Farm Mutual Reinsurance Plan Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Farm Mutual Reinsurance Plan Inc. as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Mississauga, Ontario
February 13, 2007

BDO Dunwoody LLP
Chartered Accountants

# Farm Mutual Reinsurance Plan Inc.
# Balance Sheet

*As at December 31 (in thousands of dollars)*

| | **2006** | 2005 |
|---|---|---|
| **ASSETS** | | |
| Cash | **$ 8,386** | $ 7,712 |
| Receivables (Note 2) | **21,666** | 25,606 |
| Prepaids | **246** | 151 |
| Investments (Note 3) | **454,772** | 399,327 |
| Unpaid claims recoverable from reinsurers (Note 7) | **51,516** | 38,837 |
| Income taxes recoverable | **–** | 458 |
| Property and equipment (Note 4) | **6,629** | 5,900 |
| Future income tax assets (Note 11) | **5,553** | 2,784 |
| Deferred acquisition expenditures | **5,779** | 7,072 |
| | **$ 554,547** | $ 487,847 |
| **LIABILITIES** | | |
| Payables and accruals (Note 5) | **$ 4,971** | $ 7,648 |
| Income taxes payable | **2,120** | – |
| Provision for unpaid claims (Note 7) | **337,867** | 285,370 |
| Unearned premiums | **18,770** | 19,935 |
| | **$ 363,728** | $ 312,953 |
| CONTINGENCIES (NOTES 1, 7, 8 AND 9) | | |
| **SURPLUS** | | |
| | **190,819** | 174,894 |
| | **$ 554,547** | $ 487,847 |

*On behalf of the Board:*

Brian Bessey
*Director*

Bruce Williams
*Director*

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

# Farm Mutual Reinsurance Plan Inc.
# Statement of Earnings and Surplus

*For the year ended December 31 (in thousands of dollars)*

| | 2006 | 2005 |
|---|---|---|
| **Net premiums earned** (Note 8) | | |
| Property | $ 81,880 | $ 69,480 |
| Liability | 16,335 | 16,668 |
| Automobile | 39,494 | 44,347 |
| | 137,709 | 130,495 |
| **Net claims incurred** (Note 8) | | |
| Property | 58,886 | 52,959 |
| Liability | 25,251 | 32,713 |
| Automobile | 35,760 | 34,625 |
| | 119,897 | 120,297 |
| **Underwriting gain before expenses** | 17,812 | 10,198 |
| **Expenses** | | |
| Commissions | 16,598 | 17,135 |
| Operating | 8,009 | 6,807 |
| | 24,607 | 23,942 |
| **Net underwriting loss** | (6,795) | (13,744) |
| **Net investment income** | 26,215 | 44,170 |
| **Earnings before income taxes** | 19,420 | 30,426 |
| **Income taxes** (Note 11) | | |
| Current taxes | 6,264 | 4,984 |
| Future taxes (recovery) | (2,769) | 829 |
| | 3,495 | 5,813 |
| **Net earnings for the year** | $ 15,925 | $ 24,613 |
| **Surplus**, beginning of year | 174,894 | 150,281 |
| **Surplus**, end of year | $ 190,819 | $ 174,894 |

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

# FARM MUTUAL REINSURANCE PLAN INC.
# STATEMENT OF CASH FLOWS

*For the year ended December 31 (in thousands of dollars)*

| CASH PROVIDED BY (USED IN): | 2006 | 2005 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net earnings for the year | $ 15,925 | $ 24,613 |
| Adjustments required to reconcile net earnings to net cash provided by operating activities | | |
| Amortization | 465 | 463 |
| Bond amortization | 1,413 | 1,797 |
| Future income taxes | (2,769) | 829 |
| Gain on sale of investments | (9,116) | (29,841) |
| Changes in non-cash working capital components (Note 12) | 43,692 | 43,259 |
| | 49,610 | 41,120 |
| **INVESTING ACTIVITIES** | | |
| Purchase of property and equipment | (1,194) | (335) |
| Net purchase of investments (Note 12) | (47,742) | (38,339) |
| | (48,936) | (38,674) |
| **INCREASE IN CASH DURING THE YEAR** | 674 | 2,446 |
| **CASH, BEGINNING OF YEAR** | 7,712 | 5,266 |
| **CASH, END OF YEAR** | $ 8,386 | $ 7,712 |

| **SUPPLEMENTARY CASH FLOW INFORMATION** | | |
|---|---|---|
| Income tax paid (recovered) | $ 3,676 | $ (2,586) |

The accompanying summary of significant accounting policies and notes are an integral part of these financial statements.

# Farm Mutual Reinsurance Plan Inc.

## Summary of Significant Accounting Policies

*December 31, 2006*

**Basis of Presentation**

These financial statements have been prepared in accordance with accounting policies generally accepted in Canada. The preparation of financial statements requires management to make estimates and assumptions that affect reported assets and liabilities and disclosure of contingencies. These estimates also affect the reported amounts of income and expenses for the reporting period of the statement of earnings. Actual results could vary from these estimates.

**Investments**

Investments in bonds and debentures are carried at amortized cost less amounts written off for other than temporary declines in value. Premiums or discounts incurred on the purchase of bonds and debentures are amortized on a straight-line basis over the remaining life of the investment.

Investments in short-term securities and common shares are carried at cost less amounts written off for other than temporary declines in value.

Gains or losses on investments are included in investment income when realized and are calculated on the basis of average cost.

**Property and Equipment**

Property and equipment are recorded at cost less accumulated amortization and are amortized from the date of acquisition at the following annual rates:

| | |
|---|---|
| Building | – 4% straight-line |
| Furniture and fixtures | – 20% declining balance |
| Computer hardware and software | – 20% straight-line |

**Reinsurance Recoverable**

Premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers. Amounts recoverable from reinsurers, which are estimated in a manner consistent with the associated claim liability, are recorded separately from the provision for unpaid claims.

**Premiums Earned and Deferred Acquisition Expenditures**

Premiums are included in income on a daily pro-rata basis over the term of the contracts. Acquisition costs related to unearned premiums, comprising commissions paid on proportional reinsurance, are deferred and amortized to income over the periods in which the premiums are earned. The method followed in determining the deferred acquisition expenditures limits the amount of the deferral to its realizable value by giving consideration to claims and expenses expected to be incurred as the premiums are earned.

**Unpaid Claims**

The provision for unpaid claims includes individual claim estimates for the full amount of all costs including the investigation and the projected final settlements for losses which occurred prior to the end of the year. In addition, a further provision is made in respect of incurred but not reported claims and development of losses on all outstanding claims. The initial estimate of unpaid claims is discounted for financial statement reporting purposes to give recognition to the time value of money. The interest rate used to discount the liabilities is based upon the rate of return of the Corporation's investment portfolio. The valuation incorporates assumptions made concerning future investment income and cash flows and a provision for adverse deviation. Estimates subject to uncertainty, are selected from a wide range of possible outcomes and are adjusted up or down as additional information becomes known. All changes in estimates are recorded as incurred claims in the current period.

**Income Taxes**

Income taxes are accounted for using the liability method. Future income taxes arise from temporary differences between the tax basis of the Corporation's assets and liabilities and their reported amounts in the financial statements. These assets and liabilities include investments and provision for unpaid claims.

**Foreign Currency Translation**

Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, premium, claim and expense is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year end date, monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at that date. The resulting foreign exchange gains and losses are included in income in the current period.

# Farm Mutual Reinsurance Plan Inc.
# Notes to Financial Statements

*December 31, 2006 (in thousands of dollars)*

## 1. Nature of Business

The Farm Mutual Reinsurance Plan Inc. is incorporated without share capital under the laws of the Province of Ontario. It provides reinsurance to member mutual insurance companies across Canada.

The Corporation is a reinsurer and therefore shares in risks originally accepted by its members. These risks are generally assumed by line of business at premiums established under the terms of agreements (treaties) with individual members. The premiums charged in aggregate, together with investment income attributable to unpaid claims, are expected to cover underwriting costs and claims, which may take a number of years to settle. The business risks of reinsurance reside in determining the premiums, settlement of claims, management of invested funds, and maintaining an appropriate net underwriting exposure.

The Corporation in turn purchases reinsurance to limit its exposure to loss. This reinsurance, however, does not relieve the Corporation of its obligation to members. If any reinsurers are unable to meet their obligations under the related agreements, the Corporation would be liable for unrecoverable amounts.

## 2. Receivables

| | **2006** | 2005 |
|---|---|---|
| Accrued investment income | **$ 3,127** | $ 3,179 |
| Ceding member companies | **15,039** | 18,572 |
| Reinsurers | **3,486** | 3,747 |
| Miscellaneous | **14** | 108 |
| | **$ 21,666** | $ 25,606 |

## 3. Investments

The book values and estimated fair values of investments as at December 31 were:

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Book Value** | **Estimated Fair Value** | Book Value | Estimated Fair Value |
| Short-term securities | **$ 14,746** | **$ 14,746** | $ 13,910 | $ 13,910 |
| Bonds and debentures | | | | |
| Government and guaranteed | **215,363** | **220,646** | 186,550 | 191,898 |
| Corporate | **104,913** | **108,343** | 89,365 | 92,675 |
| Common shares | **119,750** | **144,242** | 109,502 | 122,452 |
| | **$ 454,772** | **$ 487,977** | $ 399,327 | $ 420,935 |

The estimated fair value of common shares and bonds and debentures are based on quoted market values.

Included in investments are bonds totalling $9,809 (2005 – $9,415) and common shares totalling $34,312 (2005 – $28,488) which are part of a pooled fund. The pooled fund is managed by Farm Mutual Financial Services, a company which has members in common with the Corporation.

Virtually all investments are denominated in Canadian dollars. Details of significant terms and conditions, exposure to interest rate and credit risks on debt instruments are as follows:

It is the Corporation's policy to diversify all investment portfolios. Diversification within each asset class is provided by limiting to 10% or less the percentage of the market value of fund assets invested in a single security not guaranteed by a Canadian federal or provincial government.

### Short-term Securities

These are comprised of Canadian Treasury Bills with effective interest rates of 4.9% (2005 – 3.4%).

### Bonds and Debentures

Maturity profile of the portfolio as at December 31, 2006:

| Within 1 Year | 1-3 Years | 3-5 Years | 5-10 Years | Over 10 Years | Total |
|---|---|---|---|---|---|
| $ 19,161 | $31,514 | $ 33,234 | $149,015 | $ 87,352 | $ 320,276 |
| 6.0% | 9.8% | 10.4% | 46.5% | 27.3% | 100% |

The effective interest rate at December 31, 2006 for bonds and debentures is 4.9% (2005 – 4.9%) based on book value.

Investment grade bonds are those rated BBB and above. At December 31, 2006 virtually all of the Corporation's bond portfolio is investment grade.

### Impaired Assets

The Corporation establishes specific writedowns on any investment which is impaired where that impairment is considered other than temporary. In determining the amount of the writedown, management considers the current market value of the security and the financial strength of the issuer or borrower. Changes to these provisions are reflected in net investment income in the period when the impairment is recognized. There were no provisions for impairment in 2005 and 2006.

## 4. Property and Equipment

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Cost | Accumulated Amortization |
| Land | $ 1,837 | $ – | $ 1,837 | $ – |
| Building | 5,324 | 2,306 | 5,260 | 2,096 |
| Furniture and fixtures | 1,565 | 1,105 | 1,563 | 990 |
| Computer | | | | |
| – hardware | 718 | 397 | 535 | 285 |
| – software | 1,147 | 154 | 202 | 126 |
| | $ 10,591 | $ 3,962 | $ 9,397 | $ 3,497 |
| Net book value | | $ 6,629 | | $ 5,900 |

Included in computer software are system development costs of $908 (2005 – $Nil) that are not being amortized as the software is not yet available for use.

## 5. Payables and Accruals

| | 2006 | 2005 |
|---|---|---|
| Expenses payable and accrued | $ 794 | $ 580 |
| Ceding member companies | 4,154 | 6,520 |
| Reinsurers | 23 | 548 |
| | $ 4,971 | $ 7,648 |

## 6. Role of the Actuary and Auditors

The actuary is mandated by the members of the Corporation to review the Corporation's claims liabilities. The actuary's responsibility is to carry out an annual valuation of the Corporation's provision for unpaid claims in accordance with accepted actuarial practice and report thereon to the members. In performing the valuation, the actuary makes assumptions as to the future loss ratios, trends, future rates of claims frequency and severity, inflation and both internal and external adjustment expenses, taking into consideration the circumstances of the Corporation. The actuary also makes use of the work of the external auditor in his verification of the underlying data used in the valuation. The actuary's report outlines the scope of his work and opinion.

The external auditors have been appointed by the members of the Corporation to conduct an independent and objective audit of the financial statements of the Corporation in accordance with Canadian generally accepted auditing standards and report thereon to the members. In carrying out their audit, the auditors also make use of the work of the actuary and his report on the Corporation's provision for unpaid claims. The auditors' report outlines the scope of their audit and their opinion.

## 7. Provision for Unpaid Claims

The determination of the provision for unpaid claims and the related reinsurers' share requires the estimation of claims development and reinsurance recoveries. These estimates are subject to variability which could be material. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation, or significant changes in severity or frequency of claims from historical trends. The estimates are principally based on the Corporation's historical experience but incorporate expectations as to future developments arising out of actuarial studies, changes in the regulatory environment, inflationary trends and economic conditions. Methods of estimation have been used which the Corporation believes produce reasonable results given current information.

Catastrophes are an inherent risk of property and casualty insurance and may contribute to material year-to-year fluctuations in the Corporation's results of operations and financial condition when they occur. The level of catastrophe loss experienced in any one year cannot be predicted and could be material to results of operations and financial position.

The table below details the provision for unpaid claims by line of business:

| | | **2006** | | 2005 |
|---|---|---|---|---|
| | **Gross** | **Recoverable** | Gross | Recoverable |
| Property | **$ 55,695** | **$ 3,930** | $ 46,243 | $ 3,564 |
| Liability | **99,008** | **16,326** | 82,644 | 13,088 |
| Automobile | **183,164** | **31,260** | 156,483 | 22,185 |
| | **$ 337,867** | **$ 51,516** | $ 285,370 | $ 38,837 |

The Corporation generally assumes risks from members on an excess of loss treaty basis. On the basis of historical experience, property claims are usually settled on a short-term basis, whereas claims on liability and automobile risks normally have a long settlement term.

Changes in the provision for unpaid claims recorded in the balance sheet and their impact on claims incurred reported in the statement of earnings and surplus are set out below:

| | **2006** | 2005 |
|---|---|---|
| Provision for unpaid claims, beginning of year, net | **$ 246,533** | $ 208,833 |
| Net Claims Activity | | |
| Net increase in estimated claims for losses that occurred in prior years | **(3,483)** | 6,168 |
| Net claims incurred on current year losses | **124,250** | 114,129 |
| Paid on claims incurred in | | |
| – Current year | **(30,043)** | (29,701) |
| – Prior years | **(50,906)** | (52,896) |
| Provision for unpaid claims, end of year, net | **286,351** | 246,533 |
| Reinsurers' share | **51,516** | 38,837 |
| Provision for unpaid claims, gross | **$ 337,867** | $ 285,370 |

## 8. Reinsurance

The Corporation assumes risks from its members and cedes reinsurance to other insurers in order to limit the maximum loss through the spreading of risks. Reinsurance ceded does not relieve the Corporation of liability as the originating reinsurer and accordingly it has a contingent liability for reinsurance recoverable should any of the assuming reinsurers be unable to meet their obligations.

The following table sets out the impact of ceded reinsurance on the statement of earnings and surplus:

| | **2006** | 2005 |
|---|---|---|
| **Net premiums earned** | | |
| Premiums assumed | **$ 157,317** | $ 149,354 |
| Premiums ceded | **(19,608)** | (18,859) |
| | **$ 137,709** | $ 130,495 |
| **Net claims incurred** | | |
| Claims incurred | **$ 136,884** | $ 133,878 |
| Reinsurance portion | **(16,987)** | (13,581) |
| | **$ 119,897** | $ 120,297 |

The Corporation reinsures assumed risks to limit its maximum loss to the following:

| | In Excess of | | To a Maximum of | |
|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 |
| Catastrophe – 95% | **$ 12,500** | $ 12,500 | **$ 120,000** | $ 120,000 |
| Excess reinsurance | | | | |
| Property – 100% | **1,500** | 1,250 | **6,000** | 3,000 |
| Property – 95% | **–** | 3,000 | **–** | 6,000 |
| Liability – 100% | **1,500** | 1,500 | **18,000** | 18,000 |
| Automobile – 100% | **1,500** | 1,500 | **18,000** | 18,000 |

## 9. Contingencies

The Corporation has outstanding stand-by letters of credit at December 31, 2006 totalling $3,546 (2005 – $4,494) denominated in CDN dollars (2006 – $3,043 USD and 2005 – $3,864 USD). These stand-by letters of credit are put in place to cover claims reserves as required.

The maximum facility available to the Corporation is $40,000. The facility is secured by a general hypothecation of bonds.

## 10. Pension Plan

The Corporation participates in a multiemployer pension plan through the Ontario Mutual Insurance Association. The plan is a contributory defined benefit pension plan which covers substantially all of its employees. The plan provides pension based on length of service and final average earnings.

The pension expense of $187 (2005 – $146) includes no charges for past service costs.

Based on the last actuarial valuation as at December 31, 2003, the Corporation's portion of the plan's position was as follows:

| | |
|---|---|
| Assets | $1,945 |
| Liabilities | $2,256 |

## 11. Income Taxes

The provision for income taxes reflects an effective tax rate which differs from the corporate tax rate for the following reasons:

| | 2006 | 2005 |
|---|---|---|
| Income taxes based on combined basic Canadian | | |
| federal and provincial tax rate of approximately 36% (2005 – 36%) | $ 6,991 | $ 10,953 |
| Decrease resulting from permanent differences | | |
| Non-taxable dividend income | (952) | (995) |
| Exempt income from insuring farm risks | (3,082) | (4,216) |
| Other items | (48) | – |
| Increase resulting from change in future tax rate | 586 | 15 |
| Large Corporations Tax | – | 56 |
| Total taxes – current and future | $ 3,495 | $ 5,813 |

Future income tax assets are comprised of the following:

| | 2006 | 2005 |
|---|---|---|
| Provision for unpaid claims | $ 2,891 | $ 2,624 |
| Invested assets | 2,662 | 160 |
| | $ 5,553 | $ 2,784 |

## 12. Statement of Cash Flows

Changes in non-cash working capital

| | 2006 | 2005 |
|---|---|---|
| Receivables | $ 3,940 | $ 736 |
| Prepaids | (95) | – |
| Deferred acquisition expenditures | 1,293 | (225) |
| Payables and accruals | (2,677) | 2,283 |
| Income taxes | 2,578 | 2,372 |
| Provision for unpaid claims, net of recoveries from reinsurers | 39,818 | 37,700 |
| Unearned premiums | (1,165) | 393 |
| | $ 43,692 | $ 43,259 |

Investing activities

| 2006 | Purchases | Sales | Net | 2005 | Purchases | Sales | Net |
|---|---|---|---|---|---|---|---|
| Bonds | $ 282,228 | $ 240,192 | $ (42,036) | Bonds | $ 302,092 | $ 273,022 | $ (29,070) |
| Common shares | 20,457 | 12,733 | (7,724) | Common shares | 92,575 | 87,060 | (5,515) |
| Short-term | 327,268 | 329,286 | 2,018 | Short-term | 299,189 | 295,435 | (3,754) |
| | | | $ (47,742) | | | | $ (38,339) |

## 13. Facility Association

The Facility Association is comprised of various risk sharing pools where most companies in the auto insurance industry share resources to provide insurance for high risks.

The Corporation is not a direct writer of automobile insurance policies and as a result does not participate directly in the Facility Association.

The Corporation acts as an administrator on behalf of its members participating in the Facility Association.

## 14. Fair Value of Financial Instruments

The estimated fair value of investments is set out in Note 3.

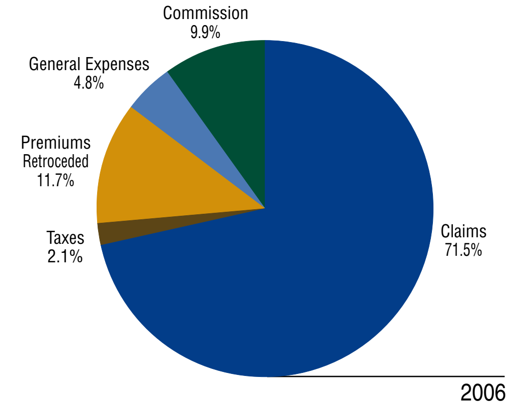
The fair values of cash, receivables and payables and accruals approximate their carrying values because of the short maturity of these instruments.

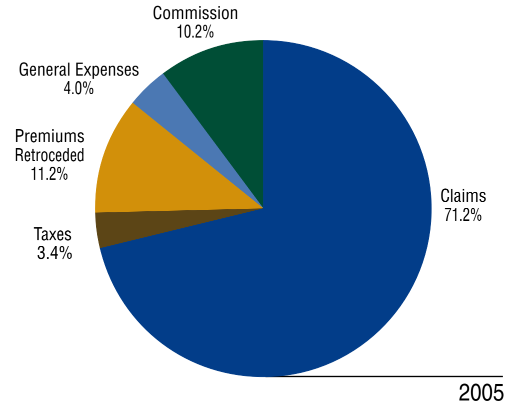
Unpaid claims and reinsurance recoverables are recorded at their discounted present value which approximates fair value.

Included in the balance sheet are the following amounts denominated in foreign currencies:

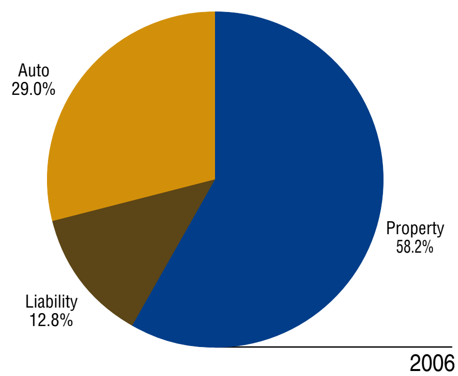
| | Currency | **2006** | 2005 |
|---|---|---|---|
| Cash | U.S. dollars | **$ 95** | $ 266 |
| Accounts receivable | U.S. dollars | **5,634** | 5,296 |
| Accounts payable | U.S. dollars | **34** | 908 |
| Provision for unpaid claims | U.S. dollars | **9,584** | 3,848 |

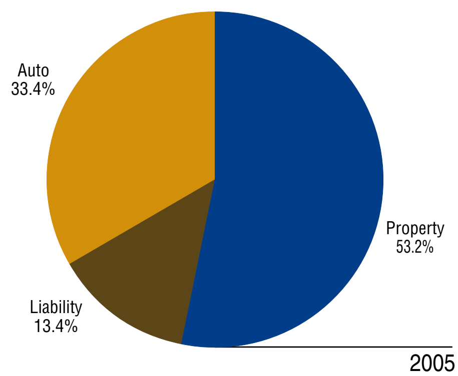
# Distribution of expenses



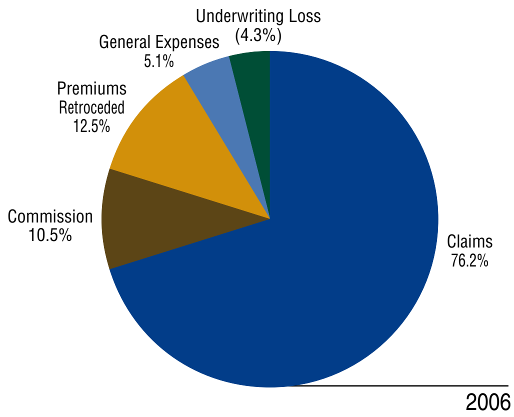



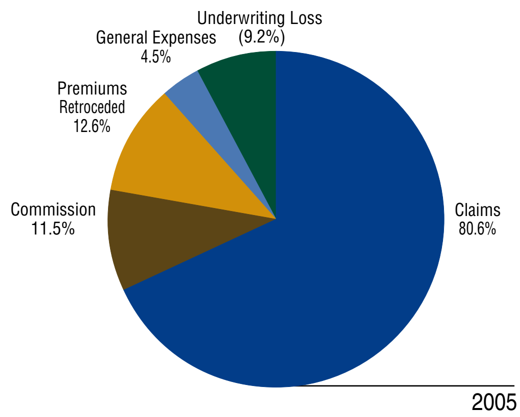

# Sources of Gross Premium Income




# Distribution of Gross Premium Dollar



# Past Presidents and Chairmen of the Board

| *Chair (President prior to 1995)* | *from* | *to* |
|---|---|---|
| Fred M. Fletcher | 1959 | 1965 |
| J. Stan Mitchell | 1965 | 1973 |
| Delmar Cobban | 1973 | 1975 |
| Willard Shaw | 1975 | 1977 |
| K. Max Forsythe | 1977 | 1979 |
| William Weir | 1979 | 1981 |
| Emory Knill | 1981 | 1983 |
| John Harper | 1983 | 1985 |
| Fred Legg | 1985 | 1987 |
| Albert McArthur | 1987 | 1989 |
| Donald Mylrea | 1989 | 1991 |
| Gordon Johnson | 1991 | 1992 |
| Vern Inglis | 1992 | 1993 |
| Edward Pellow | 1993 | 1994 |
| Brian Fisher | 1994 | 1995 |
| James Pinnock | 1995 | 1996 |
| Carl Turnbull | 1996 | 1997 |
| Ronald Perry | 1997 | 1998 |
| Douglas Winer | 1998 | 1999 |
| Gerald Brown | 1999 | 2000 |
| John McIntosh | 2000 | 2001 |
| Terry Malcolm | 2001 | 2002 |
| Philip Brett | 2002 | 2003 |
| Earl Harder | 2003 | 2004 |
| Kathryn Adie | 2004 | 2005 |
| Michael O'Shea | 2005 | 2006 |
| Serge Gauthier | 2006 | Present |

# Staff

| *President (General Manager prior to 1995)* | *from* | *to* |
|---|---|---|
| H.H. McFadden | 1959 | 1973 |
| Bruce Bird | 1974 | 1979 |
| Gerald M. Snyder | 1980 | 1986 |
| John A. Harper | 1987 | 2003 |
| G.S. (Steve) Smith | 2003 | Present |