

AYR FARMERS MUTUAL INSURANCE COMPANY

**FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2010**



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**MANAGEMENT RESPONSIBILITY FOR FINANCIAL REPORTING
DECEMBER 31, 2010**

The accompanying financial statements and all other information contained in this annual report are the responsibility of the management of Ayr Farmers Mutual Insurance Company. The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles including the accounting requirements of the Financial Services Commission of Ontario and have been approved by the Board of Directors.

Preparation of financial information is an integral part of management's broader responsibilities for the ongoing operations of Ayr Farmers Mutual Insurance Company, which includes adherence by all employees to the company's Code of Conduct. Management maintains a system of internal accounting controls to provide reasonable assurance that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial information. Such information also includes data based on management's best estimates and judgments.

The Audit Committee and the Board of Directors review and approve the annual financial statements. In addition, the Audit Committee meets periodically with financial officers of Ayr Farmers Mutual Insurance Company and the external auditors, and reports to the Board of Directors thereon. The Audit Committee and Board of Directors also review the annual report in its entirety.

The accompanying financial statements have been audited by Graham Mathew Professional Corporation, authorized to practice public accounting by The Institute of Chartered Accountants of Ontario, who are engaged by the Board of Directors and whose appointment was ratified at the annual meeting of the policyholders. The auditors have access to the Audit Committee, without management present, to discuss the results of their work. Their report dated January 19, 2011 expresses their unqualified opinion on the Company's 2010 financial statements.

A handwritten signature in black ink, appearing to read 'Donald J. Davidson'.

Donald J. Davidson, CIP
President & CEO

A handwritten signature in black ink, appearing to read 'David Paterson'.

David Paterson, BBA
Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

To the Policyholders of
Ayr Farmers Mutual Insurance Company

We have audited the accompanying financial statements of **Ayr Farmers Mutual Insurance Company**, which comprise the statement of financial position as at December 31, 2010, and the statements of income, policyholders' equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of **Ayr Farmers Mutual Insurance Company** as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.



Cambridge, Ontario
January 19, 2011

CHARTERED ACCOUNTANTS, authorized to practice public
accounting by The Institute of Chartered Accountants of Ontario



AYR FARMERS MUTUAL INSURANCE COMPANY

**FINANCIAL POSITION
DECEMBER 31, 2010**

	2010 \$	2009 \$
ASSETS		
Cash and investments (note 4 and 5)	45,111,648	41,945,725
Premiums receivable	4,165,557	3,787,770
Receivable from Facility Association	18,460	33,430
Income taxes recoverable	98,103	
Reinsurer's share of provision for unpaid claims (note 7)	5,824,677	6,431,720
Future income taxes	104,545	172,225
Deferred policy acquisition expenses	1,067,973	1,002,229
Capital assets (note 6)	2,219,158	2,029,163
	58,610,121	55,402,262
LIABILITIES		
Provision for unpaid claims (note 7)	19,817,641	20,757,147
Unearned premiums	9,504,869	8,736,309
Accounts payable and accrued liabilities	607,417	992,447
Income taxes payable		1,117,457
Provision for refund from surplus	785,000	406,000
	30,714,927	32,009,360
POLICYHOLDERS' EQUITY		
Policyholders' equity (page 5)	27,402,871	24,091,317
Accumulated other comprehensive income (loss) (page 5)	492,323	(698,415)
	27,895,194	23,392,902
	58,610,121	55,402,262

APPROVED BY THE BOARD:

Director

Director

**AYR FARMERS MUTUAL INSURANCE COMPANY****STATEMENT OF INCOME
YEAR ENDED DECEMBER 31, 2010**

	2010 \$	2009 \$
Gross premiums written	19,696,364	18,192,741
Deduct		
Reinsurance premiums	2,735,811	3,210,263
Increase in reserve for unearned premiums	768,560	1,055,780
	3,504,371	4,266,043
Net premiums earned	16,191,993	13,926,698
Service charge revenue	255,084	232,380
Net underwriting revenue	16,447,077	14,159,078
Claims and expenses		
Claims incurred, net of reinsurance recoveries	6,553,634	7,352,256
Adjusting expenses, net	644,535	613,763
Agents' and brokers' commissions	2,205,704	1,939,859
Salaries, fees and employee development (page 18)	2,209,145	1,637,096
General (page 18)	1,419,378	1,008,745
	13,032,396	12,551,719
Underwriting profit	3,414,681	1,607,359
Other revenue (expense)		
Investment income	1,520,084	1,355,428
Profit (loss) for year, subsidiary company	(153,470)	7,304
Refund from surplus	(765,506)	(397,157)
Income tax expense	(704,235)	(523,961)
	(103,127)	441,614
Net income for year	3,311,554	2,048,973

The explanatory financial notes form an integral part of these financial statements.

**AYR FARMERS MUTUAL INSURANCE COMPANY****STATEMENT OF POLICYHOLDERS' EQUITY
YEAR ENDED DECEMBER 31, 2010**

	Policyholders' Equity	Accumulated Other Comprehensive Income (Loss)	2010	2009
	\$	\$	\$	\$
Balance at beginning of year	24,091,317	(698,415)	23,392,902	18,626,212
Comprehensive income:				
Net income for year	3,311,554		3,311,554	2,048,973
Realized losses transferred to net income		368,742	368,742	19,565
Unrealized gains on available-for-sale investments		1,071,996	1,071,996	3,538,752
Income tax expense		(250,000)	(250,000)	(840,600)
Comprehensive income	3,311,554	1,190,738	4,502,292	4,766,690
Balance at end of year	27,402,871	492,323	27,895,194	23,392,902

The explanatory financial notes form an integral part of these financial statements.

**AYR FARMERS MUTUAL INSURANCE COMPANY****STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2010**

	2010 \$	2009 \$
Cash flows from operating activities:		
Net income from operations	3,311,554	2,048,973
Items not involving cash:		
Amortization, capital assets	194,210	158,639
Amortization, bonds	27,425	22,404
Future income taxes	67,680	45,810
(Profit) loss of subsidiary company	153,470	(7,304)
Unrealized losses on held-for-trading investments	(110,354)	(133,022)
	3,643,985	2,135,500
Net change in non-cash working capital balances relating to operations:		
Unearned premiums	768,560	1,055,781
Reinsurer's share of provision for unpaid claims	607,043	564,606
Provision for unpaid claims	(939,506)	(1,795,773)
Other payables	(1,600,590)	2,237,445
Receivables, premiums and other	(362,817)	(529,970)
Deferred policy acquisition expenses	(65,744)	(133,109)
Investment income due and accrued	3,591	(34,602)
Recognized loss (gain) on investments	101,436	(157,415)
	2,155,958	3,342,463
Cash flows from investment activities:		
Proceeds from sale of investments	15,318,224	16,763,293
Purchase of investments	(19,089,998)	(19,562,318)
Net additions to capital assets	(384,205)	(96,874)
	(4,155,979)	(2,895,899)
Cash flows from equity activities:		
Provision for refund from surplus, net change	379,000	56,000
Current income tax expense	(250,000)	(840,600)
	129,000	(784,600)
Decrease in cash during year	(1,871,021)	(338,036)
Cash, beginning of year	6,648,311	6,986,347
Cash, end of year (notes 4 and 10)	4,777,290	6,648,311

The explanatory financial notes form an integral part of these financial statements.



1. General

The company was incorporated without share capital on December 13, 1893 under the laws of the Province of Ontario as a mutual insurance company and is subject to the Ontario Insurance Act. It is licensed to conduct its principal business activity which is to write property, liability and automobile insurance in Ontario. The business risk of insurance resides in pricing the product, in management of investment funds, and in the estimation of claim costs. Ongoing management practices and policies of the company in underwriting, claims and investment activities control the risk exposure.

To mitigate some of this risk, the company follows the policy of underwriting and reinsuring contracts of insurance which, in the main, limit the liability of the company to a maximum amount on any one claim of \$370,000 in the event of liability and automobile claims, \$415,000 in the event of property claims and \$1,050,000 plus 5% of the excess for property catastrophe. The reinsurance treaties also contain a "stop-loss" provision which limits the company's total liability from claims occurring in the year.

Because the company writes automobile insurance, it is required to participate in the Facility Association for high risk insureds.

2. Summary of Significant Accounting Policies

This summary of the major accounting policies of the company conform with those generally accepted in Canada and comply with the requirements for filing with the Financial Services Commission of Ontario. These policies have been followed consistently, in all material respects, for the periods covered and require management to make estimates and assumptions that affect reported amounts of assets, liabilities, income and expenses. Actual results could differ from those estimates.

(a) Investments

The company is required to classify its investments as a) held-to-maturity, b) held-for-trading, or c) available-for-sale.

Its investments in government debt securities, which are classified as held-to-maturity, are recorded at amortized cost with discounts and premiums being amortized to income using the effective yield method over the period to maturity. Investments in common and preferred shares and corporate debt securities, which are classified as held-for-trading or available-for-sale, are recorded at fair value. Realized gains or losses on both of these classes of investments are reported as investment income in the statement of income.

Unrealized gains or losses of the held-for-trading investments are reported as investment income in the statement of income. Unrealized gains or losses of the available-for-sale investments are reported as other comprehensive income in the statement of policyholders' equity.



2. Summary of Significant Accounting Policies (Continued)

(b) Premiums earned and deferred policy acquisition expenses

Insurance premiums are included in income on a prorata basis over the life on the policies. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums.

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

Premiums receivable are recorded at amounts due less any required provision for doubtful amounts.

(c) Reinsurance

The company reflects reinsurance balances on the 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 income and policyholders' equity 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 obligations under the reinsurance agreements. The company ascertained that no provision is necessary at December 31 for doubtful collection of reinsurance recoveries.

(d) Unpaid claims

Individual loss estimates are provided on each claim reported. In addition, provisions are made for adjustment expenses, changes in reported claims and for claims incurred but not reported, based on past experience and business in force. The estimates are regularly reviewed and updated and any resulting adjustments are included in current income.

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.

(e) Capital assets

The building, furniture and fixtures, computer equipment and automobile are stated at cost less accumulated amortization. Amortization is provided in order to write off these assets over their expected useful lives using the following rates and methods:

Building	4%	declining-balance
Furniture and fixtures	5 years	straight-line
Computer equipment	3 years	straight-line
Automobiles	30%	declining-balance



2. Summary of Significant Accounting Policies (Continued)

(f) 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.

(g) Contingent liabilities

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

(h) Future income taxes

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

(i) Financial instruments and comprehensive income

The company's financial instruments consist of cash and investments, amounts receivable, and amounts payable. Unless otherwise noted, it is management's opinion that the company is not exposed to significant credit, market or liquidity risks arising from these financial instruments (note 14). The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

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

3. Role of the Actuary and Auditors

The actuary is retained by the company's Board of Directors to review the claims liability, in particular the IBNR reserves. The actuary's responsibility is to carry out an annual valuation of the company's provision for unpaid claims in accordance with accepted actuarial practices and report thereon to the company. In performing the valuation, the actuary makes assumptions as to the future loss ratios, trends, future rates of claims frequency and severity, inflation and both internal and external adjustment expenses, taking into consideration the circumstances of the company. The actuary also makes use of the work of the external auditor in his verification of the underlying data used in the valuation. The actuary's report outlines the scope of his work and recommendation.

The external auditors have been appointed by the company to conduct an independent and objective audit of the financial statements of the company in accordance with Canadian generally accepted auditing standards and report thereon to the company. In carrying out their audit, the auditors also make use of the work of the actuary and his report on the company's provision for unpaid claims. The auditors' report outlines the scope of their audit and their opinion.



**EXPLANATORY FINANCIAL NOTES
YEAR ENDED DECEMBER 31, 2010**

4. Investment Information

The book values and market values on cash and investments as at December 31 were as follows:

	2010		2009	
	<u>Book value</u>	<u>Market value</u>	<u>Book value</u>	<u>Market value</u>
	\$	\$	\$	\$
Cash	4,777,290	4,777,290	6,648,311	6,648,311
Debt securities	27,361,161	27,548,636	23,115,052	23,179,026
Preferred shares	171,239	171,239	437,306	437,306
Common shares	12,479,247	12,479,247	11,265,284	11,265,281
Subsidiary company (note 9)	193,843	193,843	347,313	347,313
Accrued interest	128,868	128,868	132,459	132,459
	45,111,648	45,299,123	41,945,725	42,009,696

The market value of the debt securities and preferred and common shares is based on quoted market values.

	2010	2009
	\$	\$
The debt securities mature as follows:		
Within 1 year	1,981,243	1,621,217
Over 1 to 5 years	9,227,969	5,707,948
Over 5 years	16,151,949	15,785,887
	27,361,161	23,115,052

The effective investment yield for the year is 3.6% (3.6% for 2009).

The book value of the investments is shown in the following tables categorized by available-for-sale, held-for-trading and held-to-maturity. Book values are equal to their fair values. The maximum exposure to credit risk would be the fair value indicated.

Available-for-Sale

	2010		2009	
	<u>Cost</u>	<u>Fair value (Book value)</u>	<u>Cost</u>	<u>Fair value (Book value)</u>
	\$	\$	\$	\$
Debt securities:				
Corporate				
A or better	6,066,795	6,459,953	6,806,865	7,219,132
Below A	996,058	1,004,789	1,035,924	1,011,647
Pooled funds	11,594,773	11,681,095	7,979,987	7,979,987
Guarantee fund	43,795	43,795	42,560	42,560
	18,701,421	19,189,632	15,865,336	16,253,326



EXPLANATORY FINANCIAL NOTES
YEAR ENDED DECEMBER 31, 2010

4. Investment Information (Continued)

Available-for-Sale (Continued)

	2010		2009	
	Cost	Fair value (Book value)	Cost	Fair value (Book value)
	\$	\$	\$	\$
Equity investments:				
Canadian common	11,556,412	11,572,861	10,987,485	10,197,272
Canadian preferred	180,698	171,239	447,979	437,306
U.S. equities	883,663	906,386	1,577,924	1,068,012
	12,620,773	12,650,486	13,013,388	11,702,590
Total available-for-sale	31,322,194	31,840,118	28,878,724	27,955,916

Held-for-Trading

Debt securities:				
Linked notes	2,751,178	2,850,802	2,151,182	2,140,448

Held-to-Maturity

Debt securities:				
Provincial	4,454,556	4,454,556	3,800,574	3,800,574
Municipal	866,171	866,171	920,704	920,704
	5,320,727	5,320,727	4,721,278	4,721,278

5. Disclosures Relating to Fair Value Measurements

In compliance with Handbook Section 3862, the company has categorized its assets that are carried at fair value (which is book value) on a recurring basis, based on the priority of the inputs to the valuation techniques used to measure fair value, into a three level fair value hierarchy. Financial assets measured at fair value are categorized as follows:

Level 1: Fair value is based on unadjusted quoted prices for identical assets in an active market.

Level 2: Fair value is based on quoted prices for similar assets in active markets, valuation that is based on significant observable inputs or inputs that are derived principally for or corroborated with observable market data through correlation or other means.

Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs or the use of broker quotes. These unobservable inputs reflect the company's assumptions about the assumptions market participants would use in pricing the assets.



**EXPLANATORY FINANCIAL NOTES
YEAR ENDED DECEMBER 31, 2010**

5. Disclosures Relating to Fair Value Measurements (Continued)

	Level 1 \$	Level 2 \$	Level 3 \$	2010 Total \$
Assets				
Cash and cash equivalents	4,777,290			4,777,290
Bonds				
Corporate		7,464,742		7,464,742
Linked notes		2,850,802		2,850,802
Fire Mutual guarantee fund		43,795		43,795
Pooled funds				
Canadian fixed income		11,681,095		11,681,095
Canadian equity		1,030,879		1,030,879
U.S. equity		726,670		726,670
Equity investments				
Canadian	9,798,396		5,004	9,803,400
U.S.	179,716			179,716
Mutual funds		909,820		909,820
Total assets measured at fair value	14,755,402	24,707,803	5,004	39,468,209

	2010 \$	2009 \$
6. Capital Assets		
Cost		
Land and building	2,599,450	2,599,450
Furniture and fixtures	332,788	311,105
Computer equipment	737,697	450,967
Automobiles	142,225	101,690
	3,812,160	3,463,212
Accumulated amortization		
Building	807,228	738,971
Furniture and fixtures	269,276	269,233
Computer equipment	477,868	397,515
Automobiles	38,630	28,330
	1,593,002	1,434,049
Net Book Value	2,219,158	2,029,163

The unamortized cost of capital assets available to reduce net income for income tax purposes amounts to approximately \$1,817,000 (\$1,850,000 in 2009).



**EXPLANATORY FINANCIAL NOTES
YEAR ENDED DECEMBER 31, 2010**

7. Provision for Unpaid Claims

The provision for unpaid claims and adjustment expenses and related reinsurers' share are estimates subject to variability, which could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability 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 principally based on the company's historical experience, as well as other factors inherent with the current state of the insurance industry. Methods of estimation have been used which the company believes produce reasonable results given current information.

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

	2010	2009
	\$	\$
Property	1,099,957	505,918
Automobile	11,307,058	11,981,776
Liability	1,585,949	1,837,733
Net position	13,992,964	14,325,427

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

Gross provision	19,817,641	20,757,147
Deduction for reinsurance ceded	5,824,677	6,431,720
Net position	13,992,964	14,325,427

8. Pension Plan

The company participates in a multiemployer pension plan through the Ontario Mutual Insurance Association. The plan is a defined benefit pension plan for the employees for which the company made contributions during the year on their behalf in the amount of \$129,332 and a defined contribution pension plan for the sales agents for which the company made contributions during the year on their behalf in the amount of \$54,288.

The most recent actuarial valuation of the defined benefit plan on December 31, 2009 indicated that the plan was in a deficit position. As a result of that valuation, the company was required to make a lump sum additional contribution in 2010 on behalf of the employees in the amount of \$360,672.

Since the company makes up for any funding deficits and discontinues contributions when there is a funding surplus as a result of an actuarial valuation, no accrued assets or liabilities of the defined benefit plan are included in the financial position.



**EXPLANATORY FINANCIAL NOTES
YEAR ENDED DECEMBER 31, 2010**

9. Non-Consolidated Financial Statements

The operations of Ayr Farmers Financial Services Inc., a wholly-owned subsidiary of this company, have not been consolidated with these financial statements in order to comply with the accounting requirements of the Financial Services Commission of Ontario and because consolidation would not provide a more informative presentation.

The investment in Ayr Farmers Financial Services Inc. recorded on the non-consolidated, equity basis amounting to \$193,843 (\$347,313 in 2009) reflects the capital investment of \$300,300 for 300,300 common shares less accumulated after tax losses of the subsidiary amounting to \$106,457 through 2010 (\$47,013 income through 2009).

	2010 \$	2009 \$
10. Statement of Cash Flows		
Cash paid relating to income taxes	2,283,298	64,800
Cash received relating to income taxes	145,607	707,070

11. Income Taxes

As a result of provisions in the Income Tax Act the company is liable for income taxes on that percentage of its taxable income that relates to non-farm insurance business written. This amounted to 73% of taxable income during the year.

12. Future Accounting Changes

The Canadian Accounting Standards Board confirmed in 2008 that the use of International Financial Reporting Standards ("IFRS") by publicly accountable enterprises will be required in 2011 with comparative data for the prior year. IFRS uses a conceptual framework similar to Canadian GAAP, but there could be significant differences in recognition, measurement and disclosures that will need to be addressed.

In order to prepare for the conversion to IFRS, the company has developed an IFRS Conversion Plan. The IFRS Conversion Plan is well underway with key IFRS standards analyzed and compared against the company's current Canadian GAAP policies. The key accounting policy alternatives have been identified including contract classification and first-time adoption of IFRS. The transition status is currently on track with the company's implementation schedule.



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. Reinsurance is utilized to protect capital from catastrophic losses as the frequency and severity of these losses are inherently unpredictable. To limit their potential impact, catastrophe coverage limits Ayr Farmers Mutual Insurance Company exposure to \$1,050,000 plus 5% of the remaining loss. The \$1,050,000 retained amount represents approximately 4% of company's capital. For the purpose of capital management, the company has defined capital as policyholders equity including accumulated other comprehensive income.

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, 2010 was 521% (462% at December 31, 2009).

14. Financial Instrument Risk Management

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 and corporate sector limits. The bond portfolio remains very high quality with 94% of the bonds rated A or better. All fixed income portfolios are measured for performance on a quarterly basis and monitored by management on a monthly basis.

Reinsurance is placed with Farm Mutual Reinsurance Plan Inc. (FMRP), a Canadian registered reinsurer. Management monitors the credit-worthiness 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.

Amounts receivables are short-term in nature and are not subject to material credit risk.

The maximum exposure to credit risk and concentration of this risk is outlined in note 2(i).

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



**EXPLANATORY FINANCIAL NOTES
YEAR ENDED DECEMBER 31, 2010**

14. Financial Instrument Risk Management (Continued)

Market risk

Market risk is the risk that the fair value of 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 Investment Committee and the Board of Directors. Diversification techniques are utilized to minimize risk. The policy limits the investment in any one corporate issuer to a maximum of 10% of the company's total assets.

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's foreign exchange risk is related to its stock holdings. The company limits its holdings in foreign equity to 10% of investments in accordance with its investment policy. Foreign currency changes are monitored by the investment committee and holdings are adjusted when out of balance with its investment policy. A 1% change in the value of the United States dollar would affect the fair value of stocks and cash by approximately \$16,500, which would be reflected in net income or other comprehensive income.

There have been no significant changes from the previous period 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, which include treasury bills, guaranteed investment certificates and bonds.

Historical data and current information is used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. 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 gains or losses in other comprehensive income. There are no occurrences where interest would be charged on liabilities; therefore, little protection is needed to ensure the fair market value of assets will be offset by a similar change in liabilities due to an interest rate change.

The objective, policies and procedures for managing interest rate risk is to diversify the bond portfolio in such a way that the bonds portfolio are laddered over a period of years. This protects the company from fluctuations in the interest rates. At December 31, 2010, a 1% move in interest rates, with all other variables held constant, could impact the market value of bonds by approximately \$1,422,000.

There have been no significant changes from the previous period in the exposure to risk, nor any significant changes to policies, procedures and methods used to measure the risk.



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 stocks with fair values that move with the Toronto Stock Exchange Composite Index, United States stocks with fair values that move with the S&P 500 Index, and international stocks that move with financial markets in Europe, Australia and Far East. A 10% movement in the stock markets with all other variables held constant would have an estimated effect on the fair values of the company's Canadian common stocks and United States common stocks of approximately \$1,248,000. A 10% move in the fair value of the company's Canadian preferred stocks would have an impact of approximately \$17,100. For stocks that the company did not sell during the period, the change would be recognized in the asset value and in other comprehensive income. For stocks that the company did sell during the period, the change during the period and changes prior to the period would be recognized as net realized gains or losses in net income during the period.

The Investment Committee of the Board of Directors follows investment policies, procedures and processes for managing equity risk.

Liquidity Risk

Liquidity risk is the risk that the company will not be able to meet all cash outflow obligations as they come due. The company mitigates this risk by monitoring cash activities and expected outflows. The company's current liabilities arise as claims are made. The company does not have material liabilities that can be called unexpectedly at the demand of a lender or client, nor does it have material commitments for capital expenditures and there is no need for such expenditures in the normal course of business. Claim payments are funded by current operating cash flow including investment income.

There have been no significant changes from the previous period in the exposure to risk, nor significant changes in policies, procedures and methods used to measure the risk.

**AYR FARMERS MUTUAL INSURANCE COMPANY****SCHEDULES TO FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2010**

	2010 \$	2009 \$
Salaries, fees and employee development		
Salaries and benefits	1,934,410	1,402,226
Directors' fees	39,990	39,720
Professional fees	63,766	47,781
Employee development, travel and conventions	170,979	147,369
	2,209,145	1,637,096
General expenses		
Marketing and promotion	344,339	143,532
Bad debts	15,046	6,478
Bank charges and interest	13,480	10,009
Cleaning and repairs	75,227	64,973
Amortization, capital assets	168,287	138,681
Fire prevention expense, net	2,847	2,503
Fuel and hydro	33,974	32,000
Insurance	42,920	26,774
Licenses	28,316	25,236
Memberships	50,532	42,308
Municipal taxes	65,266	61,815
Postage and telephone	82,779	61,608
Premium and other taxes	29,891	30,469
Office and computer expense	312,312	235,363
Statistical service	69,304	61,269
Underwriting expenses	82,289	72,309
Facility Association, operating expenses and premium deficiency (recovery)	2,569	(6,582)
	1,419,378	1,008,745