



## Financial Statements

Prince Edward Island Mutual Insurance Company

December 31, 2016

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**MANAGEMENT RESPONSIBILITY FOR FINANCIAL REPORTING**

**DECEMBER 31, 2016**

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The accompanying financial statements and all other information contained in this annual report are the responsibility of the management of Prince Edward Island Mutual Insurance Company. The financial statements have been prepared by management in accordance with International Financial Reporting Standards and have been approved by the Board of Directors.

Preparation of financial information is an integral part of management's broader responsibilities for the ongoing operations of Prince Edward Island Mutual Insurance Company. Management maintains a system of internal accounting controls to provide reasonable assurance that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial information. Such information also includes data based on management's best estimates and judgements.

The Audit Committee and the Board of Directors review and approve the annual financial statements. In addition, the Audit Committee meets periodically with financial officers of Prince Edward Island Mutual Insurance Company and the external auditors, and reports to the Board of Directors thereon.

The accompanying financial statements have been audited by Grant Thornton LLP, authorized to practice public accounting by the Chartered Professional Accountants of Prince Edward Island, who are engaged by the Board of Directors and whose appointment was ratified at the annual meeting of the policyholders. The auditors have access to the Audit Committee, without management present, to discuss the results of their work. Their report dated February 14, 2017 expresses their unqualified opinion on the Company's 2016 financial statements.

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Terry Shea,  
CEO/Manager

Rudy Smith,  
Treasurer/CFO

# Independent auditor's report

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To the policyholders of  
Prince Edward Island Mutual Insurance Company

We have audited the accompanying financial statements of Prince Edward Island Mutual Insurance Company, which comprise the statement of financial position as at December 31, 2016, and the statement of comprehensive income, statement of members' surplus and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

## **Management's responsibility for the financial statements**

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

## **Auditor's responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 financial statements.

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

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of Prince Edward Island 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.

Summerside, Canada  
February 14, 2017

Chartered Professional Accountants

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# Prince Edward Island Mutual Insurance Company

## Statement of Financial Position

December 31

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	<u>2016</u>	<u>2015</u>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 5,679,086	\$ 5,437,774
Receivables (Note 6)	3,066,386	2,655,994
Income taxes receivable	-	339,815
Prepaid items	62,446	76,075
Deferred policy acquisition expenses	1,301,778	1,204,622
Reinsurers' share of provision for unpaid claims	268,429	484,084
Assets held for sale (Note 7)	250,050	375,095
Investments (Note 8)	59,092,732	51,002,388
Property, plant and equipment (Note 9)	4,520,786	4,710,570
Deferred income taxes (Note 12)	245,354	245,169
	<u>\$ 74,487,047</u>	<u>\$ 66,531,586</u>

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<b>LIABILITIES</b>		
Accounts payables and accrued liabilities	\$ 615,022	\$ 536,172
Income taxes payable	1,460,604	-
Provision for unpaid claims (Note 10)	8,764,040	9,331,354
Unearned premium reserve	13,113,169	11,993,403
	<u>23,952,835</u>	<u>21,860,929</u>

<b>MEMBERS' SURPLUS</b>		
Unappropriated members' surplus	48,145,863	42,971,102
Accumulated other comprehensive income	2,388,349	1,699,555
	<u>50,534,212</u>	<u>44,670,657</u>
	<u>\$ 74,487,047</u>	<u>\$ 66,531,586</u>

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

On behalf of the Board

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

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# Prince Edward Island Mutual Insurance Company

## Statement of Comprehensive Income

Year ended December 31

	2016	2015
<b>Underwriting Income</b>		
Gross premiums written	\$ 22,764,586	\$ 21,014,951
Less: reinsurance premiums ceded	(1,897,479)	(1,817,316)
Net premiums written	20,867,107	19,197,635
Less: increase in unearned premiums	(1,119,766)	(789,127)
<b>Net premiums earned</b>	<b>19,747,341</b>	<b>18,408,508</b>
<b>Direct losses incurred</b>		
Gross claims and adjustment expenses (Note 13)	10,120,629	13,974,108
Less: reinsurance recoveries	(279,401)	(394,902)
Net losses incurred	9,841,228	13,579,206
<b>Underwriting income</b>	<b>9,906,113</b>	<b>4,829,302</b>
<b>Expenses</b>		
Fees, commissions and other acquisition expenses (Note 14)	2,162,742	2,256,731
Other operating and administrative expenses (Note 15)	4,387,291	4,110,426
	<b>6,550,033</b>	<b>6,367,157</b>
<b>Net underwriting income (loss)</b>	<b>3,356,080</b>	<b>(1,537,855)</b>
<b>Investment and other income (Note 17)</b>	<b>3,244,120</b>	<b>2,991,112</b>
<b>Other expense (Note 7)</b>	<b>(125,045)</b>	<b>-</b>
<b>Income before income taxes</b>	<b>6,475,155</b>	<b>1,453,257</b>
<b>Provision for income taxes (Note 12)</b>	<b>1,300,394</b>	<b>60,098</b>
<b>Net income</b>	<b>5,174,761</b>	<b>1,393,159</b>
<b>Other comprehensive income (loss)</b>		
Items that may be classified subsequently to net income:		
Change in unrealized gain on available for sale investments	1,669,369	(648,942)
Net gain reclassified to net income	(795,043)	(565,066)
	<b>874,326</b>	<b>(1,214,008)</b>
Income tax effect	(185,532)	252,149
	<b>688,794</b>	<b>(961,859)</b>
<b>Total comprehensive income for the year</b>	<b>\$ 5,863,555</b>	<b>\$ 431,300</b>

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The accompanying notes are an integral part of these financial statements

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# Prince Edward Island Mutual Insurance Company

## Statement of Members' Surplus

December 31

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	Unappropriated Members' Surplus	Accumulated Other Comprehensive Income	Total
<b>Balance at January 1, 2015</b>	\$ 41,577,943	\$ 2,661,414	\$ 44,239,357
Net income	1,393,159	-	1,393,159
Change in unrealized gain/losses on available-for-sale investments, net of income taxes	-	(961,859)	(961,859)
<b>Balance at December 31, 2015</b>	42,971,102	1,699,555	44,670,657
Net income	5,174,761	-	5,174,761
Change in unrealized gain/losses on available-for-sale investments, net of income taxes	-	688,794	688,794
<b>Balance at December 31, 2016</b>	<b>\$ 48,145,863</b>	<b>\$ 2,388,349</b>	<b>\$ 50,534,212</b>

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

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# Prince Edward Island Mutual Insurance Company

## Statement of Cash Flows

Year ended December 31

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	<u>2016</u>	<u>2015</u>
Increase (decrease) in cash equivalents		
<b>Operating</b>		
Net income, being total comprehensive income for the year	\$ 5,863,555	\$ 431,300
Depreciation	298,651	218,295
Bond premium amortized	247,504	225,168
Gain on sale of investments	(795,043)	(565,066)
(Gain) loss on disposal of equipment	(2,955)	3,362
Impairment of assets held for sale	125,045	-
Deferred income taxes	(185)	(218,395)
Unrealized (gains) losses on investments	(688,794)	961,859
	<u>5,047,778</u>	<u>1,056,523</u>
Change in non-cash operating working capital (Note 18)	2,153,457	2,449,842
Income tax provision - comprehensive income	(185,532)	252,149
	<u>7,015,703</u>	<u>3,758,514</u>
<b>Investing</b>		
Purchase of investments	(13,781,982)	(6,219,818)
Proceeds on disposal of investments	7,113,503	7,372,386
Purchase of property, plant and equipment	(118,332)	(2,287,905)
Proceeds on disposal of property, plant and equipment	12,420	-
	<u>(6,774,391)</u>	<u>(1,135,337)</u>
<b>Net increase in cash and cash equivalents</b>	<b>241,312</b>	<b>2,623,177</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>5,437,774</b>	<b>2,814,597</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 5,679,086</b>	<b>\$ 5,437,774</b>

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

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 1. Nature of operations

The Company is incorporated without share capital under the laws of Prince Edward Island and is subject to the Prince Edward Island Insurance Act. It is licensed to write property and casualty insurance in Prince Edward Island. The Company's head office is located at 116 Walker Avenue, Summerside, Prince Edward Island.

These financial statements have been authorized for issue by the Board of Directors on February 14, 2017.

### 2. Basis of presentation

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

These financial statements were prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets.

The Company's functional and presentation currency is the Canadian dollar.

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment of complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 4.

### 3. Significant accounting policies

#### Insurance contracts

In accordance with IFRS 4, Insurance Contracts, the Company has continued to apply the accounting policies it applied in accordance with pre-changeover Canadian GAAP.

Balances arising from insurance contracts primarily include unearned premiums, provisions for unpaid claims and adjustment expenses, the reinsurer's share of provisions for unearned premiums and unpaid claims and adjustment expenses, deferred policy acquisition expenses, and salvage and subrogation recoverable.

(a) Premiums and unearned premiums

Premiums written comprise the premiums on contracts incepting in the financial year. Premiums written are stated gross of commissions' payable to agents.

The Company earns premium income evenly over the term of the insurance policy generally using the pro rata method. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums.

(b) Deferred policy acquisition expenses

Acquisition costs are those expenses such as agents' commissions, which relate directly to the acquisition of premiums. These costs are deferred and amortized over the terms of the related policies to the extent that they are considered to be recoverable from unearned premiums.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 3. Significant accounting policies (cont'd)

(c) Provisions for unpaid claims and adjustment expenses

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, changes in reported claims and for claims incurred but not reported, based on past experience and business in force. The estimates are regularly reviewed and updated, and any resulting adjustments are included in current income.

Claim liabilities are carried on an undiscounted basis.

(d) Reinsurers' share of provisions for unpaid claims and adjustment expenses

The Company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Reinsurance premiums are accounted for in the same period as the related premiums for the direct insurance business being reinsured. Reinsurance liabilities, comprised of premiums payable for the purchase of reinsurance contracts, are included in accounts payable and accrued liabilities and are recognized as an expense when due.

Expected reinsurance recoveries on unpaid claims and adjustment expenses are recognized as assets at the same time and using principles consistent with the Company's method for establishing the related liability.

(e) Refund from premium

Under the discretion of the board of directors the Company may declare a refund to its policyholders based on the premiums paid in the fiscal period. This refund is recognized as a reduction of revenue in the period for which it is declared.

### Financial instruments

The Company's financial assets are classified as held for trading, held to maturity, available for sale, or loans and receivables. Financial liabilities are classified as held for trading or other financial liabilities. Financial assets and liabilities are initially recognized at fair value with subsequent measurement based on classification. The classification depends on the purpose for which the financial instruments were acquired, their characteristics and choice where applicable.

All financial instruments are measured at fair value except for loans & receivable, held to maturity and other financial liabilities, which are measured at amortized cost using the effective interest method. Unrealized gains and losses on available for sale investments are recognized in other comprehensive income until the financial asset is derecognized or other than temporarily impaired, at which time any unrealized gains or losses are recorded in net income.

Accumulated other comprehensive income is included in the balance sheet as a separate component of equity (net of income tax) and includes net unrealized gains or losses on available for sale assets.

Fair values are based on quoted market values where available from active markets, otherwise fair values are estimated using a variety of valuation techniques and models.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 3. Significant accounting policies (cont'd)

#### Property, plant and equipment

Property, plant & equipment is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses, with the exception of land which is not depreciated. Assets under construction are not depreciated until they are available for use. Depreciation of an asset commences when it is available for use and is recognized in net income using the diminishing balance method over the estimated useful life of the assets at the following rates:

Building structure	4%
Building components	8%
Office equipment	20%
Computer equipment	30%, 45%
Vehicles	30%
Parking lots	8%

Depreciation methods, useful lives and residual values are reviewed annually and adjusted, if necessary.

#### Impairment of non-financial assets

Non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly.

Where it is not possible to estimate the recoverable amount of an individual asset, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash flows. The Company has one cash-generating unit for which impairment testing is performed.

Impairment charges are included in net income, except to the extent they reverse gains previously recognized in other comprehensive income.

#### Income taxes

Income tax expense comprises of current and deferred tax. Current tax and deferred tax are recognized in net income except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes payable in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting or taxable profit or loss.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 3. Significant accounting policies (cont'd)

The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date and are expected to apply when the liabilities / (assets) are settled / (recovered).

#### **Provisions**

Provisions are recognized for liabilities of uncertain timing or amount that have arisen as a result of past transaction, including legal, equitable or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle at the reporting date.

#### **Foreign currency translation**

Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, revenue and expense denominated in a foreign currency is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year-end date, unsettled monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at the year-end date and the related translation differences are recognized in net income. Exchange gains and losses arising on the retranslation of monetary available-for-sale financial assets are treated as a change in fair value and recognized in net income or other comprehensive income.

#### **Cash and cash equivalents**

Cash and cash equivalents comprise cash on hand together with other short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

#### **Assets held for sale**

Non-current assets are classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is met when the sale is highly probable and the asset is available for immediate sale in its present condition. For the sale to be highly probable, management must be committed to a plan to sell the asset and an active program to locate a buyer and complete the plan must have been initiated. The asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value and the sale should be expected to be completed within one year from the date of classification.

Non-current assets classified as held for sale are measured at the lower of the carrying amount and fair value less costs of disposal, with impairments recognized in the statement of income in the period measured. Non-current assets held for sale are presented in current assets and liabilities within the balance sheet. Assets held for sale are not depleted, depreciated or amortized.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 3. Significant accounting policies (cont'd)

#### **Standards, amendments and interpretations not yet effective**

Certain new standards, amendments and interpretations have been published that are mandatory for the Company's accounting periods beginning on or after January 1, 2017 or later periods that the Company has decided not to early adopt.

The Company has not yet determined the extent of the impact of the following new standards, amendments and interpretations, which have not been applied in these financial statements:

- IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets; amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The effective date of this standard is January 1, 2018.

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### 4. Critical accounting estimates and judgments

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated and based on historical experience and other IAS factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only; or in the period of the change and future periods, if the change affects both.

The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

#### **Deferred policy acquisition expenses**

Deferred policy acquisition expenses are those expenses such as agents' commissions, which relate directly to the acquisition of policies. These expenses, to the extent that they are considered recoverable, are estimated, deferred and amortized over the terms of the related policies.

#### **Provision for unpaid claims**

The estimation of the provision for unpaid claims and the related reinsurers' share are the Company's most critical accounting estimates. There are several sources of uncertainty that need to be considered by the Company in estimating the amount that will ultimately be paid on these claims. The uncertainty arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Changes in the estimate of the provisions can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, or significant changes in severity or frequency of claims from historical trends. The estimates are based on the Company's historical experience and industry experience. More details are included in Note 8.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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#### 4. Critical accounting estimates and judgments (cont'd)

##### Unearned premium reserve

The unearned premium reserve is calculated based on the estimated unexpired term of all policies of the Company in force as at December 31. The factor used to estimate the unexpired term is based on the Company's historical experience.

##### Impairment of available-for-sale investments

The Company determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in fair value below its cost. The determination of what is significant or prolonged requires judgment. In making this judgment the Company considers among other factors, the normal volatility in market price, the financial health of the investee and industry and sector performance. Had the Company considered all declines in fair value to be significant or prolonged, the Company would have suffered an additional loss of \$1,422 in its 2016 financial statements, being the transfer of the entire amount in accumulated other comprehensive income related to available-for-sale investments to net income.

##### Income taxes

The Company periodically assesses its liabilities and contingencies related to income taxes for all years open to audit based on the latest information available. For matters where it is probable that an adjustment will be made, the Company records its best estimate of the tax liability including the related interest and penalties in the current tax provision. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

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#### 5. Financial instrument classification

The carrying amount of the Company's financial instruments by classification is as follows:

	Available for sale	Held to maturity	Loans and receivables	Other financial liabilities	Total
<b>December 31, 2016</b>					
Cash and cash equivalents	\$ -	\$ -	\$ 5,679,086	\$ -	\$ 5,679,086
Receivables (Note 6)	-	-	3,066,386	-	3,066,386
Investments (Note 8)	12,805,511	46,287,221	-	-	59,092,732
Accounts payable and accrued liabilities	-	-	-	(615,022)	(615,022)
	<b>\$12,805,511</b>	<b>\$ 46,287,221</b>	<b>\$ 8,745,472</b>	<b>\$(615,022)</b>	<b>\$67,223,182</b>
<b>December 31, 2015</b>					
Cash and cash equivalents	\$ -	\$ -	\$ 5,437,774	\$ -	\$ 5,437,774
Receivables (Note 6)	-	-	2,655,994	-	2,655,994
Investments (Note 8)	9,911,931	41,090,457	-	-	51,002,388
Accounts payable and accrued liabilities	-	-	-	(536,172)	(536,172)
	<b>\$ 9,911,931</b>	<b>\$ 41,090,457</b>	<b>\$ 8,093,768</b>	<b>\$(536,172)</b>	<b>\$58,559,984</b>

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 6. Receivables

	<u>2016</u>	<u>2015</u>
Policyholders for premiums	\$ <b>2,478,416</b>	\$ 2,061,399
Accrued interest	<b>500,113</b>	463,017
Other	<b>87,857</b>	131,578
	<u><b>\$ 3,066,386</b></u>	<u>\$ 2,655,994</u>

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### 7. Assets held for sale

In June 2015, the Company relocated its head office from 201 Water Street, Summerside, PE to 116 Walker Avenue, Summerside, PE. This decision was made as per the Board's approved plan in February 2013, to construct a new head office building. All remaining assets at 201 Water Street were classified as held for sale and measured at their carrying value, as calculated immediately before their held for sale classification. No subsequent depreciation has been recognized on these assets.

Subsequent to original classification, assets held for sale are measured at the lower of carrying amount and fair value less costs to sell. At December 31, 2015, these assets were measured at \$375,095, being their carrying value. At December 31, 2016, these assets were measured at \$250,050, being their fair value less cost to sell. This has resulted in an impairment loss of \$125,045, which had been recognized as other expense in the current year's statement of comprehensive income.

On November 29, 2016, the company signed a purchase and sale agreement for these assets, with a closing date of February 24, 2017. The fair value, less cost to sell, amount of \$250,050 is based on this signed agreement.

Measurement details are as follows:

	<u>2016</u>	<u>2015</u>
Carrying value	<u>\$ 375,095</u>	<u>\$ 375,095</u>
Fair value, less costs to sell	<u>\$ 250,050</u>	<u>\$ 418,000</u>
Impairment loss	<u>\$ 125,045</u>	<u>\$ -</u>

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

### 8. Investments

The following table provides cost and fair value information of investments by type of security and issuer. The maximum exposure to credit risk would be the carrying value as shown below.

Carrying value	2016	2015
Held to maturity investments, at amortized cost	<b>\$ 46,287,221</b>	\$ 41,090,457
Available for sale investments, at fair value	<b>12,805,511</b>	9,911,931
	<b>\$ 59,092,732</b>	\$ 51,002,388

	December 31, 2016		December 31, 2015	
	Cost	Fair Value	Cost	Fair Value
<b>Held to maturity investments</b>				
Term deposits and GIC's	<b>\$ 3,820,000</b>	<b>\$ 3,820,000</b>	\$ 1,340,000	\$ 1,340,000
Bonds, at par less unamortized purchase discounts and premiums				
- Federal	<b>191,815</b>	<b>229,138</b>	190,906	232,688
- Provincial	<b>13,107,601</b>	<b>14,283,721</b>	11,990,604	13,584,532
- Municipal	<b>12,223,304</b>	<b>13,613,478</b>	11,834,934	13,521,851
- Corporate	<b>16,944,501</b>	<b>18,131,010</b>	15,734,013	17,105,435
Total bonds	<b>42,467,221</b>	<b>46,257,347</b>	39,750,457	44,444,506
	<b>\$ 46,287,221</b>	<b>\$ 50,077,347</b>	\$ 41,090,457	\$ 45,784,506
<b>Available for sale investments</b>				
Equities - Canadian				
Common Stock	<b>\$ 7,663,443</b>	<b>\$ 9,960,078</b>	\$ 6,274,946	\$ 7,661,622
Equities - US				
Common Stock	<b>2,239,972</b>	<b>2,845,433</b>	1,609,215	2,250,309
	<b>\$ 9,903,415</b>	<b>\$ 12,805,511</b>	\$ 7,884,161	\$ 9,911,931

# Prince Edward Island Mutual Insurance Company Notes to the Financial Statements

December 31, 2016

## 8. Investments (cont'd)

The following table summarizes fair value measurements recognized in the statement of financial position or disclosed in the Company's financial statements, categorized by level according to the significance of the inputs used in making the measurements.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities using the last bid price;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Carrying Value	Fair Value			Total
		Level 1	Level 2	Level 3	
<b>December 31, 2016</b>					
Equity investments					
- Canadian	\$ 9,960,078	\$ 9,960,078	\$ -	\$ -	\$ 9,960,078
- US	2,845,433	2,845,433	-	-	2,845,433
Bonds	46,287,221	-	50,077,347	-	50,077,347
<b>Total</b>	<b>\$59,092,732</b>	<b>\$12,805,511</b>	<b>\$50,077,347</b>	<b>\$ -</b>	<b>\$62,882,858</b>
 December 31, 2015					
Equity investments					
- Canadian	\$ 7,661,622	7,661,622	-	-	7,661,622
- US	2,250,309	2,250,309	-	-	2,250,309
Bonds	41,090,457	-	45,784,506	-	45,784,506
<b>Total</b>	<b>\$51,002,388</b>	<b>\$ 9,911,931</b>	<b>\$45,784,506</b>	<b>\$ -</b>	<b>\$55,696,437</b>

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2015 and 2016.

The company has determined that certain investments have incurred a significant or prolonged decline in their fair value, which constitutes objective evidence of impairment. As a result, an impairment loss of \$140,283 has been recognized in net income for the year ended December 31, 2016 and \$619,679 for the year ended December 31, 2015.

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**Prince Edward Island Mutual Insurance Company**  
**Notes to the Financial Statements**  
December 31, 2016

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**8. Investments (cont'd)**

Maturity profile of held to maturity investments is as follows:

	<b>Within 1 Year</b>	<b>2 to 5 Years</b>	<b>6 to 10 Years</b>	<b>Over 10 Years</b>	<b>Total</b>
<b>December 31, 2016</b>					
Bonds	\$ 1,600,000	\$ 10,093,536	\$ 17,994,927	\$ 12,778,758	\$ 42,467,221
Term Deposits	1,820,000	2,000,000	-	-	3,820,000
<b>Total</b>	<b>\$ 3,420,000</b>	<b>\$ 12,093,536</b>	<b>\$ 17,994,927</b>	<b>\$ 12,778,758</b>	<b>\$ 46,287,221</b>
<b>Percent of total</b>	<b>7%</b>	<b>26%</b>	<b>39%</b>	<b>28%</b>	<b>100%</b>
<hr/>					
<b>December 31, 2015</b>					
Bonds	\$ 2,800,000	\$ 10,290,589	\$ 12,191,131	\$ 14,468,737	\$ 39,750,457
Term Deposits	520,000	820,000	-	-	1,340,000
<b>Total</b>	<b>\$ 3,320,000</b>	<b>\$ 11,110,589</b>	<b>\$ 12,191,131</b>	<b>\$ 14,468,737</b>	<b>\$ 41,090,457</b>
<b>Percent of total</b>	<b>8%</b>	<b>27%</b>	<b>30%</b>	<b>35%</b>	<b>100%</b>

The effective interest rate of the held to maturity investments is 4.42% and 4.68% at December 31, 2016 and December 31, 2015 respectively.

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**Prince Edward Island Mutual Insurance Company**  
**Notes to the Financial Statements**  
**December 31, 2016**

**9. Property, plant & equipment**

							Assets Under		Total
	Land	Building	Office equipment	Computer equipment	Vehicles	Parking lots	Construction		
<b>Cost</b>									
Balance on January 1, 2015	\$ 740,440	\$ 588,168	\$ 224,413	\$ 212,143	\$ 290,233	\$ 25,711	\$ 1,843,339	\$ 3,924,447	
Additions	-	-	221,489	41,469	-	89,666	1,935,281	2,287,905	
Transferred to available for use		3,778,620					(3,778,620)	-	
Transferred to held for sale asset	(132,097)	(588,169)	(122,902)	-	-	(25,711)	-	(868,879)	
Disposals	-	-	(20,743)	(25,845)	-	-	-	(46,588)	
Balance on December 31, 2015	608,343	3,778,619	302,257	227,767	290,233	89,666	-	5,296,885	
Additions	-	2,872	11,446	35,536	68,478	-	-	118,332	
Disposals	-	-	-	(71,966)	(60,873)	-	-	(132,839)	
<b>Balance on December 31, 2016</b>	<b>\$ 608,343</b>	<b>\$ 3,781,491</b>	<b>\$ 313,703</b>	<b>\$ 191,337</b>	<b>\$ 297,838</b>	<b>\$ 89,666</b>	<b>\$ -</b>	<b>\$ 5,282,378</b>	
<b>Accumulated depreciation</b>									
Balance on January 1, 2015	\$ -	\$ 372,108	\$ 173,156	\$ 163,453	\$ 180,113	\$ 16,200	\$ -	\$ 905,030	
Depreciation expense	-	87,559	50,698	39,834	33,031	7,173	-	218,295	
Transferred to held for sale asset	-	(372,108)	(105,476)	-	-	(16,200)	-	(493,784)	
Disposals	-	-	(18,913)	(24,313)	-	-	-	(43,226)	
Balance on December 31, 2015	-	87,559	99,465	178,974	213,144	7,173	-	586,315	
Depreciation expense	-	170,772	42,848	36,912	41,520	6,599	-	298,651	
Disposals	-	-	-	(69,664)	(53,710)	-	-	(123,374)	
<b>Balance on December 31, 2016</b>	<b>\$ -</b>	<b>\$ 258,331</b>	<b>\$ 142,313</b>	<b>\$ 146,222</b>	<b>\$ 200,954</b>	<b>\$ 13,772</b>	<b>\$ -</b>	<b>\$ 761,592</b>	
<b>Net book value</b>									
Thursday, December 31, 2015	\$ 608,343	\$ 3,691,060	\$ 202,792	\$ 48,793	\$ 77,089	\$ 82,493	\$ -	\$ 4,710,570	
<b>Saturday, December 31, 2016</b>	<b>\$ 608,343</b>	<b>\$ 3,523,160</b>	<b>\$ 171,390</b>	<b>\$ 45,115</b>	<b>\$ 96,884</b>	<b>\$ 75,894</b>	<b>\$ -</b>	<b>\$ 4,520,786</b>	

**10. Insurance contracts**

The following is a summary of the insurance contract provisions and related reinsurance assets at December 31.

	December 31, 2016			December 31, 2015		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Outstanding claims provision						
Long settlement term	\$2,580,328	\$ 232,929	\$2,347,399	\$1,971,487	\$ 67,433	\$1,904,054
Short settlement term	4,596,480	35,500	4,560,980	5,945,328	416,651	5,528,677
	7,176,808	268,429	6,908,379	7,916,815	484,084	7,432,731
Provision for claims incurred but not reported	1,587,232	-	1,587,232	1,414,539	-	1,414,539
	<b>\$8,764,040</b>	<b>\$ 268,429</b>	<b>\$8,495,611</b>	<b>\$9,331,354</b>	<b>\$ 484,084</b>	<b>\$8,847,270</b>

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 10. Insurance contracts (cont'd)

#### Comments and assumptions for specific claims categories

The ultimate cost of long settlement general liability claims are difficult to predict for several reasons. Claims may not be reported until many years after a policy expires. Changes in the legal environment have created further complications. Court decisions and federal and provincial legislation may dramatically increase the liability between the time a policy is written and associated claims are ultimately resolved. For example, liability for exposure to toxic substances and environmental impairment, which did not appear likely or even exist when the policies were written, has been imposed by legislators and judicial interpretation. Tort liability has been expanded by some jurisdictions to cover defective workmanship. Provisions for such difficult-to-estimate-liabilities are established by examining the facts of tendered claims and adjusted in the aggregate for ultimate loss expectations based upon historical experience patterns and current socioeconomic trends.

#### Claims and adjustment expenses

Changes in claim liabilities recorded in the balance sheet for the years-ended December 31, 2016 and 2015 and their impact on claims and adjustment expenses for the two years follow:

	<u>2016</u>	<u>2015</u>
Unpaid claim - beginning of year – net of reinsurance	\$ 7,432,731	\$ 5,146,131
Increase (decrease) in estimated losses and expenses, for losses occurring in prior years	(906,704)	(179,937)
Provision for losses and expenses on claims occurring in the current year	10,575,239	13,945,432
Payment on claims:		
Current year	(5,643,016)	(8,184,937)
Prior years	(4,549,871)	(3,293,958)
	<u>\$ 6,908,379</u>	<u>\$ 7,432,731</u>
Unpaid claims – end of year - net of reinsurance		

The change in estimate of losses occurring in prior years is due to changes arising from new information received.

#### Provision for unpaid claims and adjustment expenses

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables which are the development of claims, reinsurance recoveries, and future investment income. As the Company does not sell auto insurance, future investment income has been disregarded for this purpose.

# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

### 10. Insurance contracts (cont'd)

#### Claim development

The estimation of claim development involves assessing the future behavior of claims, taking into consideration the consistency of the Company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises and historical delays in reporting claims. In general, the longer the term required for the settlement of a group of claims the more variable the estimates. Short settlement term claims are those which are expected to be substantially paid within a year of being reported.

The tables that follow present the development of claims payments and the estimated ultimate cost of claims for the claim year 2007 to 2016. The upper half of the tables shows the cumulative amounts paid or estimated to be paid during successive years related to each claim year. The original estimates will be increased or decreased, as more information becomes known about the original claims and overall claim frequency and severity.

In 2011, the year of adoption of IFRS, only information from periods beginning on or after January 1, 2007 is required to be disclosed. This is being increased in each succeeding additional year, until ten years of information is included.

<i>Net Claims</i>	(\$'000)										
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
<b>Net estimate of cumulative claims cost</b>											
At the end year of claim	7,764	8,746	8,098	8,890	9,885	9,012	12,918	13,670	13,945	10,575	
One year later	7,592	8,133	8,347	8,797	9,966	8,596	12,472	13,893	13,523		
Two years later	7,602	8,110	8,296	8,774	9,846	8,344	12,362	13,770			
Three years later	7,595	8,127	8,326	8,731	9,778	8,335	12,309				
Four years later	7,516	8,121	8,123	8,686	9,677	8,340					
Five years later	7,536	8,144	8,325	8,592	9,499						
Six years later	7,470	8,020	8,318	8,576							
Seven years later	7,317	7,920	8,304								
Eight years later	7,257	7,920									
Nine years later	7,256										
Current estimate of cumulative claims cost	7,256	7,920	8,304	8,576	9,499	8,340	12,309	13,770	13,523	10,575	
Cumulative payments	7,256	7,885	8,304	8,576	9,292	8,186	12,124	13,242	12,732	5,643	
Outstanding claims	-	35	-	-	207	154	185	528	791	4,932	6,832
Outstanding claims 2006 and prior											76
Claims handling expense											(471)
<b>Total net outstanding claims net of claims handling expense</b>											<b>6,437</b>

### 11. Pension plan

The Company has a defined contribution plan providing pension benefits to eligible employees. The total plan expense for the Company's defined contribution plan for 2016 was \$230,827 (2015 - \$212,478).

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**Prince Edward Island Mutual Insurance Company**  
**Notes to the Financial Statements**  
December 31, 2016

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**12. Income taxes**

The Company is subject to income taxes on that portion of its income derived from insuring other than fishing and farming related risks.

The significant components of tax expense included in net income are composed of:

	<u>2016</u>	<u>2015</u>
<b>Current tax expense</b>		
Based on current year taxable income	\$ 1,300,579	\$ 278,493
Adjustments for over / under provision in prior periods	-	-
	<u>\$ 1,300,579</u>	<u>\$ 278,493</u>
<b>Deferred tax expense</b>		
Origination and reversal of temporary differences	6,385	(211,184)
(Increase) reduction in tax rate	(6,570)	(7,211)
	<u>(185)</u>	<u>(218,395)</u>
<b>Total income tax expense</b>	<u>\$ 1,300,394</u>	<u>\$ 60,098</u>

The significant components of the tax affect of the amounts recognized in other comprehensive income are composed of:

	<u>2016</u>	<u>2015</u>
<b>Current tax</b>		
Change in unrealized gain / losses on available-for-sale investments	\$ 185,532	\$ (252,149)

**Prince Edward Island Mutual Insurance Company**  
**Notes to the Financial Statements**  
December 31, 2016

**12. Income taxes (cont'd)**

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rates are as follows:

	<b>2016</b>	2015
Income before income taxes	<b>\$ 6,475,155</b>	\$ 1,453,257
Combined basic Canadian Federal and provincial income tax rate	<b>31%</b>	31%
Income taxes at statutory rates	<b>2,007,298</b>	450,510
Income from insuring farming & fishing related risks	<b>(685,296)</b>	(12,970)
Non deductible portion of claims liabilities	<b>(17,586)</b>	46,090
Depreciation in excess of capital cost allowance	<b>2,063</b>	(8,103)
Other non deductible expenses	<b>(1,014)</b>	16,062
Market to market and other adjustments related to investments	<b>271,041</b>	(376,342)
Deduction for CCPC dividends	<b>(90,395)</b>	(88,903)
Change in tax rates	<b>(6,570)</b>	(7,211)
Origination and reversal of temporary timing differences	<b>6,385</b>	(211,184)
Total income tax expense	<b>\$ 1,485,926</b>	\$ (192,051)

The significant components of deferred tax assets are:

<b>Deferred tax assets</b>	<b>2016</b>	<b>2015</b>
Pension obligation	<b>\$ 17,431</b>	<b>\$ 14,398</b>
Charitable donations	<b>-</b>	<b>5,674</b>
Provision for unpaid claims	<b>189,829</b>	<b>196,705</b>
Property, plant & equipment	<b>38,094</b>	<b>28,392</b>
	<b>\$ 245,354</b>	<b>\$ 245,169</b>

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**Prince Edward Island Mutual Insurance Company**  
**Notes to the Financial Statements**  
December 31, 2016

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**13. Gross claims and adjustment expenses**

Included in claims expenses were wage costs of \$422,017 (2015 - \$451,490).

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**14. Fees, commissions and other acquisition expenses**

	<u>2016</u>	<u>2015</u>
Commissions	\$ 1,515,676	\$ 1,540,976
Sales salaries	487,822	556,393
Other	159,244	159,362
	<u>\$ 2,162,742</u>	<u>\$ 2,256,731</u>

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**15. Other operating and administrative expenses**

	<u>2016</u>	<u>2015</u>
Advertising	\$ 138,212	\$ 152,795
Conventions, courses and travel	92,605	69,150
Depreciation	262,076	192,735
Directors fees	262,357	230,328
Donations	86,205	84,825
Fire prevention tax	227,646	210,150
Loss Prevention	30,863	32,523
Office supplies	182,385	168,269
Other administration costs	369,487	402,205
Postage	200,071	177,242
Professional fees	48,496	57,912
Salaries and benefits	2,312,838	2,172,866
Taxes, dues and licences	111,312	94,249
Telephone	62,738	65,177
	<u>\$ 4,387,291</u>	<u>\$ 4,110,426</u>

**Prince Edward Island Mutual Insurance Company**  
**Notes to the Financial Statements**  
December 31, 2016

**16. Salaries, benefits and directors fees**

	<u>2016</u>	<u>2015</u>
Claims handling - Salaries, adjusting fees & benefits (Note 13)	\$ 422,017	\$ 451,490
Sales salaries, commissions and benefits (Note 14)	2,003,498	2,097,369
Director fees (Note 15)	262,357	230,328
Other salaries and benefits (Note 15)	2,312,838	2,172,866
	<u>\$ 5,000,710</u>	<u>\$ 4,952,053</u>

**17. Investment and other income**

2016	AFS	FVTPL	HTM	Other	Total
Interest Income	\$ -	\$ 23,638	\$ 1,930,147	\$ -	\$ 1,953,785
Interest Expense				(1,328)	(1,328)
Dividend Income	370,923				370,923
Net realized gains	935,326				935,326
Impairment Losses	(140,283)				(140,283)
Gain (loss) on disposal of PPE				2,955	2,955
Other income				122,742	122,742
Investment and Other Income	<u>\$ 1,165,966</u>	<u>\$ 23,638</u>	<u>\$ 1,930,147</u>	<u>\$ 124,369</u>	<u>\$ 3,244,120</u>
2015	AFS	FVTPL	HTM	Other	Total
Interest Income	\$ 3,176	\$ 18,445	\$ 1,919,286	\$ -	\$ 1,940,907
Interest Expense				(2,502)	(2,502)
Dividend Income	371,766				371,766
Net realized gains	1,184,745				1,184,745
Impairment Losses	(619,679)				(619,679)
Gain (loss) on disposal of PPE				(3,362)	(3,362)
Other income				119,237	119,237
Investment and Other Income	<u>\$ 940,008</u>	<u>\$ 18,445</u>	<u>\$ 1,919,286</u>	<u>\$ 113,373</u>	<u>\$ 2,991,112</u>

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**Prince Edward Island Mutual Insurance Company**  
**Notes to the Financial Statements**  
December 31, 2016

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**18. Changes in non-cash operating working capital**

	<u>2016</u>	<u>2015</u>
Receivables	\$ (410,392)	\$ (336,202)
Prepaid expenses	13,629	(4,801)
Deferred policy acquisition expenses	(97,156)	145,982
Reinsurers' share of provision for unpaid claims	215,655	613,518
Payables and accruals	78,850	(24,091)
Income tax payable/receivable	1,800,419	(220,484)
Unpaid claims	(567,314)	1,486,793
Unearned premiums	1,119,766	789,127
	<u>\$ 2,153,457</u>	<u>\$ 2,449,842</u>
Income taxes paid, net	<u>\$ (314,308)</u>	<u>\$ 246,828</u>

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**19. Related party transactions**

The Company entered into the following transactions with key management personnel, which are defined by IAS 24, Related Party-Disclosures, as those persons having authority and responsibility for planning, directing and controlling the activities of the Company, including directors and management:

	<u>2016</u>	<u>2015</u>
Compensation		
Short term employee benefits and director's fees	\$ 1,092,585	\$ 1,057,853
Total pension and other post-employment benefits	82,722	77,432
	<u>\$ 1,175,307</u>	<u>\$ 1,135,285</u>

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 20. Capital management

The Company's objectives with respect to capital management are to maintain a capital base that is structured to exceed regulatory requirements and to best utilize capital allocations. Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable. To limit their potential impact, catastrophe coverage limits the Company's exposure to \$1.35 million. The \$1.35 million net retained amount represents approximately 2.8% of Company's capital. For the purpose of capital management, the Company has defined capital as policyholders' security fund, excluding accumulated other comprehensive income (loss).

Section 317.(1) of the Insurance Act of Prince Edward Island requires insurers to maintain a reserve fund equal to the sum of \$500 for every \$100,000 of the first \$1 million of insurance in force, and \$3,000 for each additional \$1 million or part thereof insurance in force. The Company's reserve fund as at December 31, 2016 was 1.57 times that which is required by S317.(1) of the Insurance Act.

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### 21. Financial instrument and Insurance risk management

#### Insurance risk management

The principal risk the Company faces under insurance contracts is that the actual claims and benefit payments or the timing thereof, differ from expectations. This is influenced by the frequency of claims, severity of claims, actual benefits paid and subsequent development of long-term claims. Therefore, the objective of the Company is to ensure that sufficient reserves are available to cover these liabilities.

The above risk exposure is mitigated by diversification across a large portfolio of insurance. The variability of risks is also improved by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements.

The Company purchases reinsurance as part of its risk mitigation program. Retention limits for the excess-of-loss reinsurance vary by product line.

Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contracts. Although the Company has reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus a credit exposure exists with respect to ceded insurance, to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements.

The Company writes insurance primarily over a twelve month duration. The most significant risks arise through high severity, low frequency events such as natural disasters or catastrophes. A concentration of risk may arise from insurance contracts issued in a specific geographic location since all insurance contracts are written in Prince Edward Island.

The Company manages this risk via its underwriting and reinsurance strategy within an overall risk management framework. Exposures are limited by having documented underwriting limits and criteria. Pricing of property and liability policies are based on assumptions in regard to trends and past experience, in an attempt to correctly match policy revenue with exposed risk.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 21. Financial instrument and Insurance risk management (cont'd)

Reinsurance is purchased to mitigate the effect of the potential loss to the company. Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer.

The Company follows a policy of underwriting and reinsuring contracts of insurance which, in the main, limit the liability of the Company to an amount on any one claim of \$450,000 in the event of a property claim, and \$400,000 in the event of a liability claim. The Company also obtained reinsurance which limits the Company's liability to \$1.35 million in the event of a series of claims arising out of a single occurrence. In addition, the Company has obtained stop loss reinsurance which limits the liability of all claims in a specific year to 80% of gross net earned premiums for property and liability combined.

The Company is exposed to a pricing risk to the extent that unearned premiums are insufficient to meet the related future policy costs. Evaluation is performed regularly to estimate future claims costs, related expenses, and expected profit in relation to unearned premiums. There was no premium deficiency at December 31, 2016 and 2015.

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The company uses various techniques based on past claims development experience to quantify these sensitivities. This includes indicators such as average claim cost, amount of claims occurrence, expected loss ratios and claims development as described in Note 10.

Results of sensitivity testing based on expected loss ratios are as follows, shown gross and net of reinsurance as impact on pre-tax income.

	Property claims		Liability claims	
	2016	2015	2016	2015
5% increase in loss ratios				
Gross	<b>988,270</b>	898,303	<b>149,960</b>	152,445
Net	<b>921,936</b>	839,993	<b>121,419</b>	119,889
5% decrease in loss ratios				
Gross	<b>(988,270)</b>	(898,303)	<b>(149,960)</b>	(152,445)
Net	<b>(921,936)</b>	(839,993)	<b>(121,419)</b>	(119,889)

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the risk.

#### Credit Risk

Credit risk is the risk of financial loss to the Company if a debtor fails to make payments of interest and principal when due. The Company is exposed to this risk relating to its debt holdings in its investment portfolio and the reliance on reinsurers to make payment when certain loss conditions are met.

The Company's investment policy includes guidelines on the bond portfolio relating to portfolio composition, issuer type, bond quality ratings (at time of acquisition – rated as "A" or better) and general guidelines for geographic exposure. All fixed income portfolios and monitored by management on a monthly basis.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 21. Financial instrument and Insurance risk management (cont'd)

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRP by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Accounts receivable are short-term in nature consisting of a large number of policyholders, and are not subject to material credit risk. Regular review of outstanding receivables is performed to ensure credit worthiness.

The maximum exposure to investment credit risk is outlined in Note 8.

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the risk.

#### **Market risk**

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of market factors. Market factors include three types of risk: currency risk, interest rate risk and equity risk.

The Company's investment policy operates within the guidelines of the Insurance Act. An investment policy is in place and its application is monitored by the Investment Committee and the Board of Directors. Diversification techniques are utilized to minimize risk.

#### **Currency risk**

Currency risk relates to the Company operating in different currencies and converting non-Canadian earnings at different points in time at different foreign exchange levels when adverse changes in foreign currency exchange rates occur.

The Company's foreign exchange risk is related to stock holdings which are limited to United States equities in sectors which are not readily available in Canada. The Company limits its holdings in foreign equity to 25% of its total equity holdings in accordance with its investment policy. Foreign currency changes are monitored by the investment committee and holdings are adjusted when offside of the investment policy. A 1% change in the value of the United States dollar would affect the fair value of stocks by \$28,454 which would be reflected in net income or OCI.

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the risk.

#### **Interest rate risk**

Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates.

The Company is not exposed to this risk as its interest bearing investments are being held to maturity.

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the risk.

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# Prince Edward Island Mutual Insurance Company

## Notes to the Financial Statements

December 31, 2016

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### 21. Financial instrument and Insurance risk management (cont'd)

#### Equity risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Company is exposed to this risk through its equity holdings within its investment portfolio.

The Company's portfolio includes Canadian stocks with fair values that move with the Toronto Stock Exchange Composite Index and United States stocks with fair values that move with the S&P 500 Index. A 10% movement in the stock markets with all other variables held constant would have an estimated effect on the fair values of the Company's Canadian common stock and United States common stock of \$1.28 million (2015 - \$991,000). For stocks that the Company did not sell during the period, the change would be recognized in the asset value and in other comprehensive income. For stocks that the Company did sell during the period, the change during the period and changes prior to the period would be recognized as net realized gains (losses) in income during the period.

The Company's investment policy limits investment in common shares to a maximum of 25% of the adjusted cost base of the portfolio.

Equities are monitored by the board of directors on a semi-annual basis. Holdings are adjusted by the Investment Committee, as required.

#### Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet all cash outflow obligations as they come due. The Company mitigates this risk by monitoring cash activities and expected outflows. The Company's current liabilities arise as claims are made. The Company does not have material liabilities that can be called unexpectedly at the demand of a lender or client. The Company has no material commitments for capital expenditures and there is no need for such expenditures in the normal course of business. Claim payments are funded by current operating cash flow including investment income.

There have been no significant changes from the previous year in the exposure to risk or policies, procedures and methods used to measure the risk.

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