

SOUTHEASTERN MUTUAL INSURANCE COMPANY
FINANCIAL STATEMENTS
DECEMBER 31, 2019



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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, 2019, 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, 2019, 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 10, 2020



Chartered Professional Accountants

SOUTHEASTERN MUTUAL INSURANCE COMPANY

STATEMENT OF FINANCIAL POSITION

Statement 1

DECEMBER 31, 2019

	2019	2018
ASSETS		
Cash and cash equivalents	\$ 1,605,858	\$ 1,511,440
Accrued interest receivable	77,200	61,200
Premiums receivable	2,869,304	2,298,508
Income taxes recoverable (Note 9)	268,189	202,797
Deferred premium acquisition costs (Note 4)	1,219,010	988,280
Investments (Note 5)	18,694,673	14,404,088
Investment in associate (Note 6)	-	3,437,999
Property and equipment (Note 7)	1,522,520	1,414,305
Intangible assets (Note 7)	354,437	42,948
Held in trust (Note 6)	531,160	-
Prepaid expenses	29,987	540,228
	<u>\$ 27,172,338</u>	<u>\$ 24,901,793</u>
LIABILITIES		
Accounts payable and accrued liabilities (Note 8)	\$ 644,699	\$ 393,987
Reserve for unpaid claims, net of reinsurance (Note 4)	2,370,180	1,398,657
Mortgage payable on demand (Note 10)	1,092,917	1,153,917
Unearned premiums (Note 4)	6,468,728	5,438,378
	<u>10,576,524</u>	<u>8,384,939</u>
EQUITY		
General Reserve - Statement 2	15,025,636	15,512,173
Accumulated other comprehensive income - Statement 2	1,570,178	1,004,681
	<u>16,595,814</u>	<u>16,516,854</u>
	<u>\$ 27,172,338</u>	<u>\$ 24,901,793</u>

APPROVED ON BEHALF OF THE BOARD:

Peter M. Wright

[Signature]

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, 2019

	2019	2018
General Reserve (Note 15)		
General Reserve, beginning of year	\$ 15,512,173	\$ 15,557,775
Net loss for the year - Statement 3	<u>(486,537)</u>	<u>(45,602)</u>
General Reserve, end of year - Statement 1	<u>\$ 15,025,636</u>	<u>\$ 15,512,173</u>
Accumulated Other Comprehensive Income		
Accumulated other comprehensive income, beginning of year	\$ 1,004,681	\$ 1,625,744
Other comprehensive income (loss) - Statement 4	<u>565,497</u>	<u>(621,063)</u>
Accumulated other comprehensive income, end of year - Statement 1	<u>\$ 1,570,178</u>	<u>\$ 1,004,681</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, 2019

	2019	2018
Premiums written	\$12,050,488	\$10,227,902
Reinsurance premiums	(1,377,100)	(1,060,916)
Change in unearned premiums (Note 4)	<u>(1,030,350)</u>	<u>(550,445)</u>
Net premiums earned	9,643,038	8,616,541
Service charge revenue	<u>234,325</u>	<u>195,720</u>
Net underwriting revenue	<u>9,877,363</u>	<u>8,812,261</u>
Losses		
Claims incurred	6,736,567	4,431,594
Adjusting expenses	606,776	558,608
Reinsurance recoveries	<u>(1,507,926)</u>	<u>(161,978)</u>
Net claims incurred (Note 4)	<u>5,835,417</u>	<u>4,828,224</u>
	<u>4,041,946</u>	<u>3,984,037</u>
Premium acquisition expenses		
Commissions expense	1,740,356	1,490,402
Change in commissions earned	<u>(185,426)</u>	<u>(59,518)</u>
Net commissions	1,554,930	1,430,884
Agents expenses	53,570	40,658
Agent benefits	167,076	156,447
Premium tax	347,372	254,257
Fire Marshall's tax	92,612	64,197
Other premium acquisition costs	<u>36,473</u>	<u>27,838</u>
	<u>2,252,033</u>	<u>1,974,281</u>
Operating expenses - Schedule 1	<u>2,758,118</u>	<u>1,897,658</u>
	<u>5,010,151</u>	<u>3,871,939</u>
Underwriting profit (loss)	<u>(968,205)</u>	<u>112,098</u>
Investment and other income (expense)		
Equity loss from associate (Note 6)	-	(475,780)
Loss on sale of associate (Note 6)	(199,392)	-
Investment income (Note 12)	476,808	372,648
Rental income (loss) net of expenses (Note 12)	<u>(99)</u>	<u>15,816</u>
	<u>277,317</u>	<u>(87,316)</u>
Income (loss) before income taxes	(690,888)	24,782
Recovery of (provision for) income taxes (Note 9)	<u>204,351</u>	<u>(70,384)</u>
Net loss for the year - Statement 2	<u>\$ (486,537)</u>	<u>\$ (45,602)</u>

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, 2019

	2019	2018
Net loss - Statement 3	\$ <u>(486,537)</u>	\$ <u>(45,602)</u>
Other comprehensive income (loss):		
Unrealized gain (loss) on available-for-sale financial assets:		
Equities	696,986	(316,443)
Bonds and debentures	<u>(16,757)</u>	<u>(16,701)</u>
	<u>680,229</u>	<u>(333,144)</u>
Reclassification of loss (gains) included in net income:		
Equities	76,843	(6,170)
Bonds and debentures	<u>(79,730)</u>	<u>(14,647)</u>
	<u>(2,887)</u>	<u>(20,817)</u>
Other comprehensive income (loss) from associate (Note 6)	<u>81,155</u>	<u>(351,602)</u>
Net unrealized gain (loss)	<u>758,497</u>	<u>(705,563)</u>
Recovery of (provision) for income tax:		
Current income tax (Note 9)	(193,000)	96,617
Deferred income tax (Note 9)	<u>-</u>	<u>(12,117)</u>
	<u>(193,000)</u>	<u>84,500</u>
Other comprehensive income (loss) - Statement 2	<u>565,497</u>	<u>(621,063)</u>
Comprehensive income (loss)	\$ <u>78,960</u>	\$ <u>(666,665)</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, 2019

	2019	2018
Cash (used for) from operating activities:		
Net loss for the year - Statement 3	\$ (486,537)	\$ (45,602)
Income taxes in other comprehensive income	(193,000)	84,500
Items not requiring an outlay of cash:		
Depreciation and amortization	166,166	149,156
Gain on disposal of investments	(26,755)	(12,090)
Equity loss from associate	-	475,780
Amortization of bond premiums	21,045	51,235
Loss on sale of associate (Note 6)	<u>199,392</u>	<u>-</u>
	(319,689)	702,979
Changes in non-cash working capital balances:		
Accrued interest receivable	(16,000)	8,500
Premiums receivable	(1,577,448)	(393,213)
Prepaid expenses	510,242	(357,463)
Deferred premium acquisition costs	(230,729)	(78,863)
Accounts payable and accrued liabilities	250,709	18,415
Reserve for unpaid claims, net of reinsurance	1,447,016	(185,220)
Income taxes payable/recoverable	(65,393)	(276,937)
Unearned premiums	<u>1,030,350</u>	<u>550,445</u>
Cash flows from (used for) operating activities	<u>1,029,058</u>	<u>(11,357)</u>
Cash flows used for financing activities:		
Payments on mortgage payable	<u>(61,000)</u>	<u>(61,000)</u>
Cash flows used for financing activities	<u>(61,000)</u>	<u>(61,000)</u>
Cash flows used for investing activities:		
Additions to property, equipment and intangibles	(585,870)	(54,374)
Proceeds from sale of investments	4,986,448	2,631,633
Purchase of investments	(8,593,981)	(3,501,109)
Proceeds on sale of associate (net of outlays) (Note 6)	<u>3,319,763</u>	<u>-</u>
Cash flows used for investing activities	<u>(873,640)</u>	<u>(923,850)</u>
Increase (decrease) in cash and cash equivalents	94,418	(996,207)
Cash and cash equivalents, beginning of year	<u>1,511,440</u>	<u>2,507,647</u>
Cash and cash equivalents, end of year - Statement 1	<u>\$ 1,605,858</u>	<u>\$ 1,511,440</u>
See supplementary cash flow information		
Interest paid	\$ <u>32,774</u>	\$ <u>32,111</u>
Interest received	\$ <u>329,271</u>	\$ <u>266,831</u>
Income taxes paid	\$ <u>108,466</u>	\$ <u>220,097</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, 2019

	2019	2018
Advertising and donations	\$ 147,409	\$ 111,769
Association fees and memberships	14,196	13,002
Building occupancy costs	93,222	80,679
Computer operations	612,971	211,159
Conventions and meetings	22,918	20,169
Depreciation and amortization	150,149	135,099
Directors' remuneration (Note 13)	94,255	90,416
Directors expenses (Note 13)	6,334	21,778
Insurance and bonding	11,550	24,666
Interest and bank charges	59,841	50,099
Interest on long-term debt	32,774	32,111
Loss prevention	99,573	139,962
Office, postage and stationery	76,516	63,550
Professional fees	86,929	55,554
Salaries and employee benefits	1,152,979	777,840
Scholarship	6,000	6,000
Telephone	19,402	16,177
Training and education	13,199	14,685
Travel	<u>57,901</u>	<u>32,943</u>
	<u>\$ 2,758,118</u>	<u>\$ 1,897,658</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, 2019

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

As of January 1, 2019, the company was required to adopt IFRS 16 Leases. The adoption of this standard has had no 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.

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 2019 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.

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 17.

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.

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 was 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, 2019

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 to 12 years.

(g) 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.

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.

2. Summary of significant accounting policies (continued)

(h) 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.

(i) Leased assets

The company leases a portion of its operating premises to a third party. The lease includes base rent and a charge for common area costs. This lease is considered to be an operating lease. Rental revenue is recognized over the period of the lease on a straight-line 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.

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 at the inception of the contract. Insurance risk is transferred when the counterparty to an insurance contract agrees to compensate a policyholder on the occurrence of an adverse specified uncertain future event. As a general guideline, the company determines whether it has significant insurance risk by comparing the benefits that could become payable or receivable under various possible scenarios relative to the premium received or paid for insuring the 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, 2019

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

(b) Key sources of estimation uncertainty (continued)

Valuation of reserve for 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:

	2019	2018
Beginning of year	\$ 988,280	\$ 909,417
Acquisition costs incurred during the year	2,482,763	2,053,144
Expensed during the year	<u>(2,252,033)</u>	<u>(1,974,281)</u>
End of year	<u>\$ 1,219,010</u>	<u>\$ 988,280</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:

	2019	2018
Beginning of year	\$ 5,438,378	\$ 4,887,933
Premiums written in year	12,050,488	10,227,902
Premiums earned in year	<u>(11,020,138)</u>	<u>(9,677,457)</u>
Change in year	<u>1,030,350</u>	<u>550,445</u>
End of year	<u>\$ 6,468,728</u>	<u>\$ 5,438,378</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

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, 2019 and 2018 and their impact on claims and adjustment expenses for the two years is as follows:

	2019		
	Insurance contract liabilities	Reinsurance of liabilities	Net
Unpaid claims, beginning of year	\$ 1,489,303	\$ 90,646	\$ 1,398,657
Change in provision for insured events of prior year	25,303	52,853	(27,550)
Provision for insured events of current year	7,318,040	1,455,073	5,862,967
	<u>7,343,343</u>	<u>1,507,926</u>	<u>5,835,417</u>
Net payments attributable to:			
Prior events	1,010,102	17,622	992,480
Current year events	3,871,414	-	3,871,414
	<u>4,881,516</u>	<u>17,622</u>	<u>4,863,894</u>
Unpaid claims, end of year	<u>\$ 3,951,130</u>	<u>\$ 1,580,950</u>	<u>\$ 2,370,180</u>
	2018		
	Insurance contract liabilities	Reinsurance of liabilities	Net
Unpaid claims, beginning of year	\$ 1,738,841	\$ 154,964	\$ 1,583,877
Change in provision for insured events of prior year	(132,680)	(102,602)	(30,078)
Provision for insured events of current year	5,122,882	264,580	4,858,302
	<u>4,990,202</u>	<u>161,978</u>	<u>4,828,224</u>
Net payments attributable to:			
Prior events	1,287,484	29,669	1,257,815
Current year events	3,952,256	196,627	3,755,629
	<u>5,239,740</u>	<u>226,296</u>	<u>5,013,444</u>
Unpaid claims, end of year	<u>\$ 1,489,303</u>	<u>\$ 90,646</u>	<u>\$ 1,398,657</u>

The company has determined estimated settlements in the next fiscal year on the reserve for unpaid claims noted above to be \$2,174,000 (2018 - \$1,258,000). 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

DECEMBER 31, 2019

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 tables below presents the development of claim payments and the estimated total cost of claims for the years 2015 to 2019 on a gross and net claims basis. 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.

Gross claims

(\$'000)

	2015	2016	2017	2018	2019	Total
Net estimate of cumulative claims cost						
At the end year of claim	3,630	\$ 2,970	\$ 4,433	\$ 5,123	\$ 7,157	
One year later	3,444	2,942	4,203	5,111		
Two years later	3,426	2,998	4,255			
Three years later	3,468	3,003				
Four years later	3,447					
Current estimate of cumulative claims cost	3,447	3,003	4,255	5,111	7,157	22,973
Cumulative payments	3,447	2,941	4,074	4,850	3,710	19,022
Outstanding claims	-	62	181	261	3,447	\$ 3,951

Claims net of reinsurance

(\$'000)

	2015	2016	2017	2018	2019	Total
Net estimate of cumulative claims cost						
At the end year of claim	3,423	\$ 2,743	\$ 4,205	\$ 4,858	\$ 5,702	
One year later	3,289	2,791	4,099	4,794		
Two years later	3,271	2,826	4,151			
Three years later	3,312	2,831				
Four years later	3,291					
Current estimate of cumulative claims cost	3,291	2,831	4,151	4,794	5,702	20,769
Cumulative payments	3,291	2,769	3,971	4,658	3,710	18,399
Outstanding claims	-	62	180	136	1,992	\$ 2,370

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

5. Investments

Investments are classified on an available-for-sale basis, and therefore are carried at their fair value.

	2019 Fair Value	2018 Fair Value
<i>Available-for-Sale</i>		
Bonds and debentures maturing within one year:		
Government of Canada	\$ -	\$ 161,317
Provincial/Municipal Governments	336,233	977,184
Canadian Corporate	<u>2,724,456</u>	<u>1,886,939</u>
	<u>3,060,689</u>	<u>3,025,440</u>
Bonds and debentures maturing between one and five years:		
Provincial/Municipal Governments	2,233,760	2,051,937
Canadian Corporate	<u>3,754,177</u>	<u>2,525,247</u>
	<u>5,987,937</u>	<u>4,577,184</u>
Bonds and debentures maturing in more than five years:		
Provincial/Municipal Governments	255,412	762,776
Canadian Corporate	<u>1,439,145</u>	<u>811,602</u>
	<u>1,694,557</u>	<u>1,574,378</u>
	<u>10,743,183</u>	<u>9,177,002</u>
Equities	4,525,349	3,601,055
Preferred shares	1,278,044	1,589,910
Short term investments	<u>2,148,097</u>	<u>36,121</u>
	<u>7,951,490</u>	<u>5,227,086</u>
	<u>\$18,694,673</u>	<u>\$14,404,088</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 2.89% (2018 - 2.38%).

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

6. Investment in associate

On January 1, 2019 the company sold its interest in United General Insurance Corporation. The following is the detail of the sale:

Proceeds on sale	\$ 3,532,522
Investment associate (\$3,437,999 plus share of associate AOCI \$81,156 reversed in AOCI)	(3,519,155)
Outlays on sale	<u>(212,759)</u>
Loss on sale	<u>\$ (199,392)</u>

As part of the sale, legal counsel has held back a portion of the proceeds from the sale of the above shares. This holdback is included in the statement of financial position as fund Held in Trust. The holdback is expected to be paid out in the following years

2020	\$ 132,790
2021	<u>398,370</u>
	<u>\$ 531,160</u>

Prior to January 1, 2019, United General Insurance Corporation (United General) was 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 included:

	2019	2018
Voting shares	\$ -	\$ 73,838
Preferred and Participating shares	-	3,921,097
Undistributed share of loss (see below)	<u>-</u>	<u>(475,780)</u>
	-	3,519,155
Undistributed share of other comprehensive loss	<u>-</u>	<u>(81,156)</u>
	<u>\$ -</u>	<u>\$ 3,437,999</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019



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, 2018	\$ 338,000	\$ 969,226	\$ 170,313	\$ 363,935	30,798	\$ -	\$ 155,325
Additions	-	173,948	32,712	24,089	-	-	355,121
Disposals	-	-	-	-	-	-	-
Balance December 31, 2019	<u>338,000</u>	<u>1,143,174</u>	<u>203,025</u>	<u>388,024</u>	<u>30,798</u>	<u>-</u>	<u>510,446</u>
Depreciation and impairment							
Balance December 31, 2018	-	169,256	120,901	158,570	9,240	-	112,377
Additions	-	55,229	10,181	50,964	6,160	-	43,632
Disposals	-	-	-	-	-	-	-
Balance December 31, 2019	<u>-</u>	<u>224,485</u>	<u>131,082</u>	<u>209,534</u>	<u>15,400</u>	<u>-</u>	<u>156,009</u>
Carrying amount, December 31, 2019	<u>\$ 338,000</u>	<u>\$ 918,689</u>	<u>\$ 71,943</u>	<u>\$ 178,490</u>	<u>\$ 15,398</u>	<u>\$ -</u>	<u>\$ 354,437</u>
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>

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, 2019

8. Accounts payable and accrued liabilities

	2019	2018
Payable to reinsurer	\$ 146,586	\$ 96,787
Premium and fire marshall taxes payable	217,639	132,570
Due to other government agencies	7,337	1,859
Other payables and accruals	<u>273,137</u>	<u>162,771</u>
	\$ <u>644,699</u>	\$ <u>393,987</u>

9. Income taxes

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

	2019	2018
Current income tax recovery (expense)	\$ 453,351	\$ (262,363)
Deferred income tax recovery (expense)	<u>(249,000)</u>	<u>191,979</u>
	\$ <u>204,351</u>	\$ <u>(70,384)</u>

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

	2019	2018
Company's income (loss) before income taxes	\$ (690,888)	\$ 24,782
Temporary differences	(297,144)	(70,776)
Non-taxable loss from associate	-	475,781
Mark to market adjustments	677,342	(353,962)
Tax reserve on mark to market adjustments	-	48,470
Non-taxable dividends	(134,654)	(134,000)
Safe income gain (loss) realized on sale of associate	(475,781)	697,441
Non-deductible and restricted deductible expenses	<u>7,674</u>	<u>8,000</u>
Taxable income (loss)	(913,451)	695,736
Current effective tax rate	<u>29.0 %</u>	<u>29.0 %</u>
	(264,901)	201,763
Small business deduction	-	(36,017)
Adjustment for difference in tax rate of loss carryback	<u>4,550</u>	<u>-</u>
Income tax (recovery) expense	\$ <u>(260,351)</u>	\$ <u>165,746</u>

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

Income tax (recovery) expense included on Statement 3 - statement of operations	\$ (453,351)	\$ 262,363
Income tax expense (recovery) included on Statement 4 - statement of comprehensive income	<u>193,000</u>	<u>(96,617)</u>
	\$ <u>(260,351)</u>	\$ <u>165,746</u>



SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

9. Income taxes (continued)

Income taxes payable is comprised of the following:

	2019	2018
Current income recoverable	\$ 347,527	\$ 33,135
Deferred income taxes recoverable (payable)	<u>(79,338)</u>	<u>169,662</u>
	<u>\$ 268,189</u>	<u>\$ 202,797</u>

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

	Beginning of year	2019 Included in comprehensive income	End of year
Net book value of property and equipment over their undepreciated capital cost for income tax purposes	(29,793)	\$ (88,422)	\$ (118,215)
Other temporary differences	7,500	1,750	9,250
Temporary difference 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>17,595</u>	<u>12,032</u>	<u>29,627</u>
	<u>\$ 169,662</u>	<u>\$ (249,000)</u>	<u>\$ (79,338)</u>
	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	-
Future loss on safe income gain	-	174,360	174,360
Other temporary differences	6,000	1,500	7,500
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>

Deferred income taxes included above comprise of the following:

Deferred income tax recovery - above	\$ 249,000	\$ 191,979
Deferred income tax expense - Statement 4	<u>-</u>	<u>(12,117)</u>
	<u>\$ 249,000</u>	<u>\$ 179,862</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

10. Mortgage payable on demand

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 \$1,256,689. The mortgage is due on demand. The due date set in the mortgage is May 31, 2020.

The anticipated principal payments on the mortgage payable for each of the five years subsequent to December 31, 2019 are as follows, assuming similar terms of repayments subsequent to May 31, 2020:

2020	\$ 61,000
2021	61,000
2022	61,000
2023	61,000
2024	61,000

11. Related party transactions

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

	2019	2018
Key management remuneration	\$ <u>612,268</u>	\$ <u>493,992</u>
Included in the statement of operations are the following items relating to key management:		
Property and liability insurance premiums received	\$ <u>9,123</u>	\$ <u>8,550</u>
Property and liabilities insurance claims incurred	\$ <u>7,534</u>	\$ <u>17,168</u>

12. Investment and other income

	2019	2018
<i>Investment income</i>		
Interest from bonds and debentures net of bond amortization	\$ 307,820	\$ 207,307
Dividends	142,233	153,251
Gain on disposal of investments	<u>26,755</u>	<u>12,090</u>
	\$ <u>476,808</u>	\$ <u>372,648</u>
<i>Rental income (loss)</i>		
Revenue and common area charges	\$ 55,146	\$ 65,395
Expenses	(39,229)	(35,522)
Depreciation allocated	<u>(16,016)</u>	<u>(14,057)</u>
Rental income (loss)	\$ <u>(99)</u>	\$ <u>15,816</u>

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

13. Board compensation and expense reimbursement

Each director of the company received an annual stipend in 2019 of \$7,708 per director, \$15,010 for the chair (2018 - \$7,704 per director, \$15,001 for the chair).

In addition, each director received an attendance fee in 2019 of \$424 (2018 - \$288) for each attendance at board meetings, board committee meetings and various industry events.

The total compensation paid and expenses reimbursed to each director in respect of 2019 and 2018 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					
2019	7,708	6,996	14,704	2,617	17,321
2018	7,704	6,341	14,045	1,439	15,484
Jack Low					
2019	7,708	6,360	14,068	-	14,068
2018	7,704	6,918	14,622	4,244	18,866
James Stark					
2019	7,708	6,784	14,492	520	15,012
2018	7,704	6,053	13,757	3,422	17,179
Lynn Roy					
2019	7,708	6,784	14,492	75	14,567
2018	7,704	6,053	13,757	6,408	20,165
Nancy Whipp					
2019	7,708	7,421	15,129	3,122	18,251
2018	7,704	5,765	13,469	5,953	19,422
Peter Wright					
2019	15,010	6,360	21,370	-	21,370
2018	15,001	5,765	20,766	312	21,078
Total for all directors					
2019	\$ 53,550	\$ 40,705	\$ 94,255	\$ 6,334	\$ 100,589
2018	\$ 53,521	\$ 36,895	\$ 90,416	\$ 21,778	\$ 112,194

Directors are provided with coverage under the company's Medavie Blue Cross health insurance plan. These benefits include coverage for Accidental Death and Dismemberment (AD&D) and Life Insurance.

The directors did not receive any retirement benefits, pension benefits, bonuses, profit sharing benefits or 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).

14. 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, 2019

15. 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 16(a)).

Government regulators expect the company to establish an internal target capital ratio above the 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, 2019 and 2018, 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 detailed MCT calculations of the company:

	2019	2018
Calculated capital available	\$ 16,241,000	\$ 13,281,000
Supervisory target capital required	\$ 3,759,000	\$ 2,938,000
Internal target capital	\$ 11,277,000	\$ 8,814,000
Ratio of capital available over supervisory target capital required	432 %	452 %
Ratio of capital available over internal target capital	144 %	151 %

If the company were required to maintain a reserve referred to in section 32b.1 of the Insurance Act of New Brunswick, the company would be in a shortfall of \$791,441. However, management and the board of directors do not believe the reserve is applicable to the company and has requested that the Insurance Act of New Brunswick be amended to remove all doubt.

16. 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, 2019

16. 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 70% 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, 2019 would be \$300,000.

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, 2019

16. 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 (2018 - \$1,200,000). For this reinsurance undertaken the company has recorded \$96,646 (2018 - \$67,269) of premium income included in premiums written on Statement 3.

Property insurance risk

The company's property and equipment (Note 7) is insured for any losses exceeding \$250,000 for each of property and liability insurance, which results in a maximum risk of \$500,000.

(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 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 Farm Mutual Re, a Canadian registered reinsurer. Farm Mutual Re's creditworthiness is monitored through its A.M. Best rating. As of July 19, 2019, A.M. Best has rated Farm Mutual Re 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, 2019

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

(b) Other risks (Continued)

Credit risks (Continued)

The aggregate gross credit risk is as follows:

	2019	2018
Cash and cash equivalents	\$ 1,605,858	\$ 1,511,440
Accrued interest receivable	77,200	61,200
Bonds and guaranteed investment certificates	10,743,183	9,177,002
Equities	4,525,349	3,601,055
Preferred shares	1,278,044	1,589,910
Short-term investments	<u>2,148,097</u>	<u>36,121</u>
	<u>\$ 20,377,731</u>	<u>\$ 15,976,728</u>

The table below shows debt securities by financial strength rating.

	2019			
	Short-term	Bonds and debentures	Preferred	Total
AAA/PFD-1	\$ -	\$ 235,115	\$ -	\$ 235,115
AA/PFD-2	-	2,097,438	1,249,259	3,346,697
A/PFD-3	-	5,389,210	28,785	5,417,995
BBB/PFD-4	-	1,175,674	-	1,175,674
Unrated	<u>2,148,097</u>	<u>1,845,746</u>	<u>-</u>	<u>3,993,843</u>
	<u>\$ 2,148,097</u>	<u>\$10,743,183</u>	<u>\$ 1,278,044</u>	<u>\$14,169,324</u>

	2018			
	Short-term	Bonds and debentures	Preferred	Total
AAA/PFD-1	\$ -	\$ 461,947	\$ -	\$ 461,947
AA/PFD-2	-	1,809,594	1,484,085	3,293,679
A/PFD-3	-	5,309,233	105,825	5,415,058
Unrated	<u>36,121</u>	<u>1,596,228</u>	<u>-</u>	<u>1,632,349</u>
	<u>\$ 36,121</u>	<u>\$ 9,177,002</u>	<u>\$ 1,589,910</u>	<u>\$10,803,033</u>

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.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

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

(b) Other risks (Continued)

Liquidity risks (Continued)

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 10. 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 finance committee. Foreign stocks included in the company's available-for-sale financial assets primarily relate to US dollar denominated equities totaling \$2,357,814 Canadian at year end. A 10% increase or decrease in the value of the US dollar, with all other variables held constant, would increase or decrease comprehensive income by \$178,000, 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, 2019

16. 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, 2019, an increase or decrease of 1% in interest rates, with all other variables held constant, would increase or decrease bond fair values by \$99,000 and increase or decrease other comprehensive income by \$75,000 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 or decrease in the stock markets, with all other variables held constant would change the fair value of equities held by the company by \$123,000 and increase or decrease other comprehensive income by \$93,000 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.

17. 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, 2019

17. 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, 2019 is as follows:

	Total Fair Value	Level 1 Quoted Prices	Level 2 Observable Inputs	Level 3 Unobservable Inputs
Assets				
Cash and cash equivalents	\$ 1,605,858	\$ 1,605,858	\$ -	\$ -
Accrued interest receivable	77,200	-	-	77,200
Bonds and guaranteed investment certificates	10,743,183	-	10,743,183	-
Equities	4,525,349	4,525,349	-	-
Preferred shares	1,278,044	-	1,278,044	-
Short-term investments	2,148,097	2,148,097	-	-
	<u>\$20,377,731</u>	<u>\$ 8,279,304</u>	<u>\$12,021,227</u>	<u>\$ 77,200</u>
Liabilities				
Accounts payable and accrued charges	\$ 644,699	\$ -	\$ -	\$ 644,699
Reserve unpaid claims net of reinsurance	2,370,180	-	-	2,370,180
Mortgage payable	1,092,917	-	-	1,092,917
	<u>\$ 4,107,796</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,107,796</u>

18. 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.

SOUTHEASTERN MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2019

19. Subsequent event

The outbreak of a novel strain of coronavirus (COVID-19) resulted in the global declaration of a pandemic by the World Health Organization. Government measures in place to combat the health threat of the virus have caused material disruption to businesses globally resulting in an economic slowdown. The duration and impact of the outbreak are unknown at this time, as are the efficacy of government and central bank interventions. It is not possible to reliably estimate the length and severity of the measures nor their impact on the future financial results and condition of the Company.

The Company is invested in shares traded on various stock exchanges. These stock exchanges have decreased significantly from the year end date (approximately 22% to 27%). As a result the fair market value of the Company's investments have been affected. The value of the investments has not been adjusted to reflect these market changes as they are a result of an event occurring subsequent to the year end of these financial statements. Due to the currently volatility of the financial markets, it is not possible to predict the eventual effect this event will have on the Company's investments.