Consolidated Financial Statements of

HEARTLAND FARM MUTUAL INC.

And Independent Auditors' Report thereon

Year ended December 31, 2020

HEARTLAND FARM MUTUAL INC.

Consolidated Financial Statements

December 31, 2020

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INDEPENDENT AUDITORS' REPORT

To the Policyholders and Directors of Heartland Farm Mutual Inc.

Opinion

We have audited the consolidated financial statements of Heartland Farm Mutual Inc. (the "Company"), which comprise:

- the consolidated statement of financial position as at December 31, 2020;
- the consolidated statement of income and comprehensive income for the year then ended;
- the consolidated statement of changes in surplus for the year then ended;
- the consolidated statement of cash flows for the year then ended;
- the consolidated schedule of operating expenses for the year then ended;
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of Heartland Farm Mutual Inc. as at December 31, 2020, and its consolidated results of financial performance, and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the ***Auditors' Responsibilities for the Audit of the Financial Statements*** section of our auditors' report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the 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.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represents the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company and its subsidiaries to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Waterloo, Canada
February 19, 2021

APPOINTED ACTUARY’S REPORT

To the Policyholders and Directors of Heartland Farm Mutual Inc.

I have valued the policy liabilities and reinsurance recoverable of Heartland Farm Mutual Inc. for its consolidated statement of financial position as at December 31, 2020 and their change in the consolidated statement of income and comprehensive income for the year then ended in accordance with accepted actuarial practice in Canada, including selection of appropriate assumptions and methods.

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

Toronto, Ontario
February 19, 2021

Nicolas Beaudoin
Fellow, Canadian Institute of Actuaries

HEARTLAND FARM MUTUAL INC.

Consolidated Statement of Financial Position
(in thousands of dollars)

As at December 31, 2020, with comparative information for 2019

	2020	2019
Assets		
Cash	$ 22,787	$ 34,207
Invested assets (note 4)	194,382	178,470
Due from brokers	4,026	4,171
Premiums receivable from policyholders	28,664	27,576
Accrued investment income	599	677
Insurance and other receivables	2,039	1,822
Deferred income taxes (note 10)	490	613
Reinsurers' share of:		
Unearned premiums (note 8(b))	529	900
Unpaid claims and adjustment expenses (note 8)	27,703	32,867
Deferred policy acquisition costs	15,128	13,504
Property and equipment (note 6)	7,034	7,131
Intangible assets (note 7)	11,579	2,835
Other assets	1,429	1,064
	$ 316,389	$ 305,837
Liabilities		
Expenses due and accrued	$ 4,269	$ 4,423
Due to other insurers	271	2,718
Due to brokers	5,166	4,515
Income taxes payable	2,074	2,461
Provision for unpaid claims (note 8)	116,452	128,144
Unearned reinsurance commissions	91	103
Unearned premiums (note 8(b))	67,003	64,943
Total liabilities	195,326	207,307
Surplus for the protection of policyholders		
Policyholders' equity	111,464	86,410
Accumulated other comprehensive income	9,599	12,120
Total surplus	121,063	98,530
	$ 316,389	$ 305,837

See accompanying notes to the consolidated financial statements.

On behalf of the Board: Larry Binning, Chair, Louis Durocher, Director

HEARTLAND FARM MUTUAL INC.

Consolidated Statement of Income and Comprehensive Income
(in thousands of dollars)

For the year ended December 31, 2020, with comparative information for 2019

		2020		2019
Gross written premiums	$	132,500	$	128,396
Reinsurance ceded		(12,580)		(16,171)
Net written premiums		119,920		112,225
Change in unearned premiums				
Gross amount		(2,060)		(239)
Reinsurer's share		368		(200)
		(1,692)		(439)
Net premiums earned		118,228		111,786
Other		2,664		867
Underwriting revenue		120,892		112,653
Underwriting expenses				
Gross claims and adjustments expenses		63,775		91,555
Reinsurer's share of claims and adjustment expenses		(10,013)		(23,532)
Net claims and adjustment expense		53,762		68,023
Commissions		24,811		23,715
Premium taxes		3,896		3,649
Salaries and benefits		10,152		9,947
Operating expenses		6,815		5,175
		99,436		110,509
Underwriting income		21,456		2,144
Interest income		3,828		4,573
Investment expenses		(486)		(496)
Realized gain on available-for-sale financial assets		4,491		655
Unrealized gain on financial assets at fair value through profit or loss		5,065		1,497
Income before income taxes		34,354		8,373
Income taxes (note 9)				
Current		9,176		1,249
Deferred		124		474
		9,300		1,723
Net income	$	25,054	$	6,650
Other comprehensive income (loss)				
Unrealized gain (loss) on available-for-sale assets arising during the period, net of tax $281 (2019 - $1,204)	$	780	$	3,419
Reclassification of realized (gain)/loss on available-for-sale financial assets to net income, net of tax of $(1,190) (2019 - $(170))		(3,301)		(485)
Other comprehensive income (loss)		(2,521)		2,934
Total comprehensive income	$	22,533	$	9,584

See accompanying notes to the consolidated financial statements.

HEARTLAND FARM MUTUAL INC.

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

For the year ended December 31, 2020, with comparative information for 2019

		2020		2019
Policyholders' equity				
Balance, beginning of year	$	86,410	$	79,760
Net income		25,054		6,650
Balance, end of year		111,464		86,410
Accumulated other comprehensive income				
Balance, beginning of year		12,120		9,186
Other comprehensive income (loss), net of income taxes		(2,521)		2,934
Balance, end of year		9,599		12,120
Total surplus	$	121,063	$	98,530

Accumulated other comprehensive income ("AOCI") is composed of unrealized gains on available-for-sale securities, net of income taxes of $2,151 (2019 - $3,060).

See accompanying notes to the consolidated financial statements.

HEARTLAND FARM MUTUAL INC.

Consolidated Statement of Cash Flows
(in thousands of dollars)

For the year ended December 31, 2020, with comparative information for 2019

	2020	2019
Operating activities		
Premiums received, net of reinsurance $12,580 (2019 - $16,171)	$ 117,268	$ 112,222
Fee income received	2,664	867
Investment income received	3,420	3,928
Income taxes recovered (paid)	(8,654)	1,546
	114,698	118,563
Claims payments	(60,506)	(67,211)
Policy acquisition expenses paid, net of commissions from reinsurers	(29,691)	(30,109)
Operating expenses	(16,785)	(10,857)
	(106,982)	(108,177)
Cash provided by operating activities	7,716	10,386
Investing activities		
Bonds and bond fund purchases	(75,100)	(54,215)
Bonds sold, redeemed or matured	70,087	53,487
Short-term investments purchased	2,228	(2,341)
Common equities and equity fund sales (purchases)	(7,000)	5,000
Proceeds from disposal of property and equipment	19	429
Purchase of property and equipment	(301)	(236)
Purchase of intangible assets	(9,069)	(2,768)
Cash used by investing activities	(19,136)	(644)
Increase (decrease) in cash	(11,420)	9,742
Cash, beginning of year	34,207	24,465
Cash, end of year	$ 22,787	$ 34,207

See accompanying notes to the consolidated financial statements.

HEARTLAND FARM MUTUAL INC.

Consolidated Schedule of Operating Expenses
(in thousands of dollars)

For the year ended December 31, 2020, with comparative information for 2019

	2020	2019
Education and training	$ 93	$ 93
Occupancy	823	853
Marketing, branding and advertising	58	133
Automobile and travel	188	400
Bureaus and associations	528	792
Donations	160	82
Information technology	3,828	2,480
Furniture and equipment	(29)	86
Underwriting reports	480	696
Insurance	175	189
Postage and courier	242	240
Printing and stationery	93	128
Professional fees	1,722	747
Telephone and other communications	59	75
Bad debts	7	7
Miscellaneous	543	92
	8,970	7,093
Less portion allocated to net claims and adjustment expenses	2,155	1,918
Operating expenses	$ 6,815	$ 5,175

See accompanying notes to the consolidated financial statements.

Organization and nature of the business

Heartland Farm Mutual Inc. (“the Company”) was incorporated under the laws of Canada and is subject to the Insurance Companies Act of Canada. It is licensed to write property, general liability, automobile, hail, boiler and machinery, aircraft, fidelity and accident and sickness insurance in Ontario, Nova Scotia, Prince Edward Island, New Brunswick, Manitoba, Saskatchewan and Alberta. The Company’s Head Office is located in Waterloo, Ontario.

1. Basis of presentation

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The financial statements were approved by the Board of Directors on February 19, 2021.

(b) Basis of measurement

The consolidated financial statements have been prepared on a historical cost basis, except for the following items in the statement of financial position:

- financial instruments at fair value through profit or loss are measured at fair value
- available-for-sale financial assets which are measured at fair value
- and insurance contract assets and liabilities which are measured using acceptable actuarial practices

(c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. Except as otherwise indicated, all financial information presented in Canadian dollars has been rounded to the nearest thousand.

(d) Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future periods affected.

Information about critical judgments in applying accounting policies that have the most significant effect on amounts recognized in the consolidated financial statements is discussed in note 3.

2. Significant accounting policies

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

(a) Basis of consolidation

(i) Subsidiaries

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

The consolidated financial statements include all financial operations of Heartland Farm Mutual Inc. and its wholly-owned subsidiaries 8037574 Canada Inc. and 3078191 Canada Inc.

(ii) Transactions eliminated on consolidation

Intra-company balances and transactions, and any unrealized revenue and expenses arising from intra-company transactions, are eliminated in preparing these consolidated financial statements.

(b) Financial instruments

The Company's financial instruments are classified into one of the following four categories, as defined below

- Financial assets at fair value through profit or loss ("FVTPL")
- Available-for-sale ("AFS")
- Loans and receivables
- Other financial liabilities

All financial instruments are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Instruments classified as FVTPL may never be reclassified and, except in very limited circumstances, the classification of other instruments is not changed subsequent to initial recognition. Financial assets purchased and sold, where the contract requires the asset to be delivered within an established time frame, are recognized on a settlement date basis.

2. Significant accounting policies (continued)

(b) Financial instruments (continued)

Transaction costs are expensed as incurred for FVTPL financial instruments. For other financial instruments, transaction costs are capitalized on initial recognition. The effective interest method of amortization is used for any transaction costs capitalized on initial recognition and for the premiums or discounts earned on AFS investments.

The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. Subsequent to initial recognition, the fair values are determined based on available information. The fair values of investments are based on the quoted market prices at bid. The fair values of commercial loans and other financial instruments are obtained using discounted cash flow analysis. Unless otherwise disclosed, the carrying values of financial instruments approximate their fair values.

(i) Financial assets at fair value through profit or loss

A financial asset is classified as FVTPL if it was classified as held-for-trading or is designated as such upon initial recognition. FVTPL financial assets are purchased with the intention of generating profits in the near term or are voluntarily so designated by the Company. Changes in fair values are recorded as unrealized gain (loss) on financial assets at fair value through profit or loss in the statement of income and comprehensive income with the related tax impact included in the current and deferred tax line items.

(ii) Available-for-sale

Changes in fair values are recorded, net of income taxes, in other comprehensive income (“OCI”) in the statement of income and comprehensive income until the financial instrument is disposed of, or where there has been a significant or prolonged decline in the fair value of an AFS financial asset. When the instrument is disposed of, the gain or loss is reclassified from OCI to realized gain (loss) on available for sale financial assets in the statement of income and comprehensive income. Gains and losses on the sale of AFS financial instruments are calculated on an average cost basis.

(iii) Loans and receivables

Financial instruments classified as loans and receivables are carried at amortized cost using the effective interest rate method. When there is a significant or prolonged decline in value, the value of these financial instruments is written down to the estimated net realizable value.

2. Significant accounting policies (continued)

(b) Financial instruments (continued)

(iv) Financial liabilities

Financial liabilities are recognized initially on the trade date at which the Company becomes party to the contractual provisions of the instrument. The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

(c) Investment income and expenses

Interest income from fixed income securities is recognized on an accrual basis using the effective interest rate method and reported within interest and dividend income.

Dividends on equity investments are recognized when the shareholder's right to receive payment is established, which is the ex-dividend date, and are reported within interest and dividend income.

General investment expenses are recognized as incurred.

(d) Real estate

Items of real estate are recorded at cost less accumulated depreciation and accumulated impairment losses. Any gain or loss on disposal of real estate calculated as the difference between the net proceeds from the disposal and the carrying amount of the item, is recognized in profit or loss.

(e) Impairment

(i) Financial assets

A financial asset not carried at FVTPL is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

Factors considered in determining whether a loss is significant or prolonged include the duration and extent to which fair value has been below cost, financial condition and near-term prospects of the issuer, and the Company’s ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

If an AFS investment becomes impaired, the loss is reclassified from OCI to realized gain (loss) on available for sale financial assets in the statement of income and comprehensive income.

2. Significant accounting policies (continued)

(e) Impairment (continued)

(i) Financial assets (continued)

The cumulative loss that is removed from accumulated other comprehensive income and recognized in income is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in income.

If, in a subsequent period, the fair value of an impaired AFS debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognized in income, then the impairment loss is reversed, with the amount of the reversal recognized in income.

The Company considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant receivables are assessed for specific impairment. Receivables that are not individually significant are collectively assessed for impairment. In assessing collective impairment, the Company uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in income and reflected in an allowance account against receivables. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through income.

(ii) Non-financial assets

The carrying amounts of the Company’s non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset’s recoverable amount is estimated. An impairment loss is recognized if the carrying amount of an asset exceeds its estimated recoverable amount.

The recoverable amount of an asset is the greater of its value in use and its fair value less expected selling costs. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in income in the period in which the impairment is determined.

2. Significant accounting policies (continued)

(f) Property and equipment

(i) Recognition and measurement

Head office property is stated at its revalued amounts, being the fair value at January 1, 2010, the date of revaluation upon adoption of IFRS ("deemed cost") plus subsequent additions less accumulated depreciation and accumulated impairment losses. Equipment and automobiles are recorded at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset.

Gains and losses on disposals of property and equipment are determined by comparing the proceeds with the carrying amount of the item disposed, and are recognized on a net basis within income.

(ii) Subsequent costs

The cost of replacing a part of an item of property and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day maintenance and repairs are expensed as incurred.

(iii) Depreciation

Depreciation is recognized in net income and is amortized over the estimated useful life of the assets as follows

Buildings and building components	10 - 40 years, straight line
Computer hardware	3 years, straight line
Furniture and fixtures	20% declining balance
Vehicles	30% declining balance

Depreciation methods, useful lives and residual values are reviewed periodically and adjusted if necessary. Depreciation is prorated over the number of months of functional use in both the year of purchase and disposal.

(iv) Reclassification of real estate

When the use of a property changes between owner-occupied and investment property, the property is reclassified based on its carrying value.

2. Significant accounting policies (continued)

(g) Intangible assets

Intangible assets consist of computer software which is not integral to the computer hardware owned by the Company. Software is recorded at cost less accumulated amortization and accumulated impairment losses. Software is amortized on a straight-line basis over its estimated useful life of 3 to 10 years. The amortization expense is included within the other operating expenses in the statement of income and comprehensive income.

(h) Insurance contracts

(i) Classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk arises when the Company agrees to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. Contracts not meeting the definition of insurance contracts are classified as investment contracts, derivative contracts or service contracts. The Company has reviewed all the contracts issued to its policyholders and concluded that they all meet the definition of insurance contracts.

(ii) Premiums and unearned premiums

Premiums are taken into income on a pro rata basis over the contract period. Premiums on policies written with monthly payment terms are accounted for on an annualized basis. Premiums related to the unexpired portion of the policy at the end of the fiscal year are reflected in unearned premiums. Amounts receivable from policyholders represents the premiums due for the remaining months of the contracts. The Company records a liability for the unearned portion of premiums.

(iii) Deferred policy acquisition expenses

Commissions and premium taxes related to securing new insurance contracts and renewing existing insurance contracts are deferred to the extent they are considered recoverable. All other costs are recognized as expenses when incurred. The deferred policy acquisition expenses are subsequently amortized over the terms of the related policies. To the extent they are considered non-recoverable, they are expensed as incurred.

2. Significant accounting policies (continued)

(h) Insurance contracts (continued)

(iv) Provision for unpaid claims and adjustment expenses

The provision for unpaid claims is calculated based on Canadian accepted actuarial practice. The provision consists of case estimates prepared by claims adjusters and a provision for incurred but not reported claims ("IBNR"). The estimates include related investigation, settlement and adjustment expenses. The valuation of claims liabilities, which is valued on a discounted basis, is disclosed in note 8.

(v) Liability adequacy test

At the end of each reporting period, the Company performs a liability adequacy test on its insurance liabilities less deferred policy acquisition expenses to ensure the carrying value is adequate. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities are used. Any deficiency is immediately charged to income initially by writing off deferred policy acquisition expenses and by subsequently establishing a provision for losses arising from liability adequacy tests (the "premium deficiency"). Impairment losses resulting from liability inadequacy can be reversed in future years if the impairment no longer exists.

(vi) Reinsurance contracts held

Contracts entered into by the Company with the reinsurer under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held.

Reinsurance does not relieve the Company of its liability to its policyholders and is reflected on the statement of financial position on a gross basis to indicate the extent of credit risk related to reinsurance and the obligations to policyholders.

The benefits to which the Company is entitled under its reinsurance contracts held are recognized as amounts recoverable from reinsurer (reinsurance asset). These assets consist of short-term balances due from reinsurer, as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from reinsurer are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract.

2. Significant accounting policies (continued)

(h) Insurance contracts (continued)

(vi) Reinsurance contracts held (continued)

The Company assesses its reinsurance assets for impairment on a yearly basis. If there is objective evidence that the amount recoverable is impaired, the Company reduces the carrying amount of the reinsurance asset to its recoverable amount and recognizes that impairment loss in the statement of income and comprehensive income. The carrying amount is reduced through the use of an allowance account.

(vii) Salvage and subrogation recoverable

In the normal course of business, the Company obtains the ownership of damaged property, which is then resold to various salvage operations. Unsold property is valued at its estimated net realizable value.

Where the Company indemnifies policyholders against a liability claim, it acquires rights to subrogate its claim against other parties.

(i) Income taxes

Income tax expense comprises current and deferred taxes. Current tax and deferred tax are recognized in income except to the extent that it relates to items recognized directly in equity or in OCI.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to taxes payable in respect of previous years.

Deferred tax is a result of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for tax purposes. Deferred tax assets are recognized only to the extent it is probable that sufficient taxable profits will be available against which the benefit of these deferred tax assets can be utilized.

Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Changes in deferred income taxes related to a change in tax rates are recognized in income in the period in which the tax change was enacted or substantively enacted.

Deferred income tax assets and liabilities are offset when they arise from the same taxation authority and the Company has both the legal right and the intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

2. Significant accounting policies (continued)

(j) Business combinations

The Company accounts for business combinations using the acquisition method when control is transferred. In the statement of financial position, the deemed acquiree's identifiable assets and liabilities are initially measured at their fair values at the acquisition date. In the statement of changes in surplus, the deemed acquiree's net assets are recognized as a direct addition to surplus. The results of acquired operations are included in the statement of comprehensive income from the date on which control is obtained.

(k) Future changes in accounting policies

(i) IFRS 17, *Insurance Contracts*

On May 18, 2017 the IASB issued IFRS 17 Insurance Contracts. On June 25, 2020, the IASB issued amendments to IFRS 17 aimed at helping companies implement the Standard and to defer the effective date. IFRS 17 will replace IFRS 4 Insurance Contracts. The new standard and its amendments are effective for annual periods beginning on or after January 1, 2023.

This Standard introduces consistent accounting for all insurance contracts. The Standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires an entity to recognize profits as it delivers insurance services, rather than when it receives premiums.

The Company intends to adopt IFRS 17 in its financial statements for the annual period beginning on January 1, 2023. The extent of the impact of adoption of the standard has not yet been determined.

(ii) IFRS 9, *Financial Instruments*

In July 2014, the IASB issued the complete amended IFRS 9, Financial Instruments. The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2019 and must be applied retrospectively with some exemptions. Early adoption is permitted. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight.

IFRS 9 introduces new requirements for the classification and measurement of financial assets based on the business model in which they are held and the characteristics of their contractual cash flows. It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

The standard also introduces additional changes relating to financial liabilities.

2. Significant accounting policies (continued)

(k) Future changes in accounting policies (continued)

(ii) IFRS 9, *Financial Instruments (continued)*

IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. Special transitional requirements have been set for the application of the new general hedging model.

In September 2016, the IASB issued amendments to IFRS 4, Insurance Contracts to address accounting mismatches and volatility that may arise in profit or loss in the period between the effective date of IFRS 9 and the new insurance contracts standard, IFRS 17. The amendments allow insurance entities whose predominant activities are to issue insurance contracts within the scope of IFRS 4, an optional temporary exemption from applying IFRS 9 until the effective date of IFRS 17.

The amendments introduce two approaches that may be adopted by insurers in the period between the effective date of IFRS 9 and IFRS 17:

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

- temporary exemption – an optional temporary exemption from IFRS 9 for companies whose activities are predominately connected with insurance. This exemption allows an entity to continue to apply existing financial instrument requirements in IAS 39 to all financial assets until the earlier of the application of IFRS 17 or January 1, 2023.

The Company is an eligible insurer that qualifies for optional relief from the application of IFRS 9.As at January 1, 2019, the Company elected to apply the optional transitional relief under IFRS 4 that permits the deferral of the adoption of IFRS 9 for eligible insurers. The Company will continue to apply IAS 39 until January 1, 2021. See note 4(d) for additional disclosures which enable comparison between the Company and entities that applied IFRS 9 at January 1, 2019.

3. Significant judgments and estimates

The Company makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The effect of a change in an accounting estimate is recognized in 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.

(a) Significant judgments

Significant judgments made in applying accounting policies are as follows:

(i) Impairments on AFS financial assets

As of each reporting date, the Company evaluates AFS financial assets in an unrealized loss position for impairment on the basis described in note 2(e).

For investments in bonds and debentures, evaluation of whether impairment has occurred is based on the Company's best estimate of the cash flows expected to be collected at the individual investment level. The Company considers all available information relevant to the collectability of the investment, including information about past events, current conditions, and reasonable and supportable forecasts. Estimating such cash flows is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of any underlying collateral for asset-backed securities. Where possible, this data is benchmarked against third party sources.

Impairments for bonds and debentures in an unrealized loss position are deemed to exist when the Company does not expect full recovery of the amortized cost of the investment based on the estimate of cash flows expected to be collected or when the Company intends to sell the investment prior to recovery from its unrealized loss position.

For equity investments, the Company recognizes an impairment loss in the period in which it is determined that an investment has experienced significant or prolonged losses and is not expected to recover to its cost.

There were no write-downs of AFS equities in 2020 (2019 - $nil).

3. Significant judgments and estimates (continued)

(b) Estimates

Information about assumptions and estimation uncertainties that have a risk of resulting in material adjustment within the next 12 months are as follows:

(i) Provision for unpaid claims

The Appointed Actuary is appointed by the Board of Directors of the Company. With respect to preparation of these consolidated financial statements, the Appointed Actuary is required to carry out a valuation of the policy liabilities and to provide an opinion to the Company's policyholders regarding their appropriateness at the reporting date. The factors and techniques used in the valuation are in accordance with accepted actuarial practice, applicable legislation and associated regulations.

Provisions for unpaid claims and adjustment expenses are valued based on Canadian accepted actuarial practice, which are designed to ensure the Company establishes an appropriate reserve on the statement of financial position to cover insured losses with respect to the reported and unreported claims incurred as of the end of each accounting period and claims expenses.

The policy liabilities consist of the provisions for, and reinsurance recovery of, net policy liabilities under insurance contracts, unpaid claims and adjustment expenses on insurance policies in force, and future obligations on the unearned portion of insurance policies in force, including deferred policy acquisition costs. In performing the valuation of the liabilities, the Appointed Actuary makes assumptions, which are by their nature inherently variable, as to future loss ratios, trends, rates of claims frequency and severity, inflation, reinsurance recoveries, investment rates of return, expenses and other contingencies, taking into consideration the circumstances of the Company and the nature of the insurance policies.

The assumptions underlying the valuation of provisions for unpaid claims are reviewed and updated by the Company on an ongoing basis to reflect recent and emerging trends in experience and changes in risk profit of the business.

(ii) Deferred policy acquisition expenses

Deferred policy acquisition expenses are deferred and amortized in accordance with the accounting policy in note 2(h)(iii). The Company estimates expenses eligible for deferral based on the nature of expenses incurred.

(in thousands of dollars)

4. Invested assets

(a) Classification

The Company manages its investments according to the directives outlined in its Investment Policy Statement, which is reviewed and approved by the Finance and Audit Committee on an annual basis. The Company's financial risk management objectives are to maximize the long-term surplus of the Company, and to partially offset the effects of discounting the Company's claims liabilities at the fair value yield.

Invested asset balances at carrying values by financial instrument classification are as follows:

2020	Other	FVTPL	AFS	Total
Term deposits	$ 32,311	$ ---	$ ---	$ 32,311
Bonds				
Federal government	---	26,199	---	26,199
Provincial government	---	54,627	---	54,627
Corporate	---	37,984	---	37,984
Equities				
Pooled Fund Canadian	---	---	11,979	11,979
Common Shares Global	---	---	30,802	30,802
Real estate	480	---	---	480
	$ 32,791	$ 118,810	$ 42,781	$ 194,382

2019	Other	FVTPL	AFS	Total
Term deposits	$ 34,539	$ ---	$ ---	$ 34,539
Bonds				
Federal government	---	33,657	---	33,657
Provincial government	---	42,410	---	42,410
Corporate	---	32,664	---	32,664
Pooled funds				
Canadian equity	---	---	18,803	18,803
Global equity	---	---	15,917	15,917
Real estate	480	---	---	480
	$ 35,019	$ 108,731	$ 34,720	$ 178,470

(in thousands of dollars)

4. Invested assets (continued)

(b) Fair value hierarchy

The table below provides an analysis of the basis of measurement used to fair value financial instruments carried at fair value, categorized by the following fair value hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: 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)

Level 3: Inputs for the asset or liability not based on observable market data (unobservable inputs).

2020	Level 1	Level 2	Level 3	Total
Bonds				
Federal government	$ ---	$ 26,199	$ ---	$ 26,199
Provincial government	---	54,627	---	54,627
Corporate	---	37,984	---	37,984
Equities				
Pooled Funds Canadian	11,979	---	---	11,979
Common Shares Global	30,802	---	---	30,802
	$ 42,781	$ 118,810	$ ---	$ 161,591

2019	Level 1	Level 2	Level 3	Total
Bonds				
Federal government	$ ---	$ 33,657	$ ---	$ 33,657
Provincial government	---	42,410	---	42,410
Corporate	---	32,664	---	32,664
Pooled funds				
Canadian equity	18,803	---	---	18,803
Global equity	15,917	---	---	15,917
	$ 34,720	$ 108,731	$ ---	$ 143,451

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2020 and December 31, 2019. There were no Level 3 investments for the years ended December 31, 2020 and December 31, 2019.

(in thousands of dollars)

4. Invested assets (continued)

(c) Term to maturity

2020	Within 1 year	1 - 5 years	5 - 10 years	10 years or more	Total
Bonds	$ 12,071	$ 77,170	$ 15,797	$ 13,772	$ 118,810
Term Deposits	32,311	---	---	---	32,311
Total	$ 44,382	$ 77,170	$ 15,797	$ 13,772	$ 151,121
Percent of total	29.4%	51.1%	10.5%	9.1%	100.0%

2019	Within 1 year	1 - 5 years	5 - 10 years	10 years or more	Total
Bonds	$ 8,033	$ 67,406	$ 23,257	$ 10,035	$ 108,731
Term Deposits	34,539	---	---	---	34,539
Total	$ 42,572	$ 67,406	$ 23,257	$ 10,035	$ 143,270
Percent of total	29.7%	47.0%	16.2%	7.0%	100.0%

The effective interest rate of the bonds portfolio held at December 31, 2020 is 0.81% (2019 - 2.05%).

(d) Additional disclosures

The following additional disclosure, required by IFRS 9 for eligible insurers, presents the fair value and the amount of change in the fair value of the Company's financial assets, showing separately the fair value of financial assets with contractual terms that give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding ("SPPI") and the fair value of financial assets that do not give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding ("Non-SPPI"):

		2020	SPPI	Non-
SPPI				
	Fair Value	Change in fair value	Fair value	Change in fair value
Term deposits	$ 32,311	$ ---	$ ---	$ ---
Bonds	118,810	5,065	---	---
Pooled and Equity funds	---	---	42,781	1,061
	$ 151,121	$ 5,065	$ 42,781	$ 1,061

(in thousands of dollars)

4. Invested assets (continued)

(d) Additional disclosures (continued)

2019	SPPI		Non-SPPI	
	Fair Value	Change in fair value	Fair value	Change in fair value
Term deposits	$ 34,539	$ ---	$ ---	$ ---
Bonds	108,731	1,498	---	---
Pooled funds	---	---	34,720	4,623
	$ 143,270	$ 1,498	$ 34,720	$ 4,623

The following additional disclosure, required by IFRS 9 for eligible insurers, presents the credit risk ratings of SPPI financial assets:

2020			
Credit rating	Credit risk	(fair value)	Carrying amount % of total
AAA	Low	$ 59,379	39.3
AA	Low	69,811	46.2
A	Low	17,386	11.5
BBB	Low	4,545	3.0
		$ 151,121	100.0

2019			
Credit rating	Credit risk	(fair value)	Carrying amount % of total
AAA	Low	$ 69,159	48.3
AA	Low	45,279	31.6
A	Low	24,688	17.2
BBB	Low	4,144	2.9
		$ 143,270	100.0

5. Company pension plan

The Company has a defined contribution pension plan for employees. The Company’s portion of payments to the plan amounted to $538 in 2020 (2019 - $516) and these payments were charged to employee benefits expense as incurred.

(in thousands of dollars)

6. Property and equipment

	Land and land improvements	Buildings	Furniture and equipment	Computer equipment	Automobiles	Total
Cost or deemed cost						
Balance, December 31, 2019	$ 1,437	$ 6,732	$ 2,141	$ 2,103	$ 422	$ 12,835
Additions	---	25	73	203	---	301
Disposals	---	---	---	---	(37)	(37)
Balance, December 31, 2020	$ 1,437	$ 6,757	$ 2,214	$ 2,306	$ 385	$ 13,099
Accumulated depreciation						
Balance, December 31, 2019	$ ---	$ 1,548	$ 1,987	$ 1,981	$ 188	$ 5,704
Depreciation for the year	---	275	(40)	82	68	385
Disposals	---	---	--	---	(24)	(24)
Balance, December 31, 2020	$ ---	$ 1,823	$ 1,947	$ 2,063	$ 232	$ 6,065
Net book value						
Balance, December 31, 2019	$ 1,437	$ 5,184	$ 154	$ 122	$ 234	$ 7,131
Balance, December 31, 2020	1,437	4,934	267	243	153	7,034

Depreciation of property and equipment included in operating expenses amounted to $385 in 2020 (2019 - $685).

(in thousands of dollars)

7. Intangible assets

	Computer Software
Cost	
Balance, December 31, 2019	$ 6,098
Additions	9,069
Balance, December 31, 2020	$ 15,167
Accumulated amortization	
Balance, December 31, 2019	$ 3,263
Amortization for the year	325
Balance, December 31, 2020	$ 3,588
Net book value	
December 31, 2019	$ 2,835
December 31, 2020	11,579

The company invested in a new policy administration system which will be amortized over a 7 year period. Amortization of intangible assets included in operating expenses amounted to $325 in 2020 (2019 - $131).

8. Insurance contracts

The following is a summary of the contract provisions and related reinsurance assets:

Gross	2020	2019
Outstanding claims provision	$ 68,027	$ 83,318
Provision for claims incurred but not reported	35,514	34,756
Effect of discounting	(2,725)	(4,468)
Provision for adverse deviations (``PfAD``)	13,000	11,897
Other	2,636	2,641
Total provision for gross unpaid claims and adjustment expenses	$ 116,452	$ 128,144

Ceded	2020	2019
Outstanding claims provision	$ 21,639	$ 25,889
Provision for claims incurred but not reported	4,172	5,861
Effect of discounting	(503)	(941)
PfAD	2,395	2,058
Total reinsurer’s share of unpaid claims and adjustment expenses	$ 27,703	$ 32,867

(in thousands of dollars)

8. Insurance contracts (continued)

Net	2020	2019
Outstanding claims provision	$ 46,388	$ 57,429
Provision for claims incurred but not reported	31,342	28,895
Effect of discounting	(2,222)	(3,527)
PfAD	10,605	9,839
Other	2,636	2,641
Total provision for net unpaid claims and adjustment expenses	$ 88,749	$ 95,277

The following is a summary of the insurance contracts by line of business as at December 31, 2020 and December 31, 2020.

2020	Gross	Reinsurance ceded	Net
Long-term settlement			
Automobile – Injury	$ 61,058	$ 10,124	$ 50,934
General liability	18,442	3,362	15,080
	79,500	13,486	66,014
Short-term settlement			
Automobile	3,085	189	2,896
Property	23,591	12,136	11,455
	26,676	12,325	14,351
Total undiscounted	106,176	25,811	80,365
Discounting with PfAD	10,276	1,892	8,384
Total discounted insurance contract liabilities	$ 116,452	$ 27,703	$ 88,749

2019	Gross	Reinsurance ceded	Net
Long-term settlement			
Automobile – Injury	$ 67,502	$ 12,575	$ 54,927
General liability	16,983	3,790	13,193
	84,485	16,365	68,120
Short-term settlement			
Automobile	5,818	1,490	4,328
Property	30,412	13,894	16,518
	36,230	15,384	20,846
Total undiscounted	120,715	31,749	88,966
Discounting with PfAD	7,429	1,118	6,311
Total discounted insurance contract liabilities	$ 128,144	$ 32,867	$ 95,277

8. Insurance contracts (continued)

(a) Nature of the provision for unpaid claims

The provision for unpaid claims represent an estimate of the amounts which, together with estimated future premiums and investment income, will be sufficient to pay outstanding claims, estimated future benefits, expenses and taxes on all policies in force.

(i) Methodology and assumptions

Determining the provision for unpaid claims, adjustment expenses and the related reinsurer’s share involves an assessment of the future development of claims. The provision for unpaid claims is determined using a range of accepted actuarial claims projection techniques determined based on the line of business. The key assumption in developing these estimates is that claims recorded to date will continue to develop in a similar manner in the future. Other factors include changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Company's claims personnel and independent adjusters retained to handle individual claims, the effect of inflationary trends on future claims settlement costs, investment rates of return, court decisions, economic conditions and public attitudes.

The unpaid claims projections are reported net of non-reinsurance recoveries, including salvage and subrogation. The actuarially determined carrying value of unpaid claims and adjustment expenses is considered an indicator of fair value, as there is no ready market for the trading of insurance policy liabilities.

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 liabilities provided by the actuaries of the pools.

(ii) Canadian accepted actuarial practices

Under Canadian accepted actuarial practice, the appropriate amount representing future obligations is defined as policy liabilities, which takes into consideration the time value of money and include provisions for adverse deviation. Consequently, the provisions for unpaid claims, adjustment expenses and related reinsurance recoveries have been recorded on a discounted basis. The discount rate used in the December 31, 2020 valuation was 1.26% (2019 - 1.91%).

For 2020 and 2019, the discount rate used to determine the actuarial value of claims liabilities is based on the yield of the Company’s FVTPL bond portfolio, which has been matched to the claims liabilities. In assessing the risks associated with investment income, the Company considers the nature of the investment portfolio and the timing of claim payments and their matching to investment cash flows.

8. Insurance contracts (continued)

(a) Nature of the provision for unpaid claims (continued)

(iii) Methodology and assumptions (continued)

Future changes in the investment yield could change the value of these claims. A 1% increase in this rate would decrease claims liabilities by $1,923 (2019 - $2,119), while a 1% decrease in this rate would increase claims liabilities by $1,770 (2019 - $2,005).

The basic assumptions made in establishing actuarial liabilities are best estimates. To allow for possible deterioration in experience, and to increase the likelihood that the actuarial liabilities are adequate to pay future benefits, actuaries are required to include margins in some assumptions. A range of allowable margins is prescribed by the Canadian Institute of Actuaries relating to claim development, reinsurance recoveries and investment income variables. The effect of the margins produces the provision for adverse deviation which for December 31, 2020 amounted to $10,606 (2019 - $9,839) on a net basis.

(iv) Changes in assumptions

These provisions for unpaid claims and adjustment expenses are estimates and, as such, are subject to variability, which could be material in the near term. Changes to the estimates could result from future events such as receiving additional claim information, changes in judicial interpretation of contracts or significant changes in severity or frequency of claims from past trends. In general, the longer the term required for the settlement of claims, the more variable the estimates. As additional experience and other data becomes available, the estimates could be revised. Any future changes in estimates would be reflected in the statement of income and comprehensive income for the period in which the change occurred. The historical studies are regularly compared to current emerging experience so that adjustments may be made as necessary.

The actual amount of ultimate claims can only be ascertained once all claims are closed. The effect of changes in assumptions is disclosed in note 13(a)(vi) sensitivity analysis.

(in thousands of dollars)

8. Insurance contracts (continued)

(b) Movements in insurance liabilities and reinsurance assets

The following changes have occurred in the provision for unearned premiums during the year:

	2020	2019
Provision for gross unearned premiums, beginning of year	$ 64,943	$ 64,705
Less: reinsurer's share of unearned premiums, beginning of year	900	1,100
Add: Adjustment for change in reinsurance coverages	739	-
Provision for net unearned premiums, beginning of year	64,782	63,605
Net premiums written	119,920	112,225
Less: net premiums earned	118,228	111,786
Change in provision for net unearned premiums	1,692	439
Provision for net unearned premiums, end of year	66,474	64,043
Plus: reinsurer's share of unearned premiums, end of year	529	900
Provision for gross unearned premiums, end of year	$ 67,003	$ 64,943

"Net premiums earned" represents the income arising from insurance contracts.

The table below summarizes the change in the provision for unpaid claims:

	2020	2019
Gross claims reserve, beginning of year	$ 128,144	$ 118,471
Current year claims	66,266	89,986
Prior year favourable claims development	(5,542)	(2,653)
Total claims incurred	60,724	87,333
Claims paid	(72,416)	(77,660)
Gross claims reserve, end of year	$ 116,452	$ 128,144

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

(in thousands of dollars)

8. Insurance contracts (continued)

(b) Movements in insurance liabilities and reinsurance assets (continued)

The following changes have occurred in the reinsurers' claims reserve:

	2020	2019
Reinsurer's share in claims reserve, beginning of year	$ 32,867	$ 24,875
Reinsurer's share in total claims incurred	10,013	23,429
Reinsurer's share in total claims payments	(15,177)	(15,437)
Reinsurer's share in claims reserve, end of year	$ 27,703	$ 32,867

(c) Structured settlements

The Company has purchased a number of annuities with an estimated fair value of $8,405 ($2019 - $7,567) in settlement of claims. These annuities have been purchased from registered Canadian life insurers with the highest claims paying ability ratings as determined by outside ratings organizations. The Company has a contingent credit risk with respect to the failure of these life insurers, with a maximum contingent credit risk applicable to any one life insurer of $5,490. Management has concluded that no provision for credit loss is required as at December 31, 2020.

(d) Claims development tables

The following tables show the estimates of cumulative incurred claims, including both claims notified and IBNR for each successive loss year at each reporting date, together with cumulative payments to date.

(in thousands of dollars)

8. Insurance contracts (continued)

(d) Claims development tables (continued)

Gross basis:

	Total all insurance risks										
Year of loss	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
Estimate of ultimate claims costs at end of the year of loss	$ 47,504	$ 42,351	$ 40,075	$ 54,680	$ 50,871	$ 67,365	$ 75,426	77,367	$ 85,121	$ 60,187	
one year later	49,244	41,725	40,716	54,449	59,215	70,042	72,335	78,125	86,388	---	
two years later	48,412	43,454	42,728	58,609	59,240	69,162	73,322	76,474	---	---	
three years later	49,183	44,317	45,545	56,258	57,184	69,373	72,520	---	---	---	
four years later	49,876	48,558	44,676	55,511	57,726	67,792	---	---	---	---	
five years later	54,043	48,003	45,679	55,650	56,942	---	---	---	---	---	
six years later	52,099	46,992	46,362	55,241	---	---	---	---	---	---	
seven years later	51,010	46,886	46,070	---	---	---	---	---	---	---	
eight years later	50,788	47,134	---	---	---	---	---	---	---	---	
nine years later	50,709	---	---	---	---	---	---	---	---	---	
Current estimate of ultimate claims	50,709	47,134	46,070	55,241	56,942	67,792	72,520	76,474	86,388	60,187	619,457
Cumulative payments to date	50,054	46,444	43,115	52,850	52,576	60,839	61,571	62,894	62,039	28,638	521,020
Outstanding claims	$ 655	$ 690	$ 2,955	$ 2,391	$ 4,366	$ 6,953	$ 10,949	$ 13,580	$ 24,349	$ 31,549	$ 98,437
Outstanding claims 2009 and prior											1,167
Unallocated loss adjustment expense											3,936
Facility Association											2,636
Effect of discounting and PfAD											10,276
Gross liabilities in statement of financial position											$ 116,452

Note: Due to the limitations in available information, the ultimate estimate of claims costs as at December 31, 2015 and prior only include the former North Waterloo Farmers Mutual Insurance Company.

(in thousands of dollars)

8. Insurance contracts (continued)

(d) Claims development tables (continued)

Net basis:

					Total all insurance risks						
Year of loss	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
Estimate of ultimate claims costs at end of the year of loss	$ 37,442	$ 33,471	$ 36,850	$ 47,104	$ 44,017	$ 55,061	$ 63,657	$ 65,667	$ 66,355	$ 51,674	
one year later	38,528	33,073	37,379	46,355	50,334	57,257	61,116	64,800	66,224	---	
two years later	38,981	34,486	37,909	50,223	51,055	57,009	61,838	63,804	---	---	
three years later	38,902	34,430	40,571	48,420	48,056	55,404	60,722	---	---	---	
four years later	38,577	37,040	38,957	47,768	48,608	53,745	---	---	---	---	
five years later	42,081	36,784	39,014	47,373	48,280	---	---	---	---	---	
six years later	41,308	36,289	39,255	47,221	---	---	---	---	---	---	
seven years later	40,464	36,216	39,046	---	---	---	---	---	---	---	
eight years later	40,030	36,064	---	---	---	---	---	---	---	---	
nine years later	39,992	---	---	---	---	---	---	---	---	---	
Current estimate of ultimate claims	39,992	36,064	39,046	47,221	48,280	53,745	60,722	63,804	66,224	51,674	506,772
Cumulative payments to date	39,465	35,686	37,980	45,221	45,419	49,409	52,058	52,559	48,629	26,965	433,391
Outstanding claims	$ 527	$ 378	$ 1,066	$ 2,000	$ 2,861	$ 4,336	$ 8,664	$ 11,245	$ 17,595	$ 24,709	$ 73,381
Outstanding claims 2009 and prior											412
Unallocated loss adjustment expense											3,936
Facility Association											2,636
Effect of discounting and PfAD											8,384
Net liabilities in statement of financial position											$ 88,749

Note: Due to the limitations in available information, the ultimate estimate of claims costs as at December 31, 2015 and prior only include the former North Waterloo Farmers Mutual Insurance Company.

(in thousands of dollars)

9. Income taxes

(a) Components of income tax expense

The major components of income tax expense are:

		2020		2019
Current tax expense (recovery)				
Current period taxes on income	$	9,043	$	1,428
Adjustment for prior years		133		(179)
Deferred tax expense				
Origination and reversal of temporary differences		124		474
Reduction in tax rate		---		---
Total income tax expense	$	9,300	$	1,723
Income tax recognized in other comprehensive income				
Unrealized gain (loss) on AFS financial assets	$	281	$	1,204
Reclassification of realized gains on AFS financial assets to net income		(1,190)		(170)
Total income tax charged directly to OCI	$	(909)	$	1,034

(b) Reconciliation of effective tax rate

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

		2020		2019
Income before income taxes	$	34,354	$	8,373
Income subject to tax		34,354		8,373
Combined basic Canadian federal and provincial income tax rate		26.5%		26.5%
Provision based on combined basic income tax rate		9,104		2,219
Adjustment for prior year		179		(168)
Other increase (decrease) in taxes		17		(328)
Income tax expense	$	9,300	$	1,723

(in thousands of dollars)

10. Deferred tax assets and liabilities

(a) Recognized deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

2020	Assets	Liabilities	Net
Property and equipment	$ --	$ 670	$ (670)
Available-for-sale financial assets	--	18	(18)
Provisions	1,178	--	1,178
Net tax assets (liabilities)	$ 1,178	$ 688	$ 490

2019	Assets	Liabilities	Net
Property and equipment	$ ---	$ (669)	$ (669)
Available-for-sale financial assets	---	(21)	(21)
Provisions	1,303	---	1,303
Net tax assets (liabilities)	$ 1,303	$ (690)	$ 613

(b) Movement in temporary differences during the year

	Property and equipment	AFS financial assets	Provisions	Other items	Total
Balance, December 31, 2018	$ (698)	$ (25)	$ 1,722	$ 89	$ 1,088
Recognized in income	29	4	(419)	(89)	(475)
Balance, December 31, 2019	(669)	(21)	1,303	---	613
Recognized in income	(1)	3	(125)		(123)
Balance, December 31, 2020	$ (670)	$ (18)	$ 1,178	$ --	$ 490

(in thousands of dollars)

11. Equity

Accumulated Other Comprehensive Income

AOCI is comprised of unrealized gains (losses) on equity investments designated AFS financial assets. AFS differences comprise the cumulative net change in the fair value of AFS financial assets until the investments are derecognized or impaired.

12. Related party transactions

The Company entered into the following transactions with key management personnel. Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, including all directors, executives, and non-executive senior management.

	2020	2019
Compensation		
Salaries and short term employee benefits and directors' fees	$ 3,176	$ 2,360
Total pension and other post-employment benefits	278	238
	3,454	2,598
Premiums received	$ 34	$ 36

Amounts owing to key management personnel at December 31, 2020 were $nil (2019 - $nil). Amounts due from key management personnel were $nil (2019 - $nil). The amounts are included in premium receivable from policyholders and expenses due and accrued on the statement of financial position.

13. Financial risk management

The primary goals of the Company's financial risk management are to ensure that the outcomes of activities involving elements of risk are consistent with the Company's objectives and risk tolerance, and to maintain an appropriate risk/reward balance while protecting the Company's statement of financial position from events that have the potential to materially impair its financial strength.

Risks identified as potentially significant are managed through a combination of Board policy, management monitoring and other management practices. The Company's Investment Policy Statement establishes asset mix parameters and risk limits to help minimize undue exposure to these risks in the investment portfolio while attempting to maximize the long-term value of policyholders' surplus. The Investment Policy Statement is reviewed annually by the Finance and Audit Committee. Compliance with the Investment Policy is monitored quarterly by the Finance and Audit Committee of the Board of Directors.

13. Financial risk management (continued)

The Company’s exposure to potential loss is primarily due to underwriting risk along with various market risks, including interest rate risk, liquidity risk, as well as credit risk.

(a) Underwriting risk

Underwriting risk is the risk that the total cost of claims and acquisition expenses will exceed premiums received and can arise from numerous factors, including pricing risk, reserving risk, catastrophic loss risk and reinsurance coverage risk.

The Company’s underwriting objective is to develop business within the target market on a prudent and diversified basis and to achieve profitable underwriting results.

In Canada, automobile insurance premium rates, other than for fleet automobile, are regulated by provincial government authorities. Regulation of premium rates is based on claims and other costs of providing insurance coverage, as well as projected profit margins. Regulatory approvals can limit or reduce premium rates that can be charged, or delay the implementation of changes in rates. Accordingly, a significant portion of the Company's revenue is subject to regulatory approval.

The business risk of insurance is primarily in pricing and underwriting the product, in managing investment funds, and in estimating and settling claims. To mitigate some of its risks, the Company purchases reinsurance to share part of the risk originally accepted in writing the policy. The Company cedes approximately 9.4% (2019 - 12.6%) of its premiums with external reinsurers. The Company has established risk management policies and procedures to measure and control risk. These policies and procedures are reviewed periodically by senior management, the Board of Directors, external auditors and regulators.

(i) Pricing risk

Pricing risk arises when actual claims experience differs from the assumptions included in pricing calculations. Historically, the underwriting results of the property and casualty industry have fluctuated significantly due to the cyclicality of the insurance market. The market cycle is affected by the frequency and severity of losses, levels of capacity and demand, general economic conditions and price competition. The Company’s pricing process is designed to ensure an appropriate return on capital while also providing long-term rate stability. These factors are reviewed and adjusted regularly to ensure prices are responsive to the current environment and competitor behaviour. The premium deficiency at December 31, 2020 was $nil (2019 - $1,307)

13. Financial risk management (continued)

(a) Underwriting risk (continued)

(ii) Reserving risk

Reserving risk arises due to the length of time between the occurrence of a loss, the reporting of the loss to the insurer and ultimate resolution of the claim.

Claim provisions are expectations of the ultimate cost of resolution and administration of claims based on an assessment of facts and circumstances then known, a review of historical settlement patterns, estimates of trends in claim severity and frequency, legal theories of liability and other factors. Variables in the reserve estimation process can be affected by receipt of additional claim information and other internal and external factors, such as changes in claims handling procedures, economic inflation, legal and judicial trends, legislative changes, inclusion of exposures not contemplated at the time of policy inception, and significant changes in severity or frequency of claims relative to historical trends. Due to the amount of time between the occurrence of a loss, the actual reporting of the loss and the ultimate payment, provisions may ultimately develop differently from the assumptions made when initially estimating the provision for claims.

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

(iii) Regulatory risk

Regulation covers a number of areas including solvency, change in control and capital movement limitations. The Company works closely with regulators and monitors regulatory developments to assess their potential impact on its ability to meet solvency and other requirements.

In Ontario, automobile insurance premium rates, other than for fleet automobile, are regulated by provincial government authorities. Regulation of premium rates is based on claims and other costs of providing insurance coverage, as well as projected profit margins. Regulatory approvals can limit or reduce premium rates that can be charged, or delay the implementation of changes in rates. Accordingly, a significant portion of the Company's revenue is subject to regulatory approvals.

13. Financial risk management (continued)

(a) Underwriting risk (continued)

(iv) Concentration risk

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

The Company has a concentration of business in automobile and property insurance in the province of Ontario. For the year ended December 31, 2020, automobile premiums represented 40.1% (2019 - 38.5%) and property premiums represented 59.9% (2019 - 61.5%) of gross written premiums. Of gross written premiums in 2020, Ontario accounted for 100% (2019 - 100%).

(v) Catastrophic loss risk

Catastrophic loss risk is the exposure to losses resulting from multiple claims arising out of a single catastrophic event. Property and casualty insurance companies experience large losses arising from man-made or natural catastrophes that can result in significant underwriting losses. Catastrophes can cause losses in a variety of property and casualty lines and may have continuing effects which could delay or hamper efforts to timely and accurately assess the full extent of the damage they cause. The incidence and severity of catastrophes are inherently unpredictable. The Company evaluates catastrophic events and assesses the probability of occurrence and magnitude of catastrophic events through various modeling techniques and through the aggregation of limits exposed. The Company's exposure to catastrophic loss is also managed through geographic and product diversification as well as through the use of reinsurance.

The Company reinsures claims from a single catastrophe when the sum exceeds $1,500 (2019 - $1,500) which represents less than 1.2% (2019 - 1.5%) of the Company's surplus. Reinsurance coverage risk arises because reinsurance terms, conditions and/or pricing may change on renewal, particularly following catastrophes.

(vi) Sensitivity analysis

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

13. Financial risk management (continued)

(a) Underwriting risk (continued)

(vi) Sensitivity analysis (continued)

To ensure that the Company has sufficient capital to withstand a variety of significant and plausible adverse event scenarios, the Company performs Financial Condition Testing (“FCT”) on the capital adequacy of the Company. FCT is performed annually as required by the Canadian Institute of Actuaries, and is prepared by the appointed actuary. The adverse event scenarios are reviewed annually to ensure that the appropriate risks are included in the FCT process. Plausible adverse event scenarios used include consideration of claims frequency and severity risk, inflation risk, premium risk, reinsurance risk and investment risk. The exposure of the peril of earthquake with default of reinsurers is also applied in a stress test analysis. The most recent results indicated that the Company’s future financial and capital positions are satisfactory under the assumptions applied.

(b) Credit risk

Credit risk is the risk of financial loss as the result of the Company's counterparties not being able to meet payment obligations as they become due. The Company's credit risk is concentrated in the bond portfolio. Unless otherwise stated, the Company's credit exposure is limited to the carrying amount of these assets.

(i) Invested assets

The Company's Investment Policy Statement requires the Company to invest in bonds and preferred stocks of high credit quality and to limit exposure with respect to any one issuer. No more than 10% of the market value of the bond portfolio may be in any one issuer, except for Federal or Provincial issuers with at least an “AA” rating. At least 90% of all bonds shall be rated not less than “A” or equivalent and remaining 10% shall be rated not less than “BBB” or equivalent. Common shares, preferred stocks or convertible securities of Canadian Corporations, cannot represent more than 70% of the market value of the equity portfolio. Common shares, preferred shares or convertible securities of Global Corporations cannot represent more than 70% of the market value of the equity portfolio. Not more than 5% of the equity portfolio shall be invested in any one corporation and any investments in a single industry group should not exceed 25% of the equity portfolio. 100% of the bonds held at December 31, 2020 (2019 - 100%) were rated "BBB" or better.

13. Financial risk management (continued)

(b) Credit risk (continued)

(i) Invested assets (continued)

The Company did not own any preferred stock as at December 31, 2020 and December 31, 2019.

The Company performed a review of all AFS securities with unrealized losses at December 31, 2020 and concluded that, due to no objective evidence of impairment, a provision for impairment was not required.

The Company periodically lends amounts to brokers in order to finance the growth of their business. Sufficient collateral, in the form of an assignment over the ownership interest in the brokerage, is held to protect the Company against default on these loans. Annual financial reviews are undertaken to determine if the broker will be able to make the required payments when due.

The Company's broker appointment process ensures a full financial review of each brokerage before they are granted a contract. This review includes an assessment by the finance department on the ability of the brokerage to meet payment obligations as they become due. Periodic broker reviews are conducted to ensure continued profitability or solvency.

(ii) Reinsurance recoverable and receivables

The Company relies on reinsurance to manage underwriting risk, however, reinsurance does not release the Company from its primary commitments to its policyholders. Therefore, the Company is exposed to the credit risk associated with the amounts ceded to reinsurers.

The Company regularly assesses the financial soundness of the reinsurer it deals with. An allowance for losses on reinsurance contracts is established when a reinsurance counterparty becomes unable or unwilling to fulfill its contractual obligations. The allowance for loss is based on current recoverable and ceded claim liabilities. No information has come to the Company's attention indicating weakness or failure of its current reinsurer; consequently, no impairment provision has been made in the accounts due to credit risks. The Company's credit exposure to any one individual policyholder included in premiums receivable from policyholders is not material.

The Company’s retained risk is $500 in the case of each property claim, $1,500 each property catastrophe, $1,000 for each automobile and each general liability claim in 2020 (2019 - $500 for property, $1,500 for a property catastrophe, $1,000 for automobile and $800 for general liability). In addition the company has an annual aggregate deductible of $2,000 for property and $1,000 for automobile and general liability combined.

(in thousands of dollars)

13. Financial risk management (continued)

(b) Credit risk (continued)

(ii) Reinsurance recoverable and receivables

The following table summarizes the Company's maximum exposure to credit risk related to financial instruments. The maximum credit exposure is the carrying value of the asset net of any allowances for losses:

	2020	2019
Cash	$ 22,787	$ 34,207
Term deposits	32,311	34,539
Bonds	118,810	108,731
Due from brokers	4,027	4,171
Premium receivable from policyholders	28,664	27,576
Accrued investment income	599	677
Insurance and other receivables	2,039	1,822
Reinsurer's share of unpaid claims and adjustment expenses	27,703	32,867
Structured settlements (note 8(c))	8,405	7,567
	$ 245,345	$ 252,157

(c) Market risk

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

(i) Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Typically, investment income will be reduced during sustained periods of low interest rates but this will also create unrealized gains within the bond portfolio. It will also create realized gains to be recognized in net income to the extent any bonds are sold during the period. The reverse is true during a sustained period of increasing interest rates.

(in thousands of dollars)

13. Financial risk management (continued)

(c) Market risk (continued)

(i) Interest rate risk (continued)

Duration is a measure used to estimate the extent fair values of fixed income instruments change with changes in interest rates. Using this measure, it is estimated that an immediate hypothetical 100 basis points or 1% parallel increase in interest rates, with all other variables held constant, would decrease the fair value of bonds as well as net income by $5,406 (2019 - $4,904). Similarly, a 100 basis point or 1% parallel decrease in interest rates would generate a corresponding increase in the fair value of bonds and net income.

(ii) Equity market risk

Economic trends, the political environment and other factors can positively and adversely impact the equity markets and consequently the value of equity investments the Company holds. The Company's portfolio includes Canadian equities with fair values that move as a result of market pressures as reflected in the Toronto Stock Exchange Composite Index, and foreign index equities that move with the Standard & Poor's 500 Index as the Canadian and foreign equities are all classified as AFS investments. 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 and foreign equities and pooled funds and OCI of $4,278 (2019 - $3,472).

(iii) Foreign exchange risk

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to change in foreign exchange rates. The Company's foreign exchange risk is related to the underlying investments in its equity investments, pooled funds and common shares. The equities are invested in:

	2020	2019
Cash	12.7%	2.0%
Canadian equities	32.8%	53.9%
US equities	42.6%	22.6%
European equities	7.2%	14.0%
Australian equities	4.7%	--
Asian equities	--	4.7%
Emerging market equities	--	2.8%
	100.0%	100.0%

13. Financial risk management (continued)

(d) Liquidity risk

Liquidity risk is the risk of having insufficient cash resources to meet current financial obligations. Liquidity risk arises from the Company's general business activities and in the course of managing the assets and liabilities. The liquidity requirements of the Company's business are met primarily by funds generated by operations, asset maturities and investment returns. Cash provided from these sources normally exceeds cash requirements to meet claims costs and operating expenses.

At December 31, 2020, the Company had $55,098 (2019 - $68,746) of cash and cash equivalents. The Company also has a highly liquid investment portfolio. Canadian fixed-income securities issued or guaranteed by domestic governments and investment grade corporate bonds held by the Company had a fair value of $118,810 as at December 31, 2020 (2019 - $108,731).

The maturity profile of the Company's investment portfolio is shown in note 4(c). The Company's bond portfolio designated as FVTPL is managed to match the Company's claim liability profile in order to ensure sufficient funding to meet claim liabilities.

The Company believes that it has the flexibility to obtain, from internal sources, the funds needed to meet cash and regulatory requirements on an ongoing basis.

14. Capital management

Management develops the capital strategy for the Company and oversees the capital management processes. As a federally regulated property and casualty insurance company, the Company's capital position is monitored by the Office of the Superintendent of Financial Institutions (“OSFI”). OSFI evaluates the Company's financial strength through the Minimum Capital Test ("MCT") which measures available capital against required risk-weighted capital. Available capital comprises total policyholders' surplus plus or minus adjustments prescribed by OSFI. Capital required is calculated by applying risk factors to the assets and liabilities of the Company. The Company’s MCT is 396% (2019 - 369%). Management actively monitors the MCT ratio and the effect that external and internal actions have on the capital base of the Company. In particular, management determines the effect on capital before entering into any significant transactions to ensure that policyholders are not put at risk through the depletion of capital to unacceptable levels.

Reinsurance is also used to protect the Company's capital level from large losses, including those of a catastrophic nature, which could have a detrimental impact on capital. The Company has adopted policies that specify tolerance for financial risk retention. Once the retention limits and the annual aggregate deductibles are reached, reinsurance is utilized to cover the excess risk.

On an annual basis, the Company performs Financial Condition Testing on the MCT ratio to ensure that the Company has sufficient capital to withstand certain significant adverse event scenarios.

15. Operations subject to rate regulation

The Company writes insurance only in the Province of Ontario. Auto insurance in Ontario is regulated by the Financial Services Commission of Ontario. Underwriting rules, risk selection criteria and pricing are all subject to review and approval by the regulator prior to implementation. The rate filing must include actuarial justification for rate increases or decreases. Auto insurance represents 40.1% (2019 - 38.5%) of the direct premium written of the Company. Rate regulation may affect the automobile revenues that are earned by the Company.

16. Comparative information

Certain comparative information has been reclassified to conform with the financial statement presentation adopted in the current year.

17. Impact of COVID-19 pandemic

On March 11, 2020, the World Health Organization declared the Coronavirus (COVID-19) outbreak a pandemic. This has resulted in significant financial, market and societal impacts in Canada and around the world.

The ultimate duration and magnitude of the COVID-19 pandemic's impact on the Company's operations and financial position is not known at this time and can cause additional uncertainty around estimates and judgements used in preparing these financial statements.

If applicable, financial statements are required to be adjusted for events occurring between the date of the financial statements and the date of the auditors' report to provide additional evidence relating to conditions that existed as at year end. No adjustments were necessary.

18. Subsequent event

On January 15, 2021, the Company entered into a proposed merger agreement with another farm mutual insurance company, The Kings Mutual Insurance Company, providing for the amalgamation of the two companies effective June 30, 2021. The name of the amalgamated company will be Heartland Farm Mutual Inc. The transaction is contingent upon receiving OSFI and Ministerial approval and policyholder approval at each of the company's upcoming annual meetings.