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2007 *Annual Report*





YOUR OWN COMPANY

Prince Edward Island

Mutual Insurance Company

201 Water Street
Summerside, P.E.I.
C1N 1B4

Phone 1-800-565-5441
Local 436-2185
Fax 436-0148

E-mail: protect@peimutual.com
www.peimutual.com

DIRECTORS

Percy Affleck

Bedeque, P.E.I. 887-2507

Claude Dorgan

Tignish, P.E.I. 882-3452

Jim Doyle

Auburn, P.E.I. 676-2472

Allison Johnson

Belmont, Lot 16, P.E.I. 436-5200

Stewart MacRae

Ebenezer, P.E.I. 964-2979

Brian MacKinley

Cornwall, P.E.I. 566-4163

George Matheson

Albion Cross, P.E.I. 583-2340

Gordon Vessey

York, P.E.I. 629-1332

Brian Annear

Lower Montague, P.E.I. 838-3038

OFFICERS

President

Gordon Vessey
York, P.E.I.

Vice-President

George Matheson
Albion Cross, P.E.I.

General Manager

Terrence Shea
Summerside, P.E.I.

Secretary/Legal Counsel

Blair Campbell
Summerside, P.E.I.

Treasurer

Rudy Smith
Summerside, P.E.I.

NOTICE OF ANNUAL MEETING

P.E.I. Mutual Insurance Company will be holding its annual meeting on Tuesday, April 8, 2008, at 2:00 P.M. at the Royal Canadian Legion, 340 Notre Dame Street, Summerside, P.E.I.

The purpose of the meeting is to receive the financial statements and auditors report for 2007; to elect directors; to appoint auditors and to transact other business which may properly be brought before the meeting.

Blair Campbell, Corporate Secretary





PRESIDENT'S REPORT

It has been a privilege and pleasure to serve as President of PEI Mutual Insurance Company during 2007.

Premiums continue to grow and were up 5% this past year. Claims were also up 8% over the previous year, but were average when comparing our claims ratio to the last 10 year period. Although our claims were up significantly in 2007, we ended the year on quite a positive note. Our Manager and Controller have done a great job with our investment portfolio. Due to this and the hard work of all the PEI Mutual team we ended the year with quite a healthy surplus.

I would like to report that we now have 56% of policyholders on a Claims Free Discount.

PEI Mutual is always striving to meet the insurance needs of our policyholders whether it be Farming, Fishing, Commercial, Residential or Liability. During the past year we continued to make changes that we hope will be beneficial to policyholders.

I would like to thank Cam Trail who retired on June 1st, 2007, for his many years of dedicated service as agent for the West Prince area. Cam came to PEI Mutual in September of 1980 and spent 27 years with us. Congratulations and thank you Cam.

I would also like to welcome our two new agents, Eddie Trail and Randy Wedge who will serve the western end of the province. We hope your time with us will be both productive and enjoyable.

It has been very rewarding to serve as President of PEI Mutual during 2007 and at this time I would like to extend my thanks to our Management Team, Office Staff, Agents and to the Board of Directors for all their hard work, guidance and support over the past year.

Gordon Vessey,
President





MANAGER'S REPORT

Our 2007 financial year was average when compared to our past 10 years. 2006 was our best year in 25 years. Based on our success in 2006, the Board of Directors declared a Special Mutual Rebate of \$1,240,000 to be paid in 2007. This rebate was paid in April, 2007 and deducted from our earnings for 2007, reducing our 2007 income by \$1,240,000.

We experienced an increase in large losses in 2007 having 33 losses reported that were greater than \$50,000. Claims relating to wood heat practices were significantly higher in 2007 representing 12% of our total payout for all claims.

PEI Mutual has an investment portfolio totaling \$39,000,000. These investments are managed by our controller, Rudy Smith and myself. Our investment policy limits the amount of risk that we can assume in purchasing investments. Our return on investments realized for 2007 was 7.5%, a total of \$2,800,000.

In 2007, Cam Trail, our service agent for West Prince County, retired after 27 years of service to PEI Mutual. Over these years, PEI Mutual experienced significant growth and Cam was instrumental in contributing to this growth. On behalf of everyone at PEI Mutual, I thank Cam for his hard work and long term service to our Company and wish him much happiness in his retirement years.

Randy Wedge from Palmer Road and Eddie Trail from Cascumpec were hired in 2007 as service agents for West Prince County. Randy is a graduate of Concordia University and has been employed in the sales and service industries for the past 10 years. Eddie is a graduate of The University of New Brunswick and has been employed in sales and service for the past 20 years. I welcome both Randy and Eddie to our team.

PEI Mutual is an Island company owned by its policyholders with its Head Office located on PEI. Decisions are made promptly on PEI. In profitable years, we give Dividends or Mutual Rebates back to our policyholders either in the form of a cheque or as a reduction from premiums due in the following year. I am pleased to advise that a 10% Mutual Rebate has been approved by our Board of





Directors for 2007. This rebate will be deducted off your premium due in 2008. Mutual Rebates have been given to policyholders in 19 of the past 25 years with a total payout of approximately \$21,000,000.

PEI Mutual is an Island company which contributes greatly to our Island economy through contributions to local charities and organizations and through the employment of 33 full time permanent staff. PEI Mutual is 123 years old.

Providing excellent service to our policyholders is our key to success. I thank our team of dedicated employees and directors for their hard work.

Thank you for choosing PEI Mutual as your insurance provider.

Terry Shea
General Manager



PROTECTING EACH OTHER
SINCE 1885





AUDITOR'S REPORT

To the Policyholders of Prince Edward Island Mutual Insurance Company

We have audited the balance sheet of Prince Edward Island Mutual Insurance Company as at December 31, 2007 and the statements of earnings, comprehensive income, equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Summerside, P.E.I.
January 31, 2008

Grant Thornton LLP
Chartered Accountants





STATEMENT OF EARNINGS

Year Ended December 31

	<u>2007</u>	<u>2006</u>
Underwriting income		
Gross premiums written	\$ 13,178,586	\$ 12,526,543
Reinsurance premiums assumed (Note 9)	27,248	29,012
Reinsurance premiums ceded (Note 9)	<u>(1,621,019)</u>	<u>(1,672,008)</u>
Net premiums written	11,584,815	10,883,547
Less: increase in unearned premiums	<u>399,074</u>	<u>11,596</u>
Net premiums earned	<u>11,185,741</u>	<u>10,871,951</u>
Claims and expenses		
Gross claims incurred	7,046,915	6,259,864
Adjusting, legal and appraisals	518,349	599,262
Less: reinsurance recoveries	<u>309,692</u>	<u>1,117,643</u>
Net claims and adjusting	7,255,572	5,741,483
Operating expenses (Schedule)	<u>4,299,086</u>	<u>3,984,943</u>
	<u>11,554,658</u>	<u>9,726,426</u>
Net underwriting (loss) earnings	<u>(368,917)</u>	<u>1,145,525</u>
Other income		
Net investment income (Note 7)	2,799,865	2,703,307
(Loss) gain on sale of property and equipment	(2,573)	809
Refund from surplus from reinsurer (Note 10)	94,983	—
Miscellaneous	<u>27,809</u>	<u>38,730</u>
	<u>2,920,084</u>	<u>2,742,846</u>
Earnings before special mutual rebate	2,551,167	3,888,371
Special mutual rebate (Note 11)	<u>(1,240,491)</u>	<u>—</u>
Earnings before income taxes	<u>1,310,676</u>	<u>3,888,371</u>
Income tax expense (recovery) (Note 12)		
Current	170,711	858,654
Future	<u>89,804</u>	<u>(61,654)</u>
	<u>260,515</u>	<u>797,000</u>
Net earnings	<u>\$ 1,050,161</u>	<u>\$ 3,091,371</u>

STATEMENT OF COMPREHENSIVE INCOME

Year Ended December 31

	<u>2007</u>	<u>2006</u>
Net earnings	<u>\$ 1,050,161</u>	<u>\$ 3,091,371</u>
Other comprehensive loss		
Change in unrealized gain on available for sale investments, net of taxes	<u>(344,667)</u>	<u>—</u>
Total comprehensive income	<u>\$ 705,494</u>	<u>\$ 3,091,371</u>





STATEMENT OF EQUITY

December 31

	<u>2007</u>	<u>2006</u>
Policyholders' security fund, beginning of year	\$ 30,351,858	\$ 27,260,487
Net earnings	<u>1,050,161</u>	<u>3,091,371</u>
Policyholders' security fund, end of year	<u>31,402,019</u>	<u>30,351,858</u>
Accumulated other comprehensive income, transitional adjustment on adoption of new accounting policy, net of income tax recovery (Note 3)	965,976	—
Other comprehensive loss	<u>(344,667)</u>	<u>—</u>
Accumulated other comprehensive income, end of year	<u>621,309</u>	<u>—</u>
Total equity	<u>\$ 32,023,328</u>	<u>\$ 30,351,858</u>

BALANCE SHEET

December 31

	<u>2007</u>	<u>2006</u>
Assets		
Cash and short term deposits	\$ 1,763,031	\$ 1,027,063
Receivables (Note 4)	1,177,454	1,112,703
Income tax receivable	480,183	—
Prepaid items	17,924	16,746
Deferred premium acquisition expenses		
Re-insurers' share of provision for unpaid claims and adjustment expenses	929,275	936,577
	1,456,991	1,200,829
Investments (Note 5)	38,957,921	37,324,057
Property and equipment (Note 6)	524,854	504,904
Future income taxes	<u>17,629</u>	<u>290,386</u>
	<u>\$ 45,325,262</u>	<u>\$ 42,413,265</u>
Liabilities		
Payables and accruals	\$ 237,201	\$ 245,810
Income taxes payable	—	160,530
Provision for unpaid claims	5,695,720	4,685,128
Unearned premium reserve	<u>7,369,013</u>	<u>6,969,939</u>
	<u>13,301,934</u>	<u>12,061,407</u>
Equity		
Policyholders' security fund	31,402,019	30,351,858
Accumulated other comprehensive income	<u>621,309</u>	<u>—</u>
	<u>32,023,328</u>	<u>30,351,858</u>
	<u>\$ 45,325,262</u>	<u>\$ 42,413,265</u>





STATEMENT OF CASH FLOWS
Year Ended December 31

	<u>2007</u>	<u>2006</u>
Increase (decrease) in cash and cash equivalents		
Operating		
Net earnings	\$ 1,050,161	\$ 3,091,371
Depreciation	88,110	85,059
Bond premium amortized	92,095	83,205
Gain on sale of investments	(767,745)	(781,175)
Loss (gain) on sale of equipment	2,573	(348)
Future income taxes	<u>89,804</u>	<u>(61,654)</u>
	554,998	2,416,458
Change in non-cash operating working capital (Note 8)	<u>443,506</u>	<u>(352,300)</u>
	<u>998,504</u>	<u>2,064,158</u>
Investing		
Purchase of property and equipment	(111,041)	(81,846)
Proceeds on disposal of bonds and equities	5,887,585	5,389,933
Purchase of bonds and equities	(6,039,488)	(7,884,168)
Proceeds on disposal of property and equipment	<u>408</u>	<u>4,546</u>
	<u>(262,536)</u>	<u>(2,571,535)</u>
Net increase (decrease) in cash and cash equivalents	735,968	(507,377)
Cash and cash equivalents, beginning of year	<u>1,027,063</u>	<u>1,534,440</u>
Cash and cash equivalents, end of year	<u>\$ 1,763,031</u>	<u>\$ 1,027,063</u>

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2007

1. Nature of operations

The Company is incorporated without share capital under the laws of Prince Edward Island and is subject to the Prince Edward Island Insurance Act. It is licensed to write property and casualty insurance in Prince Edward Island.

2. Summary of significant accounting policies

Depreciation

Depreciation of fixed assets is recorded on the diminishing balance method at the rates indicated in Note 6.





Unearned premium reserve

The unearned premium reserve is based on the unexpired term of all policies of the Company in force as at December 31.

Deferred premium acquisition expenses

Deferred premium acquisition expenses are those expenses such as agents' commissions, which relate directly to the acquisition of premiums. These expenses, to the extent that they are considered recoverable, are deferred and amortized over the terms of the related premiums.

Provision for unpaid claims and adjusting expenses

The provision for unpaid claims represents an estimate for the full amount of all costs including investigation and the projected final settlements of reported claims and for claims incurred but not reported prior to the balance sheet date. These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. These provisions are adjusted up or down as additional information affecting the estimated amounts become known during the course of claims settlement. All changes in estimates are recorded as incurred claims in the current period.

Premium revenues

Premiums are recognized as earned over the term of the policy on a pro rata basis.

Income taxes accounting policy

The Company uses the tax liability method for determining income taxes. Under this method, future tax assets and liabilities are determined according to differences between their respective carrying amounts and tax basis. Future tax assets and liabilities are measured based on enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which these temporary differences are expected to reverse. Adjustments to these balances are recognized in earnings as they occur.





Reinsurance

The Company reflects reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to reinsurance and its obligations to policyholders.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, balances with banks and short term deposits with original maturities of one year or less.

Use of estimates

In preparing the Company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from estimates used in these financial statements.

3. Changes in accounting policies

Financial instruments

On January 1, 2007, the Company adopted CICA Handbook Sections 3855, "Financial Instruments – Recognition and Measurement", 1530, "Comprehensive Income" and 3861, "Financial Instruments – Disclosure and Presentation". These standards have been applied without restatement of prior periods.

The standards requires that financial assets are classified as held for trading (HFT), held to maturity (HTM), available for sale (AFS), or loans and receivables (L&R). Financial liabilities are classified as HFT or other financial liabilities (OFL). Financial assets and liabilities are initially recognized at fair value with subsequent measurement based on classification. The classification depends on the purpose for which the financial instruments were acquired, their characteristics and choice where applicable.

All financial instruments, including derivatives, are measured at fair value except for L&R, HTM and OFL





which are measured at amortized cost using the effective interest method. Unrealized gains and losses on available for sale investments are recognized in other comprehensive income until the financial asset is derecognized or other than temporary impaired, at which time any unrealized gains or losses are recorded in net earnings.

Accumulated other comprehensive income is included in the balance sheet as a separate component of equity (net of income tax) and includes net unrealized gains or losses on available for sale assets.

Fair values are based on quoted market values where available from active markets, otherwise fair values are estimated using a variety of valuation techniques and models.

As a result of the adoption of these new standards, the Company has classified bonds, term deposits and guaranteed investment certificate financial instruments as “held to maturity” and equity financial instruments as “available for sale”. The adoption of the new standards resulted in the following adjustments:

	<u>Increase</u>	<u>Decrease</u>
Investments	1,242,195	—
Future income taxes	-	276,219
Accumulated other comprehensive income	965,976	—

Fair values

The estimated fair values of financial instruments are intended to approximate values at which these instruments could be exchanged in a current market.

No fair values have been determined for property and equipment, or any other asset or liability that is not a financial instrument. The fair values of cash and cash equivalents, receivables, and payables and accruals are assumed to approximate their carrying values due to the short term nature of these financial instruments.





4. Receivables

	<u>2007</u>	<u>2006</u>
Policyholders for premiums	\$ 736,247	\$ 644,062
Accrued interest	439,952	450,425
Other	<u>1,255</u>	<u>18,216</u>
	<u>\$ 1,177,454</u>	<u>\$ 1,112,703</u>

5. Investments

	<u>2007</u>	<u>2006</u>
Held to maturity, investments at cost	\$31,693,392	\$30,787,958
Available for sale, investments at cost	—	6,536,099
Available for sale, investments at market value	<u>7,264,529</u>	<u>—</u>
	<u>\$38,957,921</u>	<u>\$37,324,057</u>

	<u>2007</u>		<u>2006</u>	
	<u>Cost</u>	<u>Market Value</u>	<u>Cost</u>	<u>Market Value</u>
Held to maturity - investments				
Term deposits and GIC's	\$ 2,900,000	\$ 2,900,000	\$ 2,700,000	\$ 2,700,000
Bonds at par less unamortized purchase discounts and premiums				
Federal	700,756	738,775	800,678	851,679
Provincial	15,244,523	16,756,200	15,688,749	17,473,648
Municipal	3,448,832	3,595,781	3,260,277	3,439,824
Corporate	<u>9,399,281</u>	<u>9,052,437</u>	<u>8,338,254</u>	<u>8,438,896</u>
Total bonds	<u>28,793,392</u>	<u>30,143,193</u>	<u>28,087,958</u>	<u>30,204,047</u>
Total held to maturity investments	<u>\$ 31,693,392</u>	<u>\$ 33,043,193</u>	<u>\$ 30,787,958</u>	<u>\$ 32,904,047</u>
Available for sale - investments				
Equities - Canadian Common stock	\$ 4,927,525	\$ 5,705,756	\$ 4,959,692	\$ 5,996,652
Equities - US Common stock	<u>1,530,693</u>	<u>1,558,773</u>	<u>1,576,407</u>	<u>1,782,764</u>
Total available for sale investments	<u>\$ 6,458,218</u>	<u>\$ 7,264,529</u>	<u>\$ 6,536,099</u>	<u>\$ 7,779,416</u>

Held to maturity investments - maturity profile

	Within <u>1 Year</u>	1 to 5 <u>Years</u>	5 to 10 <u>Years</u>	10 to 20 <u>Years</u>	<u>Total</u>
Bonds	\$ 2,100,000	\$ 8,496,846	\$ 12,860,255	\$ 5,336,291	\$ 28,793,392
Term deposits	<u>600,000</u>	<u>2,300,000</u>	<u>—</u>	<u>—</u>	<u>2,900,000</u>
Total	<u>\$ 2,700,000</u>	<u>\$ 10,796,846</u>	<u>\$ 12,860,255</u>	<u>\$ 5,336,291</u>	<u>\$ 31,693,392</u>
Percent of total	<u>9%</u>	<u>33%</u>	<u>41%</u>	<u>17%</u>	<u>100%</u>





6. Property and equipment

				<u>2007</u>	<u>2006</u>
	Rate	Cost	Accumulated Depreciation	Net Book Value	Net Book Value
Land		\$ 132,097	—	\$ 132,097	\$ 132,097
Building	5%	473,895	\$ 269,237	204,658	198,137
Office equipment	20%	197,457	130,655	66,802	53,527
Computer equipment	30%, 45%	181,782	145,215	36,567	45,855
Motor vehicle	30%	188,033	107,312	80,721	70,930
Parking lot	8%	<u>13,715</u>	<u>9,706</u>	<u>4,009</u>	<u>4,358</u>
		\$ 1,186,979	\$ 662,125	\$ 524,854	\$ 504,904

7. Investment income

	<u>2007</u>	<u>2006</u>
Interest from bonds and short term deposits	\$ 1,767,676	\$ 1,677,890
Dividend income	264,444	244,242
Gain on sale of investments	<u>767,745</u>	<u>781,175</u>
	\$ 2,799,865	\$ 2,703,307

8. Change in non-cash operating working capital

	<u>2007</u>	<u>2006</u>
Receivables	\$ (64,751)	\$ 24,160
Prepaid expenses	(1,178)	6,533
Deferred premium acquisition expenses	7,302	(129,912)
Re-insurers' share of provision for unpaid claims	(256,162)	354,456
Payables and accruals	(10,658)	(8,000)
Income taxes	(640,713)	(266,011)
Unpaid claims	1,010,592	(345,122)
Unearned premiums	<u>399,074</u>	<u>11,596</u>
	\$ 443,506	\$ (352,300)
Income taxes paid	\$ 811,424	\$ 1,124,665

9. Reinsurance

All reinsurance is ceded and assumed from Farm Mutual Reinsurance Plan Inc., a mutual re-insurer incorporated without share capital, of which the Company is a member.

Reinsurance ceded

The Company follows the policy of underwriting and reinsuring contracts of insurance which, in the main limits the liability of the Company to a maximum amount on any one property loss to \$415,000 or liability loss to \$199,000. The reinsurance contracts also limit the Company's liability on the sum of all individual losses arising out of one event to \$1,200,000. In addition, the Company has obtained reinsurance which limits the Company's overall liability on losses to a maximum of 80% of the Company's earned premium.



Reinsurance assumed

The Company is participating as a re-insurer of losses from catastrophe suffered by members of the Farm Mutual Reinsurance Plan Inc. to the extent of \$150,000 for a single catastrophe loss. The Company's participation commences if a catastrophe loss exceeds \$10 million and reaches the limit of \$150,000 if the loss is \$100 million or greater.

The Company is also participating with a group of Canadian mutual insurance companies as a re-insurer of Agricorp, a crown corporation in Ontario that provides crop insurance to Ontario farmers. The Company's maximum exposure in any one year is \$150,000.

10. Refund from surplus from reinsurer

The Board of Directors of Farm Mutual Reinsurance Plan Inc., our reinsurer, declared a refund from surplus payable to qualifying member companies. Our proportionate share of the refund was \$94,983 in 2007. There was no refund declared in 2006.

11. Special mutual rebate

The Board of Directors declared a Special Mutual Rebate in 2007, payable to all policyholders with policies in force on December 31, 2006, at a rate of 10% of gross written premiums on December 31, 2006.

12. Income taxes

Forty two percent (42%) of premiums are from farming and fishing producers. The Company is taxable on the portion of its income that is attributed to non-farming/fishing premiums.

13. Pensions

The Company has a defined contribution plan providing pension benefits to eligible employees. The total plan expense for the Company's defined contribution plan for all of 2007 was \$127,521 (2006 - \$113,698).





SCHEDULE OF EXPENSES

Year Ended December 31

	<u>2007</u>	<u>2006</u>
Advertising	\$ 107,780	\$ 93,986
Canada pension plan	76,969	67,068
Conventions, courses and travel	80,375	77,530
Depreciation	62,743	63,928
Directors fee	203,633	189,880
Donations	65,000	67,600
Employment insurance	37,274	34,293
Fire prevention tax	131,786	125,265
Group insurance	96,865	92,008
Loss prevention	125,966	121,045
Office supplies	96,812	87,800
Other administration costs	191,931	186,454
Postage	120,787	102,224
Premium acquisition expenses	1,685,431	1,553,327
Professional fees	25,958	26,507
Salaries	1,102,760	1,020,262
Taxes, dues and licences	32,552	32,051
Telephone	54,464	43,715
	<u>\$ 4,299,086</u>	<u>\$ 3,984,943</u>

CLAIMS MANAGER

Blair Campbell Summerside

SAFETY SURVEYOR

Franklin Sanderson Warren Grove

AGENTS

J. Randall Wedge	Palmer Road
Eddie Trail	Cascumpec
Jane MacLaurin	Grand River
Paul Power	Summerside
Myles Grady	South Freetown
Bruce Simpson	Bayview
Darren Baglole	Kinkora
Mark MacDonald	Cornwall
Tom Kickham	Souris
David MacAdam	Morell
Peter Johnston	Kinlock
David Walsh	Summersville
Janice Taylor	Montague

