Business Plan
for the proposed
HT&C Mutual Insurance Company

A version of this Business Plan was submitted to and reviewed by the Financial Services Regulatory Authority of Ontario

July 23, 2020

Background and Summary

This proposed amalgamation of Hay Mutual Insurance Company ("Hay") located in Zurich Ontario and Town & Country Mutual Insurance Company ("T&C") of Strathroy Ontario, will bring together two strong mutuals with common values and shared visions as to what it means to be a community-based local insurer. Both Companies are members of the Fire Mutuals Guarantee Fund, the Ontario Mutual Insurance Association ("OMIA") and reinsure with the Farm Mutual Reinsurance Plan Inc. ("Farm Mutual Re").

The principles underlying the amalgamation will be to maintain a local presence at the current office locations and to maintain employment in each of the current offices.

The proposed name of the amalgamated company is:

"HT&C Mutual Insurance Company"

The benefits to be realized from amalgamation include:

- Broader geographic spread of risk;
- Sharing cost and benefits of technology;
- Enhanced business continuity and disaster recovery capabilities;
- Enhanced career development opportunities;
- Enhanced predictability of financial results, driven by larger volumes;
- Shared cost and resources to meet regulatory obligations;
- In the case of Hay, an opportunity to add broker distribution exposure;
- The ability to offer enhanced products to new and potential Members;
- Provide continued economic benefit to small, local communities

Proposed Board of Directors

Currently, Hay has six directors while T&C has nine. The Board of the amalgamated company will be comprised of twelve Directors initially, six from each company.

The terms of office of the initial twelve Directors are shown in the Amalgamation Agreement submitted with this Business Plan.

Commencing with the first Annual General Meeting in March 2022, 4 Directors will be elected for three-year terms in accordance with the Act.

It is the view of the current Hay and T&C boards that the number of directors should be reduced to nine within five years of amalgamation.

Proposed Management Team

The CEO of Hay, Shawn Durnin, will assume that role with HT&C Mutual.
Mr. Durnin will then operate with a management team comprised of:

- Manager, Finance and Corporate Services

- Manager, Business Development
- Manager, Personal Lines Underwriting Services
- Manager, Commercial/Farm Underwriting services
- Manager, Claim Services

The current CEO of T&C, Rob Pearson, will remain with the amalgamated corporation to assist with the transition after amalgamation and implementation of the business plan.

The amalgamated corporation will operate out of both current offices with each location being the base of senior management personnel.

The CEO will divide his time between both offices but will be based in Zurich. It is expected that employment will increase due to the enhanced growth opportunities presented by the amalgamation and the need to fill some manager positions.

Some existing job functions may change and there may be additional travel required for some senior management and staff.

Strategic Plan

The strategic issues that motivated the companies to pursue an amalgamation include the following common points, which will be the benefits of amalgamation:

- Achieve greater geographical spread of risk
- Better manage and interact with distribution networks
- Leverage internal expertise and gain redundancy for key roles
- Enable stronger investment in technology to enhance efficiency
- Reduce the risk of rising reinsurance costs
- Build a stronger and broader infrastructure
- Strength in management depth
- Improved surplus and capital position
- Creation of a platform for controlled long-term growth to offset the aging client base of both companies
- Combine resources for more efficiency in meeting regulatory requirements
- Improved capacity for long range planning
- Creating a more diversified Board from a larger pool of Directors
- Improvement in the ability to plan for succession of Directors and staff.

The key strengths supporting the strategy going forward include:

- Both companies have strong financial positions
- Both companies are well established in their communities with loyal client bases
- Both companies use the same insurance related software and will be in a better position to include enhanced products offered by the provider

- The companies share the same philosophy of mutuality and are strong supporters of the Mutual system in Ontario
- There are synergies with respect to underwriting expertise
- Both companies use the same IT infrastructure provider, with servers on premises
- Increased capital allows for improved structures in human resources, technology, regulation and market position, with the goal of eventually achieving economy of scale

The challenges to be addressed will include:

- Harmonizing rates, policies and products, taking the best from each company and going beyond, in order to build better products for our members;
- Communicating clearly with our members, our staff, and other stakeholders;
- Maintaining service standards during the transition;
- Integrating our operations and building a single unified team;
- The time and effort required for the merging of both Companies' files in the Titan software platform that both Companies use;
- Combining the sales teams to facilitate a sales channel that includes Brokers and Captive Agents for the amalgamated Company
- Hay participates in the OMIA pension plan while Town & Country does not. The intent will be to transition the T&C employees out of their group RRSP and into the defined contribution section of the OMIA plan.

Work will begin to review and plan to harmonize products, pricing, procedures and processes.

The Boards use different consultants for their strategic planning processes. It is suggested that a RFP be prepared and proposals considered for the new company's initial strategic planning review.

Proposed Governance Structure

Both companies' Boards operate as policy boards rather than "hands on" boards and that will continue with the amalgamated corporation. There will be a comprehensive process of Board evaluations including assessments for:

- Governance manual
- Board Chair and Vice Chair
- Committees of the Board
- Director self-evaluations
- Director Peer-to-Peer evaluations
- Skill Matrices

Initially, the amalgamated corporation will have the following standing Board committees, with appropriate mandates and structure:

- Executive
- Amalgamation Transition

- Conduct Review, which will also monitor the application of established procedures to identify and resolve conflicts of interest
- Audit
- Investment
- Nomination.

Distribution of Products

Hay uses an agent distribution model exclusively while T&C uses staff agents and two corporate agents, as well as a network of brokers. We believe the two channels are complimentary and both will continue to be part of the amalgamated corporation.

The opportunity will exist to expand the broker exposure in Hay's trading area, especially north of Goderich. We expect to be able to appoint new agents as well.

There is virtually no overlap in the current geographical coverage of the two companies; rather, the trading areas complement each other. With the amalgamation, the combination of the geographical areas will increase the spread of risk from what is presently available.

The agent contracts differ with respect to terms and commission structures, and new contracts and terms will need to be decided upon.

Underwriting

Both companies are part of the OMIA & Farm Mutual Re automobile rate-filing group and reinsure with Farm Mutual Re. The amalgamated company will continue to be part of both organizations and therefore there should be no issues with aligning the rates or the products of the automobile line as both companies use the same underwriting manual and rate filing.

Both companies use the residential property wording established by OMIA so the coverages will align, but there are differences in rating structures. Those rates will be territorially based and significant differences between the two companies will be aligned over a period of one to three years.

T&C has an actuarial template for residential property rating developed in conjunction with Farm Mutual Re that will be expanded to include Hay's rates and form the basis of the amalgamated company's rate structure.

There will not be one Manager of Underwriting Services; the role will be split into personal lines and commercial/farm in order to take advantage of current underwriting experience.

The Personal Lines manager will be based in Zurich, while the Commercial/Farm manager will be in Strathroy.

Financial and Capital Management

With this amalgamation, the estimated surplus of the new company will be approximately $60M with Gross Written Premium estimated to be $30M.. The anticipated MCT will be in the range of 650%. Both companies have current *Enterprise Risk Management* plans, which will be aligned. The amalgamated corporation will complete its *Own Risk Solvency Assessment* by the end of Q2, 2021.

The amalgamated corporation will open with claim and premium liability reserves and provision for adverse deviations consistent with Accepted Actuarial Practice (AAP).

Proposed Computer Systems

Both amalgamating companies currently use the Titan policy management system through SEH Computer Systems Inc. ("SEHC") and there is no plan to change systems.

We have already reached out to SEHC to begin discussion on how best to merge the data bases. We anticipate that process will be in place to accommodate a January 2, 2021 effective date.

Similarly, both amalgamating companies utilize the same information technology company. Hay Mutual owns its equipment and T&C leases its. The amalgamation provides an opportunity to store information in Strathroy and Zurich. This will be beneficial in an event where disaster recovery is required.

Claims Handling

Claims will continue to be serviced out of both physical offices, primarily by staff adjusters. Hay outsources its accident benefit claims to an independent adjuster while T&C has a dedicated AB adjuster, using a different adjusting firm for training purposes. It is anticipated the current outside providers will continue in some capacity.

After hour claims service is contracted out and will continue to be so.

Neither company has a Manager of Claims Services presently, with both CEO's acting in that capacity. Amalgamation will allow for a dedicated Manager of Claims Services to be hired and a search for such a Manager will be undertaken.

Complaints Handling

Both amalgamating companies have complaints policies. It has been decided that Hay's will be adopted and updated as necessary, to achieve the following objectives when complaints are received:

- Investigate the facts;

- Evaluate if the corporation complied with the law and with the requirement to treat customers fairly;
- Identify any market conduct issues stemming from the complaint;
- Evaluate if any policies and procedures need to change as a result of the complaint.

A member of senior management will be designated as the company Ombudsman/Liaison Representative.

Fair Treatment of Consumers

Fair treatment of Consumers encompasses concepts such as ethical behavior, acting in good faith and the prohibition of abusive practices. Ensuring fair treatment of Customers encompasses achieving outcomes such as:

- Developing, marketing and selling products in a way that puts Customers' interests ahead of their own;
- Providing Customers with accurate, clear, not misleading and sufficient information before, during and after the point of sale, which will allow them to make informed decisions;
- Minimizing the risk of sales which are not appropriate to the Customers' needs;
- Ensuring that any advice given is relevant;
- Dealing with Customer claims, complaints and disputes in a fair and timely manner;
- Protecting the privacy of Customer information.

Estimated Financial Results (five-year horizon)

Both Hay and T&C prepared 5 year budgets individually which were then combined for the amalgamated Company. These 5 year budgets are attached.

In reviewing the attached combined budget the following key metrics are to be noted:

- **Gross written premiums** will increase by an average of 7% per year over 5 years to $40 million at the end of 2025. This growth will be controlled with organic growth, adapting property rating structure to the actuarial template, and expanding the distribution network to brokers in Hay's current territory. The territory of the amalgamated company will not be expanded into trading areas not already covered by the two current Mutuals. We are striving to build a new brand and develop the combined agent force.

- **Reinsurance premiums ceded** is showing an average increase of 6% over 5 years to approximately $6 million dollars. This estimate is very conservative, as the amalgamated Company would not be paying the combined reinsurance premiums of the current Mutuals. The excess of loss retention would be set at Hay's current levels being $550K for all lines of business with Catastrophe set at $1,650K and stop loss at 70%. As ERM and ORSA are being reviewed annually, the risk appetite of the combined Board may warrant increasing retentions over the 5-year period. At this point, the estimated reinsurance rates would need to be determined by Farm Mutual

Re for the combined Company as historical loss experience is taken into account in the rating factors.

- **Net claims and adjustment expenses** were estimated using historical trends and accounting for the occurrence of one catastrophe occurrence per year. The resulting net claims ratio amounted to 65% for each of the forecasted years.

- **Commissions** are dependent on direct premiums written and for budget purposes the average of agent and broker commission rates currently in use, has been taken.

- **General Expenses** have been estimated to increase by 7% annually, using the current individual Companies expense budgets over the next 5 years. These expenses take into account the initial expenses for technology, hardware security upgrades, HR consulting as well as addition of staff for managerial positions impacting results in years one and two especially, then levelling out afterwards.

- **Expected synergies and savings** of the amalgamated company have not been taken into account as reduction in fees for combined IT licenses, association fees, audit fees, insurance policies and other business expenses has not been discussed with system vendors or suppliers.

- **Expense ratio** in year 5 is estimated at 38% of net premiums earned.

- **Combined ratio** is estimated at 101.8%.

- **Underwriting income** is estimated to be at or near zero for the first few years to allow for the operations to be streamlined. The Mutual philosophy is providing insurance at cost as we are owned by our Members. In the past, Hay was proud to refund premiums to Members when underwriting income was positive and the surplus position supported this initiative.

- **Investment income** is difficult to forecast in these unprecedented times. Both Mutuals are using the same investment consultant and therefore the current dividend and interest income were combined, with increases for the combined company showing 1% each year. The unrealized and realized losses and gains were not forecast. The companies are not in the business of trading their financial instruments. The current investment policies are to protect capital while maximizing yield. The volatility of the markets will remain over several years and the interest rates are not expected to rise considerably in the foreseeable future. Any changes to fair market values are difficult to project and the expectation is that unrealized gains and losses will most likely zero out over the next 5 years.

- **Investment expenses** represent fees paid to the investment consultant as well as management fees charged by the Fund companies. These were forecast to increase by 3% annually. Therefore, the most conservative approach to investment income is to assume that it will not increase materially over the next 5 years, remaining in the $2 million dollars range per fiscal year.

- **Net income before taxes** would appear to range between $1 to $2 million dollars per annum. With the tax rate applied of 26.5%, results in net income after taxes of approximately $1 million per annum.

- **Surplus** for the amalgamated company is estimated at $60 million dollars on the effective date of amalgamation, which will not change significantly with the conservative budget over the 5 years. The amount will increase more materially if investment results are boosting net income and our claims experience or operating expenses were overestimated.

- **Combined MCT** is estimated at 650%, which is not anticipated to change materially over the 5 years with investment policies remaining consistent, and market risk usually being the most volatile component in the MCT calculation.

While large expense savings are not the primary objective of amalgamation, the following are the expected efficiencies to be realized through amalgamation:

- Combining the Titan systems will result in savings in fees, based on what each company currently pays for the same software.

- The costs involved in updating HR policies and processes will be shared, expanding and improving the services available to staff.

- Better use of Power Broker, T&C's choice for its business management sales tool as it is introduced to Hay's agent.

- The expenses to develop upload capabilities will now be shared as well.

- The resources applied to regulatory compliance should be reduced from the current situation. It should be no more onerous or costly to apply regulation to the amalgamated company.

Reinsurance

As required by Ontario statute, the amalgamated corporation will continue to use Farm Mutual Re for general reinsurance. Retentions for the following lines reflect the per risk retention level currently used by Hay of $550K per risk on all lines.

- Property Excess of Loss retention;
- Catastrophe per occurrence retention;
- Automobile Excess of Loss retention; and
- General Liability Excess of Loss retention.

The property risk limit will be $9M, which is the limit provided for in Hay's current contract. Reinsurance premium savings are not a primary objective of the amalgamation, but we do anticipate some savings due to the amalgamated corporation's ability to absorb larger retentions.

Enhanced product lines, such as Home Systems Protection, can be more easily expanded and marketed for increased sales as well as better coverage for our membership.

Investment Operations

The investment policies of each company are similar; both use the same investment manager and will continue to do so after amalgamation, at least on an interim basis.

The Board of Directors of each amalgamating company will approve a harmonized Investment Policy Statement for the amalgamated company in the fourth quarter of 2020.

The incoming Board of Directors of the amalgamated company will review and amend the Investment Policy Statement in accordance with the requirements of the Insurance Act and adhere to “investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return.”

Plans to maintain stability in operations during transition period

Rob Pearson, the current CEO of Town & Country was not a candidate for the CEO position of the amalgamated corporation, but he will remain with the amalgamated corporation to assist with the transition after amalgamation.

The use of a Human Resource professional to assist with job descriptions is anticipated. This will help with clarity of duties and performance expectations. The same professional might be beneficial to determine strengths of current employees and offer suggestions of improvement plans.

A strategic planning process will be developed immediately, upon approval, with the goal of holding planning sessions in September or early October. Both companies are in the midst of current planning cycles, through different facilitators, which will be blended into a new plan for HT&C Mutual.

During the transition, it will be important that the managers report their observations directly to the CEO. This will allow successes to be celebrated and issues escalated for reassessment.

The ability and willingness to evaluate and correct course of action quickly will assist in the successful transition.

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