TOWN & COUNTRY MUTUAL INSURANCE COMPANY

FINANCIAL STATEMENTS

DECEMBER 31, 2010

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

DECEMBER 31, 2010

CONTENTS

Bailey
Kearney
Ferguson LLP
CHARTERED ACCOUNTANTS

AUDITORS' REPORT

PARTNERS
JAMES D. KEARNEY, C.A.
STEPHEN J. OUTRIDGE, C.A.
KEVIN M. SABOURIN, C.A.

To the Policyholders of
Town & Country Mutual Insurance Company

We have audited the accompanying financial statements of Town & Country Mutual Insurance Company, which comprise the balance sheet as at December 31, 2010, and the statements of income, comprehensive income, policyholders' equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 overall presentation of the 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 financial statements present fairly, in all material respects, the financial position of Town & Country Mutual Insurance Company as at December 31, 2010, and of its financial performance and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Bailey Kearney Ferguson LLP

February 10, 2011

Chartered Accountants
Licensed Public Accountants

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BALANCE SHEET

AS AT DECEMBER 31, 2010

ASSETS

	2010	2009
CURRENT		
Cash (Note 3)	$ 1,342,569	$ 941,416
Investments (Note 4)	19,686,956	17,596,710
Investment income due and accrued	131,294	94,886
Accounts receivable	2,644,407	2,468,918
Due from reinsurers	7,671,801	8,278,339
Prepaid expenses	20,748	123,302
	31,497,775	29,503,571
DEFERRED POLICY ACQUISITION EXPENSES	704,842	631,755
CAPITAL ASSETS (Note 6)	526,039	592,532
FUTURE INCOME TAXES	53,000	33,000
	$ 32,781,656	$ 30,760,858

LIABILITIES

	2010	2009
CURRENT		
Accounts payable and accrued liabilities	$ 627,939	$ 591,911
Provision for unpaid claims (Note 7)	12,126,595	11,893,940
Unearned premiums	5,169,157	4,679,163
Income taxes payable	163,135	75,851
	18,086,826	17,240,865
POLICYHOLDERS' EQUITY		
POLICYHOLDERS' SURPLUS	14,200,307	13,438,230
ACCUMULATED OTHER COMPREHENSIVE INCOME	494,523	81,763
	14,694,830	13,519,993
	$ 32,781,656	$ 30,760,858

APPROVED ON BEHALF OF THE BOARD

____________________ **DIRECTOR**

____________________ **DIRECTOR**

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

STATEMENT OF INCOME

FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
GROSS INSURANCE PREMIUMS WRITTEN	$ 10,737,059	$ 9,565,941
REINSURANCE PREMIUMS	2,753,154	2,442,472
NET PREMIUMS WRITTEN	7,983,905	7,123,469
INCREASE IN PROVISION FOR UNEARNED PREMIUMS	489,994	386,669
NET PREMIUMS EARNED	7,493,911	6,736,800
SERVICE CHARGES	166,546	140,837
TOTAL UNDERWRITING REVENUE	7,660,457	6,877,637
CLAIMS AND EXPENSES	7,288,664	7,156,553
UNDERWRITING GAIN (LOSS)	371,793	(278,916)
OTHER INCOME (EXPENSE)		
Investment income	777,833	615,158
Unusual item (Note 15)	(274,225)	-
	503,608	615,158
INCOME BEFORE INCOME TAXES	875,401	336,242
PROVISION FOR (RECOVERY OF) INCOME TAXES		
Current	133,324	(48,624)
Future	(20,000)	32,000
	113,324	(16,624)
NET INCOME FOR THE YEAR	$ 762,077	$ 352,866

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

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
NET INCOME FOR THE YEAR	$ 762,077	$ 352,866
OTHER COMPREHENSIVE INCOME (LOSS)		
Changes in unrealized gains and losses on available-for-sale investments	537,221	975,868
Reclassification to income of realized losses (gains) on available-for-sale investments	(21,461)	23,343
Related income tax effect	(103,000)	(138,000)
	412,760	861,211
COMPREHENSIVE INCOME FOR THE YEAR	$ 1,174,837	$ 1,214,077

STATEMENT OF POLICYHOLDERS' EQUITY

FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
POLICYHOLDERS' SURPLUS		
Balance, beginning of the year	$ 13,438,230	$ 13,085,364
Net income for the year	762,077	352,866
Balance, end of the year	14,200,307	13,438,230
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)		
Balance, beginning of the year	81,763	(779,448)
Other comprehensive income for the year	412,760	861,211
Balance, end of the year	494,523	81,763
POLICYHOLDERS' EQUITY, end of the year	$ 14,694,830	$ 13,519,993

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

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
OPERATING ACTIVITIES		
Net income for the year	$ 762,077	$ 352,866
Items not requiring cash		
Amortization	75,568	110,541
Future income taxes	(20,000)	32,000
Realized loss (gain) on disposal of investments	(23,499)	21,723
Income taxes related to Other Comprehensive Income (Loss)	(103,000)	(138,000)
	691,146	379,130
Net change in non-cash working capital balances		
Investment income due and accrued	(36,408)	(7,401)
Accounts receivable	(175,489)	(253,477)
Income taxes recoverable	-	306,852
Due from reinsurers	606,538	(1,736,904)
Prepaid expenses	102,554	(102,977)
Deferred policy acquisition expenses	(73,087)	(52,372)
Provision for unpaid claims	232,655	1,646,529
Accounts payable and accrued liabilities	36,028	32,007
Income taxes payable	87,284	75,851
Unearned premiums	489,994	386,668
Cash provided by operating activities	1,961,215	673,906
INVESTING ACTIVITIES		
Net increase in investments	(1,550,987)	(873,698)
Additions to capital assets	(9,075)	(23,103)
Cash used in investing activities	(1,560,062)	(896,801)
INCREASE (DECREASE) IN CASH, during the year	401,153	(222,895)
CASH, beginning of the year	941,416	1,164,311
CASH, end of the year	$ 1,342,569	$ 941,416

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

SCHEDULE OF CLAIMS AND EXPENSES

FOR THE YEAR ENDED DECEMBER 31, 2010

	2010	2009
Net claims and adjusting incurred	$ 4,135,895	$ 4,467,388
Commission	1,521,232	1,355,903
Premium tax	23,153	21,010
Agency	7,475	2,894
Salaries and benefits	808,096	733,729
Directors' fees	57,618	47,885
Professional fees	19,161	25,820
Advertising, promotion and donations	25,553	27,874
Education and convention	86,323	70,115
Dues and fees	82,654	71,820
Loss prevention	47,858	51,647
Telephone	16,593	16,029
Computer	363,800	158,339
Office	18,028	35,494
Utilities, property taxes and repairs	61,523	59,025
Insurance	13,702	11,581
	$ 7,288,664	$ 7,156,553

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

NATURE OF BUSINESS

Town & Country Mutual Insurance Company is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. The company is licensed to write automobile, property, liability and farmers' accident insurance in Ontario. The accounting policies of the company conform with those generally accepted in Canada and comply with the requirements for filing with the Financial Services Commission of Ontario (the "regulators").

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) PREMIUMS EARNED AND DEFERRED POLICY ACQUISITION EXPENSES

Insurance premiums are included in income on a daily prorata basis over the life of the policies. 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. Acquisition expenses related to unearned premiums, which are comprised primarily of commissions and premium taxes, are deferred and amortized to income over the periods in which the premiums are earned. The method followed in determining the deferred acquisition expenses limits the amount of the deferral to its realizable value by giving consideration to claims and expenses expected to be incurred as the premiums are earned.

(b) 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 current income.

Claim liabilities are carried on an undiscounted basis.

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

(c) REINSURANCE CEDED

Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. Estimates of amounts recoverable from the reinsurer on unpaid claims and adjusting expenses are recorded as assets on the balance sheet. The company reflects reinsurance balances on the balance sheet on a gross basis to indicate the extent of the credit risk related to reinsurance and its obligations to policyholders and on a net basis on the statement of income to indicate the results of its retention of premiums written.

A contingent liability exists with respect to reinsurance which could become a liability of the company in the event that the reinsurer might be unable to meet its obligations under the reinsurance agreements.

The company places all of its reinsurance business through the Farm Mutual Reinsurance Plan Inc.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) CAPITAL ASSETS

Capital assets are recorded at cost less accumulated amortization. Amortization is provided in order to write off these assets over their expected useful lives using the following annual rates and methods:

Buildings	4	% declining balance basis
Parking lot	8	% declining balance basis
Office furniture and equipment	20	% declining balance basis
Computer hardware	5	years straight line
Computer software	2	years straight line

(e) FUTURE INCOME TAXES

The company accounts for income taxes using the liability method. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities as well as for the benefit of losses available, if any, to be carried forward to future years for tax purposes that are likely to be realized.

(f) USE OF ESTIMATES

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from managements' best estimates as additional information becomes available in the future.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) FINANCIAL INSTRUMENTS AND COMPREHENSIVE INCOME

The company recognizes and measures financial assets and financial liabilities on the balance sheet when they become a party to the contractual provisions of a financial instrument. All financial instruments are measured at fair value on initial recognition. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, loans and receivables, available-for-sale or other financial liabilities.

Held-for-Trading

Financial assets classified as held-for-trading are measured at fair value. The financial instrument included in this category is cash.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable repayment dates, usually with interest, that are not debt securities or instruments classified as held-for-trading on initial recognition. Accounts receivable have been classified as loans and receivables.

These instruments are initially recognized at fair value. Direct and incremental costs are expensed immediately. They are subsequently valued at amortized cost using the effective interest method less any provision for impairment.

Available-for-Sale

Available-for-sale assets are non-derivative financial assets that are designated as available-for-sale or are not categorized into any of the other categories described above. Investments in equity instruments and debt securities have been classified as available-for-sale. They are initially recognized at fair value. They are subsequently held at fair value with gains and losses arising from changes in fair value being recognized in other comprehensive income in the Statement of Comprehensive Income when they have a quoted market price in an active market. When a decline in the fair value is determined to be other than temporary, the amount of the loss is removed from other comprehensive income and recognized in the Statement of Income. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost less any provision for impairment.

Other Financial Liabilities

Other financial liabilities are non-derivative financial liabilities and include accounts payable and accrued liabilities, due to reinsurers and due to facility association. These instruments are initially recognized at fair value. Direct and incremental transaction costs are expensed immediately. They are subsequently measured at amortized cost using the effective interest method.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) FINANCIAL INSTRUMENTS AND COMPREHENSIVE INCOME (continued)

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values are determined by reference to quoted bid or asking prices as appropriate, in the most advantageous active market for that instrument to which the company has immediate access. Fair values determined using valuation models require the use of assumptions concerning the amount and timing of estimated future cash flows and discounted rates. In determining those assumptions, the company looks primarily to external readily observable market inputs including interest rate yield curves, currency rates and price and rate volatilities, as applicable.

The Canadian Institute of Chartered Accountants now requires the reporting of "comprehensive income" which consists of net income and other comprehensive income. Other comprehensive income comprises unrealized gains or losses on available-for-sale securities. Cumulative changes in comprehensive income are included in accumulated other comprehensive income which is stated within policyholders' equity on the Balance Sheet.

(h) FACILITY ASSOCIATION

Automobile risks that do not meet the underwriting criteria of the company and the other insurers are referred to a Facility Association. The company is required to include in its own financial statements its proportionate share of the revenue, expenses, assets and liabilities of the Association.

(i) INTEREST INCOME

Interest income is recognized in the statement of income for all interest bearing financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortized cost of a financial asset and allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts the expected future cash receipts through the expected life of the financial instrument to the new carrying amount of the financial instrument. The application of this method has the effect of recognizing income on the instrument evenly in proportion to the amount outstanding over the period to maturity.

2. CHANGES IN ACCOUNTING POLICIES

FUTURE ACCOUNTING CHANGES

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

The Accounting Standards Board has confirmed that all publicly accountable enterprises will have to comply with IFRS for fiscal years beginning on or after January 1, 2011. Management understands there are differences between current Canadian GAAP and IFRS. The company has completed its plan which sought to address all differences that could potentially impact the company. The company does not anticipate any significant differences other than enhanced note disclosure.

The regulator has confirmed that the company and all other Ontario Regulated Insurance Companies are considered publicly accountable enterprises.

3. CASH

The company's bank accounts are held at one Canadian Financial Institution.

4. INVESTMENTS

The book values and fair values of investments as at December 31 were as follows:

	2010		2009	
	Book Value	Fair Value	Book Value	Fair Value
Available-for-Sale				
Fixed Income Pooled Fund	$ 3,537,246	$ 3,570,749	$ 3,293,671	$ 3,327,857
Equity Pooled Fund	706,284	692,082	706,102	596,444
Mutual Funds	802,876	861,316	802,876	765,460
Short-Term Deposits	938,753	938,753	828,907	865,176
Debt Securities:				
Federal	1,468,422	1,491,273	1,787,715	1,855,499
Provincial	5,776,640	6,013,724	4,904,770	5,014,507
Corporate	3,107,142	3,181,953	2,644,022	2,728,713
Common Shares	2,555,044	2,760,079	2,341,366	2,257,535
Total Available-for-Sale	18,892,407	19,509,929	17,309,429	17,411,191
Held-to-Maturity				
Debt Securities:				
Municipal	155,711	155,711	164,931	164,931
Fire Mutuals Guarantee Fund	21,316	21,316	20,588	20,588
Total Held-to-Maturity	177,027	177,027	185,519	185,519
Total Investments	$ 19,069,434	$ 19,686,956	$ 17,494,948	$ 17,596,710

The maturity profile of the short-term deposits and debt securities at December 31, 2010 was as follows:

	Within 1 year	1 to 5 years	Over 5 years	Total Book Value
Short-Term deposits	$ 788,753	$ 150,000	$ -	$ 938,753
Debt Securities	313,619	4,177,965	6,016,331	10,507,915
	$ 1,102,372	$ 4,327,965	$ 6,016,331	$ 11,446,668

The estimated fair values of the short-term deposits, debt securities and pooled funds are based on quoted market values. The estimated fair values of equities are determined using last bid prices. The company has reviewed the values of the above investments and has determined that there are no impairments other than temporary due to the current economic downturn.

All investments are denominated in Canadian dollars. Interest income, dividends received and realized gains or losses on disposal of investments are included in net investment income.

5. FAIR VALUE MEASUREMENT

Fair Value

In compliance with CICA Handbook Section 3862, "Financial Instruments - Disclosures", 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. Financial assets and liabilities measured at fair value are categorized as follows:

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
Fixed Income Pooled Fund	$ -	$ 3,570,749	$ -	$ 3,570,749
Equity Pooled Fund	692,082	-	-	692,082
Mutual Funds	861,316	-	-	861,316
Short-Term Deposits	778,465	160,288	-	938,753
Debt Securities:				
Federal	-	1,491,273	-	1,491,273
Provincial	-	6,013,724	-	6,013,724
Corporate	-	3,181,953	-	3,181,953
Municipal	-	155,711	-	155,711
Common Shares	2,760,079	-	-	2,760,079
Fire Mutuals Guarantee Fund	-	21,316	-	21,316
Total Investments Measured at Fair Value	$ 5,091,942	$ 14,595,014	$ -	$ 19,686,956

6. CAPITAL ASSETS

	2010		2009	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Land and land improvements	$ 125,000	$ -	$ 125,000	$ -
Buildings	455,037	137,752	451,404	123,916
Parking lot	32,320	15,907	32,320	14,480
Office furniture and equipment	127,341	92,530	127,341	83,827
Computer hardware	189,162	157,724	183,720	143,112
Computer software	155,211	154,119	155,211	117,129
	1,084,071	558,032	1,074,996	482,464
		$ 526,039		$ 592,532

Amortization in the amount of $75,568 (2009 - $110,541) has been deducted in claims and expenses in the Statement of Income.

7. PROVISION FOR UNPAID CLAIMS

The establishment of the provision for unpaid claims and adjusting expenses relies on the judgment and opinions of a number of individuals, on historical precedence and experience, on legal opinions, on economic, local and regulatory bodies, and on trends and future developments. The process of determining the provision by its nature involves risks, that the final results may vary substantially from the best estimate. The variance may arise when events affecting the final settled value of claims are not known at the time the unpaid claim liability is established.

The provision for unpaid claims and adjustment expenses by class of insurance is as follows:

	2010	2009
Property	$ 1,515,069	$ 1,676,286
Liability	1,665,411	1,526,872
Automobile	8,946,115	8,690,782
Gross Provision	$ 12,126,595	$ 11,893,940

The company cedes all reinsurance to Farm Mutual Reinsurance Plan Inc. in order to limit the maximum loss through the spreading of risks. Reinsurance does not relieve the company of primary liability as the originating insurer. The following table sets out the impact of reinsurance ceded on the provision for unpaid claims:

	2010	2009
Gross provision	$ 12,126,595	$ 11,893,940
Deduction for Reinsurance Ceded	7,671,801	8,278,339
Net Position	$ 4,454,794	$ 3,615,601

8. GOVERNMENT REGULATION OF AUTOMOBILE INSURANCE

The company's generation of revenue from underwriting automobile risks is impacted by the regulation of automobile premium rates by the provincial government. Such regulation requires that the company file any changes in premium rates proposed for use in Ontario with the Financial Services Commission of Ontario.

Provincial government rate regulatory approval processes can result in the prescription of premium rates other than those the company deems appropriate for the risks to be underwritten. The company's exposure to such prescribed rates is increased in Ontario where the company is required to accept all risks presented to it under so called "all comers rules".

The company is also required by regulation to assume a share of automobile insurance underwritten through the Facility Association, which operates insurance pools in several provinces, and through Plan de repartition des risques du Groupement des assureurs automobiles, which operates an insurance pool in Quebec. Such pools are designed to insure higher risk drivers that might otherwise be unable to obtain insurance. The company's share of pool premiums and costs are generally determined in relation to its share of total automobile premiums written by all insurers in Ontario. Pool premium rates are regulated by provincial governments.

The company's claims costs are influenced by governments to the extent they pass legislation or regulations that specify the nature and extent of benefits and other requirements that impact claims costs and the settlement process.

The company's gross written automobile insurance premiums are $4,829,378 (2009 - $4,179,255), which are subject to rate regulation. The extent to which gross premiums written would have differed in the absence of regulation is not determinable.

Amounts related to premiums subject to rate regulation are accounted for in these financial statements in the same manner as amounts related to other premiums.

9. REINSURANCE CEDED

The company follows the policy of underwriting and reinsuring contracts of insurance which limit the liability of the company to a maximum amount on any one claim as follows:

Property	- First $200,000 (2009 - $150,000) plus 10% of the next $800,000
Liability	- First $150,000 (2009 - $100,000) plus 10% of the next $850,000
Automobile	- First $140,000 (2009 - $90,000) plus 10% of the next $860,000

The company also carries reinsurance, which limits the company's liability to the first $600,000 (2009 - $450,000) plus 5% of the remainder to protect itself against certain catastrophic losses. 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 automobile.

10. REINSURANCE ASSUMED

In addition to the above reinsurance programs, the Company has assumed units of reinsurance through the Farm Mutual Reinsurance Plan Inc. on their Catastrophe Treaty, Manitoba Crop Insurance and Agricorp Crop Insurance Programs. The units on the Catastrophe Treaty present a maximum exposure to the Company's surplus of $75,000 (2009 - $75,000) per catastrophe. The Manitoba Crop Insurance and Agricorp Crop Insurance units present a maximum exposure to the Company's surplus of $100,000 per annum each.

11. INCOME TAXES

Under the Canadian Income Tax Act, the company is subject to income taxes on the portion of its taxable income that relates to non-farm income. In 2010, that portion of the company's taxable income which related to non-farm business was 72.5% (2009 - 70.3%).

12. 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 unpredictable. To limit the potential impact, catastrophe coverage limits the company's exposure to $600,000 plus 5% of the remaining loss in one event. The $600,000 amount represents approximately 4.1% (2009 - 3.3%) of the company's capital. For the purpose of capital management, the company considers capital as policyholders' equity excluding accumulated other comprehensive income (loss).

The regulators measure the financial strength of property and casualty insurance companies 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 company. 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 MCT for the company at December 31, 2010 was 709% (697% at December 31, 2009). The regulator has authority to request more extensive reporting and can place restrictions on the company's operations if deemed necessary.

13. FINANCIAL INSTRUMENT RISK MANAGEMENT

CREDIT RISK

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The company is exposed to credit 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 99% of the bonds either government bonds or corporate 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 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 and the Board of Directors prior to renewal of the reinsurance contract.

Due from agents and policyholders are short-term in nature and are not subject to material credit risk.

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.

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

13. FINANCIAL INSTRUMENT RISK MANAGEMENT (continued)

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.

There have been no significant changes from the previous year in the exposure to risk or policies procedures and methods to used 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 (treasury bills and debt securities).

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 as bonds are reinvested, with the change in fair value reflected in unrealized gain 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 and policies and procedures for managing interest rate risk is to diversify the bond portfolio in such a way that the bonds have maturity terms ranging from 1 to 10 years. A portion of the bond portfolio would come due each year and be reinvested. This protects the company from fluctuations in the interest rates.

At December 31, 2010, a 1% increase in interest rates, with all other variables held constant, could decrease the market value of bonds by $760,000 (2009 - $670,000). Conversely, a decrease of 1% in interest rates could increase the market value of bonds by a comparable amount.

For bonds that the company did not sell during the year, the change during the year would be recognized as other comprehensive income during the year.

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.

13. FINANCIAL INSTRUMENT RISK MANAGEMENT (continued)

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.

Investments in shares are limited to 25% of the investment portfolio and restricted to equities which are contained in the S&P/TSX Index.

The company's portfolio includes Canadian equities with fair values that move with the Toronto Stock Exchange Composite Index and United States equities with fair values that move with the S&P 500 index. A 10% 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 equity shares and United States equity shares of $430,000 (2009 - $360,000). For stocks that the company did not sell during the year, the change would be recognized in the asset value and in other comprehensive income. For equities that the company did sell during the year, the change during the year would be recognized as investment income during the year.

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 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 risk or policies, procedures and methods used to measure the risk.

14. CONTINGENT LIABILITIES AND GUARANTEES

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 should the Plan's capital fall below a prescribed minimum. The additional capital would be provided by purchasing subordinated debt obligations issued by the Plan.

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

15. UNUSUAL ITEM

During the year, the company participated in a settlement relating to legal actions which had been commenced in 2009 against other farm mutual insurers. The settlement resolves the litigation relating to the matter and was concluded out of court without admission of liability.