



Howard Mutual  
Insurance Company  
Financial Statements  
For the year ended December 31, 2020

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For the year ended December 31, 2020

Table of Contents	Page
Independent Auditor's Report	1
Statement of Financial Position	3
Statement of Comprehensive Loss	4
Statement of Policyholders' Surplus	5
Statement of Cash Flows	6
Notes to the Financial Statements	
1. Corporate Information	7
2. Basis of Preparation	7
3. Adoption of New Accounting Standards	8
4. Insurance Contracts	8
5. Investments	16
6. Investment and Other Income	20
7. Capital Management	21
8. Sales Commissions	21
9. Other Operating and Administrative Expenses	21
10. Salaries, Benefits and Directors Fees	22
11. Gross Claims and Adjustment Expenses	22
12. Income Taxes	22
13. Fire Mutuals Guarantee Fund and Financial Guarantee Contracts	23
14. Property, Plant & Equipment	24
15. Pension Plan	24
16. Related Party Transactions	25
17. Standards, Amendments and Interpretations Not Yet Effective	25



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## Independent Auditor's Report

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To the Policyholders of  
Howard Mutual Insurance Company

### Opinion

We have audited the financial statements of Howard Mutual Insurance Company ("the Company"), which comprise the statement of financial position as at December 31, 2020 and the statement of comprehensive loss, statement of policyholders' surplus and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

### Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the 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 these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

### Auditor's 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 auditor's 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.

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.

Chartered Professional Accountants, Licensed Public Accountants

Chatham, Ontario  
February 23, 2021

Howard Mutual Insurance Company  
Statement of Financial Position

December 31

2020

2019

Assets

Cash	\$ 2,937,535	\$ 3,500,793
Investments (Note 5)	41,263,852	38,850,157
Investment income accrued	158,838	198,851
Income taxes recoverable (Note 12)	17,959	21,686
Due from reinsurer (Note 4)	3,000	292,651
Due from policyholders (Note 4)	3,416,012	2,952,368
Reinsurer's share of provision for unpaid claims (Note 4)	5,970,309	4,228,877
Deferred policy acquisition expenses (Note 4)	624,618	569,411
Property, plant & equipment (Note 14)	1,482,639	1,470,748
Other assets	44,670	36,286
Deferred income taxes (Note 12)	2,606,400	2,361,900
	<u>\$58,525,832</u>	<u>\$ 54,483,728</u>

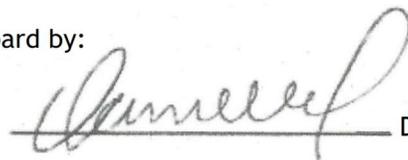
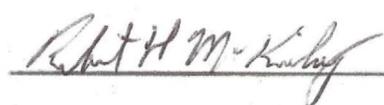
Liabilities

Accounts payable and other liabilities	\$ 454,429	\$ 362,743
Premiums due to reinsurer	133,945	113,562
Unearned premiums (Note 4)	7,238,798	6,746,140
Provision for unpaid claims (Note 4)	16,497,369	12,628,812
	<u>24,324,541</u>	<u>19,851,257</u>

Policyholders' Surplus

Unappropriated policyholders' surplus	34,201,291	34,632,471
	<u>\$58,525,832</u>	<u>\$ 54,483,728</u>

Signed on behalf of the Board by:

  
 \_\_\_\_\_ Director  
  
 \_\_\_\_\_ Director

Howard Mutual Insurance Company  
Statement of Comprehensive Loss

For the year ended December 31	2020	2019
Underwriting income		
Gross premiums written	\$14,839,063	\$ 13,815,537
Less reinsurance ceded	1,687,525	1,536,381
Net premiums written	13,151,538	12,279,156
Less increase in unearned premiums	492,658	624,462
Net premiums earned	12,658,880	11,654,694
Service charges	100,106	88,614
	12,758,986	11,743,308
Direct losses incurred		
Gross claims and adjustment expenses (Note 11)	14,033,635	11,669,942
Less reinsurer's share of claims and adjustment expenses	2,572,391	1,437,502
	11,461,244	10,232,440
	1,297,742	1,510,868
Expenses		
Sales commissions (Note 8)	1,270,630	1,217,141
Other operating and administrative expenses (Note 9)	3,280,976	2,965,150
	4,551,606	4,182,291
Net underwriting loss	(3,253,864)	(2,671,423)
Other items		
Investment and other income (Note 6)	2,585,793	2,236,817
Comprehensive loss before income taxes	(668,071)	(434,606)
Recovery for income taxes (Note 12)	(236,891)	(160,401)
Comprehensive loss for the year	\$ (431,180)	\$ (274,205)

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Howard Mutual Insurance Company  
Statement of Policyholders' Surplus

For the year ended December 31 2020 2019

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Unappropriated policyholders' surplus

Balance, beginning of year	\$34,632,471	\$ 34,906,676
Comprehensive loss for the year	<u>(431,180)</u>	<u>(274,205)</u>
Balance, end of year	<u>\$34,201,291</u>	<u>\$ 34,632,471</u>

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Howard Mutual Insurance Company  
Statement of Cash Flows

For the year ended December 31	2020	2019
Operating activities		
Comprehensive loss for the year	\$ (431,180)	\$ (274,205)
Adjustments for:		
Depreciation property, plant and equipment	131,042	154,281
Interest and dividend income	(1,062,584)	(1,056,466)
Realized loss (gains) from disposal of investments	34,242	(160,980)
Unrealized gain on investments	(1,658,394)	(1,114,849)
Recovery for income tax	(236,891)	(160,401)
	<u>(2,792,585)</u>	<u>(2,338,415)</u>
Changes in working capital		
Change in due from policyholders	(463,644)	(366,528)
Change in other assets	(8,384)	(3,295)
Change in accounts payable and other liabilities	91,686	51,703
Change in amounts due to/from reinsurer	310,034	(113,530)
Change in premium refund payable	-	(600,000)
	<u>(70,308)</u>	<u>(1,031,650)</u>
Changes in insurance contract related balances, provisions		
Change in deferred policy acquisition expenses	(55,207)	(76,530)
Change in unearned premiums	492,658	624,462
Reinsurer's share of provision for unpaid claims	(1,741,432)	(800,910)
Change in provision for unpaid claims	3,868,557	3,543,753
	<u>2,564,576</u>	<u>3,290,775</u>
Cash flows related to interest, dividends and income taxes		
Interest and dividends received	1,102,597	1,097,930
Income taxes paid	(3,882)	(1,021,445)
	<u>1,098,715</u>	<u>76,485</u>
Total cash inflows (outflows) from operating activities	<u>369,218</u>	<u>(277,010)</u>
Investing activities		
Proceeds from sale of investments	7,159,356	20,194,312
Purchase of investments	(7,948,900)	(19,650,106)
Purchase of property, plant & equipment	(142,932)	(222,902)
Total cash inflows (outflows) from investing activities	<u>(932,476)</u>	<u>321,304</u>
Net increase (decrease) in cash and cash equivalents	(563,258)	44,294
Cash and cash equivalents, beginning of year	<u>3,500,793</u>	<u>3,456,499</u>
Cash and cash equivalents, end of year	<u>\$ 2,937,535</u>	<u>\$ 3,500,793</u>

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# Howard Mutual Insurance Company

## Notes to Financial Statements

December 31, 2020

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### 1. Corporate Information

Howard Mutual Insurance Company ("the Company") is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property, liability, automobile and farmers' accident insurance in Ontario. The Company's head office is located at 20 Ebenezer Street West in Ridgeway, Ontario.

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

These financial statements have been authorized for issue by the Board of Directors on February 23, 2021.

### 2. Basis of Preparation

#### (a) Statement of compliance

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

#### (b) Basis of measurement

These financial statements were prepared under the historical cost convention, as modified by the revaluation of financial assets designated at fair value through profit and loss ("FVTPL").

The financial statements are presented in Canadian dollars ("CDN"), which is also the Company's functional currency.

#### (c) Judgment and estimates

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving critical judgments and estimates in applying accounting policies that have the most significant risk of causing material adjustment to the carrying amounts of assets and liabilities recognized in the financial statements within the next financial year are:

- The calculation of unpaid claims, including the determination of the initial claim liability, the development of claims, the estimate of time until ultimate settlement and the performance of a liability adequacy test (Note 4).
- The determination of the recoverability of the deferred policy acquisition expenses (Note 4); and
- The classification of financial assets at FVTPL, which includes assessing the business model within which the assets are held and whether the contractual terms of the assets are solely payments of principal and interest on the principal amount outstanding (Note 5).

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## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

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### 2. Basis of Preparation (continued)

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

### 3. Adoption of New Accounting Standards

Accounting standards, interpretations and amendments effective for accounting years beginning on or after January 1, 2020, did not materially affect the Company's financial statements.

### 4. Insurance Contracts

In accordance with IFRS 4, Insurance Contracts, the Company has continued to apply the accounting policies it applied in accordance with pre-changeover Canadian generally accepted accounting principles.

Balances arising from insurance contracts primarily include unearned premiums, provisions for unpaid claims and adjustment expenses, the Reinsurer's share of provisions for unearned premiums and unpaid claims and adjustment expenses and deferred policy acquisition expenses.

#### (a) Premiums and unearned premiums

Premiums written comprise the premiums on contracts incepting in the financial year. Premiums written are stated gross of commissions payable to agents and exclusive of taxes levied on premiums.

The Company recognizes premium income evenly over the term of the insurance policy using the pro rata method. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums (UEP). Changes in unearned premiums recorded in the statement of financial position for the years ended December 31, 2020 and 2019 and their impact on net premiums earned for the two years follow:

	<u>2020</u>	<u>2019</u>
Balance, beginning of the year	\$ 6,746,140	\$ 6,121,678
Premiums written	14,839,063	13,815,537
Premiums earned during year	(13,853,747)	(12,566,613)
Changes in UEP recognized in income	<u>(492,658)</u>	<u>(624,462)</u>
Balance, end of the year	<u>\$ 7,238,798</u>	<u>\$ 6,746,140</u>

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## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

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#### 4. Insurance Contracts (Continued)

##### (a) Premiums and unearned premiums (continued)

Pricing of property and liability policies are based on assumptions in regard to trends and past experience, in an attempt to correctly match policy revenue with exposed risk. Automobile premiums are subject to approval by the Financial Services Regulatory Authority of Ontario and therefore may result in a delay in adjusting the pricing to exposed risk.

The Company is exposed to a pricing risk to the extent that unearned premiums are insufficient to meet the related future policy costs. Evaluation is performed regularly to estimate future claims costs, related expenses, and expected profit in relation to unearned premiums. There was no premium deficiency at December 31, 2020 and 2019.

Amounts due from policyholders are measured at amortized cost less any impairment losses. These amounts are short-term in nature consisting of a large number of policyholders. The COVID-19 crisis impacted the level of bad debt expense and allowance for doubtful accounts on premiums receivable and other customer receivables. The Company applied judgement in its evaluation of the provision to consider flexible payment options provided, as well as experience during the crisis and in past economic downturns. Regular review of amounts outstanding is performed to ensure credit worthiness.

##### (b) Deferred policy acquisition expenses

Acquisition costs are comprised of agents' commissions costs of acquiring and renewing policies. These costs are deferred and amortized over the terms of the related policies to the extent that they are considered to be recoverable from unearned premiums, after considering the related anticipated claims and expenses. Changes in deferred policy acquisition expenses recorded in the statement of financial position for the years ended December 31, 2020 and 2019 and their impact on sales commissions for the two years follow:

	<u>2020</u>	<u>2019</u>
Balance, beginning of the year	\$ 569,411	\$ 492,881
Acquisition costs incurred	1,325,837	1,293,671
Expensed during the year	<u>(1,270,630)</u>	<u>(1,217,141)</u>
Balance, end of the year	<u>\$ 624,618</u>	<u>\$ 569,411</u>

##### (c) Unpaid claims and adjustment expenses

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, claims development, changes in reported claims and for claims incurred but not reported, based on past experience and business in force. The estimates are regularly reviewed and updated, and any resulting adjustments are included in current income.

Claims liabilities are carried on an undiscounted basis.

In relation to COVID-19, the Company applied judgement and actuarial standards to determine its unpaid claims, using different scenarios and assumptions based on the information currently available.

Howard Mutual Insurance Company  
Notes to Financial Statements

December 31, 2020

4. Insurance Contracts (Continued)

(c) Unpaid claims and adjustment expenses (continued)

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

	December 31, 2020		
	Gross	Reinsurance	Net
Outstanding claims provision			
Long settlement term	\$ 2,138,862	\$ 147,595	\$ 1,991,267
Short settlement term	10,137,670	3,572,714	6,564,956
Facility Association and other residual pools	342,337	-	342,337
	<u>12,618,869</u>	<u>3,720,309</u>	<u>8,898,560</u>
Provision for claims incurred but not reported	3,878,500	2,250,000	1,628,500
	<u>\$16,497,369</u>	<u>\$ 5,970,309</u>	<u>\$10,527,060</u>
	December 31, 2019		
	Gross	Reinsurance	Net
Outstanding claims provision			
Long settlement term	\$ 3,046,860	\$ 884,686	\$ 2,162,174
Short settlement term	5,378,045	1,094,191	4,283,854
Facility Association and other residual pools	325,407	-	325,407
	<u>8,750,312</u>	<u>1,978,877</u>	<u>6,771,435</u>
Provision for claims incurred but not reported	3,878,500	2,250,000	1,628,500
	<u>\$ 12,628,812</u>	<u>\$ 4,228,877</u>	<u>\$ 8,399,935</u>

The ultimate cost of long settlement general liability claims is difficult to predict for several reasons. Claims may not be reported until many years after a policy expires. Changes in the legal environment can create further complications. Court decisions and federal and provincial legislation may dramatically increase the liability between the time a policy is written and associated claims are ultimately resolved. For example, liability for exposure to toxic substances and environmental impairment, which did not appear likely or even exist when the policies were written, has been imposed by legislators and judicial interpretation. Tort liability has been expanded by some jurisdictions to cover defective workmanship. Provisions for such difficult-to-estimate liabilities are established by examining the facts of tendered claims and adjusted in the aggregate for ultimate loss expectations based upon historical experience patterns and current socioeconomic trends.

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

## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

### 4. Insurance Contracts (Continued)

#### (c) Unpaid claims and adjustment expenses (continued)

Changes in claim liabilities recorded in the statement of financial position for the years ended December 31, 2020 and 2019 and their impact on claims and adjustment expenses for the two years follow:

	2020	2019
Unpaid claim liabilities - beginning of year - net of reinsurance	\$ 8,399,935	\$ 5,657,092
Increase (decrease) in estimated losses and expenses, for losses occurring in the prior years	(22,022)	474,962
Provision for losses and expenses on claims occurring in the current year	11,478,627	9,757,478
Payment on claims:		
Current year	(6,726,241)	(5,580,913)
Prior years	(2,603,239)	(1,908,684)
	10,527,060	8,399,935
Unpaid claim liabilities - end of year - net of reinsurance		
Reinsurer's share of outstanding claims	5,970,309	4,228,877
	\$16,497,369	\$ 12,628,812

#### Claim development

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

The Company writes insurance primarily over a twelve month duration. The most significant risks arise through high severity, low frequency events such as natural disasters or catastrophes. A concentration of risk may arise from insurance contracts issued in a specific geographic location since all insurance contracts are written in Ontario.

The above risk exposure is mitigated by diversification across a large portfolio of insurance. The variability of risks is also improved by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements.

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

The tables below show how the Company's estimate of cumulative incurred claim cost for each accident year has changed at successive year ends and reconcile the cumulative claims to the amount appearing in the statement of financial position. An accident-year basis is considered to be the most appropriate for the business written by the Company.

December 31, 2020

4. Insurance Contracts (Continued)

(c) Unpaid claims and adjustment expenses (continued)

Gross claims	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
Gross estimate of cumulative claims cost											
At the end of accident year	\$6,876,961	\$7,142,497	\$7,513,848	\$7,609,941	\$6,821,730	\$7,469,126	\$10,221,591	\$8,852,199	\$11,888,532	\$14,823,075	
One year later	6,232,963	5,908,276	6,323,927	6,233,941	5,590,696	6,887,574	8,335,728	8,145,703	11,561,818		
Two years later	5,699,128	5,748,122	5,981,550	5,637,745	5,040,226	6,678,800	9,177,170	8,113,599			
Three years later	5,276,094	5,787,239	5,867,014	5,387,429	4,678,967	6,686,548	8,285,117				
Four years later	5,098,305	5,816,993	6,123,577	5,180,259	4,542,308	6,749,046					
Five years later	5,017,115	5,690,613	6,007,063	5,506,333	4,798,126						
Six years later	5,131,737	5,613,295	5,634,579	5,523,346							
Seven years later	5,070,833	5,454,228	5,634,580								
Eight years later	5,044,703	5,454,228									
Nine years later	5,153,876										
Current estimate of cumulative claims cost	5,153,876	5,454,228	5,634,580	5,523,346	4,798,126	6,749,046	8,285,117	8,113,599	11,561,818	14,823,075	\$76,096,811
Cumulative payments	4,453,876	5,454,228	5,634,580	5,116,243	4,733,126	6,302,125	6,911,203	7,065,195	7,245,541	7,025,662	59,941,779
Outstanding claims	\$ 700,000	\$ -	\$ -	\$ 407,103	\$ 65,000	\$ 446,921	\$ 1,373,914	\$ 1,048,404	\$ 4,316,277	\$ 7,797,413	16,155,032
Outstanding reserves - facility and risk sharing pool											342,337
Total gross unpaid claims and adjustment expenses											\$16,497,369

4. Insurance Contracts (Continued)

(c) Unpaid claims and adjustment expenses (continued)

Net of reinsurance	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
Net estimate of cumulative claims cost											
At the end of accident year	\$ 5,535,000	\$ 4,926,000	\$ 6,607,332	\$ 5,885,099	\$ 5,307,742	\$ 6,119,486	\$ 6,119,486	\$ 7,502,199	\$ 9,757,478	\$ 11,478,627	
One year later	5,204,000	4,314,021	5,666,293	5,089,191	4,268,075	5,732,545	7,523,592	7,585,385	9,773,324		
Two years later	4,911,327	4,453,368	5,545,407	4,788,995	3,998,057	5,495,821	7,770,032	8,039,088			
Three years later	4,644,483	4,521,170	5,543,905	4,673,217	3,998,086	5,657,772	7,195,222				
Four years later	4,507,657	4,570,775	5,578,912	4,614,948	3,966,424	5,714,304					
Five years later	4,464,838	4,428,204	5,501,104	4,809,089	4,013,726						
Six years later	4,483,918	4,403,688	5,385,151	4,773,002							
Seven years later	4,391,159	4,374,134	5,385,151								
Eight years later	4,350,291	4,374,134									
Nine years later	4,353,492										
Current estimate of cumulative claims cost	4,353,492	4,374,134	5,385,151	4,773,002	4,013,726	5,714,304	7,195,222	8,039,088	9,773,324	11,478,627	\$ 65,100,070
Cumulative payments	4,291,208	4,374,134	5,385,151	4,563,494	3,961,126	5,331,583	6,503,287	6,808,977	6,970,146	6,726,241	54,915,347
Outstanding claims	\$ 62,284	\$ -	\$ -	\$ 209,508	\$ 52,600	\$ 382,721	\$ 691,935	\$ 1,230,111	\$ 2,803,178	\$ 4,752,386	10,184,723
Outstanding reserves - facility and risk sharing pool											342,337
Total net unpaid claims and adjustment expenses											\$ 10,527,060

## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

### 4. Insurance Contracts (Continued)

#### (c) Unpaid claims and adjustment expenses (continued)

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The Company uses various techniques based on past claims development experience to quantify these sensitivities. This includes indicators such as average claim cost, amount of claims frequency, expected loss ratios and claims development.

Results of sensitivity testing based on expected loss ratios are as follows, showing gross and net of reinsurance and the impact on comprehensive loss before tax:

	Property claims		Auto claims		Liability claims	
	2020	2019	2020	2019	2020	2019
5% increase in loss ratios						
Gross	\$ 328,000	\$ 303,000	\$ 329,000	\$ 296,000	\$ 54,000	\$ 52,000
Net	\$ 306,000	\$ 285,000	\$ 306,000	\$ 282,000	\$ 46,000	\$ 47,000
5% decrease in loss ratios						
Gross	\$ (328,000)	\$ (303,000)	\$ (329,000)	\$ (296,000)	\$ (54,000)	\$ (52,000)
Net	\$ (306,000)	\$ (285,000)	\$ (306,000)	\$ (282,000)	\$ (46,000)	\$ (47,000)

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

#### (d) Liability adequacy test

At each reporting date the Company performs a liability adequacy test on its insurance liabilities less deferred policy acquisition expenses to ensure the carrying value is adequate, using current estimates of future cash flows, taking into account the relevant discount rate. If that assessment shows that the carrying amount of the liabilities is inadequate, any deficiency is recognized as an expense in profit and loss initially by writing down the deferred policy acquisition expense and subsequently by recognizing additional unearned premiums.

#### (e) Reinsurer's share of provisions for unpaid claims and adjustment expenses

The Company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Retention limits for the excess-of-loss reinsurance are set by product line. Reinsurance premiums are accounted for in the same period as the related premiums for the direct insurance business being reinsured. Reinsurance liabilities, comprised of premiums payable for the purchase of reinsurance contracts, are included in accounts payable and accrued liabilities and are recognized as an expense on the same basis as revenue on the underlying policies being reinsured.

The Company follows a policy of underwriting and reinsuring contracts of insurance which, in the main, limit the liability of the Company to an amount on any one claim of \$355,000 (2019 - \$355,000) in the event of a property claim, an amount of \$600,000 (2019 - \$600,000) in the event of an automobile claim and \$450,000 (2019 - \$450,000) in the event of a liability claim. The Company also obtained reinsurance which limits the Company's liability to \$1,065,000 (2019 - \$1,065,000) in the event of a series of claims arising out of a single occurrence. In addition, the Company has obtained stop loss reinsurance which limits the liability of all claims in a specific year to 80% (2019 - 80%) of gross net earned premiums income.

## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

### 4. Insurance Contracts (Continued)

#### (e) Reinsurer's share of provisions for unpaid claims and adjustment expenses (continued)

Amounts recoverable from reinsurer are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contracts. Although the Company has reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus a credit exposure exists with respect to ceded insurance, to the extent that the reinsurer is unable to meet its obligations assumed under such reinsurance agreements.

Expected reinsurance recoveries on unpaid claims and adjustment expenses are recognized as assets at the same time and using principles consistent with the Company's method for establishing the related liability. Changes in due from reinsurer recorded in the statement of financial position for the years ended December 31, 2020 and 2019 follow:

	2020	2019
Balance, beginning of the year	\$ 292,651	\$ 135,050
Submitted to reinsurer	835,599	636,592
Received from reinsurer	(1,125,250)	(478,991)
	<u>\$ 3,000</u>	<u>\$ 292,651</u>

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

Changes in reinsurer's share of provision for unpaid claims recorded in the statement of financial position for the years ended December 31, 2020 and 2019 and their impact on net premiums earned for the two years follow:

	2020	2019
Reinsurer's share of provision for unpaid claims		
Balance, beginning of the year	\$ 4,228,877	\$ 3,427,967
New claims reserve	2,323,750	485,754
Change in prior years' reserve	253,281	951,748
Submitted to reinsurer	(835,599)	(636,592)
	<u>\$ 5,970,309</u>	<u>\$ 4,228,877</u>

#### (f) Refund of premium

At the discretion of the Board of Directors, the Company may declare a refund to its policyholders based on the premiums paid. This refund is recognized as an expense in the period for which it is declared.

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## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

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### 5. Investments

#### (a) Recognition and initial measurement

The Company recognizes debt instruments on the date on which they are originated. Equity instruments are recognized on the settlement date, which is the date that the asset is received by the Company. The instruments are initially measured at fair value.

#### (b) Classification and subsequent measurement

The Company classifies its debt instruments, treasury bills / bankers' acceptance, GICs and bonds as FVTPL because the Company manages the debt instruments and evaluates their performance on a fair value basis in accordance with a documented investment strategy and the instruments are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

The Company classifies its equity instruments in listed and unlisted companies, as FVTPL.

The debt and equity instruments are subsequently measured at fair value where the net gains and losses, including any interest or dividend income and foreign exchange gains and losses, are recognized in profit or loss.

#### (c) Derecognition

The Company derecognizes investments when the contractual rights to the cash flows from the investment expires or the Company transfers the investment. On derecognition, the difference between the carrying amount at the date of derecognition and the consideration received is recognized in profit or loss.

Howard Mutual Insurance Company  
Notes to Financial Statements

December 31, 2020

5. Investments (Continued)

(d) Risks

The following table provides fair value information of investments by type of security and issuer.

	December 31, 2020 Fair value	December 31, 2019 Fair value
Guaranteed Investment		
Certificates maturing from April 2021 to April 2025 with interest rates from 1.40% to 2.59%	\$ 3,205,000	\$ 2,419,000
Bonds issued by		
Federal	11,528,363	12,034,561
Provincial	4,548,055	3,233,988
Corporate		
Canadian	9,316,004	9,522,341
Foreign	851,689	744,767
	26,244,111	25,535,657
Equity investments		
Canadian	9,737,790	9,223,135
Foreign	1,748,777	1,344,612
	11,486,567	10,567,747
Other investments		
Fire Mutuals guarantee fund	28,174	27,753
Debentures	300,000	300,000
	328,174	327,753
Total investments	\$ 41,263,852	\$ 38,850,157

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

The Company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The bond portfolio includes 100% (2019 - 100%) of bonds rated B or better. The Company's investment policy limits investment in bonds and debentures of the various ratings to limits ranging from 60% to 90% of the Company's portfolio. The Company's policy requires that funds be invested in high quality bonds and debentures of Federal, Provincial or Municipal Government and corporations. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

# Howard Mutual Insurance Company

## Notes to Financial Statements

December 31, 2020

### 5. Investments (Continued)

#### (d) Risks (continued)

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

Due to the impact of COVID-19, bond yields have decreased in the current year. The Company continues to monitor investments for credit ratings to ensure investments are made in bonds rated A or better.

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

The Company's investment policy requires that up to 40% of the Company's portfolio be held in cash and short-term investments, which mitigates liquidity risk. Short-term investments include bonds and GICs with an original maturity of less than one year.

Maturity profile of bonds and GICs held is as follows:

	Within 1 year	2 to 5 years	6 to 10 years	Over 10 years	Fair value
December 31, 2020	\$ 1,294,242	\$11,865,909	\$15,121,578	\$ 1,167,382	\$29,449,111
Percent of Total	5 %	40 %	51 %	4 %	
December 31, 2019	\$ 1,418,514	\$ 6,937,599	\$16,109,250	\$ 3,489,294	\$27,954,657
Percent of Total	5 %	25 %	58 %	12 %	

The effective interest rate of the bond portfolio is 2.85% at December 31, 2020 (2019 - 3.22%).

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

Market factors that will impact the fair value of investments include three types of risk: currency risk, interest rate risk and equity risk.

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

The Company's currency risk is related to stock holdings which are limited to foreign equities in sectors which are not readily available in Canada. The Company limits its holdings in foreign equities to 20% of the total investment portfolio in accordance with its investment policy. Foreign currency changes are monitored by the Investment Committee and holdings are adjusted when offside of the investment policy. The Company is not exposed to significant current risk on its investment portfolio.

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# Howard Mutual Insurance Company

## Notes to Financial Statements

December 31, 2020

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### 5. Investments (Continued)

#### (d) Risks (continued)

The Company is exposed to interest rate risk through its interest bearing investments (GICs and Bonds).

Historical data and current information is used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. However, because a significant portion of the Company's assets relate to its capital rather than liabilities, the value of its interest rate based assets exceeds its interest rate based liabilities. As a result, generally, the Company's investment income will move with interest rates over the medium to long-term with short-term interest rate fluctuations creating unrealized gains or losses.

At December 31, 2020, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by \$1,386,103 (2019 - \$1,839,442). These changes would be recognized in income.

The Company is exposed to equity risk through its portfolio of Canadian and foreign stocks through investments in pooled funds. At December 31, 2020, a 10% movement in the stock markets with all other variables held constant would have an estimated effect on the fair values of the Company's equities of \$1,148,657 (2019 - \$846,681). This change would be recognized in profit or loss.

The Company's investment policy limits investments in preferred shares to a maximum of 10% and common shares to a maximum of 25% of the market value of the investment assets, including investments in pooled funds.

Equities are monitored by the Investment Committee and the Board of Directors and holdings are adjusted following each quarter to ensure the investments portfolio remains in compliance with the investment policy.

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

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

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Howard Mutual Insurance Company  
Notes to Financial Statements

December 31, 2020

5. Investments (Continued)

(d) Risks (continued)

	Level 1	Level 2	Level 3	Total
December 31, 2020				
Guaranteed investment certificates	\$ -	\$ 3,205,000	\$ -	\$ 3,205,000
Bonds	-	26,244,111	-	26,244,111
Equities	11,486,567	-	-	11,486,567
Other investments	-	-	328,174	328,174
<b>Total</b>	<b>\$11,486,567</b>	<b>\$29,449,111</b>	<b>\$ 328,174</b>	<b>\$41,263,852</b>
December 31, 2019				
Guaranteed investment certificates	\$ -	\$ 2,419,000	\$ -	\$ 2,419,000
Bonds	-	25,535,657	-	25,535,657
Equities	10,567,747	-	-	10,567,747
Other investments	-	-	327,753	327,753
<b>Total</b>	<b>\$ 10,567,747</b>	<b>\$ 27,954,657</b>	<b>\$ 327,753</b>	<b>\$ 38,850,157</b>

There were no transfers between any levels of the fair value hierarchy for the years ended December 31, 2020 and 2019.

6. Investment and Other Income

	2020	2019
Interest income	\$ 797,054	\$ 840,368
Dividend income	265,530	216,098
Realized gains (losses) on disposal of investments	(34,242)	160,980
Investment expenses	(102,443)	(96,978)
Unrealized gains on investments	1,658,394	1,114,849
Other income	1,500	1,500
<b>Total</b>	<b>\$ 2,585,793</b>	<b>\$ 2,236,817</b>

# Howard Mutual Insurance Company

## Notes to Financial Statements

December 31, 2020

### 7. Capital Management

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

The Company's objectives with respect to capital management are to maintain a capital base that is structured to exceed regulatory requirements and to best utilize capital allocations.

The regulators measure the financial strength of property and casualty insurers using a minimum capital test (MCT). The regulators require property and casualty companies to comply with capital adequacy requirements. This test compares a company's capital against the risk profile of the organization. The risk-based capital adequacy framework assesses the risk of assets, policy liabilities and other exposures by applying various factors that are dependent on the risks associated with the company's assets. Additionally, an interest rate risk margin is included in the MCT by assessing the sensitivity of the company's interest-sensitive assets and liabilities to changes in interest rates. The regulator indicates that the company should produce a minimum MCT of 150%. As at December 31, 2020 the Company has exceeded this minimum. The regulator has the authority to request more extensive reporting and can place restrictions on the company's operations if the Company falls below this requirement and deemed necessary.

### 8. Sales Commissions

	2020	2019
Sales commissions	\$ 1,270,630	\$ 1,217,141

### 9. Other Operating and Administrative Expenses

	2020	2019
Advertising, donations and community support	\$ 327,309	\$ 196,416
Bad debt	9,728	6,136
Bank charges and interest	25,400	14,474
Computer costs	461,567	422,813
Directors' fees and expenses	71,207	131,142
Equipment expenses	20,306	44,688
Inspections and investigations	25,502	67,542
Insurance	33,910	32,271
Licenses, fees and dues	55,373	50,435
Occupancy costs	214,754	166,974
Postage and office supplies	79,307	66,769
Professional fees	308,414	208,750
Salaries and benefits	1,542,257	1,360,022
Telephone and communication	31,977	37,340
Travel and education	43,108	107,314
Other	30,857	52,064
	\$ 3,280,976	\$ 2,965,150

Howard Mutual Insurance Company  
Notes to Financial Statements

December 31, 2020

9. Other Operating and Administrative Expenses (Continued)

Depreciation is included in the above expense categories as follows:

	2020	2019
Advertising, donations and community support	\$ 484	\$ 972
Computer costs	64,983	69,000
Equipment expenses	15,813	34,931
Occupancy costs	43,764	41,460
Travel and education	5,998	1,000
	\$ 131,042	\$ 147,363

10. Salaries, Benefits, Commissions and Directors Fees

	2020	2019
Claims salaries and benefits (Note 11)	\$ 340,102	\$ 311,755
Sales commissions and salaries (Note 8)	1,270,630	1,217,141
Other salaries and benefits (Note 9)	1,542,257	1,360,022
Directors' fees and expenses (Note 9)	71,207	131,142
	\$ 3,224,196	\$ 3,020,060

11. Gross Claims and Adjustment Expenses

Included in claims expenses were salaries and benefits of \$340,102 (2019 - \$311,755), other operating and administrative costs of \$1,025,754 (2019 - \$936,364) and depreciation of \$NIL (2019 - \$6,918).

12. Income Taxes

At December 31, 2020, a deferred tax asset of \$2,606,400 (2019 - \$2,361,900) has been recorded. The utilization of this tax asset is dependent on future taxable profits in excess of the reversal of existing temporary differences. The Company believes that this asset should be recognized as it will be recovered through future profits.

	2020	2019
Deferred income tax asset		
Claims liabilities and unearned premiums	\$ 2,660,700	\$ 2,400,700
Property, plant & equipment	(68,800)	(53,400)
Net capital losses	14,500	14,600
	2,606,400	2,361,900

## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

### 12. Income Taxes (Continued)

Income tax expense is comprised of current and deferred tax. Current and deferred tax are recognized in comprehensive loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income (loss).

For 2018 and prior years, under previous tax legislation, the Company was subject to income taxes on that portion of its income derived from insuring other than farm related risks.

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

	2020	2019
Current tax		
Based on current year taxable income	\$ 7,609	\$ 7,199
Deferred tax		
Change resulting from temporary differences	(244,500)	(167,600)
Total provision (recovery) for income taxes	\$ (236,891)	\$ (160,401)

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

	2020	2019
Comprehensive loss before tax for the year	\$ (668,071)	\$ (434,606)
Expected taxes based on the statutory rate of 26.5%	(177,039)	(115,171)
Canadian dividends	(63,146)	(50,305)
Other	3,294	5,075
Total recovery for income taxes	\$ (236,891)	\$ (160,401)

### 13. Fire Mutuals Guarantee Fund and Financial Guarantee Contracts

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

The Company is a member of the Farm Mutual Re (FMRe), which is a general reinsurer that shares in the insurance risks originally accepted by member insurance companies. As a member of FMRe, the Company may be required to contribute additional capital to FMRe in the form of subordinated debt should FMRe's capital fall below a prescribed minimum.

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

Howard Mutual Insurance Company  
Notes to Financial Statements

December 31, 2020

14. Property, Plant & Equipment

Property, plant & equipment is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses, with the exception of land which is not depreciated. Depreciation is recognized in comprehensive loss and is provided on a straight-line basis over the estimated useful lives of the assets.

	Useful Life	Cost	2020 Accumulated Depreciation	Net Book Value
Land	N/A	\$ 41,878	\$ -	\$ 41,878
Buildings	40 years	1,890,159	833,095	1,057,064
Land improvements	10 years	24,657	24,657	-
Computer	3 to 5 years	1,011,758	789,006	222,752
Furniture and fixtures	5 years	588,288	498,979	89,309
Vehicles	4 to 8 years	113,198	41,562	71,636
<b>Total</b>		<b>\$ 3,669,938</b>	<b>\$ 2,187,299</b>	<b>\$ 1,482,639</b>

	Useful Life	Cost	2019 Accumulated Depreciation	Net Book Value
Land	N/A	\$ 41,878	\$ -	\$ 41,878
Buildings	40 years	1,845,411	794,994	1,050,417
Land improvements	10 years	24,657	24,657	-
Computer	3 to 5 years	949,785	724,023	225,762
Furniture and fixtures	5 years	552,077	477,020	75,057
Vehicles	4 to 8 years	113,198	35,564	77,634
<b>Total</b>		<b>\$ 3,527,006</b>	<b>\$ 2,056,258</b>	<b>\$ 1,470,748</b>

15. Pension Plan

The Company maintains a defined contribution pension plan for its employees with more than six months of service. The Company's obligation with respect to this plan is to make specified monthly contributions based on a percentage of the employee's eligible earnings. The pension contributions by the Company for the year amounted to \$148,063 (2019 - \$124,333), were for current service and have been recognized in comprehensive loss.

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## Howard Mutual Insurance Company Notes to Financial Statements

December 31, 2020

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### 16. Related Party Transactions

The Company entered into the following transactions with key management personnel, which are defined by IAS 24, Related Party Disclosures, as those persons having authority and responsibility for planning, directing and controlling the activities of the Company, including directors and management:

	<u>2020</u>	<u>2019</u>
Compensation		
Short-term salaries, directors' fees and other benefits	\$ 362,309	\$ 367,591
Total pension and other post-employment benefits	18,546	16,813
	<u>\$ 380,855</u>	<u>\$ 384,404</u>
Insurance premiums paid by key management	<u>\$ 71,982</u>	<u>\$ 75,002</u>
Insurance claims paid to key management	<u>\$ -</u>	<u>\$ 3,499</u>

There are no amounts owing to or from key management personnel at December 31, 2020 or 2019.

### 17. Standards, Amendments and Interpretations Not Yet Effective

Certain new standards, amendments to standards, and interpretations were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting years beginning after January 1, 2020, or later, that the Company has decided not to adopt early.

Of those new standards, interpretations and amendments that are not yet effective, IFRS 17 Insurance Contracts is expected to have a material impact on the Company's financial statements in the period of initial application.

- IFRS 17 Insurance Contracts supersedes IFRS 4 Insurance Contracts. IFRS 17 establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts. IFRS 17 requires entities to measure insurance contract liabilities using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires entities to recognize profits as it delivers insurance services. The effective date for IFRS 17 is January 1, 2023. The Company has not yet determined the impact of adoption, however, it is expected to significantly impact the overall Financial Statements.