Gore Mutual
Insurance Company

# 2016 Annual Report

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GORE MUTUAL
GO FORWARD

# DIRECTORS' REPORT

Dear Mutual Members,

We are pleased to report that it has been another very successful year for Gore Mutual. Notwithstanding historic catastrophic events and an unprecedented pace of change in our industry, we exceeded our targets and continued to focus our efforts on strengthening our company through our people, our business partners, and by deploying innovative business solutions.

## YEAR IN REVIEW

Below are the highlights of some of our achievements during 2016.

### Financial Achievements

- Our revenues increased by 6% to $410 million.
- We achieved an underwriting profit of $14 million with a combined ratio of 97.3%.
- We achieved net income of $30 million and comprehensive income of $38M.
- Our return on surplus on a net income basis was 10.8%.
- Our return on surplus on a comprehensive income basis was 13.7%. These returns reflect a combination of profitable underwriting results and strong investment returns.
- We achieved a significant milestone with total assets surpassing $1 billion during 2016.
- Our Minimum Capital Test (MCT) ratio was 272% at year-end.

### Company Achievements

- We reaffirmed our commitment to remain a mutual company, preserving our proud history and confidence in our value proposition.
- We modernized our mutual membership system, which qualified long-standing policyholders for membership and increased our member engagement. We welcome all new members reading this letter.
- We refreshed and revitalized our brand, positioning us as an ambitious modern mutual company, building on our core strengths with a forward-looking strategy focused on the future.
- Building on our strategic focus on business intelligence and analytics, we rolled out our *confident pricing* for auto, positioning us to compete on a more sophisticated level. We also delivered on our first phase of overland water coverage for Ontario.
- Our digital capability received a lot of notice, with our new digital brand uBiz garnering much attention throughout the year. BrokerLift, our digital investment, gained recognition and traction in the broker community. We partnered with InsureActive to round out our investment in digital solutions, in partnership with our brokers. We received a Celent Model Insurer award for digital and omni-channel solutions.

- We had a strong presence at the Insurance Brokers Association of Ontario convention, with high visibility and engagement throughout the event with our broker partners.

- St. Clair Insurance Brokers (wholly owned by Gore Mutual) achieved significant growth with two acquisitions in 2016.

- Our Claims team demonstrated its quick action, excellence and customer service focus in the aftermath of the Fort McMurray wildfire catastrophe and the Windsor/Essex County storm that resulted in a major water event.

- We were recognized by Great Places to Work Canada.

- For the 8th year in a row, we received a Top Employer designation in the Waterloo Region.

- We were presented with an Excellence in Governance award by the Governance Professionals of Canada for *Best Engagement by a Governance Team*.

**Philanthropic Achievements**

- In line with our core mutual philosophy, we gave back to the community through a donation of $550,000 to the Gore Mutual Foundation, which, in turn, granted over $700,000 in partnership with brokers to local charities supporting the communities in which we do business.
- Gore Mutual employees also gave back to the community through their strong support of local United Way campaigns along with a number of community volunteering programs. Through our new Hearts in Action program, employees donated their time to help local charities provide important services to community members in need.

**YEAR AHEAD AND OUTLOOK**

Gore Mutual has a long history in Canada spanning over 177 years and in the spirit of celebrating Canada's 150th birthday, has launched a charitable campaign called *150 Ways*. At Gore Mutual, we are focused on supporting our communities. The Gore Mutual Foundation, in collaboration with our broker partners, is donating $1 million to charitable organizations in the communities in which we do business. In addition, our employees will be volunteering their time to help local charities through our *Hearts in Action* program. All together, we will demonstrate 150 ways in which we have strengthened our communities. We launched the campaign with a $500,000 gift to the Cambridge Memorial Hospital for the construction of a new rehabilitation centre, and in June we will be announcing a new keystone charity partner.

Gore Mutual continues to demonstrate its core values in real and meaningful ways.

Gore Mutual remains financially strong, forward-focused and well positioned for the many challenges and opportunities that will face our organization in the years to come. We will continue to focus our efforts on building and strengthening our company to enable us to continue to give back to our policyholders, employees, community and other stakeholders.

We look forward to discussing further our achievements and exciting future plans for our company at our upcoming annual and general meeting of members.

Heidi Sevcik
President and Chief Executive Officer

Farouk Ahamed
Chair of the Board

Consolidated Financial Statements of

# GORE MUTUAL INSURANCE COMPANY

Year ended December 31, 2016

# MANAGEMENT'S STATEMENT ON RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements are the responsibility of management and have been prepared in conformity with International Financial Reporting Standards including the accounting requirements of the Superintendent of Financial Institutions Canada. In the opinion of management, the consolidated financial statements fairly reflect the financial position, results of operations and cash flows of Gore Mutual Insurance Company within reasonable bounds of materiality.

Preparation of financial information is an integral part of management's broader responsibilities for the ongoing operations of the Company. Management maintains an extensive system of internal accounting controls to ensure that transactions are accurately recorded on a timely basis, are properly approved and result in reliable consolidated financial statements. The adequacy of operation of the control systems is monitored on an ongoing basis by an internal audit department.

The Board of Directors is responsible for approving the consolidated financial statements. It establishes an Audit and Risk Committee, comprised of directors who are neither officers nor employees of the Company, who meet with management, the internal auditor, actuary and external auditors, all of whom have unrestricted access and the opportunity to have private meetings with the Audit and Risk Committee, to review the consolidated financial statements. The Audit and Risk Committee then submits its report to the Board of Directors recommending its approval of the consolidated financial statements.

The Office of the Superintendent of Financial Institutions Canada makes examinations and inquiries into the affairs of the Company as deemed necessary to ensure that the Company is in sound financial condition and that the interests of the policyholders are protected under the provisions of the Insurance Companies Act.

Heidi Sevcik
President and Chief Executive Officer

Andrew Taylor
Chief Financial Officer

Cambridge, Canada
February 23, 2017

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# INDEPENDENT AUDITORS' REPORT

To the Members and Directors of Gore Mutual Insurance Company

We have audited the accompanying consolidated financial statements of Gore Mutual Insurance Company, which comprise the consolidated statement of financial position as at December 31, 2016, and the consolidated statements of comprehensive income, changes in surplus and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Consolidated Financial Statements*

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

*Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated 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 entity'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 consolidated financial statements.

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

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Gore Mutual Insurance Company as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

February 23, 2017
Toronto, Canada

**APPOINTED ACTUARY'S REPORT**

To the Members and Directors of Gore Mutual Insurance Company

I have valued the policy liabilities of Gore Mutual Insurance Company for its statement of financial position at 31 December 2016 and their changes in the statement of income for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods.

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

| | |
|---|---|
| Cambridge, Canada | Pierre Bourassa |
| February 23, 2017 | Fellow, Canadian Institute of Actuaries |

# GORE MUTUAL INSURANCE COMPANY

Consolidated Statement of Financial Position
(In thousands of dollars)

December 31, 2016, with comparative information for 2015

| | 2016 | 2015 |
|---|---|---|
| **Assets** | | |
| Investments: (note 5) | | |
| Cash and cash equivalent | $ 135,999 | $ 179,536 |
| Bonds | 243,503 | 229,235 |
| Equities | 211,755 | 202,262 |
| Commercial Mortgages | 75,129 | 22,109 |
| Securities on loan | 37,751 | 38,754 |
| Other investments | 22,318 | 5,973 |
| | 726,455 | 677,869 |
| Accounts receivable: | | |
| Brokers and insureds | 115,040 | 110,107 |
| Other (note 6) | 3,361 | 2,113 |
| Accrued investment income | 1,595 | 1,900 |
| Insurance and premium taxes receivable | - | 3,479 |
| Reinsurance assets (note 8) | 53,119 | 65,122 |
| Deferred policy acquisition costs (note 7) | 42,409 | 39,719 |
| Deferred income taxes (note 13) | 3,626 | 3,464 |
| Property and equipment (note 9) | 19,727 | 18,892 |
| Intangible assets (note 10) | 40,439 | 33,090 |
| | $ 1,005,771 | $ 955,755 |
| **Liabilities and Surplus** | | |
| Liabilities: | | |
| Accounts payable and other liabilities (note 6) | $ 48,673 | $ 38,961 |
| Unearned premiums (note 11) | 210,757 | 199,234 |
| Unpaid claims and adjustment expenses (note 12) | 419,101 | 435,472 |
| Income and premium taxes payable | 8,467 | 1,847 |
| | 686,998 | 675,514 |
| Surplus: | | |
| Retained earnings | 303,288 | 273,470 |
| Accumulated other comprehensive income | 15,485 | 6,771 |
| | 318,773 | 280,241 |
| | $ 1,005,771 | $ 955,755 |

See accompanying notes to consolidated financial statements.

On behalf of the Board:

F. Ahamed

Director

Heidi Sivak

Director

# GORE MUTUAL INSURANCE COMPANY

Consolidated Statement of Comprehensive Income
(In thousands of dollars)

Year ended December 31, 2016, with comparative information for 2015

| | 2016 | 2015 |
|---|---|---|
| Gross written premiums | $ 410,539 | $ 387,416 |
| Reinsurance premiums ceded | 27,024 | 25,962 |
| Net written premiums | 383,515 | 361,454 |
| Change in gross unearned premium | (11,523) | (13,237) |
| Change in ceded unearned premium | 132 | (168) |
| Net premiums earned (note 11) | 372,124 | 348,049 |
| Other | 6,766 | 6,935 |
| | 378,890 | 354,984 |
| Underwriting expenses: | | |
| Claims and adjustment expenses, gross | 225,831 | 227,302 |
| Less ceded losses on claims | (2,221) | (14,794) |
| Claims and adjustment expenses, net | 223,610 | 212,508 |
| Commissions | 79,601 | 71,435 |
| Premium taxes | 13,555 | 12,614 |
| Operating (note 15) | 47,772 | 42,531 |
| Mutual policyholders' premium rebates | 192 | 188 |
| | 364,730 | 339,276 |
| Underwriting income | 14,160 | 15,708 |
| Net investment income: | | |
| Interest and dividends | 13,256 | 14,123 |
| Gain (loss) on investments | 11,318 | (672) |
| | 24,574 | 13,451 |
| Donation to Gore Mutual Insurance Company Foundation | 550 | 300 |
| Income before income taxes | 38,184 | 28,859 |
| Income taxes: (note 13) | | |
| Current | 7,966 | 6,731 |
| Deferred (recovery) | 400 | (363) |
| | 8,366 | 6,368 |
| Net income | 29,818 | 22,491 |
| Other comprehensive income (OCI), net of taxes: | | |
| Change in unrealized gains on available for sale investments | 18,611 | (9,570) |
| Reclassification to income of realized gains (losses) on investments included in income | (8,330) | 515 |
| Defined benefit plan remeasurements/actuarial losses | (1,567) | (243) |
| Total other comprehensive income (loss) | 8,714 | (9,298) |
| Total comprehensive income | $ 38,532 | $ 13,193 |

All comprehensive income is attributable to surplus. See accompanying notes to consolidated financial statements.

# GORE MUTUAL INSURANCE COMPANY

Consolidated Statement of Changes in Surplus
(In thousands of dollars)

Year ended December 31, 2016, with comparative information for 2015

| | Retained earnings | Accumulated OCI | Total |
|---|---|---|---|
| Balance, December 31, 2014 | $ 250,979 | $ 16,069 | $ 267,048 |
| Net income | 22,491 | - | 22,491 |
| Other comprehensive loss | - | (9,298) | (9,298) |
| Balance, December 31, 2015 | $ 273,470 | $ 6,771 | $ 280,241 |
| Net income | 29,818 | - | 29,818 |
| Other comprehensive income | - | 8,714 | 8,714 |
| Balance, December 31, 2016 | $ 303,288 | $ 15,485 | $ 318,773 |

See accompanying notes to consolidated financial statements.

# GORE MUTUAL INSURANCE COMPANY

Consolidated Statement of Cash Flows
(In thousands of dollars)

Year ended December 31, 2016, with comparative information for 2015

| | 2016 | 2015 |
|---|---|---|
| Premiums received | $ 376,378 | $ 354,720 |
| Fee income received | 7,472 | 7,260 |
| Investment income received | 16,993 | 20,029 |
| | 400,843 | 382,009 |
| Claims payments | (225,643) | (194,285) |
| Commission payments | (79,158) | (72,590) |
| Operating expenses | (40,831) | (35,096) |
| Mutual policyholders' premium rebates paid | (192) | (188) |
| Donation to Gore Mutual Insurance Company Foundation | (550) | (300) |
| Income, premium and other taxes paid | (17,293) | (21,722) |
| Income, premium and other taxes received | 3,647 | - |
| | (360,020) | (324,181) |
| Cash provided by operating activities | 40,823 | 57,828 |
| Investing cash inflows (outflows): | | |
| Proceeds from sale or maturity of bonds and equities | 663,113 | 524,736 |
| Purchase of investments | (733,262) | (549,916) |
| Purchase of brokerage by subsidiary | (3,732) | (6,437) |
| Purchase of property and equipment | (10,479) | (13,604) |
| | (84,360) | (45,221) |
| Increase (decrease) in cash and cash equivalents | (43,537) | 12,607 |
| Cash and cash equivalents, beginning of year | 179,536 | 166,929 |
| Cash and cash equivalents, end of year | $ 135,999 | $ 179,536 |
| Composition of cash and cash equivalents, beginning of year: | | |
| Cash | $ 119,428 | $ 99,486 |
| Cash equivalents | 60,108 | 67,443 |
| | $ 179,536 | $ 166,929 |
| Composition of cash and cash equivalents, end of year: | | |
| Cash | $ 72,739 | $ 119,428 |
| Cash equivalents | 63,260 | 60,108 |
| | $ 135,999 | $ 179,536 |

See accompanying notes to consolidated financial statements.

The Company is incorporated under the laws of Canada and is subject to the Insurance Companies Act (the "Act"). It is licensed to write all major classes of insurance other than life, in all provinces and territories in Canada, except Quebec. The Company is subject to regulation by the Office of the Superintendent of Financial Institutions Canada ("OSFI") and the Provincial Superintendents of Financial Institutions/Insurance for provinces in which the Company is licensed. The Company's registered office is located at 252 Dundas Street North, Cambridge, Ontario, N1R 5T3, Canada. The consolidated financial statements of the Company comprise the Company and its subsidiary, St. Clair Insurance Brokers Inc. (together referred to as the "Group").

## 1. Basis of presentation:

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). The accounting policies used to prepare the consolidated financial statements comply with IFRS as issued by the IASB. These consolidated financial statements were approved by the Board of Directors on February 23, 2017.

The consolidated financial statements have been prepared on a historical cost basis, except for available for sale financial assets which are measured at fair value, and accrued benefit liabilities under employee benefit plans which are recognized at the present value of the defined benefit obligation.

As a financial services company, the statement of financial position is presented on a non-classified basis. Assets and liabilities expected to be settled in greater than 12 months are disclosed in the notes to the consolidated financial statements.

The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

The preparation of consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and liabilities as at the date of the consolidated financial statements. Actual results could differ from those estimates. See Note 4 for a description of the significant judgments and estimates made by the Company.

**2. Significant accounting policies:**

The significant accounting policies used in the preparation of these consolidated financial statements are summarized below.

(a) Basis of consolidation:

The consolidated financial statements include all financial operations of Gore Mutual Insurance Company and its wholly-owned subsidiary St. Clair Insurance Brokers Inc.

(i) Business combinations:

For business acquisitions, the Company measures goodwill as the fair value of the consideration transferred less the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date.

Transaction costs, other than those associated with the issue of debt or equity securities that the Company incurred in connection with a business combination are expensed as incurred.

(ii) Subsidiaries:

Subsidiaries are entities controlled by the Company. The consolidated financial statements of the subsidiary are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of the subsidiary have been changed when necessary to align them with the policies adopted by the Company.

(iii) Transactions eliminated on consolidation:

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

(b) Financial instruments:

Financial assets are classified as fair value through profit or loss (“FVTPL”), available for sale (“AFS”), held to maturity (“HTM”), or loans and receivables based on their characteristics and purpose of their acquisition. Financial liabilities are required to be classified as FVTPL or other liabilities.

**2. Significant accounting policies (continued):**

(b) Financial instruments (continued):

The Company has classified bonds and equities, as AFS and they are measured in the balance sheet at fair value. Accounts receivable or recoverable are classified as loans and receivables and are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities and are measured at amortized cost. AFS securities are carried at fair value whereby the unrealized gains and losses are included in accumulated other comprehensive income ("AOCI") until sale or an impairment is recognized, at which point cumulative unrealized gains or losses are included in investment income. Realized gains and losses on sale and write-downs to reflect impairments in value are included in net realized gain on sales of securities.

Cash and cash equivalents are recognized at face value. Dividends and interest income from these securities are included in investment income and are recorded as they accrue. Dividend income on common and preferred shares is recorded on the ex-dividend date.

The Company accounts for all financial instruments using trade date accounting. Transaction costs are capitalized and, where applicable, amortized over the expected life of the instrument using the effective interest rate method.

Securities lending transactions are entered into on a collateralized basis. The transfer of the securities themselves is not derecognized on the statement of financial position given that the risks and rewards of ownership are not transferred from the Company to the counterparties in the course of such transactions. The securities are reported separately on the statement of financial position on the basis that counterparties may resell or re-pledge the securities during the time that the securities are in their possession.

Securities received from counterparties as collateral are not recorded on the statement of financial position given that the risks and rewards of ownership are not transferred from the counterparties to the Company in the course of such transactions.

(c) Property, equipment and intangible assets:

Land and buildings are stated at their revalued amounts, being the fair value at January 1, 2010, the date of revaluation upon initial adoption of IFRS (“deemed cost”), less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Depreciation on revalued buildings is recognized in profit or loss.

Property, equipment and intangible assets other than the Company's head office premises are stated at cost less accumulated depreciation and accumulated impairment losses.

## 2. Significant accounting policies (continued):

(c) Property, equipment and intangible assets (continued):

Depreciation is recognized so as to write off the cost or valuation of assets less their residual values over their useful lives, using the straight line method. The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period. The following are the principal annual rates used:

| | |
|---|---|
| Buildings and building renovations | 2% - 10% |
| Furniture and land improvements | 10% |
| Office equipment | 20% |
| Computer equipment and related software | 10% - 33-1/3% |
| Intangible assets – computer software | 10% - 33-1/3% |
| Leasehold improvements | lesser of useful life or remaining term of the lease |

(d) Goodwill:

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. For measurement of goodwill at initial recognition, see note 2(a)(i).

Goodwill is measured at cost less accumulated impairment losses, and is tested for indication of impairment at least annually on the basis described in accounting policy 2(g)(ii).

(e) Insurance contracts:

Insurance contracts are those contracts that have significant insurance risk at the inception of the contract. Insurance risk arises when the Company agrees to compensate a policyholder if a specified uncertain future event adversely affects the policyholder. It is defined as the possibility of paying significantly more in a scenario where the insured event occurs than when it does not occur. Any contracts not meeting the definition of an insurance contract under IFRS are classified as investment contracts, derivative contracts or service contracts, as appropriate.

(i) Deferred policy acquisition costs:

Deferred policy acquisition costs represent certain costs such as commissions and premium taxes related to the acquisition of new and renewal premiums written during the year and are expensed as the related premiums are recorded as income. The method followed in determining the deferred policy acquisition costs limits the deferral to its realizable value by giving consideration to claims and expenses expected to be incurred as premiums are earned.

**2. Significant accounting policies (continued):**

(e) Insurance contracts (continued):

(ii) Premiums earned and unearned premiums:

The Company recognizes premium income over the period covered by each individual insurance contract. Unearned premiums represent premiums written by the Company for insurance contracts which are in force at the year end and will continue into the next fiscal year.

(iii) Unpaid claims and adjustment expenses:

The provision for unpaid claims represents the amounts needed to provide for the estimated ultimate expected cost of settling claims related to insured events (both reported and unreported) that have occurred on or before each balance sheet date. The provision for adjustment expenses represents the estimated ultimate expected costs of investigating, resolving and processing these claims. Estimated recoveries of these costs from reinsurance ceded are included in assets. The computation of these provisions takes into account the time value of money using discount rates based on projected investment income from assets supporting the provisions.

The process of determining the provision for unpaid claims and adjustment expenses necessarily involves risks that the actual results will deviate from the best estimates made.

These risks vary in proportion to the length of the estimation period and the volatility of each component comprising the liabilities. To recognize the uncertainty in establishing these best estimates and to allow for possible deterioration in experience, actuaries are required to include explicit margins for adverse deviation in assumptions for asset defaults, reinvestment risk, claims development and recoverability of reinsurance balances.

All provisions are periodically reviewed and evaluated in light of emerging claim experience and changing circumstances. The resulting changes in estimates of the ultimate liability are recorded as incurred claims in the current year.

The carrying value of the provision for unpaid claims and adjustment expenses is based on the present value of expected future cash flows plus provisions for adverse deviations and is considered an indicator of fair value, as there is no ready market for the trading of insurance policies.

## 2. Significant accounting policies (continued):

(f) Reinsurance premiums ceded:

Premiums, claims and commission expenses are recorded in the statement of operations and retained earnings. Estimates of amounts recoverable from reinsurers on unpaid claims and adjustment expenses are recorded separately from estimated amounts payable to policyholders. Unearned premiums and deferred policy acquisition costs are reported gross of business ceded to reinsurers, and the reinsurers' portion of unearned premiums is recorded as an asset. The reinsurers' portion of deferred policy acquisition costs is recorded under accounts payable and other liabilities.

Amounts recoverable from reinsurers are estimated in a manner consistent with the policy liabilities associated with the reinsured policy.

(g) Impairment:

(i) Impairment of financial assets:

The Company conducts a quarterly review to identify and evaluate securities that show objective indications of possible impairment. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

Factors considered in determining whether a financial asset is impaired include a significant prolonged decline in fair value of an equity security below its cost; financial condition and near-term prospects of the issuer; and our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

Impairment losses on AFS financial assets are recognized by reclassifying losses accumulated in AOCI to income. The cumulative loss that is reclassified from AOCI to income is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss recognized previously in income. If, in a subsequent period, the fair value of an impaired AFS debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognized in income, then the impairment loss is reversed, with the amount of the reversal recognized in income. However, any subsequent recovery in fair value of an impaired AFS equity security is recognized in other comprehensive income.

**2. Significant accounting policies (continued):**

(g) Impairment (continued):

(ii) Impairment of non-financial assets:

The carrying amounts of the Company's non-financial assets are reviewed at each reporting period to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognized if the carrying amount of an asset exceeds its estimated recoverable amount. The recoverable amount of an asset is the greater of its value in use and its fair value less expected selling costs. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in income in the period in which the impairment is determined.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

The assessment of impairment of non-financial assets excludes assessment of deferred policy acquisition costs. The ability of the Company to recover its deferred policy acquisition costs is assessed as part of the Company's overall insurance liability adequacy testing. In the event that a provision for premium deficiency is required based on this test, the deferred policy acquisition cost asset is reduced with a corresponding charge recognized as change in deferred policy acquisition costs in income.

(h) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred income tax assets and liabilities are determined based on temporary differences (differences between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax liabilities and assets and they relate to income taxes imposed by the same taxation authority.

**2. Significant accounting policies (continued):**

(i) Employee benefit plans:

The Company accrues its obligations under employee defined benefit plans (including pension plans and post-retirement plans other than pensions) and the related costs, net of plan assets, as the employees render the services necessary to earn the pension and other employee future benefits.

The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance based on assets valued at market-related value, salary escalation, retirement ages of employees and expected health care costs.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in OCI. The Company determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expense related to defined benefit plans are recognized in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. The Company recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

(j) Accounting standards issued but not yet applied:

(i) IFRS 4 *Insurance Contracts* (“IFRS 4”):

The International Accounting Standards Board ("IASB") issued an exposure draft proposing changes to the accounting standard for insurance contracts in July 2010 and a re-exposure draft reflecting comments received on the initial exposure draft in June 2013. These proposals would require an insurer to measure insurance liabilities using a model focusing on the amount, timing, and uncertainty of future cash flows associated with fulfilling its insurance contracts and show the movement in the insurance contract liability due to a change in the discount rate in other comprehensive income. This proposal could materially affect the measurement of insurance contract liabilities.

**2. Significant accounting policies (continued):**

(j) Accounting standards issued but not yet applied (continued):

(i) IFRS 4 *Insurance Contracts* ("IFRS 4") (continued):

The forthcoming insurance contracts Standard is expected to be issued in the first half of 2017, in which case the expected effective date will be annual reporting periods beginning on or after January 1, 2021.

On September 12, 2016, the IASB issued amendments to IFRS 4 to address accounting mismatches and volatility that may arise in profit or loss in the period between the effective date of IFRS 9, Financial Instruments ("IFRS 9") and the forthcoming insurance contracts standard. The amendments apply in the same period in which a Company adopts IFRS 9.

The amendments introduce two approaches that may be adopted by insurers in the period between the effective date of IFRS 9 and the forthcoming insurance contracts Standard:

- overlay approach – an option for all issuers of insurance contracts to reclassify amounts between profit or loss and other comprehensive income for eligible financial assets by removing any additional accounting volatility that may arise from applying IFRS 9; and

- temporary exemption – an optional temporary exemption from IFRS 9 for companies whose activities are predominately connected with insurance. This exemption allows an entity to continue to apply existing financial instrument requirements in IAS 39 to all financial assets until the earlier of the application of the forthcoming contracts Standard; or January 1, 2021.

The Company intends to adopt the amendments to IFRS 4 in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the amendments has not yet been determined.

(ii) IFRS 9 *Financial Instruments* ("IFRS 9"):

In July 2014, the IASB published an amended version of IFRS 9 *Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement*, and includes guidance on the classification and measurement of financial instruments, impairment of financial assets, and a new general hedge accounting model. Financial asset classification is based on the cash flow characteristics and the business model in which an asset is held. The classification determines how a financial instrument is accounted for and measured. IFRS 9 also introduces a single impairment model for financial instruments not measured at fair value through profit or loss that requires recognition of expected credit losses at initial recognition of a financial instrument and the recognition of full lifetime expected credit losses if certain criteria are met. The new model for hedge accounting aligns hedge accounting with risk management activities.

**2. Significant accounting policies (continued):**

(j) Accounting standards issued but not yet applied (continued):

(ii) IFRS 9 *Financial Instruments* ("IFRS 9") (continued):

The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. Early adoption is permitted. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018 unless it adopts the temporary exemption described previously. The Company continues to assess the impact of these changes on the financial statements.

(iii) IFRS 15 *Revenue from Contracts with Customers* ("IFRS 15"):

In May 2014, the IASB issued a new standard that revises previous guidance on revenue recognition, from sources other than insurance premiums and investment income, which are unaffected. The financial reporting impact of adopting IFRS 15 is being assessed. The new standard is effective for years beginning on or after January 1, 2018.

(iv) IFRS 16 *Leases* ("IFRS 16"):

IFRS 16 was issued on January 13, 2016. The new standard will replace existing lease guidance in IFRS and related interpretations, and requires companies to bring most leases on-balance sheet. The financial reporting impact of adopting IFRS 16 is being assessed. The new standard is effective for years beginning on or after January 1, 2019.

**3. Role of the actuary and auditors:**

The actuary is appointed by the Board of Directors of the Company and is responsible for ensuring that the assumptions and methods for the valuation of the policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations and directives. The actuary is required to provide an opinion on the appropriateness of the policy liabilities at the balance sheet date to meet all policyholder obligations of the Company. The work to form that opinion includes an examination of the sufficiency and reliability of policy data and an analysis of the ability of the assets to support the policy liabilities. The actuary's report outlines the scope of the actuary's work and opinion. The actuary is also required each year to analyze the financial condition of the Company and prepare a report for the Board of Directors. The analysis tests the capital adequacy of the Company for the following three years under adverse economic and business conditions.

**3. Role of the actuary and auditors (continued):**

The external auditors have been appointed by the Members pursuant to the Act to conduct an independent and objective audit of the consolidated financial statements of the Company in accordance with Canadian generally accepted auditing standards and to report thereon to the Members. In carrying out their audit, the auditors also make use of the work of the actuary and the actuary's report on the Company's policy liabilities. The auditors' report outlines the scope of their audit and their opinion.

**4. Significant judgments and estimates:**

(a) Judgments:

Impairments on AFS financial assets:

As of each balance sheet date, the Company evaluates AFS financial assets in an unrealized loss position for significant or prolonged impairment on the basis described in accounting policy 2(g)(i).

For investments in bonds, evaluation of whether impairment has occurred is based on the Company's best estimate of the cash flows expected to be collected at the individual investment level. The Company considers all available information relevant to the collectability of the investment, including information about past events, current conditions, and reasonable and supportable forecasts. Estimating such cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments. Impairments for bonds in an unrealized loss position are deemed to exist when the Company does not expect full recovery of the amortized cost of the investment based on the estimate of cash flows expected to be collected or when the Company intends to sell the investment prior to recovery from its unrealized loss position.

For equity investments, the Company recognizes an impairment loss in the period in which it is determined that an investment has experienced significant or prolonged declines in value.

**4. Significant judgments and estimates (continued):**

(b) Estimates:

Information about assumptions and estimation uncertainties that have a risk of resulting in material adjustment within the next twelve months are as follows:

(i) Unpaid claims and adjustment expenses:

The provision for unpaid claims is valued based on Canadian accepted actuarial practices, which are designed to ensure that the Company establishes an appropriate reserve on the balance sheet to cover insured losses with respect to reported and unreported claims incurred at the end of each accounting period and adjustment expenses. The assumptions underlying the valuation of provisions for unpaid claims are reviewed and updated by the Company on an ongoing basis to reflect recent and emerging trends in experience and changes in the risk profile of the business. The estimation techniques employed by the Company in determining provisions for unpaid claims and the inherent uncertainties associated with insurance contracts are described in notes 2(e) and 12.

(ii) Employee future benefits:

Actuarial valuations of benefit liabilities for pension and other post-employment benefit plans are performed as at December 31 of each year based on the Company's assumptions on the discount rate, rate of compensation increase, retirement age, mortality and the trend in health care cost rate. The discount rate is determined by the Company based on a market-related discount rate. Other assumptions are determined with reference to long-term expectations.

**5. Investments:**

The Company utilizes the prudent person approach to asset management as required by the Act. An investment policy is in place, and its application is monitored by the Board of Directors. Diversification techniques are employed to minimize risk. Policies limit investments in any entity or group of related entities to a maximum of 5% of the Company's assets. Limitations are also placed on the quality of investments, particularly relating to investment-grade bonds.

(Tabular amounts in thousands of dollars)

## 5. Investments (continued):

The amortized costs, fair value, unrealized gain or loss and term to maturity, are summarized as follows:

| December 31, 2016 | Amortized cost | Fair value | Unrealized gain (loss) |
|---|---|---|---|
| Cash | $ 72,739 | $ 72,739 | $ - |
| Cash equivalents | 63,225 | 63,260 | 35 |
| Cash and cash equivalents | 135,964 | 135,999 | 35 |
| Bonds (including bonds held under securities lending program): | | | |
| Government of Canada: | | | |
| Due under 1 year | - | - | - |
| Due in 1 - 5 years | 97,001 | 96,868 | (133) |
| After 5 years | 9,840 | 9,843 | 3 |
| Provincial Governments: | | | |
| Due under 1 year | 190 | 177 | (13) |
| Due in 1 - 5 years | 37,622 | 37,491 | (131) |
| After 5 years | 8,551 | 8,449 | (102) |
| Municipal: | | | |
| After 5 years | - | - | - |
| Corporate: | | | |
| Due under 1 year | 16,462 | 16,621 | 159 |
| Due in 1 - 5 years | 91,351 | 91,947 | 596 |
| After 5 years | 19,945 | 19,858 | (87) |
| Total bonds | 280,962 | 281,254 | 292 |
| Commercial mortgages | 75,446 | 75,129 | (317) |
| Total commercial mortgages | 75,446 | 75,129 | (317) |
| Equities: | | | |
| Canadian common stocks | 93,737 | 123,441 | 29,704 |
| Canadian preferred stocks | 64,922 | 65,690 | 768 |
| Total Canadian equities | 158,659 | 189,131 | 30,472 |
| Foreign common stocks | 22,078 | 22,624 | 546 |
| Total foreign equities | 22,078 | 22,624 | 546 |
| Total equities | 180,737 | 211,755 | 31,018 |
| Other investments | 22,318 | 22,318 | - |
| | $ 695,427 | $ 726,455 | $ 31,028 |

(Tabular amounts in thousands of dollars)

## 5. Investments (continued):

| December 31, 2015 | Amortized cost | Fair value | Unrealized gain (loss) |
|---|---|---|---|
| Cash | $ 119,428 | $ 119,428 | $ - |
| Cash equivalents | 60,108 | 60,108 | - |
| Cash and cash equivalents | 179,536 | 179,536 | - |
| Bonds (including bonds held under securities lending program): | | | |
| Government of Canada: | | | |
| Due under 1 year | - | - | - |
| Due in 1 - 5 years | 92,673 | 93,301 | 628 |
| After 5 years | 1,297 | 1,308 | 11 |
| Provincial Governments: | | | |
| Due under 1 year | 147 | 142 | (5) |
| Due in 1 - 5 years | 47,059 | 47,449 | 390 |
| After 5 years | - | - | - |
| Municipal: | | | |
| After 5 years | - | - | - |
| Corporate: | | | |
| Due under 1 year | 16,858 | 16,931 | 73 |
| Due in 1 - 5 years | 92,232 | 93,396 | 1,164 |
| After 5 years | 15,508 | 15,462 | (46) |
| Total bonds | 265,774 | 267,989 | 2,215 |
| Commercial mortgages | 21,957 | 22,109 | 152 |
| Total commercial mortgages | 21,957 | 22,109 | 152 |
| Equities: | | | |
| Canadian common stocks | 123,615 | 136,068 | 12,453 |
| Canadian preferred stocks | 36,049 | 29,885 | (6,164) |
| Total Canadian equities | 159,664 | 165,953 | 6,289 |
| Foreign common stocks | 27,909 | 36,309 | 8,400 |
| Total foreign equities | 27,909 | 36,309 | 8,400 |
| Total equities | 187,573 | 202,262 | 14,689 |
| Other investments | 5,973 | 5,973 | - |
| | $ 660,813 | $ 677,869 | $ 17,056 |

(Tabular amounts in thousands of dollars)

## 5. Investments (continued):

Included in fixed income is $328,842,000 (2015 - $270,855,000) which is expected to settle in greater than 12 months.

Equities have no fixed maturity dates.

Actual and effective interest rates of the bond portfolio are summarized as follows:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Effective rates (% range) | Coupon rates (% range) | Effective rates (% range) | Coupon rates (% range) |
| Government of Canada | 0.72 – 1.55% | 0.50 – 4.25% | 0.48 - 1.17% | 0.75 - 4.10% |
| Canadian Provincial | 1.17 – 2.08% | 1.25 – 4.40% | 0.95 - 1.36% | 1.25 - 4.40% |
| Canadian Municipal | N/A | N/A | N/A | N/A |
| Canadian Corporate | 1.01 – 9.33% | 1.33 – 9.75% | 1.05 - 4.29% | 1.33 - 10.45% |

Investment policy and strategy have been established taking into consideration historic claims settlement patterns. Since the nature of the business is ongoing, current cash flow is utilized to settle claims and any excess cash flow is invested. Fluctuations in interest rates could have a significant impact on the market value of the bond portfolio. This could result in the need to realize gains or losses if actual claims payments differed significantly from expected and some liquidation of assets was required to meet policy obligations.

On an ongoing basis, the Company assesses the value of its equity and bond portfolios to determine if a decline in the fair value of its investments below cost is significant or prolonged. During the year, the Company wrote down $6,878,000 (2015 - $8,653,000) of equity investments that were deemed to have a significant or prolonged impairment.

(Tabular amounts in thousands of dollars)

## 5. Investments (continued):

Fair values:

The Company uses a fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value. The extent of the Company's use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2), and internal models without observable market information as inputs (Level 3) in the valuation of bond and equity investments, as well as derivatives were as follows:

| | | | | December 31, 2016 |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Equities | $ 202,152 | $ 3,555 | $ 6,048 | $ 211,755 |
| Bonds | - | 281,254 | - | 281,254 |
| Commercial Mortgages | 32,156 | - | 42,973 | 75,129 |
| Total | $ 234,308 | $ 284,809 | $ 49,021 | $ 568,138 |

The Company did not have any transfers between the Level 1, Level 2 and Level 3 categories.

| | | | | December 31, 2015 |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Equities | $ 202,262 | $ - | $ - | $ 202,262 |
| Bonds | - | 267,989 | - | 267,989 |
| Commercial Mortgages | 22,109 | - | - | 22,109 |
| Total | $ 224,371 | $ 267,989 | $ - | $ 492,360 |

The Company did not have any transfers between the Level 1 and Level 2 categories.

(Tabular amounts in thousands of dollars)

## 5. Investments (continued):

Securities lending:

The Company participates in a securities lending program through an intermediary that is a financial institution for the purpose of generating fee income. Non-cash or cash collateral, which exceeds the fair value of the loaned securities by at least 102%, is retained by the Company until the underlying securities have been returned to the Company.

The fair value of the loaned securities is monitored on a weekly basis with additional collateral obtained, if required. The market value of the loaned assets may not exceed 40% of the total invested assets. These transactions are conducted under terms that are usual and customary to security lending activities as well as requirements determined by exchanges and where a financial institution acts as an intermediary.

As at December 31, 2016, the Company had loaned AFS bonds with a fair value of $37,751,000 (2015 - $38,754,000) and has accepted eligible securities as collateral with a fair value of approximately $39,709,000 (2015 - $40,720,000).

## 6. Other assets and other liabilities:

(a) Other assets are comprised as follows:

| | 2016 | 2015 |
|---|---|---|
| Due from risk sharing pools | $ 1,106 | $ 838 |
| Prepaid assets | 2,219 | 1,155 |
| Other | 36 | 120 |
| | $ 3,361 | $ 2,113 |

Included in other assets is $127,000 (2015 - $109,000) which is due to settle in greater than 12 months.

(Tabular amounts in thousands of dollars)

## 6. Other assets and other liabilities (continued):

(b) Other liabilities are comprised as follows:

| | 2016 | 2015 |
|---|---|---|
| Employee future benefit obligations | $ 13,695 | $ 11,719 |
| Employee costs | 6,242 | 5,173 |
| Reinsurance premiums payable | 386 | 205 |
| Commissions payable | 18,243 | 15,121 |
| Sales tax payable | 3,461 | 2,894 |
| Deferred ceded policy acquisition costs | 491 | 456 |
| Other | 6,155 | 3,393 |
| | $ 48,673 | $ 38,961 |

Included in other liabilities is $14,550,000 (2015 - $12,452,000) which is due to settle in greater than 12 months.

## 7. Deferred policy acquisition costs:

Changes in deferred policy acquisition costs recorded in the statement of financial position are as follows:

| | 2016 | 2015 |
|---|---|---|
| Balance, beginning of year | $ 39,719 | $ 36,875 |
| Policy acquisition costs deferred during the year | 42,409 | 39,719 |
| Amortization recognized during the year | (39,719) | (36,875) |
| Balance, end of year | $ 42,409 | $ 39,719 |

(Tabular amounts in thousands of dollars)

## 8. Recoverable from reinsurers and reinsurance premiums ceded:

The amount recoverable from reinsurers is detailed as follows:

| | 2016 | 2015 |
|---|---|---|
| Unearned premiums | $ 1,759 | $ 1,627 |
| Unpaid claims | 48,908 | 63,246 |
| Reinsurance receivables | 2,452 | 249 |
| | $ 53,119 | $ 65,122 |

Included in the reinsurance balances above is $33,581,000 (2015 - $44,061,000) which is expected to settle in greater than 12 months.

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophe or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. While reinsurance is obtained to protect against large losses, the primary liability to the policyholder remains with the Company. Failure of reinsurers to honour their obligations could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectible. It is the policy of the Company to place reinsurance with companies registered with the Superintendent of Financial Institutions Canada. The Company monitors the financial condition of its reinsurers relying largely on information prepared by outside organizations, and monitors concentrations of credit risk to minimize its exposure to significant losses from reinsurer insolvency. As at December 31, 2016, reinsurance receivables with a carrying value of $29,190,000 (2015 - $30,458,000) were associated with a single reinsurer. Management has included a provision for credit loss as at December 31, 2016 of $172,000 relating to reinsurance recoverable (2015 - $nil).

The Company's 2016 reinsurance treaties limit the liability of the Company to a basic maximum amount of $1,650,000 on any property or liability claim. The reinsurance for property catastrophe losses has an upper limit of $410,000,000 and limits the Company's liability to $3,000,000 in respect of any single loss or series of losses arising out of a single occurrence.

The figures shown in the statement of comprehensive income are net of the following amounts relating to reinsurance ceded to other companies:

| | 2016 | 2015 |
|---|---|---|
| Net premiums earned reduced by | $ 26,892 | $ 26,130 |
| Claims incurred reduced by | 2,221 | 14,794 |
| Commissions reduced by | 1,074 | 1,367 |

(Tabular amounts in thousands of dollars)

## 9. Property and equipment:

| | Land and land improvements | Buildings and building improvements | Furniture and equipment | Computer software and equipment | Total |
|---|---|---|---|---|---|
| **Cost or deemed cost:** | | | | | |
| Balance, December 31, 2015 | $ 7,703 | $ 11,717 | $ 8,154 | $ 12,914 | $ 40,488 |
| Assets acquired on acquisition | - | - | 16 | 8 | 24 |
| Additions | 540 | 943 | 433 | 707 | 2,623 |
| Disposals | - | (21) | (22) | (14) | (57) |
| Balance, December 31, 2016 | 8,243 | 12,639 | 8,581 | 13,615 | 43,078 |
| **Accumulated depreciation:** | | | | | |
| Balance, December 31, 2015 | 869 | 3,356 | 6,392 | 10,979 | 21,596 |
| Depreciation for the year | 62 | 615 | 362 | 718 | 1,757 |
| Disposals | - | (1) | - | (1) | (2) |
| Balance, December 31, 2016 | 931 | 3,970 | 6,754 | 11,696 | 23,351 |
| **Carrying amounts:** | | | | | |
| Balance, December 31, 2015 | $ 6,834 | $ 8,361 | $ 1,762 | $ 1,935 | $ 18,892 |
| Balance, December 31, 2016 | $ 7,312 | $ 8,669 | $ 1,827 | $ 1,919 | $ 19,727 |

## 10. Intangible assets:

| | Goodwill | Computer Software | Total |
|---|---|---|---|
| **Cost:** | | | |
| Balance, December 31, 2015 | $ 10,856 | $ 48,212 | $ 59,068 |
| Assets acquired on acquisition | 3,774 | - | 3,774 |
| Acquisition – internally developed | - | 7,834 | 7,834 |
| Balance, December 31, 2016 | 14,630 | 56,046 | 70,676 |
| **Amortization:** | | | |
| Balance, December 31, 2015 | - | 25,978 | 25,978 |
| Amortization for the year | - | 4,259 | 4,259 |
| Balance, December 31, 2016 | - | 30,237 | 30,237 |
| **Carrying amounts:** | | | |
| December 31, 2015 | $ 10,856 | $ 22,234 | $ 33,090 |
| December 31, 2016 | $ 14,630 | $ 25,809 | $ 40,439 |

Goodwill acquired during 2016 related to the acquisition of two brokerages by the Company's subsidiary.

During 2016, St. Clair Insurance Brokers Inc., a wholly-owned subsidiary, acquired 100% ownership of an insurance brokerage operation. The acquisition of the brokerage operation will enable the company to grow their core business operations. The fair value of the consideration transferred on the acquisitions was $3,732,388. The fair value of the identifiable net liabilities acquired was $380 and goodwill recorded on the transactions amounted to $3,732,768.

(Tabular amounts in thousands of dollars)

## 11. Unearned premium reserve and insurance premiums:

Changes in unearned premium reserves recorded in the statement of financial position and their impact on net premiums earned are as follows:

| | 2016 | 2015 |
|---|---|---|
| Unearned premium reserves, beginning of year | $ 199,234 | $ 185,997 |
| Unearned reinsurance premium reserves, beginning of year | (1,627) | (1,795) |
| | 197,607 | 184,202 |
| Net premiums written during the year | 383,515 | 361,454 |
| Net premiums earned during the year | (372,124) | (348,049) |
| Unearned premium reserves, end of year | 210,757 | 199,234 |
| Unearned reinsurance premium reserves, end of year | (1,759) | (1,627) |
| | $ 208,998 | $ 197,607 |

## 12. Unpaid claims and adjustment expenses:

(a) Nature of unpaid claims and adjustment expenses:

The establishment of the provision for unpaid claims and adjustment expenses 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 payment patterns, loss payments, pending levels of unpaid claims, product mix or concentration, claim severity and claim frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Company's claims personnel and independent adjusters retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices including claims handling and settlement practices, the effect of inflationary trends on future claims settlement costs, investment rates of return, 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-term settlement claims such as property claims, tend to be more reasonably predictable than long-term settlement claims, such as automobile bodily injury, accident benefit claims and general liability claims.

(Tabular amounts in thousands of dollars)

**12. Unpaid claims and adjustment expenses (continued):**

(a) Nature of unpaid claims and adjustment expenses (continued):

Consequently, the establishment of the provision for unpaid claims and adjustment expenses process relies on the judgment and opinions of a large number of individuals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining the provisions necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimates made.

(b) Profile of unpaid claims and adjustment expenses and amounts recoverable from reinsurers:

| December 31, 2016 | Gross | Ceded | Net |
|---|---|---|---|
| Long-term settlement: | | | |
| Automobile | $ 319,782 | $ 38,830 | $ 280,952 |
| General liability | 65,193 | 6,699 | 58,494 |
| | 384,975 | 45,529 | 339,446 |
| Short-term settlement: | | | |
| Automobile | 2,764 | 73 | 2,691 |
| Property | 31,151 | 3,328 | 27,823 |
| Other | 211 | 150 | 61 |
| | 34,126 | 3,551 | 30,575 |
| | $ 419,101 | $ 49,080 | $ 370,021 |

| December 31, 2015 | Gross | Ceded | Net |
|---|---|---|---|
| Long-term settlement: | | | |
| Automobile | $ 348,014 | $ 53,967 | $ 294,047 |
| General liability | 62,442 | 8,040 | 54,402 |
| | 410,456 | 62,007 | 348,449 |
| Short-term settlement: | | | |
| Automobile | 1,851 | 63 | 1,788 |
| Property | 23,106 | 1,153 | 21,953 |
| Other | 59 | 23 | 36 |
| | 25,016 | 1,239 | 23,777 |
| | $ 435,472 | $ 63,246 | $ 372,226 |

Included in gross claims are $286,750,000 (2015 - $303,377,000) which is expected to be settled in greater than 12 months.

(Tabular amounts in thousands of dollars)

## 12. Unpaid claims and adjustment expenses (continued):

(c) Change in gross claims reserve:

| | 2016 | 2015 |
|---|---|---|
| Claims reserve, January 1 | $ 395,327 | $ 362,352 |
| Claims expense reserve, January 1 | 40,145 | 44,026 |
| Gross claims reserve, January 1 | 435,472 | 406,378 |
| Current year change | 233,261 | 232,893 |
| Loss reserve development (prior years) | (7,430) | (5,591) |
| Total claims incurred | 225,831 | 227,302 |
| Claims payments (current year) | 124,678 | 110,010 |
| Claims payments (prior years) | 117,524 | 88,198 |
| Total claims payments | 242,202 | 198,208 |
| Claims expense reserve, December 31 | 37,210 | 40,145 |
| Claims reserve, December 31 | 381,891 | 395,327 |
| Gross claims reserve, December 31 | $ 419,101 | $ 435,472 |

(d) Change in reinsurers’ claims reserve:

| | 2016 | 2015 |
|---|---|---|
| Reinsurers’ share in claims reserve, January 1 | $ 63,246 | $ 52,375 |
| Reinsurers’ share in total claims incurred | 2,221 | 14,794 |
| Reinsurers’ share in total claims payments | (16,387) | (3,923) |
| Reinsurers’ share in claims reserve, December 31 | $ 49,080 | $ 63,246 |
| Provision for unrecoverable | (172) | - |
| Reinsurers’ share in claims reserve, December 31 | $ 48,908 | $ 63,246 |

(e) Methodologies and assumptions:

The Company's appointed actuary completes an annual evaluation of the adequacy of policy liabilities at the end of each financial year. This evaluation includes a re-estimation of the liability for unpaid claims relating to each preceding financial year compared to the liability that was originally established.

The unpaid claims liability includes both unpaid claims and an adjustment expense provision to cover claims incurred but not settled at the end of the reporting period. The unpaid claims provision contains both individual claims estimates and an incurred but not reported (IBNR) provision.

**12. Unpaid claims and adjustment expenses (continued):**

(e) Methodologies and assumptions (continued):

The IBNR provision is intended to cover future development on both reported claims and claims that have occurred but have yet to be reported. Uncertainty exists on reported claims in that all information may not be available at the valuation date. Claims that have occurred may not be reported to the Company immediately; therefore estimates are made as to their value.

The total unpaid claims and adjustment expense provision is an estimate that is determined using a range of accepted actuarial claims projection techniques, such as the Bornhuetter-Ferguson and reported/paid claims development methods. The key assumption of the Bornhuetter-Ferguson method is that unreported claims will develop based on expected claims. The key assumption of the reported/paid claims development method is that claims recorded to date will continue to develop in a similar manner in the future. These techniques use the Company's historical claims development patterns to predict future claims development. In situations where there has been a significant change in the environment or underlying risks, the historical data is adjusted to account for expected differences.

The initial actuarial estimate of unpaid claims and adjustment expenses and related reinsurance recoverable is an undiscounted amount. This estimate is then discounted to recognize the time value of money. The discount rate applied to measure the value of net unpaid claims and adjustment expenses is based upon the market yield of assets supporting the claims liabilities. This rate could fluctuate significantly based on changes in interest rates and credit spreads. The provisions have been discounted using an interest assumption of 1.5% (2015 – 1.4%). See note 17 for information regarding the impact of interest rate changes on the provision for unpaid claims and adjustment expenses.

The discounted unpaid claims and adjustment expense provisions incorporate assumptions concerning future investment income, projected cash flows and appropriate provisions for adverse deviation (PFADs). As the estimates for unpaid claims are subject to measurement uncertainty and the variability could be material in the near term, the Company includes PFADs in its assumptions for claims development, reinsurance recoveries and future investment income. The incorporation of PFADs is in accordance with accepted actuarial practice in order to ensure that the actuarial liabilities are adequate to pay future benefits. The selected PFADs are within the ranges recommended by the Canadian Institute of Actuaries (CIA).

(Tabular amounts in thousands of dollars)

## 12. Unpaid claims and adjustment expenses (continued):

(e) Methodologies and assumptions (continued):

The following table shows the revised estimate of the prior year unpaid claims and adjustment expense provisions, net of reinsurance, relative to their original valuation as at December 31. The claims development table is presented on a discounted basis.

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|
| Valuation: | | | | | | | | | | |
| Original estimate | $ 152,802 | $ 160,682 | $ 178,689 | $ 186,764 | $ 221,436 | $ 255,672 | $ 301,225 | $ 335,425 | $ 354,002 | $ 372,226 |
| Re-estimation at December 31, 2016 | 149,709 | 153,676 | 179,876 | 187,135 | 218,679 | 221,617 | 249,286 | 280,020 | 299,705 | 341,805 |
| Claims development | 3,093 | 7,006 | (1,187) | (371) | 2,757 | 34,055 | 51,939 | 55,405 | 54,297 | 30,421 |
| 1st year | 3,789 | 4,270 | (1,330) | (4,059) | (12,927) | (5,238) | 14,481 | 17,700 | 29,592 | 30,421 |
| 2nd year | 2,244 | 2,097 | (461) | (3,630) | (4,404) | 11,427 | 14,161 | 20,168 | 24,705 | - |
| 3rd year | 347 | 1,149 | (407) | (2,131) | 4,274 | 11,964 | 14,073 | 17,537 | - | - |
| 4th year | (859) | (563) | (1,648) | 3,473 | 6,345 | 10,107 | 9,224 | - | - | - |
| 5th year | (1,366) | (1,372) | 809 | 1,972 | 6,745 | 5,795 | - | - | - | - |
| 6th year | 247 | 684 | 882 | 3,306 | 2,724 | - | - | - | - | - |
| 7th year | 101 | 90 | 1,914 | 698 | - | - | - | - | - | - |
| 8th year | (396) | 992 | (946) | - | - | - | - | - | - | - |
| 9th year | 694 | (341) | - | - | - | - | - | - | - | - |
| 10th year | (1,708) | - | - | - | - | - | - | - | - | - |
| Claims development | $ 3,093 | $ 7,006 | $ (1,187) | $ (371) | $ 2,757 | $ 34,055 | $ 51,939 | $ 55,405 | $ 54,297 | $ 30,421 |

(Tabular amounts in thousands of dollars)

## 12. Unpaid claims and adjustment expenses (continued):

(f) Changes in assumptions used in measuring insurance contracts:

Assumptions used to develop this estimate are selected by class of business and geographic location. Consideration is given to the characteristics of the risks, historical trends, the amount of data available on individual claims, inflation and any other pertinent factors. Some assumptions require a significant amount of judgment such as the expected future impacts of future judicial decisions and government legislation. The diversity of these considerations result in it not being practicable to identify and quantify all individual assumptions that are more likely than others to have a significant impact on the measurement of the Company's insurance contracts. There were no assumptions identified in the year or the preceding year as having a potential or identifiable material impact on the overall claims estimate.

(g) Structured settlements:

The Company has purchased a number of annuities with an estimated fair value of $40,253,000 in settlement of claims. These annuities have been purchased from registered Canadian life insurers with the highest claims paying ability ratings as determined by outside ratings organizations. The Company has a contingent credit risk with respect to the failure of these life insurers, with a maximum contingent credit risk applicable to any one life insurer of $13,091,000. Management has concluded that no provision for credit loss is required as at December 31, 2016.

## 13. Income taxes:

(a) The major components of income tax expense are:

| | 2016 | 2015 |
|---|---|---|
| Statement of income: | | |
| Current income tax: | | |
| Current taxes on income for the reporting period | $ 8,138 | $ 6,538 |
| Current taxes referring to previous periods | (172) | 193 |
| Amount of previously unused tax losses | - | - |
| | 7,966 | 6,731 |
| Deferred income tax: | | |
| Origination and reversal of temporary differences | 400 | (365) |
| Impact of changes in tax rates | - | 2 |
| | 400 | (363) |
| Income tax expense reported in the income statement | $ 8,366 | $ 6,368 |

(Tabular amounts in thousands of dollars)

## 13. Income taxes (continued):

(a) The major components of income tax expense are (continued):

| | 2016 | 2015 |
|---|---|---|
| Statement of other comprehensive income: | | |
| Income tax recognized in other comprehensive income: | | |
| Unrealized gain (loss) on AFS financial assets | $ 6,655 | $ (3,406) |
| Reclassification from OCI to profit or loss relating to AFS financial assets | (2,988) | 176 |
| Defined benefit plan remeasurements | (562) | (88) |
| Income tax charged directly to other comprehensive income | $ 3,105 | $ (3,318) |

(b) Reconciliation of effective tax rate:

The Company's provision for income taxes varies from the expected provision at the combined statutory rate for the following reasons:

| | 2016 | 2015 |
|---|---|---|
| Combined basic Canadian federal and provincial income tax rate | 26.4% | 26.4% |
| Income tax expense based on combined basic income tax rate | $ 10,081 | $ 7,637 |
| Increase (decrease) in taxes resulting from: | | |
| Dividend income not subject to income taxes | (1,694) | (1,552) |
| Non-deductible items | 108 | 89 |
| Other | (129) | 194 |
| Total income tax expense | $ 8,366 | $ 6,368 |

(Tabular amounts in thousands of dollars)

## 13. Income taxes (continued):

(c) Deferred taxes:

(i) Deferred tax relates to the following:

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Deferred income tax assets: | | | | |
| Policy reserves | $ | 4,892 | $ | 4,915 |
| Deferred policy acquisition costs | | 2,043 | | 2,019 |
| Employee future benefits | | 3,872 | | 3,227 |
| | | 10,807 | | 10,161 |
| Deferred income tax liabilities: | | | | |
| Loss reserves | | 830 | | 836 |
| Property and equipment and intangible assets | | 5,398 | | 4,798 |
| Deferred realized gains | | 953 | | 1,063 |
| | | 7,181 | | 6,697 |
| Net deferred tax asset | $ | 3,626 | $ | 3,464 |

(ii) Reconciliation of net deferred tax asset (liability):

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Opening balance | $ | 3,464 | $ | 3,013 |
| Tax income (expense) during the year recognized in profit or loss | | (400) | | 363 |
| Tax income during the year recognized in OCI | | 562 | | 88 |
| Closing balance | $ | 3,626 | $ | 3,464 |

## 14. Employee future benefits:

(a) 1977 Pension Plan:

(i) Plan characteristics:

Commencing January 1, 2008, the Company established a defined contribution plan for new employees. The Company's share of contributions is expensed as they are incurred. The Company's contributions totalled $916,000 for the year ended December 31, 2016 (2015 - $562,000).

(Tabular amounts in thousands of dollars)

## 14. Employee future benefits (continued):

(a) 1977 Pension Plan (continued):

(i) Plan characteristics (continued):

The defined benefit component is a contributory defined benefit pension plan covering employees hired by the Company prior to January 1, 2008. Effective January 1, 2008, new employees of the Company are enrolled in the defined contribution component of the Pension Plan. Retirement benefits are based on the length of pensionable service and the employee's highest average annual compensation over 60 consecutive months. Employees are required to contribute a percentage of their pensionable salary to the plan, with the Company providing the balance of the funding, as required, based on actuarial valuations.

(ii) Regulatory framework:

The Pension Plan is registered under the *Pension Benefits Act* of Ontario.

Under the *Pension Benefits Act* of Ontario, the employer is required to make contributions to fully finance the plan over a period of time, in order to constitute the benefits as defined by the plan provisions. The value of these benefits is determined in actuarial valuations at least once every three years or on an annual basis if the market value of assets does not exceed 85% of the liability on the solvency basis.

According to the most recent actuarial valuation for funding purposes as at December 31, 2015, the plan has a shortfall on the solvency basis. Thus, the employer is required to contribute the minimum amortization payment in addition to the residual normal cost, as shown below. The minimum amortization payment is the amount required to fund the shortfall over the periods shown below.

| | | |
|---|---|---|
| January 1, 2013 to December 31, 2017 | $ | 1,492 |
| January 1, 2018 to December 31, 2018 | | 1,416 |
| January 1, 2019 to December 31, 2021 | | 1,081 |

**14. Employee future benefits (continued):**

(b) 1987 Pension Plan for Senior Employees, the Supplemental Pension Plan for Senior Employees and the Defined Contribution Retirement Plan for Senior Employees:

(i) Plan characteristics:

Gore Mutual Insurance Company maintains the Senior Plan, a non-contributory defined benefit pension plan covering employees or officers of the Company who are designated in writing by the Company as senior employees. Retirement benefits are based on the length of pensionable service and the employee's highest average annual compensation over 36 consecutive months.

The Company also maintains the Supplemental Plan. This arrangement is a funded non-contributory defined benefit pension arrangement. It is available to all the employees enrolled in the Senior Plan. The benefits under this arrangement are based on the difference between the benefits under the Senior Plan without applying the maximum limits under the Income Tax Act and the actual benefits provided by the Senior Plan. The entire cost of the Supplemental Plan is funded by the Company. Effective January 1, 2013 new executives of the company are enrolled in the Defined Contribution Retirement Plan for Senior Employees in place of the 1987 Pension Plan and Supplemental Plan. This Plan is not registered under any of the provincial or federal pension benefits acts. The plan assets are maintained in individual Retirement Compensation Accounts which are registered with the Canada Revenue Agency.

(ii) Regulatory framework:

The 1987 Pension Plan is registered under the *Pension Benefits Act* of Ontario.

Under the *Pension Benefits Act* of Ontario, the employer is required to make contributions to fully finance the plan over a period of time, in order to constitute the benefits as defined by the plan provisions. However, the Senior Plan is considered to be a Designated Plan under the Regulations to the *Income Tax Act*. As a result, the amount of contributions that may be made are limited to those required based on a valuation of the Senior Plan using assumptions as prescribed in that section of the regulation.

Under the *Pension Benefits Act* of Ontario, the requirement for annual valuations for plans whose market value of assets does not exceed 85% of the liability on the solvency basis is not applicable to Designated Plans. Therefore, for the Senior Plan, the value of benefits is determined using actuarial valuations at least once every three years.

(Tabular amounts in thousands of dollars)

## 14. Employee future benefits (continued):

(b) 1987 Pension Plan for Senior Employees, the Supplemental Pension Plan for Senior Employees and the Defined Contribution Retirement Plan for Senior Employees (continued):

(ii) Regulatory framework (continued):

According to the most recent actuarial valuation for funding purposes as at December 31, 2015, the plan has a shortfall on both the going-concern and solvency basis. Thus under the *Pension Benefits Act* of Ontario, the employer would be required to contribute the minimum amortization payment in addition to the residual normal cost. However, as mentioned above, the Income Tax Act imposes limitations on required contributions. The minimum required and maximum permitted amortization payments in the three year period following December 31, 2013 are shown below.

| | Amortization payments | Maximum permitted amortization payments |
|---|---|---|
| January 1, 2017 to December 31, 2019 | $ 465 | $ - |
| January 1, 2020 to December 31, 2020 | $ 420 | $ - |

(c) Directors Plan:

(i) Plan characteristics:

Gore Mutual Insurance Company maintains the Directors Plan which has a defined benefit and a defined contribution component. This arrangement covers directors of the Company who are not eligible to join the Senior Plan. The defined benefit component is a non-contributory defined benefit pension plan covering members who became directors of the Company prior to January 1, 2012. Effective January 1, 2012, new directors of the Company are enrolled in the defined contribution component of the Directors Plan. Retirement benefits in the defined benefit component are based on the length of pensionable service multiplied by a flat dollar benefit.

The Directors Plan is not registered under any of the provincial or federal pension benefits acts. The plan assets for the defined benefit component of this arrangement are maintained in a Retirement Compensation Account which is registered with the Canada Revenue Agency and in a Refundable Tax account held with the Canada Revenue Agency. The plan assets for the defined contribution component are maintained in notional accounts for each member.

**14. Employee future benefits (continued):**

(d) Non-Pension Benefits Plan:

(i) Plan characteristics:

Gore Mutual Insurance Company maintains the Benefits Plan which provides post-retirement benefits coverage (health, dental and life insurance) on a covered employee's retirement. All employees hired prior to January 1, 2006 who retire after age 55 will be eligible for post-retirement benefits coverage provided that they retire from active employment from the Company and are in receipt of pension payments from the Pension Plan of the Company.

The Benefits Plan is not registered under any of the provincial or federal pension benefits acts. The benefits in this arrangement are not pre-funded.

(e) Pension plan governance:

In accordance with the *Pension Benefits Act* of Ontario and the *Income Tax Act*, Gore Mutual Insurance Company is the administrator of the plans and is ultimately responsible for all aspects of the plans, including administration, financial management, oversight and compliance with legislative requirements and plan documents. Some of the duties for which the administrator is responsible have been delegated, where appropriate, to a pension committee or third-party advisors. The administrator, directly or with delegates, has a duty to apply the knowledge and skills needed to meet governance responsibilities with respect to the plans.

(f) Funding arrangements and funding policy:

Gore Mutual Insurance Company has adopted a funding practice to make the minimum required contributions as required by law or such greater amount as the Company may deem appropriate.

(g) Risks associated with defined benefit plans:

Risks associated with this plan are similar to those of typical defined benefit plans, including market risk, interest rate risk, liquidity risk, credit risk, currency risk, and longevity risk. There are no significant risks associated with this plan that could be deemed unusual or require special disclosure.

(Tabular amounts in thousands of dollars)

## 14. Employee future benefits (continued):

(h) Duration of defined benefit obligation:

The interest rate sensitivity of the defined benefit obligation can be measured using duration. The duration also provides information on the maturity profile of the obligation. The duration of the defined benefit obligation as at December 31, 2016 is presented in the following table:

| | Pension Plan | Senior Plan | Supplemental Plan | Directors Plan | Non-Pension Benefits Plan |
|---|---|---|---|---|---|
| Membership data | Dec. 31, 2015 | Dec. 31, 2015 | Dec. 31, 2015 | Dec. 31, 2015 | Dec. 31, 2014 |
| Duration of defined benefit obligation | 17 years | 16 years | 15 years | 9 years | 17 years |

(i) Sensitivity analysis:

Reasonably possible changes as at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation as at December 31, 2016 by the amounts shown below:

| | Pension Plan | Senior Plan | Supplemental Plan | Directors Plan | Non-Pension Benefits Plan |
|---|---|---|---|---|---|
| Membership data | Dec. 31, 2015 | Dec. 31, 2015 | Dec. 31, 2015 | Dec. 31, 2015 | Dec. 31, 2014 |
| Discount rate: (+50bps) | $ (3,590) | $ (580) | $ (784) | $ (116) | $ (470) |
| Discount rate: (-50bps) | $ 3,383 | $ 625 | $ 841 | $ 122 | $ 508 |
| Salary growth: (+50bps) | $ 1,075 | $ - | $ 386 | $ - | $ - |
| Salary growth: (-50bps) | $ (1,003) | $ - | $ (368) | $ - | $ - |

Mortality Sensitivity: The effect of increasing the overall life expectancy by one year, on average, is an increase to the accrued benefit obligation of 2.8%.

(Tabular amounts in thousands of dollars)

## 14. Employee future benefits (continued):

(i) Sensitivity analysis (continued):

Post-Retirement Plan:

The sensitivity analysis of the Post-Retirement Plan at December 31, 2016 for a 1% increase and decrease in health and dental claims cost trend rates is as follows:

| | 1% Increase | 1% Decrease |
|---|---|---|
| Defined benefit obligation impact - December 31, 2016 | $ 1,307 | $ (1,002) |
| Current service and interest cost impact - for 2017 | 47 | 34 |

(j) Other information related to the Company's defined benefit plans:

Actuarial valuations of the pension plans are made periodically for accounting purposes, based on a market-related discount rate. The following table presents information related to the Company's benefit plans:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Pension benefits | Other benefits | Pension benefits | Other benefits |
| Accrued benefit obligation, end of year | $ 70,042 | $ 6,224 | $ 65,156 | $ 6,012 |
| Fair value of plan assets, end of year | 62,571 | - | 59,449 | - |
| Net accrued benefit assets (liabilities), end of year | $ (7,471) | $ (6,224) | $ (5,707) | $ (6,012) |

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Pension benefits | Other benefits | Pension benefits | Other benefits |
| Employer contributions | $ 2,828 | $ 171 | $ 3,571 | $ 149 |
| Employees' contributions | 168 | - | 177 | - |
| Benefits paid | 3,153 | 171 | 3,216 | 149 |
| Net benefit plan expense | 2,559 | 383 | 2,610 | 368 |

(Tabular amounts in thousands of dollars)

## 14. Employee future benefits (continued):

(j) Other information related to the Company's defined benefit plans (continued):

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Pension benefits | Other benefits | Pension benefits | Other benefits |
| Measurement date | December 31 | December 31 | December 31 | December 31 |
| Most recent actuarial valuation for funding purposes | 2015 | 2014 | 2013 | 2014 |
| Discount rate, beginning of year | 4.0% | 4.0% | 4.0% | 4.0% |
| Discount rate, end of year | 4.0% | 4.0% | 4.0% | 4.0% |
| Rate of compensation increase | 3.2% - 3.75% | - | 3.0 - 3.75% | - |

The assumed blended cost trend rate for health benefits at December 31 is 6.75% in 2016, reducing by 0.25% per annum to an ultimate rate of 4.75% in 2024. The assumed dental care trend rate is 3.75%.

The fair value of plan assets for the Company's pension plans is as follows:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| | Amount | Percent | Amount | Percent |
| Cash and cash equivalents | $ 6,337 | 10% | $ 5,567 | 9% |
| Debt securities | 37,867 | 61% | 36,654 | 62% |
| Equities | 18,367 | 29% | 17,228 | 29% |
| | $ 62,571 | 100% | $ 59,449 | 100% |

(Tabular amounts in thousands of dollars)

## 15. Operating expenses:

Operating expenses for the year are comprised of the following:

| | 2016 | 2015 |
|---|---|---|
| Salaries and other employee expenses | $ 37,030 | $ 33,110 |
| Audit, legal and professional fees | 1,678 | 2,393 |
| Depreciation, amortization and impairment charges | 6,014 | 5,520 |
| Inspection costs | 2,444 | 2,404 |
| Postage and courier costs | 2,533 | 2,123 |
| Data services costs | 3,690 | 3,040 |
| Building costs | 1,361 | 977 |
| Other | 6,942 | 6,001 |
| | 61,692 | 55,568 |
| Reallocation to claims and investment expenses | (13,920) | (13,037) |
| Underwriting expense | $ 47,772 | $ 42,531 |

## 16. Capital management:

Capital is comprised of the Company's surplus which includes retained earnings and accumulated other comprehensive income. As at December 31, 2016, the Company's surplus was $318,773,000 (2015 - $280,241,000) composed primarily of retained earnings of $303,288,000 (2015 - $273,740,000) and an accumulated other comprehensive income of $15,485,000 (2015 - $6,771,000). The Company's objectives when managing capital are to protect its claims paying abilities and ensure the long-term strength and stability of the organization. Senior executive management develops the capital strategy and oversees the capital management processes of the Company. Capital is managed using both regulatory capital measures and internal metrics.

Canadian property and casualty insurance companies are regulated by the Insurance Companies Act and supervised by OSFI and the Financial Services Commission of Ontario ("FSCO"). The minimum regulatory solvency ratio requirement is 150%. To measure the degree to which the Company is able to meet regulatory solvency requirements, the Appointed Actuary must present an annual report to the Audit and Risk Committee and management on the Company's current and future solvency. The Appointed Actuary tests a number of adverse scenarios which could impact the financial position of the Company. None of the scenarios tested resulted in a financial position below the regulatory guideline. As at December 31, 2016, the Company has an MCT ratio of 272% (2015 - 241%).

## 17. Financial risk management:

The Company's exposure to potential loss from financial instruments is primarily due to underwriting risk, various investment market risks, including interest rate risk and equity market fluctuation risk, foreign currency risk, derivative risk, liquidity risk, as well as credit risk.

(a) Underwriting risk:

Underwriting risk is the risk that the total cost of claims and acquisition expenses will exceed premiums received and can arise from numerous factors, including pricing risk, reserving risk, concentration of risk, catastrophic loss risk and reinsurance coverage risk. The Company's underwriting objective is to develop business within its target market which is a low to medium risk profile using a diversified independent broker network to achieve long-term underwriting profitability.

The business risk of insurance is primarily in pricing and underwriting the product, in managing investment funds, and in estimating and settling claims costs. To mitigate some of its risks, the Company purchases reinsurance to share part of the risk originally accepted in writing the premiums. The Company reinsures approximately 6.6% (2015 - 6.7%) of its premiums with external reinsurers. The Company has established risk management policies and procedures to measure and control risk. These policies and procedures are reviewed periodically by senior management, the Board of Directors, internal and external auditors and regulators.

(i) Concentration of risk:

The Company writes property and casualty insurance contracts over twelve-month durations. The most significant risks arise from natural disasters, climate change and other catastrophes. The Company has a reinsurance program to limit the exposure to catastrophic losses from any one event.

The Company has a concentration of business in automobile and property insurance in the province of Ontario and property insurance in the province of British Columbia. For the year ended December 31, 2016, automobile premiums represented 46% (2015 - 47%) and property premiums represented 54% (2015 - 53%) of gross written premiums. Of gross written premiums in 2016, Ontario accounted for 78% (2015 - 79%) and British Columbia accounted for 22% (2015 - 21%). In Ontario, automobile insurance premium rates, other than for fleet automobile, are regulated by provincial government authorities. Regulation of premium rates is based on claims and other costs of providing insurance coverage, as well as projected profit margins. Regulatory approvals can limit or reduce premium rates that can be charged, or delay the implementation of changes in rates. Accordingly, a significant portion of the Company's revenue is subject to regulatory approvals.

## 17. Financial risk management (continued):

(a) Underwriting risk (continued):

(i) Concentration of risk (continued):

Reserving risk is reduced through various internal and external control processes including: minimum reserve standards, quality assurance reviews, monthly committee review, and legal counsel. The year end provision for unpaid claims is reviewed by an independent appointed actuary who reports on the adequacy of the reserves. The work of the appointed actuary is also subject to audit and peer review.

(ii) Pricing risk:

Pricing risk arises when actual claims experience differs from the assumptions included in pricing calculations. Historically, the underwriting results of the property and casualty industry have fluctuated significantly due to the cyclicality of the insurance market. The Company focuses on profitable underwriting using a combination of experienced underwriting staff, pricing models and price adequacy monitoring tools. The Company's pricing process is designed to ensure an appropriate return on capital while also providing long-term rate stability. These factors are reviewed and adjusted regularly to ensure our prices are responsive to the current environment and competitor behaviour.

(iii) Reserving risk:

Reserving risk arises when actual ultimate paid claims and adjustment expenses are different from the estimated unpaid claims and adjustment expense reserves. Due to the amount of time between the occurrence of a loss, the actual reporting of the loss and the ultimate payment, provisions may ultimately develop differently from the assumptions made when initially estimating the provision for claims. Reserving risk includes both the risk that reserves are too low with the result that not enough reserves are provided for the payment of claims, and the risk that reserves are too high because management is overly conservative in establishing reserves. Reserving patterns are the basis of the actuarial pattern of future claims costs and inconsistent patterns can have a significant impact on the financial position of the Company. Reserve changes associated with claims of prior periods are recognized in the current period, which could have an impact on current year earnings. Claims data included in the reserving is used for product and reinsurance pricing; inaccurate reserving levels may cause delays in establishing proper pricing.

**17. Financial risk management (continued):**

(a) Underwriting risk (continued):

(iv) Catastrophic loss risk:

Catastrophic loss risk is the exposure to losses resulting from multiple claims arising out of a single catastrophic event. The Company evaluates catastrophic events and assesses the probability of occurrence and magnitude of catastrophic events through various modeling techniques and through the aggregation of limits exposed. The Company's exposure to catastrophic loss is also managed through geographic and product diversification as well as through the use of reinsurance. See note 8 for additional information relating to the Company's reinsurance treaty limits.

(v) Reinsurance risk:

The Company relies on reinsurance to manage underwriting risk; however, reinsurance does not release the Company from its primary commitments to its policyholders.

Therefore, the Company is exposed to the credit risk associated with the amounts ceded to reinsurers. The Company assesses the financial soundness of all reinsurers before signing any reinsurance treaties. In addition, the Company monitors the rating of all reinsurers on a regular basis and uses a professional reinsurance broker who advises the Company on coverage as well as the ongoing financial stability of the reinsurers. To further reduce the risk of coverage gaps, the Company purchases facultative reinsurance for risks outside of its limits profile.

(vi) Sensitivity analysis:

The Company has exposures to risks in each class of business that may develop and that could have a material impact on the Company's financial position. Risks associated with property and casualty insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The Company considers that the liability for its unpaid claims and adjustment expenses is adequate. However, actual experience will differ from the expected outcome.

To ensure that the Company has sufficient capital to withstand a variety of significant and plausible adverse event scenarios, the Company performs Dynamic Capital Adequacy Testing (DCAT) on the capital adequacy of the Company. DCAT is performed annually as required by the CIA, and is prepared by the appointed actuary. The adverse event scenarios are reviewed annually to ensure that the appropriate risks are included in the DCAT process.

**17. Financial risk management (continued):**

(a) Underwriting risk (continued):

(vi) Sensitivity analysis (continued):

Plausible adverse event scenarios used include consideration of claims frequency and severity risk, inflation risk, premium risk, reinsurance risk and investment risk. The exposure of the peril of earthquake with default of reinsurers is also applied in a stress test analysis. The most recent results indicated that the Company's future financial and capital positions are satisfactory under the assumptions applied.

(b) Credit risk:

Credit risk is the risk that one party to a financial instrument fails to discharge an obligation and causes financial loss to another party. The Company is exposed to credit risk primarily through its investment assets, balances receivable from policyholders and brokers, and balances recoverable from reinsurers on ceded losses. The total credit risk exposure at December 31, 2016 is $590,474,000 (2015 - $514,072,000), and is comprised of $152,828,000 (2015 - $142,200,000) of government bonds, $128,426,000 (2015 - $125,789,000) of corporate bonds, $75,129,000 (2015 - $22,109,000) of commercial mortgages, $22,318,000 (2015 - $5,973,000) of other investments, $115,040,000 (2015 - $110,107,000) of brokers and insureds receivables, $5,813,000 (2015 - $3,015,000) of accounts receivable, $50,667,000 (2015 - $64,873,000) of reinsurance recoverable and $40,253,000 (2015 - $40,006,000) of off balance sheet annuities from life insurers (see note 12(g)).

(i) Investment assets:

The Company's risk management strategy is to invest primarily in debt instruments of high credit quality issuers and to limit the amount of credit exposure with respect to any one issuer. The Company limits credit exposure by imposing portfolio limits on individual corporate issuers as well as limits based on credit quality.

The DBRS credit ratings of the bond portfolio at December 31, 2016 are 43% AAA, 27% AA, 16% A, and 14% BBB (2015 - 37% AAA, 33% AA, 17% A, and 13% BBB).

## 17. Financial risk management (continued):

(b) Credit risk (continued):

(ii) Reinsurance recoverables and receivables:

Credit exposure on the Company's reinsurance recoverable and receivable balances exists at December 31, 2016 to the extent that any reinsurer may not be able or willing to reimburse the Company under the terms of the relevant reinsurance arrangements. The Company has policies which limit its exposure to individual reinsurers and a regular review process to assess the creditworthiness of reinsurers with whom it transacts business.

All of the reinsurers participating in the 2016 treaty were rated A- or better based on Standard & Poor and AM Best credit ratings. For the year ended December 31, 2016, the Company has made provisions for bad debt with respect to reinsurance recoverables of $172,000 (2015 - $nil).

(c) Liquidity risk:

Liquidity risk is the risk of having insufficient cash resources to meet financial commitments and policy obligations as they fall due, without raising funds at unfavourable rates or selling assets on a forced basis.

The liquidity requirements of the Company's business have been met primarily by funds generated from operations, asset maturities and income and other returns received on securities. Cash provided from these sources is used primarily for claims and claim adjustment expense payments and operating expenses. The timing and amount of catastrophe claims are inherently unpredictable and may create increased liquidity requirements. To reduce the liquidity risk in such an event, the Company maintains a diversified policyholder base from a risk and geographical standpoint.

The Company also holds a portion of invested assets in liquid securities. At December 31, 2016, the Company has $72,739,000 (2015 - $119,428,000) of cash and $63,260,000 (2015 - $60,108,000) of short-term investments. In addition, the Company has a line of credit available in the amount of $5,000,000. The Company carefully manages the composition and duration of its fixed income portfolio with a significant portion of the portfolio being short-term in nature.

(Tabular amounts in thousands of dollars)

## 17. Financial risk management (continued):

(c) Liquidity risk (continued):

The table below summarizes the fair value by the earliest contractual maturity of the Company's bond and commercial mortgage investments.

| | Within 1 year | 1 to 5 years | 6 to 10 years | Over 10 years | Total |
|---|---|---|---|---|---|
| As at December 31, 2016: | $ 27,541 | $ 274,011 | $ 54,517 | $ 314 | $ 356,383 |
| As at December 31, 2015: | $ 19,243 | $ 245,318 | $ 25,286 | $ 251 | $ 290,098 |

The following table shows the expected payout pattern of the Company's net unpaid claim liabilities.

| | Within 1 year | 1 to 3 years | 4 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|
| As at December 31, 2016: | | | | | |
| Net unpaid claims liabilities | $ 116,852 | $ 130,064 | $ 74,357 | $ 48,748 | $ 370,021 |
| As at December 31, 2015: | | | | | |
| Net unpaid claims liabilities | $ 112,910 | $ 136,113 | $ 73,485 | $ 49,718 | $ 372,226 |

(d) Market risk:

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity market fluctuations, foreign currency exchange rates, and other relevant market rate or price changes. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying assets are traded. Below is a discussion of the Company's primary market risk exposures and how those exposures are currently managed.

(i) Interest rate risk:

Fluctuations in interest rates have a direct impact on the market valuation of the Company's fixed income securities portfolio and liability values. Short-term interest rate fluctuations will generally create unrealized gains or losses. Generally, the Company's interest and dividend investment income will be reduced during sustained periods of lower interest rates and will likely result in unrealized gains in the value of fixed income securities the Company continues to hold, as well as realized gains to the extent the relevant securities are sold.

**17. Financial risk management (continued):**

(d) Market risk (continued):

(i) Interest rate risk (continued):

During periods of rising interest rates, the market value of the Company's existing fixed income securities will generally decrease and gains on fixed income securities will likely be reduced or result in unrealized or realized losses.

Under the current accounting and actuarial standards, unpaid claims are discounted using a market yield tied to the assets backing the unpaid claim liabilities (typically the bond portfolio). To the extent that the duration of the liabilities and the duration of the supporting assets are mismatched, there is a potential for a change in the discount rate to have a favourable or unfavourable impact on net income as changes in the bond portfolio that are designated as AFS are recognized through other comprehensive income, while changes in the unpaid claim liabilities flow through the income statement.

As at December 31, 2016, management estimates that a 1% increase in interest rates would decrease the market value of the fixed income securities by $10,736,000 (2015 - $8,587,000), representing 3.0% (2015 – 3.0%) of the $356,383,000 (2015 - $290,098,000) fair value fixed income securities portfolio. Conversely, a 1% decrease in interest rates would increase the fair value of the fixed income securities by approximately the same amount.

The same 1% increase noted above would decrease the net discounted unpaid claim liabilities by $8,853,000 (2015 - $8,690,000) (net of reinsurance) representing 2.4% (2015 - 2.3%) of the $370,021,000 (2015 - $372,226,000) net discounted unpaid claim liabilities. Conversely, a 1% decrease in the interest rate would increase the net discounted unpaid claims liabilities by $5,929,000 (2015 - $5,910,000) (net of reinsurance) representing 1.6% (2015 - 1.6%) of the $370,021,000 (2015 - $372,226,000) net discounted unpaid claim liabilities.

(ii) Equity market fluctuation risk:

Fluctuations in the value of equity securities affect the level and timing of recognition of gains and losses on securities held, and cause changes in realized and unrealized gains and losses. General economic conditions, political conditions and many other factors can also adversely affect the stock markets and, consequently, the value of the equity securities the Company owns.

**17. Financial risk management (continued):**

(d) Market risk (continued):

(ii) Equity market fluctuation risk (continued):

To mitigate these risks, the Company has an investment policy which is approved by the investment committee. The policy outlines limits for each type of investment and compliance with the policy is closely monitored. The Company manages market risk through asset class diversification, policies to limit and monitor its individual issuers and aggregate equity exposure.

As all of the Company's investments are designated AFS, management estimates that a 10% increase in equity markets, with all other variables held constant, would increase OCI by $21,175,000 (2015 - $20,226,000). A 10% decrease in equity prices would have the corresponding opposite effect; lowering OCI by the same amount. Stocks comprise 29% (2015 - 30%) of the fair value of the Company's total investments.

(iii) Foreign exchange risk:

Foreign exchange risk is the possibility that changes in exchange rates produce an unintended effect on earnings and equity when measured in domestic currency. This risk is larger when assets backing liabilities are payable in one currency and are invested in financial instruments of another currency. The Company manages foreign exchange risk by holding assets in the same currency as our liabilities (Canadian dollars) and has nominal exposure to assets denominated in a foreign currency.

(iv) Derivatives risk:

Risks associated with investments in derivative securities include market risk, liquidity risk and credit risk. Although the Company's investment policy statement allows for the use of derivatives to manage risk within the portfolio, the Company does not actively use derivative instruments and, as at December 31, 2016, there are no material outstanding derivative instruments being used for this purpose.

(Tabular amounts in thousands of dollars)

## 18. Related party transactions:

The following transactions were carried out with related parties:

Key management compensation:

| | | 2016 | | 2015 |
|---|---|---|---|---|
| Salaries and other short-term employee benefits | $ | 3,331 | $ | 3,251 |
| Bonus awards | | 1,616 | | 1,554 |
| Pension benefits | | 153 | | 139 |
| | $ | 5,100 | $ | 4,944 |

Key management includes external directors and executives with responsibility for planning, directing and controlling the activities of the Company.

## 19. Comparative figures:

Certain of the comparative figures have been reclassified to conform with the presentation adopted in the current year.

## Board of Directors (as at February 23, 2017)

**Farouk Ahamed** [4]
Chair of the Board
Gore Mutual Insurance Company
President, ADF Invescap Inc.
Oakville

**Ronald D. Beaubien** [1,3,5]
Corporate Director
Waterloo

**Susan Black** [3,4,5]
Senior Vice President, People
Holt Renfrew Limited
Toronto

**Charles A. Cipolla** [3, 4]
Chair of the Board
Gore Mutual Insurance Company Foundation
Cambridge

**Joan S. Fisk** [1,2, 5]
Chair
Waterloo Wellington
Local Health Integration Network
Kitchener

**Randall J. Howard** [1,2,4]
General Partner
Verdexus inc.
Kitchener-Waterloo

**Heidi Sevcik** [4]
President and Chief Executive Officer
Gore Mutual Insurance Company
Cambridge

**Carol Hunter**
Corporate Director
Guelph

**C. Thomas LeBrun** [1,2]
Corporate Director
Cambridge

**Ian M. Lightstone** [2,3,5]
Director
MJI Global Inc.
Toronto

**Neil Parkinson**
Corporate Director
Cambridge

**Karen Wensley** [1,2,3]
President
Karen Wensley Consulting
Mississauga

### Committees

1 Audit and Risk Committee
2 Conduct Review & Governance Committee
3 Human Resources & Compensation Committee
4 Investment Committee
5 Pension Administration Committee

## OFFICERS (AS AT FEBRUARY 23, 2017)

**Heidi Sevcik**
President and Chief Executive Officer

**Andrew T. Taylor**
Chief Financial Officer

**Sean Christie**
Chief Information Officer

**Sonya Stark**
Chief Compliance Officer
VP, Corporate Affairs and
Corporate Secretary

**Catherine Leclair**
Vice President
Human Resources

**Paul Jackson**
Vice President
Sales, Marketing and Distribution

**Anna McCrindell**
Vice President
Underwriting

**Neil Weir**
Vice President
Claims

**Jamie McDougall**
Vice President
Business Intelligence and Analytics