SOUTH EASTHOPE MUTUAL INSURANCE COMPANY

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2010

SOUTH EASTHOPE MUTUAL INSURANCE COMPANY

INDEX
DECEMBER 31, 2010

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BDO Canada LLP
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INDEPENDENT AUDITOR'S REPORT

To the Policyholders,
SOUTH EASTHOPE MUTUAL INSURANCE COMPANY

We have audited the accompanying consolidated financial statements of **SOUTH EASTHOPE MUTUAL INSURANCE COMPANY**, which comprise of the consolidated balance sheet as at December 31, 2010, and the consolidated statements of operations, members' surplus, comprehensive income, accumulated other comprehensive income and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of South Easthope Mutual Insurance Company as at December 31, 2010 and the results of it operations and its cash flows for the year ended in accordance with Canadian generally accepted accounting principles.

BDO Canada LLP

Chartered Accountants, Licensed Public Accountants
Woodstock, Ontario
January 27, 2011

SOUTH EASTHOPE MUTUAL INSURANCE COMPANY

CONSOLIDATED BALANCE SHEET
AS AT DECEMBER 31, 2010

	2010	2009
ASSETS		
Cash and short-term deposits	$ 3,507,135	$ 4,591,099
Due from policyholders	3,277,762	2,995,384
Investment income accrued	89,094	95,048
Other receivables	276,270	42,921
Deferred policy acquisition expenses	502,835	467,298
Reinsurer's share of provision for unpaid claims (Note 1)	4,065,314	3,772,203
Future income taxes	101,146	126,903
Other assets	20,464	11,162
Developed software (net)	26,797	91,021
Capital assets (Note 2)	947,322	960,147
Investments (Note 3)	29,273,860	25,276,914
	$ 42,087,999	$ 38,430,100
LIABILITIES		
Provision for unpaid claims (Note 1)	$ 11,614,461	$ 12,226,757
Unearned premiums	6,412,256	5,878,856
Accounts payable and accrued liabilities	736,391	665,002
Deferred revenue	3,925	-
Income taxes payable	295,836	380,727
Provision for refund of premium	686,348	325,367
	19,749,217	19,476,709
MEMBERS' SURPLUS		
Members' surplus	20,635,391	17,847,086
Accumulated other comprehensive income	1,703,391	1,106,305
	$ 42,087,999	$ 38,430,100

On behalf of the Board

Gordon I Gross, Director

John I Mackey, Director

The accompanying notes are an integral part of these financial statements

SOUTH EASTHOPE MUTUAL INSURANCE COMPANY

CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
UNDERWRITING INCOME		
Gross premiums written	$ 13,066,731	$ 12,024,313
Less reinsurance ceded	2,332,912	2,122,214
Net premiums written	10,733,819	9,902,099
Change in unearned premiums	(533,400)	(384,748)
NET PREMIUMS EARNED	10,200,419	9,517,351
EXPENSES		
Net claims and adjusting expenses incurred	4,123,276	6,458,246
Policy acquisition cost	1,991,884	1,292,566
Salaries, benefits and directors' fees	818,247	617,585
Computer expense	46,129	44,410
Office premise expense	71,247	71,346
Professional fees	48,465	47,054
Premium tax	26,622	27,042
Postage, telephone and courier	61,804	46,066
Printing and stationery	29,546	29,939
Sundry and miscellaneous expense	477,820	415,495
Amortization of capital assets	92,798	91,618
TOTAL CLAIMS AND EXPENSES	7,787,838	9,141,367
NET UNDERWRITING INCOME BEFORE REFUND	2,412,581	375,984
REFUND OF PREMIUM	660,291	312,997
NET UNDERWRITING INCOME	1,752,290	62,987
NET LOSS FROM SUBSIDIARY OPERATIONS (Note 7)	(30,221)	(97,319)
INVESTMENT INCOME		
Investment income	1,762,872	783,168
Investment expenses	(51,193)	(41,609)
NET INVESTMENT INCOME	1,711,679	741,559
INCOME BEFORE PROVISION FOR INCOME TAXES	3,433,748	707,227
PROVISION FOR (RECOVERY OF) INCOME TAXES		
Current	707,886	555,053
Future	(62,443)	(422,543)
	645,443	132,510
NET INCOME FOR THE YEAR	$ 2,788,305	$ 574,717

The accompanying notes are an integral part of these financial statements

SOUTH EASTHOPE MUTUAL INSURANCE COMPANY

CONSOLIDATED STATEMENT OF MEMBERS' SURPLUS
FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
BALANCE AT BEGINNING OF YEAR	$ 17,847,086	$ 17,272,369
NET INCOME FOR THE YEAR	2,788,305	574,717
BALANCE AT END OF YEAR	$ 20,635,391	$ 17,847,086

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
NET INCOME	$ 2,788,305	$ 574,717
OTHER COMPREHENSIVE INCOME		
Change in unrealized gain (loss) on available-for-sale financial assets		
Debt securities	211,682	66,727
Common shares	869,206	1,423,574
Farm mutual pooled fund	(1,645)	(4,827)
	1,079,243	1,485,474
Reclassification adjustment for gain included in income		
Common shares	(228,537)	(198,951)
Debt securities	(165,420)	(6,743)
	(393,957)	(205,694)
Net unrealized income	685,286	1,279,780
Income tax effect	(88,200)	(255,000)
	597,086	1,024,780
COMPREHENSIVE INCOME	$ 3,385,391	$ 1,599,497

CONSOLIDATED STATEMENT OF ACCUMULATED OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
BALANCE AT BEGINNING OF YEAR	$ 1,106,305	$ 81,525
OTHER COMPREHENSIVE INCOME	597,086	1,024,780
BALANCE AT END OF YEAR	$ 1,703,391	$ 1,106,305

The accompanying notes are an integral part of these financial statements

SOUTH EASTHOPE MUTUAL INSURANCE COMPANY

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income for the year	$ 2,788,305	$ 574,717
Adjustments for:		
Amortization of capital assets	162,246	211,146
Amortization of developed software	79,169	152,898
Realized gain from disposal of investments	(393,957)	(205,694)
Write down of investments (Note 3)	-	226,982
Future income tax provision	(62,443)	(422,543)
	2,573,320	537,506
Changes in non-cash working capital items	(575,215)	2,828,713
Total cash from operating activities	1,998,105	3,366,219
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of investments	4,137,414	1,493,068
Purchase of investments	(7,055,117)	(2,545,101)
Purchase of capital assets	(164,366)	(107,322)
Total cash used for investing activities	(3,082,069)	(1,159,355)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,083,964)	2,206,864
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	4,591,099	2,384,235
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 3,507,135	$ 4,591,099
Income taxes paid (recovered) during the year	$ 791,869	$ (334,259)

The accompanying notes are an integral part of these financial statements

South Easthope Mutual Insurance Company is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property, liability and automobile insurance in Ontario.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of financial statements is in accordance with Canadian generally accepted accounting principles, including the requirements of the Financial Services Commission of Ontario. Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period of the statement of operations. Actual results could differ from these estimates.

Basis of presentation of financial statements

These financial statements include the financial statements of South Easthope Mutual Insurance Company and those of its subsidiary company, SEH Computer Systems Inc.

Premiums earned and deferred policy acquisition expenses

(a) Premiums and unearned premiums

The Company earns premium income evenly over the term of the insurance policy generally 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.

Premiums receivable are recorded at amounts due less any required provision for doubtful amounts.

(b) Deferred policy acquisition costs

Acquisition costs are comprised of agents' commissions, premium taxes, and other expenses which relate directly to the acquisition of premiums. 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 and investment income. Based on the above there was no premium deficiency for December 31, 2010 and 2009.

Capital Assets

Capital assets are stated at cost less accumulated amortization. Amortization is provided using the straight-line method at rates reflecting the useful lives of the assets (building at 20 years, computer hardware and software at 3-5 years, all others at 5 years).

Financial Instruments

The Company classifies its financial instruments into one of the following categories based on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Held-for-trading

This category is comprised of cash and cash equivalents. They are carried on the balance sheet at fair value with changes in fair value recognized in the statement of operations. Transaction costs are expensed as incurred.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

Loans and receivables

These assets are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand. They arise principally through the provision of goods and services to customers, but also incorporate other types of contractual monetary assets. They are recognized initially at fair value and subsequently carried at amortized cost, using the effective interest rate method, less any provision for impairment. Transaction costs are expensed as incurred.

Available-for-sale investments

This category is comprised of non-derivative financial assets not included in the above categories and includes investments in debt securities and equity, including the Company's investments in private companies. Investments that have a quoted market price in an active market are carried at fair value with changes in fair value recognized as a separate component of other comprehensive income. Investments that do not have a quoted market price in an active market are carried at cost. Any decline in the fair market value (loss) that is determined to be other than temporary, is removed from other comprehensive income and recognized in the statement of operations. Purchases and sales of these assets are accounted for at settlement date. Transaction costs are included in the amount initially recognized.

Other financial liabilities

Other financial liabilities includes all financial liabilities other than those classified as held-for-trading and comprises trade payables, and other short-term monetary liabilities. These liabilities are initially recognized at fair value and subsequently carried at amortized cost using the effective interest rate method. Transaction costs are expensed as incurred.

The carrying amount of the Company's financial instruments is as follows:

	Designated held-for-trading	Available-for-sale	Loans and receivables	Other financial liabilities	Total
Cash	$ 3,507,135	$ -	$ -	$ -	$ 3,507,135
Investment income accrued	-	-	89,094	-	89,094
Investments	-	29,273,860	-	-	29,273,860
Accounts payable and accrued liabilities	-	-	-	(736,391)	(736,391)
	$ 3,507,135	$ 29,273,860	$ 89,094	$ (736,391)	$ 32,133,698

Fair values

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arms length transaction between knowledgeable, willing parties who are under no compulsion to act. The initial value recognized is the transaction price being the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets held and offer prices for financial liabilities. When independent prices are not available, fair values are determined by using valuation techniques that refer to observable market data.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Instruments (continued)

Impaired investments

When the value of any debt security or equity is identified as impaired, the carried amounts are adjusted to estimated realizable amounts. Estimated realizable amounts are measured by discounting reasonably determinable expected future cash flows at the effective interest rate inherent in the investment or using the estimated fair values of underlying security less realization costs or observable market prices. Adjustments to carried amounts are included in investment income in the year the impairment is recognized.

Unpaid claims

The provision for unpaid claims represents an estimate for the full amount of all costs including investigation and the projected final settlements of claims incurred prior to the balance sheet date. These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. These provisions are adjusted up or down as additional information affecting the estimated amounts become known during the course of claims settlement. All changes in estimates are recorded as incurred claims in the current year.

The table below details the provision for unpaid claims and adjustment expenses by risk categories.

	2010		2009	
	Gross	**Ceded**	Gross	Ceded
Long settlement term	**$ 10,073,646**	**$ 3,549,321**	$ 11,180,523	$ 3,754,202
Short settlement term	**1,049,893**	**515,993**	575,798	18,001
Facility Association and other residual pools	**490,922**	**-**	470,436	-
	$ 11,614,461	**$ 4,065,314**	$ 12,226,757	$ 3,772,203

Reinsurance ceded

Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. Unearned premiums on business ceded and estimates of amounts recoverable from the reinsurer on unpaid claims and adjustment expenses are recorded on a gross basis.

Income taxes

The Company follows the asset/liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets, that are likely to be realized and future income tax liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities.

Future tax amounts are measured at enacted tax rates expected to be applied to taxable income in the years in which temporary differences are expected to be recovered or settled.

2. CAPITAL ASSETS

	2010		2009	
	Cost	**Accumulated Amortization**	Cost	Accumulated Amortization
Land	**$ 413,509**	**$ -**	$ 413,509	$ -
Buildings	**988,780**	**772,737**	967,032	745,554
Land improvements	**42,565**	**42,565**	42,565	42,565
Leasehold improvements	**38,800**	**-**	-	-
Computer software	**316,056**	**213,230**	299,661	213,880
Computer hardware	**655,051**	**601,231**	637,699	561,223
Automobiles	**158,479**	**114,864**	158,479	93,256
Furniture and fixtures	**356,910**	**278,201**	345,045	247,365
	$ 2,970,150	**$ 2,022,828**	$ 2,863,990	$ 1,903,843
Net book value		**$ 947,322**		$ 960,147

3. INVESTMENTS

The carrying value of bonds and equities by issuer and industry sector as at December 31 is shown in the following table.

	2010			2009		
	Amortized Cost	**Fair Value**	**Carrying Value**	Amortized Cost	Fair Value	Carrying Value
Bonds issued by:						
Federal	**$ 2,115,554**	**$ 2,236,876**	**$ 2,236,876**	$ 2,671,375	$ 2,777,677	$ 2,777,677
Provincial	**2,836,996**	**2,994,720**	**2,994,720**	2,595,386	2,690,720	2,690,720
Corporate						
"AAA"	**3,921,038**	**3,951,952**	**3,951,952**	2,588,613	2,667,657	2,667,657
"AA"	**2,564,002**	**2,676,922**	**2,676,922**	2,710,113	2,813,065	2,813,065
"A"	**682,548**	**695,437**	**695,437**	430,563	436,439	436,439
	12,120,138	**12,555,907**	**12,555,907**	10,996,050	11,385,558	11,385,558
Farm Mutual Pooled Fund						
Canadian Fixed Income	**8,557,564**	**8,598,025**	**8,598,025**	7,971,058	8,013,164	8,013,164
Equity investments						
Canadian common						
Finance/Utility	**2,516,640**	**3,054,163**	**3,054,163**	2,078,069	2,413,354	2,413,354
Consumer	**467,963**	**442,548**	**442,548**	538,208	489,184	489,184
Mining/Energy/Industrials	**2,321,510**	**3,508,731**	**3,508,731**	1,594,044	2,347,988	2,347,988
Technology	**227,390**	**203,245**	**203,245**	-	-	-
U.S. common						
Finance/Utility	**94,297**	**69,769**	**69,769**	66,000	47,295	47,295
Consumer	**361,170**	**325,907**	**325,907**	296,254	260,292	260,292
Mining/Energy/Industrials	**140,230**	**156,572**	**156,572**	116,218	91,715	91,715
Technology	**354,190**	**326,902**	**326,902**	194,623	197,368	197,368
	6,483,390	**8,087,837**	**8,087,837**	4,883,416	5,847,196	5,847,196
Fire Mutuals Guarantee Fund	**32,091**	**33,243**	**32,091**	30,996	32,156	30,996
	$ 27,193,183	**$ 29,275,012**	**$ 29,273,860**	$ 23,881,520	$ 25,278,074	$ 25,276,914

The maximum exposure to credit risk would be the fair value as shown above.

The estimated fair value of bonds and pooled funds are based on quoted market values. The estimated fair value of equities are determined using last bid price.

The investment in the Fire Mutuals Guarantee Fund does not have an active market. This investment has been carried at cost for accounting purposes.

3. INVESTMENTS (continued)

Based on the analysis by the equity portfolio investment managers, equities that have declined from their cost value at December 31, 2010 and are anticipated to have a prolonged or doubtful prospect of recovery to cost due to economic uncertainty in their respective sectors were deemed as other than temporarily impaired and written down.

Equities that have declined from their purchase price at December 31, 2010 in sectors where improvement is probable within the a timeframe consistent to the investment managers conservative strategy were deemed as temporarily impaired and not written down.

The Company determined that none of its equities that have declined from their purchase price at December 31, 2010 are other than temporary impaired. As a result, no writedown has been recognized in the statement of operations.

Liquidity

Maturity profile as at December 31, 2010

	2010		2009	
	Cost	**Fair Value**	Cost	Fair Value
Maturing within one year	**$ 310,726**	**$ 312,522**	$ 650,141	$ 654,772
Maturing between one and five years	**8,428,845**	**8,651,136**	4,126,300	4,279,004
Maturing over five years	**3,380,567**	**3,592,249**	6,219,609	6,451,782
	$ 12,120,138	**$ 12,555,907**	$ 10,996,050	$ 11,385,558

The effective interest rate at December 31, 2010 for debt securities is 3.66% (4.12% in 2009).

4. FAIR VALUE MEASUREMENT

The company has categorized its assets and liabilities that are carried at fair value, based on the priority of the inputs to the valuation techniques used to measure fair value, into a three level fair value hierarchy.

Level 1: Fair value is based on unadjusted quoted prices for identical assets or liabilities in an active market.

Level 2: Fair value is based on quoted prices for similar assets or liabilities in active markets, valuation that is based on significant observable inputs or inputs that are derived principally for or corroborated with observable market data through correlation or other means.

Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs or the use of broker quotes. These unobservable inputs reflect the company's assumptions about the assumptions market participants would use in pricing the assets or liabilities.

	Level 1	Level 2	Level 3	Total
Bonds				
Canadian Government	$ 2,236,876	$ -	$ -	$ 2,236,876
Provincial	2,994,720	-	-	2,994,720
Corporate	7,324,311	-	-	7,324,311
Farm Mutual Pooled Funds				
Canadian Fixed Income	-	8,598,025	-	8,598,025
Fire Mutuals Guarantee Fund	-	32,091	-	32,091
Equity Investments				
Canadian	7,208,687	-	-	7,208,687
US	879,150	-	-	879,150
Total assets measured at fair value	$ 20,643,744	$ 8,630,116	$ -	$ 29,273,860

The company did not have any significant transfers between level 1 and level 2.

5. INCOME TAXES

The Company is subject to income taxes on that portion of its income derived from insuring other than farm related risks.

6. PENSION PLAN

The Company makes contributions to the Ontario Mutual Insurance Association Pension Plan, which is a multi-employer plan, on behalf of its staff. The plan is the greater of a defined benefit plan or a money purchase plan. A defined benefit plan specifies the amount of the retirement benefit to be received by the employees based on length of service and rates of pay. A money purchase plan is the amount to be received by the employees based on the investing of the pension assets and the return they have received during the length of service.

Contributions made during the year on behalf of the employees amounted to $ 222,265 (2009 - $165,684) for current service. A payment of $620,129 was also made in 2010 for the Company's share of the pension plan deficit that existed for the year ending December 31, 2009 based on an actuarial valuation. The next actuarial valuation will be prepared for the year ended December 31, 2010. An accrual for $230,000 was made in 2010 for the Company's estimated share of pension plan deficit that existed for the year ending December 31, 2010.

All of the payments related to the pension plan are included in the Consolidated Statement of Operations.

7. SUBSIDIARY OPERATIONS

	2010	2009
REVENUE	$ 1,360,698	$ 1,089,204
EXPENSES		
Salaries and benefits	948,950	683,761
Amortization	128,014	251,824
General and administrative	246,918	183,468
Premise expenses	67,037	67,470
	1,390,919	1,186,523
NET LOSS FROM SUBSIDIARY	$ (30,221)	$ (97,319)

Intercompany revenue and expenses have been removed from the above statement of operations.

8. COMMITMENTS

The company's subsidiary has entered into two operating leases for some of its computer hardware. The equipment is leased at $2,623 per month and $596 per month under leases expiring in October 2011.

During the year, the company's subsidiary entered into a building lease which will commence in February 2011 and expire in January 2021.

The minimum annual lease payments for the next five years is as follows:

2011	$ 63,055
2012	$ 34,287
2013	$ 34,961
2014	$ 35,682
2015	$ 36,407

9. CAPITAL MANAGEMENT

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 generally expect 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. The regulator indicates that the Company should produce a minimum MCT of 150%. The regulator has the authority to request more extensive reporting and can place restrictions on the Company's operations if deemed necessary.

In an actuarial study done, the Risk Ratio was shown to have a high correlation to the MCT. As a result of these findings the Company uses Risk Ratio (surplus to gross premiums written) to monitor capital adequacy.

The minimum risk ratio set out by the regulators is 1:2 (50%). The ratio that the board of directors desires for the Company is more conservative at 1.5:1 (150%) with a minimum not less than a 1:1 (100%). The risk ratio for the Company at December 31, 2010 was 1.58:1 (158%).

9. CAPITAL MANAGEMENT CONTINUED

The Company's objective is to maintain this ratio by increasing surplus in proportion to written premium. Accordingly, this ratio is the primary consideration in determining the amount of new business written, allocating new business budgets for agents and brokers and policyholder premium refunds in years the Company realizes an underwriting profit.

For the purpose of capital management, the Company considers capital as policyholders' equity excluding accumulated other comprehensive income.

Reinsurance

The Company purchases excess of loss reinsurance which limits the liability of the Company on property, liability and automobile insurance contracts to a maximum amount on any one claim of $200,000 plus 10% of the excess up to $1,000,000. In addition the Company has obtained stop loss reinsurance which limits the liability of all claims in a specific year to 80% of gross net earned premiums for property and 100% of gross net earned premium for liability and automobile.

The company purchases catastrophe reinsurance to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable. To limit the potential impact of a catastrophic event, catastrophe reinsurance limits the Company's exposure to $600,000 plus 5% of the remaining loss in one event. The $600,000 net retained amount represents approximately 3% of Company's capital.

10. GUARANTEES AND CONTINGENT LIABILITIES

Pursuant to an agreement effective January 1, 1976, 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 Reinsurance Plan Inc. ("the Plan"), which is a general reinsurer that shares in the insurance risks originally accepted by member insurance companies. As a member of the Plan, the Company may be required to contribute additional capital to the Plan in the form of subordinated debt should the Plan's capital fall below a prescribed minimum.

11. FINANCIAL INSTRUMENT RISK MANAGEMENT

Credit Risk

Credit risk is the risk of financial loss to the Company if a debtor fails to make payments of interest and principal when due. The Company is exposed to this risk relating to its debt holdings in its investment portfolio and the reliance on reinsurers to make payment when certain loss conditions are met.

The Company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The bond portfolio remains very high quality with 100% of the bonds rated A 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 Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRP by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Accounts receivables are short-term in nature and are not subject to material credit risk.

The maximum exposure to investment credit risk and concentration of this risk is outlined in note 3.

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.

11. FINANCIAL INSTRUMENT RISK MANAGEMENT CONTINUED

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 Investment Committee and the Board of Directors. Diversification techniques are utilized to minimize risk. The Policy limits the investment in any one corporate issuer rated "AAA/AA" to a maximum of 5% and "A" to a maximum of 2.5% of the Company's fixed income portfolio. There is no single issuer limit on securities of the Government of Canada or of Provinces and guaranteed Crown Corporations rated A- or better.

The Company's investment policy limits investment in the Farm Mutual Canadian Fixed Income Pool Fund to a maximum of 50% of assets available to be invested. Funds are invested in bonds and debentures of Federal, Provincial or Municipal Government and Canadian companies rated BBB or better. The fund is monitored by the Farm Mutual Pooled Fund Investment Committee appointed by the Ontario Mutual Insurance Association.

Derivative instruments are not used in any investment activity.

Currency Risk

Currency risk relates to the Company operating in different currencies and converting non Canadian earnings at different points in time at different foreign exchange levels when adverse changes in foreign currency exchange rates occur.

The Company's foreign exchange risk is related to stock holdings which are limited to United States equities in sectors which are not readily available in Canada. The Company limits its holdings in foreign equity to 15% of the equity 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. A 1% change in the value of the United States dollar would affect the fair value of stocks by $9,000 which would be reflected in other comprehensive 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.

Interest rate risk

Interest rate risk is the potential for financial loss caused by fluctuations in fair value or future cash flows of financial instruments because of changes in market interest rates.

The Company is exposed to this risk through its interest bearing investments (bonds and fixed income pooled funds).

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 in other comprehensive income. There are no occurrences where interest would be charged on liabilities; therefore, little protection is needed to ensure the fair market value of assets will be offset by a similar change in liabilities due to an interest rate change.

The objective of the policies and procedures for managing interest rate risk is to diversify the bond portfolio in such a way that the bonds are a portfolio laddered over 10 years. One tenth of the bond portfolio would come due each year and be reinvested. This protects the Company from fluctuations in the interest rates.

11. FINANCIAL INSTRUMENT RISK MANAGEMENT CONTINUED

At December 31, 2010, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by $525,000. This change in market value would impact other comprehensive 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.

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 Canadian stocks with fair values that move with the Toronto Stock Exchange Composite Index and United States stocks with fair values that move with the S&P 500 Index. A 1% movement in the stock markets with all other variables held constant would have an estimated affect on the fair values of the Company's Canadian common and United States common of $80,000. This change in fair values would impact other comprehensive income.

The Company's investment policy limits equity investments to 25% of total assets in accordance with the Insurance Act. Investment managers are mandated to follow the same conservative strategy that they have demonstrated to the Company since 1992. All stocks must be freely tradable and listed on a recognized stock exchange in Canada or the US. The Company investment policy limits the investment in any single issuer to a maximum of 15% by market value of the equity portfolio. In the 10 global classification sectors, sector weights are limited to a maximum of 35%. Holdings in four sectors (Technology, Consumer, Energy/Industrials and Financial/Utilities) are maintained within 50% to 150% of the BMO/TSX CAP 10% index. The Investment Manager must suspend further sales when net realized losses in one quarter exceed $40,000.

Equities are monitored by the board of directors and holdings are adjusted following each quarter when they are out of balance with the investment policy.

Liquidity Risk

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 including investment income. Applicable reinsurance recoveries in excess of the Company's retention are submitted immediately upon confirmation of the claim.

The Company's investment policy requires that 2.5% to 7.5% of assets available for investments to be held in cash in an interest bearing bank demand account which includes a pre-approved line of credit to meet immediate cash flow requirements.

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.

12. GOVERNMENT REGULATION OF AUTOMOBILE INSURANCE

The Company's automobile insurance rates are subject to approval by the Financial Services Commission of Ontario (FSCO). Application for automobile rate changes are presented to FSCO by the Farm Mutual Reinsurance Plan (FMRP) on behalf of some members of Ontario Mutual Insurance Association (OMIA). The rate filings include actuarial justification for the rate increases or decreases. All rate filings must be approved by FSCO prior to implementation.