

**Pro-Demnity Insurance
Company
Summary Financial Statements
For the year ended December 31, 2019**

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Independent Auditor's Report on Summary Financial Statements

To the Shareholder of Pro-Demnity Insurance Company

Opinion

The summary financial statements, which comprise the summary statement of financial position as at December 31, 2019, and the summary statements of operations and retained earnings, comprehensive income (loss) and accumulated other comprehensive income, and cash flows for the year then ended, and related notes, are derived from the audited financial statements of Pro-Demnity Insurance Company (the "Company") for the year ended December 31, 2019.

In our opinion, the accompanying summary financial statements are a fair summary of the financial statements, in accordance with the criteria disclosed in Note 1 to the summary financial statements.

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by International Financial Reporting Standards. Reading the summary financial statements and the auditor's report thereon, therefore, is not a substitute for reading the Company's audited financial statements and the auditor's report thereon.

The Audited Financial Statements and Our Report Thereon

We expressed an unmodified audit opinion on the audited financial statements in our report dated February 19, 2020.

Responsibilities of Management for the Summary Financial Statements

Management is responsible for the preparation of the summary financial statements in accordance with the criteria disclosed in Note 1 to the summary financial statements.

Auditor's Responsibility for the Audit of the Summary Financial Statements

Our responsibility is to express an opinion on whether the summary financial statements are a fair summary of the audited financial statements based on our procedures, which were conducted in accordance with Canadian Auditing Standard (CAS) 810, *Engagements to Report on Summary Financial Statements*.

BDO Canada LLP

Chartered Professional Accountants, Licensed Public Accountants
Mississauga, Ontario
February 19, 2020

Pro-Demnity Insurance Company Summary Statement of Financial Position

December 31 **2019** **2018**

Assets

Cash and cash equivalents	\$ 6,173,314	\$ 3,689,987
Investments (Note 4)	80,748,472	74,196,432
Receivables	7,346,658	6,854,451
Accrued interest	465,575	412,644
Prepaid expenses	146,124	123,481
Reinsurer's share of unearned premiums	7,828,496	6,937,789
Reinsurer's share of provision for unpaid claims	14,199,000	10,936,000
Deferred policy acquisition expenses	459,938	405,782
Income taxes recoverable	-	214,441
Property and equipment (Note 5)	400,576	393,740
Right-of-use assets (Note 6)	549,586	-
Deferred tax asset (Note 8)	610,952	726,121
	\$118,928,691	\$104,890,868

Liabilities and Shareholders' Equity

Liabilities

Payables and accruals	\$ 3,435,900	\$ 1,985,893
Income taxes payable	348,777	-
Unearned premiums	15,831,259	14,026,073
Provision for unpaid claims	65,064,000	57,247,000
Lease liabilities (Note 6)	589,716	-
	85,269,652	73,258,966

Shareholders' equity

Share capital (Note 7)	25,106,500	25,106,500
Contributed surplus	2,051,915	2,051,915
Retained earnings	4,702,735	3,828,544
Accumulated other comprehensive income	1,797,889	644,943
	33,659,039	31,631,902
	\$118,928,691	\$104,890,868

On behalf of the Board:

_____ Director

_____ Director

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

Pro-Demnity Insurance Company Summary Statement of Operations and Retained Earnings

For the year ended December 31	2019	2018
Direct premiums written	\$ 33,525,642	\$ 29,675,676
Less: Reinsurance ceded	17,530,538	15,386,322
Net premiums written	15,995,104	14,289,354
Increase in net unearned premiums	(914,479)	(707,621)
Net premiums earned	15,080,625	13,581,733
Less: Claims and adjustment expenses	13,904,309	12,462,482
Underwriting income before expenses, commissions and premium tax	1,176,316	1,119,251
Operating expenses (schedule page 32)	5,358,961	4,750,574
Commissions earned	(2,780,301)	(2,412,184)
Premium tax	951,096	841,522
Net underwriting loss	(2,353,440)	(2,060,661)
Net investment income (Note 9)	3,275,323	2,764,301
Income before income taxes	921,883	703,640
Income taxes (recovery) (Note 8)		
Current	348,212	(89,154)
Deferred	(300,520)	148,530
	47,692	59,376
Net income for the year	874,191	644,264
Retained earnings, beginning of year	3,828,544	3,184,280
Retained earnings, end of year	\$ 4,702,735	\$ 3,828,544

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

Pro-Demnity Insurance Company
Summary Statement of Comprehensive Income (Loss) and
Accumulated Other Comprehensive Income

For the year ended December 31	2019	2018
Net income for the year	\$ 874,191	\$ 644,264
Other Comprehensive Income (Loss)		
Unrealized gains (losses) on available for sale assets, net of tax expense of \$584,597 (2018 - tax recovery of \$291,221)	1,621,427	(807,725)
Transfer of realized gains on available for sale assets to statement of operations, net of tax recovery of \$168,908 (2018 - tax recovery of \$90,772)	(468,481)	(251,763)
Total other comprehensive income (loss)	1,152,946	(1,059,488)
Comprehensive income (loss) for the year	\$ 2,027,137	\$ (415,224)
Accumulated other comprehensive income , beginning of year	\$ 644,943	\$ 1,704,431
Total other comprehensive income (loss) , for the year	1,152,946	(1,059,488)
Accumulated other comprehensive income , end of year	\$ 1,797,889	\$ 644,943

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

Pro-Demnity Insurance Company Summary Statement of Cash Flows

For the year ended December 31	2019	2018
Cash provided by (used in)		
Operating activities		
Net income for the year	\$ 874,191	\$ 644,264
Adjustments for:		
Depreciation of property and equipment and right-of-use asset	185,061	82,346
Amortization of premium/discount on bonds and debentures	548,195	645,430
Interest and dividend income	(1,267,608)	(1,041,397)
Provision for income taxes	47,692	59,376
Realized gain from disposal of investments	(487,973)	(340,671)
	<u>(100,442)</u>	49,348
Changes in working capital and insurance contract related balances		
Receivables	(492,207)	(550,201)
Prepaid expenses	(29,915)	(52,076)
Reinsurer's share of unearned premiums	(890,707)	(900,086)
Deferred policy acquisition expenses	(54,156)	(48,231)
Payables and accruals	1,487,994	(755,166)
Unearned premiums	1,805,186	1,607,707
Provision for unpaid claims, net of reinsurer's share	4,554,000	5,318,000
	<u>6,279,753</u>	4,669,295
Cash flows related to interest, dividends and income taxes		
Interest and dividends received	1,214,677	1,014,932
Income taxes recovered	630,695	(214,500)
Interest paid	19,620	-
	<u>1,865,000</u>	880,432
Total cash inflows from operating activities	<u>8,144,745</u>	<u>5,469,727</u>
Investing activities		
Purchase of investments	(83,507,891)	(67,455,402)
Proceeds from sale of investments	78,048,576	64,603,089
Purchase of property and equipment	(120,197)	(99,363)
Total cash outflows from investing activities	<u>(5,579,512)</u>	<u>(2,951,676)</u>
Financing activity		
Repayment of lease liabilities	(81,906)	-
Increase in cash during the year	<u>2,483,327</u>	<u>2,518,051</u>
Cash and cash equivalents, beginning of year	<u>3,689,987</u>	<u>1,171,936</u>
Cash and cash equivalents, end of year	<u>\$ 6,173,314</u>	<u>\$ 3,689,987</u>
Cash and cash equivalents consist of the following:		
Cash	\$ 3,173,314	\$ 3,689,987
Guaranteed Investment Certificates (GICs) (Note 4)	3,000,000	-
	<u>\$ 6,173,314</u>	<u>\$ 3,689,987</u>

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

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies

Reporting entity

Pro-Demnity Insurance Company (the "Company" or "Pro-Demnity") was incorporated under the laws of Ontario on August 9, 2002. The Company is an insurer dedicated to the underwriting of architects' liability coverages. The Company is licensed in Ontario and the Company's registered office is 200 Yorkland Boulevard, Suite 1200, Toronto, Ontario.

These summary financial statements have been authorized for issue by the Board of Directors on February 19, 2020.

Basis of preparation

Management is responsible for the preparation of these summary financial statements. The summary presented includes the Summary Statement of Financial Position, Summary Statement of Operations and Retained Earnings, Summary Statement of Comprehensive Income (Loss) and Accumulated Other Comprehensive Income, Summary Statement of Cash Flows, and selected accounting notes. It does not include all disclosures required under International Financial Reporting Standards. Copies of the December 31, 2019 audited financial statements are available at the Pro-Demnity Insurance Company office.

The audited financial statements were authorized for issue by the Board of Directors on February 19, 2020. The audited financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These summary financial statements were prepared under the historical cost convention, as modified by the revaluation of investments. (Note 4)

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

The preparation of summary 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 a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the summary financial statements are disclosed in Note 2.

Significant accounting policies

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 GAAP.

Balances arising from insurance contracts primarily include unearned premiums, provision for unpaid claims, reinsurer's share of unearned premiums, provision for unpaid claims, and deferred policy acquisition expenses.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

(a) Premiums and unearned premiums

Direct premiums written comprise the premiums on contracts incepting in the financial year. Premiums written are exclusive of taxes levied on premiums.

The Company earns 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.

(b) Reinsurer's share of unearned premiums

The reinsurer's share of unearned premiums are recognized as an asset using principles consistent with the Company's method for determining the unearned premium liability.

(c) Deferred policy acquisition expenses

Acquisition costs are comprised of premium taxes. 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.

(d) Provision for unpaid claims

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, 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 net income.

Claim liabilities are carried on a discounted basis to reflect the time value of money. As required by actuarial standards in Canada claims liabilities also include a provision for adverse deviation (PFAD), which represents an additional margin on valuation variable factors, which are claims development, reinsurance recoveries and interest rates used in discounting claims liabilities.

(e) 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 investment return. If that assessment shows that the carrying amount of the liabilities is inadequate, any deficiency is recognized as an expense to the statement of operations and retained earnings initially by writing off the deferred policy acquisition expense and subsequently by recognizing additional unearned premiums.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

(f) Reinsurer's share of provision for unpaid claims

The Company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. 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 payables and accruals and are recognized as an expense on the same basis as revenue on the underlying policies being reinsured.

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.

(g) Refund of premiums

Under the discretion of the Board of Directors the Company may declare a refund to its policyholders based on premiums to the mandatory insurance program required by the Architect's Act and its regulations.

Financial instruments

The Company classifies its financial instruments into one of the following categories based on the purpose for which the asset was acquired or liability incurred. All transactions related to financial instruments are recorded on a trade date basis. The Company's accounting policy for each category is as follows:

(a) 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 are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition or issue and subsequently carried at amortized cost, using the effective interest rate method, less any impairment losses.

Impairment provisions are recognized when there is objective evidence (such as significant financial difficulties on the part of the counterparty or default or significant delay in payment) that the Company will be unable to collect all of the amounts due under the terms receivable, the amount of such a provision being the difference between the net carrying amount and the present value of the future expected cash flows associated with the impaired receivable. For amounts due from policyholders and reinsurers, such provisions are recorded in a separate allowance account with the loss being recognized in net income. On confirmation that the amounts receivable will not be collectable, the gross carrying value of the asset is written off against the associated provision.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

(b) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Company has the positive intention and ability to hold to maturity. These investments are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition. Subsequently they are carried at amortized cost using the effective interest rate method. The Company classifies its debt securities that are backing its claims liabilities as held-to-maturity. This aims to reduce the volatility caused by the fluctuations in carrying values of underlying claims liabilities due to the impact of changes in investment returns on claims discount rates. Interest on debt securities classified as held-to-maturity is calculated using the effective interest method and is included in net income. Where there is a significant or prolonged decline in the fair value of a held-to-maturity financial asset, which constitutes objective evidence of impairment, the full amount of the impairment is recognized in net income.

(c) Available-for-sale investments

Non-derivative financial assets not included in the above categories are classified as available-for-sale and comprise investments in debt securities and equity pooled funds. These instruments are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition. Subsequently they are carried at fair value, unless they do not have a quoted market price in an active market and fair value is not reliably determinable. When they do not have a quoted market price in an active market and fair value is not reliably determinable, they are carried at cost. Investments in pooled funds are valued at the net asset value provided by the investment fund manager.

Changes in fair value are recognized as a separate component of other comprehensive income (OCI). Where there is a significant or prolonged decline in the fair value of an available-for-sale financial asset, which constitutes objective evidence of impairment, the full amount of the impairment, including any amount previously recognized in other comprehensive income (loss), is recognized in net income.

Purchases and sales of equity pooled funds are recognized on the trade date with any change in fair value between trade date and settlement date being recognized in accumulated other comprehensive income (loss).

On sale, the amount held in accumulated other comprehensive income (loss) associated with that asset is removed from shareholders' equity and recognized in net income. Interest on debt securities classified as available-for-sale is calculated using the effective interest method and is included in net income.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

(d) Other financial liabilities

Other financial liabilities include all financial liabilities and comprise payables and accruals. These liabilities are initially recognized at fair value net of any transaction costs directly attributable to the issuance of the instrument and subsequently carried at amortized cost using the effective interest rate method, which ensures that any interest expense over the period to repayment is at a constant rate on the balance of the liability carried in the statement of financial position. Interest expense in this context includes initial transaction costs and premiums payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

Property and equipment

Property and equipment is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses. Depreciation is recognized in net income and is provided on a straight-line basis over the estimated useful life of the assets as follows:

Depreciation based on the estimated useful life of the asset is calculated as follows:

Computer hardware	- 20-33% straight-line basis
Furniture and fixtures	- 10% straight-line basis

Depreciation methods, useful lives and residual values are reviewed annually and adjusted if necessary.

Right-of-Use Assets and Lease Liabilities

At inception of a contract, the Company assess whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. This policy is applied to contracts entered into, or changed, on or after January 1, 2019. All leases are accounted for by recognizing a right-to-use asset and a lease liability except for:

- Leases of low value assets (based on the value of the underlying asset when new); and
- Short-term leases with a lease term of twelve months or less.

a) Nature of leasing activities (in the capacity as lessee)

The Company leases facilities.

Leases of facilities are made for a period of 5 years, with an extension option exercisable by the Company for an additional 5 years after the end of the non-cancellable period. Extension options are included in the lease term when the Company is reasonably expected to exercise that option. The lease payments comprise fixed payments over the lease term.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Right-of-Use Assets and Lease Liabilities (continued)

b) Recognition and initial measurement

The Company recognizes right-of-use assets and lease liabilities at the lease commencement date.

The right-of-use assets are initially measured at the amount of the lease liabilities, reduced for any lease incentives received, and increased for lease payments made at or before commencement of the lease or initial direct costs incurred.

Lease liabilities are initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally the Company uses its incremental borrowing rate as the discount rate. Variable lease payments are only included in the measurement of the lease liabilities if they depend on an index or rate (e.g. CPI or inflation). In such cases, the initial measurement of the lease liabilities assumes the variable element will remain unchanged throughout the lease term. Other variable lease payments that are not dependent on an index or rate are expensed in the period to which they relate.

For contracts that both convey a right to the Company to use an identified asset and require services to be provided to the Company by the lessor, the Company has elected to account for the entire contract as a lease, and therefore the Company does not allocate the amount of the contractual payments to, and account separately for, any services provided by the supplier as part of the contract.

c) Subsequent measurement

Right-of-use assets are subsequently measured at cost less any accumulated depreciation and impairment losses, and adjusted for certain remeasurements of the lease liabilities.

Lease liabilities are subsequently increased by the interest cost on the lease liabilities and decreased by lease payments made. Lease liabilities are remeasured when there is a change in future lease payments arising from a change in an index or rate. The revised future lease payments are discounted at the same discount rate that applied on lease commencement. Lease liabilities are also remeasured when there is a change in the assessment of the term of any lease (for example, a change in the Company's assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised). The future lease payments over the revised term are discounted at the revised discount rate at the date of reassessment. In both cases, an equivalent adjustment is made to the carrying value of the right-of-use asset.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Impairment of non-financial assets

Non-financial assets are subject to impairment tests whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an asset exceeds its recoverable amount, which is the higher of value in use and fair value less costs to sell, the asset is written down accordingly.

For the purpose of 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.

Where it is not possible to estimate the recoverable amount of an individual asset, an impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets to which the asset belongs for which there are separately identifiable cash flows.

Impairment charges are included in net income, except to the extent they reverse gains previously recognized in other comprehensive income (loss).

Income taxes

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

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current year and any adjustment to income taxes in respect of previous years. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year end date.

Deferred tax assets and liabilities are recognized where the carrying amount of an asset or liability differs from its tax base, except for taxable temporary differences arising on the initial recognition of goodwill and temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination, and at the time of the transaction affects neither accounting or taxable profit or loss.

Recognition of deferred tax assets for unused tax losses, tax credits and deductible temporary differences is restricted to those instances where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

The amount of the deferred tax asset or liability is measured at the amount expected to be recovered from or paid to the taxation authorities. This amount is determined using tax rates and tax laws that have been enacted or substantively enacted by the year end date and are expected to apply when the liabilities / (assets) are settled / (recovered).

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Standards, amendments and interpretations not yet adopted

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting years beginning after January 1, 2020 or later. The Company has not yet determined the extent of the impact of the following new standards, interpretations and amendments, which have not been applied in these financial statements.

IFRS 9 Financial Instruments replaces IAS 39 Financial Instruments: Recognition and Measurement

In July 2014, the IASB issued the final version of IFRS 9, which reflects all phases of the financial instruments project and replaces IAS 39 – *Financial Instruments: Recognition and Measurement* and all previous versions of IFRS 9. IFRS 9 sets out the requirements for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This single, principle-based approach replaces existing rule-based requirements and is intended to improve and simplify the reporting for financial instruments. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Retrospective application is required with certain exceptions.

In September 2016, the IASB issued amendments to IFRS 4 to address issues arising from the different effective dates of IFRS 9 and the new insurance contracts standard (IFRS 17). The amendments introduced an optional temporary exemption, which permits eligible companies to defer the implementation date of IFRS 9 until annual periods beginning on or after January 1, 2021. The temporary exemption is available to companies whose predominant activity is to issue insurance contracts. The amendments also include an option to apply the “overlay approach” to the presentation of qualifying financial assets, in which an entity would be permitted to remove from profit or loss and present instead in OCI, the impact of measuring financial assets at fair value through profit or loss under IFRS 9 when they would not have been so measured under IAS 39. The Company meets the eligibility criteria of the temporary exemption from IFRS 9 and intends to defer the application of IFRS 9 until the effective date of IFRS 17.

IFRS 17 Insurance Contracts

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, 2021, however the IASB has proposed to delay the effective date to January 1, 2022. The Company has not yet determined the impact of adoption, however it is expected to significantly impact the overall summary financial statements.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

2. Critical Accounting Estimates and Judgments

The Company makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

Estimates

The effect of a change in an accounting estimate is recognized prospectively by including it in net income in the period of the change, if the change affects that period only; or in the period of the change and future periods, if the change affects both.

The estimates and assumptions that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Provision for unpaid claims

The estimation of the provision for unpaid claims and the related reinsurer's share are the Company's most critical accounting estimates. There are several sources of uncertainty that need to be considered by the Company in estimating the amount that will ultimately be paid on these claims. The uncertainty arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Changes in the estimate of the provision 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 based on the Company's historical experience and industry experience.

Judgments

Impairment of available-for-sale investments

The Company determines that available-for-sale investments are impaired when there has been a significant or prolonged decline in fair value below cost. The determination of what is significant or prolonged requires judgment. In making this judgment the Company considers among other factors, the normal volatility in market price, the financial health of the investee and industry and sector performance.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

3. Adoption of New Accounting Standards

Accounting standards, interpretations and amendments effective for accounting years beginning on or after January 1, 2019 did not materially affect the Company's summary financial statements other than those described below.

IFRS 16 Leases

On January 1, 2019, the Company adopted IFRS 16 *Leases* (IFRS 16). IFRS 16 provides a single lessee accounting model, requiring the recognition of assets and liabilities for all leases, unless the lease term is 12 months or less, or the underlying asset is of low value. IFRS 16 substantially carries forward the lessor accounting in IAS 17 - *Leases* (IAS 17), with the distinction between operating leases and finance leases being retained.

The Company adopted IFRS 16 using the modified retrospective approach without restatement of comparative figures. The Company elected to apply the practical expedient to not reassess whether a contract is, or contains a lease at the date of initial application. Contracts entered into before the transition date that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed. The definition of a lease under IFRS 16 was applied only to contracts entered into or changed on or after January 1, 2019.

IFRS 16 provides for certain optional practical expedients, including those related to the initial adoption of the standard. The Company applied the following practical expedients when applying IFRS 16 to leases previously classified as operating leases under IAS 17:

- Applied a single discount rate to a portfolio of leases with reasonably similar characteristics;
- Reliance on previous assessments on whether leases are onerous as opposed to preparing an impairment review under IAS 36 as at the date of initial application

(i) Recognition and measurement

As a lessee, the Company previously classified leases as operating or finance leases based on its assessment of whether the lease transferred substantially all of the risks and rewards of ownership. Under IFRS 16, the Company recognizes right-of-use assets and lease liabilities for most leases. However, the Company has elected not to recognize right-of-use assets and lease liabilities for some leases of low value assets based on the value of the underlying asset when new.

On adoption of IFRS 16, the Company recognized right-of-use assets and lease liabilities in relation to leases of facilities which had previously been classified as operating leases.

Pro-Demnity Insurance Company Notes to Summary Financial Statements

December 31, 2019

3. Adoption of New Accounting Standards (continued)

(i) Recognition and measurement (continued)

The lease liabilities and right-of-use assets were measured as follows:

- (a) The lease liabilities were measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as at January 1, 2019. The Company's incremental borrowing rate is the rate at which a similar borrowing could be obtained from an independent creditor under comparable terms and conditions; and
- (b) Right-of-use assets are measured at an amount equal to the lease liabilities, adjusted by the amount of any prepaid or accrued lease payments.

(ii) Impacts on the Company's summary financial statements on January 1, 2019

The following table presents the impact of adopting IFRS 16 on the summary statement of financial position as at January 1, 2019:

	Balance, December 31, 2018	IFRS 16 adjustments	Adjusted balance, January 1, 2019
Right-of-use assets	\$ -	\$ 621,286	\$ 621,286
Prepaid expenses	123,481	(7,271)	116,210
Total assets	\$ 123,481	\$ 614,015	\$ 737,496
Payables and accruals	\$ 1,985,893	\$ (37,987)	\$ 1,947,906
Lease liabilities (i)	-	652,002	652,002
Total liabilities	\$ 1,985,893	\$ 614,015	\$ 2,599,908

- (i) When measuring lease liabilities for leases that were previously operating leases, the Company discounted lease payments using its incremental borrowing rate at January 1, 2019. The weighted average incremental borrowing rate applied to the lease liabilities was 3.45%.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

3. Adoption of New Accounting Standards (continued)

(iii) Reconciliation of operating lease commitments and aggregate lease liabilities

The following table reconciles the Company's operating lease commitments at December 31, 2018, as previously disclosed in the Company's summary financial statements, to the lease liabilities recognized on initial application of IFRS 16 at January 1, 2019:

	January 1, 2019
Minimum operating lease commitment disclosed as at December 31, 2018	\$ 1,036,375
Less: low value leases not recognized under IFRS 16	(29,115)
Less: non-fixed payments not recognized under IFRS 16	(250,544)
	756,716
Effect of discounting using the incremental borrowing rate on initial application	(104,714)
	652,002
Lease liabilities recognized at January 1, 2019	\$ 652,002
Of which are:	
Current lease liabilities	\$ 62,286
Non-current lease liabilities	589,716
	\$ 652,002

(iv) Impacts on the Company's summary financial statements for the year ending December 31, 2019

As a result of initially applying IFRS 16, in relation to the leases that were previously classified as operating leases, the Company recognized \$549,586 of right-of-use assets and \$589,716 of lease liabilities as at December 31, 2019.

Also in relation to those leases under IFRS 16, the Company recognized depreciation and interest costs, instead of operating lease expense. During the year ended December 31, 2019, the Company recognized \$71,700 of depreciation expense, \$19,620 of interest costs and \$10,634 of deferred tax expense from these leases.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

3. Adoption of New Accounting Standards (continued)

IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* (IFRIC 23)

IFRIC 23 provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. The Interpretation requires:

- An entity to contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution;
- An entity to determine if it is probable that the tax authorities will accept the uncertain tax treatment; and
- If it is not probable that the uncertain tax treatment will be accepted, measure the tax uncertainty based on the most likely amount or expected value, depending on whichever method better predicts the resolution of the uncertainty.

The adoption of IFRIC 23 did not have a material impact on the Company's summary financial statements.

4. Financial Instrument Classification

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

	Held to maturity	Available- for-sale	Loans and receivables	Other financial liabilities	Total
December 31, 2019					
Cash	\$ -	\$ -	\$ 6,173,314	\$ -	\$ 6,173,314
Investments	47,347,224	33,401,248	-	-	80,748,472
Receivables	-	-	7,346,658	-	7,346,658
Accrued interest	-	-	465,575	-	465,575
Payables and accruals	-	-	-	(3,435,900)	(3,435,900)
	\$ 47,347,224	\$ 33,401,248	\$ 13,985,547	\$ (3,435,900)	\$ 91,298,119
December 31, 2018					
Cash	\$ -	\$ -	\$ 3,689,987	\$ -	\$ 3,689,987
Investments	46,388,050	27,808,382	-	-	74,196,432
Receivables	-	-	6,854,451	-	6,854,451
Accrued interest	-	-	412,644	-	412,644
Payables and accruals	-	-	-	(1,985,893)	(1,985,893)
	\$ 46,388,050	\$ 27,808,382	\$ 10,957,082	\$ (1,985,893)	\$ 83,167,621

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

4. Financial Instrument Classification (continued)

The following table provides carrying value and fair value information of investments by type of security and issuer. The maximum exposure to credit risk would be the fair value as shown below.

Available-for-Sale

	December 31, 2019		December 31, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Guaranteed investment certificates (GICs)	\$ 1,669,976	\$ 1,669,976	\$ 351,131	\$ 351,131
Bonds				
Government	9,981,692	9,981,692	8,604,232	8,604,232
Asset backed securities	1,407,588	1,407,588	572,436	572,436
Canadian municipal	231,717	231,717	744,752	744,752
Corporate	12,816,881	12,816,881	11,032,492	11,032,492
	<u>24,437,878</u>	<u>24,437,878</u>	<u>20,953,912</u>	<u>20,953,912</u>
Equities				
Equity pooled fund (Canadian)	3,632,388	3,632,388	3,013,733	3,013,733
Equity pooled fund (International)	3,661,006	3,661,006	3,489,606	3,489,606
	<u>7,293,394</u>	<u>7,293,394</u>	<u>6,503,339</u>	<u>6,503,339</u>
Total Available-for-Sale	<u>\$ 33,401,248</u>	<u>\$ 33,401,248</u>	<u>\$ 27,808,382</u>	<u>\$ 27,808,382</u>

Held-to-Maturity

	December 31, 2019		December 31, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Guaranteed investment certificates (GICs)	\$ 775,000	\$ 775,000	-	-
Bonds				
Government	23,710,758	23,773,997	23,267,324	23,145,629
Corporate	22,861,466	23,029,011	23,120,726	22,785,439
	<u>46,572,224</u>	<u>46,803,008</u>	<u>46,388,050</u>	<u>45,931,068</u>
Total Held-to-Maturity	<u>\$ 47,347,224</u>	<u>\$ 47,578,008</u>	<u>\$ 46,388,050</u>	<u>\$ 45,931,068</u>

	December 31, 2019		December 31, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Total Investments	<u>\$ 80,748,472</u>	<u>\$ 80,979,256</u>	<u>\$ 74,196,432</u>	<u>\$ 73,739,450</u>

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 using the last bid price;
- 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).

Pro-Demnity Insurance Company Notes to Summary Financial Statements

December 31, 2019

4. Financial Instrument Classification (continued)

Financial assets recorded at fair value by the level of the fair value hierarchy:

	Level 1	Level 2	Level 3	Total
December 31, 2019				
GICs	\$ 1,669,976	\$ -	\$ -	\$ 1,669,976
Bonds	-	24,437,878	-	24,437,878
Equity pooled funds	-	7,293,394	-	7,293,394
Total	\$ 1,669,976	\$ 31,731,272	\$ -	\$ 33,401,248

	Level 1	Level 2	Level 3	Total
December 31, 2018				
GICs	\$ 351,131	\$ -	\$ -	\$ 351,131
Bonds	-	20,953,912	-	20,953,912
Equity pooled funds	-	6,503,339	-	6,503,339
Total	\$ 351,131	\$ 27,457,251	\$ -	\$ 27,808,382

Transfers between levels are considered to have occurred at the date of the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and Level 2 for the years ended December 31, 2019 and 2018. There were also no transfers in or out of Level 3.

Included in cash and cash equivalents is \$3,000,000 of retractable GICs. GICs in cash and cash equivalents and investments have interest rates ranging from 0.00% - 1.90% and maturities within 1 year.

Maturity profile of bonds held is as follows:

	Within 1 year	1 to 3 years	3 to 5 years	5 to 7 years	Greater than 7 years	Total
December 31, 2019	\$ 9,476,467	\$ 21,158,164	\$ 21,305,084	\$ 3,536,227	\$ 15,534,160	\$ 71,010,102
Percent of Total	13.35 %	29.79 %	30.00 %	4.98 %	21.88 %	100.00 %
December 31, 2018	\$ 8,397,272	\$ 21,125,266	\$ 23,461,128	\$ 2,087,339	\$ 12,270,750	\$ 67,341,755
Percent of Total	12.47 %	31.37 %	34.84 %	3.10 %	18.22 %	100.00 %

The effective interest rate of the bond portfolio is 3.28% (2018 - 3.19%).

Pro-Demnity Insurance Company Notes to Summary Financial Statements

December 31, 2019

5. Property and Equipment

	Property and equipment		
	Furniture and fixtures	Computer hardware	Total
Cost			
Balance at January 1, 2018	\$ 146,248	\$ 838,430	\$ 984,678
Additions	2,366	96,997	99,363
Disposals	(30,371)	(91,926)	(122,297)
Balance on December 31, 2018	118,243	843,501	961,744
Additions	585	119,612	120,197
Balance on December 31, 2019	\$ 118,828	\$ 963,113	\$ 1,081,941
 Accumulated depreciation			
Balance at January 1, 2018	\$ 84,617	\$ 523,338	\$ 607,955
Depreciation	7,116	75,230	82,346
Disposals	(30,371)	(91,926)	(122,297)
Balance on December 31, 2018	61,362	506,642	568,004
Depreciation	7,578	105,783	113,361
Balance on December 31, 2019	\$ 68,940	\$ 612,425	\$ 681,365
 Net Book Value			
December 31, 2018	\$ 56,881	\$ 336,859	\$ 393,740
December 31, 2019	\$ 49,888	\$ 350,688	\$ 400,576

6. Right-of-Use Assets and Lease Liabilities

Right-of-use assets consist of the following:

	Facilities
Cost	
Balance at January 1, 2019	\$ -
Additions	621,286
Balance at December 31, 2019	\$ 621,286
 Accumulated Depreciation	
Balance at January 1, 2019	\$ -
Depreciation for the year	71,700
Balance at December 31, 2019	\$ 71,700
 Carrying amount	
At December 31, 2019	\$ 549,586

Pro-Demnity Insurance Company Notes to Summary Financial Statements

December 31, 2019

6. Right-of-Use Assets and Lease Liabilities (continued)

Lease liabilities consist of the following:

	Facilities
Balance at January 1, 2019	\$ -
Additions	652,002
Interest expense	19,620
Lease payments	(81,906)
Balance at December 31, 2019	\$ 589,716

Amounts recognized in the summary statement of operations and retained earnings:

	2019	2018
Depreciation of right-of-use assets	\$ 71,700	\$ -
Interest expense on lease liabilities	19,620	-

Amounts recognized in the summary statement of cash flows:

	2019	2018
Total cash outflow for leases	\$ 81,906	\$ -

The following table sets out the contractual maturities, representing undiscounted contractual cash-flows of lease liabilities at December 31, 2019:

No later than 1 year	\$ 84,936
Later than 1 year and not later than 5 years	348,398
Later than 5 years	239,943
	\$ 673,277

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

7. Share Capital

Authorized:

100,000	Class A preferred shares having a par value of \$100, redeemable by the Company at par value, non-voting, non-participating, non-cumulative, maximum annual dividend of 6.5%
100	preferred shares having a par value of \$100, redeemable by the Company at par value, non-voting, non-participating, non-cumulative 6% dividends
250,000	common shares having a par value of \$100

Issued:

		2019	2018
50,000	Class A Preference shares	\$ 5,000,000	\$ 5,000,000
65	Preference shares	6,500	6,500
201,000	Common shares	20,100,000	20,100,000
		\$ 25,106,500	\$ 25,106,500

8. Income Taxes

The significant components of tax expense included in net income are composed of:

	2019	2018
Current tax expense		
Based on current year taxable income (loss)	\$ 348,212	\$ (89,154)
Deferred tax expense (recovery)		
Origination and reversal of temporary differences	\$ 1,363	\$ 18,573
Non deductible claims	(60,341)	(70,477)
Change in deferred tax on other comprehensive income	(415,689)	381,993
Loss carryforwards	177,853	(177,853)
Other	(3,706)	(3,706)
	(300,520)	148,530
Total income tax expense	\$ 47,692	\$ 59,376

Pro-Demnity Insurance Company Notes to Summary Financial Statements

December 31, 2019

8. Income Taxes (continued)

The significant components of the tax effect of the amounts recognized in other comprehensive income (loss) are composed of:

	2019	2018
Change in unrealized gains (losses) on available-for-sale investments	\$ 584,597	\$ (291,221)
Reclassification of realized gains on available-for-sale investments	(168,908)	(90,772)
Total tax effect of amounts recorded in other comprehensive income	\$ 415,689	\$ (381,993)

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rate of 26.5% (2018 – 26.5%) are as follows:

	2019	2018
Income before income taxes	\$ 921,883	\$ 703,640
Expected taxes based on the statutory rate	\$ 244,299	\$ 186,465
Non deductible expenses	3,831	3,488
Canadian dividend income not taxable	(191,801)	(148,617)
Under provision (recovery) in prior years	(8,637)	18,040
Total income tax	\$ 47,692	\$ 59,376

The movements in 2019 deferred tax liabilities and assets are:

	Opening balance at Jan 1, 2019	Recognize in net income	Recognize in OCI	Closing balance at Dec 31, 2019
2019				
<i>Deferred tax assets</i>				
Claims liabilities	\$ 613,621	\$ 60,340	\$ -	\$ 673,961
Loss carryforwards	177,853	(177,853)	-	-
Right of Use and lease liability	-	10,634	-	10,634
Deferred tax assets	\$ 791,474	\$ (106,879)	\$ -	\$ 684,595
2019				
<i>Deferred tax liabilities</i>				
Investments	\$ -	\$ (415,689)	\$ 415,689	\$ -
Bond transitional provision	20,483	(3,708)	-	16,775
Plant & equipment	44,870	11,998	-	56,868
Deferred tax liabilities	65,353	(407,399)	415,689	73,643
Net deferred tax asset	\$ 726,121	\$ 300,520	\$ (415,689)	\$ 610,952

Pro-Demnity Insurance Company Notes to Summary Financial Statements

December 31, 2019

8. Income Taxes (continued)

The movements in 2018 deferred tax liabilities and assets are:

	Opening balance at Jan 1, 2018	Recognize in net income	Recognize in OCI	Closing balance at Dec 31, 2018
2018				
<i>Deferred tax assets</i>				
Claims liabilities	\$ 543,144	\$ 70,477	\$ -	\$ 613,621
Loss carryforwards	-	177,853	-	177,853
Deferred tax assets	<u>\$ 543,144</u>	<u>\$ 248,330</u>	<u>\$ -</u>	<u>\$ 791,474</u>
2018				
<i>Deferred tax liabilities</i>				
Investments	\$ -	\$ 381,993	\$ (381,993)	\$ -
Bond transitional provision	24,189	(3,706)	-	20,483
Plant & equipment	26,297	18,573	-	44,870
Deferred tax liabilities	<u>50,486</u>	<u>396,860</u>	<u>(381,993)</u>	<u>65,353</u>
Net deferred tax	<u>\$ 492,658</u>	<u>\$ (148,530)</u>	<u>\$ 381,993</u>	<u>\$ 726,121</u>

9. Investment Income

	2019	2018
Interest income	\$ 2,282,238	\$ 2,111,575
Dividend income	723,779	560,819
Realized gains on disposal of investments	487,973	340,671
Investment expenses	<u>(218,667)</u>	<u>(248,764)</u>
	<u>\$ 3,275,323</u>	<u>\$ 2,764,301</u>

Pro-Demnity Insurance Company Notes to Summary Financial Statements

December 31, 2019

10. 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>2019</u>	<u>2018</u>
Compensation		
Executives' compensation and directors' fees	\$ 1,826,093	\$ 1,515,203

In addition, the Company had the following transactions with its parent company, The Ontario Association of Architects:

	<u>2019</u>	<u>2018</u>
Administrative services and practice consultation service	\$ 3,121	\$ 2,646

11. 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. Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable. To limit their potential impact, the Company purchases reinsurance, the details of which are outlined in Note 12. For the purpose of capital management, the Company has defined capital as its share capital, contributed surplus and retained earnings.

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%. During the year, the Company has exceeded this minimum in its quarterly filings. 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.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

12. Financial Instrument and Insurance Risk Management

Insurance risk management

The principal risk the Company faces under insurance contracts is that the actual claims payments or the timing thereof, differ from expectations. This is influenced by the frequency of claims, 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 Company insures architects in Ontario and as a result the Company is exposed to geographical and industry concentration risk. These risks are mitigated by regular review of the claims reserves as well as risk management strategies and the use of reinsurance arrangements.

The Company writes insurance primarily over a twelve month duration on a claims made basis.

The Company follows a policy of underwriting and reinsuring contracts of insurance which limit the liability of the Company to an amount on any one claim of \$250,000 (2018 - \$250,000). In 2019, the reinsurer agreed to pay claims expenses in excess of \$300,000 (2018 - \$300,000) on each claim for claim limits above \$250,000. In addition, the Company has obtained stop loss reinsurance and clash reinsurance against catastrophic events. The stop loss reinsurance attaches when claims liabilities in a specific underwriting year exceed \$18,000,000 (2018 - \$17,000,000) and ceases when claims liabilities reach \$31,000,000 of the ultimate net loss (2018 - \$31,000,000). The clash reinsurance applies to predefined events that cause a multiplicity of claims in excess of \$1,500,000 (2018 - \$1,500,000). The coverage is \$4,000,000 (2018 - \$4,000,000) in excess of a deductible of \$1,500,000 (2018 - \$1,500,000) for claims arising from a predefined event. In 2019, the clash reinsurance includes an interlocking clause that permits spreading the coverage limit over multiple underwriting years. An additional layer of clash reinsurance was obtained for 2019. This additional coverage is \$4,000,000 in excess of a deductible of \$5,500,000 for claims arising from a predefined event.

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 any reinsurer is unable to meet its obligations assumed under such reinsurance agreements.

The Company is exposed to 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, 2019 and 2018.

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.

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

12. Financial Instrument and Insurance Risk Management (continued)

Results of sensitivity testing based on expected loss ratios are as follows, shown gross and net of reinsurance as impacted on pre-tax income:

	Liability claims	
	2019	2018
5% increase in loss ratios		
Gross	\$ 2,273,000	\$ 2,330,000
Net	1,447,000	1,559,000
5% decrease in loss ratios		
Gross	\$ (2,217,000)	\$ (2,329,000)
Net	(1,468,000)	(1,559,000)

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.

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 the reinsurer 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 corporate sector limits. Funds are invested in bonds, asset backed securities and debentures of Federal, Provincial or Municipal Government and corporations rated BBB or better. The held-to-maturity investment policy limits investment in bonds of the various ratings to limits ranging from 80% to 100% of the Company's portfolio. The available-for-sale investment policy limits investment in bonds of the various ratings to limits ranging from 70% to 85% of the Company's portfolio. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

Reinsurance is placed with Lloyds, a Canadian registered reinsurer. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Receivables are short-term in nature consisting of a large number of policyholders, and are not subject to material credit risk. Regular review of outstanding receivables is performed to ensure credit worthiness.

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

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

12. Financial Instrument and Insurance 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 Finance and Audit Committee and the Board of Directors. Diversification techniques are utilized to minimize risk.

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 is exposed to currency risk through its investment in an international equity pool fund.

There have been no significant changes from the previous year in the exposure to currency 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 (GICs, asset backed securities 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 for its investments held in support of its claims liabilities and classified as held-to-maturity. This allows the Company to effectively manage a portion of its interest rate risk. 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 the Company is exposed to significant interest rate risk. Generally, the Company's investment income related to its available-for-sale financial investment portfolio 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 (loss).

Pro-Demnity Insurance Company

Notes to Summary Financial Statements

December 31, 2019

12. Financial Instrument and Insurance Risk Management (continued)

Interest rate risk (continued)

At December 31, 2019, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds and asset backed securities held as available-for-sale by approximately \$1,970,000 (2018 - \$1,596,000) and those classified as held-to-maturity by \$1,051,000 (2018 - \$1,047,000). The change would be recognized in other comprehensive income (loss) for the available-for-sale portfolio. A 1% change in the interest rate used to discount the Company's claims liabilities, with all other variables held constant, could have an offsetting impact on claims liabilities of approximately \$ 1,587,000 (2018 - \$1,437,000).

There have been no significant changes from the previous year in the exposure to interest rate 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 holdings in equity pooled funds within its investment portfolio. At December 31, 2019, 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 approximately \$729,000 (2018 - \$650,000).

Equity pooled funds are monitored by the Board of Directors and holdings are adjusted to ensure the investment portfolio remains in compliance with the investment policy.

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

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.

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

The Company does not face a significant liquidity risk with regard to its lease liabilities. Lease liabilities are monitored within the Company's finance function.

The Company has the availability of an operating line of credit in the amount of \$1,500,000 (2018 - \$1,500,000). The line of credit is secured by a first-priority security interest over all assets of the Company. Interest on the line of credit is payable monthly at the prime rate per annum. The Company has not drawn any funds on the facility.

Pro-Demnity Insurance Company Summary Schedule of Operating Expenses

For the year ended December 31	2019	2018
Salaries and benefits	\$ 3,111,181	\$ 2,770,029
Employee acquisition costs	2,934	118,815
Marketing and communications	16,950	3,135
Automobile and travel	110,815	86,348
Bad debts	18,598	458
Directors' remuneration	532,800	577,307
Computer maintenance	30,306	21,075
Insurance	169,213	144,194
Postage and courier	24,719	28,842
Printing and stationary	86,886	98,073
Professional fees	474,380	302,880
Telephone and communications	40,048	31,972
Depreciation of property and equipment	113,361	82,346
Training, membership and general	106,964	79,150
Regulatory assessment	18,712	17,505
Occupancy costs	223,970	236,232
OAA service agreement	3,121	2,646
Practice risk management	274,003	149,567
	\$ 5,358,961	\$ 4,750,574
