ANNUAL REPORT

FINANCIAL STATEMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2018

2018

La Mutuelle des municipalités du Québec

15 ANS

PORTRAIT OF MMQ

PROFILE

La Mutuelle des municipalités du Québec (MMQ) was created in 2003 under the *Municipal Code of Québec* and the *Cities and Towns Act* to meet the specific property and casualty insurance needs of municipalities. The MMQ is wholly-owned by the municipalities, Regional County Municipalities (RCMs) and intermunicipal boards that constitute its Mutual Members.

The MMQ was born out of the Québec municipal sector's desire to be self-endowed with comprehensive and diversified long-term insurance. The MMQ distinguishes itself by its exclusive risk management program that results in fewer claims and more stable premiums.

MISSION

Enable Québec municipalities, RCMs and intermunicipal boards to take advantage of the mutual principle and coach them in the search and implementation of risk management measures so that, by reducing the risks associated with their activities, they can benefit from privileged access to insurance products adapted to their needs and under advantageous conditions.

VALUES

The MMQ's decisions and actions are guided by the following six values: transparency, respect, dynamism, equity, excellence and openness.

BROKER NETWORK

La Mutuelle des municipalités du Québec works in close collaboration with Ultima Group's network of member insurance brokers, who have more than 30 years of experience and expertise in the municipal insurance field. Thanks to the presence of these firms across Québec, all Mutual Members can enjoy the benefit of coverage that is fully adapted to their needs, while having privileged access to the best possible guidance and advice in effective risk management.

OUR GOVERNANCE PHILOSOPHY

The Mutual Members' Fundamental Authority

The philosophy underlying governance at *La Mutuelle des municipalités du Québec* rests upon the fundamental authority of its Mutual Members, who impart legitimacy and authority and to whom the Board of Directors must render an account of results.

Principles

In keeping with the mutualist culture, the philosophy of governance at *La Mutuelle des municipalités du Québec* is founded upon compliance with legislative requirements, regulations and standards, while drawing its strength from models of democracy, transparency, efficiency and vigilance.

Integrity

La Mutuelle des municipalités du Québec demands of its directors, management team and employees unwavering commitment to honesty, integrity and equity when they promote its services and conduct its overall business.

Sound Financial Management

To ensure its institutional dynamics and development, *La Mutuelle des municipalités du Québec* takes great care in looking after its decision-making procedures based upon sound financial management.

Risk Management

Risk is a day-to-day challenge underpinning institutional development. It is the mission of the Board of Directors to understand and approve strategies related to risk management, and it is up to the Directors to develop a dynamic and evolving environment, as well as appropriate policies and procedures.

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SERVING MUNICIPALITIES FOR 15 YEARS

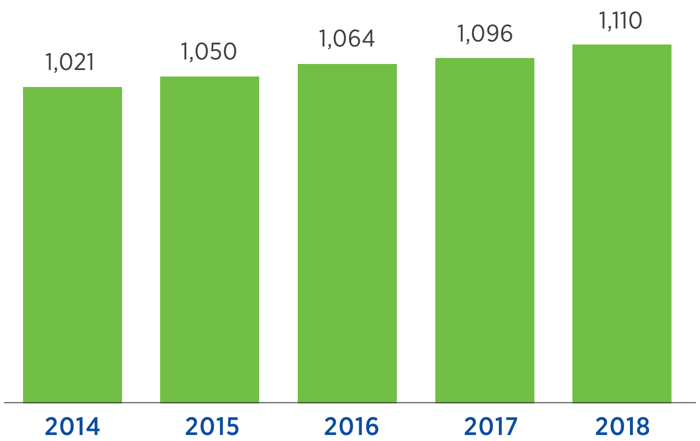
Created in 2003 by and for the municipal sector, *La Mutuelle des municipalités du Québec* (MMQ) has unequalled expertise in municipal property and casualty insurance, claim settlement and risk management.

Playing a dual role of both insurer and municipality, the MMQ allows its Mutual Members to enjoy numerous benefits that only the MMQ is in a position to offer. Fully attuned to the evolution of insurance market conditions, the preoccupations of municipalities, and to emerging risks, the MMQ is uniquely able to provide the municipal sector with the best possible support in meeting existing challenges and in guarding it against new risks.

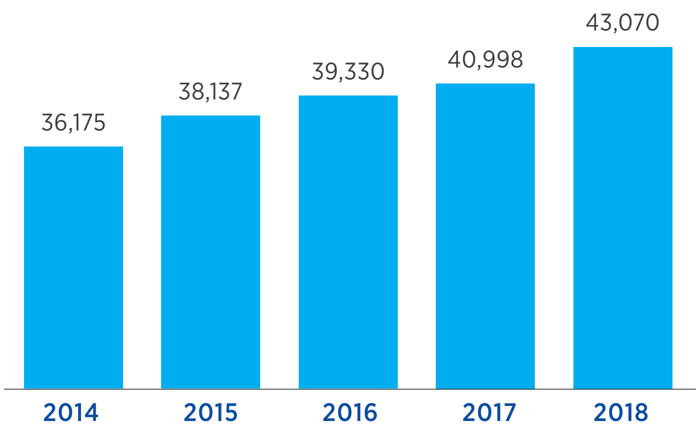
HIGHLIGHTS

FINANCIAL DATA

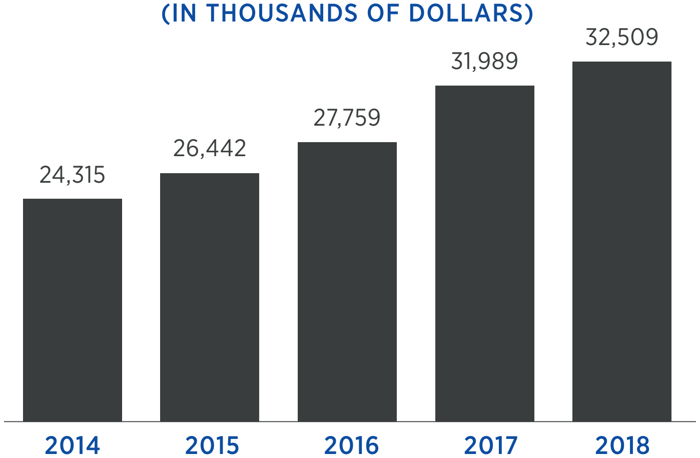
NUMBER OF MUTUAL MEMBERS



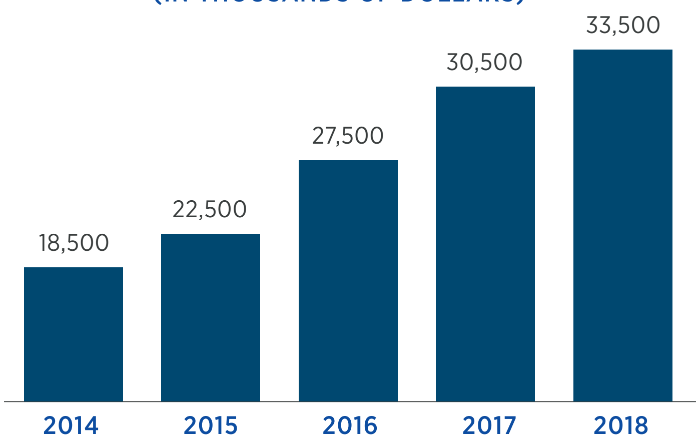
WRITTEN PREMIUMS (IN THOUSANDS OF DOLLARS)



MUTUAL MEMBERS EQUITY
(IN THOUSANDS OF DOLLARS)



EXPERIENCE REFUND PAID
(IN THOUSANDS OF DOLLARS)



HIGHTLIGHTS

MUTUAL MEMBERS' SERVICES

	2018	2017
TRAINING		
MMQ Training		
Number of Training Sessions	24	29
Number of Participants	981	654
Training in Partnership		
Number of Training Sessions	38	41
Number of Subsidized Participants	500	465
TOTAL		
Number of Training Sessions	62	70
Number of Participants	1,481	1,119
INSPECTIONS		
Fire and Premises Safety		
Number of Fire Safety and Site Inspections	193	167
Number of Building Inspections – Fire and Premises Safety	2,479	2,304
Thermal Imagery		
Number of Thermographic Inspections	119	183
Number of Buildings Inspected Using Thermal Imagery	1,236	2,054
Number of Electrical Installations Inspected Using Thermal Imagery	4,499	9,298
SUPPORT		
Number of Requests for Assistance and Analysis	1,333	1,316
LEGAL ASSISTANCE SERVICE		
Number of cases processed	546	520

MESSAGE

FROM THE CHAIRMAN OF THE BOARD

Mr. Jacques Demers

A PROUD HISTORY OF SUCCESS

The municipal sector should be proud of its decision in 2003 of creating the only property and casualty insurance mutual dedicated entirely to serving this sector. Serving as an indispensable partner to Québec municipalities, the MMQ has totally modified the environment in which municipal managers operate.

Indeed, one of the municipal sector's main concerns only a few years ago was to have access to insurance products to protect municipal activities without having to pay exponentially high premiums. Today, the municipal sector can count on the MMQ's effective support to its risk management, while guaranteeing access to insurance coverage adapted to its changing needs at the best possible cost.

Of course, such success attracts attention. Competition intensifies, boosted by potential gains. It is precisely for this reason that the municipal sector must continue to be engaged in the MMQ's development. As the organization belongs to all its members, the MMQ's financial results will always be of benefit to its members, and its members alone.

In that regard, once again, the Board of Directors approved the distribution of an experience refund of $3 million at the end of 2018. In fact, thanks to the organization's sound management practices and its structure as a mutual, it has distributed a total of $33.5 million in experience refunds to members since its creation.

15 YEARS – CAUSE FOR CELEBRATION!

Wanting to underline its 15th anniversary and to thank its members for their confidence and support, the MMQ undertook a number of actions in 2018 to mark this major milestone in its history. Among these was the *15 ans, ça se fête* contest, which would reward one municipality that has been a member for more than 10 consecutive years by receiving an award representing 15% of its gross annual premium paid in 2018 to accomplish risk management projects. The deserving winner of this competition was the municipality of Verchères, which has been a member of the MMQ since 2004. On behalf of the Board of Directors, I would like to thank Verchères for its longstanding commitment and to congratulate it on receiving this award.

SOLID FOUNDATIONS FOR A PROSPEROUS FUTURE

This past year, the Board of Directors pursued the development of a synergy with the main actor in the creation of the MMQ – the *Fédération québécoise des municipalités* (FQM). This consolidation has allowed the MMQ to gain a more accurate and detailed understanding of the municipal sector's needs, which, in turn, gave rise to the launch of an insurance product to cover legal costs related to discretionary power. This product is unique in Canada and is offered exclusively to municipalities.

Convinced of the many advantages it represents to the Québec municipalities to pool together their expertise, the Board of Directors have decided to further solidify the bonds that unite these two organizations. Thus, it has been decided that the CEO of the FQM, Mr. Sylvain Lepage, will also take on the role of acting CEO of the MMQ.

MESSAGE

FROM THE CHAIRMAN OF THE BOARD

“*La Mutuelle des municipalités du Québec* (MMQ) is proud to be marking 15 years of service to municipalities, RCMs and intermunicipal boards. The past decade and a half has been fuelled by innovation, collaboration and support. Through their firm commitment to reducing risks, our members continue to contribute day after day to promoting the MMQ’s advancement.”

Among the MMQ’s major projects for 2019 is the modernization of its computer infrastructures. Subsequent to the Board of Directors’s approval of the plan, preparatory work got underway in 2018. In order to support management and the Board of Directors in the identification of strategic orientations for the technologies to be implemented, the evaluation of technological options available, and the validation and approval of the information technologies master plan, a new advisory committee dedicated entirely to this matter has been created – the Technologies Committee.

Moreover, a committee devoted exclusively to the MMQ’s indemnity transactions has also been formed. Thus, the organization now has an Insurance Committee in place to look after underwriting activities, as well as the Compensation Committee focused on matters related to indemnification.

The past year also saw the Board of Directors approve the revision of the MMQ’s emergency measures plan, which involved the complete updating of information and simplification of decision-making processes. The plan is henceforth focused on the consequences of an event and includes manual procedures related to certain instrumental activities, as well as more realistic critical thresholds. Additional in-depth work has been planned for fiscal 2019.

ACKNOWLEDGEMENTS

To conclude, I would like to express my gratitude to Mr. Richard Lehoux, past Chairman of the Board, who provided his judicious support to Directors in exercising their mandate over the course of 2018. In contributing his vast experience, expertise and knowledge of the municipal sector, Mr. Lehoux enabled the MMQ to enrich its reflections, enhance its interventions, and to make more enlightened decisions.

I would also like to thank Mr. Bernard Deschamps who has helped improve the strategic vision of the new business model that the consolidation of the MMQ and the FQM has created. It is with great pleasure that the Board of Directors will continue to benefit from Mr. Deschamps’ expertise over the next few years by actively participating in the deliberation and further development of the insurance vision for the MMQ and the FQM.

I would also like to thank my colleagues – the members of the Board of Directors – who actively work hand-in-hand to make the MMQ the most pertinent, comprehensive and innovative solution to meeting the insurance needs of municipalities. By constantly putting the interests of members at the forefront of their considerations, Directors contribute invaluably to the continuous development and improvement of the MMQ. It is sincerely a great privilege to sit alongside these individuals on the Board of Directors.

Finally, I would like to underline the professional support and dedication of the members of our statutory and advisory Committees, whose contributions have been significant in our decision making.

Jacques Demers
Mayor of Sainte-Catherine-de-Hatley
Reeve of Memphrémagog

MESSAGE

FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Mr. Bernard Deschamps

SERVING MUNICIPALITIES FOR A DECADE AND A HALF

The year 2018 marked the MMQ's 15th anniversary. This milestone allowed us to reflect upon its creation in 2003 as the only mutual property and casualty insurance provider dedicated exclusively to the Québec municipal sector. At the time, municipalities were plagued with increasing insurance costs, making access to adequate coverage very difficult, if not impossible, for some of them.

Faced with these highly challenging conditions, municipalities decided to create their own mutual property and casualty insurer – the MMQ. In doing so, they provided themselves with an effective and concrete way to ensure long-term access to insurance coverage at the best possible price. In addition, they gained access to an exceptional ally to support them in the management of their claims and risks.

After 15 years of close ties with its members, the MMQ now possesses unparalleled expertise in the areas of property and casualty insurance, claim settlement and risk management. This expertise, combined with its extensive knowledge of evolving insurance market conditions, municipal concerns and emerging risks allow the MMQ to provide unequalled support to the municipal sector in preparing to confront new risks.

Property of its 1,110 members, the MMQ is in a position to allow them to enjoy the benefits of unmatched purchasing power in municipal property and casualty insurance.

A YEAR MARKED BY INNOVATION

Building on the strength of its vast expertise and knowledge of municipal issues, the MMQ demonstrated its innovativeness again in 2018 with the development of an insurance product that is unique in Canada – insurance covering legal fees related to exercising discretionary power. Offered free of charge to its members having subscribed to the Errors and Omissions benefit, this protection has no reimbursement limit and covers legal defence costs incurred in connection with a claim arising from decisions made in the discretionary sphere.

The MMQ has also launched a new optional benefit known as the Wrap-Up Liability coverage, which enables municipalities to enjoy complete protection for their different small-scale construction projects. The benefit protects against the major costs related to risks not covered on these types of municipal sites.

Furthermore, the MMQ has made 25 improvements to its *La Municipale*™ insurance policy, thus offering its members access to even more extensive coverage. Among the enhancements made to the policy are the withdrawal of the proportional rule, the addition of an involuntary errors and omissions clause, as well as the expansion of the "insured" definition in the Civil Liability section.

The past year also saw the MMQ undertake preparatory work for the modernization of its computer infrastructures and insurance software. A long-term endeavour, this project will be actively pursued throughout 2019.

MESSAGE

FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

“The fact that *La Mutuelle des municipalités du Québec* (MMQ) belongs to its members means that it is able to offer benefits that no other insurer can. Focusing on the objective of creating value for its members, the MMQ develops innovative products and services designed to meet the existing and emerging needs of municipalities. The organization’s success over the past 15 years is closely tied to its unique ability to effectively support its members in their activities. As such, it should come as no surprise that more than 99% of them renew their insurance contracts with the MMQ.”

UPDATING ITS IMAGE

The celebration of our 15th anniversary also served as the perfect occasion for the MMQ to update its image. In that regard, during the course of the past year, the organization undertook the design of a brand new logo that better represents the exceptional dynamism of its members, partners and personnel.

In addition, the organization’s new website went online at the end of the year after undergoing a complete makeover. The new site offers a more user-friendly navigation experience, while presenting enriched content that provides its members and brokers with ready access to personalized information.

As part of this rejuvenation initiative, the MMQ also took advantage of the opportunity to rethink its risk management competition. Henceforth, the contest known as the *Inspiration MMQ en gestion des risques 2019*, recognizes the outstanding commitment and efforts of its members in the area of risk management. During the course of the past year, the MMQ rewarded three of its members for their initiatives.

ENVIABLE FINANCIAL RESULTS

The MMQ posted excellent financial results once again this past fiscal year. As at December 31, 2018, gross written premiums totalled $43.1 million, up 5.1% from year-end 2017. This increase is due to the exceptional loyalty of Mutual Members, whose retention rate was at 99.6%, as well as to the addition of 18 new members in 2018.

Our technical results were also very satisfactory notably thanks to risk diversification and our members’ successful risk management efforts.

Our income for the year before experience refund to our Mutual Members equalled $3.5 million. After deducting the experience refund paid to Mutual Members, amounting to $3 million, we obtain net income and comprehensive income attributable to Mutual Members of $0.5 million at the end of December 31, 2018. This amount is added to Mutual Members’ equity, which totalled $32.5 million as at December 31, 2018.

A PRIVILEGE TO SERVE MUTUAL MEMBERS

In conclusion, I would like to take this opportunity to thank each and every MMQ member. Their commitment and confidence push us to be consistently rethinking our ways of doing things, while working to continuously improve our responsiveness to their needs. In 2018, the MMQ again demonstrated its ability to innovate, and the organization intends to pursue this approach going forward. Indeed, we are already focusing on a number of excellent development paths in accordance with the results of a survey conducted among our members last June. During the course of 2019, the MMQ will firmly pursue its efforts in this regard through various discussion sessions to be held with members.

Finally, I wish to thank all our collaborators and staff, who by way of their everyday actions, contribute to the fulfillment of our organization’s mission. Without them, the MMQ certainly could not have become the essential partner and preferred solution of municipalities in terms of municipal risk management.

Bernard Deschamps, M.A.P., CPA, CMA

GOVERNANCE

BOARD OF DIRECTORS

The Board of Directors is responsible for the MMQ's governance. It directs and oversees the organization's activities so as to ensure that they constantly serve the best interests of Mutual Members. The Board also works to assure the financial health, sound governance and long-term development of the MMQ.

JACQUES DEMERS

Chairman
Mayor of Sainte-Catherine-de-Hatley
Reeve of Memphrémagog

LOUIS-GEORGES SIMARD

Vice-Chairman
Mayor of Rivière-Ouelle

JACLIN BÉGIN

Director
Mayor of Sainte-Germaine-Boulé
Reeve of Abitibi-Ouest

JOCELYN COUTURE

Director
President and Chief Executive Officer of Tink

MARTIN DULAC

Director
Mayor of McMasterville

JONATHAN LAPIERRE

Director
Mayor of Îles-de-la-Madeleine

JACQUES LEFEBVRE

Director
Certified Administrator of Companies, teacher at Collège des Administrateurs de Sociétés and Companion of the Ordre des comptables professionnels agréés du Québec

ANDRÉ NORMANDIN

Director
Actuary and Founding Chairman of Normandin Actuaires

GUY SAINT-PIERRE

Director
Mayor of Manseau

RICHARD LEHOUX

Outgoing Chairman of the Board

NON-ELECTED OFFICERS

BERNARD DESCHAMPS

President and Chief Executive Officer of
La Mutuelle des municipalités du Québec

SYLVAIN LEPAGE

Board Secretary

GOVERNANCE

STATUTORY COMMITTEES

ETHICS AND GOVERNANCE

The Ethics and Governance Committee is mandated to assure that the MMQ rigorously respects the ethics and conflict of interest rules it has established to the highest possible standards.

In addition, the Committee has developed and implements a governance program that promotes a culture of democratic, effective and ethical administration in accordance with the mission and values of the MMQ. The Committee also closely monitors compensation programs, working conditions, strategy, policies and programs related to human resources management.

Members : Jacques Lefebvre (Chairman), Jocelyn Couture and Martin Dulac

AUDIT

The Audit Committee is responsible for reviewing the MMQ's financial statements and other financial information. It is also mandated to assure that proper accounting and actuarial practices are respected and to monitor external audit and appointed actuary activities. In addition, the Committee analyzes financial risk control and management mechanisms, and it ensures the effectiveness and respect of operational control measures. Finally, the Board has also given this Committee the mandate to oversee the MMQ's investment practices.

Members : André Normandin (Chairman), Arthur Gobeil, Louis-Georges Simard and Guy St-Pierre

ADVISORY COMMITTEES

INSURANCE

The Insurance Committee advises management and the Board on orientations to be adopted with respect to underwriting. In that regard, all modifications to underwriting practices and filed rates are submitted to the Committee, and it is informed of any addition to or cancellation of coverage by the MMQ. Moreover, the Committee ensures that underwriting files are managed in compliance with the MMQ's values. In the event of a suspension of benefits or cancellation of coverage, the Committee analyzes the files and assures the fairness of all decisions rendered.

Members : Martin Dulac (Chairman), Guy-Lin Beaudoin, Yves Corriveau, Serge Dufresne, Clément Filion, Sylvie Fortin Graham and Raymond Noël

MUTUAL MEMBERS' RISK MANAGEMENT

The mandate of the Mutual Members' Risk Management Committee consists of assisting senior management with the presentation of risk management orientations to the Board of Directors. To that end, the Committee determines the subjects to be prioritized with respect to risk management, approves the training programs to be presented to the Board, and it proposes appropriate risk management tools. The Committee also recommends the MMQ's level of intervention in legislative, regulatory, legal or other matters.

Members : Jaclin Bégin (Chairman), Jean-François Downing, Jean-Claude Dumas, Amélie Genois, Louise Labonté and Guillaume Lamoureux

COMPENSATION

The Compensation Committee advises management and the Board on orientations to be adopted in the area of compensation. In that regard, the Committee examines all changes affecting the Compensation Department's policies and directives. It also assures that claims are managed in accordance with the MMQ's values. In the event of a dispute related to the settlement of a claim or a denial of coverage, the Committee thoroughly reviews the file in question and assures the fairness of decisions rendered.

Members : Jonathan Lapierre (Chairman), Patrick Bousez, Michel Giroux, Louise Leclerc, Martin Rondeau and Francis St-Pierre.

TECHNOLOGIES

The mandate of the Technologies Committee is to provide management and the Board of Directors with recommendations regarding the MMQ's technological infrastructures in terms of investment, profitability, efficiency, security and quality. More specifically, the Committee proposes strategic orientations related to technologies to be implemented, evaluates available technological options, and it validates and approves the information technologies master plan. The Committee's primary objective is to support the MMQ in its technological transformation initiative, while assuring the continuity of its computer infrastructures.

Members : Jocelyn Couture (Chairman), Mario Alain and Dominique Chartier

MANAGEMENT'S RESPONSIBILITY

WITH RESPECT TO THE PRESENTATION OF FINANCIAL INFORMATION

The management of *La Mutuelle des municipalités du Québec* (MMQ) is responsible for the preparation and accurate presentation of its financial statements in accordance with International Financial Reporting Standards (IFRS).

In order to provide the most reliable and pertinent financial information, the MMQ maintains rigorous internal accounting and administrative control systems.

For its part, the Audit Committee examines the MMQ's financial statements before they are presented to the Board of Directors. The Committee also reviews the control and financial risk management mechanisms, and it ensures the effectiveness and respect of operational control measures. In addition, the Committee oversees the organization's investment strategies and ensures that proper accounting and actuarial practices are adhered to in prudent fashion.

The MMQ's financial statements have been audited on behalf of Mutual Members by the external audit firm KPMG LLP in accordance with Canadian generally accepted auditing standards. Subsequent to a call for tenders, this firm was recommended by the Board of Directors and selected for the fiscal periods from 2014 to 2018 inclusively during the Annual General Meeting of Mutual Members held in May 2014.

Policy and claims liabilities were certified by the appointed actuary, Mr. Michel Trudeau, FCIA, FCAS, of the firm Deloitte LLP in accordance with Canadian accepted actuarial practices. Mr. Trudeau was designated for the fiscal periods from 2018 to 2021 inclusively by the MMQ's Board of Directors at their meeting in September 2018 subsequent to a call for tenders.

The external auditors and appointed actuary had free access to the Audit Committee. Upon completion of their audit, they presented the conclusions of their analysis to members of the Committee.

After examination of the auditors' report, the Audit Committee recommended approval of the financial statements by the Board of Directors, which approved them at their meeting held on February 21, 2019.

The audited financial statements and related reports were then filed with the *Autorité des marchés financiers* (AMF).

Bernard Deschamps, M.A.P., CPA, CMA
President and chief executive officer

François Dufault, CPA, CA
Chief financial officer

INDEPENDENT AUDITOR'S REPORT

TO THE MUTUAL MEMBERS OF *LA MUTUELLE DES MUNICIPALITÉS DU QUÉBEC*

OPINION

We have audited the financial statements of *La Mutuelle des municipalités du Québec* (the Entity), which comprise:

- the statement of financial position as at December 31, 2018
- the statement of comprehensive income for the year then ended
- the statement of surplus and of Mutual Members' shares for the year then ended
- the statement of cash flows for the year then ended
- and notes to the financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2018, and financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

BASIS FOR OPINION

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the ***"Auditors' Responsibilities for the Audit of the Financial Statements"*** section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

RESPONSIBILITIES OF MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards (IFRS), 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.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

AUDITORS' RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

INDEPENDENT AUDITOR'S REPORT

TO THE MUTUAL MEMBERS OF *LA MUTUELLE DES MUNICIPALITÉS DU QUÉBEC*

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG LLP (signed)

February 21, 2019
Montréal, Canada

* FCPA auditor, FCA Public accountancy permit N° A110618

ACTUARY'S CERTIFICATE

I have valued the policy liabilities and reinsurance recoverable of *La Mutuelle des municipalités du Québec* (the "Insurer") for its statement of financial position at December 31, 2018 and their change in the statement of income for the year then ended in accordance with accepted actuarial practice in Canada, including selection of appropriate assumptions and methods.

I am satisfied that the data used for the valuation of the policy liabilities are reliable and sufficient and I have verified the consistency of the valuation data with the Insurer's financial records.

In my opinion, the amount of policy liabilities net of reinsurance recoverable makes appropriate provision for all policy obligations and the financial statements fairly present the results of the valuation.

Michel Trudeau, FCIA, FCAS
February 18, 2019
Montréal, Québec

STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31, 2018, WITH COMPARATIVE INFORMATION FOR 2017

	2018	2017
	$	$
REVENUES		
Written premiums		
Gross premiums	43,069,541	40,997,758
Ceded premiums	(6,069,972)	(6,218,396)
Net premiums (Note 10)	36,999,569	34,779,362
Net change in unearned premiums (Note 10)	(1,084,357)	(398,554)
Net earned premiums (Note 10)	35,915,212	34,380,808
Ceding commissions (Note 11)	13,971	2,885
Total revenues	**35,929,183**	34,383,693
POLICY BENEFITS AND EXPENSES		
Policyholders benefits and claims expenses (Note 6)	24,683,729	17,174,731
Ceded benefits and claims expenses (Note 6)	(3,815,567)	(1,523,610)
Policyholders benefits and claims expenses – net	20,868,162	15,651,121
Commissions (Note 7)	6,297,768	6,089,873
Mutual Members services (Notes 12 & 23)	1,691,473	1,943,740
Operating expenses (Notes 12 & 23)	4,875,469	4,652,205
Total policy benefits and expenses	**33,732,872**	28,336,939
Technical surplus	2,196,311	6,046,754
Investment income (Note 13)	1,305,554	1,142,617
Income for the year before experience refund to Mutual Members	**3,501,865**	7,189,371
Experience refund to Mutual Members (Note 14)	3,000,000	3,000,000
Experience refund to withdrawn Mutual Members (Note 14)	(16,703)	(37,076)
	2,983,297	2,962,924
Net income and comprehensive income attributable to Mutual Members	**518,568**	4,226,447

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

STATEMENT OF SURPLUS AND OF MUTUAL MEMBERS' SHARES

FOR THE YEAR ENDED DECEMBER 31, 2018, WITH COMPARATIVE INFORMATION FOR 2017

	2018	2017
	$	$
Surplus at beginning	31,879,143	27,652,296
Withdrawals of Mutual Members during the year (Note 15)	400	400
Net income and comprehensive income	518,568	4,226,447
Surplus at end	**32,398,111**	31,879,143
Mutual Members' shares at beginning	109,600	106,400
Contributions from Mutual Members during the year (Note 15)	1,800	3,600
Withdrawals of Mutual Members during the year (Note 15)	(400)	(400)
Mutual Members' shares at end	**111,000**	109,600
Total Mutual Members' equity	**32,509,111**	31,988,743

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

STATEMENT OF FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 2018, WITH COMPARATIVE INFORMATION FOR 2017

	2018	2017
	$	$
ASSETS		
Cash	4,743,042	2,947,940
Investments (Note 4)	61,553,406	58,938,939
Premiums receivable (Note 5)	13,736,672	13,025,717
Accounts receivable	352,159	222,664
Prepaid reinsurance premiums	1,395,791	1,387,188
Reinsurers’ share in claims and settlement expenses paid	569,806	1,042,349
Reinsurers’ share in the provision for unpaid claims and settlement expenses (Note 6)	10,519,826	9,461,421
Prepaid expenses	181,095	78,743
Deferred commissions costs (Note 7)	3,261,110	3,098,447
Fixed assets (Note 8)	253,295	305,534
Intangible assets (Note 9)	353,625	688,353
	96,919,827	91,197,295
LIABILITIES		
Provision for unpaid claims and settlement expenses (Note 6)	38,361,950	34,438,646
Unearned premiums (Note 10)	21,740,606	20,656,249
Unearned ceding commissions (Note 11)	12,387	3,903
Accounts payable and accrued expenses	1,144,964	940,444
Experience refund payable to Mutual Members (Note 14)	3,000,000	3,000,000
Deferred lease obligation and lease inducement	150,809	169,310
	64,410,716	59,208,552
MUTUAL MEMBERS’ EQUITY		
Surplus	32,398,111	31,879,143
Mutual Members’ shares (Note 15)	111,000	109,600
	32,509,111	31,988,743
	96,919,827	91,197,295

Commitments (Note 17)
Contingencies (Note 18)

On behalf of the Board,

Jacques Demers

Jacques Demers, Chairman of the Board

Martin Dulac

Martin Dulac, Director

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

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2018, WITH COMPARATIVE INFORMATION FOR 2017

	2018	2017
	$	$
CASH PROVIDED BY (USED IN)		
OPERATING		
Net income	518,568	4,226,447
Items not affecting cash:		
Depreciation of fixed assets	83,831	90,857
Amortization of intangible assets	417,596	355,038
Deferred lease obligation and lease inducement	(18,501)	(18,500)
	1,001,494	4,653,842
Reinsurers' share in the provision for unpaid claims and settlement expenses	(1,058,405)	(1,069,953)
Deferred commissions costs	(162,663)	(59,791)
Unearned premiums	1,084,357	398,554
Unearned ceding commissions	8,484	3,903
Provision for unpaid claims and settlement expenses	3,923,304	1,192,300
Interest earned	(1,305,554)	(1,142,617)
Change in non-cash operating working capital items (Note 16)	(169,146)	(1,329,162)
	3,321,871	2,647,076
INVESTING		
Acquisition of investments	(30,115,777)	(10,431,737)
Proceeds from the sale of investments	27,293,069	6,419,000
Interest received	1,408,599	1,304,546
Acquisition of fixed assets	(31,592)	(38,116)
Acquisition of intangible assets	(82,868)	(218,355)
	(1,528,569)	(2,964,662)
FINANCING		
Contributions from Mutual Members	1,800	3,600
Net increase (decrease) in cash and cash equivalents	1,795,102	(313,986)
Cash and cash equivalents at beginning	2,947,940	3,261,926
Cash and cash equivalents at end	**4,743,042**	2,947,940

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

La Mutuelle des municipalités du Québec was incorporated on November 17, 2003 under the *Cities and Towns Act* and the *Municipal Code of Québec*. In the normal course of its business, the core activities of *La Mutuelle des municipalités du Québec* consists in underwriting property and casualty insurance products (P&C) as well as assisting its Mutual Members in their own risk management. Its Mutual Members are comprised of municipalities within the meaning of articles 465.1 of the *Cities and Towns Act* and 711.2 of the *Municipal Code of Québec.* The head office of *La Mutuelle des municipalités du Québec* is located at 7100 Jean-Talon Street East, Suite 805, Montréal, Québec, H1M 3S3, Canada.

Under the *Income Tax Act* (Canada) and the *Taxation Act* (Québec), *La Mutuelle des municipalités du Québec* is exempt from federal and provincial income tax as well as from the compensation tax for financial institutions.

The publication of these financial statements was authorized by the Board of Directors of *La Mutuelle des municipalités du Québec* on February 21, 2019.

1. ROLE OF THE APPOINTED ACTUARY AND THE INDEPENDENT AUDITOR

The appointed actuary is designated by the Board of Directors of *La Mutuelle des municipalités du Québec*. The appointed actuary is responsible for making sure that the assumptions and methods used for purposes of valuating policy liabilities comply with the recognized actuarial practices, the legislation in force, and any regulations or guidelines in this field. The appointed actuary must also express an opinion regarding the appropriateness of the policy liabilities as at the statement of financial position date with respect to the totality of obligations toward policyholders. This review, which seeks to verify the accuracy and completeness of the valuation data as well as the analysis of the assets, are important elements to be considered when establishing his opinion.

Policy liabilities are made up of two components: the claims liability and the premium liability. The claims liability includes provisions for indemnifications, provisions for external and internal adjustment expenses, provisions for claims incurred but not declared as well as reinsurers' share in such settlements. The premium liability represents the costs that will have to be incurred to acquire the premiums.

The services of the independent auditor were retained by the Mutual Members at the time of the annual general meeting. The engagement of the independent auditor consists in conducting an independent audit of the financial statements in accordance with Canadian generally accepted auditing standards. Within the context of this audit engagement, the independent auditor considers the work of the appointed actuary and his report on the policy liabilities of *La Mutuelle des municipalités du Québec*. The independent auditor's report indicates management's responsibility for the financial statements, the auditor's responsibility as well as his opinion on the financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and reflect the following significant accounting policies:

a) Basis of preparation

The financial statements, reported in Canadian dollars, have been prepared on a historical cost basis, as explained in the following accounting policies. Historical cost is generally based on the fair value of the consideration given in exchange for the assets.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

b) Current and non-current classification

Assets expected to be realized and liabilities expected to be settled within *La Mutuelle des municipalités du Québec*'s normal operating cycle of one year are typically considered as current. All other assets and liabilities are classified as non-current. The statement of financial position does not make a distinction as to the current or non-current nature of assets and liabilities. However, the following items are typically considered as current: cash, premiums receivable, accounts receivable, prepaid reinsurance premiums, reinsurers' share in claims and settlement expenses paid, prepaid expenses, deferred commissions costs, unearned premiums, unearned ceding commissions, accounts payable and accrued expenses and experience refund payable to Mutual Members. The following items are typically considered as non-current: fixed assets and intangible assets. The remaining items are comprised of both current and non-current amounts. The current and non-current portions of such balances are disclosed, where applicable, throughout the notes to the financial statements or within the risk management section.

c) Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents include cash and term deposits with maturities of three months or less from the acquisition date. As at December 31, 2018 and December 31, 2017, cash and cash equivalents consisted solely of cash.

d) Financial instruments

Financial assets and liabilities are recognized when *La Mutuelle des municipalités du Québec* becomes a party to the contractual provisions of the financial instruments. They are initially recognized at fair value and their subsequent measurement depends on their classification, as described below. Their classification depends on the nature and purpose for which the financial instruments were acquired or issued, their characteristics and the designation of such instruments by *La Mutuelle des municipalités du Québec*.

Cash	Loans and receivables
Investments – Term deposits	Loans and receivables
Investments – High-interest accounts	Loans and receivables
Investments – Capital shares	Loans and receivables
Investments – Bonds	Held-to-maturity
Premiums receivable	Loans and receivables
Accounts receivable	Loans and receivables
Reinsurers' share in claims and settlement expenses paid	Loans and receivables
Accounts payable and accrued expenses	Other liabilities
Experience refund payable to Mutual Members	Other liabilities

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

d) Financial instruments (cont'd)

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market or designated into another category and that are recognized at amortized cost using the effective interest method, less any impairment.

Held-to-maturity

Financial assets held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturities, other than loans and receivables, that *La Mutuelle des municipalités du Québec* has the positive intent and ability to hold until maturity. These financial assets are measured at amortized cost using the effective interest method, less any impairment.

Other liabilities

Other liabilities are recorded at amortized cost using the effective interest method and include all financial liabilities.

Transaction costs

Transaction costs related to financial assets held to maturity, other liabilities, and loans and receivables are added to the carrying amount of the asset or deducted from the carrying amount of the liability and are then recorded in net income over the expected life of the instrument using the effective interest method.

Effective interest method

The effective interest method is a method of calculating the amortized cost of a financial instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts future cash receipts (including transaction costs, premiums and discounts earned or incurred) through the expected life of an instrument, to the net carrying amount on initial recognition.

NOTES TO THE FINANCIAL STATEMENTS

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

d) Financial instruments (cont'd)

Impairment of financial assets

Financial assets measured at amortized cost are tested for impairment at the end of each financial reporting period. The financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the assets have been adversely affected.

Objective evidence of impairment includes the following situations:

- Significant financial difficulties of the issuer or counterparty;
- A breach of contract, such as a default in interest or principal payments;
- The increasing probability that the borrower will enter bankruptcy or any other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial assets, assets that are assessed not to be impaired individually are collectively assessed for impairment. Objective evidence of impairment for a portfolio could include *La Mutuelle des municipalités du Québec*'s past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period as well as observable changes in national or local economic conditions that correlate with default on receivables.

The amount of the impairment loss recognized is the difference between the asset's carrying amount and the present value of estimated future cash flows taking into account guarantees and sureties, discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is directly reduced by the impairment loss for all financial assets.

If, in a subsequent period, the amount of the impairment loss decreases, and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through net income to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

Derecognition of financial assets

La Mutuelle des municipalités du Québec derecognizes a financial asset when the contractual rights to the cash flows from the asset expire or when the financial asset and substantially all risks and rewards of ownership of the financial asset are transferred to another party. If *La Mutuelle des municipalités du Québec* neither transfers nor retains substantially all risks and rewards of ownership and continues to control the transferred asset, it recognizes its retained interest in the asset and an associated liability for amounts it must pay.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

d) Financial instruments (cont'd)

Derecognition of financial liabilities

La Mutuelle des municipalités du Québec derecognizes financial liabilities when, and only when, *La Mutuelle des municipalités du Québec*'s obligations are discharged, cancelled or expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in net income.

Regular-way purchases or sales of financial assets

Regular-way purchases and sales of held to maturity financial assets are recorded on the trade date, which is the date on which *La Mutuelle des municipalités du Québec* commits to buy or sell the asset.

Offsetting of financial assets and liabilities

Financial assets and liabilities are presented on a net basis when there is a legally enforceable right to set off the recognized amount and *La Mutuelle des municipalités du Québec* intends to settle on a net basis or to realize the asset and settle the liability simultaneously.

Fair value

The fair values of cash, premiums receivable, accounts receivable, the reinsurers' share in claims and settlement expenses paid, accounts payable and accrued expenses, and experience refund payable to Mutual Members approximate their carrying amounts due to their short-term maturities.

e) Fixed assets

Fixed assets are held for administrative purposes. They are recognized at cost less accumulated depreciation and impairment losses. Depreciation is calculated based on their estimated useful lives using the straight-line method over the following terms:

Asset	Period
Leasehold improvements	Term of the lease
Furniture	10 years
Computer equipment	3 years

The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period. The impact of any change in estimates is accounted for on a prospective basis.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

e) Fixed assets (cont'd)

Derecognition of fixed assets

A fixed asset is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising from the disposal or retirement of a fixed asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in net income.

f) Intangible assets

Intangible assets with finite useful lives, which consist of software, and acquired separately are recognized at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives, which is a planned duration between three to seven years. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimates being accounted for on a prospective basis. Intangible assets begin to be amortized as soon as they are ready for use.

Derecognition of intangible assets

An intangible asset is derecognized on disposal or when no future economic benefits are expected from its use or disposal. Gains or losses arising from derecognition of an intangible asset (measured as the difference between the net disposal proceeds and the carrying amount of the asset) are recognized in net income when the asset is derecognized.

g) Impairment of fixed assets and intangible assets

At the end of each reporting period, *La Mutuelle des municipalités du Québec* reviews the carrying amounts of its fixed assets and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If such an indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. When it is not possible to estimate the recoverable amount of an individual asset, *La Mutuelle des municipalités du Québec* estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in net income.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

g) Impairment of fixed assets and intangible assets (cont'd)

When an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately net income.

h) Balances related to premiums

i) Premiums and unearned premiums

Premiums are recorded when they are written and recognized on the statement of comprehensive income over the period covered by the insurance policy.

Unearned premiums represent the portion of written premiums related to the remaining coverage period up to fiscal year-end.

ii) Deferred commissions costs

Commissions associated with the earning of premiums are deferred and amortized over the duration of the related policies insofar as they are deemed recoverable, after having taken into account the claims and the related expenses as well as any expected investment income.

iii) Unearned ceding commissions

Unearned ceding commissions are recognized as a liability following consistent principles with the method used by *La Mutuelle des municipalités du Québec* to determine its unearned premiums.

i) Balances related to claims

i) Provision for unpaid claims and settlement expenses

The provision for unpaid claims and settlement expenses is the estimate of the total cost to settle all claims occurring before the closing of the financial statements, regardless of whether or not they were reported to *La Mutuelle des municipalités du Québec*. The provision for unpaid claims and settlement expenses has been established in accordance with the generally accepted actuarial principles under the standards set by the Canadian Institute of Actuaries. Since this provision is necessarily based on estimates, the final value may differ from the estimates. A provision for claims and settlement expenses is included for claims incurred but not reported based on past experience. The established methods for making these estimates are periodically revised and updated, and all adjustments are reflected in the year's results. These adjustments are attributable to events related to the final settlement of claims but which have not yet occurred and which perhaps may not occur for some time. These adjustments may also be caused by additional information concerning claims, changes in the interpretation of contracts by the courts or major variances in relation to historical trends in terms of the seriousness or frequency of claims. Consequently, claims and settlement expenses are recognized when incurred. A provision is determined for external and internal settlement expenses.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

i) Balances related to claims (cont'd)

i) Provision for unpaid claims and settlement expenses (cont'd)

The nominal value of the claims liabilities estimated on a basis gross of reinsurance is based on generally accepted actuarial methods.

The estimation process first determines the ultimate value of the benefits payable by accident year and by lines of business. From those ultimate values, the cumulative value of paid losses reported at the valuation date are deducted to determine the nominal value of the claims liabilities estimated on a basis gross of reinsurance for each accident year and each line of business. The nominal value of the claims liabilities estimated on a basis net of reinsurance is obtained by deducting the amount of recoverable reinsurance from the nominal value of the claims liabilities estimated on a basis gross of reinsurance. The ultimate amount of recoverable reinsurance is determined using a seriatim process where the amount of reinsurance recoverable, if any is deducted from the estimated ultimate nominal value of each claim. The ultimate nominal value of each claim is obtained by apportioning the claim development estimated on a basis gross of reinsurance for the applicable line of business and year of accident. The discounted values of the claims liabilities estimated on a basis gross and net reinsurance are determined by applying a discount rate to the estimated benefits payable in future years and a margin for adverse deviation.

When the undiscounted claims liability is established, it is adjusted to present value. The claims liability is discounted using a rate based on the rate of return of investments held by *La Mutuelle des municipalités du Québec*, from which a 0.25% margin is deducted. This discount rate is 1.99% as at December 31, 2018 (1.66% in 2017).

Actuarial standards require that a margin for unfavourable variances be considered to take into consideration the uncertainty level of the assumptions used. The rates used to establish the margins for unfavourable variances as at December 31, 2018 vary from 5% (5% in 2017) for short-term risks, such as for property and automobiles, and 12.5% (12.5% in 2017) for long-term risks, such as civil liability, errors and omissions.

As mentioned previously, the method used to established the claims liability is based on a loss ratio on the earned premiums. As at December 31, 2018, this ratio varies from 10% to 80% (10% to 90% in 2017) on a net basis.

ii) Reinsurers' share in the provision for unpaid claims and settlement expenses

The reinsurance amounts that are expected to be collected in relation to claims and settlement expenses are recorded as assets in accordance with the reinsurance contracts and based on principles consistent with the recognition of the provision for unpaid claims and settlement expenses. The margin for unfavourable variances applied for reinsurance is 1% as at December 31, 2018 (1% in 2017).

j) Leases

Leases in which substantially all of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any lease inducements received from the lessor) are recognized in net income on a straight-line basis over the entire term of the lease.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

k) Deferred lease obligation and lease inducement

La Mutuelle des municipalités du Québec leases office space with a predetermined fixed escalation clause. *La Mutuelle des municipalités du Québec* recognizes the related rent expense on a straight-line basis and, consequently, records the difference between the recognized rental expense and the amounts payable under the lease as deferred lease obligation.

Lease inducement consists of an allocation received from lessor for leasehold improvements and which is amortized over the lease term.

l) Investment income

Interests earned on a financial asset are recognized when it is probable that the economic benefits will flow to *La Mutuelle des municipalités du Québec* and that the amount of revenues can be reliably measured.

Interests are recognized on a time basis, based on the amount of unpaid capital and the applicable effective interest rate.

Experience refunds declared by a financial institution and calculated on interest received are recognized when the right to receive such income has been established.

m) Experience refund to Mutual Members

Experience refund is presented in the statement of comprehensive income on the date that it is declared by the Board of Directors. At that time, experience refund is recorded as experience refund payable to Mutual Members on the statement of financial position. Experience refunds disbursed to Mutual Members that withdraw before the end of the eligibility period are deducted from the current period charge.

n) Use of estimates

The preparation of financial statements in accordance with IFRS requires management 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 year. Actual results could differ from management's best estimates. The most significant estimates are related to the determination of:

- the provision for unpaid claims and settlement expenses as well as the reinsurers' share;
- the estimated useful lives of fixed assets and intangible assets.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

o) Critical judgements in applying accounting policies

The following are the critical judgements, apart from those involving estimates, that management has made in the process of applying the accounting policies of *La Mutuelle des municipalités du Québec*.

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

o) Critical judgements in applying accounting policies (cont'd)

Impairment of financial assets

At the end of each reporting period, *La Mutuelle des municipalités du Québec* determines if there is objective evidence of the impact of one or more events that occurred after the initial recognition of the financial assets on the estimated future cash flows of the assets. During the year considered, management determined that no such objective evidence exists.

Held-to-maturity financial assets

Management has reviewed the financial assets held to maturity of *La Mutuelle des municipalités du Québec* based on its capital and liquidity requirements and has confirmed that *La Mutuelle des municipalités du Québec* has the positive intention and ability to hold these assets to maturity. The financial assets held to maturity are the municipal and provincial bonds presented in Note 4.

3. CHANGES IN ACCOUNTING POLICIES

a) Initial application of new or amended accounting standards

IFRS 15 *Revenue from Contracts with Customers*

On May 28, 2014 the IASB issued IFRS 15 *Revenue from Contracts with Customers*. On April 12, 2016, the IASB issued *Clarifications to IFRS 15, Revenue from Contracts with Customers*, which is effective at the same time as IFRS 15.

IFRS 15 replaces IAS 18, *Revenue*, IAS 11, *Construction contracts*, as well as some revenue-related interpretations and the new standard was adopted on January 1, 2018. IFRS 15 introduces a new control-based revenue recognition model, changes the basis for deciding when revenue is recorded at a point in time or over time, provides new and more detailed guidance on specific topics, and expands and improves disclosures about revenues. The requirements of IFRS 15 on revenue recognition do not apply to revenues stemming from insurance contracts, leases and financial instruments.

On January 1, 2018, *La Mutuelle des municipalités du Québec* adopted IFRS 15, *Revenues from Contracts with Customers* and its *clarifications*. Following the adoption of the new standard, there was no impact on *La Mutuelle des municipalités du Québec*'s financial statements.

3. CHANGES IN ACCOUNTING POLICIES (CONT'D)

b) New accounting standards and interpretations not yet applied

Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* (Amendments to IFRS 4)

On July 24, 2014 the IASB issued the complete IFRS 9 standard.

The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight.

IFRS 9 introduces new requirements for the classification and measurement of financial assets. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows.

The standard introduces additional changes relating to financial liabilities.

It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

On September 12, 2016, the IASB issued amendments to IFRS 4, *Insurance Contracts* to address accounting mismatches and volatility that may arise in profit or loss in the period between the effective date of IFRS 9 and the new insurance contracts standard, IFRS 17 *Insurance Contracts*, issued in May 2017.

The amendments apply in the same period in which a Company adopts IFRS 9 *Financial Instruments*.

The amendments introduce two approaches that may be adopted by insurers in the period between the effective date of IFRS 9, January 1, 2018, and IFRS 17, effective January 1, 2022:

- overlay approach – an option for all issuers of insurance contracts to reclassify amounts between profit or loss and other comprehensive income for eligible financial assets by removing any additional accounting volatility that may arise from applying IFRS 9; and
- temporary exemption – an optional temporary exemption from IFRS 9 for companies whose activities are predominately connected with insurance. This exemption allows an entity to continue to apply existing financial instrument requirements in IAS 39 to all financial assets until the earlier of the application of IFRS 17 or January 1, 2022.

La Mutuelle des municipalités du Québec intends to exercise the permitted temporary exemption and to continue to apply the existing requirements of IAS 39 to all financial instruments until the expected effective date of IFRS 17, which is January 1, 2022. The extent of the impact of adoption of the standard has not yet been determined.

3. CHANGES IN ACCOUNTING POLICIES (CONT'D)

b) New accounting standards and interpretations not yet applied (cont'd)

IFRS 16 *Leases*

On January 13, 2016 the IASB issued IFRS 16 *Leases.*

The new standard is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply IFRS 15 *Revenue from Contracts with Customers* at or before the date of initial adoption of IFRS 16. IFRS 16 will replace IAS 17 *Leases*.

This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided.

On January 1, 2019, *La Mutuelle des municipalités du Québec* will adopt the new standard in its financial statements and will use the modified retrospective transition method. *La Mutuelle des municipalités du Québec* expects that the initial adoption of IFRS 16 will result in approximately to an operating lease liabilities of $350,000 (primarily for the rental of premises) in the statement of financial position, with a corresponding right-of-use asset being recognized.

La Mutuelle des municipalités du Québec also expects a decrease of its operating lease costs, offset by a corresponding increase of its depreciation and financial expenses resulting from the changes in the recognition, measurement, and presentation requirements.

However, no significant impact on net earnings is expected at this time.

Amendments to References to the Conceptual Framework in IFRS Standards

On March 29, 2018 the IASB issued a revised version of its *Conceptual Framework for Financial Reporting* (the Framework), that underpins IFRS Standards. The IASB also issued *Amendments to References to the Conceptual Framework in IFRS Standards* (the Amendments) to update reference in IFRS Standards to previous versions of the Conceptual Framework.

Both documents are effective from January 1, 2020 with early application permitted. The extent of the impact of adoption of these two documents has not yet been determined.

Definition of Material (Amendments to IAS 1 and IAS 8)

On October 31, 2018, the IASB refined its definition of material and removed the definition of material omissions or misstatements from IAS 8.

The amendments are effective for annual periods beginning on or after January 1, 2020. Their early adoption is permitted. The extent of the impact of adoption of these amendments has not yet been determined.

3. CHANGES IN ACCOUNTING POLICIES (CONT'D)

b) New accounting standards and interpretations not yet applied (cont'd)

IFRS 17 *Insurance Contracts*

On May 18, 2017 the IASB issued IFRS 17 *Insurance Contracts*.

The new standard is effective for annual periods beginning on or after January 1, 2021. However, the IASB has tentatively decided to propose deferring the effective date to January 1, 2022. IFRS 17 will replace IFRS 4 *Insurance Contracts*.

This standard introduces consistent accounting for all insurance contracts. The standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires a company to recognize profits as it delivers insurance services, rather than when it receives premiums.

La Mutuelle des municipalités du Québec intends to adopt IFRS 17 in its financial statements for the annual period beginning on January 1, 2022 and is currently evaluating the impact of this new standard on its financial statements.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

4. INVESTMENTS

			2018
	Nominal value $	**Fair value $**	**Carrying amount $**
HELD-TO-MATURITY			
Municipal and Provincial bonds, stipulated interest rates from 1.35% to 6.15%, effective interest rates from 1.27% to 4.90% and maturing from March 2019 to April 2028	27,885,359	28,008,761	28,103,284
LOANS AND RECEIVABLES			
High-interest accounts at variable rates currently bearing interest from 1.35% to 1.89% with no fixed maturity	26,122,122	26,122,122	26,122,122
Capital shares bearing interest at variable rates from 0% to 4.25% with no fixed maturity	2,000,000	2,000,000	2,000,000
Term deposits, including $3,000,000 redeemable annually, bearing interest from 1.6% to 2.1%, maturing from April 2019 to January 2023	5,328,000	5,328,000	5,328,000
	61,335,481	**61,458,883**	**61,553,406**

			2017
	Nominal value $	Fair value $	Carrying amount $
HELD-TO-MATURITY			
Municipal and Provincial bonds, stipulated interest rates from 1.40% to 5.45%, effective interest rates from 1.25% to 4.90% and maturing from January 2018 to March 2024	18,901,485	19,161,847	19,087,540
LOANS AND RECEIVABLES			
High-interest accounts at variable rates currently bearing interest from 1.05% to 1.20% with no fixed maturity	35,523,399	35,523,399	35,523,399
Capital shares bearing interest at variable rates from 0% to 4.25% with no fixed maturity	2,000,000	2,000,000	2,000,000
Term deposits bearing interest from 1.6% to 2.6%, maturing from April 2019 to November 2020	2,328,000	2,328,000	2,328,000
	58,752,884	59,013,246	58,938,939

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

4. INVESTMENTS (CONT'D)

Hierarchy of recurring fair value measurements

Disclosures regarding financial instruments must be presented as a hierarchy that categorizes the inputs to valuation models used to value financial assets and liabilities. The hierarchy gives the highest priority to readily available unadjusted quoted prices in active markets for identical assets or liabilities and lowest priority to unobserved inputs. The three levels of the measurement hierarchy are described below:

Level 1 - Fair value measurement based on unadjusted quoted prices in active market for identical assets or liabilities.

Level 2 – Fair value measurement based on inputs other than quoted prices included in Level 1 that are observable in the market for the asset or liability, either directly or indirectly.

Level 3 – Fair value measurement based on significant unobservable inputs that are supported by no market activity and incorporate management's best estimates.

The fair value of municipal and provincial bonds for which the market is not active is determined by independent valuation services that take into consideration the return or quoted price of financial instruments that have comparable conditions, such as quality, maturity and type of investment. Municipal and provincial bonds are classified at Level 2.

The fair value of high-interest cash accounts approximates the carrying amount since interest rates adjust depending on the market's interest rates variances.

The fair value of capital shares cannot be determined by using quoted prices from active markets for similar assets, either directly or indirectly. It is based mostly on non-observable market input and management's best estimates. Capital shares are classified at Level 3.

The fair value of term deposits approximates their carrying amount due to the weak interest rate fluctuations and their relatively short maturity.

There were no transfers between levels in 2018 and 2017.

5. PREMIUMS RECEIVABLE

In accordance with the provisions of an enforceable netting agreement, *La Mutuelle des municipalités du Québec* recognizes premiums receivable and commissions payable on a net basis. The gross amounts are as follows:

	2018	2017
	$	$
GROSS FINANCIAL ASSETS		
Premiums receivable	16,160,791	15,324,373
OFFSET FINANCIAL LIABILITIES		
Commissions payable	(2,424,119)	(2,298,656)
Net balance presented in the statement of financial position	**13,736,672**	13,025,717

6. CLAIMS AND SETTLEMENT EXPENSES

The change in the provision for claims and settlement expenses as well as the reinsurers' share in the claims and settlement expenses included in the statement of financial position, together with its impact on the claims and settlement expenses shown in the statement of comprehensive income for the year are as follows:

			2018
	Gross	**Ceded**	**Net**
	$	**$**	**$**
Provision for unpaid claims and settlement expenses at beginning	34,438,646	9,461,421	24,977,225
Increase (decrease) in estimated losses and expenses			
During the current year	27,348,001	5,233,023	22,114,978
During previous years	(4,570,874)	(3,324,058)	(1,246,816)
	22,777,127	1,908,965	20,868,162
Amounts paid for claims incurred			
During the current year	8,265,365	223,373	8,041,992
During previous years	10,588,458	627,187	9,961,271
	18,853,823	850,560	18,003,263
Provision for unpaid claims and settlement expenses at end	**38,361,950**	**10,519,826**	**27,842,124**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

6. CLAIMS AND SETTLEMENT EXPENSES (CONT'D)

			2017
	Gross $	Ceded $	Net $
Provision for unpaid claims and settlement expenses at beginning	33,246,346	8,391,468	24,854,878
Increase (decrease) in estimated losses and expenses			
During the current year	21,366,983	3,609,681	17,757,302
During previous years	(4,192,252)	(2,086,071)	(2,106,181)
	17,174,731	1,523,610	15,651,121
Amounts paid for claims incurred			
During the current year	8,061,620	382,257	7,679,363
During previous years	7,920,811	71,400	7,849,411
	15,982,431	453,657	15,528,774
Provision for unpaid claims and settlement expenses at end	34,438,646	9,461,421	24,977,225

Loss ratio sensitivity analysis

Given that a loss ratio is used to establish the provision for unpaid claims and settlement expenses, as mentioned in second paragraph of Note 2 i) i), a 5% increase or decrease in the loss ratio would result in an increase or decrease in the net provision of reinsurers' share for unpaid claims and settlement expenses, of approximately $825,000 as at December 31, 2018 ($725,000 as at December 31, 2017).

6. CLAIMS AND SETTLEMENT EXPENSES (CONT'D)

Estimated ultimate claims (in thousands of dollars)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**Total**
	$	$	$	$	$	$	$	$	$	$	$	**$**
At the end of year of occurrence	8,992	9,689	12,680	11,034	12,993	16,254	14,850	15,643	17,650	17,757	22,115	
One year later	9,642	11,920	11,998	10,656	11,131	15,596	14,807	14,868	16,482	16,850		
Two years later	11,626	11,624	11,855	10,128	11,149	16,010	14,827	15,067	14,275			
Three years later	11,879	11,590	11,644	10,245	10,892	15,046	14,076	13,801				
Four years later	11,651	11,560	11,685	10,493	10,920	14,710	13,062					
Five years later	11,461	11,652	11,640	10,432	10,977	13,355						
Six years later	11,447	11,285	11,576	10,215	9,874							
Seven years later	11,286	11,341	11,835	9,474								
Eight years later	11,353	11,333	10,920									
Nine years later	11,311	10,513										
Ten years later	10,371											
Current estimate of cumulative claims	10,371	10,513	10,920	9,474	9,874	13,355	13,062	13,801	14,275	16,850	22,115	144,610
Less cumulative payments	10,370	10,437	10,373	9,395	9,493	12,560	11,696	11,335	11,660	11,428	8,042	116,789
Provision for unpaid claims and settlement expenses - net	1	76	547	79	381	795	1,366	2,466	2,615	5,422	14,073	27,821
Years before 2008												21
Reinsurers' share in the provision for unpaid claims and settlement expenses												10,520
Provision for unpaid claims and settlement expenses – gross												**38,362**

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

7. DEFERRED COMMISSIONS COSTS

	2018	2017
	$	$
Balance at beginning	3,098,447	3,038,656
Deferred commissions costs during the year	6,460,431	6,149,664
Amortization of deferred commissions costs during the year	(6,297,768)	(6,089,873)
	162,663	59,791
Balance at end	**3,261,110**	3,098,447

8. FIXED ASSETS

	Leasehold improvements	**Furniture**	**Computer equipment**	**Total**
	$	**$**	**$**	**$**
COST				
Balance as at December 31, 2016	294,970	127,921	242,041	664,932
Disposals	–	–	(14,704)	(14,704)
Acquisitions	–	–	38,116	38,116
Balance as at December 31, 2017	294,970	127,921	265,453	688,344
Disposals	–	–	(7,890)	(7,890)
Acquisitions	–	2,369	29,223	31,592
Balance as at December 31, 2018	294,970	130,290	286,786	712,046
DEPRECIATION				
Balance as at December 31, 2016	76,983	53,353	176,321	306,657
Disposals	–	–	(14,704)	(14,704)
Depreciation expense	29,088	12,780	48,989	90,857
Balance as at December 31, 2017	106,071	66,133	210,606	382,810
Disposals	–	–	(7,890)	(7,890)
Depreciation expense	29,088	12,940	41,803	83,831
Balance as at December 31, 2018	135,159	79,073	244,519	458,751
CARRYING AMOUNT				
As at December 31, 2017	188,899	61,788	54,847	305,534
As at December 31, 2018	**159,811**	**51,217**	**42,267**	**253,295**

9. INTANGIBLE ASSETS

	Software
	$
COST	
Balance as at December 31, 2016	1,498,896
Acquisition	218,355
Balance as at December 31, 2017	1,717,251
Acquisitions	82,868
Balance as at December 31, 2018	1,800,119
AMORTIZATION	
Balance as at December 31, 2016	673,860
Amortization expense	355,038
Balance as at December 31, 2017	1,028,898
Amortization expense	417,596
Balance as at December 31, 2018	1,446,494
CARRYING AMOUNT	
As at December 31, 2017	688,353
As at December 31, 2018	**353,625**

10. UNEARNED PREMIUMS

	2018	2017
	$	$
Balance at beginning	20,656,249	20,257,695
Net written premiums during the year	36,999,569	34,779,362
Net earned premiums during the year	(35,915,212)	(34,380,808)
	1,084,357	398,554
Balance at end	**21,740,606**	20,656,249

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

11. UNEARNED CEDING COMMISSIONS

	2018	2017
	$	$
Balance at beginning	3,903	–
Commissions on ceded premiums during the year	22,455	6,788
Net earned ceding commissions during the year	(13,971)	(2,885)
Balance at end	**12,387**	3,903

12. STAFF RELATED COSTS

	2018	2017
	$	$
Salaries	3,471,077	3,695,060
Severances	38,311	637,510
Fringe benefits	651,466	651,682
	4,160,854	4,984,252

13. INVESTMENT INCOME

	2018	2017
	$	$
LOANS AND RECEIVABLES		
Interest	712,292	616,080
Experience refunds on cashed interest	33,042	21,854
	745,334	637,934
HELD-TO-MATURITY		
Interest	560,220	504,683
	1,305,554	1,142,617

14. EXPERIENCE REFUND TO MUTUAL MEMBERS

The payment of experience refund must be approved by the Board of Directors. In accordance with the experience refund policy, the amount of the experience refund is based on the historic performance of *La Mutuelle des municipalités du Québec* and on the conclusions of the dynamic capital adequacy test prepared annually by the appointed actuary. Among other things, this test determines whether *La Mutuelle des municipalités du Québec* has the financial capacity to meet adverse situations while remaining financially viable.

On December 7, 2018, the Board of Directors approved an experience refund totalling $3,000,000 for the year ended December 31, 2018 ($3,000,000 for the year ended December 31, 2017).

To be eligible for experience refund for the year ended December 31, 2018, a Mutual Member must:

- Be a Mutual Member of *La Mutuelle des municipalités du Québec* since January 1, 2015; and
- Keep its insurance policy in force between December 31, 2018 and December 30, 2019.

The method used for calculating each eligible Mutual Member's share is a two-step process:

- The first portion of $1,500,000 in experience refund is distributed to eligible Mutual Members in proportion to the total amount of premiums paid during a defined period;
- The second portion of $1,500,000 in experience refund is based on the Mutual Member's contribution to the profitability of *La Mutuelle des municipalités du Québec*. The latter is established according to the insurance records' quality and is based upon the loss experience of the corresponding period, which must be below a maximum threshold.

Experience refund for Members that withdraw before the end of the eligibility period is presented separately in the statement of comprehensive income.

15. MUTUAL MEMBERS' SHARES

Membership, initial contribution and rights

To become a Mutual Member of *La Mutuelle des municipalités du Québec*, a municipality, as defined in Note 1, must adopt a resolution in which it adheres to the Agreement under section 465.1 and thereafter of the *Cities and Towns Act* and section 711.2 and thereafter of the *Municipal Code of Québec* signed on April 3, 2003, which is deemed to form an integral part of the said resolution, take out insurance with *La Mutuelle des municipalités du Québec* and pay an initial contribution of $100. The initial contribution is non-refundable.

Each Mutual Member has the right to be invited to any Mutual Members' general assembly of *La Mutuelle des municipalités du Québec*, to attend such meetings, and to cast a vote on the basis of one vote per Mutual Member. The head of a Mutual Member's Board may perform any duty within the Board of Directors of *La Mutuelle des municipalités du Québec* or one of its committees under the terms set out in By-law 1.1, subject to legislative provisions in force.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

15. MUTUAL MEMBERS' SHARES (CONT'D)

Annual contribution

The Board of Directors can set the amount of the annual contribution, as necessary. If no annual contribution is determined, the amount is considered to be zero.

Special contribution

The Board of Directors may order that a special contribution be paid, as necessary. This contribution is divided among the Mutual Members in proportion to the amount of the premium written by the Mutual Member and its agencies.

Suspension or expulsion

The Board of Directors may order the suspension or expulsion of a Mutual Member under the terms and conditions set out in By-law 1.1 of *La Mutuelle des municipalités du Québec*

Withdrawal

According to the *Municipal Code of Québec* and the *Cities and Towns Act*, a Mutual Member may not withdraw from *La Mutuelle des municipalités du Québec* within five years of joining *La Mutuelle des municipalités du Québec*.

In addition, a Mutual Member may not withdraw from *La Mutuelle des municipalités du Québec* without providing twelve months' prior notice to top management.

A Mutual Member who withdraws from *La Mutuelle des municipalités du Québec* remains subject to any special contribution as determined by the Board of Directors within a period of two years following its withdrawal. If applicable, the contribution is based on the premium paid by this Mutual Member and its agencies prior to the withdrawal.

In all cases, the withdrawal of a Mutual Member must be approved by the *Autorité des marchés financiers* in accordance with the *Municipal Code of Québec* and the *Cities and Towns Act*.

15. MUTUAL MEMBERS' SHARES (CONT'D)

Withdrawal (cont'd)

	2018	2017
Number of Mutual Members	**1,110**	1,096
Contributions from Mutual Members	**$111,000**	$109,600

During the year ended December 31, 2018, 18 Mutual Members (36 Mutual Members in 2017) joined *La Mutuelle des municipalités du Québec* and 4 Mutual Members withdrew (4 Mutual Members withdrew in 2017).

16. ADDITIONAL CASH FLOW INFORMATION

Changes in non-cash working capital items:

	2018	2017
	$	$
Premiums receivable	(710,955)	(233,653)
Accounts receivable	(24,299)	845
Prepaid reinsurance premiums	(8,603)	692,645
Reinsurers' share in claims and settlement expenses paid	472,543	60,674
Prepaid expenses	(102,352)	14,930
Accounts payable and accrued expenses	204,520	135,397
Experience refund payable to Mutual Members	–	(2,000,000)
	(169,146)	(1,329,162)

17. COMMITMENTS

La Mutuelle des municipalités du Québec leases automotive equipment and premises under operating leases that expire on various dates until June 2024. Future rental payments will total $1,236,294 and include the following payments over the next years:

Year	$
2019	230,010
2020	237,193
2021	221,847
2022	215,930
2023	219,612
2024	111,702

The costs relating to these recognized operating leases totalled $217,931 in 2018 ($225,986 in 2017). These costs are included in the administrative expenses as well as in the policyholders' benefits and settlement expenses

18. CONTINGENCIES

In the normal course of business, various claims are pending against *La Mutuelle des municipalités du Québec*. Such claims are often subject to much uncertainty and their outcome cannot be predicted. According to management, adequate provision has been made for these claims and their settlement should not have a significant adverse effect on *La Mutuelle des municipalités du Québec*'s future operating results or financial position.

19. CAPITAL MANAGEMENT

La Mutuelle des municipalités du Québec manages its capital funds so as to comply with the capital adequacy requirements prescribed by *An Act respecting insurance* (R.S.Q. c. A-32) and its financial commitments to stakeholders in the settlement of claims. The regulatory capital differs from the Mutual Members' equity as stated in the statement of financial position owing to the fact that it is weighted according to the risk associated with the financial situation and insurance activities.

Under *An Act respecting insurance*, *La Mutuelle des municipalités du Québec* is required to maintain adequate capital funds to ensure sound and prudent management practices. The *Autorité des marchés financiers* has issued a guideline that limits the minimum capital funds standard according to the minimum capital test (MCT), represented by the ratio of available capital over the minimum required capital (the solvency ratio).

The available capital corresponds to the Mutual Members' equity. The minimum required capital comes from the assessment of the financial assets and liabilities risk related to policies by the application of various weighting factors. The *Autorité des marchés financiers* has established the minimal MCT at 100%. Furthermore, the target MCT is set at 150% for Canadian property & casualty insurance companies. In order to reach its own objectives, *La Mutuelle des municipalités du Québec* has set its minimal target ratio at 200% (200% as at December 31, 2017).

19. CAPITAL MANAGEMENT (CONT'D)

As at December 31, 2018 and 2017, the MCT is detailed as follows:

(in thousands of dollars)	**2018**	2017
	$	$
Total capital available	32,155	31,301
Total capital required	8,446	7,682
Excess capital	23,709	23,619
Result of MCT Measure	380 %	407 %

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK

Risk management policies and objectives

In its normal course of business, *La Mutuelle des municipalités du Québec* is exposed to a variety of financial risks, namely credit, liquidity, interest rate, market, insurance and reinsurance risks.

The Board of Directors is in charge of understanding and approving the financial risk management strategies, and management is in charge of implementing these strategies. *La Mutuelle des municipalités du Québec*'s goal with regard to financial risks management is to optimize the risk-return ratio within defined limits throughout all its activities. Risk control is carried out through the application of policies, strategies as well as sound and cautious management procedures that are blended into all of *La Mutuelle des municipalités du Québec*'s operations. The Board of Directors has created the following committees to identify, understand, communicate and manage *La Mutuelle des municipalités du Québec*'s risk exposure: the statutory committee of ethics and governance and the statutory committee of audit, as well as the advisory committees of insurance, compensation, technologies and Mutual Members' risk management. *La Mutuelle des municipalités du Québec* adopted an integrated risk management policy so as to help in organizing and integrating upstream actions to be taken for all types of risk to which it is exposed, including financial risks. This policy has been updated in 2018.

La Mutuelle des municipalités du Québec has an investment policy whose objectives are prioritized as follows: safeguarding of capital from risks of losses, safeguarding of capital against poor matching of its cash requirements, and optimizing return on investment within the set investment boundaries for each eligible investments. The investment policy is revised annually and updated if required by changing circumstances.

The risk exposure, objectives, procedures and risk management processes have not changed significantly during the year.

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Financial risks

a) Credit risk

Credit risk arises from potential losses involving a borrower's or a counterparty's failure to fulfill its contractual duties when outstanding. A counterparty can be any person or entity whose cash resources or other valuable considerations are considered forthcoming in order to extinguish a liability or obligation owed to *La Mutuelle des municipalités du Québec*.

The credit risk also includes the concentration risk. The concentration risk arises when investments are made in entities with similar characteristics, or when a substantial investment is made in a single entity.

Based on the valuation performed by *La Mutuelle des municipalités du Québec*, cash, investments, accounts receivable, amounts receivable from reinsurers and premiums receivables are the main items that may represent a credit risk.

Cash

All cash is held in a financial institution with good standings in Québec and with an excellent credit rating. *La Mutuelle des municipalités du Québec* considers that the credit risk related to this financial institution is low. *La Mutuelle des municipalités du Québec* does not actively manage the concentration risk related to cash.

Investments

All term deposits, high-interest accounts and capital shares are held in financial institutions with a credit rating of A- or better. *La Mutuelle des municipalités du Québec* considers that the credit risk relating to these financial institutions is low.

To satisfy the objectives of its investment policy and comply with all applicable rules, *La Mutuelle des municipalités du Québec* favours investing in instruments whose credit risk rating is low. The investment policy makes it possible to acquire bonds issued or guaranteed by the federal, provincial or municipal government, with preference being given to Québec municipalities. In general, municipal and provincial bond issuers have no credit rating on the market, making it impossible to measure the credit risk of most issuers. The policy also allows for investment in term deposits, mutual or exchange-traded funds, deposit notes and capital shares.

As at December 31, 2018, the bond portfolio was composed of Québec municipal bonds and provincial bonds. As at December 31, 2018, five municipalities and provinces represented 52% of the portfolio (four municipalities represented 57% of the portfolio in 2017).

Accounts receivable

Accounts receivable are mainly comprised of interest receivable. The credit risk associated with interest receivable is the same as for term deposits, municipal and provincial bonds and capital shares.

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Financial risks (cont'd)

a) Credit risk (cont'd)

Due from reinsurers

Failure on the part of reinsurers to fulfill their obligations could result in losses for *La Mutuelle des municipalités du Québec*. *La Mutuelle des municipalités du Québec* does business with more than one reinsurer, thereby reducing its concentration risk. In addition, all reinsurers with which it does business are certified with a credit rating of A- or better, which reduces the credit risk.

Premiums receivable

All premiums are receivable from the sole broker network mandated by *La Mutuelle des municipalités du Québec*. *La Mutuelle des municipalités du Québec* has no knowledge of information leading it to believe that this broker may be faced with insolvency problems. As at December 31, 2018 and 2017, no premiums receivable were outstanding.

Maximum credit risk

The maximum credit risk exposure associated with financial instruments is equivalent to the carrying amount of the financial assets presented in the statement of financial position.

b) Liquidity risk

The liquidity risk represents the possibility that *La Mutuelle des municipalités du Québec* may not be able to gather sufficient cash resources, when required and under reasonable conditions, to meet its financial obligations. The investment policy uses the timeframe established to settle claims in the dynamic capital adequacy testing to establish acceptable investment terms.

The liquidity risk for current financial items is low. Cash, premiums receivable, accounts receivable and the reinsurers' share in claims and settlement expenses paid are sufficient to allow *La Mutuelle des municipalités du Québec* to meet its financial obligations to settle accounts payable and accrued expenses and experience refund payable to Mutual Members.

The liquidity risk mainly relates to the provision for unpaid claims and settlement expenses, net of the reinsurers' share. The following tables present an estimate of amounts established for each settlement period and the matching of investment maturities, at nominal value. Investments with non maturity are presented under the column "Less than 12 months".

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20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Financial risks (cont'd)

b) Liquidity risk (cont'd)

(in thousands of dollars)				**2018**
	Less than 12 months **$**	**1 to 2 years** **$**	**2 to 4 years** **$**	**More than 4 years** **$**
Provision for unpaid claims and settlement expenses, net of the reinsurers' share (undiscounted amount)	**13,521**	**5,949**	**5,589**	**2,783**
Bonds	12,301	2,176	7,371	6,037
High-interest accounts	26,122	–	–	–
Capital shares	2,000	–	–	–
Term deposits	328	5,000	–	–
Total	**40,751**	**7,176**	**7,371**	**6,037**

(in thousands of dollars)				2017
	Less than 12 months $	1 to 2 years $	2 to 4 years $	More than 4 years $
Provision for unpaid claims and settlement expenses, net of the reinsurers' share (undiscounted amount)	10,489	5,495	6,429	3,288
Bonds	7,220	5,540	3,655	2,487
High-interest accounts	35,523	–	–	–
Capital shares	2,000	–	–	–
Term deposits	–	328	2,000	–
Total	44,743	5,868	5,655	2,487

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Financial risks (cont'd)

c) Market risk

Market risk occurs when the value of an investment fluctuates due to variances in market prices, whether those variances are caused by factors specific to the investment or its issuer, or by factors affecting all instruments traded in the market. *La Mutuelle des municipalités du Québec* seeks to minimize this risk by making investments whose market risks are low. The policy of *La Mutuelle des municipalités du Québec* is to hold on to its bond investments to maturity, thereby limiting market risk.

d) Interest rate risk

The interest rate risk occurs when interest rates fluctuate and negatively affect the financial position of *La Mutuelle des municipalités du Québec*, which occurs when market interest rates increase.

None of the investments made by *La Mutuelle des municipalités du Québec* are recognized at their fair value because all of the latter's investments are classified as loans and receivables or held-to-maturity investments. As a result, a positive or negative shifting of the rate curve would have no significant impact on the bottom line.

Information on the maturity of interest-bearing investments is presented in the Liquidity risk section in this note.

e) Interest rate sensitivity

When the time value of money is taken into consideration to establish provisions for unpaid claims and settlement expenses, an increase or decrease in the discount rate may result in a decrease or increase in the burden of losses and settlement expenses. Therefore, a 1% variance in the discount rate would have a $470,000 impact on the provision for unpaid claims and settlement expenses as at December 31, 2018 ($455,000 as at December 31, 2017).

Management estimates that an immediate hypothetical 1% parallel rise or decline in interest rates would respectively decrease or increase the fair value of bonds by approximately $622,000 as at December 31, 2018 ($379,000 as at December 31, 2017).

Insurance risk

La Mutuelle des municipalités du Québec was created to provide general insurance and manage risks for its Mutual Members as well as their agencies.

The risk in any insurance contract is the possibility that an insured event will occur, together with the uncertainty as to the value of the resulting claim. Due to the very nature of an insurance contract, this risk is random and therefore unpredictable. However, overall, these risks follow probability trends making it possible to manage insurance risks.

There are three possible types of insurance risks in the normal course of business: the product design and pricing risk, the underwriting risk and the claims settlement risk.

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Insurance risk (cont'd)

Product design and pricing risk

The product design and pricing risk is the financial risk of losses related to insurance operations, namely, when commitments exceed those that were anticipated or when such commitments exceed the price that was set for such products.

La Mutuelle des municipalités du Québec is a niche market insurer specializing in the municipal sector. It has acquired insurance expertise in this sector for both insurance products and their application. Since its creation, the insurance committee has validated changes to underwriting parameters or the pricing schedule and submitted them to the Board, as well as any additions, extensions or deletions of guarantees, therefore monitoring profitability.

La Mutuelle des municipalités du Québec's exposure to insurance risk concentration is mitigated by its portfolio diversification across the Québec province and various lines of business. *La Mutuelle des municipalités du Québec* has exposure to catastrophic losses and has sought protection by signing reinsurance treaties limiting the losses that could result from each event.

Underwriting risk

The underwriting risk is the risk resulting from the selection and acceptance of risks to be insured.

Under its statutes, *La Mutuelle des municipalités du Québec*'s sole purpose is to insure municipal risks in Québec. This specialization provides greater stability and predictability, thereby reducing the anti-selection risk. Moreover, to minimize risks, insurance policies are underwritten in accordance with *La Mutuelle des municipalités du Québec*'s management practices taking its risk tolerance and underwriting standards into account.

La Mutuelle des municipalités du Québec's products are available to local municipalities, regional county municipalities, inter-municipal boards and other municipal agencies allowed under its statutes.

La Mutuelle des municipalités du Québec offers property insurance, loss of income, civil liability insurance, umbrella (Follow-form) liability, errors and omissions, automobile, crime, boiler and machinery, cyber risk, as well as insurance of unmanned air vehicules for professional use.

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Insurance risk (cont'd)

Underwriting risk (cont'd)

The insurance portfolio is stable, with a retention rate of more than 99% since its creation. Notwithstanding the fact that a Mutual Member becomes a member for an initial five-year period, *La Mutuelle des municipalités du Québec* issues twelve months insurance contracts that are reviewed annually upon their renewal. Following the initial five-year period, if a Mutual Member wishes to withdraw, a twelve-month advance notice must be provided to *La Mutuelle des municipalités du Québec*. These rules allow *La Mutuelle des municipalités du Québec* to invest substantially in risk management while also enabling it to acquire in-depth knowledge of each municipality being insured. Given its very high market penetration rate, *La Mutuelle des municipalités du Québec* underwrites a limited number of new business annually in accordance with the standards of *La Mutuelle des municipalités du Québec* as well as prices in effect.

Moreover, *La Mutuelle des municipalités du Québec* has created two committees to oversee underwriting activities. The insurance technical committee reviews, on a weekly basis, the more complex applications submitted by brokers representing Mutual Members. The president and chief executive officer along with members of the management team are part of this committee. The committee reaches a decision regarding applications following their analysis. On another level, the Board of Directors' insurance committee, chaired by a Board member and composed of management team members as well as external members, makes proposals to the Board of Directors on such matters as changes to the underwriting guide.

As mentioned previously, the underwriting risk is also mitigated by a comprehensive risk management program. All Mutual Members undergo periodic inspections and new risks are inspected upon request to enable underwriters to make informed decisions.

Claims settlement risk

The claims settlement risk is influenced by the frequency and seriousness of claims as well as by the uncertainty in estimating future claims payments.

Property - In general, the most significant claims relating to property insurance involve fires, water damage and natural risks such as storms, floods and earthquakes.

As most fires in municipal buildings are electrical in origin, *La Mutuelle des municipalités du Québec* has implemented a thermographic analysis program for electrical panels as well as a building inspection program. Furthermore, Mutual Members benefit from training in fire and premises safety.

Loss of income - Given the nature of Mutual Members' activities, loss of income is not a major concern for *La Mutuelle des municipalités du Québec*.

Civil liability and umbrella (Follow-form) liability - Civil liability claims often involve a bodily injury suffered on city property, in particular after falling on a sidewalk or accidents taking place during events or recreational activities. Firefighting activities also result in a large number of claims. Due to climate change, environmental risks such as sewer backups and ditch overflows are likely to increase.

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Insurance risk (cont'd)

Claims settlement risk (cont'd)

The general civil liability-related risks are mitigated by the risk management program. A prevention program for recreational and sport accidents is made available to Mutual Members to plan activities or for the use of specialized equipment and to put in place risk mitigation measures. *La Mutuelle des municipalités du Québec* provides to its Mutual Members an expert in risk management who go on site to assess the location, establish relevant standards and best practices or to provide training regarding matters involving high or particular risks. Where firefighting activities are concerned, municipalities that have a fire risk coverage diagram and that have put in place measures in their implementation plan in accordance with the established timetable will be granted immunity under the *Fire Safety Act*. In addition, *La Mutuelle des municipalités du Québec* travels around the province to support Mutual Members in implementing their diagram. Also, *La Mutuelle des municipalités du Québec* has implemented another program to inform municipalities on the application of the many legislative parameters relating to environmental matters. *La Mutuelle des municipalités du Québec* is also offering a free legal assistance program to its Mutual Members. This program's goal is to reduce the number of loss experiences by giving legal advice and support to Mutual Members in specific areas of law.

Errors and omissions - Most claims relating to errors and omissions result from alleged errors relating to the issuance of permits or the awarding of a contract being contested by certain bidders. *La Mutuelle des municipalités du Québec* has developed a range of training activities given by its specialized staff or in collaboration with municipal associations.

Automobile - This risk is rather low since, in Québec, automobile risk is limited to property. Bodily injuries are covered by government insurance.

Crime - Given the nature of Mutual Members' activities, theft is not a major concern for *La Mutuelle des municipalités du Québec*.

Boiler and machinery - In general, the frequency of equipment breakdown claims is low. Furthermore, the risk is offset by the inspection program implemented in accordance with *An Act respecting pressure vessels* and by the regular inspections carried out on other insured property.

Cyber risk - *La Mutuelle des municipalités du Québec* has added this emerging risk to its insurance policy in 2017. This new optional protection covers fees related to an incident and losses incurred by the insured related to digital assets, business interruption and cyber extortion. It also covers civil liability related to network security, personal information protection and those linked to the media on the Internet in addition to fees related to regulatory procedures.

Drones for professional use - *La Mutuelle des municipalités du Québec* has also added this emerging risk to its insurance policy in 2017. This new optional protection covers drones for professional use in property and civil liability insurance.

La Mutuelle des municipalités du Québec prepares many publications on risk management, which are emailed to Mutual Members, posted on its website, or included in specialized magazines dedicated to the municipal sector. Training activities are held annually in meeting rooms in most regions and via web conference so as to reach as many Mutual Members as possible.

20. RISK MANAGEMENT RELATED TO FINANCIAL INSTRUMENTS AND INSURANCE RISK (CONT'D)

Insurance risk (cont'd)

Causes of uncertainty in estimating future claims payments

In addition to managing the underwriting risk resulting from the selection and acceptance of risk to be insured, the reserve valuation risk is monitored specifically. Provisions for claims payable must be established as soon as the claim is reported. *La Mutuelle des municipalités du Québec* has set guidelines for reserves to which analysts refer daily. These reserves are valued individually for each case by the indemnification department. In addition to a regular follow-up, each file is reviewed annually by the department manager. Although the department analysts spare no effort in preparing reliable financial data, this is not an exact science and surpluses or deficiencies in provisions may occasionally occur in spite of the control methods put in place to limit them. Moreover, insurers will always have to face changes in legal decisions, which can sometimes complicate the settlement of disputes as might be expected. Any important loss is examined by the insurance technical committee.

Additional provisions for claims incurred but that have not yet been reported and provisions for claims that have arisen and been reported but for which inadequate provisions exist are also recognized.

Reinsurance

The severity of claims is limited by reinsurance treaties in which, as a result, *La Mutuelle des municipalités du Québec* will bear up to $835,000 ($665,000 in 2017) on a net basis per event. Moreover, *La Mutuelle des municipalités du Québec* optimizes its reinsurance strategies to limit certain exposure.

Beyond this retention, excess, catastrophic, facultative and quota share loss treaties bring together the reinsurance capacity required for the operations of *La Mutuelle des municipalités du Québec*.

Reinsurance operations do not relieve *La Mutuelle des municipalités du Québec* of its obligations toward policyholders.

La Mutuelle des municipalités du Québec has treaties in all lines of business, which, beyond its retention, provide a limit of $15 million. It also has a catastrophe treaty for property and automobile insurance with a limit of $45 million in excess of $15 million.

To select its reinsurers, *La Mutuelle des municipalités du Québec* applies certain criteria as defined by its risk management policy for reinsurance. This policy provides selection criteria for both the reinsurers and the reinsurance broker chosen to represent it.

Moreover, *La Mutuelle des municipalités du Québec* does not use non-traditional ceded reinsurance treaties such as obligations in the event of a disaster.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

21. COMPENSATION OF KEY MANAGEMENT PERSONNEL

Compensation of key management personnel, i.e., the directors and executive committee members, are detailed in the table below:

	2018	2017
	$	$
SHORT-TERM BENEFITS		
Executive committee	**1,062,763**	1,228,941
Severances - Executive Committee	**–**	608,510
Directors	**88,125**	98,287

22. RELATED PARTY TRANSACTIONS

During the annual general assembly, *La Mutuelle des municipalités du Québec* Mutual Members unanimously resolved to ratify by way of Regulation the fact that the President of the *Fédération québécoise des municipalités* (FQM) ex officio serve as Chair of *La Mutuelle des municipalités du Québec*'s Board of Directors.

In the course of its activities, *La Mutuelle des municipalités du Québec* established a number of partnership agreements with the FQM related to legal assistance services, visibility, the inclusion of *La Mutuelle des municipalités du Québec* in all FQM activities, as well as the sharing of personnel.

These agreements amount to a cost of $1,026,067 for the year ended December 31, 2018 ($379,258 for the year ended December 31, 2017). A portion of these activities in 2017 were led by internal personnel from *La Mutuelle des municipalités du Québec*.

23. ADDITIONAL INFORMATION TO THE STATEMENT OF COMPREHENSIVE INCOME

Mutual Members Services are comprised of the following:

	2018	2017
	$	$
Salaries and fringe benefits (Note 21)	745,013	1,128,543
Risk management events	110,237	150,496
Professional fees	618,507	462,221
Travel expenses	144,214	132,745
Relations with Mutual Members	73,502	69,735
	1,691,473	1,943,740

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

23. ADDITIONAL INFORMATION TO THE STATEMENT OF COMPREHENSIVE INCOME (CONT'D)

Operating expenses are comprised of the following:

	2018	2017
	$	$
Salaries and corporate fringe benefits (Note 21)	2,190,798	2,628,455
Rent and administrative expenses	282,470	268,780
IT service expenses	485,146	321,174
Communication & public relations activities	401,984	215,029
Professional fees	387,021	301,589
Business partnerships	313,143	130,188
Attendance fees - directors	88,125	98,287
Attendance fees – external members	22,425	11,375
Travel expenses	105,843	117,880
Dues and subscriptions	31,681	61,616
Representation expenses	65,406	51,937
Depreciation of fixed assets (Note 8)	83,831	90,857
Amortization of intangible assets (Note 9)	417,596	355,038
	4,875,469	4,652,205

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