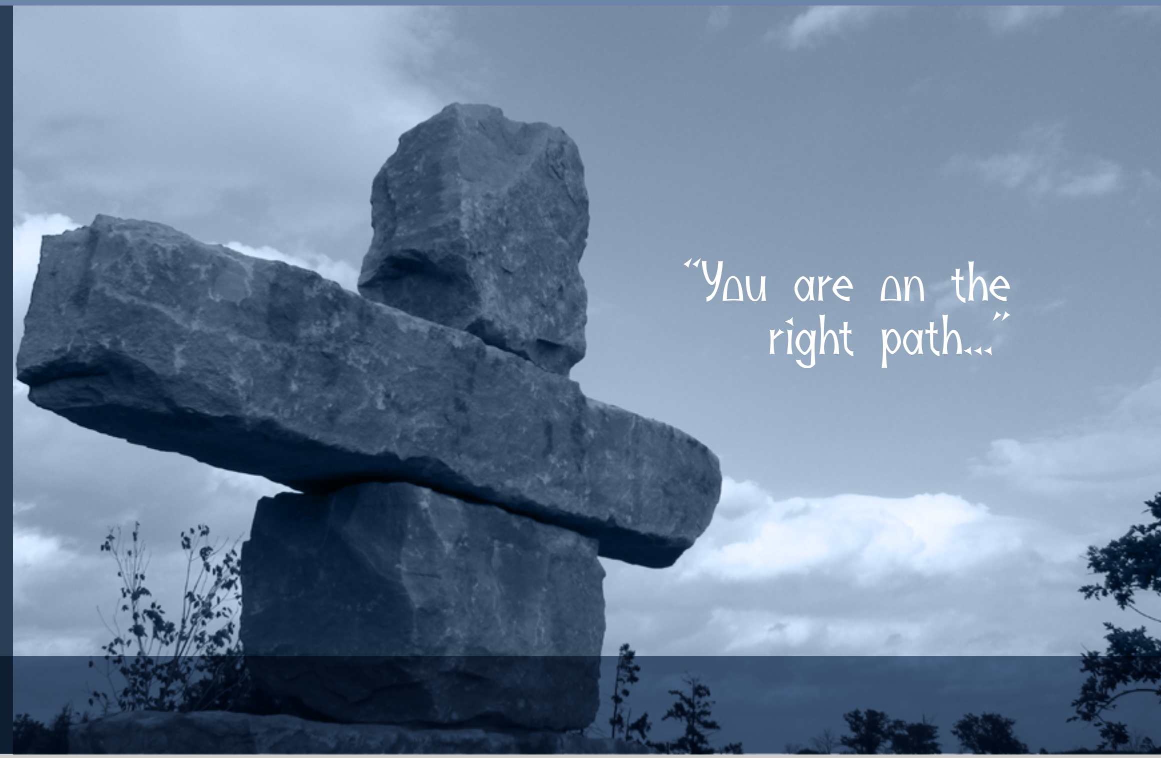



# 2013 Annual Report

Farm Mutual Reinsurance Plan Inc.

# Contents

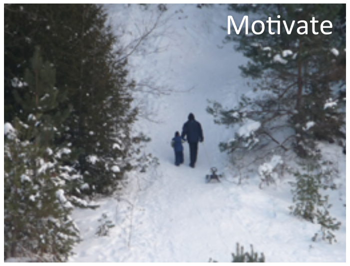
# VISION

Our vision is to be a strategic partner in the mutual insurance community through constant innovation, professionalism and teamwork.

# MISSION

Our mission is to provide our Members with a competitive edge in their markets through leadership, strong financial backing, innovative use of reinsurance products and effective delivery of support services.

# Core Values




Farm Mutual Reinsurance Plan Inc. is a Canadian owned reinsurance company formed in 1959. We have a unique and diverse corporate culture defined by our core values and the way we interact with our Members.

**Focus**

At FMRP we focus on people and the development of long-term relationships. We promote a healthy balance between career and family.

**Motivate**

We are motivated to support and strengthen our mutual Members, while being mindful of our past and focused on our future.

**Respect**

Respecting and recognizing the values of honesty, integrity and accountability, we treat one another with dignity and fairness. We acknowledge and appreciate the diversity of our workplace and the contributions of each person.

**Professional**

Together we promote an environment that fosters professionalism, education, leadership and trust. We embrace open communication, encourage each other to listen and seek to understand.

Photos submitted by FMRP staff for a photo challenge depicting our core values. Chosen by a representative from each department, the winners from right to left are: *Chuck Salvalaggio*, Loss Control - FOCUS, *Amanda Lantz*, Claims - MOTIVATE, *Sid Dijkema*, Loss Control, - RESPECT, *Sid Dijkema*, Loss Control - PROFESSIONAL

# Message from the Chair

Daniel J. Hill
Chair of the Board

*President*
*Germania Mutual Insurance Company*

On behalf of the Board of Directors, management and staff, I am pleased to present Farm Mutual Reinsurance Plan Inc.'s 2013 Annual Report.

The Board of Directors wishes to report that we continue to improve our financial position and achieved comprehensive income for the period of $39.1 million. It is a pleasure to confirm to the Members that we have met or exceeded the internal financial targets that the Board has established for the Company.

In December 2013, the Board of Directors declared a refund of premiums of $7.4 million, which was distributed to voting Members. The refund of premiums was declared in light of the Company's favourable financial performance and in recognition that in 2009 the Company made an unprecedented call on our voting Members in the form of a mid-year premium rate increase.

Your Board of Directors continues to be fully engaged in the development and oversight of the Company's strategic and business plans and actively monitor the Company's performance throughout the year. Our current priority is strengthening risk governance, risk management and capital management.

During 2013, we evaluated our risk governance by contracting for an independent review of policies and guidelines. This evaluation confirmed that we have designed, implemented and follow well thought and clearly formulated board mandates and policies that meet requirements established by regulatory authorities for Canadian financial institutions.

During the period we also finalized a Capital Assistance Policy. This policy formalizes the process that we will use where we provide special assistance to members.

The Board also wishes to acknowledge and recognize the contributions that management and staff have made to our financial performance and thank them for their continued efforts to provide valuable products and services to Members.

It has been an honour and privilege for me to serve as the Chair and I want to thank my fellow members of your Board of Directors for their support. Together the board and our professional management team will continue to strive to meet our collective vision to be "a strategic partner in the mutual insurance community through constant innovation, professionalism and teamwork".

The Board of Directors of Farm Mutual Reinsurance Plan Inc. encourage you to attend and participate in our Annual Meeting, which will be held at the Sheraton Centre Hotel, Toronto, Ontario on Wednesday March 19th, 2014.

# Directors and Officers

Standing, Left to Right:

*Jeff Whiting*, Director; *Jeff Consitt*, Vice President Operations; *Ross Lincoln*, Director; *Peter Wright*, Director; *Brian Downie,* First Vice-Chair; *Claude Smith,* Senior Vice President & Chief Financial Officer; *Tom Oegema*, Director; *David Crowley,* Director; *Ross Gowan,* Director

Sitting, Left to Right:

*Ed Dick*, Director; *Doug Crockett*, Past Chair; *Steve Smith*, President & Chief Executive Officer; *Dan Hill,* Chair; *Terry Shea,* Director *Barbara Bethune,* Second Vice-Chair

## Board Commitments

### Practise Board Governance

- Clearly understand Board responsibilities and expectations
- Commit to education and learning
- Strive for excellent Board performance and standards
- Exercise mutual respect for other Board Members
- Follow communication protocol
- Value all Board members' input

### Direct and Protect

- Develop the strategic plan with management
- Monitor and measure the strategic plan
- Develop and meet goals and objectives
- Focus on connecting with staff and voting Members
- Be results oriented
- Monitor financial performance
- Demonstrate a concern for excellence

### Represent Members' Interests

- Be conscious of conflict of interest and objectivity
- Connect with and listen to voting Members
- Respect voting Members' expectations
- Exercise good judgment
- Listen to those at the grass roots
- Preserve the farm mutual culture

### Encourage Staff Involvement

- Welcome recommendations and input from staff
- Encourage staff development and participation
- Maintain a culture in which people are a priority
- Support staff fulfillment

# Our Staff

*Human Resources (HR), Statistics & Public Relations*

Left to Right, Top to Bottom

*Nicole Murphy,* Statistics; *Melissa Boyd,* HR; *Sue Perkons,* Statistics; *Marina Clarke,* Operations; *Lindsay Gordan,* HR; *Arden MacIntyre*, Public Relations; *Elaine Reaume,* Public Relations; *Marilyn Paquette,* HR Manager; *Krista Seiling,* Operations; *Kathleen Seemann,* Reception; *Emily McHugh,* Statistics; *Marie Byrne,* Public Relations/Facilities Manager; *Arijana Ilibasic,* HR

*Reinsurance, Accounting & Information Systems (IS)*

Left to Right, Top to Bottom

*Bob Brown,* Assistant Vice President Accounting*; Dusan Mataruga,* IS; *Kyle Allen*, IS; *Henry Wouda,* IS; *Jack Black,* IS Manager; *Shannon Simpson,* IS; *Deb Field*, Accounting; *Chris Puttock,* IS; *Mellissa Matusiak*, Reinsurance; *Wendy Dugal*, IS; *Jane Burnside,* Accounting; *Jeff Barnard,* Assistant Vice President Reinsurance

*Loss Control (LC)*

Left to Right, Top to Bottom

*Sid Dijkema*, LC; *Chuck Salvalaggio*, LC; *Debbie Delair,* LC; *Peter Stolk,* LC; Mike McDonald, LC; *Tara MacArthur,* LC; *Sandra Conners,* LC; *Harry Jang,* Co-Op Student, LC; *Paul Wigood,* LC; *Jackie Miller,* LC; *James Taylor*, LC; *Jim Straatman*, LC

*Claims*

Left to Right, Top to Bottom

*Lori Corrigan,* Claims Manager; *Sharon Jenne,* Claims; *Bryce Witherspoon,* Claims; *Stefan Milanovic,* Co-Op Student, Claims; *Amanda Taylor,* Claims; *Sonny D'Agostino*, Claims; *Ursula Yetman,* Claims; *Chris Serran,* Claims; *Cheri Claxton, Claims*

*Claims*

Left to Right, Top to Bottom

*Jaclyn Morgan,* Claims*; Jon Hodson,* Claims*; Rob Scott,* Claims; *Lisa Stadnik,* Claims; *Dave Darke*, Claims; *Karen Xian,* Claims; *Matt Boyd,* Co-Op Student, Claims; *Carolyn Durber*, Claims; *Elaine Lockhart,* Claims; *Genna Black,* Claims; *Amanda Lantz,* Claims

*Research and Delevlopment (R&D) & Underwriting*

Left to Right, Top to Bottom

*Kevin Cameron,* Underwriting Manager; *Angela Boost,* Underwriting; *Carla Layton,* Underwriting; *Christina Garvey,* Co-Op Student, Underwriting; *Sharon Turnbull,* R&D Manager; Zachary Tisdale, R&D; *Cynthia White,* Underwriting; *Jenn Kearsey,* Underwriting; *Anjana Dhillon,* R&D; *Richard Soehner,* Underwriting

# Service Commitments

Farm Mutual Reinsurance Plan Inc. is the exclusive reinsurer and financial partner of our voting Member mutual insurance companies. We are committed to providing and maintaining a very high level of service in all aspects of our operation.

Our entire organization is dedicated to providing our services in a prompt and courteous manner. The following departmental service guidelines define our commitments and establish the measurement for our ongoing performance.

## Accounting

- Issue payments for reinsurance recoveries within one business day of the receipt of the authorization from the claims department.

## Reinsurance/Member Services

- Respond to individual reinsurance inquiries within two business days of the receipt of the inquiry.
- Visit each individual Member company on a semi-annual basis to review reinsurance issues related to capacity, retention and resource protection.
- Respond to individual requests for meetings or consultations with an open door policy subject to immediate availability.

## Underwriting

- Respond to individual underwriting inquiries within two business days of the receipt of the inquiry.
- Respond to commercial risk approval requests within two business days of the receipt of the required documentation.
- Respond to individual facultative reinsurance requests within three business days of the receipt of the required documentation.
- Issue confirmation of facultative reinsurance coverage within three business days of acceptance of the risk and to issue a facultative certificate/endorsement within seven business days of the confirmation of the coverage.

## Claims

- Process, examine and authorize normal reinsurance recovery requests within five business days of the receipt of the required documentation.
- Process special requests for reinsurance claim payment advances within one business day of the receipt of  the required documentation.
- Respond to individual claims inquires within two business days of the receipt of the inquiry.
- Respond to individual requests for meetings or consultations with an open door policy subject to immediate availability.
- Participate in conference calls, claims settlement meetings and mediations upon request and to represent the financial interests of FMRP and/or the financial interests of the reinsurers of FMRP.

## Loss Control Services

- Provide loss prevention guidance and services supporting the Member Company assessment or risk.
- Schedule facultative risk assessments and pre-inspections as our top priority.
- Provide a written report to the Member Company within twenty one business days of the completion of the risk assessment.
- Provide one to one mentorship and training for Member Company loss control staff.
- Complete all risk assessments as soon as practicable based on demand, risk type and location.

# Report to the Members

It was the
**BEST**
of times

It was the
**WORST**
of times

When we reflect on 2013 from the Canadian insurance industry perspective, the often quoted opening paragraph from Charles Dickens' Tale of Two Cities comes to mind:

*"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, …."*

**"The worst of times…"** In 2013, the insurance industry experienced two of the worst storms in Canadian history. Floods occurred in Calgary and Toronto less than a month apart, with combined losses exceeding $3 billion. The year was then capped off with a December 21st ice storm that generated industry losses of approximately $200 million. Globally, there were extreme storms in Europe, wildfires in Australia, and severe tornado activity in the US. Weather related catastrophes dominated headlines for most of the year.

**"The best of times…"** From the Mutuals' perspective, the rural demographic focus and spread of risk allowed our Members to escape most of the wrath of the two major Canadian storms, differentiating us from the balance of the industry. The other distinguishing aspect of 2013 for the Mutuals was Ontario auto. The rural demographic of our business does not generate the frequency of auto losses associated with fraud and urban congestion. As a result, the performance of our collective auto results is approximately 6 percentage points better than the industry average.

The Mutuals, like the rest of the insurance industry, will be facing challenges in the coming years. The misguided political directive to mandate a 15% reduction in primary auto rates in Ontario without industry input and proper analysis may have long term ramifications. The other challenge is the clear need for our industry to address the issue of overland flood. Canada is the only G8 country not explicitly providing flood cover. The industry's response to losses resulting from the Calgary and Toronto floods was inconsistent, incomplete, and at times damaging to reputation. There is a need for the Canadian insurance industry to provide proper coverage for loss from overland flood.

Investments in 2013 continued to reflect volatility, with wide yield swings on fixed income on an almost monthly basis. Fortunately, the last quarter of 2013 saw a significant positive yield shift as well as strong equity performance, resulting in a relatively favourable outcome for investment income against an initial negative forecast. In spite of two major catastrophic events in Canada and investment market volatility, our capital and MCT have been rebuilt well beyond our forecasts. At year end our capital reached $283 million with an MCT of 411%. Our success can be attributed to several years of premium strengthening, a 5 year focused effort on claims settlements and our appointed actuary's analysis with respect to recognizing redundancies on prior year auto and liability claims.

During 2013, our internal focus was on 3 major priorities: risk governance and management, capital management and enhanced member services. Our strategic plan and tactical objectives provide uncompromised commitment and full corporate engagement to these priorities. This commitment and engagement will continue in 2014.

Risk governance and management included the development of a Risk Governance and Risk Management Framework that was vetted by an external third party to validate and critique our process. Our governance framework is posted to our website for reference. Included in our Risk Governance initiatives is the adoption of the OSFI directed process of a company's own risk and solvency assessment, or "ORSA". Our capital management efforts involved a thorough examination of our capital, risk and requirements and validated both our internal minimum capital threshold as well as our working capital threshold. The latter defines our optimum capital position required to withstand single or multiple adverse events identified through an extensive stress testing process.

Our focus on enhanced member services includes recognizing the need to develop capabilities to underwrite specialty risks within voting Member's traditional market segments, such as large farming operations, agri-business and related automobile exposures. Qualified and experienced resources have been recruited to support this initiative. Our operations personnel, including Claims, Underwriting, Loss Control and Statistics, are all engaged in on-site meetings and discussions with our voting Members to maximize dialogue and communication, resulting in recognizing and addressing our Member's needs.

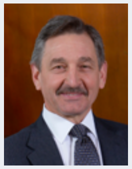
Further improvements to member services include streamlining processes for facultative underwriting, physical risk inspections, loss reporting, enhancing processes for managing regulatory filings for automobile insurance rates and rules, and the introduction of electronic payment of reinsurance recoveries.

Like the rest of the Canadian insurance industry, the mutuals are involved in significant consolidation activity. In January 2014, two amalgamations will be finalized and will reduce our membership from 57 voting Members to 54. The amalgamation of Farmers' (Lindsay), Lanark and Glengarry Mutuals will result in our largest voting Member company writing in excess of $130 million of premium. The merger activity that is taking place within the mutuals will ultimately result in reduced revenues to FMRP as newly formed entities are able to assume higher retentions. This will encourage us to seek alternative avenues of revenue generation and growth so that we can continue to support Member services on a cost effective basis.

When we look at our business on a segmented basis, the property excess of loss experience deteriorated by 25.7% over 2012 due to increased frequency and severity, ending the year with a 115.1% combined ratio. Conversely, the property catastrophe results were very positive, generating a 19.3% combined ratio, well below our forecast. With respect to the automobile line of business, the year finished with a 46.6% combined ratio, reflecting an improvement of 17 percentage points over the previous year. The liability line ended the year with a 49.3% combined ratio, continuing the positive downward trend in loss experience that we have seen during the last few years.

As we move into 2014, our priorities remain steadfast with a continued focus on member services and risk governance and management. We are very confident that our collective efforts and initiatives with our Members are laying the strong foundation to be competitive, efficient and progressive, even in times of volatility that are now the new normal. We look forward to working with all our Members and providing our ongoing commitment and support to help all of us enjoy a *mutually* prosperous and successful 2014.

G. S. (Steve) Smith
President and CEO
*Farm Mutual Reinsurance Plan Inc.*



# Management's Statement of Responsibility

## Role of Management

Management is responsible for preparation and presentation of the financial statements of Farm Mutual Reinsurance Plan Inc. ("the Company"). This responsibility includes selecting appropriate accounting policies and making estimates and informed judgments based on the anticipated impact of current transactions, events, and trends, consistent with International Financial Reporting Standards.

In meeting its responsibility for the reliability of the financial statements, management maintains and relies on a comprehensive system of internal control comprising organizational procedural controls and internal accounting controls. The Company's system of internal controls includes the communication of policies and the Company's Code of Business Conduct and Ethics, comprehensive business planning, proper segregation of duties, delegation of authority for transactions and personal accountability, selection and training of personnel, safeguarding of assets and maintenance of records.

The Company's Board of Directors, acting through the Audit Committee, which is composed entirely of Directors who are neither officers nor employees of the Company, oversees management's responsibility for the design and operation of effective financial reporting and internal control systems and the preparation and presentation of financial information.

## Role of the Actuary

The independent actuary is appointed by the Board of Directors pursuant to the Insurance Act (Ontario) to carry out a review of management's valuation of the estimated policy liabilities and provide an opinion to the Board of Directors regarding the appropriateness of the estimated policy liabilities recorded by management to meet all insurance policy obligations of the Company at the statement of financial position date. In performing the review of these estimated liabilities determined by management, which are by their very nature inherently variable, the independent actuary makes assumptions as to future loss ratios, trends, future rates of claims frequency and severity, inflation and both internal and external loss adjustment expenses taking into consideration the circumstances of the Company and the nature of the insurance policies in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In carrying out his work, the independent actuary makes use of the work of the independent auditor with regards to data upon which his calculations are based.

Management is responsible for the accuracy and completeness of the underlying data used in the valuation. The independent actuary's report outlines the scope of the review and the opinion.

## Role of the Auditor

The independent auditor is appointed by the Board of Directors and ratified by the Members to conduct an independent and objective audit of the financial statements of the Company in accordance with Canadian generally accepted auditing standards and to report thereon to the Members. In carrying out the audit procedures relating to the claims liabilities of the Company, the auditor makes use of the work and report of the independent actuary. The auditor has full and unrestricted access to the Board of Directors and the Audit Committee to discuss audit, financial reporting and related findings. The auditor's report outlines the scope of the audit and the auditor's opinion.

G.S. (Steve) Smith
**President and CEO**

Claude Smith
**Sr. Vice President and CFO**

# Independent Auditor's Report

## *To the Members of Farm Mutual Reinsurance Plan Inc.*

We have audited the accompanying financial statements of Farm Mutual Reinsurance Plan Inc., which comprise the statement of financial position as at December 31, 2013 and the statements of comprehensive income and equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Farm Mutual Reinsurance Plan Inc. as at December 31, 2013 and the financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**BDO Canada LLP**
**Chartered Accountants, Licensed Public Accountants**
Mississauga, Ontario
February 26, 2014

# Actuary's Report

## *To the Members of Farm Mutual Reinsurance Plan Inc.*

I have valued the policy liabilities of Farm Mutual Reinsurance Plan Inc. for its statement of financial position at December 31, 2013 and their change in the statement of comprehensive income and equity for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of policy liabilities makes appropriate provision for all policyholder obligations and the financial statements fairly present the results of the valuation.

Liam M. McFarlane
Fellow, Canadian Institute of Actuaries

Toronto, Ontario
February 26, 2014

# Statement of Financial Position

(in thousands of dollars)

**The accompanying notes are an integral part of these financial statements.**

| As at December 31 | | 2013 | | 2012 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | $ | 14,992 | $ | 14,920 |
| Investments - note 6(b) | | 583,666 | | 555,435 |
| Accrued investment income | | 2,631 | | 3,218 |
| Accounts receivable - note 6(a) | | 19,861 | | 32,429 |
| Reinsurance assets - note 7(a) | | 125,357 | | 138,301 |
| Income taxes receivable | | 3,249 | | - |
| Property and equipment - note 8 | | 16,725 | | 17,583 |
| Deferred tax assets - note 10(a) | | 2,067 | | 2,013 |
| Deferred acquisition costs - note 7(e) | | 3,422 | | 4,695 |
| Intangible assets - note 9 | | 444 | | 1,088 |
| | $ | 772,414 | $ | 769,682 |
| **Liabilities** | | | | |
| Accounts payable - note 6(h) | $ | 2,537 | $ | 1,950 |
| Income taxes payable | | - | | 6,397 |
| Unpaid claims - note 7(b) | | 473,265 | | 500,429 |
| Unearned premiums - note 7(d) | | 13,129 | | 16,537 |
| Unearned commissions - note 7(e) | | 224 | | 175 |
| | | 489,155 | | 525,488 |
| **Voting and participating Members' equity** | | 283,259 | | 244,194 |
| | $ | 772,414 | $ | 769,682 |

*On behalf of the Board:*

Brian Downie
**1st Vice Chair**

Barbara Bethune
**2nd Vice Chair**

# Statement of Comprehensive Income and Equity

(in thousands of dollars)

**The accompanying notes are an integral part of these financial statements.**

| For the year ended December 31 | 2013 | 2012 |
|---|---|---|
| **Revenue** | | |
| Premiums assumed | $ 178,958 | $ 185,452 |
| Premiums ceded | 43,482 | 44,269 |
| Net premiums written | 135,476 | 141,183 |
| Changes in net unearned premiums | 3,311 | 1,239 |
| Net premiums earned – note 7(d) | 138,787 | 142,422 |
| **Underwriting expenses** | | |
| Gross claims and adjustment expenses – note 7(c) | 83,352 | 96,994 |
| Reinsurers’ share of gross claims and adjustment expenses | (1,148) | (22,371) |
| Commissions and fees – note 7(e) | 12,673 | 15,602 |
| Operating expenses – note 11 | 9,765 | 9,208 |
| | 104,642 | 99,433 |
| Underwriting profit | 34,145 | 42,989 |
| Investment income – note 6(g) | 20,971 | 23,573 |
| Gain (loss) on foreign exchange | (104) | (105) |
| Refund of premiums – note 12 | (7,415) | - |
| Income before income taxes | 47,597 | 66,457 |
| **Income tax expense** - note 10(b) | | |
| Current | 8,586 | 11,957 |
| Deferred (recovery) | (54) | (133) |
| | 8,532 | 11,824 |
| Net income and comprehensive income for the year | 39,065 | 54,633 |
| Voting and participating Members’ equity, beginning of year | 244,194 | 189,561 |
| Voting and participating Members’ equity, end of year | $ 283,259 | $ 244,194 |

# Statement of Cash Flows

(in thousands of dollars)

**The accompanying notes are an integral part of these financial statements.**

| For the year ended December 31 | 2013 | 2012 |
|---|---|---|
| **Cash flows from (used in) operating activities** | | |
| Comprehensive income for the year | $ 39,065 | $ 54,633 |
| Items not affecting cash | | |
| Depreciation of property and equipment | 1,021 | 1,008 |
| Amortization of intangible assets | 778 | 1,357 |
| Deferred income tax expense (recovery) | (54) | (133) |
| Realized gain on sale of investments | 3,778 | 11,969 |
| Change in unrealized loss on investments | (1,334) | 5,364 |
| Changes in other non-cash balances – note 18 | (12,210) | (29,769) |
| Cash provided by operating activities | 31,044 | 44,429 |
| **Cash flows from (used in) investing activities** | | |
| Investments purchased | (1,048,978) | (471,931) |
| Investments sold, redeemed, or matured | 1,018,303 | 433,562 |
| Purchase of property and equipment | (163) | (252) |
| Purchase of intangible assets | (134) | (386) |
| Cash used in investing activities | (30,972) | (39,007) |
| Increase in cash position during the year | 72 | 5,422 |
| Cash and cash equivalents, beginning of year | 14,920 | 9,498 |
| Cash and cash equivalents, end of year | $ 14,992 | $ $14,920 |
| | | |
| Supplementary disclosure of cash information | | |
| Interest received | $ 15,122 | $ 15,751 |
| Dividends received | $ 2,312 | $ 1,986 |
| Income taxes paid | $ 18,232 | $ 10,614 |

# Notes to Financial Statements

December 31, 2013

## 1. Nature of business

Farm Mutual Reinsurance Plan Inc. ("the Company") is incorporated without share capital under the laws of the Province of Ontario and is domiciled in Canada. The address of the Company's registered office is 350 Pinebush Road, Cambridge, Ontario. The Company is a general reinsurer and therefore shares in the property, automobile, liability and other risks originally accepted by insurance companies operating in Canada and the United States.

## 2. Basis of preparation

### a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

As permitted by IFRS 4 *Insurance Contracts,* the Company has applied Canadian generally accepted accounting principles ("GAAP") for the accounting of its insurance contracts.

The financial statements were authorized for issue by the Board of Directors on February 26, 2014.

### b) Basis of measurement

The financial statements have been prepared on a going concern basis under the historical cost convention excluding certain financial instruments and insurance contract assets and liabilities whose measurement basis is disclosed in the significant accounting policies.

### c) Functional and presentation currency

The financial statements are presented in Canadian dollars, which is the Company's functional currency. All financial information presented in Canadian dollars has been rounded to the nearest thousand.

### d) Use of judgments, estimates and assumptions

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the reporting date and the reported amounts of revenues and expenses during the year. Actual results may differ from these estimates. Although some variability is inherent in these estimates, management believes that the amounts provided are appropriate.

*Judgments*

In the process of applying the Company's accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the financial statements.

Management has applied judgment in its assessment of the identification of objective evidence of impairments of financial assets, other than those classified or designated at fair value through profit or loss, measurement of income taxes and recoverability of deferred tax assets and identifying the indicators of impairment for reinsurance assets, property and equipment, and intangible assets with finite useful lives.

*Estimates and assumptions*

Estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year are included in the following notes:

| | |
|---|---|
| Note 3(g) | Insurance contracts |
| Note 3(h) | Insurance contract assets |
| Note 3(i) | Insurance contract liabilities |
| Note 3(k) | Income taxes |
| Note 3(m) | Post-employment benefits |

## 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements unless otherwise indicated.

### a) Financial assets

The Company has the following non-derivative financial assets: financial assets at fair value through profit or loss, loans and receivables, and cash and cash equivalents. The Company initially recognizes loans and receivables and deposits on the date that they are originated. All other financial assets are recognized on the trade date at which the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expires or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

*Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Investments typically bought with intention to sell in the near future are classified as held for trading.  Financial assets are designated as at fair value through profit or loss if the assets are part of a group of financial assets that are managed and their performance evaluated on a fair value basis in accordance with a documented risk management or investment strategy.

Debt securities backing claims liabilities are reported at fair value through profit or loss. This reduces the volatility caused by the fluctuations in underlying claims liabilities due to changes in discount rates. The Company ensures that the weighted dollar duration of the debt securities at fair value through profit and loss is approximately equal to the weighted dollar duration of the claims liabilities. The rate used to discount claims liabilities is calculated based on a dollar match of debt securities backing these claims liabilities.

Financial assets at fair value through profit or loss are measured at fair value and changes therein are recognized in profit or loss. The fair value on initial recognition is the fair value of the consideration given. Subsequent to initial recognition, fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act.

Fair value is best evidenced by quoted bid or ask price, as appropriate, in an active market. Where bid or ask prices are not available, such as in an illiquid or inactive market, the closing price of the most recent transaction of that instrument subject to appropriate adjustments as required is used. Where quoted market prices are not available, the quoted prices of similar financial instruments or valuation models with observable market based inputs are used to estimate the fair value. These valuation models may use multiple observable market inputs, including observable interest rates, foreign exchange rates, index levels, credit spreads, equity prices, counterparty credit quality, and corresponding market volatility levels. Minimal management judgment is required for fair values calculated using quoted market prices or observable market inputs for models. The calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values.

The Company uses the services of external security pricing vendors to obtain estimated fair values of securities in its investment portfolio. Fair values of pooled funds and mutual funds are based on the quoted market values of the underlying investments.

The Company employs a fair value hierarchy as follows:

- Level 1: inputs represent unadjusted quoted prices for identical financial instruments exchanged in active markets. The fair values of the majority of the Company's common stocks are based on published quotes in active markets.
- Level 2: inputs include directly or indirectly observable inputs, other than Level 1 inputs, such as quoted prices for similar financial instruments exchanged in active markets, quoted prices for identical or similar financial instruments exchanged in active markets and other market observable inputs. The fair value of the majority of the Company's investments in debt securities are based on third-party broker-dealer quotes.
- Level 3: inputs include unobservable inputs used in the measurement of financial instruments. The fair value of the Company's investment in common shares of a regulated general insurance company is provided by the National Association of Insurance Commissioners Securities Valuation Office, which is responsible for the day-to-day credit quality assessment and valuation of securities owned by regulated insurance companies in the United States.

*Loans and receivables*

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest rate method, less any impairment losses.

Loans and receivables comprise receivables arising from insurance contracts, accrued premium under insurance contracts net of applicable commissions and fees, deposits under insurance contracts, investment transactions pending settlement, and other miscellaneous receivables. Due to the short-term nature of receivables, carrying value is considered to approximate fair value.

*Cash and cash equivalents*

Cash and cash equivalents consist of cash on hand, balances on deposit with banks and highly liquid investments that are readily converted into a known amount of cash, are subject to insignificant risk of changes in value and have an original maturity of ninety days or less in the statement of financial position. The carrying value of cash and cash equivalents approximates fair value.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above.

b) **Impairment of financial assets**

The Company assesses at each reporting date whether a financial asset or group of financial assets, other than financial assets at fair value through profit or loss, is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

c) **Financial liabilities**

Financial liabilities are recognized initially at fair value. The fair value on initial recognition is the fair value of the consideration received. Subsequent to initial recognition financial liabilities are measured at amortized cost using the effective interest rate method. A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expires.

Financial liabilities comprise payables arising from insurance contracts, accrued premium under insurance contracts net of applicable commissions and fees, investment transactions pending settlement, and trade payables and accrued liabilities. Due to the short-term nature of payables, carrying value is considered to approximate fair value.

d) **Offsetting of financial instruments**

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

e) **Property and equipment**

Property and equipment, including owner-occupied property, is stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment losses. Replacement costs are capitalized when incurred and if it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Depreciation is provided on a straight line basis over the estimated useful lives of the assets. The useful lives of each part of occupied premises are estimated separately and range from 15 years for parking lot and mechanical, 20 years for roof, and 50 years for building. The useful lives of other property and equipment range from 5 to 10 years for furniture and equipment, 3 years for desktop computer equipment and 5 years for other computer equipment.

The assets' residual values and useful lives and method of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

Impairment reviews are performed when there are indicators that the carrying value may not be recoverable. The recoverable amount is determined as the higher of an asset's fair value less costs to sell and value in use. If an asset is impaired, the carrying amount is reduced to the asset's recoverable amount with an offsetting charge recorded in the statement of comprehensive income and equity. If events or changes in circumstances indicate that a previously recognized impairment loss has decreased or no longer exists, the reversal is recognized in the statement of comprehensive income and equity to the extent that the carrying amount of the asset after reversal does not exceed the carrying amount that would have been had no impairment taken place.

Gains and losses arising from the disposition of a property and equipment asset are measured as the difference between the net disposal proceeds and the carrying value of the asset and are reported in operating expenses in the statement of comprehensive income and equity.

An item of property and equipment is derecognized upon disposal or when no further economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the asset, is included in the statement of comprehensive income and equity in the year the asset is derecognized.

### f) Intangible assets

Intangible assets comprise capitalized costs to license and develop computer software where the software is not integral to the hardware on which it operates. Intangible assets are measured initially at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and impairment losses.

Capitalized computer software assets have a finite useful life. Capitalized computer software costs are amortized over the estimated useful life of the asset and assessed for impairment whenever there is an indication that the asset may be impaired. The estimated useful life of capitalized computer software assets is 5 years.

Gains and losses arising from the disposition or impairment of an intangible asset are accounted for in the same manner as gains and losses arising from the disposition or impairment of property and equipment.

## g) Insurance contracts

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the counterparty to an insurance contract agrees to compensate a policyholder on the occurrence of an adverse specified uncertain future event. As a general guideline, the Company determines whether it has significant insurance risk by comparing the benefits that could become payable or receivable under various possible scenarios relative to the premium received or paid for insuring the risk.

During the normal course of its business, the Company assumes insurance risk from other insurance companies (inwards reinsurance) and cedes insurance risk to other reinsurance companies (outwards reinsurance). Inwards reinsurance generally results in the Company holding insurance contract liabilities while outwards reinsurance generally results in the Company holding insurance contract assets.

*Premiums assumed*

Premiums assumed comprise the total premiums receivable for the whole period of cover provided by inwards reinsurance contracts entered into during the accounting period and are recognized on the date on which the insurance contract commences. Premiums assumed include any adjustments arising in the accounting period for changes in estimated premium in respect of reinsurance assumed in prior accounting periods.

Premiums assumed are based upon reports received from ceding companies. Estimates of premiums assumed and unearned premium are made at the individual contract level, based on historical patterns and experience from the ceding company and management judgment for certain business that has not been reported to the Company.

*Premiums ceded*

Premiums ceded comprise the total premium payable for the whole period of cover provided by outwards reinsurance contracts entered into during the accounting period and are recognized on the date on which the insurance contract commences. Premiums ceded include any adjustments arising in the accounting period for changes in premium in respect of reinsurance ceded in prior accounting periods.

*Claims and adjustment expenses*

Gross claims and adjustment expenses on the statement of comprehensive income and equity include all claims under inwards reinsurance contracts that occurred during the year, whether reported or not, related internal and external claims handling costs that are directly related to the processing and settlement of claims, a reduction for the value of subrogation and other recoveries against third parties, and any adjustments to claims outstanding from previous years.

Reinsurers' share of claims and adjustment expenses under outwards reinsurance contracts are recognized when the related claim under an inwards reinsurance contract is recognized according to the terms of the relevant reinsurance contract.

*Commissions and fees*

Commissions payable under certain inwards reinsurance contracts providing proportional transfer of property risk vary according to a specific measure of profit under the contract. Commissions receivable under an outwards reinsurance contract providing proportional transfer of risk vary inversely to the loss ratio, within stated parameters. Estimates of commission expense or commission revenue are made at the individual contract level when the contract is initiated based on historical experience and management judgment. These estimates are reviewed throughout the life of the insurance contract and are adjusted prospectively, if appropriate.

### h) Insurance contract assets

Insurance contract assets comprise reinsurance assets and deferred acquisition costs.

*Reinsurance assets*

The benefits to which the Company is entitled under its outwards reinsurance contracts are recognized as reinsurance assets, which comprise unpaid claims and unearned premiums. Reinsurance does not relieve the Company of its liability under inwards reinsurance contracts.

Unpaid claims and unearned premiums associated with outwards reinsurance contracts are estimated in a manner consistent with estimates of unpaid claims and unearned premiums associated with inwards reinsurance contracts and in accordance with the related reinsurance contract.

Reinsurance assets are reviewed for impairment at each reporting period or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Company may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer. Considerations include the balance sheet strength of the reinsurer, its ability to pay, its desire to pay based on prior history, financial strength ratings as determined by external rating agencies and specific disputed amounts based on contract interpretations, which may occur from time to time. The impairment loss is recorded in the statement of comprehensive income and equity in the reporting period in which the Company determines that there is objective evidence that the full amount or disputed amounts due from reinsurers will not be collectible.

*Deferred acquisition costs*

Deferred acquisition costs comprise commissions and brokerage expenses directly related to the writing or renewal of inwards reinsurance contracts. Acquisition costs are deferred and amortized on the same basis as unearned premiums and are reported in commissions and fees on the statement of comprehensive income and equity.

The recoverability of deferred acquisition costs is tested through a liability adequacy test performed at the end of each period in accordance with IFRS. The portion of deferred acquisition costs that appears not to be covered by estimated future benefits is considered as irrecoverable and expensed as incurred in the statement of comprehensive income and equity.

### i) Insurance contract liabilities

Insurance contract liabilities comprise unpaid claims, unearned premiums, and unearned commissions.

*Unpaid claims*

Unpaid claims is the estimated ultimate cost of all claims incurred but not settled on inwards reinsurance contracts at the reporting date, whether reported to the Company or not, together with related claims handling costs and reduction for the expected value of subrogation and other recoveries. Unpaid claims are reported gross of any related recoverable on outwards reinsurance contracts. The recoverable on outwards reinsurance contracts is reported as an asset in reinsurance assets.

Unpaid claims are estimated by the appointed actuary using standard actuarial techniques and based on assumptions such as historical loss development factors and payment patterns, future rates of insurance claims frequency and severity, inflation, expenses, changes in the legal environment, changes in the regulatory environment and other matters, taking into consideration the circumstances of the Company and the nature of the insurance contracts. These liabilities are recognized on the statement of financial position and changes are recognized in gross claims and adjustment expenses on the statement of comprehensive income and equity. The liabilities are derecognized when the obligation to pay a claim expires, is discharged, or is cancelled.

Unpaid claims are first determined on a case-by-case basis as insurance claims are reported and then reassessed as additional information becomes known. Included in unpaid claims is a provision to account for the future development of these insurance claims, including insurance claims incurred but not reported by ceding insurers (“IBNR”), as well as a provision for adverse deviation, as required by Canadian accepted actuarial practice. Unpaid claims are discounted to take into account the time value of money.

Unpaid claims are discounted using a rate that reflects the estimated market yield of the underlying assets backing these unpaid claims. Several actuarial assumptions are used to calculate this discount rate. These may change from period to period in order to arrive at the most accurate and representative market yield based discount rate.

*Unearned premiums*

Unearned premiums are those proportions of premiums written in a year on inwards reinsurance contracts that relate to periods of risk after the reporting date. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums and is recognized over the remaining term of the insurance contract in net premiums earned on the statement of comprehensive income and equity.

At the end of each reporting period, a liability adequacy test is performed, in accordance with IFRS, to validate the adequacy of unearned premiums and deferred acquisition costs. A premium deficiency would exist if unearned premiums are deemed insufficient to cover the estimated future costs associated with the unexpired portion of written insurance contracts. A premium deficiency would be recognized immediately as a reduction of deferred acquisition costs to the extent that unearned premiums plus anticipated investment income is not considered adequate to cover all deferred acquisition costs and related insurance claims and expenses. If the premium deficiency is greater than the unamortized deferred acquisition costs, a liability is accrued for the excess deficiency.

*Unearned commissions*

Unearned commissions on outwards reinsurance contracts are recognized as liabilities using principles consistent with the Company's method for determining deferred acquisition costs.

### j) Investment income

Dividends are recognized when the shareholder's right to receive payment is established, which is the ex-dividend date. Interest income from debt securities is recognized on an accrual basis. Dividends received, interest income, realized and unrealized gains and losses on financial assets at fair value through profit and loss, and investment expenses are reported in investment income on the statement of comprehensive income and equity.

### k) Income taxes

Income tax expense (recovery) comprises current and deferred tax and is recognized on the statement of comprehensive income and equity.

Current income tax is based on the results of operations in the current year, adjusted for items that are not taxable or not deductible. Current income tax is calculated based on income tax laws and rates enacted or substantively enacted as at the reporting date. Provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided using the liability method on temporary differences between the carrying value of assets and liabilities and their respective tax values. Deferred tax is calculated using income tax laws and rates enacted or substantially enacted as at the statement of financial position date, which are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax assets are recognized for all deductible temporary differences as well as unused tax losses and tax credits to the extent that it is probable that taxable profit will be available against which the losses can be utilized.

Management exercises judgment in estimating income tax expense. The Company is subject to income tax laws in the jurisdictions where it operates. Various tax laws are subject to different interpretations by the taxpayer and the relevant tax authority. To the extent that the Company's interpretations differ from those of the tax authorities or the timing of realization is not as expected, the income tax expense may increase or decrease in future periods to reflect actual experience.

In determining the recoverability of deferred tax assets, the Company primarily considers current and expected profitability and the ability to use any recorded tax assets. The Company takes into consideration the underlying operation's performance as compared to plan, the outlook of the business going forward, the impact of enacted and proposed changes to tax law, the availability of tax planning strategies, and the expiry date of the tax losses.

### l) Foreign currency

Transactions in foreign currencies are translated to the Company's functional currency at exchange rates at the dates of the transactions. Monetary assets and monetary liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the reporting period. Foreign currency differences arising on retranslation are recognized in net income and comprehensive income for the year.

**m) Post-employment benefits**

The Company provides certain pension and other post-employment benefits to eligible participants upon retirement.

*Pension benefits*

Most of the Company's employees participate in a multi-employer pension plan that is a defined benefit plan. Because the plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan. The plan is therefore accounted for as if it were a defined contribution plan. The contribution payable to the plan in exchange for service rendered by a participating employee is recognized as a liability, after deducting any contribution already paid, and as an expense. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to income when assessed by the plan administrator.

*Non-pension benefits*

The Company provides post-retirement health and dental benefits to its retired employees. Entitlement to these benefits is conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. Coverage is based on years of completed service to a maximum of five years following retirement. There are no employee contributions and the benefits are not funded. The estimated present value of these benefits is charged to income in the period in which services are rendered.

**n) Current versus noncurrent**

Assets are classified as current when expected to be realized within the Company's normal operating cycle of one year. Liabilities are classified as current when expected to be settled within the Company's normal operating cycle of one year. All other assets and liabilities are classified as noncurrent.

The Company's statement of financial position is not presented using current and noncurrent classifications. However, the following balances are generally classified as current: cash and cash equivalents, investments, accrued investment income, accounts receivable, income taxes receivable, deferred acquisition costs, accounts payable, income taxes payable, unearned premiums, and unearned commissions.

The following balances are generally classified as noncurrent: investments, property and equipment, reinsurance assets, deferred tax assets, intangible assets, and unpaid claims.

The Company presents its statement of financial position broadly in order of liquidity.

### o) Operating segments

The Company's business activities are directed towards property and casualty reinsurance operations. These activities are captured within a sole reporting and operating segment. Internal reports on the performance of the segment are regularly reviewed by senior management, the Company's Chief Executive Officer and by the Board of Directors.

## 4. Adoption of new accounting standards

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were adopted in accordance with the applicable transitional provisions of each new or revised standard.

IFRS 13 *Fair Value Measurement*. This standard provides a single comprehensive framework for measuring fair value. IFRS 13 applies to IFRS that require or permit fair value measurement, but does not address when to measure fair value or require use of fair value. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. The new standard requires disclosures similar to those in IFRS 7 *Financial Instruments: Disclosures*, but applies to substantially all assets and liabilities measured at fair value, whereas IFRS 7 applies only to financial assets and liabilities measured at fair value. The Company adopted IFRS 13 prospectively on January 1, 2013. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

IAS 19 *Employee Benefits*. Amendments to this standard require additional disclosure for multi-employer pension plans that are defined-benefit plans and accounted for as if they were defined contribution plans. The Company adopted IAS 19 retrospectively on January 1, 2013, which has no impact on voting and participating Members' equity as at January 1, 2012 and December 31, 2012 nor any impact on net income and comprehensive income or net cash flows for the year ended December 31, 2012.

## 5. Standards issued but not yet effective

The IASB has issued certain new standards, amendments, and interpretations that are effective for annual periods beginning on or after January 1, 2014. The standards, amendments, and interpretations that the Company reasonably expects to be applicable at a future date are listed below. The Company intends to adopt standards when they become effective.

IFRS 9 *Financial Instruments: Classification and Measurement.* This standard represents the completion of the first part of a three-part project to replace IAS 39 – *Financial Instruments: Recognition and Measurement*. The new standard reduces complexity by replacing the many different rules in IAS 39. The key features of the new standard are as follows:

- a business model test is applied first in determining whether a financial asset is eligible for amortized cost measurement. The business model objective is based on holding financial assets in order to collect contractual cash flows rather than realizing cash flows from the sale of the financial assets;

- in order to be eligible for amortized cost measurement an asset must have contractual cash flow characteristics representing principle and interest;

- all other financial assets are measured at fair value on the statement of financial position;

- an entity can elect on initial recognition to present the fair value changes on an equity investment that is not held for trading directly in other comprehensive income ("OCI"). The dividends on investments for which this election is made must be recognized in net income and comprehensive income for the year but gains and losses are not removed from OCI when the equity investment is disposed; and

- if a financial asset is eligible for amortized cost measurement an entity can elect to measure its fair value if it eliminates or significantly reduces an accounting mismatch.

The standard is effective for annual periods beginning on or after January 1, 2015. The standard is not expected to have a material impact on the Company's financial statements.

IFRS 7 *Financial Instruments: Disclosures*. This amendment to the standard provides guidance on disclosures upon initial adoption of IFRS 9. An entity is required to disclose information with respect to the fair value of reclassified financial assets and liabilities, the basis for measurement of reclassified items, the changes in carrying amount, the fair value of gains/losses that would have been recognized in profit or loss or OCI during the reporting period if the financial assets or liabilities had not been reclassified, the effective interest rate determined at the date of reclassification and the interest income/expense recognized. The amendment is effective for annual periods beginning on or after January 1, 2015. It is not expected to have a material impact on the Company's financial statements.

## 6. Financial instruments

### a) Carrying amount of financial assets

| (in thousands of dollars) | As at December 31, 2013 | As at December 31, 2012 |
|---|---|---|
| Loans and receivables | | |
| Insurance contracts | $ 3,009 | $ 8,576 |
| Net accrued premium | 14,180 | 14,102 |
| Deposits | 2,246 | 1,549 |
| Pending investment transactions | - | 7,852 |
| Other receivables | 426 | 350 |
| Total accounts receivable | 19,861 | 32,429 |
| At fair value through profit or loss | 583,666 | 555,435 |
| Cash and cash equivalents | 14,992 | 14,920 |
| Total financial assets | $ 618,519 | $ 602,784 |

### b) Financial assets at fair value through profit or loss classified as held for trading and designated as such upon initial recognition

| | As at December 31, 2013 | | |
|---|---|---|---|
| (in thousands of dollars) | Classified as at fair value through profit or loss | Designated as at fair value through profit or loss | Total |
| Debt securities | $ 432,338 | $ 58,359 | $ 490,697 |
| Common shares | 85,746 | 693 | 86,439 |
| Mutual fund common shares | 6,530 | - | 6,530 |
| Total investments | $ 524,614 | $ 59,052 | $ 583,666 |

| As at December 31, 2012 | | | | | | |
|---|---|---|---|---|---|---|
| (in thousands of dollars) | | Classified as at fair value through profit or loss | | Designated as at fair value through profit or loss | | Total |
| Debt securities | $ | 421,332 | $ | 61,518 | $ | 482,850 |
| Common shares | | 66,493 | | 606 | | 67,099 |
| Mutual fund common shares | | 5,486 | | - | | 5,486 |
| Total investments | $ | 493,311 | $ | 62,124 | $ | 555,435 |

The Company reports its income trust unit investments with common shares.

### c) Debt securities by holding

| As at December 31, 2013 | | | | | | |
|---|---|---|---|---|---|---|
| (in thousands of dollars) | | Indirectly Held | | Directly Held | | Total |
| Canadian government | $ | 18,131 | $ | 104,987 | $ | 123,118 |
| Canadian provincial | | 12,080 | | 76,733 | | 88,813 |
| Canadian municipal | | 1,306 | | - | | 1,306 |
| Corporate | | 74,163 | | 203,297 | | 277,460 |
| Total debt securities | $ | 105,680 | $ | 385,017 | $ | 490,697 |

| As at December 31, 2012 | | | | | | |
|---|---|---|---|---|---|---|
| (in thousands of dollars) | | Indirectly Held | | Directly Held | | Total |
| Canadian government | $ | 16,715 | $ | 136,523 | $ | 153,238 |
| Canadian provincial | | 13,021 | | 90,326 | | 103,347 |
| Canadian municipal | | 1,330 | | 21,403 | | 22,733 |
| Corporate | | 15,028 | | 188,504 | | 203,532 |
| Total debt securities | $ | 46,094 | $ | 436,756 | $ | 482,850 |

Investments are directly held or indirectly held through pooled funds and mutual funds. Included in indirectly-held debt securities are funds on deposit with the Fire Mutuals Guarantee Fund that are invested by the Fund in Canadian government debt securities having an estimated fair value as at December 31, 2013 of $204 (2012: $192).

The effective interest rate as at December 31, 2013 for fixed income investments is 2.3 percent (2012: 2.1 percent).

### d) Debt securities by maturity

| (in thousands of dollars) | | As at December 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| Less than one year | $ | 72,054 | $ | 40,119 |
| One to three years | | 136,089 | | 188,306 |
| Three to five years | | 145,799 | | 67,948 |
| Five to ten years | | 81,210 | | 91,444 |
| Over ten years | | 55,545 | | 95,033 |
| Total debt securities | $ | 490,697 | $ | 482,850 |

### e) Collateral pledges

The Company has pledged securities with an estimated fair value as at December 31, 2013 of $12,860 (2012: $15,424) to collateralize a standby letter of guarantee facility. The letter of guarantee facility is used to collateralize unpaid claim liabilities. At December 31, 2013 the letter of guarantee utilization is $10,287 (2012: $3,364) in Canadian dollars. The letters of guarantee are denominated in United States dollars.

### f) Financial assets recorded at fair value by the level of the fair value hierarchy

| | | As at December 31, 2013 | | |
|---|---|---|---|---|
| (in thousands of dollars) | Total | Level 1 Quoted Prices | Level 2 Observable Inputs | Level 3 Other Inputs |
| Debt securities | $ 490,697 | $ - | $ 490,697 | $ - |
| Common shares | 92,969 | 85,746 | 6,530 | 693 |
| Total | $ 583,666 | $ 85,746 | $ 497,227 | $ 693 |

| | | As at December 31, 2012 | | |
|---|---|---|---|---|
| (in thousands of dollars) | Total | Level 1 Quoted Prices | Level 2 Observable Inputs | Level 3 Other Inputs |
| Debt securities | $ 482,850 | $ - | $ 482,850 | $ - |
| Common shares | 72,585 | 66,493 | 5,486 | 606 |
| Total | $ 555,435 | $ 66,493 | $ 488,336 | $ 606 |

The following table provides a reconciliation of changes in fair value of common shares classified as Level 3 financial assets.

| (in thousands of dollars) | As at December 31, 2013 | As at December 31, 2012 |
|---|---|---|
| Balance, beginning of year | $ 606 | $ 606 |
| Unrealized gain (loss) | 87 | - |
| Balance, end of year | $ 693 | $ 606 |

The unrealized gain (loss) on Level 3 financial assets is included in investment income in the statement of comprehensive income and equity.

## g) Investment income

| | Year ended December 31, 2013 | | | | | |
|---|---|---|---|---|---|---|
| (in thousands of dollars) | | Classified as at fair value through profit or loss | | Designated as at fair value through profit or loss | | Total |
| Debt securities | | | | | | |
| Realized gains (losses) | $ | 231 | $ | 263 | $ | 494 |
| Unrealized gains (losses) | | (11,675) | | (959) | | (12,634) |
| Interest income | | 14,659 | | 126 | | 14,785 |
| Sub-total | | 3,215 | | (570) | | 2,645 |
| Common shares | | | | | | |
| Realized gains (losses) | | 3,284 | | - | | 3,284 |
| Unrealized gains (losses) | | 13,880 | | 88 | | 13,968 |
| Dividends | | 2,311 | | - | | 2,311 |
| Sub-total | | 19,475 | | 88 | | 19,563 |
| Investment expense | | 1,237 | | - | | 1,237 |
| Total | $ | 21,453 | $ | (482) | $ | 20,971 |

| | Year ended December 31, 2012 | | | | | |
|---|---|---|---|---|---|---|
| (in thousands of dollars) | | Classified as at fair value through profit or loss | | Designated as at fair value through profit or loss | | Total |
| Debt securities | | | | | | |
| Realized gains (losses) | $ | 9,007 | $ | 1,568 | $ | 10,575 |
| Unrealized gains (losses) | | (10,027) | | 13 | | (10,014) |
| Interest income | | 16,247 | | 53 | | 16,300 |
| Sub-total | | 15,227 | | 1,634 | | 16,861 |
| Common shares | | | | | | |
| Realized gains (losses) | | 1,394 | | - | | 1,394 |
| Unrealized gains (losses) | | 4,650 | | - | | 4,650 |
| Dividends | | 2,018 | | - | | 2,018 |
| Sub-total | | 8,062 | | - | | 8,062 |
| Investment expense | | 1,350 | | - | | 1,350 |
| Total | $ | 21,939 | $ | 1,634 | $ | 23,573 |

### h) Carrying amount of financial liabilities

| (in thousands of dollars) | | As at December 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| Accounts payable | | | | |
| Insurance contracts | $ | 1,338 | $ | 557 |
| Accrued net premium payable | | - | | 781 |
| Pending investment transactions | | 155 | | - |
| Other payables | | 1,044 | | 612 |
| Total financial liabilities | $ | 2,537 | $ | 1,950 |

## 7. Insurance contracts

### a) Reinsurance assets

| (in thousands of dollars) | | As at December 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| Unpaid claims | $ | 124,622 | $ | 137,469 |
| Unearned premiums | | 735 | | 832 |
| Total | $ | 125,357 | $ | 138,301 |

## b) Unpaid claims by type of contract

| | As at December 31, 2013 | | |
|---|---|---|---|
| (in thousands of dollars) | Insurance contract liabilities | Reinsurance of liabilities | Net |
| Property | $ 77,959 | $ 9,474 | $ 68,485 |
| Automobile | 275,268 | 91,146 | 184,122 |
| Liability and other | 120,038 | 24,002 | 96,036 |
| Total | $ 473,265 | $ 124,622 | $ 348,643 |

| | As at December 31, 2012 | | |
|---|---|---|---|
| (in thousands of dollars) | Insurance contract liabilities | Reinsurance of liabilities | Net |
| Property | $ 73,725 | $ 11,636 | $ 62,089 |
| Automobile | 301,138 | 95,550 | 205,588 |
| Liability and other | 125,566 | 30,283 | 95,283 |
| Total | $ 500,429 | $ 137,469 | $ 362,960 |

The Company considers property insurance contracts, which have an average settlement time for claim liabilities of approximately 1.3 years, to be short-settlement insurance contracts. The Company considers automobile and liability insurance contracts, which have an average settlement for claim liabilities of approximately 6.2 years and 5.8 years respectively, to be long-term settlement insurance contracts.

c) **Claims and adjustment expenses in the statement of comprehensive income and equity and the changes in unpaid claims recorded in the statement of financial position**

| (in thousands of dollars) | Year ended December 31, 2013 Insurance contract liabilities | Reinsurance of liabilities | Net |
|---|---|---|---|
| Unpaid claims at 1 January | $ 500,429 | $ 137,469 | $ 362,960 |
| Adjustments to claims incurred in prior accident years due to changes in assumptions | (57,195) | (18,090) | (39,105) |
| Claims incurred in the current accident year | 140,547 | 19,238 | 121,309 |
| Claims paid during the year: | | | |
| On claims incurred in prior accident years | (89,111) | (13,495) | (75,616) |
| On claims incurred in the current accident year | (21,405) | (500) | (20,905) |
| Unpaid claims at 31 December | $ 473,265 | $ 124,622 | $ 348,643 |

| (in thousands of dollars) | Year ended December 31, 2012 Insurance contract liabilities | Reinsurance of liabilities | Net |
|---|---|---|---|
| Unpaid claims at 1 January | $ 540,611 | $ 152,162 | $ 388,449 |
| Adjustments to claims incurred in prior accident years due to changes in assumptions | (52,994) | (4,839) | (48,155) |
| Claims incurred in the current accident year | 149,988 | 27,210 | 122,778 |
| Claims paid during the year: | | | |
| On claims incurred in prior accident years | (110,767) | (36,987) | (73,780) |
| On claims incurred in the current accident year | (26,409) | (77) | (26,332) |
| Unpaid claims 31 December | $ 500,429 | $ 137,469 | $ 362,960 |

### d) Unearned premiums, written premiums and earned premiums

| (in thousands of dollars) | | Insurance contract liabilities | | Reinsurance of liabilities | | Net |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2013 |
| At 1 January | $ | 16,537 | $ | 832 | $ | 15,705 |
| Premiums written in the year | | 178,958 | | 43,482 | | 135,476 |
| Premiums earned during the year | | (182,366) | | (43,579) | | (138,787) |
| At 31 December | $ | 13,129 | $ | 735 | $ | 12,394 |

| (in thousands of dollars) | | Insurance contract liabilities | | Reinsurance of liabilities | | Net |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2012 |
| At 1 January | $ | 17,575 | $ | 631 | $ | 16,944 |
| Premiums written in the year | | 185,452 | | 44,269 | | 141,183 |
| Premiums earned during the year | | (186,490) | | (44,068) | | (142,422) |
| At 31 December | $ | 16,537 | $ | 832 | $ | 15,705 |

### e) Deferred acquisition costs, unearned commissions, and commission and fees expense

| (in thousands of dollars) | | Insurance contract liabilities | | Reinsurance of liabilities | | Net |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2013 |
| At 1 January | $ | 4,695 | $ | 175 | $ | 4,520 |
| Paid or received during the year | | 12,224 | | 873 | | 11,351 |
| Incurred during the year | | (13,497) | | (824) | | (12,673) |
| At 31 December | $ | 3,422 | $ | 224 | $ | 3,198 |

| (in thousands of dollars) | | Insurance contract liabilities | | Reinsurance of liabilities | | Net |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2012 |
| At 1 January | $ | 3,965 | $ | 124 | $ | 3,841 |
| Paid or received in the year | | 16,802 | | 521 | | 16,281 |
| Incurred during the year | | (16,072) | | (470) | | (15,602) |
| At 31 December | $ | 4,695 | $ | 175 | $ | 4,520 |

## 8. Property and equipment

| (in thousands of dollars) | | Occupied Premises | | Equipment | | Total |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2013 |
| Cost | | | | | | |
| At 1 January | $ | 15,580 | $ | 5,635 | $ | 21,215 |
| Additions | | - | | 163 | | 163 |
| At 31 December | | 15,580 | | 5,798 | | 21,378 |
| Accumulated depreciation | | | | | | |
| At 1 January | | 1,344 | | 2,288 | | 3,632 |
| Additions | | 425 | | 596 | | 1,021 |
| At 31 December | | 1,769 | | 2,884 | | 4,653 |
| Carrying amount at 31 December | $ | 13,811 | $ | 2,914 | $ | 16,725 |

| (in thousands of dollars) | | Occupied Premises | | Equipment | | Total |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2012 |
| Cost | | | | | | |
| At 1 January | $ | 15,580 | $ | 5,383 | $ | 20,963 |
| Additions | | - | | 252 | | 252 |
| At 31 December | | 15,580 | | 5,635 | | 21,215 |
| Accumulated depreciation | | | | | | |
| At 1 January | | 918 | | 1,706 | | 2,624 |
| Additions | | 426 | | 582 | | 1,008 |
| At 31 December | | 1,344 | | 2,288 | | 3,632 |
| Carrying amount at 31 December | $ | 14,236 | $ | 3,347 | $ | 17,583 |

## 9. Intangible assets

| (in thousands of dollars) | | Cost | | Accumulated Amortization | | Carrying Amount |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2013 |
| At 1 January | $ | 7,126 | $ | 6,038 | $ | 1,088 |
| Additions | | 134 | | 778 | | (644) |
| At 31 December | $ | 7,260 | $ | 6,816 | $ | 444 |

| (in thousands of dollars) | | Cost | | Accumulated Amortization | | Carrying Amount |
|---|---|---|---|---|---|---|
| | | | | | | As at December 31, 2012 |
| At 1 January | $ | 6,740 | $ | 4,681 | $ | 2,059 |
| Additions | | 386 | | 1,357 | | (971) |
| At 31 December | $ | 7,126 | $ | 6,038 | $ | 1,088 |

## 10. Income taxes

### a) Deferred tax assets and deferred tax expense recognized in the statement of comprehensive income and equity

| | Year ended December 31, 2013 | | |
|---|---|---|---|
| (in thousands of dollars) | At 1 January | Recognized in income | At 31 December |
| Unpaid claims | $ 3,507 | $ (134) | $ 3,373 |
| Investments | (974) | 139 | (835) |
| Property and equipment | (623) | 49 | (574) |
| Other | 103 | - | 103 |
| Total | $ 2,013 | $ 54 | $ 2,067 |

| | Year ended December 31, 2012 | | |
|---|---|---|---|
| (in thousands of dollars) | At 1 January | Recognized in income | At 31 December |
| Unpaid claims | $ 3,593 | $ (86) | $ 3,507 |
| Investments | (1,073) | 99 | (974) |
| Property and equipment | (737) | 114 | (623) |
| Other | 97 | 6 | 103 |
| Total | $ 1,880 | $ 133 | $ 2,013 |

### b) Income tax expense compared to statutory income tax rates

| (in thousands of dollars) | As at December 31, 2013 | As at December 31, 2012 |
|---|---|---|
| Approximate statutory income tax rates | 26.50% | 26.50% |
| Income tax expense based on statutory rates | $ 12,613 | $ 17,611 |
| Adjustments to income tax expense related to: | | |
| Canadian dividend income not subject to tax | (612) | (535) |
| Non-taxable income from insuring farm risks | (3,393) | (5,075) |
| Effect of change in income tax rates | (94) | (192) |
| Other | 18 | 15 |
| Income tax expense in the statement of comprehensive income and equity | $ 8,532 | $ 11,824 |

## 11. Operating expenses

| (in thousands of dollars) | | As at December 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| Salaries and benefits | $ | 4,902 | $ | 4,001 |
| Information technology | | 1,275 | | 1,613 |
| Occupancy | | 782 | | 794 |
| Membership meetings, conventions | | 609 | | 813 |
| Office | | 732 | | 744 |
| Professional fees | | 453 | | 362 |
| Travel | | 391 | | 370 |
| Education | | 88 | | 71 |
| Other | | 533 | | 440 |
| Total | $ | 9,765 | $ | 9,208 |

## 12. Refund of premiums

The Company's by-laws provide that the Board of Directors may declare a refund of premiums to voting and participating Members in any year. In making such a determination, the Board of Directors must consider the Company's capital position at the end of the previous financial year and will consider whether current capital available is adequate for current capital needs and likely future capital needs. The Board of Directors declared a refund of premiums to voting and participating Members of $7,415 for the year ended December 31, 2013 (2012: nil).

## 13. Capital management

The Company's objectives when managing capital are to maintain sufficient capital to support claim liabilities, ensure the confidence of policyholders, provide liquidity, exceed regulatory capital measures and maximize return on capital. Capital is managed using regulatory capital measures and internal metrics and is composed of the Company's equity. Capital is managed in accordance with policies established by the Board of Directors. These policies relate to capital strength, investments, pricing and return on capital. The Company has a capital management process in place to measure and monitor its available capital and assess its adequacy on a continuous basis.

A capital stress test known as Dynamic Capital Adequacy Testing ("DCAT") is completed annually by the appointed actuary to estimate the impact on capital of possible future adverse events scenarios. These scenarios are reviewed each year to ensure appropriate risks are included in the testing process. In addition, the target, actual and forecasted capital position of the Company is subject to ongoing monitoring by management using stress and scenario analysis to ensure its adequacy.

Outwards reinsurance is used to protect the Company's capital level from large losses, including those of a catastrophic nature, which could have a detrimental impact on capital. The Company has adopted policies that specify tolerance for insurance risk retention. Once the retention limits are reached, as disclosed in note 14(a), outwards reinsurance is used to cover the excess risk.

The Company is subject to the regulatory capital requirements defined by the Financial Services Commission of Ontario ("FSCO") and the Insurance Act. FSCO has established a Minimum Capital Test Guideline ("MCT") which sets out 100 percent as the minimum and 150 percent as the supervisory target MCT standards for property/casualty insurance companies. In addition, the Company has set an internal target minimum ratio of no less than 270 percent and intends to maintain an MCT ratio of no less than 360 percent.

The following table shows the Minimum Capital Test.

| (in thousands of dollars) | | As at December 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| Total capital available | $ | 283,259 | $ | 244,179 |
| Minimum capital required | | 68,943 | | 69,611 |
| Excess of capital available over capital required | $ | 214,316 | $ | 174,568 |
| MCT ratio | | 411% | | 351% |
| Excess of capital available over capital required at 150% | $ | 94,420 | $ | 81,393 |

Total capital available and minimum capital required are determined in accordance with prescribed regulatory rules. Total capital available mostly represents equity less specific deductions for disallowed assets. Minimum capital required is calculated by categorizing assets and liabilities and applying prescribed risk factors to each category. The Company's MCT ratio was above the regulatory minimum ratio and the internal target minimum ratio during the year.

## 14. Insurance and financial risk

The Company's exposure to potential loss from financial assets and insurance contracts primarily relates to insurance risk, credit risk, liquidity risk and various market risks, including interest rate, market price fluctuation risk, and foreign currency risk. The Company manages these risks using risk management policies and practices.

### a) Insurance risk

Insurance risk is the risk that the total cost of claims and claims adjustment expenses will exceed premiums received for reinsurance coverage and can arise as a result of numerous factors including pricing risk, reserving risk and catastrophe risk.

*Pricing risk*

Pricing risk arises when actual claims experience differs from the assumptions included in pricing calculations. The Company focuses on profitable underwriting using a combination of pricing models and price adequacy monitoring tools. Reinsurance products are priced taking into account numerous factors including claims frequency and severity trends, the capital required to support the product line, and the investment income earned on that capital. The Company's pricing is designed to ensure an appropriate return on capital while also providing long term rate stability. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

*Reserving risk*

Reserving risk arises when actual claims experience differs adversely from the assumptions included in setting reserves. The establishment of the estimated liability for unpaid claims is based on known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. These factors include the Company's experience with similar cases and historical trends involving claim patterns, loss payments, pending levels of unpaid claims, product mix or concentration, claims severity and claim frequency patterns. Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and existing claims management practices, the effect of inflationary trends on future claims settlement costs, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination, since the longer the span between the incidence of a loss and the payment or settlement of the claims, the more variable the ultimate settlement amount can be. Accordingly short tail claims, such as property claims, tend to be more reasonably predictable than long term claims, such as general liability and automobile accident benefit claims that are less predictable. The Company's liability for claims is reviewed by and must be acceptable to the independent appointed actuary.

The following analysis is performed for reasonably possible movements in key assumptions with all other assumptions held constant, showing the impact on gross and net liabilities for the Company's property per risk and casualty per occurrence excess of loss insurance contracts, which comprise 83.8 percent and 81.2 percent of total gross and net claim liabilities respectively as at December 31, 2013 (2012: 86.4 percent and 84.9 percent respectively).

| | | As at December 31, 2013 | |
|---|---|---|---|
| (in thousands of dollars) | **Change in assumptions** | **Impact on gross liabilities** | **Impact on net liabilities** |
| Average number of claims incurred but not reported | +5% | $ 1,486 | $ 1,212 |
| Average incurred claims settlement cost | +5% | $ 67,490 | $ 57,568 |

| | | At as December 31, 2012 | |
|---|---|---|---|
| (in thousands of dollars) | **Change in assumptions** | **Impact on gross liabilities** | **Impact on net liabilities** |
| Average number of claims incurred but not reported | +5% | $ 1,545 | $ 1,263 |
| Average incurred claims settlement cost | +5% | $ 66,404 | $ 56,349 |

The tables below show how the Company's estimate of cumulative incurred claim cost for each accident year has changed at successive year ends and reconcile the cumulative claims to the amount appearing in the statement of financial position. An accident-year basis is considered to be most appropriate for the business written by the Company. The Company has taken advantage of the transitional rules of IFRS 4 that permit only five years of information to be disclosed upon adoption of IFRS. The claims development information disclosed will be increased from eight years to ten years.

| Cumulative incurred claim cost - gross (in thousands of dollars) | Accident Year | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Reporting Date** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** |
| At end of accident year | 136,300 | 173,129 | 172,374 | 155,367 | 167,136 | 228,694 | 149,988 | 140,547 |
| 1 year later | 138,450 | 179,486 | 199,789 | 163,861 | 155,504 | 215,586 | 135,348 | |
| 2 years later | 148,092 | 173,790 | 219,558 | 149,831 | 143,768 | 205,756 | | |
| 3 years later | 142,138 | 178,790 | 210,583 | 146,285 | 138,742 | | | |
| 4 years later | 123,427 | 165,435 | 204,190 | 141,834 | | | | |
| 5 years later | 111,538 | 159,252 | 199,593 | | | | | |
| 6 years later | 108,022 | 153,127 | | | | | | |
| 7 years later | 102,865 | | | | | | | |
| Current estimate of ultimate cost | 102,865 | 153,127 | 199,593 | 141,834 | 138,742 | 205,756 | 135,348 | 140,547 |
| Cumulative payments to date | 88,659 | 136,148 | 152,870 | 96,560 | 90,429 | 134,164 | 55,744 | 21,405 |
| Current liability | 14,206 | 16,979 | 46,723 | 45,274 | 48,313 | 71,592 | 79,604 | 119,142 |
| Liability for all prior accident years | | | | | | | | 31,432 |
| Total liability in statement of financial position | | | | | | | | 473,265 |
| Current estimate of surplus/(deficiency) | 33,435 | 20,002 | (27,219) | 13,533 | 28,394 | 22,938 | 14,640 | |
| % surplus/(deficiency) of initial gross reserve | 25% | 12% | -16% | 9% | 17% | 10% | 10% | |

| Cumulative incurred claim cost - net (in thousands of dollars) | Accident Year | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Reporting Date** | **2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** |
| At end of accident year | 124,253 | 153,668 | 158,303 | 114,493 | 115,703 | 145,165 | 122,778 | 121,309 |
| 1 year later | 124,791 | 157,489 | 182,499 | 124,328 | 106,768 | 133,070 | 110,456 | |
| 2 years later | 132,727 | 141,459 | 192,956 | 118,250 | 102,101 | 127,631 | | |
| 3 years later | 130,108 | 150,479 | 185,550 | 111,668 | 99,547 | | | |
| 4 years later | 113,880 | 145,764 | 175,819 | 109,715 | | | | |
| 5 years later | 104,638 | 139,848 | 173,749 | | | | | |
| 6 years later | 101,171 | 134,711 | | | | | | |
| 7 years later | 96,960 | | | | | | | |
| Current estimate of ultimate cost | 96,960 | 134,711 | 173,749 | 109,715 | 99,547 | 127,631 | 110,456 | 121,309 |
| Cumulative payments to date | 85,607 | 118,104 | 146,293 | 73,690 | 66,990 | 85,761 | 55,653 | 20,905 |
| Current liability | 11,353 | 16,607 | 27,456 | 36,025 | 32,557 | 41,870 | 54,803 | 100,404 |
| Liability for all prior accident years | | | | | | | | 27,568 |
| Total liability in statement of financial position | | | | | | | | 348,643 |
| Current estimate of surplus/(deficiency) | 27,293 | 18,957 | (15,446) | 4,778 | 16,156 | 17,534 | 12,322 | |
| % surplus/(deficiency) of initial net reserve | 22% | 12% | -10% | 4% | 14% | 12% | 10% | |

Under Canadian accepted actuarial practice, the valuation of unpaid claims must take into account the time value of money and include a provision for adverse deviation.

To allow for possible deterioration in experience and to increase the likelihood that the valuation of unpaid claims is adequate to pay future benefits, actuaries are required to include margins in some assumptions. A range of allowable margins is prescribed by the Canadian Institute of Actuaries relating to claim development, reinsurance recoveries, and investment income variables. The effect of the margins produces the provision for adverse deviation. The fair value of unpaid claims is calculated using the same margins for adverse deviation.

The discount rate used to determine the value of claim liabilities is based on the fair value yield of the Company's bond portfolio. Future changes in the bond portfolio could change the value of these claim liabilities by impacting the fair value yield.

The table below details the fair value of unpaid claims.

| (in thousands of dollars) | Insurance contract liabilities | Reinsurance of liabilities | Net |
|---|---|---|---|
| **As at December 31, 2013** | | | |
| Undiscounted unpaid claims | $ 471,064 | $ 127,731 | $ 343,333 |
| Effect of time value of money using a discount rate of 2.8% | (39,346) | (13,144) | (26,202) |
| Provision for adverse deviation | 41,547 | 10,035 | 31,512 |
| Total | $ 473,265 | $ 124,622 | $ 348,643 |

| (in thousands of dollars) | Insurance contract liabilities | Reinsurance of liabilities | Net |
|---|---|---|---|
| **As at December 31, 2012** | | | |
| Undiscounted unpaid claims | $ 497,644 | $ 141,038 | $ 356,606 |
| Effect of time value of money using a discount rate of 2.7% | (41,662) | (14,602) | (27,060) |
| Provision for adverse deviation | 44,447 | 11,033 | 33,414 |
| Total | $ 500,429 | $ 137,469 | $ 362,960 |

An interest rate sensitivity analysis demonstrates that a 1 percent change in interest rates as at December 31 for the next twelve-month period results in an inverse change in net unpaid claims of $10,275 (2012: $11,327).

*Catastrophe risk*

Catastrophe risk arises as property and casualty insurance companies may be exposed to large losses arising from man-made or natural catastrophes that could result in significant underwriting losses. The Company evaluates potential catastrophic events and assesses the probability of occurrence and magnitude of these events through various modelling techniques. The Company manages catastrophe exposure by factoring in levels of reinsurance protection, capital levels, and risk tolerances.

### *Reinsurance*

The Company purchases outwards reinsurance as part of its insurance risk mitigation program. However, outwards reinsurance does not relieve the Company from its primary commitments to ceding insurance companies under inwards reinsurance contracts. If any reinsurers are unable to meet their obligations under the related agreements, the Company would be liable for unrecoverable amounts. The majority of outwards reinsurance contracts purchased by the Company provide coverage for a one-year term and are negotiated annually. Outwards reinsurance requirements are tendered on a regular basis to ensure that the best possible price is obtained. The availability and cost of outwards reinsurance are subject to prevailing market conditions, both in terms of price and available capacity. Market conditions are influenced by recent loss experience of the Company and of the industry in general. The Company works with well established reinsurers that have expertise in their field as well as an understanding of the Company's business. Management reviews outwards reinsurance programs to manage cost efficiency and reduce the likelihood of coverage gaps.

The Company purchases outwards reinsurance to limit its net retained exposure for any single risk or single loss occurrence ("retention") up to certain maximum per risk or per occurrence amounts ("limit"). In addition, the Company has obtained catastrophe reinsurance protection which provides coverage for the amount of loss in excess of the retention and up to the limit of coverage from an accumulation of losses resulting from a catastrophic event or series of catastrophic events, such as a severe convective storm (tornado, hail, straight-line wind, and lightning) or winter storm (snow, ice, freeze, and extra-tropical wind). The Company also purchases outwards reinsurance that provides coverage for the cumulative amount of loss resulting from all catastrophic events occurring in a year ("catastrophe net aggregate").

The table below shows the Company's per risk, per occurrence and net aggregate excess of loss reinsurance arrangements.

| | Year ended December 31, 2013 | |
|---|---|---|
| (in thousands of dollars) | **Retention** | **Limit** |
| Property per risk | $ 1,850 | $ 17,000 |
| Automobile per occurrence | 1,625 | 30,000 |
| Liability per occurrence | 1,625 | 30,000 |
| Catastrophe per occurrence | 10,000 | 195,000 |
| Catastrophe net aggregate | 20,000 | 15,000 |

| (in thousands of dollars) | | Year ended December 31, 2012<br>Retention | | Limit |
|---|---|---|---|---|
| Property per risk | $ | 1,500 | $ | 17,000 |
| Automobile per occurrence | | 1,500 | | 30,000 |
| Liability per occurrence | | 1,500 | | 30,000 |
| Catastrophe per occurrence | | 10,000 | | 170,000 |
| Catastrophe net aggregate | | 20,000 | | 15,000 |

## b) Credit risk

Credit risk is the risk that one party to a financial instrument fails to discharge an obligation and thereby causes financial loss to another party. The Company's exposure to credit risk is concentrated in two specific areas: investment assets and underwriting and operating balances, including balances recoverable and receivable from reinsurers on ceded losses (including ceded incurred losses, ceded paid losses and ceded unearned premiums).

The aggregate gross credit risk exposure at December 31 was comprised as follows:

| (in thousands of dollars) | | As at December 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| Cash and cash equivalents | $ | 14,992 | $ | 14,920 |
| Accounts receivable | | 19,449 | | 32,190 |
| Income taxes receivable | | 3,249 | | - |
| Debt securities | | 490,697 | | 482,850 |
| Recoverable from reinsurers | | 125,357 | | 138,301 |
| Total | $ | 653,744 | $ | 668,261 |

*Investments in debt instruments*

The Company monitors concentration and credit quality risk through policies to limit and monitor its exposure to individual issuers or related groups, with the exception of Canadian government bonds, as well as through ongoing review of the credit ratings of issuers held in the securities portfolio. The Company limits its investment exposure to any one corporate issuer or related group to less than 10 percent of the Company's investments. No more than 10 percent of the debt security portfolio may be held in instruments with a non-investment grade financial strength rating assigned by a recognized rating agency. The table below shows debt securities by financial strength rating.

| (in thousands of dollars) | | As at December 31, 2013 | | As at December 31, 2012 |
|---|---|---|---|---|
| Government grade | $ | 213,237 | $ | 279,320 |
| Investment grade | | 248,551 | | 184,119 |
| Non-investment grade | | 28,909 | | 19,411 |
| Total | $ | 490,697 | $ | 482,850 |

The Company follows industry practice for designating debt securities as government grade, investment grade, and non-investment grade.

- Government grade comprises: obligations of Canadian federal, provincial, territorial and municipal governments; obligations of agents of Canadian federal, provincial, territorial and municipal governments whose obligations are by virtue of their enabling legislation direct obligations of the parent government; and obligations backed by a government-grade guarantor.
- Investment grade comprises obligations with a financial strength rating of "A-" or higher.
- Non-investment grade comprises obligations with a financial strength rating of "BBB" or lower and unrated obligations.

*Recoverable from reinsurers and accounts receivable*

The Company has a regular review process to assess the credit worthiness of reinsurers with whom it transacts business and to monitor and limit its exposure to an individual reinsurer or reinsurance group. The Company assesses the financial soundness of the reinsurers before signing any reinsurance treaties and monitors their situation on a regular basis. The financial analysis and monitoring performed by the Company's reinsurance broker is also considered. In addition, the Company has minimum rating requirements for its reinsurers. Internal guidelines generally require participating reinsurers to have an "A-" or higher financial strength rating assigned by a recognized rating agency and to be approved by the Office of the Superintendent of Financial Institutions at inception of a reinsurance treaty.

Effective January 1, 2009, the Company entered into a Net Retained Liability Quota Share Reinsurance Agreement with a single reinsurer, which is assigned an "A" rating by recognized rating agencies and is approved by the Office of the Superintendent of Financial Institutions. The Agreement expired December 31, 2011. As at December 31, 2013, unpaid claims and unearned premiums for the Net Retained Liability Quota Share Reinsurance Agreement comprise 17.1 percent of reinsurance assets (2012: 21.8 percent).

Accounts receivable are short-term in nature and are not subject to material credit risk.

**c) Liquidity risk**

Liquidity risk is the risk that an entity will encounter difficulty in meeting cash flow commitments for obligations associated with insurance contracts, operating costs and expenses, and income tax payments. Obligations associated with insurance contracts include the payment of premiums under outwards reinsurance contracts and the payment of claims and commissions under inwards reinsurance contracts. Historically, the Company has used cash inflows from operating activities and investment activities to fund liquidity requirements. Operating activities are primarily the collection of premiums and reinsurance assets. Investment activities are primarily repayments of principal, sales of investment securities, and investment income.

The Company focuses on the stress that could be placed on liquidity requirements as a result of severe disruption or volatility in the capital markets or extreme catastrophic activity or the combination of both. The Company's liquidity management strategy is to hold cash, cash equivalents, and highly liquid, high quality short-term investment securities to meet anticipated obligations as they become due. The Company also has a highly liquid investment portfolio. The investment policy requires all investments to be in publicly traded securities that meet minimum size and trading requirements established for the DEX Universe Bond Index or the S&P/TSX Composite Index.

## d) Market risk

Market risk is the risk of loss from adverse changes in market rates and prices, such as interest rates, the trading price of equity and other securities, credit spreads and foreign currency exchange rates. Market risk is directly influenced by the volatility and liquidity in markets in which the underlying assets and liabilities are traded, expectations of future price and yield movements and the composition of the Company's investment portfolio.

*Interest rate risk*

Fluctuations in interest rates have a direct impact on the market valuation of the Company's fixed income securities portfolio. As interest rates rise, the market value of fixed income securities portfolios declines and, conversely, as interest rates decline, the market value of fixed income securities portfolios rises. The Company's interest rate risk management strategy is to position its fixed income securities portfolio based on its view of future interest rates and the yield curve, balanced with liquidity requirements. The Company may reposition the portfolio in response to changes in the rate environment.

It is estimated that an immediate hypothetical 100 basis point increase or decrease in interest rates, with all other variables held constant, would result in an increase or decrease of $20,837 (2012: $25,960) in the fair value of the Company's fixed income portfolio.

*Market price fluctuations*

The Company's investment portfolios are managed through the services of third party professional investment management firms with a long term, value-oriented investment philosophy emphasizing downside protection. The Company has policies to limit and monitor its individual issue exposures and aggregate equity exposure.

As at December 31, 2013, management estimates that a 10 percent increase or decrease in equity prices, with all other variables held constant, would result in an increase or decrease of $9,297 (2012: $7,259) in the fair value of the Company's equity investment portfolio.

*Foreign currency risk*

Foreign currency risk is the risk that the fair value or cash flows of a financial instrument or insurance contract will fluctuate because of changes in exchange rates and produce an adverse effect on earnings when measured in a company's functional currency.

A portion of the Company's inwards reinsurance contracts are denominated in United States dollars. For the year ended December 31, 2013, inwards reinsurance contracts denominated in United States dollars were $25,251 USD (2012: $23,815 USD).

Net exposure to United States dollar denominated amounts (in United States dollars) included in the statement of financial position as at December 31 is:

| (in thousands of dollars) | As at December 31, 2013 | As at December 31, 2012 |
|---|---|---|
| Cash | $ 126 | $ 486 |
| Accounts receivable | 2,174 | 1,565 |
| Investments | 14,368 | 15,329 |
| Unpaid claims | (21,540) | (18,696) |
| Total | $ (4,872) | $ (1,316) |

## 15. Pension plan

Substantially all employees participate in a multi-employer pension plan that is a money purchase plan with a defined benefit option available to eligible employees at retirement. The amount of the retirement benefit to be received by an employee is based on the employee's length of service and final average earnings. The plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities. The information provided to the Company by the plan administrators in accordance with the plan agreement is insufficient to consistently and reliably allocate the obligation, plan assets and cost to individual entities participating in the plan. The plan is therefore accounted for as if it were a defined contribution plan.

The plan is funded by employee and employer contributions. Current contributions are the amount required for plan service costs and the normal cost of the benefits currently accruing in accordance with the provisions of the plan, based upon the advice of the plan actuary, less the employee contributions. Current contributions are expressed as a percent of pensionable earnings of participating employees. Employers must also make contributions to provide for the amortization of any unfunded liability, experience deficiency, or solvency deficiency with respect to benefits previously accrued pursuant to the requirements of the Pension Benefit Act.

For the year ended December 31, 2013, the Company included $432 (2012: $428) for current contributions in operating expenses in the statement of comprehensive income and equity. Expected current contributions to the plan for the next annual reporting period are $571. The Company's proportion of the total current contributions to the plan for the year ended December 31, 2013 is 10.8% (2012: 12.0%).

The most recent valuation of the plan filed under the Pension Benefit Act was as at December 31, 2010 and shows that on a going-concern basis, the actuarial value of assets exceeds the actuarial value of liabilities by $4,187 and that the plan had a solvency deficiency of $3,344. The plan established a schedule of contributions with the participating employers in the plan to reduce the solvency deficiency. The Company's contribution under the schedule of contributions for the year ended December 31, 2013 is $893 (2012: nil).

The plan obtained a projected valuation of the solvency position as at December 31, 2013. This valuation indicates a solvency surplus of $700. The plan did not obtain a projected valuation of the actuarial assets and liabilities on a going-concern basis. The plan is only entitled to establish a schedule of contributions with the participating employers for a going-concern deficit or a solvency deficiency found in an actuarial valuation filed under the Pension Benefit Act. The Pension Benefit Act requires the plan to next file an actuarial valuation as at December 31, 2013. Historically, the Company has been responsible for approximately 11 percent of any schedule of contributions established by the plan to reduce a solvency deficiency.

In the event of wind up of the plan or the Company's withdrawal from the plan, the plan deficit or surplus would be allocated by the plan actuary and in accordance with the Pension Benefit Act.

## 16. Related party transactions

Compensation for the Company's Board of Directors and key management personnel is set out below.

| (in thousands of dollars) | As at December 31, 2013 | As at December 31, 2012 |
|---|---|---|
| Board of Directors | $ 249 | $ 272 |
| Key management personnel | | |
| Salaries | 1,980 | 1,871 |
| Short term employee benefits | 154 | 130 |
| Post-employment benefits | 191 | 183 |
| Total | $ 2,325 | $ 2,184 |

## 17. Contingent liabilities and guarantees

The Company can be assessed for its prescribed share of certain obligations to policyholders and claimants of insolvent insurance companies that are members of the Fire Mutuals Guarantee Fund. There is no limitation to the maximum potential future payments under the guarantee. No liability for obligations under the guarantee is carried in the Company's statement of financial position as at December 31, 2013 (2012: nil).

The Company participates in a defined benefit multi-employer pension plan that exposes the Company to a contingent liability for any shortfall in plan assets resulting from insufficient contributions including actuarial losses relating to other participating entities and any shortfall in the plan if other entities cease to participate.

The Company provides indemnification to directors and officers, to the extent permitted by law, against certain claims made against them as a result of their services to the Company. The Company has insurance coverage for these agreements.

## 18. Change in non-cash balances

The change in other non-cash balances is as follows:

| (in thousands of dollars) | Year ended December 31, 2013 | Year ended December 31, 2012 |
|---|---|---|
| Accrued investment income | $ 587 | $ (402) |
| Accounts receivable | 12,568 | (1,712) |
| Reinsurance assets | 12,944 | 14,492 |
| Income taxes receivable | (3,249) | - |
| Deferred acquisition costs | 1,273 | (730) |
| Accounts payable | 587 | (1,591) |
| Income taxes payable | (6,397) | 1,343 |
| Unpaid claims | (27,164) | (40,182) |
| Unearned premiums | (3,408) | (1,038) |
| Unearned commissions | 49 | 51 |
| Total | $ (12,210) | $ (29,769) |

# Current and Past Chairs of the Board

| Chair | From | To |
|---|---|---|
| Dan Hill | 2013 | Present |
| Doug Crockett | 2012 | 2013 |
| Bruce Caughey | 2011 | 2012 |
| John W. Leeson | 2010 | 2011 |
| Bruce Williams | 2009 | 2010 |
| Brian Bessey | 2008 | 2009 |
| Joe Facey | 2007 | 2008 |
| Serge Gauthier | 2006 | 2007 |
| Michael O'Shea | 2005 | 2006 |
| Kathryn Adie | 2004 | 2005 |
| Earl Harder | 2003 | 2004 |
| Philip Brett | 2002 | 2003 |
| Terry Malcolm | 2001 | 2002 |
| John McIntosh | 2000 | 2001 |
| Gerald Brown | 1999 | 2000 |
| Douglas Winer | 1998 | 1999 |
| Ronald Perry | 1997 | 1998 |

| Chair | From | To |
|---|---|---|
| Carl Turnbull | 1996 | 1997 |
| James Pinnock | 1995 | 1996 |
| Brian Fisher | 1994 | 1995 |
| Edward Pellow | 1993 | 1994 |
| Vern Inglis | 1992 | 1993 |
| Gordon Johnson | 1991 | 1992 |
| Donald Mylrea | 1989 | 1991 |
| Albert McArthur | 1987 | 1989 |
| Fred Legg | 1985 | 1987 |
| John Harper | 1983 | 1985 |
| Emory Knill | 1981 | 1983 |
| William Weir | 1979 | 1981 |
| K. Max Forsythe | 1977 | 1979 |
| Willard Shaw | 1975 | 1977 |
| Delmar Cobban | 1973 | 1975 |
| J. Stan Mitchell | 1965 | 1973 |
| Fred M. Fletcher | 1959 | 1965 |

# Current and Past Presidents

| President | From | To |
|---|---|---|
| G.S. (Steve) Smith | 2003 | Present |
| John A. Harper | 1987 | 2003 |
| Gerald M. Snyder | 1980 | 1986 |
| Bruce Bird | 1974 | 1979 |
| H. H. McFadden | 1959 | 1973 |

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