
TOWN & COUNTRY MUTUAL INSURANCE COMPANY

FINANCIAL STATEMENTS

DECEMBER 31, 2012

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

DECEMBER 31, 2012

CONTENTS

Page

INDEPENDENT AUDITORS' REPORT

FINANCIAL STATEMENTS

Statement of Financial Position	1
Statement of Comprehensive Income	2
Statement Policyholders' Surplus	3
Statement of Cash Flows	4
Notes to the Financial Statements	5 - 33



INDEPENDENT AUDITORS' REPORT

PARTNERS

STEPHEN J. OUTRIDGE, C.A.
KEVIN M. SABOURIN, C.A.
JAMES D. KEARNEY, C.A. (RET.)

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 statement of financial position as at December 31, 2012, and the statements of comprehensive income, policyholders' surplus 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 International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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, 2012, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

February 26, 2013
Wallaceburg, Ontario

Bailey Kearney Ferguson LLP

Chartered Accountants
Licensed Public Accountants



TOWN & COUNTRY MUTUAL INSURANCE COMPANY
(Incorporated under the Laws of Ontario)

STATEMENT OF FINANCIAL POSITION

AS AT DECEMBER 31, 2012

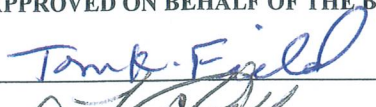
ASSETS

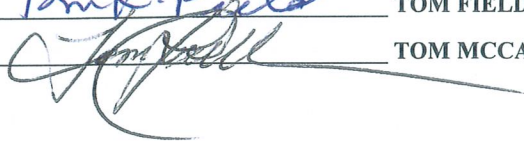
	2012	2011
CURRENT		
Cash and bank	\$ 2,109,670	\$ 526,956
Investment income due and accrued	150,473	145,254
Investments (Note 4)	21,299,965	20,574,816
Income taxes recoverable	-	117,786
Due from reinsurers (Note 6)	201,234	922,570
Reinsurers' share of provision for unpaid claims (Note 6)	7,686,120	7,014,974
Premiums receivable	2,790,578	2,722,313
Prepaid expenses	26,594	25,689
Deferred policy acquisition expenses (Note 6)	733,615	720,757
	34,998,249	32,771,115
PROPERTY, PLANT AND EQUIPMENT (Note 5)	642,055	580,622
INTANGIBLE ASSETS (Note 5)	550	13,181
DEFERRED INCOME TAXES (Note 7)	70,000	60,000
	\$ 35,710,854	\$ 33,424,918

LIABILITIES

	2012	2011
CURRENT		
Provision for unpaid claims (Note 6)	\$ 13,438,711	\$ 12,162,674
Accounts payable and accrued liabilities	372,909	504,249
Unearned premiums (Note 6)	5,500,815	5,386,172
Income taxes payable	53,453	-
	19,365,888	18,053,095
POLICYHOLDERS' SURPLUS		
POLICYHOLDERS' SURPLUS	16,344,966	15,371,823
	\$ 35,710,854	\$ 33,424,918

APPROVED ON BEHALF OF THE BOARD

 **TOM FIELD, DIRECTOR**

 **TOM MCCALLUM, DIRECTOR**

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

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31, 2012

	2012	2011
GROSS INSURANCE PREMIUMS WRITTEN	\$ 11,391,597	\$ 11,154,001
REINSURANCE PREMIUMS	2,674,117	2,885,259
NET PREMIUMS WRITTEN	8,717,480	8,268,742
INCREASE IN PROVISION FOR UNEARNED PREMIUMS	114,643	217,015
NET PREMIUMS EARNED	8,602,837	8,051,727
SERVICE CHARGES	179,453	173,558
TOTAL UNDERWRITING REVENUE	8,782,290	8,225,285
DIRECT LOSSES INCURRED		
Gross claims and adjustment expenses	6,577,070	7,755,583
Less reinsurers' share of claims and adjustment expenses	(1,396,741)	(2,492,976)
	5,180,329	5,262,607
UNDERWRITING INCOME BEFORE EXPENSES	3,601,961	2,962,678
EXPENSES		
Fees, commissions and other acquisition expenses (Note 9)	1,654,264	1,614,229
Other operating and administrative expenses (Note 10)	1,698,188	1,483,735
	3,352,452	3,097,964
UNDERWRITING INCOME (LOSS)	249,509	(135,286)
OTHER INCOME		
Investment and other income (Note 11)	884,296	922,593
Unusual item	-	2,015
	884,296	924,608
INCOME BEFORE INCOME TAXES	1,133,805	789,322
PROVISION FOR (RECOVERY OF) INCOME TAXES (Note 7)		
Current	170,662	119,329
Deferred	(10,000)	(7,000)
	160,662	112,329
COMPREHENSIVE INCOME FOR THE YEAR	\$ 973,143	\$ 676,993

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

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

STATEMENT OF POLICYHOLDERS' SURPLUS

FOR THE YEAR ENDED DECEMBER 31, 2012

	2012	2011
BALANCE, beginning of the year	\$ 15,371,823	\$ 14,694,830
Comprehensive income for the year	973,143	676,993
BALANCE, end of the year	\$ 16,344,966	\$ 15,371,823

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

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2012

	2012	2011
OPERATING ACTIVITIES		
Comprehensive income for the year	\$ 973,143	\$ 676,993
Items not requiring cash		
Depreciation	51,248	42,008
Loss on disposal of property, plant and equipment	24,887	7,466
Deferred income taxes	(10,000)	(7,000)
Realized loss (gain) on sale of investments	75,806	(14,084)
Unrealized losses (gains) on investments	(319,815)	(63,630)
	795,269	641,753
Net change in non-cash working capital balances		
Investment income due and accrued	(5,219)	(13,960)
Income taxes recoverable	117,786	(117,786)
Due from reinsurers	721,336	(750,533)
Reinsurers' share of provision for unpaid claims	(671,146)	484,790
Premiums receivable	(68,265)	(77,906)
Prepaid expenses	(905)	(4,941)
Deferred policy acquisition expenses	(12,858)	(15,915)
Provision for unpaid claims	1,276,037	36,082
Accounts payable and accrued liabilities	(131,340)	(123,694)
Unearned premiums	114,643	217,015
Income taxes payable	53,453	(163,135)
Net cash provided by operating activities	2,188,791	111,770
INVESTING ACTIVITIES		
Proceeds from sale of investments	2,869,190	68,449
Purchase of investments	(3,350,330)	(878,595)
Additions to property, plant and equipment	(126,937)	(117,237)
Proceeds on sale of property, plant and equipment	2,000	-
Net cash used in investing activities	(606,077)	(927,383)
INCREASE (DECREASE) IN CASH, during the year	1,582,714	(815,613)
CASH AND BANK, beginning of the year	526,956	1,342,569
CASH AND BANK, end of the year	\$ 2,109,670	\$ 526,956

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

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

Town & Country Mutual Insurance Company is incorporated under the laws of Ontario and is subject to the Ontario Insurance Act. It is licensed to write property, liability, automobile, accident and sickness, fidelity and boiler and machinery insurance in Ontario. The company's head office is located in Strathroy, Ontario.

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

These financial statements have been authorized for issue by the Board of Directors on February 26, 2013.

BASIS OF PRESENTATION

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

These financial statements were prepared under the historical cost convention, as modified by the revaluation of financial instruments designated as fair value through profit and loss.

The company's functional and presentation currency is the Canadian dollar. The financial statements are presented in Canadian dollars.

The preparation of financial statements in compliance with IFRS requires management to make certain critical accounting estimates. It also requires management to exercise judgment in applying the company's accounting policies. The areas involving a higher degree of judgment and complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

SIGNIFICANT ACCOUNTING POLICIES

INSURANCE CONTRACTS

The company accounts for insurance contracts in accordance with IFRS 4.

Balances arising from insurance contracts primarily include unearned premiums, provision for unpaid claims and adjustment expenses, reinsurers' share of provision for unpaid claims and adjustment expenses, deferred policy acquisition expenses, and salvage and subrogation recoverable.

(a) PREMIUMS AND UNEARNED PREMIUMS

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

The company earns premiums on income evenly over the term of the insurance policy generally using the pro rata method. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums.

(b) REINSURANCE

The company reflects reinsurance balances on the statement of financial position on a gross basis to indicate the extent of credit risk related to reinsurance and its obligations to policyholders and on a net basis in the statement of comprehensive income to indicate the results of its retention of premiums written.

Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. A contingent liability exists with respect to reinsurance ceded which could become a liability of the company in the event that the reinsurer might be unable to meet its obligation under the reinsurance agreements. The company ascertained that no provision is necessary at December 31 for doubtful collection of reinsurance recoveries.

(c) DEFERRED POLICY ACQUISITION EXPENSES

Acquisition costs are comprised of agents' commissions. 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 AND ADJUSTMENT EXPENSES

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.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(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 income statement initially by writing off the deferred policy acquisition expense and subsequently by recognizing an additional claims liability for claims provisions.

(f) REINSURERS' SHARE OF PROVISIONS FOR UNPAID CLAIMS AND ADJUSTMENT EXPENSES

The company enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Reinsurance premiums are accounted for in the same period as the related premiums for the direct insurance business being reinsured. Reinsurance liabilities, comprised of premiums payable for the purchase of reinsurance contracts, are included in accounts payable and accrued liabilities and are recognized as an expense when due.

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.

(g) SALVAGE AND SUBROGATION RECOVERABLE

In the normal course of business, the company obtains the ownership of damaged property, which they resell to various salvage operations. Unsold property is valued at its estimated net realizable value.

Where the company indemnifies policyholders against a liability claim, it acquires rights to subrogate its claim against other parties. These claims are reflected at amounts expected to be received from the subrogated parties net of related costs.

(h) REFUND FROM PREMIUM

At the discretion of the board of directors the company may declare a refund to its policyholders based on the premiums paid in the fiscal period.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STRUCTURED SETTLEMENTS, FIRE MUTUALS GUARANTEE FUND AND FINANCIAL GUARANTEE CONTRACTS

The company enters into annuity agreements with various life insurance companies to provide for fixed and recurring payments to claimants. Under such arrangements, the company's liability to its claimants is substantially transferred, although the company remains exposed to the credit risk that life insurers fail to fulfill their obligations.

The company is a member of the Fire Mutuals Guarantee Fund ("the Fund"). The Fund was established to provide payment of outstanding policyholders' claims and unearned premium 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.

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

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:

Held-to-maturity financial assets

If the Company has the positive intent and ability to hold debt securities to maturity, then such financial assets are classified as held-to-maturity. Held-to-maturity financial assets are recognized initially at fair value plus any directly attributable transactions costs. Subsequent to initial recognition held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses. Any sale or reclassification of a more than insignificant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as fair value through profit and loss, and prevent the Company from classifying investment securities as held-to-maturity for the current and the following two financial years.

Fair value through profit or loss

The company does not have any instruments that are held for trading purposes; however, management has designated to voluntarily classify its investments at fair value through profit or loss. These instruments are carried at fair value with changes in fair value recognized in comprehensive income. Transaction costs on these instruments are expensed as incurred. Interest on debt securities classified as fair value through profit or loss is calculated using the effective interest method.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FINANCIAL INSTRUMENTS (cont'd)

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 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, which are reported net, 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.

Other Financial Liabilities

Other financial liabilities include all financial liabilities and comprise accounts payable, and other short-term monetary liabilities. 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.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is initially recorded at cost and subsequently measured at cost less accumulated depreciation and accumulated impairment losses, with the exception of land which is not depreciated. Depreciation is recognized in comprehensive income and is provided as follows:

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

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

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, the impairment test is carried out on the asset's cash-generating unit, which is the lowest group of assets in which the asset belongs for which there are separately identifiable cash flows. The company has two cash-generating units for which impairment testing is performed.

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

FACILITY ASSOCIATION

As a member of the Facility Association, the company records its proportionate share of the Association's revenue, expenses, unearned premiums and provision for unpaid claims.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

INCOME TAXES

Income tax expense comprises of current and deferred tax. Current tax and deferred tax are recognized in net income except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

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 payable 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).

PROVISIONS

Provisions are recognized for liabilities of uncertain timing or amounts that have arisen as a result of past transactions, including legal, equitable or constructive obligations. The provision is measured at the best estimate of the expenditure required to settle the obligation at the reporting date.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

FOREIGN CURRENCY TRANSLATION

Foreign currency accounts are translated into Canadian dollars as follows:

At the transaction date, each asset, liability, revenue, and expense denominated in a foreign currency is translated into Canadian dollars by the use of the exchange rate in effect at that date. At the year-end date, unsettled monetary assets and liabilities are translated into Canadian dollars by using the exchange rate in effect at the year-end date and the related translation differences are recognized in net income. Exchange gains and losses on non-monetary available-for-sale financial assets form part of the overall gain or loss recognized in respect of that financial instrument.

Non-monetary assets and liabilities that are measured at historical cost are translated into Canadian dollars by using the exchange rate in effect at the date of the initial transaction and are not subsequently restated. Non-monetary assets and liabilities that are measured at fair value or a revalued amount are translated into Canadian dollars by using the exchange rate in effect at the date the value is determined and the related translation differences are recognized in net income or other comprehensive income consistent with where the gain or loss on the underlying non-monetary asset or liability has been recognized.

LEASED ASSETS

Where substantially all of the risks and rewards incidental to ownership of a leased asset have been transferred to the company (a "finance lease"), the asset is treated as if it had been purchased outright. The amount initially recognized as an asset is the lower of the fair value of the leased property and the present value of the minimum lease payments payable over the term of the lease. The corresponding lease commitment is shown as a liability. Lease payments are analyzed between capital and interest. The interest element is charged to the statement of comprehensive income over the period of the lease and is calculated so that it represents a constant proportion of the lease liability. The capital element reduces the balance owed to the lessor.

Where substantially all of the risks and rewards incidental to ownership are not transferred to the company (an "operating lease"), the total rentals payable under the lease are charged to the statement of comprehensive income on a straight-line basis over the lease term. The aggregate benefit of lease incentives is recognized as a reduction of the rental expense over the lease term on a straight-line basis.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET EFFECTIVE

Certain new standards, amendments and interpretations have been published that are mandatory for the company's accounting period beginning on or after January 1, 2013 or later periods that the company has decided not to early adopt. The standards, amendments and interpretations that will be relevant to the company are:

IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 retains but simplifies the mixed measurement model and established two primary measurement categories for financial assets, amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2015. The company is in the process of evaluating the impact of the new standard.

None of the new standards, interpretations and amendments, which are effective for the company's accounting periods beginning after January 1, 2013 and which have not been adopted early, are expected to have a material effect on the company's future financial statements.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

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.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive 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 reinsurers' 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. More details are included in Note 6.

Income taxes

The company periodically assesses its liabilities and contingencies related to income taxes for all years open to audit based on the latest information available. For matters where it is probable that an adjustment will be made, the company records its best estimate of the tax liability including the related interest and penalties in the current tax provision. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

3. FINANCIAL INSTRUMENT CLASSIFICATION

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

	Held-to-Maturity	Fair value through profit or loss	Loans and receivables	Other financial liabilities	Total
December 31, 2012					
Cash and bank	\$ -	\$ 2,109,670	\$ -	\$ -	\$ 2,109,670
Investment income due and accrued	-	-	150,473	-	150,473
Investments	160,421	21,139,544	-	-	21,299,965
Due from reinsurers	-	-	201,234	-	201,234
Premiums receivable	-	-	2,790,578	-	2,790,578
Accounts payable and accrued liabilities	-	-	-	(372,909)	(372,909)
	\$ 160,421	\$ 23,249,214	\$ 3,142,285	\$ (372,909)	\$ 26,179,011

	Held-to-Maturity	Fair value through profit or loss	Loans and receivables	Other financial liabilities	Total
December 31, 2011					
Cash and bank	\$ -	\$ 526,956	\$ -	\$ -	\$ 526,956
Investment income due and accrued	-	-	145,254	-	145,254
Investments	167,855	20,406,961	-	-	20,574,816
Due from reinsurers	-	-	922,570	-	922,570
Premiums receivable	-	-	2,722,313	-	2,722,313
Accounts payable and accrued liabilities	-	-	-	(504,249)	(504,249)
	\$ 167,855	\$ 20,933,917	\$ 3,790,137	\$ (504,249)	\$ 24,387,660

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

4. INVESTMENTS

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

	December 31, 2012		December 31, 2011	
	Cost	Fair Value	Cost	Fair Value
Financial Assets at fair value through profit or loss:				
Short-term deposits	\$ 1,450,530	\$ 1,450,530	\$ 1,074,129	\$ 1,076,196
Bonds issued by				
Federal	1,706,523	1,782,768	1,465,286	1,558,667
Provincial	5,481,089	5,929,323	5,426,608	5,932,184
A or better	3,356,733	3,585,965	3,586,693	3,776,550
	10,544,345	11,298,056	10,478,587	11,267,401
Equities				
Canadian	2,624,147	2,886,731	2,796,477	2,775,208
Mutual funds	805,002	830,438	805,002	793,183
Farm mutual pooled funds				
Canadian fixed income	4,008,268	4,042,818	3,870,146	3,905,803
Canadian equity	706,284	630,971	706,284	589,170
	4,714,552	4,673,789	4,576,430	4,494,973
	\$ 20,138,576	\$ 21,139,544	\$ 19,730,625	\$ 20,406,961
Held-to-Maturity:				
Bonds issued by				
Municipal	\$ 135,288	\$ 135,288	\$ 145,845	\$ 145,845
Other investments				
Fire Mutuals Guarantee Fund	25,133	25,133	22,010	22,010
	\$ 160,421	\$ 160,421	\$ 167,855	\$ 167,855

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

4. INVESTMENTS (continued)

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).

	Level 1	Level 2	Level 3	Total
December 31, 2012				
Short-term deposits	\$ 1,300,527	\$ 150,003	\$ -	\$ 1,450,530
Bonds	-	11,298,056	-	11,298,056
Equities	2,886,731	-	-	2,886,731
Mutual funds	830,438	-	-	830,438
Farm mutual pooled funds	-	4,673,789	-	4,673,789
Total investments at fair value	\$ 5,017,696	\$ 16,121,848	\$ -	\$ 21,139,544
December 31, 2011				
Short-term deposits	\$ 926,196	\$ 150,000	\$ -	\$ 1,076,196
Bonds	-	11,267,401	-	11,267,401
Equities	2,775,208	-	-	2,775,208
Mutual funds	793,183	-	-	793,183
Farm mutual pooled funds	-	4,494,973	-	4,494,973
Total investments at fair value	\$ 4,494,587	\$ 15,912,374	\$ -	\$ 20,406,961

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2011 and 2012.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

4. INVESTMENTS (continued)

Maturity profile of short-term deposits and bonds held is as follows:

	Within 1 Year	2 to 5 years	6 to 10 years	Over 10 years	Fair value
December 31, 2012	\$ 2,125,363	\$1,512,180	\$ 6,025,259	\$ 221,072	\$12,883,874
Percent of total	16 %	35 %	47 %	2 %	
December 31, 2011	\$ 1,591,007	\$,868,044	\$ 6,056,857	\$ 973,534	\$12,489,442
Percent of total	13 %	31 %	49 %	7 %	

The effective interest rate of the bond portfolio held is 3.53% and 3.69% at December 31, 2012 and 2011 respectively.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

5. PROPERTY, PLANT AND EQUIPMENT

	Property, plant and equipment						Intangible Assets
	Land and land improvements	Buildings	Parking Lot	Office furniture and equipment	Computer Hardware	Total	Computer Software
Cost							
Balance at January 1, 2011	\$ 125,000	\$ 455,037	\$ 32,320	\$ 127,341	\$ 189,163	\$ 928,861	\$ 155,211
Additions	-	57,130	-	3,552	38,706	99,388	17,849
Disposals	-	-	-	-	35,575	35,575	-
Balance on December 31, 2011	125,000	512,167	32,320	130,893	192,294	992,674	173,060
Additions	-	13,564	-	28,986	84,387	126,937	-
Disposals	-	-	-	13,585	38,601	52,186	171,959
Balance on December 31, 2012	\$ 125,000	\$ 525,731	\$ 32,320	\$ 146,294	\$ 238,080	\$ 1,067,425	\$ 1,101
Accumulated depreciation							
Balance at January 1, 2011	\$ -	\$ 137,752	\$ 15,907	\$ 92,530	\$ 157,724	\$ 403,913	\$ 154,119
Depreciation expense	-	12,805	1,313	7,081	15,050	36,249	5,760
Disposals	-	-	-	-	28,110	28,110	-
Balance on December 31, 2011	-	150,557	17,220	99,611	144,664	412,052	159,879
Depreciation expense	-	14,826	1,208	10,063	21,809	47,906	3,342
Disposals	-	-	-	12,246	22,342	34,588	162,670
Balance on December 31, 2012	\$ -	\$ 165,383	\$ 18,428	\$ 97,428	\$ 144,131	\$ 425,370	\$ 551
Net book value							
January 1, 2011	\$ 125,000	\$ 317,285	\$ 16,413	\$ 34,811	\$ 31,439	\$ 524,948	\$ 1,092
December 31, 2011	\$ 125,000	\$ 361,610	\$ 15,100	\$ 31,282	\$ 47,630	\$ 580,622	\$ 13,181
December 31, 2012	\$ 125,000	\$ 360,348	\$ 13,892	\$ 48,866	\$ 93,949	\$ 642,055	\$ 550

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

6. INSURANCE CONTRACTS

Due from reinsurers

	2012	2011
Balance, beginning of the year	\$ 922,570	\$ 172,037
Submitted to reinsurer	725,595	2,977,765
Received from reinsurer	(1,446,931)	(2,227,232)
Balance, end of the year	\$ 201,234	\$ 922,570
Expected settlement		
Within one year	\$ 201,234	\$ 922,570

At year end, the company reviewed the amounts owing from its reinsurer and determined that no allowance is necessary.

Reinsurers' share of provision for unpaid claims

	2012	2011
Balance, beginning of the year	\$ 7,014,974	\$ 7,499,764
New claims reserve	646,101	1,525,782
Change in prior years reserve	750,640	967,193
Submitted to reinsurer	(725,595)	(2,977,765)
Balance, end of the year	\$ 7,686,120	\$ 7,014,974
Expected settlement		
Within one year	\$ 1,585,638	\$ 1,415,351
More than one year	6,100,482	5,599,623
	\$ 7,686,120	\$ 7,014,974

Deferred policy acquisition expenses

	2012	2011
Balance, beginning of the year	\$ 720,757	\$ 704,842
Acquisition costs incurred	1,505,070	1,481,833
Expensed during the year	(1,492,212)	(1,465,918)
Balance, end of the year	\$ 733,615	\$ 720,757

Deferred policy acquisition expenses will be recognized as an expense within one year.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

6. INSURANCE CONTRACTS (continued)

Unearned premiums (UEP)

	2012	2011
Balance, beginning of the year	\$ 5,386,172	\$ 5,169,157
Premiums written	11,381,988	11,139,468
Premiums earned	(11,267,345)	(10,922,453)
Balance, end of the year	\$ 5,500,815	\$ 5,386,172

Insurance Contract Provisions and Related Reinsurance Assets

The following is a summary of the insurance contract provisions and related reinsurance assets:

	December 31, 2012		
	Gross	Reinsurance	Net
Outstanding claims provision			
Long settlement term	\$ 8,079,876	\$ 4,615,439	\$ 3,464,437
Short settlement term	1,106,033	597,238	508,795
Facility Association and other residual pools	374,802	2,443	372,359
	9,560,711	5,215,120	4,345,591
Provision for claims incurred but not reported	3,878,000	2,471,000	1,407,000
	\$ 13,438,711	\$ 7,686,120	\$ 5,752,591

	December 31, 2011		
	Gross	Reinsurance	Net
Outstanding claims provision			
Long settlement term	\$ 6,417,089	\$ 4,189,630	\$ 2,227,459
Short settlement term	1,512,917	351,901	1,161,016
Facility Association and other residual pools	354,668	2,443	352,225
	8,284,674	4,543,974	3,740,700
Provision for claims incurred but not reported	3,878,000	2,471,000	1,407,000
	\$ 12,162,674	\$ 7,014,974	\$ 5,147,700

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

6. INSURANCE CONTRACTS (continued)

Comments and assumptions for specific claims categories

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

The company must participate in industry automobile residual pools of business, and recognize a share of this business based on its automobile market share. The company records its share of the liabilities provided by the actuaries of the pools.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

6. INSURANCE CONTRACTS (continued)

Claims and adjustment expenses

Changes in claim liabilities recorded in the balance sheet for the years ended December 31, 2012 and 2011 and their impact on claims and adjustment expenses for the two years follow:

	2012	2011
Provision for unpaid claims, beginning of year	\$ 12,162,674	\$ 12,126,592
Increase (decrease) in estimated losses and expenses, for losses occurring in prior years	1,471,669	865,349
Provision for losses and expenses on claims occurring in the current year	5,105,400	6,524,877
Payment on claims:		
Current year	(3,791,467)	(3,081,169)
Prior years	(1,509,565)	(4,272,975)
Provision for unpaid claims, end of the year	\$ 13,438,711	\$ 12,162,674

The change in estimate of losses occurring in prior years is due to changes arising from new information received.

Provision for unpaid claims and adjustment expenses

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables which are the development of claims, reinsurance recoveries, and future investment income.

The Superintendent of the Financial Services Commission of Ontario has required that consideration of future investment income be disregarded except in the evaluation of automobile accident benefit claims.

Claim development

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

The table that follows presents the development of net claims payments and the estimated ultimate cost of net claims for the claim years 2007 to 2012. The upper half of the tables shows the cumulative amounts paid or estimated to be paid during successive years related to each claim year. The original estimates will be increased or decreased, as more information becomes known about the original claims and overall claim frequency and severity.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

6. INSURANCE CONTRACTS (continued)

Net estimate of cumulative claims cost

	2007	2008	2009	2010	2011	2012	Total
At the end year of claim	\$ 3,494,711	\$ 4,958,714	\$ 5,281,333	\$ 4,594,873	\$ 7,238,503	\$ 4,947,976	
One year later	3,162,353	4,521,032	4,386,609	4,074,872	7,674,496		
Two years later	2,777,845	4,393,958	4,382,229	3,667,558			
Three years later	3,246,325	4,302,213	4,460,412				
Four years later	3,168,520	4,367,158					
Five years later	3,153,204						
Current estimate of cumulative claims cost	3,153,204	4,367,158	4,460,412	3,667,558	7,674,496	4,947,976	28,270,804
Cumulative payments	3,129,583	4,042,537	3,902,058	3,175,228	5,215,167	3,286,396	22,750,969
Outstanding claims	23,621	324,621	558,354	492,330	2,459,329	1,661,580	5,519,835
Outstanding claims 2006 and prior							232,756
Total net outstanding claims							\$ 5,752,591

7. INCOME TAXES

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

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

	2012	2011
Current tax expense		
Based on current year taxable income	\$ 172,000	\$ 120,000
Adjustment for over/under provision in prior periods	(1,338)	(671)
	\$ 170,662	\$ 119,329
Deferred tax expense (recovery)		
Origination and reversal of temporary differences	\$ (10,000)	\$ (6,755)
Reduction in tax rate	-	(245)
	\$ (10,000)	\$ (7,000)
Total provision for income taxes	\$ 160,662	\$ 112,329

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

7. INCOME TAXES (continued)

Reasons for the difference between tax expense for the year and the expected income taxes based on the statutory tax rate of 26.5% (2011 - 28.25%) are as follows:

	2012	2011
Income before income taxes	\$ 1,133,805	\$ 789,322
Expected income taxes based on the statutory rate of 26.5% (2011 - 28.25%)	300,458	222,984
Income from insuring farm related risks	(84,367)	(55,015)
Non deductible portion of claims liabilities	8,015	9,787
Other non taxable income	-	2,781
Adjustments related to investments	(23,068)	(21,087)
Capital cost allowance in excess of depreciation	2,593	(4,961)
Ontario Small Business deduction	(35,000)	(37,500)
Over (under) provision in prior years	(1,338)	(671)
Other	3,369	3,011
Total current income tax expense	\$ 170,662	\$ 119,329

The movement in 2012 deferred income tax assets are:

	Opening balance at Jan 1, 2012	Recognize in net income	Closing at Dec 31, 2012
2012			
Deferred tax assets			
Property, plant and equipment	\$ 5,828	\$ 2,172	\$ 8,000
Claims liabilities	52,507	7,943	60,450
Other	1,665	(115)	1,550
Deferred tax asset	\$ 60,000	\$ 10,000	\$ 70,000
2012 net deferred tax asset movement	\$ 60,000	\$ 10,000	\$ 70,000

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

7. INCOME TAXES (continued)

The movement in 2011 deferred tax liabilities and assets are:

	Opening balance at Jan 1, 2011	Recognize in net income	Closing at Dec 31, 2011
2011			
Deferred tax assets			
Property, plant and equipment	\$ 7,450	\$ (1,622)	\$ 5,828
Claims liabilities	43,845	8,662	52,507
Other	1,705	(40)	1,665
Deferred tax asset	\$ 53,000	\$ 7,000	\$ 60,000
2011 net deferred tax asset movement	\$ 53,000	\$ 7,000	\$ 60,000

	2012	2011
Deferred tax assets		
Deferred tax assets to be recovered within 12 months	\$ 108	\$ 116
Deferred tax assets to be recovered after more than 12 months	69,892	59,884
Net deferred tax assets	\$ 70,000	\$ 60,000

8. GROSS CLAIMS AND ADJUSTMENT EXPENSES

Included in gross claims and adjustment expenses was total compensation costs of \$236,879 (2011 - \$223,409).

9. FEES, COMMISSIONS AND OTHER ACQUISITION EXPENSES

	2012	2011
Commissions	\$ 1,654,264	\$ 1,614,229

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

10. OTHER OPERATING AND ADMINISTRATIVE EXPENSES

	2012	2011
Salaries and benefits	\$ 856,306	\$ 806,751
Directors' fees	66,043	63,189
Professional fees	46,008	30,029
Advertising, promotion and donations	35,846	30,475
Education and convention	109,088	88,364
Dues and fees	90,385	85,903
Loss prevention	59,644	39,477
Telephone	18,263	18,655
Office	31,565	48,825
Utilities, property taxes and repairs	44,180	45,072
Insurance	20,605	17,075
Premium tax	24,649	24,132
Computer	244,359	143,780
Depreciation	51,247	42,008
	\$ 1,698,188	\$ 1,483,735

11. INVESTMENT AND OTHER INCOME

	2012	2011
Interest income	\$ 466,283	\$ 475,023
Dividend income	225,172	409,672
Realized gains (losses) on disposal of investments	(75,805)	14,084
Gain (loss) on disposal of property, plant and equipment	(24,885)	(7,466)
Investment expenses	(35,284)	(33,450)
Change in Unrealized gains (losses) on investments	319,815	63,630
Rental income	9,000	1,100
	\$ 884,296	\$ 922,593

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

12. 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:

	2012	2011
Compensation		
Short-term employee benefits and directors' fees	\$ 418,261	\$ 406,143
Other payments	611	43,805
	\$ 418,872	\$ 449,948
Premiums	\$ 56,913	\$ 53,772
Claims paid	\$ 6,773	\$ 12,866

Amounts owing to and from key management personnel at December 31, 2012 are \$NIL (2011 - \$NIL) and \$3,677 (2011 - \$4,874) respectively. The amounts are included in accounts payable and accrued liabilities and prepaid expenses and other on the statement of financial position.

13. CAPITAL MANAGEMENT

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

The regulators measure the financial strength of property and casualty insurers using a minimum capital test (MCT). The regulators generally expect property and casualty companies to comply with capital adequacy requirements. This test compares a company's capital against the risk profile of the organization. The risk-based capital adequacy framework assesses the risk of assets, policy liabilities and other exposures by applying various factors. The regulator indicates that the company should produce a minimum MCT of 150%. The MCT for the company at December 31, 2012 was 684% (2011 - 730%). 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.

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

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

14. FINANCIAL INSTRUMENT RISK MANAGEMENT

INSURANCE RISK MANAGEMENT

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

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

The company purchases reinsurance as part of its risks mitigation program. Retention limits for the excess-of-loss reinsurance vary by product line.

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

The company manages this risk via its underwriting and reinsurance strategy within an overall risk management framework. Exposures are limited by having documented underwriting limits and criteria. Pricing of property and liability policies are based on assumptions in regard to trends and past experience, in an attempt to correctly match policy revenue with exposed risk. Automobile premiums are subject to approval by the Financial Services Commission of Ontario and therefore may result in a delay in adjusting the pricing to exposed risk; in this case the company has policies regarding renewal and new business accepted. Reinsurance is purchased to mitigate the effect of the potential loss to the company. Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer.

The company follows a policy of underwriting and reinsuring contracts of insurance which, in the main, limit the liability of the company to an amount on any one claim of \$250,000 (2011 - \$210,000) in the event of a property claim, an amount of \$200,000 (2011 - \$150,000) in the event of an automobile claim and \$250,000 (2011 - \$200,000) in the event of a liability claim. For amounts over the respective limits there is a 10% retention to a specified maximum. The company also obtained reinsurance which limits the company's liability to \$750,000 (2011 - \$630,000) in the event of a series of claims arising out of a single occurrence. In addition, the company has obtained Stop Loss reinsurance which limits the liability for claims occurring in a specific year to 80% of gross net earned premiums for property claims and automobile claims.

The company is exposed to a pricing risk to the extent that unearned premiums are insufficient to meet the related future policy costs. Evaluation is performed regularly to estimate future claims costs, related expenses, and expected profit in relation to unearned premiums. There was no premium deficiency at December 31, 2012 and 2011.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

14. FINANCIAL INSTRUMENT RISK MANAGEMENT (continued)

INSURANCE RISK MANAGEMENT (cont'd)

The risks associated with insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The company's various techniques based on past claims development experience to quantify these sensitivities. This includes indicators such as average claim cost, amount of claims occurrence, expected loss ratios and claims development as described in Note 6.

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

	Property claims		Auto claims		Liability Claims	
	2012	2011	2012	2011	2012	2011
5% increase in loss ratio						
Gross	\$ (249,522)	\$ (242,975)	\$ (269,909)	\$ (258,202)	\$ (50,149)	\$ (50,521)
Net	\$ (194,686)	\$ (185,824)	\$ (167,357)	\$ (151,805)	\$ (30,244)	\$ (29,503)
5% decrease in loss ratio						
Gross	\$ 249,522	\$ 242,975	\$ 269,909	\$ 258,202	\$ 50,149	\$ 50,521
Net	\$ 194,686	\$ 185,824	\$ 167,357	\$ 151,805	\$ 30,244	\$ 29,503

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.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

14. FINANCIAL INSTRUMENT RISK MANAGEMENT (continued)

CREDIT RISK

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

The company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits, aggregate issuer limits, corporate sector limits and general guidelines for geographic exposure. The company's investment policy limits investment in bonds and debentures to only fixed income investments with an A rating or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the creditworthiness of FMRP by reviewing their annual financial statements and through ongoing communications. Reinsurance treaties are reviewed annually by management prior to renewal of the reinsurance contract.

Premiums receivable 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.

The maximum exposure to investment credit risk is outlined in note 4.

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 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.

TOWN & COUNTRY MUTUAL INSURANCE COMPANY

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2012

14. FINANCIAL INSTRUMENT RISK MANAGEMENT (continued)

a) 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 has no exposure to this risk as no individual investments contained in the portfolio are denominated in a foreign currency.

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.

b) 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 (Bankers Acceptances, T-Bills, GICs, Bonds, and Farm mutual pooled funds - Canadian fixed income).

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

At December 31, 2012, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by \$490,000 (2011 - \$560,000). These changes would be recognized in comprehensive income. A similar move in rates could impact the market value of the Canadian fixed income farm mutual pooled fund by \$255,000 (2011 - \$235,000).

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.

DECEMBER 31, 2012

14. FINANCIAL INSTRUMENT RISK MANAGEMENT (continued)

c) EQUITY RISK

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The company is exposed to this risk through its equity holdings within its investment portfolio.

The company's portfolio includes Canadian 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. At December 31, 2012 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 common and United States common of \$440,000 (2011 - \$415,000). This change would be recognized in comprehensive income.

The company's investment policy limits investment in preferred and common shares to a maximum of 25% of the market value of the portfolio and is restricted to equities which are contained in the S&P/TSX Index.

Equities are monitored by the investment committee and holdings are adjusted following each quarter if the investments are offside of the investment policy.

LIQUIDITY RISK

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

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