

SOUTHEASTERN MUTUAL INSURANCE COMPANY
FINANCIAL STATEMENTS
DECEMBER 31, 2018



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INDEPENDENT AUDITORS' REPORT

To the policyholders of Southeastern Mutual Insurance Company:

Report on the Financial Statements

Opinion

We have audited the accompanying financial statements of Southeastern Mutual Insurance Company which comprise the statement of financial position as at December 31, 2018, and the statements of operations, comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

In our opinion, the financial statements present fairly, in all material respects, the financial position of Southeastern Mutual Insurance Company as at December 31, 2018, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

Basis of Opinion

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

INDEPENDENT AUDITORS' REPORT (CONTINUED)

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 auditor's 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 these 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 auditor's 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 represent the underlying transactions and events in a manner that achieves fair presentation.

Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

We 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.

Riverview, NB
March 28, 2019



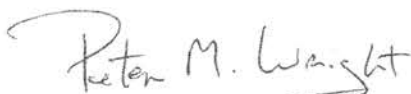
Chartered Professional Accountants

SOUTHEASTERN MUTUAL INSURANCE COMPANY**STATEMENT OF FINANCIAL POSITION**

Statement 1

DECEMBER 31, 2018

	2018	2017
ASSETS		
Cash and cash equivalents	\$ 1,511,440	\$ 2,507,647
Accrued interest receivable	61,200	69,700
Premiums receivable	2,298,508	1,905,295
Income taxes recoverable (Note 10)	202,797	-
Deferred premium acquisition costs (Note 4)	988,280	909,417
Investments (Note 5)	14,404,088	13,927,718
Investment in associate (Note 6)	3,437,999	4,265,382
Property and equipment (Note 7)	1,414,305	1,476,243
Intangible assets (Note 7)	42,948	75,792
Prepaid expenses	540,228	182,765
	<u>\$ 24,901,793</u>	<u>\$ 25,319,959</u>
LIABILITIES		
Accounts payable and accrued liabilities (Note 9)	\$ 393,987	\$ 375,573
Income taxes payable (Note 10)	-	74,140
Reserve for unpaid claims, net of reinsurance (Note 4)	1,398,657	1,583,877
Mortgage payable on demand (Note 11)	1,153,917	1,214,917
Unearned premiums (Note 4)	5,438,378	4,887,933
	<u>8,384,939</u>	<u>8,136,440</u>
EQUITY		
General Reserve - Statement 2	15,512,173	15,557,775
Accumulated other comprehensive income - Statement 2	1,004,681	1,625,744
	<u>16,516,854</u>	<u>17,183,519</u>
	<u>\$ 24,901,793</u>	<u>\$ 25,319,959</u>
Contingent Liabilities (Note 15)		
Subsequent Event (Note 19)		

APPROVED ON BEHALF OF THE BOARD:

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

STATEMENT OF CHANGES IN EQUITY

Statement 2

FOR THE YEAR ENDED DECEMBER 31, 2018

	2018	2017
General Reserve (Note 16)		
General Reserve, beginning of year	\$ 15,557,775	\$ 15,200,757
Net income (loss) for the year - Statement 3	<u>(45,602)</u>	<u>357,018</u>
General Reserve, end of year - Statement 1	<u>\$ 15,512,173</u>	<u>\$ 15,557,775</u>
Accumulated Other Comprehensive Income		
Accumulated other comprehensive income, beginning of year	\$ 1,625,744	\$ 1,207,325
Other comprehensive income (loss) - Statement 4	<u>(621,063)</u>	<u>418,419</u>
Accumulated other comprehensive income, end of year - Statement 1	<u>\$ 1,004,681</u>	<u>\$ 1,625,744</u>

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

STATEMENT OF OPERATIONS

Statement 3

FOR THE YEAR ENDED DECEMBER 31, 2018

	2018	2017
Premiums written	\$10,227,902	\$ 9,188,993
Reinsurance premiums	(1,060,916)	(887,073)
Change in unearned premiums (Note 4)	(550,445)	(451,666)
Net premiums earned	8,616,541	7,850,254
Service charge revenue	195,720	149,322
Net underwriting revenue	8,812,261	7,999,576
Losses		
Claims incurred	4,431,594	4,098,174
Adjusting expenses	558,608	335,940
Reinsurance recoveries	(161,978)	(151,421)
Net claims incurred	4,828,224	4,282,693
	3,984,037	3,716,883
Premium acquisition expenses		
Commissions expense	1,490,402	1,360,799
Change in commissions earned	(59,518)	(74,457)
Net commissions	1,430,884	1,286,342
Agents expenses	40,658	60,230
Premium tax	254,257	255,198
Fire Marshall's tax	64,197	64,167
Other premium acquisition costs	27,838	33,230
	1,817,834	1,699,167
Operating expenses - Schedule 1	2,054,105	1,762,982
	3,871,939	3,462,149
Underwriting profit	112,098	254,734
Investment and other income (expense)		
Equity loss from associate (Note 6)	(475,780)	(82,931)
Investment income (Note 13)	372,648	348,669
Rental income (loss) net of expenses	15,816	(7,648)
	(87,316)	258,090
Income before income taxes	24,782	512,824
Provision for income taxes (Note 10)	(70,384)	(155,806)
Net income (loss) for the year - Statement 2	\$ (45,602)	\$ 357,018

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

STATEMENT OF COMPREHENSIVE INCOME

Statement 4

FOR THE YEAR ENDED DECEMBER 31, 2018

	2018	2017
Net income (loss) - Statement 3	\$ <u>(45,602)</u>	\$ <u>357,018</u>
Other comprehensive income (loss):		
Unrealized gain (loss) on available-for-sale financial assets:		
Equities	(316,443)	494,155
Bonds and debentures	<u>(16,701)</u>	<u>(65,891)</u>
	<u>(333,144)</u>	<u>428,264</u>
Reclassification of loss (gains) included in net income:		
Equities	(6,170)	6,192
Bonds and debentures	<u>(14,647)</u>	<u>(11,296)</u>
	<u>(20,817)</u>	<u>(5,104)</u>
Other comprehensive income (loss) from associate (Note 6)	<u>(351,602)</u>	<u>106,259</u>
Net unrealized gain (loss)	<u>(705,563)</u>	<u>529,419</u>
Recovery of (provision) for income tax:		
Current income tax (Note 10)	96,617	(99,000)
Deferred income tax (Note 10)	<u>(12,117)</u>	<u>(12,000)</u>
	<u>84,500</u>	<u>(111,000)</u>
Other comprehensive income (loss) - Statement 2	<u>(621,063)</u>	<u>418,419</u>
Comprehensive income (loss)	\$ <u>(666,665)</u>	\$ <u>775,437</u>

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

STATEMENT OF CASH FLOWS

Statement 5

FOR THE YEAR ENDED DECEMBER 31, 2018

	2018	2017
Cash flows from operating activities:		
Net income (loss) for the year - Statement 3	\$ (45,602)	\$ 357,018
Income taxes in other comprehensive income	84,500	(111,000)
Items not requiring an outlay of cash:		
Depreciation and amortization	149,156	147,046
Loss (gain) on disposal of investments	(12,090)	21,360
Equity loss from associate	475,780	82,931
Gain on disposal of property and equipment	-	(47,345)
Amortization of bond premiums	<u>51,235</u>	<u>35,948</u>
	702,979	485,958
Changes in non-cash working capital balances:		
Accrued interest receivable	8,500	(12,500)
Premiums receivable	(393,213)	(243,726)
Prepaid expenses	(357,463)	(160,223)
Deferred premium acquisition costs	(78,863)	(92,815)
Accounts payable and accrued liabilities	18,415	1,466
Reserve for unpaid claims, net of reinsurance	(185,220)	887,075
Income taxes payable/recoverable	(276,937)	(368,541)
Unearned premiums	<u>550,445</u>	<u>451,666</u>
Cash flows from (used for) operating activities	<u>(11,357)</u>	<u>948,360</u>
Cash flows from financing activities:		
Proceeds from issue of mortgage	-	1,220,000
Payments on mortgage payable	<u>(61,000)</u>	<u>(5,083)</u>
Cash flows from (used for) financing activities	<u>(61,000)</u>	<u>1,214,917</u>
Cash flows from investing activities:		
Additions to property, equipment and intangibles	(54,374)	(358,774)
Proceeds on disposal of property and equipment	-	625,789
Proceeds from sale of investments	2,631,633	2,435,753
Purchase of investments	<u>(3,501,109)</u>	<u>(4,163,908)</u>
Cash flows used for investing activities	<u>(923,850)</u>	<u>(1,461,140)</u>
Increase (decrease) in cash and cash equivalents	(996,207)	702,137
Cash and cash equivalents, beginning of year	<u>2,507,647</u>	<u>1,805,510</u>
Cash and cash equivalents, end of year - Statement 1	<u>\$ 1,511,440</u>	<u>\$ 2,507,647</u>
See supplementary cash flow information		
Interest paid	<u>\$ 32,111</u>	<u>\$ 2,551</u>
Interest received	<u>\$ 266,831</u>	<u>\$ 245,927</u>
Income taxes paid	<u>\$ 220,097</u>	<u>\$ 635,347</u>
Income taxes received	<u>\$ -</u>	<u>\$ -</u>

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY**SCHEDULE OF OPERATING EXPENSES**

Schedule 1

FOR THE YEAR ENDED DECEMBER 31, 2018

	2018	2017
Advertising and donations	\$ 111,769	\$ 71,966
Agents' benefits	156,447	144,657
Association fees and memberships	13,002	11,310
Building occupancy costs	80,679	85,836
Computer operations	211,159	240,601
Conventions and meetings	20,169	12,323
Depreciation and amortization	135,099	110,666
Directors' remuneration (Note 14)	90,416	77,755
Directors expenses (Note 14)	21,778	5,539
Insurance and bonding	24,666	20,844
Interest and bank charges	50,099	42,040
Interest on long-term debt	32,111	2,551
Loss prevention	139,962	115,618
Office, postage and stationery	63,550	60,551
Professional fees	55,554	111,785
Salaries and employee benefits	777,840	589,681
Scholarship	6,000	6,000
Telephone	16,177	14,218
Training and education	14,685	11,576
Travel	<u>32,943</u>	<u>27,465</u>
	<u>\$ 2,054,105</u>	<u>\$ 1,762,982</u>

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

General information and statement of compliance with International Financial Reporting Standards

Southeastern Mutual Insurance Company is incorporated under the laws of New Brunswick and is subject to the Insurance Act of New Brunswick. The Company sells property and casualty insurance in the Province. Products include personal, commercial and farm insurance and automobile insurance through its associated company.

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

1. Adoption of new and revised standards and interpretations

There are no new standards, interpretations and amendments, effective for the first time on January 1, 2018 that have a material effect on the financial statements.

At the date of authorization of these financial statements, the IASB and IFRS Interpretations committee (IFRIC) has issued the following new and revised standards, amendments and interpretations which are not yet effective during period covered by these financial statements.

IFRS 17 Insurance Contracts is a new standard for insurance contracts. Under this new standard insurance contracts may be classified differently and reserve for policy and claims liabilities may be accounted for differently. This standard replaces the current IFRS 4 Insurance Contracts standard. The effective date of this standard is for year ends beginning on January 1, 2022.

IFRS 9 Financial Instruments includes revisions on the classification and measurement of financial instruments, changes to calculation of impairment on financial assets and new hedge accounting requirements. IFRS 9 replaces the current IAS 39 Financial Instruments: Recognition and Measurement and is effective for reporting periods beginning on or after January 1, 2018, with a deferral option for insurance companies to January 1, 2022 to coincide with the IFRS 17 adoption date.

IFRS 16 Leases includes new standards for accounting for leases. Under this new standard all leases except insignificant and short term leases will include an asset and corresponding liability. This standard replaces parts of standards currently in place (IAS 17, IFRIC 4, SIC-15 and SIC-27). The effective date of this standard is for year ends beginning on January 1, 2019.

The company is currently assessing the potential impact on its financial statements of the above standards. It is expected that IFRS 17 may have a material impact on the financial statements. The company has elected to defer adoption of IFRS 9 for the 2018 year.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the company's future financial statements.

2. Summary of significant accounting policies

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards and in accordance with the regulations of the Financial and Consumer Services Commission of New Brunswick (FCNB).

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments. The significant accounting policies adopted by the company are set out below.

In accordance with IFRS 4 Insurance Contracts, the company has applied previous Canadian generally accepted accounting principles (GAAP) modified as appropriate to comply with the IFRS framework. These Canadian GAAP accounting principles will continue to be applied for the company's insurance contracts until January 1, 2022 when IFRS 17 is to be adopted.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

2. Summary of significant accounting policies (continued)

(a) Financial instruments

All financial instruments are classified as either fair value through profit or loss (FVTPL), available-for-sale, held-to-maturity, loans and receivables, or other liabilities. FVTPL and available-for-sale financial instruments are revalued to their fair value as of the financial statement reporting date. FVTPL financial instruments are recognized through the statement of operations and available-for-sale financial instruments are recognized through other comprehensive income until the instrument is derecognized or impaired. Held-to-maturity, loans and receivables, and other liabilities are measured at amortized cost. Transactions costs are included in the carrying value of the financial instruments.

For information on the classification of each financial instrument of the company see Note 18.

Available-for-sale financial assets are assessed for indicators of impairment at each reporting period date. They are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted. A significant or prolonged decline in fair value of an available-for-sale financial asset below its cost is considered to be objective evidence of impairment.

For certain categories of financial assets that are assessed not to be impaired individually can subsequently be assessed for impairment on a collective basis. These assets include receivables.

The carrying amount of the financial assets is reduced by the impairment loss directly for all financial assets and the loss is recognized in net income for the year.

In respect of available-for-sale financial instruments, impairment losses previously recognized through net income are not reversed through net income for the year. Any increase in fair value subsequent to an impairment loss is recognized directly in other comprehensive income for the year.

Investments

Equities, preferred shares, bonds and debentures and short-term investments are classified as available-for-sale financial instruments. They are carried at fair value based on bid prices published in financial newspapers or bid quotations received from securities dealers. Any premiums or discounts on bond acquisitions are amortized, and any specific investment provisions flow through net earnings.

Unrealized gains and losses

Unrealized gains or losses on the Investments represents the difference between the carrying value at the year end and the carrying value at the previous year end or purchase value during the year, less the reversal of previously recognized unrealized gains and losses in respect of disposals during the year.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

2. Summary of significant accounting policies (continued)

(b) Insurance contracts

Deferred premium acquisition costs

Deferred premium acquisition costs consist of agents' commissions and premium taxes related to unearned premiums. These costs, to the extent that they are considered recoverable, are deferred and written off to income over the same periods that the related premiums are earned. In determining the amount recoverable consideration is given to claims and related expenses expected to be incurred as the premiums are earned.

Reserve for unpaid claims

Reserve for unpaid claims includes claims and adjustment expenses which represent the estimated amounts required to settle all outstanding and unreported claims incurred to the end of the fiscal year. The valuation of the claims liabilities are determined on a non-discounted basis.

Earned/unearned premium revenue

Premium revenue is recognized on a daily pro rata basis over the terms of the insurance policies. Unearned premiums represent the portion of premiums written which are applicable to the unexpired terms of the policy in force.

Reinsurance premiums and recoveries

Reinsurance premiums and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts.

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

(c) Cash and cash equivalents

Cash and cash equivalents are comprised of cash on hand, balances with banks and highly liquid temporary investments which are readily convertible into cash and which are subject to insignificant risk of changes in value.

(d) Investment in associate

The investment in the shares of the associate is accounted for on the equity basis whereby the carrying value of the investment is adjusted for the company's share of net income and other comprehensive income of the associate. Investments are written down when a decline in the value below cost is determined to be other than temporary.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

2. Summary of significant accounting policies (continued)

(e) Property and equipment

Property and equipment are recorded at cost or deemed cost less accumulated amortization and any recognized impairment loss. Depreciation is provided annually on a straight-line basis at rates calculated to write-off the cost or valuation of the property and equipment over their estimated useful lives using the following rates:

Building	2.5 % to 10%
Furniture and fixtures	10 %
Computers	17 %
Vehicles	20 %
Signs	20 %

(f) Intangible assets

Intangible assets consist of computer software, which are not integral to the operation of computer hardware owned by the company.

Software is initially recorded at cost and subsequently measured at cost less accumulated amortization and accumulated impairment losses. Software is amortized on a straight-line basis over its estimated useful life of 3 years.

(g) Investment property

The company's investment property consisted of land and building held to earn rental income. Investment property was initially recorded at cost or deemed cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses. Land was not depreciated. Buildings were depreciated on a straight-line basis over their estimated useful life of 15 to 40 years. These properties were sold in the prior year for net proceeds of \$625,789.

(h) Impairment of tangible assets

At the end of each reporting period, the company reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the asset's useful life.

The recoverable amount is the higher of fair value less costs to sell and value in use. 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 which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized as an expense immediately.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

2. Summary of significant accounting policies (continued)

(h) Impairment of tangible assets (continued)

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increase in carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized as income immediately.

(i) Income taxes

The tax expense represents the sum of current income tax payable and deferred income tax.

The income tax currently payable is based on taxable income for the year. Taxable income differs from net income as reported in the statement of operations because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The company's liability for current income tax is calculated using income tax rates effective at the statement of financial position date.

Deferred income tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statement and the corresponding income tax bases used in the computation of taxable income. Deferred tax is accounted for as an asset or liability on the statement of financial position. Deferred income tax liabilities are generally recognized for all taxable temporary differences and deferred income tax assets are recognized to the extent that it is probable that taxable income will be available against which deductible temporary differences can be utilized.

The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

Deferred income tax is calculated at the tax rates that have been enacted or substantially enacted at the end of the reporting period. Deferred tax is charged or credited to the statement of operations, except when it relates to items charged or credited directly to equity, in which case the deferred income tax is charged or credited in equity.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right of offset of current income tax assets and liabilities and when the company intends to settle its current income tax assets and liabilities on a net basis.

(j) Comprehensive income

Comprehensive income includes the change in the company's net assets that result from transactions, events and circumstances from sources other than the company's equity and includes items that would not normally be included in net income, such as unrealized gains and losses on available-for-sale financial instruments.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

2. Summary of significant accounting policies (continued)

(k) Product classification

The company's product consists of property and liability insurance and is classified, for accounting purposes, as an insurance contract. A contract that is classified as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.

Insurance contracts are those contracts that transfer significant insurance risk, if and only if, an insured event could cause an insurer to make significant additional benefits in any scenario, excluding scenarios that lack commercial substance. Such contracts may also transfer financial risk.

3. Critical accounting judgments and key sources of estimation uncertainty

In the application of the company's accounting policies, which are described in Note 2, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily available from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in a period of the revision and future periods if the revision affects both current and future periods.

(a) Critical judgments in applying the company's accounting policies

Management has not made any critical judgments apart from those involving estimations (which are dealt with separately below) in the process of applying the company's accounting policies that have significant effect on the amounts recognized in these financial statements.

(b) Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Valuation of reserve for unpaid claims

Determining the reserve for unpaid claims involves an assessment of the future development of the claims. The process takes into account the consistency of the company's claims handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises, and the delays in reporting of claims. These reserve unpaid claims 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 interpretations of contracts or significant changes in severity or frequency of claims from past trends. In general, the longer the term required for settlement of a group of claims, the more variable the estimates.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

3. Critical accounting judgments and key sources of estimation uncertainty (continued)

(b) Key sources of estimation uncertainty (continued)

Valuation of reserve unpaid claims (continued)

The estimates are principally based on the company's historical experience. Methods of estimation have been used that the company believes produce reasonable results given current information. As additional experience and other data become available, the estimates could be revised. Any future changes in estimation would be reflected in the statement operations for the year in which the change occurred.

Income taxes

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

4. Insurance contracts

Deferred premium acquisition costs

The following is a schedule of the changes in deferred premium acquisition costs for the year:

	2018	2017
Beginning of year	\$ 909,417	\$ 816,602
Acquisition costs incurred during the year	1,896,697	1,791,982
Expensed during the year	(1,817,834)	(1,699,167)
End of year	<u>\$ 988,280</u>	<u>\$ 909,417</u>

Unearned premiums

Unearned premiums on the statement of financial position consist of the unearned portions of premiums. The following is a schedule of the changes in the above for the year:

	2018	2017
Beginning of year	\$ 4,887,933	\$ 4,436,267
Premiums written in year	10,227,902	9,188,993
Premiums earned in year	(9,677,457)	(8,737,327)
Change in year	<u>550,445</u>	<u>451,666</u>
End of year	<u>\$ 5,438,378</u>	<u>\$ 4,887,933</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

4. Insurance contracts (continued)

Reserve for unpaid claims

Changes in claim liabilities recorded in the statement of financial position for the years ended December 31, 2018 and 2017 and their impact on claims and adjustment expenses for the two years is as follows:

	2018	2017
Reserve, beginning of year		
Gross	\$ 1,738,840	\$ 839,402
Reinsurance recoverable	<u>(154,964)</u>	<u>(142,600)</u>
	<u>1,583,876</u>	<u>696,802</u>
Decrease in estimated losses and expenses, for losses occurring in prior years	(30,079)	(4,907)
Provision for losses and expenses on claims occurring in the current year	<u>4,858,303</u>	<u>4,287,600</u>
	<u>4,828,224</u>	<u>4,282,693</u>
Paid claims occurring during:		
Current year events	(3,755,628)	(2,710,888)
Prior events	<u>(1,257,815)</u>	<u>(684,730)</u>
	<u>(5,013,443)</u>	<u>(3,395,618)</u>
Reserve, end of year	<u>\$ 1,398,657</u>	<u>\$ 1,583,877</u>
Reserve for unpaid claims, end of year:		
Gross	1,489,303	1,738,841
Reinsurer's share	<u>(90,646)</u>	<u>(154,964)</u>
	<u>\$ 1,398,657</u>	<u>\$ 1,583,877</u>

The company has determined estimated settlements in the next fiscal year on the reserve for unpaid claims noted above to be \$1,258,000 (2017 - 1,497,000). This estimate was determined through the use of historical data on claims payments year over year.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

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4. Insurance contracts (continued)

Reserve for unpaid claims (continued)

Claims development

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

The table below presents the development of claim payments and the estimated total cost of claims for the years 2015 to 2018. The upper half of the table shows the cumulative amounts paid or estimated to be paid during successive years related to each claim year. The original estimates will be increased or decreased, as more information becomes known about the original claims and overall claim frequency and severity.

Claims net of reinsurer's share

(\$'000)

	2015	2016	2017	2018	Total
Net estimate of cumulative claims cost					
At the end year of claim	\$ 3,423	\$ 2,743	\$ 4,205	\$ 4,858	
One year later	3,289	2,791	4,099		
Two years later	3,271	2,826			
Three years later	3,313				
Current estimate of cumulative claims cost	3,313	2,826	4,099	4,858	15,096
Cumulative payments	3,278	2,788	3,875	3,756	13,697
Outstanding claims	35	38	224	1,102	\$ 1,399

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

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5. Investments

Investments are classified on an available-for-sale basis, and therefore are carried at their fair value. The maximum exposure to credit risk would be the fair value as shown below.

	2018 Fair Value	2017 Fair Value
<i>Available-for-Sale</i>		
Bonds and debentures maturing within one year:		
Government of Canada	\$ 161,317	\$ -
Provincial/Municipal Governments	977,184	1,246,256
Canadian Corporate	<u>1,886,939</u>	<u>448,842</u>
	<u>3,025,440</u>	<u>1,695,098</u>
Bonds and debentures maturing between one and five years:		
Government of Canada	-	164,678
Provincial/Municipal Governments	2,051,937	1,759,613
Canadian Corporate	<u>2,525,247</u>	<u>3,511,625</u>
	<u>4,577,184</u>	<u>5,435,916</u>
Bonds and debentures maturing in more than five years:		
Provincial/Municipal Governments	762,776	682,763
Canadian Corporate	<u>811,602</u>	<u>603,756</u>
	<u>1,574,378</u>	<u>1,286,519</u>
	<u>9,177,002</u>	<u>8,417,533</u>
Equities	3,601,055	3,622,160
Preferred shares	1,589,910	1,788,015
Short term investments	<u>36,121</u>	<u>100,010</u>
	<u>5,227,086</u>	<u>5,510,185</u>
	<u>\$14,404,088</u>	<u>\$13,927,718</u>

The company's effective interest rate on bonds is calculated based on interest received and accrued in the year less amortization of bond premiums in the year. The effective interest rate on these investments is 2.38% (2017 - 2.75%).

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

6. Investment in associate

United General Insurance Corporation (United General) is owned by three New Brunswick Mutual Insurance companies which includes Southeastern Mutual Insurance Company. United General writes automobile policies for these New Brunswick Mutuals.

The investment in associate includes:

	2018	2017
Voting shares	\$ 73,838	\$ 73,838
Preferred and Participating shares	3,921,097	2,668,788
Undistributed share of income (loss) (see below)	<u>(475,780)</u>	<u>1,252,310</u>
	3,519,155	3,994,936
Undistributed share of income from other comprehensive income (loss)	<u>(81,156)</u>	<u>270,446</u>
	<u>\$ 3,437,999</u>	<u>\$ 4,265,382</u>

At December 31, 2018, the company's share of the total equity of United General was approximately 30% (2017 - 31%) and had 25% of voting control.

Subject to the terms of a shareholder agreement, the net income or loss of United General is to be allocated to each shareholder annually. For each dollar of income allocated to one of the shareholders, one share of United General's participating shares is to be issued. For each dollar of loss attributable to one of the shareholders, one of their participating shares must be surrendered for cancellation. In the year, \$1,252,310 of shares were issued to Southeastern.

The company's portion of United General's underwriting income is based on the auto business written by the company's agents for United General, net of the expenses relating to those premiums. The company's portion of United General's investment income and other comprehensive is based on the average net assets of United General contributed by the company. The following is a summary of the company's portion of United General's financial position and operations:

Statement of financial position

	2018	2017
Assets		
Investments	\$ 5,094,998	\$ 5,703,195
Due from agents, brokers and policyholders	547,104	556,180
Reserve for unpaid claims recoverable from reinsurers	364,484	245,511
Other assets	<u>658,392</u>	<u>403,181</u>
	<u>\$ 6,664,978</u>	<u>\$ 6,908,067</u>
Liabilities		
Reserve for unpaid claims	\$ 2,038,223	\$ 1,426,317
Unearned premiums	1,061,642	1,073,138
Other liabilities	<u>127,114</u>	<u>143,230</u>
	3,226,979	2,642,685
Shareholder's equity	<u>3,437,999</u>	<u>4,265,382</u>
	<u>\$ 6,664,978</u>	<u>\$ 6,908,067</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

6. Investment in associate (continued)

Statement of income

	2018	2017
Gross premiums earned	\$ 3,592,280	\$ 3,273,979
Reinsurance costs	<u>(659,636)</u>	<u>(702,109)</u>
Net premiums earned	2,932,644	2,571,870
Net claims incurred	(2,574,541)	(1,601,866)
Commissions and other expenses	<u>(1,321,166)</u>	<u>(1,267,260)</u>
Underwriting loss	(963,063)	(297,256)
Investment and other income	<u>290,544</u>	<u>185,802</u>
Loss before income tax	(672,519)	(111,454)
Income tax recovery	<u>196,739</u>	<u>28,523</u>
Company's portion of annual loss	(475,780)	(82,931)
Beginning undistributed share of income	1,252,310	1,335,241
Distribution of shares	<u>(1,252,310)</u>	<u>-</u>
Ending undistributed share of income (loss)	\$ <u>(475,780)</u>	\$ <u>1,252,310</u>

Subsequent to the year end, the company sold all of its shares in United General Insurance Corporation, see Note 19.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018



Stevenson & Partners
CHARTERED PROFESSIONAL ACCOUNTANTS

7. Property and equipment and intangibles

	Property and equipment						Intangibles
	Land	Building	Furniture and Fixtures	Computers Hardware	Vehicle	Signs	Computer Software
Gross Carrying Amount							
Balance December 31, 2017	\$ 338,000	\$ 947,721	\$ 151,683	\$ 350,787	30,798	\$ -	\$ 154,234
Additions	-	21,505	18,630	13,148	-	-	1,091
Disposals	-	-	-	-	-	-	-
Balance December 31, 2018	<u>338,000</u>	<u>969,226</u>	<u>170,313</u>	<u>363,935</u>	<u>30,798</u>	<u>-</u>	<u>155,325</u>
Depreciation and impairment							
Balance December 31, 2017	-	120,513	112,500	106,653	3,080	-	78,442
Additions	-	48,743	8,401	51,917	6,160	-	33,935
Disposals	-	-	-	-	-	-	-
Balance December 31, 2018	<u>-</u>	<u>169,256</u>	<u>120,901</u>	<u>158,570</u>	<u>9,240</u>	<u>-</u>	<u>112,377</u>
Carrying amount, December 31, 2018	<u>\$ 338,000</u>	<u>\$ 799,970</u>	<u>\$ 49,412</u>	<u>\$ 205,365</u>	<u>\$ 21,558</u>	<u>\$ -</u>	<u>\$ 42,948</u>
Gross Carrying Amount							
Balance December 31, 2016	\$ 338,000	\$ 947,721	\$ 148,733	\$ 108,832	-	\$ 48,300	\$ 71,663
Additions	-	-	3,450	241,955	30,798	-	82,571
Disposals	-	-	(500)	-	-	(48,300)	-
Balance December 31, 2017	<u>338,000</u>	<u>947,721</u>	<u>151,683</u>	<u>350,787</u>	<u>30,798</u>	<u>-</u>	<u>154,234</u>
Depreciation and impairment							
Balance December 31, 2016	-	72,308	105,030	64,455	-	41,292	56,844
Additions	-	48,205	7,470	42,198	3,080	1,913	21,598
Disposals	-	-	-	-	-	(43,205)	-
Balance December 31, 2017	<u>-</u>	<u>120,513</u>	<u>112,500</u>	<u>106,653</u>	<u>3,080</u>	<u>-</u>	<u>78,442</u>
Carrying amount, December 31, 2017	<u>\$ 338,000</u>	<u>\$ 827,208</u>	<u>\$ 39,183</u>	<u>\$ 244,134</u>	<u>\$ 27,718</u>	<u>\$ -</u>	<u>\$ 75,792</u>

The company did not record any impairment charges or reversals during the years noted above.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

8. Investment property

In the 2017 year the investment property was sold. As a result, only comparative 2017 figures have been disclosed.

	Land	Building	Total
Gross Carrying Amount			
Balance December 31, 2016	\$ 192,000	\$ 625,370	\$ 817,370
Additions	-	-	-
Disposals	<u>(192,000)</u>	<u>(625,370)</u>	<u>(817,370)</u>
Balance December 31, 2017	<u>-</u>	<u>-</u>	<u>-</u>
Depreciation and impairment			
Balance December 31, 2016	-	221,939	221,939
Additions	-	22,582	22,582
Disposals	<u>-</u>	<u>(244,521)</u>	<u>(244,521)</u>
Balance December 31, 2017	<u>-</u>	<u>-</u>	<u>-</u>
Carrying amount, December 31, 2017	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

9. Accounts payable and accrued liabilities

	2018	2017
Payable to reinsurer	\$ 96,787	\$ 68,374
Premium and fire marshall taxes payable	132,570	150,929
Due to other government agencies	1,859	11,708
Other payables and accruals	<u>162,771</u>	<u>144,562</u>
	<u>\$ 393,987</u>	<u>\$ 375,573</u>

10. Income taxes

Recovery of (provision for) income taxes included on Statement 3 is comprised of the following:

	2018	2017
Current income tax expense	\$ (262,363)	\$ (159,806)
Deferred income tax recovery	<u>191,979</u>	<u>4,000</u>
	<u>\$ (70,384)</u>	<u>\$ (155,806)</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

10. Income taxes (continued)

In computing the company's taxable income there are certain items that are restricted in their deduction or are not taxable as follows:

	2018	2017
Company's income before income taxes	\$ 24,782	\$ 512,824
Temporary differences	(70,776)	(1,652)
Non-taxable loss from associate	475,781	82,931
Mark to market adjustments	(353,962)	423,161
Tax reserve on mark to market adjustments	48,470	48,470
Taxable dividends deductible	(134,000)	(95,740)
Safe income gain realized	697,441	-
Non-deductible and restricted deductible expenses	<u>8,000</u>	<u>7,293</u>
Taxable income	695,736	977,287
Current effective tax rate	<u>29.0 %</u>	<u>29.0 %</u>
	201,763	283,413
Small business deduction	(36,017)	(32,537)
Adjustment for under provision of prior year	<u>-</u>	<u>7,930</u>
Income tax expense	<u>\$ 165,746</u>	<u>\$ 258,806</u>

The income tax expense noted above is made up of the following:

Income tax expense included on Statement 3 - statement of operations	\$ 262,363	\$ 159,806
Income tax expense (recovery) included on Statement 4 - statement of comprehensive income	<u>(96,617)</u>	<u>99,000</u>
	<u>\$ 165,746</u>	<u>\$ 258,806</u>

Income taxes payable is comprised of the following:

	2018	2017
Current income recoverable (payable)	\$ 33,135	\$ (63,940)
Deferred income taxes recoverable (payable)	<u>169,662</u>	<u>(10,200)</u>
	<u>\$ 202,797</u>	<u>\$ (74,140)</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

10. Income taxes (continued)

The effects of temporary differences, which give rise to the net deferred income tax assets (liabilities) reported, are as follows:

	Beginning of year	2018 Included in comprehensive income	End of year
Net book value of property and equipment over their undepreciated capital cost for income tax purposes	(23,881)	\$ (5,912)	\$ (29,793)
Temporary difference on fair value of bonds	(12,117)	12,117	-
Other temporary differences	6,000	1,500	7,500
Future loss on safe income gain	-	174,360	174,360
Unpaid claims reserve for accounting purposes in excess of their carrying value for income tax purposes	<u>19,798</u>	<u>(2,203)</u>	<u>17,595</u>
	<u>\$ (10,200)</u>	<u>\$ 179,862</u>	<u>\$ 169,662</u>

	Beginning of year	2017 Included in comprehensive income	End of year
Net book value of property and equipment over their undepreciated capital cost for income tax purposes	(9,886)	\$ (13,995)	\$ (23,881)
Temporary difference on fair value of bonds	(14,611)	2,494	(12,117)
Other temporary differences	12,071	(6,071)	6,000
Unpaid claims reserve for accounting purposes in excess of their carrying value for income tax purposes	<u>10,226</u>	<u>9,572</u>	<u>19,798</u>
	<u>\$ (2,200)</u>	<u>\$ (8,000)</u>	<u>\$ (10,200)</u>

Deferred income taxes included above comprise of the following:

Deferred income tax recovery - above	\$ 191,979	\$ 4,000
Deferred income tax expense - Statement 4	<u>(12,117)</u>	<u>(12,000)</u>
	<u>\$ 179,862</u>	<u>\$ (8,000)</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

11. Payments on mortgage payable

The company has a mortgage payable with Canadian Imperial Bank of Commerce repayable in monthly installments of \$5,083 plus interest at a rate of CIBC prime plus 0.15% per annum (currently 4.10%). The mortgage is secured by land and building located at 663 Pinewood Road which has a net book value of \$1,137,970. The mortgage is due on demand.

The anticipated principal payments on the mortgage payable for each of the five years subsequent to December 31, 2018 are as follows:

2018	\$ 61,000
2019	61,000
2020	61,000
2021	61,000
2022	61,000

12. Related party transactions

Key management of the company are senior employees, officers and members of the board of directors. The following is a detail of key management remuneration:

	2018	2017
Key management remuneration	\$ <u>493,992</u>	\$ <u>433,374</u>

Included in the statement of operations are the following items relating to key management:

Property and liability insurance premiums received	\$ <u>8,550</u>	\$ <u>8,310</u>
Property and liabilities insurance claims incurred	\$ <u>17,168</u>	\$ <u>3,547</u>

13. Investment and other income

	2018	2017
Interest from term deposits, bonds and debentures and GICs, net of bond amortization	\$ 207,307	\$ 213,443
Dividends	153,251	109,241
Gain (loss) on disposal of investments	12,090	(21,360)
Gain on sale of property and equipment	<u>-</u>	<u>47,345</u>
	\$ <u>372,648</u>	\$ <u>348,669</u>

14. Board compensation and expense reimbursement

Each director of the company received an annual stipend in 2018 of \$7,704 per director, \$15,001 for the chair (2017 - \$7,425 per director, \$14,459 for the chair).

In addition, each director received an attendance fee in 2018 of \$288 (2017 - \$256 January to March and \$264 April to December) for each attendance at board meetings, board committee meetings and various industry events.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

14. Board compensation and expense reimbursement (continued)

The total compensation paid and expenses reimbursed to each director in respect of 2018 and 2017 was as follows:

	Annual Stipend	Attendance Fees for Attending Board and Committee Meetings	Total Compensation per Director	Courses, Conferences and Mileage	Total Compensation and expenses per Director
Kevin Burdett					
2018	7,704	6,341	14,045	1,439	15,484
2017	7,425	4,181	11,606	-	11,606
Jack Low					
2018	7,704	6,918	14,622	4,244	18,866
2017	7,425	4,164	11,589	681	12,270
James Stark					
2018	7,704	6,053	13,757	3,422	17,179
2017	7,425	5,012	12,437	2,079	14,516
Lynn Roy					
2018	7,704	6,053	13,757	6,408	20,165
2017	7,425	3,901	11,326	675	12,001
Nancy Whipp					
2018	7,704	5,765	13,469	5,953	19,422
2017	7,425	3,901	11,326	2,104	13,430
Peter Wright					
2018	15,001	5,765	20,766	312	21,078
2017	14,459	5,012	19,471	-	19,471
Total for all directors					
2018	\$ 53,521	\$ 36,895	\$ 90,416	\$ 21,778	\$ 112,194
2017	\$ 51,584	\$ 26,171	\$ 77,755	\$ 5,539	\$ 83,294

Each director is provided with coverage under the OMIA health insurance plan. These benefits include coverage for Accidental Death and Dismemberment (AD&D)

The directors did not receive any retirement benefits, pension benefits, bonuses, profit sharing benefits, incentive payments. The directors did not receive any discounts on premiums payable to the company (other than the premium discounts applicable generally to all policy holders).

15. Contingent liabilities

In common with the insurance industry in general, the company is subject to litigation arising in the normal course of conducting its insurance business which is taken into account in establishing the reserve for unpaid claims.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

16. Capital management

The company's capital management objective is to ensure the company is capitalized in a manner that provides a strong financial position for its policyholders, and at the same time exceeds the regulatory capital requirements. Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable (see Note 17(a)).

Government regulators expect the company to establish an internal target capital ratio above supervisory target capital ratio when applying the Minimum Capital Test (MCT). The MCT calculation incorporates operating results, financial position and other factors and includes a calculated amount of capital available. As of December 31, 2018 and 2017, the company's MCT exceeded the supervisory target capital ratio required by the regulator (150%) as well as the company's internal target ratio (450%).

The following is the detail MCT calculations of the company:

	2018	2017
Calculated capital available	\$ 13,281,000	\$ 12,918,000
Supervisory target capital required	\$ 2,938,000	\$ 2,907,000
Internal target capital	\$ 8,814,000	\$ 8,721,000
Ratio of capital available over supervisory target capital required	452 %	444 %
Ratio of capital available over internal target capital	151 %	148 %

The company also maintains a required amount of general reserve. In accordance with the Insurance Act of New Brunswick this requirement at December 31, 2018 is computed as \$13,640,738 (2017 - \$12,415,663) and is available only to discharge obligations of the company not provided for out of its ordinary receipts. The ultimate disposition of this general reserve is at the discretion of the Lieutenant-Governor in Council.

17. Risk management, reinsurance and other risks

(a) Insurance risk

Reserve for unpaid claims

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

The reserve for unpaid claims and related reinsurer's share are estimates subject to variability and which might be material in the near term. The variability arises because all events affecting the ultimate settlement of claims may not have taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts or significant changes in severity or frequency of claims from historical trends. The estimates are principally based on the company's historical experience. Methods of estimation are used, which the company believes produce reasonable results given current information. All changes in estimates are recorded as incurred claims in the current period.

The company assists in minimizing risk of the above by diversifying risk across a large portfolio of insureds.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

17. Risk management, reinsurance and other risks (continued)

(a) Insurance risk (continued)

Reinsurance and underwriting

The company mitigates its insurance risk by having in place underwriting guidelines as well as reinsuring insurance contracts which limit the liability of the company to a maximum amount on any one claim. The company uses its underwriting guidelines to minimize risk by assessing individual policies, determining if the risk is within the tolerable range and then pricing the policy accordingly.

The current reinsurance contracts are as follows:

Property claims

First \$250,000 per loss is paid by the company, which limits the company's exposure in any one property claim to \$250,000. In addition, the company has obtained reinsurance which limits the company's liability to \$750,000 in a catastrophe. Stop loss reinsurance is also in effect which protects the company to limit the "Net Incurred Loss Ratio" to 80% of its insurance premiums.

Liability claims

The company will pay 100% of all losses, up to a maximum retention of \$250,000 per loss, which limits the company's exposure in any one liability claim to \$250,000.

The reinsurance of insurance contracts does not relieve the company's obligation to the policyholders. The company is exposed to the risk that the reinsurer will be unable to meet its obligations.

The Superintendent of Insurance also limits the company's maximum retention through its reinsurance arrangements to be the maximum of 2% of general reserve or \$350,000. The company's allowed maximum retention as of December 31, 2018 would be \$310,000.

Insurance pricing

The company is exposed to pricing risk to the extent that the company's unearned premiums are insufficient to meet related future policy cost. The company evaluates this risk on a regular basis by estimating future policy costs through extrapolation of historical loss trends.

Sensitivity analysis

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The company's uses various techniques based on past claims development and experience to determine these sensitivities. This includes indicators such as average claim cost, amount of claims occurrence, expected loss ratios and claims development as described in Note 4.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

17. Risk management, reinsurance and other risks (continued)

(a) Insurance risk (continued)

Reinsurance undertaken

The company participates in programs to provide re-insurance for crop reinsurance through two separate reinsurance programs. The maximum retained liability for the company in any one year is \$1,200,000 (2017 - \$1,200,000). For this reinsurance undertaken the company has recorded \$67,269 (2017 - \$68,832) of premium income included in premiums written on Statement 3. In the 2019 year the company will undertake two re-insurance programs with a maximum retained liability of \$1,200,000.

Property insurance risk

The company's property and equipment (Note 7) is insured for any losses exceeding \$250,000 for each property and liability insurance, which results in a maximum risk of \$500,000. This maximum risk takes into consideration that the company will be subject to maximum property and liability claims. This policy follows standard reinsurance arrangements as noted above.

(b) Other risks

Credit risks

Credit risk arises from the potential that a counter party will fail to perform its obligations. The company conducts a thorough assessment of debtors prior to granting credit and actively monitors the financial health of its debtors on an on-going basis. The company is also exposed to this risk relating to its debt holdings in its investment portfolio, premiums receivable from policyholders and the reliance on reinsurers to make payment when certain loss conditions are met.

The company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The bond portfolio consists of investment grade bonds rated "BBB" or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

Reinsurance is placed with FMRP, a Canadian registered reinsurer. FMRP's creditworthiness is monitored through its A.M. Best rating. As of April 2016, A.M. Best has rated FMRP with a rate of A- (Excellent). Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Premiums receivable are short-term in nature consisting of a large number of policyholders, and are not subject to material credit risk.

The maximum exposure to investment credit risk and concentration of this risk is outlined in Note 5.

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

17. Risk management, reinsurance and other risks (Continued)

(b) Other risks (Continued)

Liquidity Risks

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

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

Southeastern Mutual Insurance Company maintains a line of credit with Canadian Imperial Bank of Commerce in the amount of \$125,000 with an interest rate of prime plus 0.15% (currently 4.10%). The line of credit is secured the same as the mortgage in Note 11. At year end, Southeastern Mutual Insurance Company has utilized none of the line of credit available. In addition the company has a corporate visa facility in the amount of \$27,500.

Market risk

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

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

Currency risk

Foreign currency risk is the risk that the fair value or cash flows of a financial instrument will fluctuate because of changes in exchange rates and produce an adverse impact on comprehensive income when measured in the company's operating currency.

The company's foreign currency risk is related to its foreign stock holdings. Foreign currency changes are monitored by the investment committee. Foreign stocks included in the company's available-for-sale financial assets primarily relate to US dollar denominated equities totaling \$1,730,785 Canadian at year end. A 10% rise in the value of the US dollar, with all other variables held constant, would increase comprehensive income by \$135,000, net of tax. A 10% reduction in the value of the US dollar, with all other variables held constant, would decrease comprehensive income by \$135,000, net of tax. The company has not entered into any derivative financial instruments to hedge this currency risk exposure.

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

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

17. Risk management, reinsurance and other risks (Continued)

(b) Other risks (Continued)

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The company is exposed to this risk through its interest bearing investments. Diversification techniques are utilized to minimize risk. The company's investment policy sets out guidelines on types and ratings of investments to help minimize this risk. Fair value of these investments is affected positively in falling rate conditions but negatively in rising interest rate conditions. At December 31, 2018, an increase of 1% in interest rates, with all other variables held constant, would decrease bond fair values by \$84,000 and decrease other comprehensive income by \$64,000 net of income taxes. A decrease of 1% in interest rates, with all other variables held constant, would increase bond values by \$84,000 and increase other comprehensive income by \$64,000 net of income taxes.

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

Equity risk

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

The company's portfolio includes equities with fair values that move with the changes in stock markets. A 10% increase in the stock markets, with all other variables held constant would increase the fair value of equities held by the company by \$113,000 and increase other comprehensive income by \$86,000 net of income tax. A 10% decrease in the stock markets, with all other variables held constant would decrease the fair value of equities held by the company by \$113,000 and decrease other comprehensive income by \$86,000 net of income tax. For equities that the company did not sell during the year the change in fair value would be recognized in the asset value and other comprehensive income. For equities sold during the year, the change would be recognized in the asset value and in net income.

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

18. Fair value of financial instruments

Financial instruments included in the statement financial position of Southeastern Mutual Insurance Company are broken down as follows:

Loans and receivables

Accrued interest receivable

Available-for-sale

Cash and cash equivalents and investments

Other liabilities

Reserve for unpaid claims net of reinsurance, accounts payable and accrued liabilities and mortgage payable.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2018

18. Fair value of financial instruments (continued)

The above financial instruments are carried at their fair value. This is the maximum credit exposure for these financial instruments. Fair values were determined by management using the assumptions outlined below. Fair values are an estimate based on current market conditions and may not be reliable due to the use of assumption and are at a specific point in time and may not be reflective of future fair values.

The fair values of accrued interest receivable, cash and cash equivalents, accounts payable and accrued charges, reserve for unpaid claims net of reinsurance and mortgage payable are the same as their carrying amount due to their short-term nature or are due on demand.

The fair value of investments was determined through information from the company's investment statements which information is reflective of current market values.

The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of (Level 1) quoted prices in active markets for identical assets or liabilities, (Level 2) inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly, and (Level 3) inputs for the asset or liability that are not based on observable market data in the valuation of securities as at December 31, 2018 is as follows:

	Total Fair Value	Level 1 Quoted Prices	Level 2 Observable Inputs	Level 3 Unobservable Inputs
Assets				
Cash and cash equivalents	\$ 1,511,440	\$ 1,511,440	\$ -	\$ -
Accrued interest receivable	61,200	-	-	61,200
Bonds and guaranteed investment certificates	9,177,002	-	9,177,002	-
Equities	3,601,055	3,601,055	-	-
Preferred shares	1,589,910	1,589,910	-	-
Short-term investments	36,121	36,121	-	-
	<u>\$15,976,728</u>	<u>\$ 6,738,526</u>	<u>\$ 9,177,002</u>	<u>\$ 61,200</u>
Liabilities				
Accounts payable and accrued charges	\$ 393,987	\$ -	\$ -	\$ 393,987
Reserve unpaid claims net of reinsurance	1,398,657	-	-	1,398,657
Mortgage payable	1,153,917	-	-	1,153,917
	<u>\$ 2,946,561</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,946,561</u>

19. Subsequent event

Subsequent to the year end, the company sold all of its shares in United General Insurance Corporation (Note 6) for an expected proceeds of approximately \$3,532,000, subject to the final approval from all shareholders on the allocation of proceeds based on a signed side agreement by all parties.

20. Comparative figures

Certain of the prior year's figures presented for comparison purposes have been restated to conform to the presentation adopted for the current year.