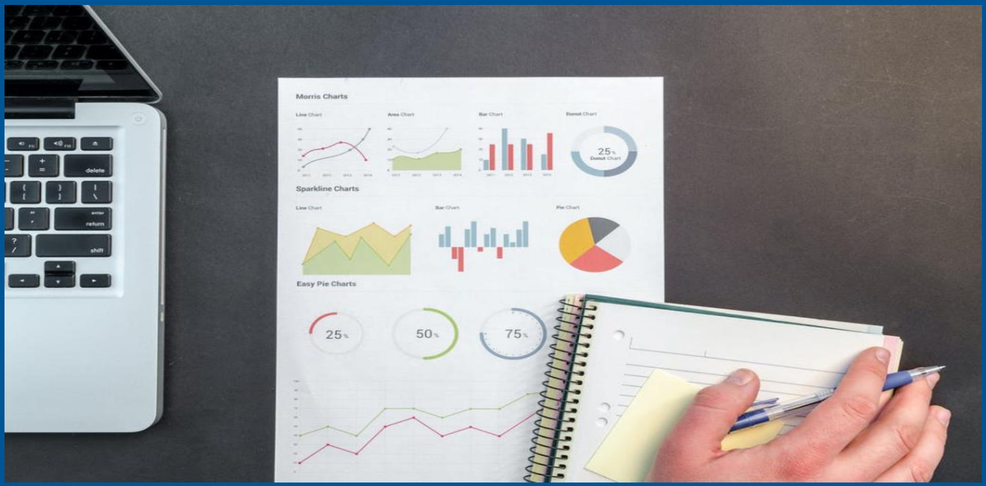
HTM
INSURANCE COMPANY

Refund From Surplus Policy



Index

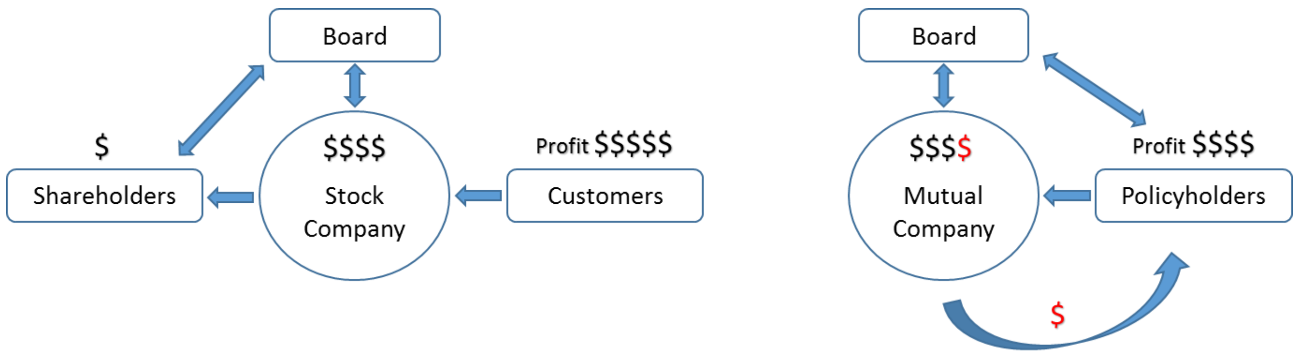
Main Topics

Overview

Shareholders versus policyholders

HTM Insurance is a Mutual insurance company founded in 1898. One of the main differences between a Mutual insurance company and a stock insurance company is policyholders versus shareholders. Stock companies have a duty to their shareholders to maximize the investment the shareholder has and return to them a portion of the company's profit in the form of a dividend. They do this by selling insurance to insurance customers at a profit. A Mutual company has no shareholders; only policyholders. Instead of sending profits (generated by the insurance customers) back to shareholders, HTM has the ability to send profits back to the policyholders (who generated the profit). This is referred to as a "refund from surplus" (RFS) or sometimes a "refund of premiums".

The diagram below shows a typical setup for stock companies versus mutual companies. The "$" represents the **opportunity** for a refund from surplus.



Building Capital or Surplus

When a stock company requires additional capital over and above what it has raised or earned, it can create a share offering. Investors purchase the shares hoping for a good return and the stock company uses the money to rebuild or expand. A mutual company does not have this option. It can only build surplus off the profits it generates from the policyholders and its investment portfolio. Consecutive poor years can erode a mutual's surplus and put it in a position of financial hardship.

History of Refunds	In the company's history, HTM has never provided a refund to its policyholders. We are not even sure if one has ever been contemplated in the past, even though an RFS section is included in the company By-laws. Locally, the Eastern Mutuals (East of Toronto) have not adopted an RFS as a philosophy or even a tool for marketing, competition or other potential reason. To the West, a number of the mutuals provide RFS; some on a very regular basis. The fact there are many more mutuals in the West, may indicate that the RFS has been used as a competitive advantage.
Representing the Policyholder	One could say that an RFS is one of the most mutual actions a company could take, positively affecting every policyholder by providing them with a portion of their policy premium returned to them. The HTM directors are elected by the policyholders and need to consider their representation. However, as directors, you are caretakers of the organization. The current and future health of HTM is the directors' first responsibility. Whether or not the directors declare a refund is secondary and this policy has been developed to help directors make that decision.

Philosophy

Target Profits	Our philosophy is to charge our policyholders a premium that is competitive and provides the company with enough profit to support future growth, our strategic plans and to maintain the financial strength of the organization.
Refund from Surplus	Based on our profit philosophy, we do not anticipate providing Refunds from Surplus to our customers. In the event there are unusual financial results which lead to significant and unexpected profits, then the board would consider this mechanism for distributing some of the unexpected profits back to the policyholders.

Responsibility

Directors	The decision to make a refund to the policyholders is solely up to the board of directors. They represent the policyholders and the refund should reflect their opinion as to what would be a fair amount, if a refund is declared.
Management	Management's responsibility is to: ➢ provide the analysis of the refund in respect to: • the financial impact, after estimated taxes of potential refund amounts • the method(s) available for sharing the refund among the policyholders • estimated impact on various strength tests ➢ a management opinion on the refund ➢ carry out the refund

Considerations for a Refund

Overall	A refund is more than just a financial transaction. A number of factors should be considered when determining whether or not to provide a refund and if a decision is made to provide a refund, how much should it be. The following are suggestions of the types of considerations that should be made.
Corporate Goals	Is the refund in alignment with corporate goals set out in the company’s strategic plan? The strategic plan highlights the company’s goals for the future, both financial and non-financial. A number of projects require a financial investment on the part of the company to carry them out. A refund should not impair our ability to achieve our financial goals or other initiatives planned to improve our services or products. Consideration should also include whether a refund could help us achieve our corporate goals, such as premium growth or retention.
Other Opportunities	Our strategic plans outline what we want to accomplish over three to five years. Sometimes opportunities we did not anticipate arise during that period, which we may want to take advantage of. Most opportunities require some kind of financial investment. The refund should not restrict or eliminate “normal” unplanned opportunities.
Surplus Adequacy	Our Surplus position should always be adequate to provide for known or emerging issues that may have a negative effect.
Financial Consideration	This document has a number of financial considerations or tests that show our financial performance over time and the strength of our company. These performance indicators are in alignment with government authorities, the financial solvency process and our own KPIs.

Key Financial Indicators

MCT

The MCT ratio cannot be calculated in time for consideration of the refund as the last part of the yearend process is the P&C1 where the MCT is calculated. The MCT must always be in excess of our ORSA MCT target and it is a given that a refund would only occur in a very successful year financially, so MCT should not be an issue.

Combined Ratio

The Combined Ratio is defined as the Net Claims and Expenses as a percentage of our Net Premium Income.

The Combined Ratio will be calculated using the best estimates for the calendar year as at the December board meeting. The Combined Ratio should exceed the following minimum targets:

Timeframe	**Target**
In the calendar year	Below 90%
In the preceding 3 year period	Below 95%
In the preceding 5 year period	Below 95%

Gross Risk Ratio

The Gross Risk Ratio is defined as Gross Premiums to Surplus.

The Gross Risk Ratio will be calculated using the best estimates for the calendar year as at the December board meeting. The Gross Risk Ratio should exceed the following minimum targets:

Timeframe	**Target**
Under $40 Million in Premiums Written	Above 1:1
Over $40 Million in Premiums Written	Above 0.9:1

Timing

Overall	If an RFS is declared, as an organization, we want the costs to go against the profits of the year that created the RFS decision. In most cases, this will be made based on the calendar year results. The actual refund to policyholders (cheques sent out) will occur in the following year. To properly account for the refund and trigger a liability for the calendar year of the refund amount, timing of the decision is important.
Management	Management would bring financial information to the board at the December meeting with a recommendation that the board should discuss a refund using this policy for reference. Assumptions would have to be made based on the potential activity in December. This conversation would only be initiated if there is a significant profit up to November 30th of the current year.
Directors	Given the recommendation from management along with the Key Financial Indicator results from this policy, the board would make a decision. If the board decides not to do a refund, the process stops there. If the board decides there is a possibility for a refund, a motion would be made directing management in the following areas: ➢ A minimum required underwriting profit after refund; and ➢ A minimum net profit before taxes; and ➢ A maximum amount to be refunded; and ➢ The line of business allocation
Yearend	As we complete the yearend process and the final underwriting results become known, if the results meet the criteria set out by the board at the December meeting, it would trigger an RFS liability (and a corresponding expense with tax consequences).

Other

Admin Duties	A third-party firm will be used to handle the thousands of cheques involved in a refund. The cost of the administration process is estimated and included in the refund costs, which is allocated to the financial year of the refund.
Notification	The declared refund should be advertised to the community. The use of marketing mediums such as paper, radio and social media should be used. This will assist with policyholder awareness when they receive the cheques as well as advertising the benefits of HTM and mutuality to the general public.