Financial Statements of

HEARTLAND FARM MUTUAL INC.

And Independent Auditors' Report thereon

Year ended December 31, 2021

HEARTLAND FARM MUTUAL INC.

Financial Statements
December 31, 2021

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KPMG LLP
115 King Street South
2nd Floor
Waterloo ON N2J 5A3
Canada
Tel 519-747-8800
Fax 519-747-8830

INDEPENDENT AUDITORS' REPORT

To the Policyholders and Directors of Heartland Farm Mutual Inc.

Opinion

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

- the statement of financial position as at December 31, 2021;
- the statement of income and comprehensive income for the year then ended;
- the statement of changes in surplus for the year then ended;
- the statement of cash flows for the year then ended;
- the schedule of operating expenses for the year then ended;
- and notes to the 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 financial position of Heartland Farm Mutual Inc. as at December 31, 2021, and its results of financial performance, and its 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 28, 2022

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 statement of financial position as at December 31, 2021 and their change in the 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 financial statements fairly present the results of the valuation.

Montréal, Québec	Nicolas Beaudoin
February 25, 2022	Fellow, Canadian Institute of Actuaries

HEARTLAND FARM MUTUAL INC.

Statement of Financial Position
(in thousands of dollars)

As at December 31, 2021, with comparative information for 2020

	2021 (Note 17)	2020
Assets		
Cash	$ 39,537	$ 22,787
Invested assets (note 4)	254,160	194,382
Due from brokers	6,218	4,026
Premiums receivable from policyholders	38,185	28,664
Accrued investment income	765	599
Insurance and other receivables	1,707	2,039
Deferred income taxes (note 10)	-	490
Reinsurers' share of:		
Unearned premiums (note 8(b))	407	529
Unpaid claims and adjustment expenses (note 8)	20,312	27,703
Deferred policy acquisition costs	19,112	15,128
Property and equipment (note 6)	8,985	7,034
Intangible assets (note 7)	11,047	11,579
Other assets	630	1,429
	$ 401,065	$ 316,389
Liabilities		
Expenses due and accrued	$ 4,998	$ 4,269
Due to other insurers	79	271
Due to brokers	7,856	5,166
Deferred income taxes (note 10)	2,361	-
Income taxes payable	2,002	2,074
Provision for unpaid claims (note 8)	117,500	116,452
Unearned reinsurance commissions	114	91
Unearned premiums (note 8(b))	84,090	67,003
Total liabilities	219,000	195,326
Surplus for the protection of policyholders		
Policyholders' equity	167,304	111,464
Accumulated other comprehensive income	14,761	9,599
Total surplus	182,065	121,063
	$ 401,065	$ 316,389

See accompanying notes to the financial statements.

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

HEARTLAND FARM MUTUAL INC.

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

For the year ended December 31, 2021, with comparative information for 2020

	2021 (Note 17)	2020
Gross written premiums	$ 151,199	$ 132,500
Reinsurance ceded	(13,526)	(12,580)
Net written premiums	137,673	119,920
Change in unearned premiums		
Gross amount	(8,767)	(2,060)
Reinsurer's share	(122)	368
	(8,889)	(1,692)
Net premiums earned	128,784	118,228
Other	998	2,664
Underwriting revenue	129,782	120,892
Underwriting expenses		
Gross claims and adjustments expenses	57,026	63,775
Reinsurer's share of claims and adjustment expenses	(1,436)	(10,013)
Net claims and adjustment expense	55,590	53,762
Commissions	30,100	24,811
Premium taxes	4,989	3,896
Salaries and benefits	11,349	10,152
Operating expenses	10,132	6,815
	112,160	99,436
Underwriting income	17,622	21,456
Interest income	3,376	3,828
Investment expenses	(594)	(486)
Realized gain on available-for-sale financial assets	214	4,491
Unrealized gain (loss) on financial assets at fair value through profit or loss	(4,319)	5,065
Income before income taxes	16,299	34,354
Income taxes (note 9)		
Current	1,345	9,176
Deferred	2,920	124
	4,265	9,300
Net income	$ 12,034	$ 25,054
Other comprehensive income (loss)		
Unrealized gain on available-for-sale assets arising during the period, net of tax $1,873 (2020 - $281)	$ 5,162	$ 780
Reclassification of realized gain on available-for-sale financial assets to net income, net of tax of $(nil) (2020 - $(1,190))	-	(3,301)
Other comprehensive income (loss)	5,162	(2,521)
Total comprehensive income	$ 17,196	$ 22,533

See accompanying notes to the financial statements.

HEARTLAND FARM MUTUAL INC.

Statement of Changes in Surplus
(in thousands of dollars)

For the year ended December 31, 2021, with comparative information for 2020

	2021 (Note 17)	2020
Policyholders' equity		
Balance, beginning of year	$ 111,464	$ 86,410
Assumed on amalgamation (note 17)	43,806	-
Net income	12,034	25,054
Balance, end of year	167,304	111,464
Accumulated other comprehensive income		
Balance, beginning of year	9,599	12,120
Other comprehensive income (loss), net of income taxes	5,162	(2,521)
Balance, end of year	14,761	9,599
Total surplus	$ 182,065	$ 121,063

Accumulated other comprehensive income ("AOCI") is composed of unrealized gains on available-for-sale securities, net of income taxes of $4,024 (2020 - $2,151).

See accompanying notes to the financial statements.

HEARTLAND FARM MUTUAL INC.

Statement of Cash Flows
(in thousands of dollars)

For the year ended December 31, 2021, with comparative information for 2020

	2021 (Note 17)	2020
Operating activities		
Premiums received, net of reinsurance $13,526 (2020 - $12,580)	$ 128,847	$ 117,268
Fee income received	998	2,664
Investment income received	2,738	3,420
Income taxes recovered (paid)	(3,658)	(8,654)
	128,925	114,698
Claims payments	(50,843)	(60,506)
Policy acquisition expenses paid, net of commissions from reinsurers	(34,555)	(29,691)
Operating expenses	(17,907)	(16,785)
	(103,305)	(106,982)
Cash provided by operating activities	25,620	7,716
Investing activities		
Bonds and bond fund purchases	(136,976)	(75,100)
Bonds sold, redeemed or matured	90,624	70,087
Short-term investments purchased	(1,100)	2,228
Short-term investments redeemed	32,311	-
Common equities and equity fund sales (purchases)	(42,400)	(7,000)
Amalgamated investment portfolio redeemed	47,310	-
Proceeds from disposal of property and equipment	169	19
Purchase of property and equipment	(113)	(301)
Purchase of intangible assets	(1,220)	(9,069)
Cash used by investing activities	(11,395)	(19,136)
Increase (decrease) in cash	14,225	(11,420)
Cash, beginning of year	22,787	34,207
Add: assumed on amalgamation (note 17)	2,525	-
Cash, end of year	$ 39,537	$ 22,787

See accompanying notes to the financial statements.

HEARTLAND FARM MUTUAL INC.

Schedule of Operating Expenses
(in thousands of dollars)

For the year ended December 31, 2021, with comparative information for 2020

	2021 (Note 17)	2020
Education and training	$ 323	$ 93
Occupancy	791	823
Marketing, branding and advertising	105	58
Automobile and travel	121	188
Bureaus and associations	714	528
Donations	197	160
Information technology	7,097	3,828
Furniture and equipment	65	(29)
Underwriting reports	605	480
Insurance	195	175
Postage and courier	352	242
Printing and stationery	241	93
Professional fees	967	1,722
Telephone and other communications	88	59
Bad debts	107	7
Miscellaneous	658	543
	12,626	8,970
Less portion allocated to net claims and adjustment expenses	2,494	2,155
Operating expenses	$ 10,132	$ 6,815

See accompanying notes to the 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.

On August 1, 2021, the Company amalgamated with The Kings Mutual Insurance Company. The name of the amalgamated company is Heartland Farm Mutual Inc.

1. Basis of presentation

(a) Statement of compliance

The 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 25, 2022.

(b) Basis of measurement

The 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 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 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.

1. Basis of presentation (continued)

(d) Use of estimates and judgments (continued)

Information about critical judgments in applying accounting policies that have the most significant effect on amounts recognized in the 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 financial statements, unless otherwise indicated.

(a) Basis of consolidation

(i) Subsidiaries

Effective November 23, 2021 the wholly-owned subsidiaries 8037574 Canada Inc. and 3078191 Canada Inc. were dissolved and the real estate holdings were transferred to the Company. The 2020 comparative figures remain on a consolidated basis.

(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 comparative figures.

(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. The properties located in Nova Scotia were revalued at fair value on August 1, 2021, the date of amalgamation, plus subsequent additions less accumulated depreciation and accumulated impairment losses

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, 2023. 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 2021 (2020 - $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 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:

2021	Other	FVTPL	AFS	Total
Term deposits	$ 1,100	$ –	$ –	$ 1,100
Bonds				
Federal government	–	42,482	–	42,482
Provincial government	–	71,393	–	71,393
Corporate	–	46,969	–	46,969
Equities				
Pooled Fund Canadian	–	–	26,838	26,838
Pooled Fund Global	–	–	19,719	19,719
Common Shares Global	–	–	45,659	45,659
Real estate	–	–	–	–
	$ 1,100	$ 160,844	$ 92,216	$ 254,160

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

(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).

2021	Level 1	Level 2	Level 3	Total
Bonds				
Federal government	$ –	$ 42,482	$ –	$ 42,482
Provincial government	–	71,393	–	71,393
Corporate	–	46,969	–	46,969
Equities				
Pooled Funds Canadian	26,838	–	–	26,838
Pooled Funds Global	19,719	–	–	19,719
Common Shares Global	45,659	–	–	45,659
	$ 92,216	$ 160,844	$ –	$ 253,060

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

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2021 and December 31, 2020. There were no Level 3 investments for the years ended December 31, 2021 and December 31, 2020.

(in thousands of dollars)

4. Invested assets (continued)

(c) Term to maturity

2021	Within 1 year	1 - 5 years	5 - 10 years	10 years or more	Total
Bonds	$ –	$ 128,757	$ 15,218	$ 16,869	$ 160,844
Term Deposits	1,100	–	–	–	1,100
Total	$ 1,100	$ 128,757	$ 15,218	$ 16,869	$ 161,944
Percent of total	0.7%	79.5%	9.4%	10.4%	100.0%

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%

The effective interest rate of the bonds portfolio held at December 31, 2021 is 1.56% (2020 - 0.81%).

(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"):

2021	SPPI		Non-SPPI	
	Fair Value	Change in fair value	Fair value	Change in fair value
Term deposits	$ 1,100	$ –	$ –	$ –
Bonds	160,844	(4,319)	–	–
Pooled and Equity funds	–	–	92,216	7,035
	$ 161,944	$ (4,319)	$ 92,216	$ 7,035

(in thousands of dollars)

4. Invested assets (continued)

(d) Additional disclosures (continued)

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

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

2021			
Credit rating	Credit risk	(fair value)	Carrying amount % of total
AAA	Low	$ 44,692	27.1%
AA	Low	70,449	43.8%
A	Low	25,296	15.7%
BBB	Low	21,507	13.4%
		$ 161,944	100%

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

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 $599 in 2021 (2020 - $538) 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, 2020	$ 1,437	$ 6,757	$ 2,214	$ 2,306	$ 385	$ 13,099
Amalgamation addition (note 17)	559	1,269	87	51	–	1,966
Additions	480	7	8	86	13	594
Disposals	–	–	–	–	(385)	(385)
Balance, December 31, 2021	$ 2,476	$ 8,033	$ 2,309	$ 2,443	$ 13	$ 15,274
Accumulated depreciation						
Balance, December 31, 2020	$ –	$ 1,823	$ 1,947	$ 2,063	$ 232	$ 6,065
Depreciation for the year	4	251	57	141	8	461
Disposals	–	–	–	–	(237)	(237)
Balance, December 31, 2021	$ 4	$ 2,074	$ 2,004	$ 2,204	$ 3	$ 6,289
Net book value						
Balance, December 31, 2020	$ 1,437	4,934	267	243	153	7,034
Balance, December 31, 2021	2,472	5,959	305	239	10	8,985

Depreciation of property and equipment included in operating expenses amounted to $461 in 2021 (2020 - $385).

(in thousands of dollars)

7. Intangible assets

		Computer Software
Cost		
Balance, December 31, 2020	$	15,167
Amalgamation addition (note 17)		1
Additions		1,218
Balance, December 31, 2021	$	16,386
Accumulated amortization		
Balance, December 31, 2020	$	3,588
Amortization for the year		1,751
Balance, December 31, 2021	$	5,339
Net book value		
December 31, 2020	$	11,579
December 31, 2021		11,047

Amortization of intangible assets included in operating expenses amounted to $1,751 in 2021 (2020 - $325).

8. Insurance contracts

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

Gross		2021		2020
Outstanding claims provision	$	71,712	$	68,027
Provision for claims incurred but not reported		34,525		35,514
Effect of discounting		(3,405)		(2,725)
Provision for adverse deviations ("PfAD")		11,950		13,000
Other		2,718		2,636
Total provision for gross unpaid claims and adjustment expenses	$	117,500	$	116,452

Ceded		2021		2020
Outstanding claims provision	$	14,390	$	21,639
Provision for claims incurred but not reported		4,725		4,172
Effect of discounting		(508)		(503)
PfAD		1,705		2,395
Total reinsurer's share of unpaid claims and adjustment expenses	$	20,312	$	27,703

(in thousands of dollars)

8. Insurance contracts (continued)

Net	2021	2020
Outstanding claims provision	$ 57,322	$ 46,388
Provision for claims incurred but not reported	29,800	31,342
Effect of discounting	(2,897)	(2,222)
PfAD	10,245	10,605
Other	2,718	2,636
Total provision for net unpaid claims and adjustment expenses	$ 97,188	$ 88,749

The following is a summary of the insurance contracts by line of business as at December 31, 2021 and December 31, 2020.

2021	Gross	Reinsurance ceded	Net
Long-term settlement			
Automobile – Injury	$ 54,010	$ 8,038	$ 45,972
General liability	21,882	3,721	18,161
	75,892	11,759	64,133
Short-term settlement			
Automobile	3,953	27	3,926
Property	29,110	7,329	21,781
	33,063	7,356	25,707
Total undiscounted	108,955	19,115	89,840
Discounting with PfAD	8,545	1,197	7,348
Total discounted insurance contract liabilities	$ 117,500	$ 20,312	$ 97,188

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

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, 2021 valuation was 1.80% (2020 - 1.26%).

For 2021 and 2020, 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 $1,811 (2020 - $1,923), while a 1% decrease in this rate would increase claims liabilities by $1,899 (2020 - $1,770).

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, 2021 amounted to $10,245 (2020 - $10,606) 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:

	2021	2020
Provision for gross unearned premiums, beginning of year	$ 67,003	$ 64,943
Less: reinsurer's share of unearned premiums, beginning of year	529	900
Add: Assumed on amalgamation (note 17)	8,320	-
Add: Adjustment for change in reinsurance coverages	-	739
Provision for net unearned premiums, beginning of year	74,794	64,782
Net premiums written	137,673	119,920
Less: net premiums earned	128,784	118,228
Change in provision for net unearned premiums	8,889	1,692
Provision for net unearned premiums, end of year	83,683	66,474
Plus: reinsurer's share of unearned premiums, end of year	407	529
Provision for gross unearned premiums, end of year	$ 84,090	$ 67,003

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

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

	2021	2020
Gross claims reserve, beginning of year	$ 116,452	$ 128,144
Assumed on amalgamation (note 17)	4,950	-
Current year claims	64,071	66,266
Prior year favourable claims development	(11,409)	(5,542)
Total claims incurred	57,612	60,724
Claims paid	(56,564)	(72,416)
Gross claims reserve, end of year	$ 117,500	$ 116,452

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:

		2021		2020
Reinsurer's share in claims reserve, beginning of year	$	27,703	$	32,867
Assumed on amalgamation (note 17)		899		-
Reinsurer's share in total claims incurred		1,436		10,013
Reinsurer's share in total claims payments		(9,726)		(15,177)
Reinsurer's share in claims reserve, end of year	$	20,312	$	27,703

(c) Structured settlements

The Company has purchased a number of annuities with an estimated fair value of $9,846 ($2020 - $8,405) 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 $6,190. Management has concluded that no provision for credit loss is required as at December 31, 2021.

(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	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
Estimate of ultimate claims costs at end of the year of loss	$ 44,575	$ 43,130	$ 58,483	$ 56,924	$ 70,901	$ 79,425	$ 83,737	$ 91,541	$ 65,988	$ 64,656	
one year later	43,680	43,533	58,952	64,962	73,163	76,090	84,166	92,630	65,299	–	
two years later	45,398	45,498	62,967	64,001	72,187	77,068	82,437	92,235	–	–	
three years later	46,199	48,396	60,674	61,910	72,310	76,310	79,347	–	–	–	
four years later	50,437	47,501	59,577	62,420	70,727	75,688	–	–	–	–	
five years later	50,038	48,498	59,675	61,620	70,660	–	–	–	–	–	
six years later	49,030	49,179	59,261	60,870	–	–	–	–	–	–	
seven years later	48,930	48,887	58,963	–	–	–	–	–	–	–	
eight years later	49,205	47,933	–	–	–	–	–	–	–	–	
nine years later	49,073	–	–	–	–	–	–	–	–	–	
Current estimate of ultimate claims	49,073	47,933	58,963	60,870	70,660	75,688	79,347	92,235	65,299	64,656	664,724
Cumulative payments to date	48,469	46,508	56,996	59,055	66,560	68,013	70,783	74,410	47,390	26,662	564,846
Outstanding claims	$ 604	$ 1,425	$ 1,967	$ 1,815	$ 4,100	$ 7,675	$ 8,564	$ 17,825	$ 17,909	$ 37,994	99,878
Outstanding claims 2011 and prior											2,250
Unallocated loss adjustment expense											4,109
Facility Association											2,718
Effect of discounting and PfAD											8,545
Gross liabilities in statement of financial position											$ 117,500

(in thousands of dollars)

8. Insurance contracts (continued)

(d) Claims development tables (continued)

Net basis:

					Total all insurance risks						
Year of loss	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Total
Estimate of ultimate claims costs at end of the year of loss	$ 35,622	$ 39,383	$ 50,289	$ 49,005	$ 58,454	$ 67,196	$ 71,200	$ 72,601	$ 57,061	$ 61,264	
one year later	34,997	39,715	49,606	55,258	60,346	64,551	70,128	72,406	56,483		
two years later	36,422	40,303	53,381	55,538	60,018	65,301	69,080	72,181	–		
three years later	36,312	43,055	51,593	52,516	58,342	64,243	66,495	–			
four years later	38,919	41,415	50,897	53,037	56,680	63,565	–	–	–		
five years later	38,819	41,466	50,490	52,695	56,628	–	–	–	–		
six years later	38,327	41,705	50,334	51,992	–	–	–	–	–		
seven years later	38,260	41,496	49,906	–	–	–	–	–	–		
eight years later	38,135	41,065	–	–	–	–	–	–	–		
nine years later	38,302	–	–	–	–	–	–	–	–		
Current estimate of ultimate claims	38,302	41,065	49,906	51,992	56,628	63,565	66,495	72,181	56,483	61,264	557,881
Cumulative payments to date	37,707	40,680	48,464	50,654	53,985	57,530	59,562	58,401	41,864	26,605	475,452
Outstanding claims	$ 595	$ 385	$ 1,442	$ 1,338	$ 2,643	$ 6,035	$ 6,933	$ 13,780	$ 14,619	$ 34,659	$ 82,429
Outstanding claims 2011 and prior											585
Unallocated loss adjustment expense											4,109
Facility Association											2,718
Effect of discounting and PfAD											7,347
Net liabilities in statement of financial position											$ 97,188

(in thousands of dollars)

9. Income taxes

(a) Components of income tax expense

The major components of income tax expense are:

	2021	2020
Current tax expense (recovery)		
Current period taxes on income	$ 4,592	$ 9,043
Adjustment for prior years	(3,247)	133
Deferred tax expense		
Origination and reversal of temporary differences	(214)	124
Adjustment for previous periods	3,132	–
Other	2	–
Total income tax expense	$ 4,265	$ 9,300
Income tax recognized in other comprehensive income		
Unrealized gain (loss) on AFS financial assets	$ 1,873	$ 281
Reclassification of realized gains on AFS financial assets to net income	–	(1,190)
Total income tax charged directly to OCI	$ 1,873	$ (909)

(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:

	2021	2020
Income before income taxes	$ 16,299	$ 34,354
Income subject to tax	16,299	34,354
Combined basic Canadian federal and provincial income tax rate	26.62%	26.5%
Provision based on combined basic income tax rate	4,339	9,104
Adjustment for prior year	(117)	179
Rate change impact	(20)	–
Other increase (decrease) in taxes	63	17
Income tax expense	$ 4,265	$ 9,300

(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:

2021	Assets	Liabilities	Net
Property and equipment	$ –	$ 3,657	$ (3,657)
Available-for-sale financial assets	–	14	(14)
Provisions	1,310	–	1,310
Net tax assets (liabilities)	$ 1,310	$ 3,671	$ (2,361)

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

(b) Movement in temporary differences during the year

	Property and equipment	AFS financial assets	Provisions	Other items	Total
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
Assumed on amalgamation (note 17)	10	–	59	–	69
Recognized in income	(2,997)	3	74	–	(2,920)
Balance, December 31, 2021	$ (3,657)	$ (15)	$ 1,311	$ –	$ (2,361)

(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.

	2021	2020
Compensation		
Salaries and short-term employee benefits and directors' fees	$ 4,573	$ 3,176
Total pension and other post-employment benefits	311	278
	4,884	3,454
Premiums received	$ 109	$ 34

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 9.6% (2020 - 9.4%) 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, 2021 was $nil (2020 - $ nil)

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 and Nova Scotia. For the year ended December 31, 2020, automobile premiums represented 38% (2020 - 40.1%) and property premiums represented 62% (2020 - 59.9%) of gross written premiums. Of gross written premiums in 2021, Ontario accounted for 95% (2020 - 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 for Ontario and $1,350 for Nova Scotia (2020 - $1,500) which represents less than 0.8% or 0.7% (2020 - 1.2%) 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. At least 80% of all bonds shall be rated not less than “A” or equivalent and remaining 20% shall be rated not less than “BBB” or equivalent. 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. 99.4% of the bonds held at December 31, 2021 (2020 - 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, 2021 and December 31, 2020.

The Company performed a review of all AFS securities with unrealized losses at December 31, 2021 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 in Ontario is $750 in the case of each property claim, $1,500 each property catastrophe, $1,000 for each automobile and each general liability claim in 2021 (2020 - $500 for property, $1,500 for a property catastrophe, $1,000 for automobile and $1,000 for general liability). In addition, the company has an annual aggregate deductible of $2,250 for property and $1,000 for automobile and general liability combined. The Company’s retained risk in Nova Scotia is $450 in the case of each property claim, $1,350 each property catastrophe, $350 for each general liability claim in 2021.

(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:

	2021	2020
Term deposits	$ 1,100	$ 32,311
Bonds	160,844	118,810
Due from brokers	6,218	4,027
Premium receivable from policyholders	38,185	28,664
Accrued investment income	765	599
Insurance and other receivables	1,707	2,039
Reinsurer's share of unpaid claims and adjustment expenses	20,312	27,703
Structured settlements (note 8(c))	9,846	8,405
	$ 238,977	$ 222,558

(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 $6,723 (2020 - $5,406). 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 $9,221 (2020 - $4,278).

(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:

	2021	2020
Cash	1.0%	12.7%
Canadian equities	32.5%	32.8%
US equities	48.7%	42.6%
European equities	5.3%	7.2%
Australian equities	2.4%	4.7%
Asian equities	10.1%	–%
	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, 2021, the Company had $40,637 (2020 - $55,098) 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 $160,844 as at December 31, 2021 (2020 - $118,810).

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 390% (2020 - 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 automobile 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 38% (2020 - 40.1%) 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. Amalgamation

On January 15, 2021, the Company entered into a merger agreement with The Kings Mutual Insurance Company providing for the amalgamation of the two companies. The mutual policyholders of both companies voted and approved the amalgamation of the two companies, which will continue to operate under the name Heartland Farm Mutual Inc. OSFI approval was received and the amalgamation was completed August 1, 2021.

The amalgamation brings geographic spreading of risk through sectors and new markets for each company, enhanced information technology investment, enhanced products and improved customer experience.

For accounting purposes, the amalgamation transaction requires the identification of one of the combining entities as the acquirer. Based on this analysis, Heartland Farm Mutual Inc. was identified as the acquirer.

(in thousands of dollars)

17. Amalgamation (continued)

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. Details of the fair value of identifiable assets and liabilities assumed on amalgamation are as follows:

Assets		
Cash and cash equivalents	$	2,525
Investments		47,096
Receivables		3,099
Accrued investment income		123
Reinsurers' share of unpaid claims		899
Deferred policy acquisition costs		1,972
Property and equipment		1,966
Intangible assets		1
Other assets		62
Deferred income tax assets		69
Liabilities		
Payables and accruals		364
Income taxes payable		372
Provision for unpaid claims		4,950
Unearned premiums		8,320
Increase in surplus upon amalgamation	$	43,806

The deemed acquiree's net assets are recognized as a direct addition to surplus, in the statement of changes in surplus. The results of acquired operations are included in the statement of comprehensive income from August 1, 2021, the date of amalgamation.