HERE FOR YOU

FINANCIAL STATEMENTS

For the year ended December 31, 2016

La Mutuelle des municipalités du Québec

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. Jean-Pierre Paquet, FCIA, FCAS, of the firm Willis Towers Watson in accordance with Canadian accepted actuarial practices. Mr. Paquet was designated for the fiscal periods from 2014 to 2017 inclusively by the MMQ's Board of Directors at their meeting in September 2014 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 23, 2017.

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

FRANÇOIS DUFAULT, CPA, CA
PRESIDENT AND CHIEF EXECUTIVE OFFICER PER INTERIM

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INDEPENDENT AUDITORS' REPORT

To Mutual Members of *La Mutuelle des municipalités du Québec*

We have audited the accompanying financial statements of *La Mutuelle des municipalités du Québec*, which comprise the statement of financial position as at December 31, 2016, the statements of comprehensive income, surplus and Mutual Member's shares and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of *La Mutuelle des municipalités du Québec* as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG LLP (signed)*

February 23, 2017
Montréal, Canada

* FCPA auditor, FCA Public accountancy permit No. A110618

ACTUARY'S CERTIFICATE

I have valued the policy liabilities and reinsurance recoverables of *La Mutuelle des municipalités du Québec* for its statement of financial position at December 31, 2016 and their changes 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 utilized for the valuation of these liabilities are reliable and sufficient. I verified the consistency of the valuation data with the insurer's financial records.

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

Jean-Pierre Paquet, FCIA, FCAS (signed)
Willis Towers Watson

February 10, 2017

STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31, 2016, with comparative information for 2015

	2016	2015
	$	$
REVENUES		
Written premiums		
Gross premiums	39,330,421	38,137,132
Ceded premiums	(6,487,794)	(6,283,894)
Net premiums (Note 10)	32,842,627	31,853,238
Net change in unearned premiums	(562,049)	(1,184,238)
Net earned premiums (Note 10)	32,280,578	30,699,000
Investment income (Note 12)	1,007,759	1,045,851
Total revenues	**33,288,337**	31,714,851
POLICY BENEFITS AND EXPENSES		
Policyholders benefits and claims expenses (Note 6)	18,343,956	17,482,146
Ceded benefits and claims expenses (Note 6)	(2,460,117)	(2,039,961)
Policyholders benefits and claims expenses - net	15,883,839	15,442,185
Commissions (Note 7)	5,815,257	5,542,931
Mutual Members services (Notes 11 & 21)	1,601,970	1,052,318
Operating expenses (Notes 11 & 21)	3,672,742	3,553,860
Total policy benefits and expenses	**26,973,808**	25,591,294
Income for the year before experience refund to Mutual Members	**6,314,529**	6,123,557
Experience refund to Mutual Members (Note 13)	5,000,000	4,000,000
Experience refund to withdrawn Mutual Members (Note 13)	(1,087)	–
	4,998,913	4,000,000
Net income and comprehensive income attributable to Mutual Members	**1,315,616**	2,123,557

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, 2016, with comparative information for 2015

	2016	2015
	$	$
Surplus at beginning	26,336,480	24,212,923
Withdrawals of Mutual Members during the year (Note 14)	200	–
Net income and comprehensive income	1,315,616	2,123,557
Surplus at end	**27,652,296**	26,336,480
Mutual Members' shares at beginning	105,000	102,100
Contributions from Mutual Members during the year (Note 14)	1,600	2,900
Withdrawals of Mutual Members during the year (Note 14)	200	–
Mutual Members' shares at end	**106,400**	105,000
Total Mutual Members' equity	**27,758,696**	26,441,480

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

STATEMENT OF FINANCIAL POSITION

December 31, 2016, with comparative information for 2015

	2016	2015
	$	$
ASSETS		
Cash	3,261,926	2,861,936
Investments (Note 4)	55,056,296	54,632,674
Premiums receivable (Note 5)	12,792,064	12,484,531
Accounts receivable	255,344	232,714
Prepaid reinsurance premiums	1,447,862	1,025,050
Reinsurers' share in claims and settlement expenses paid	1,734,994	149,886
Reinsurers' share in the provision for unpaid claims and settlement expenses (Note 6)	8,391,468	8,812,914
Prepaid expenses	93,673	69,411
Deferred commissions costs (Note 7)	3,038,656	2,954,350
Fixed assets (Note 8)	358,275	416,872
Intangible assets (Note 9)	825,036	929,185
	87,255,594	84,569,523
LIABILITIES		
Provision for unpaid claims and settlement expenses (Note 6)	33,246,346	33,401,150
Unearned premiums (Note 10)	20,257,695	19,695,646
Accounts payable and accrued expenses	805,047	824,937
Experience refund payable to Mutual Members (Note 13)	5,000,000	4,000,000
Deferred lease obligation and lease inducement	187,810	206,310
	59,496,898	58,128,043
MUTUAL MEMBERS' EQUITY		
Surplus	27,652,296	26,336,480
Mutual Members' shares (Note 14)	106,400	105,000
	27,758,696	26,441,480
	87,255,594	84,569,523

Commitments (Note 16)
Contingencies (Note 17)
The accompanying notes are an integral part of these financial statements.

On behalf of the Board,

Daniel Demers, Director

Denis Campeau, Director

STATEMENT OF CASH FLOWS

For the year ended December 31, 2016, with comparative information for 2015

	2016	2015
	$	$
Cash provided by (used in)		
OPERATING		
Net income	1,315,616	2,123,557
Items not affecting cash:		
Depreciation of fixed assets	96,472	86,685
Amortization of intangible assets	238,383	190,158
Deferred lease obligation and lease inducement	(18,500)	(18,500)
	1,631,971	2,381,900
Reinsurers' share in the provision for unpaid claims and settlement expenses	421,446	2,250,568
Deferred commissions costs	(84,306)	(177,638)
Unearned premiums	562,049	1,184,238
Provision for unpaid claims and settlement expenses	(154,804)	(31,355)
Interest earned	(1,007,759)	(1,045,851)
Change in non-cash operating working capital items (Note 15)	(1,351,887)	(586,254)
	16,710	3,975,608
INVESTING		
Acquisition of investments	(26,495,579)	(27,691,797)
Proceeds from the sale of investments	25,929,459	23,836,481
Interest received	1,119,909	1,287,513
Acquisition of fixed assets	(37,875)	(96,445)
Acquisition of intangible assets	(134,234)	(142,855)
	381,680	(2,807,103)
FINANCING		
Contributions from Mutual Members	1,600	2,900
Net increase in cash and cash equivalents	399,990	1,171,405
Cash and cash equivalents at beginning	2,861,936	1,690,531
Cash and cash equivalents at end	**3,261,926**	2,861,936

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

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 23, 2017.

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.

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, 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, 2016 and December 31, 2015, 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*.

2. Significant accounting policies (cont'd)

d) Financial instruments (cont'd)

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

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.

2. Significant accounting policies (cont'd)

d) Financial instruments (cont'd)

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.

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 in 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.

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 best estimates for incurred, but not reported, claims liabilities on a gross and net basis have been determined based on various actuarial methods, mainly the Bornhuetter-Ferguson method. This method uses the historical development of incurred and reported claims, based on reserves on a case-by-case basis plus benefits paid, per year of accident in order to anticipate changes in claims and it considers the concept of earned premiums to assess future developments, making it possible to introduce a measure of risk exposure and to use an anticipated loss ratio on the future loss experience. Different assumptions are used to estimate the unreported claims liability on a gross and net basis: the discount rate, the margin for unfavourable variances and the loss ratio.

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 1.50% as at December 31, 2016 (1.66% in 2015).

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, 2016 vary from 5% (5% in 2015) for short-term risks, such as for property and automobiles, and 12.5% (12.5% in 2015) 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, 2016, this ratio varies from 10% to 90% (10% to 80% in 2015) 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, 2016 (1% in 2015).

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 bonds presented in Note 4.

3. Changes in accounting policies

Future changes in accounting policies

IFRS 9 *Financial Instruments* ("IFRS 9")

In July 2014, the IASB published an amended version of IFRS 9 *Financial Instruments*, which replaces IAS 39 *Financial Instruments: Recognition and Measurement*, and IFRIC 9 *Reassessment of Embedded Derivatives*.

IFRS 9 includes guidance on the classification and measurement of financial instruments, impairment of financial assets, and a new general hedge accounting model. The IASB has now concluded the replacement initiative of IAS 39. The IFRS 9 version published in 2014 supersedes all preceding versions of the standard. However, early adoption of preceding versions is allowable, as long as the initial adoption date is anterior to February 1, 2015. IFRS 9 does not replace requirements in relation with portfolio fair value hedge accounting with regards to interest rate risk. This initiative was separated from the IFRS 9 project, due to the long-term nature of work currently underway related to macro coverage. As a result, the exception presented under IAS 39 related to portfolio fair value hedge accounting with regards to interest rate risk of a financial assets or liabilities portfolio continues to apply.

While the new standard is generally effective for years beginning on after January 1, 2018, in December 2015, the IASB published an Exposure Draft *Applying* IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts*, which proposes to allow some insurers optional transitional relief until the forthcoming insurance accounting standard is available for implementation. The proposed options would allow a) entities whose predominant activity is issuing insurance contracts within the scope of IFRS 4 to defer the implementation of IFRS 9 to as late as January 1, 2021, which would allow alignment of the implementation of IFRS 9 with the forthcoming insurance accounting standard, or alternatively b) give entities issuing insurance contracts the option to remove from net income the incremental volatility caused by changes in the measurement of specified financial assets upon application of IFRS 9.

3. Changes in accounting policies (cont'd)

Future changes in accounting policies (cont'd)

IFRS 9 *Financial Instruments* ("IFRS 9") (cont'd)

On September 12, 2016, the IASB issued amendments to IFRS 4 *Insurance Contracts* to address accounting mismatches and volatility that may arise in net income in the period between the effective date of IFRS 9 and the forthcoming insurance contracts standard. 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 and the forthcoming insurance contracts standard: a) overlay approach – an option for issuers of insurance contracts to reclassify amounts between net income and other comprehensive income for eligible financial assets by removing any additional accounting volatility that may arise from applying IFRS 9; or alternatively b) 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 the forthcoming contracts standard or January 1, 2021.

La Mutuelle des municipalités du Québec intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

IFRS 4 *Insurance Contracts* ("IFRS 4")

In June 2013, the IASB issued a revised exposure draft proposing a comprehensive measurement approach for all types of insurance contracts, which would replace the existing IFRS 4 *Insurance Contracts*. Deliberations of the exposure draft continue and a final standard is expected to be issued in 2017. The effective date of the final standard is not expected to be before 2021.

IFRS 15 *Revenue from Contracts with Customers* ("IFRS 15")

In May 2014, the IASB issued a new standard that revises previous guidance on revenue recognition, from sources other than insurance premiums and investment income, which are unaffected. The new standard is effective for years beginning on or after January 1, 2018. *La Mutuelle des municipalités du Québec* does not expect the application of this standard to have a significant impact on its financial statements.

IFRS 16 *Leases* ("IFRS 16")

The IFRS 16 standard was issued on January 13, 2016. The new standard will replace the existing lease guidance in IFRS and related interpretations, and requires companies to bring most leases on the balance sheet. The new standard is effective for years beginning on or after January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

4. Investments

			2016
	$	$	$
	Nominal value	**Fair value**	**Carrying amount**
HELD-TO-MATURITY			
Municipal bonds, stipulated interest rates from 1.25% to 5.45%, effective interest rates from 1.13% to 4.90% and maturing from February 2017 to March 2024	20,928,900	21,457,388	21,188,917
LOANS AND RECEIVABLES			
High-interest cash accounts at variable rates currently bearing interest from 0.85% to 1.05% with no fixed maturity	25,412,407	25,412,407	25,412,407
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 $4,126,972 redeemable at any time, bearing interest from 1.6% to 2.6%, maturing from September 2017 to November 2020	6,454,972	6,454,972	6,454,972
	54,796,279	**55,324,767**	**55,056,296**

			2015
	$	$	$
	Nominal value	Fair value	Carrying amount
HELD-TO-MATURITY			
Municipal bonds, stipulated interest rates from 1.25% to 5.45%, effective interest rates from 1.13% to 4.90% and maturing from February 2016 to March 2024	20,895,000	21,700,913	21,311,022
LOANS AND RECEIVABLES			
High-interest cash accounts at variable rates currently bearing interest from 0.85% to 1.05% with no fixed maturity	27,267,652	27,267,652	27,267,652
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 deposit redeemable at any time, currently bearing interest at 1.8%, maturing in September 2017	4,054,000	4,054,000	4,054,000
	54,216,652	55,022,565	54,632,674

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 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 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 2016 and 2015.

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:

	2016	2015
	$	$
GROSS FINANCIAL ASSETS		
Premiums receivable	15,049,487	14,693,824
OFFSET FINANCIAL LIABILITIES		
Commissions payable	(2,257,423)	(2,209,293)
Net balance presented in the statement of financial position	**12,792,064**	12,484,531

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:

			2016
	$	**$**	**$**
	Gross	**Ceded**	**Net**
Provision for unpaid claims and settlement expenses at beginning	33,401,150	8,812,914	24,588,236
Increase (decrease) in estimated losses and expenses			
During the current year	23,133,698	5,484,025	17,649,673
During previous years	(4,789,742)	(3,023,908)	(1,765,834)
	18,343,956	2,460,117	15,883,839
Amounts paid for claims incurred			
During the current year	9,644,041	1,930,277	7,713,764
During previous years	8,854,719	951,286	7,903,433
	18,498,760	2,881,563	15,617,197
Provision for unpaid claims and settlement expenses at end	**33,246,346**	**8,391,468**	**24,854,878**

6. Claims and settlement expenses (cont'd)

	2015		
	$ Gross	$ Ceded	$ Net
Provision for unpaid claims and settlement expenses at beginning	33,432,505	11,063,482	22,369,023
Increase (decrease) in estimated losses and expenses			
During the current year	18,039,555	2,397,003	15,642,552
During previous years	(557,409)	(357,042)	(200,367)
	17,482,146	2,039,961	15,442,185
Amounts paid for claims incurred			
During the current year	5,707,702	–	5,707,702
During previous years	11,805,799	4,290,529	7,515,270
	17,513,501	4,290,529	13,222,972
Provision for unpaid claims and settlement expenses at end	33,401,150	8,812,914	24,588,236

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 $472,000 as at December 31, 2016 ($436,000 as at December 31, 2015).

6. Claims and settlement expenses (cont'd)

Estimated ultimate claims (in thousands of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	TOTAL
	$	$	$	$	$	$	$	$	$	$	$
At the end of year of occurrence	7,382	8,992	9,689	12,680	11,034	12,993	16,254	14,850	15,643	17,650	
One year later	7,883	9,642	11,920	11,998	10,656	11,131	15,596	14,807	14,868		
Two years later	8,170	11,626	11,624	11,855	10,128	11,149	16,010	14,827			
Three years later	9,424	11,879	11,590	11,644	10,245	10,892	15,046				
Four years later	9,200	11,651	11,560	11,685	10,493	10,920					
Five years later	9,168	11,481	11,652	11,640	10,432						
Six years later	9,174	11,447	11,285	11,576							
Seven years later	9,216	11,286	11 341								
Eight years later	9,183	11,353									
Nine years later	9,100										
Current estimate of cumulative claims	9,100	11,353	11,341	11,576	10,432	10,920	15,046	14,827	14,868	17,650	127,113
Less cumulative payments	9,011	11,182	11,213	10,810	9,243	9,825	12,464	10,888	9,994	7,714	102,344
Provision for unpaid claims and settlement expenses - net	89	171	128	766	1,189	1,095	2,582	3,939	4,874	9,936	24,769
Years before 2007											86
Reinsurers' share in the provision for unpaid claims and settlement expenses											8,391
Provision for unpaid claims and settlement expenses – gross											**33,246**

7. Deferred commissions costs

	2016	2015
	$	$
Balance at beginning	2,954,350	2,776,712
Deferred commissions costs during the year	5,899,563	5,720,569
Amortization of deferred commissions costs during the year	(5,815,257)	(5,542,931)
	84,306	177,638
Balance at end	**3,038,656**	2,954,350

8. Fixed assets

	Leasehold improvements	Furniture	Computer equipment	Total
	$	$	$	$
COST				
Balance as at January 1, 2015	414,792	115,547	162,568	692,907
Disposals	(140,232)	–	(20,320)	(160,552)
Acquisitions	20,410	11,426	64,609	96,445
Balance as at December 31, 2015	294,970	126,973	206,857	628,800
Disposals	–	–	(1,743)	(1,743)
Acquisitions	–	948	36,927	37,875
Balance as at December 31, 2016	294,970	127,921	242,041	664,932
DEPRECIATION				
Balance as at January 1, 2015	160,301	28,595	96,899	285,795
Disposals	(140,232)	–	(20,320)	(160,552)
Depreciation expense	27,825	12,026	46,834	86,685
Balance as at December 31, 2015	47,894	40,621	123,413	211,928
Disposals	–	–	(1,743)	(1,743)
Depreciation expense	29,089	12,732	54,651	96,472
Balance as at December 31, 2016	76,983	53,353	176,321	306,657
CARRYING AMOUNT				
As at December 31, 2015	247,076	86,352	83,444	416,872
As at December 31, 2016	**217,987**	**74,568**	**65,720**	**358,275**

9. Intangible assets

	Software
	$
COST	
Balance as at January 1, 2015	1,221,807
Acquisitions	142,855
Balance as at December 31, 2015	1,364,662
Acquisitions	134,234
Balance as at December 31, 2016	1,498,896
AMORTIZATION	
Balance as at January 1, 2015	245,319
Amortization expense	190,158
Balance as at December 31, 2015	435,477
Amortization expense	238,383
Balance as at December 31, 2016	673,860
CARRYING AMOUNT	
As at December 31, 2015	929,185
As at December 31, 2016	**825,036**

10. Unearned premiums

	2016	2015
	$	$
Balance at beginning	19,695,646	18,511,408
Net written premiums during the year	32,842,627	31,853,238
Net earned premiums during the year	(32,280,578)	(30,669,000)
	562,049	1,184,238
Balance at end	**20,257,695**	19,695,646

11. Staff related costs

	2016	2015
	$	$
Salaries	3,461,161	2,914,918
Fringe benefits	612,269	519,455
	4,073,430	3,434,373

12. Investment income

	2016	2015
	$	$
LOANS AND RECEIVABLES		
Interest	507,988	448,991
Experience refunds on cashed interest	28,812	41,091
	536,800	490,082
HELD-TO-MATURITY		
Interest	470,959	555,769
	1,007,759	1,045,851

13. 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 1, 2016, the Board of Directors approved an experience refund totalling $5,000,000 for the year ended December 31, 2016 ($4,000,000 for the year ended December 31, 2015).

13. Experience refund to Mutual Members (cont'd)

To be eligible for experience refund for the year ended December 31, 2016, a Mutual Member must:

- Be a Mutual Member of *La Mutuelle des municipalités du Québec* since January 1, 2013;
- Keep its insurance policy in force between December 31, 2016 and December 30, 2017.

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

- The first portion of $2,500,000 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 $2,500,000 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.

14. 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 2.1, subject to legislative provisions in force.

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.

14. Mutual Members' shares (cont'd)

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 2.1 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*.

	2016	2015
Number of Mutual Members	**1,064**	1,050
Contributions from Mutual Members	**$106,400**	$105,000

During the year ended December 31, 2016, 16 Mutual Members (29 Mutual Members in 2015) joined *La Mutuelle des municipalités du Québec* and 2 Mutual Members withdrew (no Mutual Member withdrawal in 2015).

15. Additional cash flow information

Changes in non-cash working capital items:

	2016	2015
	$	$
Premiums receivable	(307,533)	(764,753)
Accounts receivable	7,718	(9,637)
Prepaid reinsurance premiums	(422,812)	(213,814)
Reinsurers' share in claims and settlement expenses paid	(1,585,108)	395,285
Prepaid expenses	(24,262)	57,925
Accounts payable and accrued expenses	(19,890)	(51,260)
Experience refund payable to Mutual Members	1,000,000	–
	(1,351,887)	(586,254)

16. 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 $1,593,913 and include the following payments over the next years:

	$
2017	233,879
2018	215,369
2019	202,333
2020	203,375
2021	206,680
2022 to 2024	532,277

The costs relating to these recognized operating leases totalled $219,356 in 2016 ($204,742 in 2015). These costs are included in the administrative expenses as well as in the policyholders' benefits and settlement expenses.

17. 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.

18. 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 175%.

As at December 31, 2016, the MCT is detailed as follows:

(in thousands of dollars)	**2016**	2015
	$	$
Total capital available	27,115	25,877
Total capital required	7,696	7,743
Excess capital	19,419	18,134
Result of MCT Measure	352 %	334 %

19. 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 committee of insurance and the advisory committee of 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 reviewed during a fourth exercise of integrated risk management which took place in 2014.

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, which was entirely reviewed in 2015, 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, with the exception of the above-mentioned item.

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.

19. Risk management related to financial instruments and insurance risk (cont'd)

Financial risks (cont'd)

a) Credit risk (cont'd)

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 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, 2016, its entire bond portfolio was made up of bonds from Québec municipalities. As at December 31, 2016, four municipalities accounted for 55% of the bond portfolio (four municipalities accounted for 49% in 2015).

Accounts receivable
In 2016, accounts receivable are mainly comprised of interest receivable. The credit risk associated with interest receivable is the same as for term deposits, municipal bonds and capital shares.

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 only broker 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, 2016 and December 31, 2015, no premiums receivable were outstanding.

19. Risk management related to financial instruments and insurance risk (cont'd)

Financial risks (cont'd)

a) Credit risk (cont'd)

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 no maturity are presented under the column "Less than 12 months."

(in thousands of dollars)				2016
	$	**$**	**$**	**$**
	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)	**10,561**	**5,390**	**6,371**	**3,181**
Bonds	4,419	7,220	5,344	3,946
High-interest accounts	25,412	–	–	–
Capital shares	2,000	–	–	–
Term deposits	4,127	–	2 328	–
Total	**35,958**	**7,220**	**7,672**	**3,946**

19. Risk management related to financial instruments and insurance risk (cont'd)

Financial risks (cont'd)

b) Liquidity risk (cont'd)

(in thousands of dollars)				2015
	$	$	$	$
	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)	10,870	5,696	6,187	2,485
Bonds	4,571	4,419	10,311	1,594
High-interest accounts	27,268	–	–	–
Capital shares	2,000	–	–	–
Term deposit	–	4,054	–	–
Total	33,839	8,473	10,311	1,594

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.

19. Risk management related to financial instruments and insurance risk (cont'd)

Financial risks (cont'd)

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 $445,000 impact on the provision for unpaid claims and settlement expenses as at December 31, 2016 ($411,000 as at December 31, 2015).

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 $487,000 as at December 31, 2016 ($530,000 as at December 31, 2015).

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.

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 in various geographical areas and 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.

19. Risk management related to financial instruments and insurance risk (cont'd)

Insurance risk **(cont'd)**

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, as well as boiler and machinery insurance.

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.

19. Risk management related to financial instruments and insurance risk (cont'd)

Insurance risk (cont'd)

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.

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. In 2016, *La Mutuelle des municipalités du Québec* started 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.

19. Risk management related to financial instruments and insurance risk (cont'd)

Insurance risk (cont'd)

Claims settlement risk (cont'd)

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.

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.

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 loss of more than $100,000 is examined by the insurance technical committee and the executive 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 Québe*c will bear up to $665,000 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 and facultative 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 $30 million in excess of $15 million.

19. Risk management related to financial instruments and insurance risk (cont'd)

Reinsurance (cont'd)

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.

20. Compensation of key management personnel

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

	2016	2015
	$	$
SHORT-TERM BENEFITS		
Executive committee	**1,165,353**	1,106,743
Directors	**71,875**	57,141

21. Additional information to the statement of comprehensive income

Mutual Members Services are comprised of the following:

	2016	2015
	$	$
Salaries and fringe benefits	1,041,530	546,079
Risk management events	172,128	201,456
Professional fees	159,495	153,608
Travel expenses	158,746	112,968
Relations with Mutual Members	70,071	38,207
	1,601,970	1,052,318

21. Additional information to the statement of comprehensive income (cont'd)

Operating expenses are comprised of the following:

	2016	2015
	$	$
Salaries and corporate fringe benefits	1,882,289	1,870,131
Rent and administrative expenses	265,103	253,357
IT service expenses	302,705	374,631
Communication & public relations activities	220,142	219,063
Professional fees	273,027	187,187
Business partnerships	121,615	104,463
Committee expenses	78,483	68,516
Travel expenses	100,614	101,503
Dues and subscriptions	49,456	52,812
Representation expenses	44,453	45,354
Depreciation of fixed assets (Note 8)	96,472	86,685
Amortization of intangible assets (Note 9)	238,383	190,158
	3,672,742	3,553,860