KENT & ESSEX MUTUAL INSURANCE COMPANY

FINANCIAL STATEMENTS

DECEMBER 31, 2017

KENT & ESSEX MUTUAL INSURANCE COMPANY

DECEMBER 31, 2017

CONTENTS

Bailey
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CHARTERED ACCOUNTANTS

PARTNERS
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INDEPENDENT AUDITORS' REPORT

To the Policyholders of
Kent & Essex Mutual Insurance Company

We have audited the accompanying financial statements of **Kent & Essex Mutual Insurance Company**, which comprise the statement of financial position as at December 31, 2017, and the statements of comprehensive income, policyholders' surplus and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' 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 auditors' 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 is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, these financial statements present fairly, in all material respects, the financial position of **Kent & Essex Mutual Insurance Company** as at December 31, 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Bailey Kearney Ferguson LLP

Wallaceburg, Ontario
February 20, 2018

Chartered Professional Accountants
Licensed Public Accountants

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KENT & ESSEX MUTUAL INSURANCE COMPANY
(Incorporated under the Laws of Ontario)

STATEMENT OF FINANCIAL POSITION

AS AT DECEMBER 31, 2017

ASSETS

	2017	2016
Cash	**$ 3,602,508**	$ 7,906,660
Investments (Note 4)	**72,319,017**	67,721,630
Investment income accrued	**396,150**	315,851
Due from reinsurer (Note 3)	**1,974,708**	163,783
Due from brokers and policyholders	**7,719,131**	7,108,528
Reinsurer share of provision for unpaid claims (Note 3)	**9,778,464**	10,408,663
Income taxes recoverable	**116,801**	275,318
Deferred policy acquisition expenses (Note 3)	**2,772,087**	2,556,624
Other assets	**248,676**	242,429
Property, plant and equipment (Note 12)	**3,310,984**	3,213,794
Deferred income taxes	**238,000**	214,000
	$102,476,526	$100,127,280

LIABILITIES

	2017	2016
Accounts payable and accrued liabilities	**$ 1,222,612**	$ 1,011,987
Post employment benefits (Note 13)	**237,690**	421,242
Unearned premiums (Note 3)	**16,345,905**	15,062,317
Provision for unpaid claims (Note 3)	**36,145,859**	36,042,188
Due to reinsurer	**226,226**	219,154
Due to Facility Association	**-**	8,250
	54,178,292	52,765,138

POLICYHOLDERS' SURPLUS

	2017	2016
POLICYHOLDERS' SURPLUS	**48,298,234**	47,362,142
	$102,476,526	$100,127,280

APPROVED ON BEHALF OF THE BOARD

________________________, **DIRECTOR**

________________________, **DIRECTOR**

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

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31, 2017

	2017	2016
GROSS INSURANCE PREMIUMS WRITTEN	**$ 32,878,390**	$ 30,170,032
REINSURANCE PREMIUMS	**3,386,784**	2,514,303
NET PREMIUMS WRITTEN	**29,491,606**	27,655,729
INCREASE IN PROVISION FOR UNEARNED PREMIUMS	**1,283,589**	954,070
NET PREMIUMS EARNED	**28,208,017**	26,701,659
SERVICE CHARGES	**196,732**	207,772
TOTAL UNDERWRITING REVENUE	**28,404,749**	26,909,431
DIRECT LOSSES INCURRED		
Gross claims and adjustment expenses	**26,388,432**	23,035,776
Less reinsurer share of claims and adjustment expenses	**(5,191,914)**	(2,917,721)
	21,196,518	20,118,055
UNDERWRITING INCOME BEFORE EXPENSES	**7,208,231**	6,791,376
EXPENSES		
Fees, commissions and other acquisition expenses (Note 7)	**5,973,232**	5,528,909
Other operating and administrative expenses (Note 8)	**3,021,226**	3,622,662
	8,994,458	9,151,571
UNDERWRITING LOSS	**(1,786,227)**	(2,360,195)
INVESTMENT AND OTHER INCOME (Note 5)	**2,827,319**	3,867,958
INCOME BEFORE INCOME TAXES	**1,041,092**	1,507,763
PROVISION FOR INCOME TAXES (Note 10)	**105,000**	180,000
COMPREHENSIVE INCOME FOR THE YEAR	**$ 936,092**	$ 1,327,763

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

STATEMENT OF POLICYHOLDERS' SURPLUS

FOR THE YEAR ENDED DECEMBER 31

	2017	2016
BALANCE, beginning of the year	**$ 47,362,142**	$ 46,034,379
Comprehensive income for the year	**936,092**	1,327,763
BALANCE, end of the year	**$ 48,298,234**	$ 47,362,142

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

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31

	2017	2016
OPERATING ACTIVITIES		
Comprehensive income for the year	**$ 936,092**	$ 1,327,763
Items not requiring cash		
Depreciation	**178,161**	150,051
Loss on disposition of property, plant and equipment	**125,345**	-
Deferred income taxes	**(24,000)**	(16,000)
Realized loss (gain) on disposal of investments	**(1,301,456)**	(298,313)
Unrealized loss (gain) on investments	**646,588**	(1,751,187)
	560,730	(587,686)
Net change in non-cash working capital balances		
Investment income accrued	**(80,299)**	(27,484)
Due from reinsurer	**(1,810,925)**	111,764
Due from brokers and policyholders	**(610,603)**	(177,955)
Reinsurers' share of provisions for unpaid claims	**630,199**	(2,979,106)
Income taxes recoverable	**158,517**	(46,589)
Deferred policy acquisition expenses	**(215,463)**	(157,205)
Other assets	**(6,247)**	(48,851)
Accounts payable and accrued liabilities	**210,624**	56,090
Post employment benefits	**(183,552)**	14,927
Unearned premiums	**1,283,588**	954,071
Provision for unpaid claims	**103,671**	6,068,420
Due to reinsurer	**7,072**	70,165
Due to Facility Association	**(8,250)**	2,836
Premium refund to policyholders	**-**	(726,000)
Net cash provided by operating activities	**39,062**	2,527,397
INVESTING ACTIVITIES		
Proceeds from sale of investments	**16,700,823**	31,230,750
Purchase of investments	**(20,643,344)**	(37,046,835)
Additions to property, plant and equipment	**(401,693)**	(50,546)
Proceeds from disposition of property, plant and equipment	**1,000**	-
Net cash used in investing activities	**(4,343,214)**	(5,866,631)
DECREASE IN CASH, during the year	**(4,304,152)**	(3,339,234)
CASH, beginning of the year	**7,906,660**	11,245,894
CASH, end of the year	**$ 3,602,508**	$ 7,906,660

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

1. CORPORATE INFORMATION

Kent & Essex Mutual Insurance Company (the "Company") is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property, liability, automobile and farmers' accident insurance in Ontario. The Company's head office is located in Chatham, Ontario.

The Company is subject to rate regulation in the automobile business that it writes. Before automobile insurance rates can be changed, a rate filing is prepared as a combined filing for most Ontario Farm Mutuals. The rate filing must include actuarial justification for rate increases or decreases. All rate filings are approved or denied by the Financial Services Commission of Ontario. Rate regulation may affect the automobile insurance revenues that are earned by the Company. The actual impact of rate regulation would depend on the competitive environment at the time.

These financial statements have been authorized for issue by the Board of Directors on February 20, 2018.

2. BASIS OF PRESENTATION

(a) STATEMENT OF COMPLIANCE

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

(b) BASIS OF MEASUREMENT

These financial statements were prepared under the historical cost convention, as modified by the revaluation of financial instruments designated as fair value through profit or loss.

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

(c) JUDGMENT AND ESTIMATES

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 critical judgments and estimates in applying accounting policies that have the most significant risk of causing material adjustment to the carrying amount of assets and liabilities recognized in the financial statements within the next financial year are:

The calculation of unpaid claims, including the determination of the initial claim liability, the development of claims, the estimate of time until ultimate settlement and the performance of a liability adequacy test (Note 3); and

The determination of the recoverability of deferred policy acquisition expenses.

In addition, in preparing the financial statements, the notes to the financial statements were ordered such that the most relevant information was presented earlier in the notes and the disclosures that management deemed to be immaterial were excluded from the notes to the financial statements. The determination of the relevance and materiality of disclosures involved significant judgment.

3. INSURANCE CONTRACTS

The Company accounts for insurance contracts in accordance with IFRS 4 and has continued to apply the accounting policies it applied in accordance with pre-changeover Canadian generally accepted accounting principles.

Balances arising from insurance contracts primarily include unearned premiums, provisions for unpaid claims and adjustment expenses, the reinsurer share of provision for 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 brokers and exclusive of taxes levied on premiums.

The Company earns premiums on 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. Changes in unearned premiums recorded in the statement of financial position for the years ended December 31, 2017 and 2016 and their impact on net premiums earned for the two years follows:

	2017	2016
Balance, beginning of the year	**$ 15,062,317**	$ 14,108,246
Premiums written	**32,878,390**	30,170,032
Premiums earned	**(31,594,802)**	(29,215,961)
Balance, end of the year	**$ 16,345,905**	$ 15,062,317

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. Automobile premiums are subject to approval by the Financial Services Commission of Ontario and therefore may result in a delay in adjusting the pricing to exposed risk.

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, 2017 and 2016.

Amounts due from policyholders are measured at amortized cost less any impairment losses. These amounts are short-term in nature consisting of a large number of policyholders, and are not subject to material credit risk. Regular review of amounts outstanding is performed to ensure credit worthiness.

3. INSURANCE CONTRACTS (continued)

(b) DEFERRED POLICY ACQUISITION EXPENSES

Acquisition expenses are comprised of brokers' commissions for acquiring and renewing policies. 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, after considering the related anticipated claims and expenses. Changes in deferred policy acquisition expenses recorded in the statement of financial position for the years-ended December 31, 2017 and 2016 and their impact on fees, commissions and other acquisition expenses for the two years follows:

	2017	2016
Balance, beginning of the year	**$ 2,556,624**	$ 2,399,419
Acquisition costs incurred	**5,797,874**	5,363,631
Expensed during the year	**(5,582,411)**	(5,206,426)
Balance, end of the year	**$ 2,772,087**	$ 2,556,624

(c) PROVISION FOR UNPAID CLAIMS AND ADJUSTMENT EXPENSES

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, claims development, 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 comprehensive income. The Company annually utilizes the expertise of an independent actuary to review the adequacy of its provisions and in particular its provision for claims incurred but not reported.

Claim liabilities are carried on an undiscounted basis.

3. INSURANCE CONTRACTS (continued)

A summary of the Company's outstanding gross unpaid claims liabilities, related reinsurer's share of unpaid claims and the net insurance liabilities follows:

	December 31, 2017		
	Gross	**Reinsurance**	**Net**
Outstanding claims provision			
Long settlement term	**$ 23,279,288**	**$ 4,370,868**	**$ 18,908,420**
Short settlement term	**5,135,370**	**2,207,596**	**2,927,774**
Facility Association and other residual pools	**731,201**	**-**	**731,201**
	29,145,859	**6,578,464**	**22,567,395**
Provision for claims incurred but not reported	**7,000,000**	**3,200,000**	**3,800,000**
	$ 36,145,859	**$ 9,778,464**	**$ 26,367,395**

	December 31, 2016		
	Gross	Reinsurance	Net
Outstanding claims provision			
Long settlement term	$ 23,016,250	$ 5,289,654	$ 17,726,596
Short settlement term	5,314,208	1,919,009	3,395,199
Facility Association and other residual pools	711,730	-	711,730
	29,042,188	7,208,663	21,833,525
Provision for claims incurred but not reported	7,000,000	3,200,000	3,800,000
	$ 36,042,188	$ 10,408,663	$ 25,633,525

The ultimate cost of long settlement general liability claims is 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.

The Company must participate in industry automobile residual pools of business, and recognizes a share of this business based on its automobile market share. The Company records its share of the assets, liabilities, revenue and expenses provided by the actuaries of the pools.

3. INSURANCE CONTRACTS (continued)

Changes in claim liabilities recorded in the statement of financial position for the years-ended December 31, 2017 and 2016 and their impact on claims and adjustment expenses for the two years follows:

	2017	2016
Balance - beginning of the year	**$ 36,042,188**	$ 29,973,768
Increase (decrease) in estimated losses and expenses, for losses occurring in prior years	**(8,698,679)**	(4,464,077)
Provision for losses and expenses on claims occurring in the current year	**32,306,466**	27,499,853
Payment on claims:		
Current year	**(15,224,819)**	(11,568,102)
Prior years	**(8,279,297)**	(5,399,254)
Balance, end of the year	**$ 36,145,859**	$ 36,042,188

Claim development

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 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 Ontario.

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 estimation of claim development involves assessing the future behaviour 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 2008 to 2017. 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.

3. INSURANCE CONTRACTS (continued)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
Gross estimate of cumulative claims cost											
At the end year of claim	$ 14,496,108	$ 13,302,350	$ 22,379,079	$ 19,695,734	$ 15,830,386	$ 16,897,872	$ 22,404,556	$ 20,465,886	$ 27,499,853	$ 32,306,466	
One year later	14,282,003	11,392,953	17,964,599	15,875,008	11,550,146	13,144,024	18,396,300	19,864,844	23,340,100		
Two years later	14,345,694	11,738,395	17,961,169	15,892,934	9,479,740	13,444,184	17,074,026	18,095,411			
Three years later	13,647,245	10,417,554	18,080,999	15,085,009	8,996,819	12,429,588	16,758,864				
Four years later	13,116,078	9,178,593	17,993,247	15,050,893	8,663,211	12,825,071					
Five years later	12,862,356	9,134,731	18,189,608	14,699,584	8,701,691						
Six years later	12,746,852	7,943,416	17,306,126	14,307,736							
Seven years later	12,684,099	7,797,203	17,791,357								
Eight years later	12,230,398	7,797,203									
Nine years later	12,222,305										
Current estimate of cumulative claims cost	12,222,305	7,797,203	17,791,357	14,307,736	8,701,691	12,825,071	16,758,864	18,095,411	23,340,100	32,306,466	164,146,204
Cumulative payments	(12,222,305)	(7,788,462)	(16,783,742)	(13,598,252)	(8,434,023)	(10,677,263)	(13,879,955)	(13,079,604)	(16,525,788)	(15,224,819)	(128,214,213)
Outstanding claims	-	8,741	1,007,615	709,484	267,668	2,147,808	2,878,909	5,015,807	6,814,312	17,081,647	35,931,991
Outstanding claims 2007 and prior											213,868
Total gross outstanding claims											**$ 36,145,859**

3. INSURANCE CONTRACTS (continued)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
Net estimate of cumulative claims cost											
At the end year of claim	$ 10,904,819	$ 10,695,300	$ 12,822,954	$ 15,646,937	$ 14,180,101	$ 15,410,153	$ 19,439,872	$ 17,384,111	$ 23,923,756	$ 26,980,997	
One year later	9,976,423	9,462,919	10,985,687	13,099,214	10,669,530	12,507,364	16,927,704	16,497,807	23,278,501		
Two years later	9,575,781	9,121,256	10,098,904	12,148,325	9,288,740	12,382,134	16,146,742	18,766,604			
Three years later	9,282,411	8,240,234	10,061,799	12,642,377	8,913,819	11,448,550	17,102,505				
Four years later	9,062,120	8,827,118	9,864,291	12,460,793	8,593,584	12,576,213					
Five years later	8,995,598	7,899,105	9,879,276	12,100,844	8,642,640						
Six years later	8,873,094	7,682,782	8,936,065	12,084,658							
Seven years later	8,818,341	7,583,200	8,786,796								
Eight years later	8,764,407	7,583,200									
Nine years later	8,805,029										
Current estimate of cumulative claims cost	8,805,029	7,583,200	8,786,796	12,084,658	8,642,640	12,576,213	17,102,505	18,766,604	23,278,501	26,980,997	144,607,143
Cumulative payments	(8,805,029)	(7,574,461)	(8,516,175)	(11,613,941)	(8,434,023)	(11,184,397)	(14,776,626)	(14,712,909)	(17,401,574)	(15,246,597)	(118,265,732)
Outstanding claims	-	8,739	270,621	470,717	208,617	1,391,816	2,325,879	4,053,695	5,876,927	11,734,400	26,341,411
Outstanding claims 2007 and prior											25,984
Total net outstanding claims											**$ 26,367,395**

3. INSURANCE CONTRACTS (continued)

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The Company's 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.

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		Auto claims		Liability Claims	
	2017	2016	**2017**	2016	**2017**	2016
5% increase in loss ratios						
Gross	**$ (792,919)**	$ (721,366)	**$ (713,856)**	$ (659,502)	**$ (137,144)**	$ (127,633)
Net	**$ (659,844)**	$ (609,861)	**$ (560,992)**	$ (532,442)	**$ (106,286)**	$ (102,205)
5% decrease in loss ratios						
Gross	**$ 792,919**	$ 721,366	**$ 713,856**	$ 659,502	**$ 137,144**	$ 127,633
Net	**$ 659,844**	$ 609,861	**$ 560,992**	$ 532,442	**$ 106,286**	$ 102,205

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.

(d) LIABILITY ADEQUACY TEST

At each reporting date the Company performs a liability adequacy test on its insurance liabilities less deferred policy acquisition expenses to ensure the carrying value is adequate, using current estimates of future cash flows, taking into account the relevant investment return. If that assessment shows that the carrying amount of the liabilities is inadequate, any deficiency is recognized as an expense to the income statement initially by writing off the deferred policy acquisition expense and subsequently by recognizing an additional claims liability for claims provisions.

3. INSURANCE CONTRACTS (continued)

(e) REINSURANCE

The Company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Retention limits for the excess-of-loss reinsurance are set by product line. 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 due to reinsurer and are recognized as an expense when due.

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 $600,000 (2016 - $650,000) in the event of a property claim, an amount of $700,000 (2016 - $700,000) in the event of an automobile claim and $600,000 (2016 - $650,000) in the event of a liability claim and $60,000 (2016 - $60,000) in the event of a farmers' accident claim. The Company also obtained reinsurance which limits the Company's liability to $1,800,000 (2016 - $1,950,000) 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 70% of gross net earned premiums.

Reinsurance is placed with Farm Mutual Re, a Canadian registered reinsurer. Management monitors the creditworthiness of Farm Mutual Re by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract. At year-end the Company reviewed the amounts owing from its reinsurer and determined that no allowance is necessary.

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.

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. Changes in due from reinsurer recorded in the statement of financial position for the years-ended December 31, 2017 and 2016 follows:

Due from Reinsurer

	2017	2016
Balance, beginning of the year	**$ 163,783**	$ 275,547
Submitted to reinsurer	**5,539,707**	62,738
Received from reinsurer	**(3,728,782)**	(174,502)
Balance, end of the year	**$ 1,974,708**	$ 163,783

3. INSURANCE CONTRACTS (continued)

Changes in the reinsurers' share of provision for unpaid claims recorded in the statement of financial position for the years-ended December 31, 2017 and 2016 follows:

Reinsurers' share of provision for unpaid claims

	2017	2016
Balance, beginning of the year	**$ 10,408,663**	$ 7,429,557
New claims reserve	**5,325,469**	2,037,425
Change in prior years reserve	**(415,961)**	1,004,419
Submitted to reinsurer	**(5,539,707)**	(62,738)
Balance, end of the year	**$ 9,778,464**	$ 10,408,663

(f) REFUND OF PREMIUM

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

4. INVESTMENTS

The Company classifies its investments into one of the following categories based on the purpose for which the asset was acquired.

(a) FAIR VALUE THROUGH PROFIT OR LOSS

Fair value through profit or loss includes both debt and equity instruments. These instruments are initially recognized at fair value and transaction costs that are directly attributable to their acquisition are recognized in profit or loss as incurred. Subsequently they are carried at fair value and changes therein are recognized in profit or loss.

Where there is a significant or prolonged decline in the fair value of a fair value through profit or loss financial asset, which constitutes objective evidence of impairment, the full amount of the impairment is recognized in profit or loss.

Purchases and sales of debt and equity instruments are recognized on a settlement date basis.

4. INVESTMENTS (continued)

(b) LOANS AND RECEIVABLES

These assets are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand. These instruments are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition or issue and subsequently carried at amortized cost, using the effective interest rate method, less any impairment losses.

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 fair value as shown below.

Fair value through profit or loss

	December 31, 2017		December 31, 2016	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Short-term investments				
Bankers acceptance	**$ 1,796,397**	**$ 1,798,015**	$ 1,416,814	$ 1,417,231
Bonds issued by				
Provincial	**21,365,821**	**21,355,103**	18,660,656	18,822,380
Municipal	**3,866,369**	**3,709,924**	1,948,319	1,938,916
Corporate				
A or better	**20,274,133**	**20,206,697**	22,266,822	22,531,334
BBB	**4,966,003**	**5,010,498**	1,992,355	2,111,632
	50,472,326	**50,282,222**	44,868,152	45,404,262
Equity investments				
Canadian	**9,137,606**	**14,590,724**	10,145,704	15,447,715
Foreign	**4,115,183**	**4,715,124**	3,719,846	4,390,939
	13,252,789	**19,305,848**	13,865,550	19,838,654
Other investments				
Fire Mutuals Guarantee Fund	**69,894**	**69,894**	70,813	70,170
	$ 65,591,406	**$ 71,455,979**	$ 60,221,329	$ 66,730,317

Loans and receivables

Loan receivable	**$ 863,038**	**$ 863,038**	$ 991,313	$ 991,313

4. INVESTMENTS (continued)

Credit Risk

The Company is exposed to credit risk relating to its debt holdings in its investment portfolio.

The Company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The bond portfolio includes 90% (2016 - 95%) of bonds rated A or better. The Company's investment policy limits investment in bonds and debentures of the various ratings to limits ranging from 70% to 90% of the Company's portfolio. Funds should be invested in bonds and debentures of Federal, Provincial or Municipal Government and corporations rated BBB or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

The maximum exposure to investment credit risk is the carrying value of investments.

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.

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.

The Company's investment policy requires that 0% to 25% of the Company's portfolio be held in cash and short-term investments. Short-term investments include treasury bills, commercial paper and term deposits with an original maturity of less than one year.

Maturity profile of bonds held is as follows:

	Within 1 Year	2 to 5 years	6 to 10 years	Over 10 years	Fair value
December 31, 2017	**$ 710,905**	**$ 20,301,587**	**$ 24,313,738**	**$ 4,955,992**	**$ 50,282,222**
Percent of total	**1 %**	**40 %**	**48 %**	**10 %**	
December 31, 2016	$ 402,901	$ 17,449,071	$ 19,441,159	$ 8,111,131	$ 45,404,262
Percent of total	1 %	38 %	43 %	18 %	

4. INVESTMENTS (continued)

Maturity profile of loans and receivables held is as follows:

	Within 1 Year	2 to 5 years	6 to 10 years	Over 10 years	Fair value
December 31, 2017	**$ -**	**$ -**	**$ 863,038**	**$ -**	**$ 863,038**
Percent of total	**- %**	**- %**	**100 %**	**- %**	
December 31, 2016	$ -	$ -	$ 991,313	$ -	$ 991,313
Percent of total	- %	- %	100 %	- %	

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

Market Risk

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. The policy limits the investment in any one corporate issuer to a maximum of 10% (except government sponsored bonds) of the Company's portfolio.

The Company's currency risk is related to stock holdings which are limited to United States and International equities in sectors which are not readily available in Canada. The Company limits its holding in foreign equity to 15% of the total investment portfolio 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.

The Company is exposed to interest rate risk through its interest bearing investments (Bankers Acceptances, T-Bills, GICs, and Bonds).

Historical data and current information is used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. However, because a significant portion of the Company's assets relate to its capital rather than liabilities, the value of its interest rate based assets exceeds its interest rate based liabilities. As a result, generally, the Company's investment income will move with interest rates over the medium to long-term with short-term interest rate fluctuations creating unrealized gain or losses in comprehensive income. There are no occurrences where interest would be charged on liabilities; therefore, little protection is needed to ensure the fair market value of assets will be offset by a similar change in liabilities due to an interest rate change.

At December 31, 2017, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by $2,556,220 (2016 - $2,713,198). These changes would be recognized in comprehensive income.

4. INVESTMENTS (continued)

The Company is exposed to equity risk through its portfolio of Canadian and Foreign stocks. At December 31, 2017 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 equity portfolio of $1,830,770 (2016 - $1,933,090). These changes would be recognized in comprehensive income.

The Company's investment policy limits investment in preferred and common shares to a maximum of 35% of the market value of the investment portfolio. The total investment in preferred and common shares cannot exceed 25% of the total assets of the Company. For the years December 31, 2017 and 2016 there were no holdings of preferred shares.

Equities are monitored by the board of directors and holdings are adjusted following each quarter when the investments are offside of the investment policy.

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

The following table provides an analysis of investments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- 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).

	Level 1	Level 2	Level 3	Total
December 31, 2017				
Bankers acceptance	**$ 1,798,015**	**$ -**	**$ -**	**$ 1,798,015**
Bonds	**-**	**50,282,222**	**-**	**50,282,222**
Equities	**19,305,848**	**-**	**-**	**19,305,848**
Other investments	**-**	**69,894**	**-**	**69,894**
Total	**$ 21,103,863**	**$ 50,352,116**	**$ -**	**$ 71,455,979**
December 31, 2016				
Bankers acceptance	$ 1,417,231	$ -	$ -	$ 1,417,231
Bonds	-	45,404,262	-	45,404,262
Equities	19,838,654	-	-	19,838,654
Other investments	-	70,170	-	70,170
Total	$ 21,255,885	$ 45,474,432	$ -	$ 66,730,317

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2017 and 2016.

5. INVESTMENT AND OTHER INCOME

	2017	2016
Interest income	**$ 1,800,786**	$ 1,628,428
Dividend income	**587,010**	601,393
Investment expenses	**(190,707)**	(237,308)
Net realized gains on disposal of investments	**1,301,456**	298,313
Change in unrealized gains (losses) on investments	**(646,588)**	1,751,187
Foreign exchange	**(24,638)**	(194,437)
Other income [1]	**-**	20,382
	$ 2,827,319	$ 3,867,958

[1] Other income consists of:

a) During the prior year, the Company recovered $20,382 from their investment in Group #1 Financial. This investment had been previously written down to $nil.

6. CAPITAL MANAGEMENT

For the purpose of capital management, the Company has defined capital as policyholders' surplus.

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.

The regulators measure the financial strength of property and casualty insurers using a minimum capital test (MCT). The regulators generally expect property and casualty companies to comply with capital adequacy requirements. This test compares a Company's capital against the risk profile of the organization. The risk-based capital adequacy framework assesses the risk of assets, policy liabilities and other exposures by applying various factors. The regulator indicates that the Company should produce a minimum MCT of 150%. During the year, the Company has consistently exceeded this minimum. The regulator has the authority to request more extensive reporting and can place restrictions on the Company's operations if the Company falls below this requirement and deemed necessary.

7. FEES, COMMISSIONS AND OTHER ACQUISITION EXPENSES

	2017	2016
Commissions	**$ 5,582,411**	$ 5,206,426
Other	**390,821**	322,483
	$ 5,973,232	$ 5,528,909

8. OTHER OPERATING AND ADMINISTRATIVE EXPENSES

	2017	2016
Computer costs	**$ 628,488**	$ 786,646
Licenses, fees and dues	**188,901**	207,550
Depreciation	**113,953**	107,701
Property taxes, repairs and maintenance	**108,988**	135,663
Utilities	**27,606**	50,877
Postage and office supplies	**79,883**	84,483
Professional fees	**47,895**	41,818
Salaries, benefits and directors fees (Note 9)	**1,564,053**	2,016,064
Other	**261,459**	191,860
	$ 3,021,226	$ 3,622,662

9. SALARIES, BENEFITS AND DIRECTORS FEES

	2017	2016
Underwriter salaries and benefits	**$ 1,092,009**	$ 1,355,847
Other salaries, benefits and directors fees	**472,044**	660,217
	$ 1,564,053	$ 2,016,064

Included in claims expenses were salary and benefits costs of $1,532,888 (2016 - $1,372,532).

10. INCOME TAXES

Income tax expense is comprised of current and deferred tax. Current and deferred tax are recognized in comprehensive income. The Company is subject to income taxes on the portion of its income derived from insuring other than farm related risks.

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

	2017	2016
Current tax expense		
Based on current year taxable income	**$ 129,000**	$ 196,000
Deferred tax expense		
Origination and reversal of temporary differences	**(18,000)**	(13,000)
Reduction (increase) in tax rate	**(6,000)**	(3,000)
	(24,000)	(16,000)
Total provision for income taxes	**$ 105,000**	$ 180,000

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rate of 26.5% (2016 - 26.5%) are as follows:

	2017	2016
Income before income taxes	**$ 1,041,092**	$ 1,507,763
Expected taxes based on the statutory rate of 26.5% (2016 - 26.5%)	**276,000**	400,000
Income from insuring farm related risks	**(46,000)**	(76,000)
Non deductible portion of claims liabilities	**10,000**	41,000
Other non deductible expenses	**7,000**	7,000
Adjustments related to investments	**(143,000)**	(168,000)
Capital cost allowance in excess of depreciation	**25,000**	(8,000)
Total current tax expense	**$ 129,000**	$ 196,000

11. STRUCTURED SETTLEMENTS, FIRE MUTUALS GUARANTEE FUND AND FINANCIAL GUARANTEE CONTRACTS

The Company enters into annuity agreements with various life insurance companies to provide for fixed and recurring payments to claimants. Under such arrangements, the settlement amount is removed from the provision for unpaid claims as the Company's liability to its claimants is substantially transferred. However, the Company remains exposed to the credit risk that life insurers fail to fulfill their obligations.

The Company is a member of the Fire Mutuals Guarantee Fund ("the Fund"). The Fund was established to provide payment of outstanding policyholders' claims and unearned premiums if a member company becomes insolvent. As a result, the Company may be required to contribute assets to their proportionate share in meeting this objective.

These exposures represent financial guarantee contracts. The Company accounts for financial guarantee contracts in accordance with IFRS 4, Insurance Contracts.

12. PROPERTY, PLANT AND EQUIPMENT

Property, plant and 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. Depreciation is recognized in comprehensive income and is provided on a straight-line basis over the estimated useful life of the assets.

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

		December 31, 2017		
	Useful Life	**Cost**	**Accumulated Depreciation**	**Net Book Value**
Land and land improvements	**N/A**	**$ 367,121**	**$ -**	**$ 367,121**
Buildings	**50 years**	**3,169,787**	**594,910**	**2,574,877**
Computer hardware	**3 years**	**467,666**	**351,022**	**116,644**
Office furniture and equipment	**15 & 5 years**	**465,821**	**262,288**	**203,533**
Signs	**25 years**	**50,723**	**20,289**	**30,434**
Parking lot	**20 years**	**36,750**	**18,375**	**18,375**
		$ 4,557,868	**$ 1,246,884**	**$ 3,310,984**

		December 31, 2016		
	Useful Life	Cost	Accumulated Depreciation	Net Book Value
Land and land improvements	N/A	$ 367,121	$ -	$ 367,121
Buildings	50 years	3,128,687	556,085	2,572,602
Computer hardware	3 years	315,023	294,574	20,449
Office furniture and equipment	15 & 5 years	443,181	242,234	200,947
Signs	25 years	50,723	18,260	32,463
Parking lot	20 years	36,750	16,538	20,212
		$ 4,341,485	$ 1,127,691	$ 3,213,794

13. PENSION PLAN AND POST EMPLOYMENT BENEFITS

DEFINED BENEFIT PENSION PLAN

The Company participates in a multi-employer defined benefit pension plan (the Ontario Mutual Insurance Association Pension Plan, "the plan"), however, sufficient information is not available to use defined benefit accounting. Therefore, the Company accounts for the plan as if it were a defined contribution plan, recognizing contributions as an expense in the year to which they relate.

The Company makes contributions to the plan on behalf of members of its staff. The plan is a money purchase plan, with a defined benefit option at retirement available to some employees, which specifies the amount of the retirement benefit plan to be received by the employees based on length of service and rates of pay.

The amount contributed to the plan for 2017 was $195,288 (2016 - $241,870). The contributions were made for current service and these have been recognized in comprehensive income. These contributions amount to 3.30% of the total contributions made to the Ontario Mutual Insurance Association Pension Plan by all participating entities during the current fiscal year. In 2017, there was again a contractual requirement to fund the deficit which resulted in a lump sum payment of $237,162. This amount in excess of the 2017 funding was recognized in comprehensive income.

Expected contributions to the plan for the next annual reporting period amount to $192,000, which is based on payments made to the multi-employer plan during the current fiscal year.

The defined benefit plan has been closed to future eligible employees effective January 1, 2014. The Company and all current employees enrolled prior to that date who are accruing benefits under the defined benefit plan continue to contribute to the defined benefit plan, according to the existing terms of the agreement.

DEFINED CONTRIBUTION PENSION PLAN

Eligible employees hired after January 1, 2014 are enrolled in the defined contribution plan. The Company makes, on behalf of its employees, matching contributions up to 7.5% of their gross salary. The plan is a money purchase plan. The amount contributed to the plan for 2017 was $62,722 (2016 - $42,114). Expected contributions to the plan for the next annual reporting period amount to $70,000, which is based on payments made to the plan during the current fiscal year.

14. 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:

	2017	2016
Compensation		
Short-term employee benefits and directors' fees	**$ 452,395**	$ 536,225
Total pension and other post-employment benefits	**19,648**	123,993
	$ 472,043	$ 660,218
Premiums	**$ 90,050**	$ 88,444
Claims paid	**$ 15,993**	$ -

Amounts owing from key management personnel at December 31, 2017 are $10,780 (2016 - $7,148). The amounts are included in due from brokers and policyholders on the statement of financial position.

15. STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET EFFECTIVE

Certain new standards, amendments and interpretations have been published that are mandatory for the Company's accounting period beginning on or after January 1, 2018 or later periods that the Company has decided not to early adopt.

The standards, amendments and interpretations that will be relevant to the Company are:

IFRS 9 Financial Instruments amends the requirements for classification and measurement of financial assets, impairment, and hedge accounting. IFRS 9 introduces an expected loss model of impairment and retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through profit or loss, and fair value through other comprehensive income (loss). The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The effective date for IFRS 9 is January 1, 2018; however, insurance entities have been provided the option of deferring the adoption of IFRS 9 until January 1, 2021, which is the effective date of IFRS 17, Insurance Contracts. The Company does not plan to defer the effective date of IFRS 9 and therefore expects to adopt IFRS 9 on January 1, 2018.

The Company expects that its investments will continue to be classified at fair value through profit or loss based on the business model assessment, therefore, the adoption of IFRS 9 is not expected to have a material impact on the Company’s financial position or performance.

IFRS 17 Insurance Contracts supersedes IFRS 4 Insurance Contracts. IFRS 17 fundamentally changes how entities account for insurance contracts, introducing a default "building block approach", which disaggregates the cash flows in an insurance contract and provides a different measurement basis for each component, and a simplified "premium allocation approach" for certain short-term contracts. Assumptions used in measuring insurance assets and liabilities such as cash flows, discount rates and risk adjustment will be updated at each reporting period. The discount rate will reflect the characteristics of the insurance liabilities and the estimated future cash flows to settle claims incurred will be discounted unless the period of time between claim occurrence and settlement is less than one year. Presentation changes include 'insurance revenue' replacing the current reporting of 'written premiums' and 'earned premiums' and insurance contract assets and liabilities will not be netted. Under this standard, premiums receivable, unearned premiums and claims payable may no longer be presented separately from other insurance assets and liabilities. The effective date for IFRS 17 is January 1, 2021 with mandatory restatement of comparative periods. The Company is currently assessing the impact of IFRS 17.