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2005 Annual Report



YOUR OWN COMPANY

Prince Edward Island

Mutual Insurance Company

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

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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

Blair Wood

Montague, P.E.I. 838-4689

OFFICERS

President

Brian MacKinley
Cornwall, P.E.I.

Secretary/Legal Counsel

Blair Campbell
Summerside, P.E.I.

Vice-President

Percy Affleck
Bedeque, P.E.I.

Treasurer

Rudy Smith
Summerside, P.E.I.

General Manager

Terrence Shea
Summerside, P.E.I.

NOTICE OF ANNUAL MEETING

P.E.I. Mutual Insurance Company will be holding its annual meeting on Tuesday, April 11, 2006, 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 2005; to elect directors; to amend by-laws; to appoint auditors and to transact other business which may properly be brought before the meeting.

Blair Campbell
Corporate Secretary



PRESIDENT'S REPORT

What an exciting year for PEI Mutual. Together, underwriting profit and investment income produced approximately \$2.39 million net income for the year, thus giving the Company the opportunity to provide a 10% Mutual rebate to the policyholders effective May 1, 2006.

PEI Mutual continues to work on monitoring two of our largest risks - oil escapes and wood burning losses. Oil claim losses decreased approximately \$650,000 from 2004 and wood burning losses decreased approximately \$450,000 during the same period.

On behalf of your Board of Directors, I wish to thank the PEI Mutual team members for their excellent work and dedication. They've performed well once again looking after policyholder's needs both at head office and on the road across the Island from tip to tip. Our great Company is here to work with families in their homes, with their businesses, and with their community centers & churches. We take pride in helping our insured families and communities with their unfortunate losses.

We were pleased to hire two new agents this year - Paul Power and Darren Baglole. Our team of twelve agents plus our in-office agent continue to work on our Company's growth adding more policyholders each year. This growth, together with good underwriting skills, continue to add greatly to the Company's success. Gross written premiums were up 9.1 % for the year.

Thank you to the Board of Directors for giving me the opportunity to serve as President of such a great Company. Management, agents, adjusters, our safety surveyor, office staff, and directors work together as a strong team. We take pride in working with our 20,000 (+) policyholders.

Brian MacKinley,
President



MANAGER'S REPORT 2005

A 10% Mutual Rebate to our policyholders is the story of the day.

Policyholders of PEI Mutual benefit by sharing in the Company's profits through a "Mutual Rebate" which is given in years when the Company has good financial results. I am pleased to advise that we will be giving a "Mutual Rebate" of approximately \$1,400,000 (10%) in 2006. A "Mutual Rebate" has been paid to our policyholders for 16 of the past 22 years. The total amount refunded to the policyholders in those 16 years was \$15,365,000. This "Mutual Rebate" will be given as a discount at time of renewal.

In 2005 we experienced a reduction in claims giving us the best net claims experience since 1995. In the past 5 years we have been experiencing claims resulting from oil spills that have cost PEI Mutual approximately \$1,000,000 each year. Since 2003 we have been working with our policyholders to improve oil installations. In 2005 we have seen a reduction in oil spill claims – a positive sign that better installations will reduce claims.

In 2005 we introduced a new residential wording for seasonal or tenant occupied dwellings. This new wording brings in a number of improvements in coverage in a very attractive booklet which is laid out in a manner making it easier for policyholders to read.

Our rate changes in the past number of years have been minimal and there are no planned rate increases in 2006. Our income in past years has been sufficient to grow our surplus and keep the Company in the excellent financial standing it enjoys today.

We have a total of 12,800 policyholders who are receiving a residential claims free discount ranging from a low of a 10% discount for 5 years claims free and a high of 25% for 15 years claims free. This represents approximately 50% of our residential policyholders. The claims free discount is our way of rewarding policyholders who do not have residential claims.

PEI Mutual Education Trust is very pleased to continue providing scholarships to Grade 12 graduating students across PEI. In 2005 we awarded 20 scholarships of \$500 each. Our Education Trust was a centennial project in 1985 and since inception we have awarded 420 scholarships totaling \$215,000.

As a corporate citizen, PEI Mutual is a consistent contributor to charities and organizations. We are aware of the fact that we are in business to service our policyholder's insurance needs, but also recognize our responsibility as a corporate citizen of Prince Edward Island. We pay close attention to balancing our responsibility to both our policyholders and the community. The following is a testament of PEI Mutual's commitment to community:

- Significant donation to all Island Hospitals on an annual basis for the past 19 years.
- One of three funding partners on an annual basis for PEI Special Olympics for the past 13 years.
- Major contributor to the past 3 capital campaigns at UPEI.
- Title sponsor for the Provincial Summer and Winter Games for the past 8 years.
- Corporate and Staff contributor to the United Way for the past 34 years.
- Provided funding to the Association of Exhibitions on an annual basis for the past 7 years. This donation is allocated to all the various exhibitions across PEI.



- Sponsorship of the Eric MacEwen show on CFCY radio for the past 4 years.
- Sponsorship of Community Showcase on Eastlink TV for 10 years.
- Published an Island Scenes calendar annually for the past 7 years. Amateur photos are obtained through a photo contest. We have printed 20,000 calendars annually and distributed them to our policyholders, schools, hospitals, manors and seniors housing.
- Annual donations to fire departments for the past 26 years.
- Annual donations to Sports PEI and The Sports Hall of Fame.

PEI Mutual has been a “Top 101 Company in Atlantic Canada “ for the past 8 years, as awarded by Progress Corp.

PEI Mutual is an Island Company owned by its policyholders with its head office on PEI. Decisions are made promptly on PEI. We are in the business of providing service to our policyholders and it’s our goal to give excellent service in an efficient manner. I thank our agents and staff for their hard work in achieving this goal.

Thank you for choosing PEI Mutual as your insurance provider.

Terry Shea
General Manager

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, 2005 and the statements of earnings 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, 2005 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.
February 1, 2006

Grant Thornton LLP
Chartered Accountants



STATEMENT OF EARNINGS

Year Ended December 31

Underwriting Income	2005	2004
Gross premiums written	\$ 12,359,769	\$ 11,329,131
Reinsurance premiums assumed (Note 8)	34,144	36,569
Reinsurance premiums ceded (Note 8)	<u>(1,678,911)</u>	<u>(1,481,447)</u>
Net premiums written	10,715,002	9,884,253
Less: increase in unearned premiums	675,162	424,255
Net premiums earned	<u>10,039,840</u>	<u>9,459,998</u>
Claims and expenses		
Gross claims incurred	5,418,353	6,885,661
Adjusting, legal and appraisals	604,015	765,506
Less: reinsurance recoveries	<u>459,218</u>	<u>1,133,724</u>
Net claims and adjusting	5,563,150	6,517,443
Advertising	118,408	111,737
Canada pension plan	65,357	60,999
Conventions, courses and travel	69,965	82,342
Depreciation	72,537	51,009
Directors fee	178,773	165,155
Donations	65,300	61,900
Employment insurance	35,625	34,216
Fire prevention tax	123,598	113,291
Group insurance	84,846	137,652
Loss prevention	110,046	101,283
Office supplies	89,550	68,179
Other administration costs	154,776	153,712
Postage	100,766	107,318
Premium acquisition expenses	1,559,018	1,465,768
Professional fees	32,313	16,919
Salaries	979,752	887,408
Taxes, dues and licences	37,272	39,138
Telephone	45,683	45,579
	<u>9,486,735</u>	<u>10,221,048</u>
Net underwriting earnings (loss)	<u>553,105</u>	<u>(761,050)</u>
Other income		
Net investment income (Note 6)	2,395,575	2,223,691
(Loss) gain on sale of fixed assets	(18,017)	10,336
Miscellaneous	<u>38,966</u>	<u>22,276</u>
	<u>2,416,524</u>	<u>2,256,303</u>
Earnings before income taxes	2,969,629	1,495,253
Income taxes (Note 9) - Current	698,125	274,936
- Future	<u>(114,216)</u>	<u>11,342</u>
Net earnings	<u>\$ 2,385,720</u>	<u>\$ 1,208,975</u>

See accompanying notes to the financial statements.



BALANCE SHEET

December 31

Assets	2005	2004
Cash and short term deposits	\$ 1,534,440	\$ 833,228
Receivables (Note 3)	1,136,863	988,977
Income tax receivable	-	215,947
Prepaid items	23,279	16,814
Deferred premium acquisition expenses	806,665	735,779
Reinsurers' share of provision for unpaid claims and adjustment expenses	1,555,285	2,262,413
Investments (Note 4)	34,131,853	31,245,841
Property and equipment (Note 5)	512,314	505,458
Future income taxes	228,732	114,516
	<u>\$39,929,431</u>	<u>\$36,918,973</u>

Liabilities

Payables and accruals	\$ 253,810	\$ 288,568
Income tax payable	426,541	-
Provision for unpaid claims and adjusting expenses	5,030,250	5,472,457
Unearned premiums	6,958,343	6,283,181
	<u>12,668,944</u>	<u>12,044,206</u>

Equity

Policyholders' security fund, beginning of year	24,874,767	23,665,792
Net earnings	2,385,720	1,208,975
Policyholders' security fund, end of year	27,260,487	24,874,767
	<u>\$39,929,431</u>	<u>\$36,918,973</u>

See accompanying notes to the financial statements.



PROTECTING EACH OTHER
SINCE 1885



**STATEMENT OF
CASH FLOWS**
Year ended December 31

	<u>2005</u>	<u>2004</u>
Increase (decrease) in cash and cash equivalents		
Operating		
Net earnings	\$ 2,385,720	\$ 1,208,975
Depreciation	86,401	70,112
Bond premium amortized	50,907	88,319
Gain on sale of investments	(500,367)	(401,494)
Loss (gain) on sale of equipment	18,017	(10,336)
Future income taxes	<u>(114,216)</u>	<u>11,342</u>
	1,926,462	966,918
 Change in non-cash operating working capital (Note 7)	 <u>1,322,576</u>	 <u>808,286</u>
	3,249,038	1,775,204
 Investing		
Purchase of property and equipment	(120,254)	(104,393)
Proceeds on disposal of bonds & equities	4,997,780	3,672,672
Purchase of bonds and equities	(7,434,332)	(5,577,933)
Proceeds on disposal of property and equipment	<u>8,980</u>	<u>18,394</u>
	(2,547,826)	(1,991,260)
 Net increase (decrease) in cash and cash equivalents	 701,212	 (216,056)
Cash and cash equivalents, beginning of year	<u>833,228</u>	<u>1,049,284</u>
Cash and cash equivalents, end of year	<u>\$ 1,534,440</u>	<u>\$ 833,228</u>

See accompanying notes to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

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 5.

Unearned premiums

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.

Investments

Investments in bonds and debentures are carried at amortized cost. Premiums or discounts incurred on the purchase of bonds and debentures are amortized over the remaining life of the investment. Equities are carried at cost. Gains or losses arising from the disposition of bonds and debentures sold prior to maturity are recognized at the time of sale.

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.

3. Receivables

	<u>2005</u>	<u>2004</u>
Policyholders for premiums	\$ 742,567	\$ 532,038
Accrued interest	378,336	440,341
Other	<u>15,960</u>	<u>16,598</u>
	<u>\$ 1,136,863</u>	<u>\$ 988,977</u>



4. Investments

	2005		2004	
	Cost	Market Value	Cost	Market Value
Term deposits and GIC's	<u>\$1,800,000</u>	<u>\$1,800,000</u>	<u>\$1,326,138</u>	<u>\$1,326,138</u>
Bonds at par less unamortized purchase discounts and premiums				
Federal	1,101,473	1,184,319	1,411,748	1,530,820
Provincial	15,813,606	17,908,175	15,897,217	17,940,002
Municipal	2,666,017	2,882,581	2,369,340	2,565,448
Corporate	7,027,751	7,306,638	4,624,813	4,987,250
Total bonds	<u>26,608,847</u>	<u>29,281,713</u>	<u>24,303,118</u>	<u>27,023,520</u>
Equities - Canadian				
Common stock	<u>4,328,705</u>	<u>5,414,619</u>	<u>4,285,491</u>	<u>4,960,099</u>
Equities - US				
Common stock	<u>1,394,301</u>	<u>1,307,117</u>	<u>1,331,094</u>	<u>1,156,718</u>
Total	<u>\$34,131,853</u>	<u>\$37,803,449</u>	<u>\$31,245,841</u>	<u>\$34,466,475</u>

Bonds and term deposits - maturity profile

	Within 1 Year	1 to 5 Years	5 to 10 Years	10 to 20 Years	Book Value
Bonds	\$ 2,142,947	\$7,818,850	\$12,358,193	\$4,288,857	\$26,608,847
Term deposits	<u>440,000</u>	<u>1,360,000</u>			<u>1,800,000</u>
Total	<u>\$2,582,947</u>	<u>\$9,178,850</u>	<u>\$12,358,193</u>	<u>\$4,288,857</u>	<u>\$28,408,847</u>
Percent of total	9%	32%	44%	15%	100%

5. Property and equipment

	Rate	Cost	Accumulated Depreciation	2005 Net Book Value	2004 Net Book Value
Land		\$132,097	-	<u>\$132,097</u>	\$132,097
Building	5%	455,953	\$248,038	<u>207,915</u>	215,467
Office equipment	20%	166,435	111,417	<u>55,018</u>	39,969
Computer equipment	30%, 45%	171,927	112,351	<u>59,576</u>	55,548
Motor vehicle	30%	116,994	64,023	<u>52,971</u>	57,229
Parking lot	8%	13,715	8,978	<u>4,737</u>	5,148
		<u>\$1,057,121</u>	<u>\$544,807</u>	<u>\$512,314</u>	<u>\$505,458</u>

6. Investment income

	2005	2004
Interest from bonds and short term deposits	<u>\$1,673,340</u>	\$1,655,553
Dividend income	<u>221,868</u>	166,644
Gain on sale of investments	<u>500,367</u>	401,494
	<u>\$2,395,575</u>	<u>\$2,223,691</u>

7. Change in non-cash operating working capital

	2005	2004
Receivables	\$ (147,886)	\$ 2,572
Prepaid expenses	(6,465)	(5,371)
Deferred premium acquisition expenses	(70,886)	11,091
Reinsurers' share of provision for unpaid claims	707,128	807,600
Payables and accruals	(34,758)	16,739
Income tax receivable/payable	642,488	(599,689)
Unpaid claims	(442,207)	151,089
Unearned premiums	675,162	424,255
	<u>\$ 1,322,576</u>	<u>\$ 808,286</u>
Income taxes paid	<u>\$ 271,584</u>	<u>\$ 874,625</u>

8. Reinsurance

All reinsurance is ceded and assumed from Farm Mutual Reinsurance Plan Inc., a mutual reinsurer 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 and 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 100% of the Company's earned premium.

Reinsurance assumed

The Company is participating as a reinsurer 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 reinsurer 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.

9. Income taxes

Forty four percent (44%) 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.

10. Pensions

The Company has a defined contribution plan providing pension, to all of its employees. The total plan expense for the Company's defined contribution plan for all of 2005 was \$68,497 (2004: \$77,652).

11. Financial instruments

The Company's financial instruments consist of cash, receivables, long-term investments, and payables. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximate their carrying values, unless otherwise noted.

CLAIMS MANAGER

Blair Campbell

Summerside

SAFETY SURVEYOR

Franklin Sanderson

Warren Grove

AGENTS

Cam Trail

Tignish

Jane MacLaurin

Grand River

Philip MacDonald

Margate

Myles Grady

South Freetown

Bruce Simpson

Bayview

Darren Baglole

Kinkora

Paul Power

Cornwall

Tom Kickham

Souris

David MacAdam

Morell

Peter Johnston

Kinlock

David Walsh

Summerville

Janice Taylor

Montague



**SUMMARY OF EXPERIENCE
FOR PREVIOUS TEN YEARS**

YEAR	NET PREM. EARNED	NET CLAIMS INCURRED	OTHER EXPENSES	INVESTMENT REVENUE	*MUTUAL REBATE	INCOME TAX	NET INCOME	SURPLUS
1996	6,768,726	3,915,799	2,708,109	1,630,315	12%	312,290	1,462,843	14,020,777
1997	6,633,993	4,653,254	2,604,648	2,785,462	12%	513,752	1,647,801	15,668,578
1998	6,756,012	3,994,700	2,824,784	2,723,872	14%	562,990	2,097,410	17,765,988
1999	7,031,890	5,203,445	2,971,602	2,616,524	14%	324,517	1,148,850	18,914,838
2000	6,971,952	3,911,576	3,185,892	2,786,154	26%	306,017	1,383,996	20,298,834
2001	7,502,128	6,210,218	3,204,460	2,607,342	14%	62,250	757,042	21,055,876
2002	7,807,469	6,000,153	3,274,046	2,620,001	10%	257,983	895,288	21,951,164
2003	8,651,818	5,313,350	3,478,783	2,530,329	10%	675,386	1,714,628	23,665,792
2004	9,459,998	6,517,443	3,703,605	2,256,303	5%	286,278	1,208,975	24,874,767
2005	10,039,840	5,563,150	3,923,585	2,416,524	10%	583,909	2,385,720	27,260,487

* A Mutual Rebate is given as a discount in the Policyholder's annual premium effective upon the annual renewal of the policy. The Mutual Rebate is based on the Company's financial performance each year and takes effect on May 1st of the following year.