



MICC
INVESTMENTS
LIMITED
ANNUAL REPORT
1985

C



McGILL UNIVERSITY LIBRARY
JUN 2 1986
McGILL UNIVERSITY

FINANCIAL HIGHLIGHTS

(000's omitted)	1985	1984	1983	1982	1981
Premiums Written	\$ 18,521	\$ 18,444	\$ 22,852	\$ 13,953	\$ 22,711
Underwriting Revenue	32,534	31,578	35,752	40,738	38,394
Investment Income	23,616	40,909	54,775	42,340	30,370
Losses Incurred on Claims	49,158	132,094	112,509	76,220	46,954
Net Earnings (Loss)	19,329	(87,698)	(85,445)	(1,165)	12,446
Net Earnings (Loss) Available to Common Shareholders	8,425	(98,773)	(97,189)	(8,725)	6,473
Total Assets	241,600	326,873	425,235	446,096	385,706
Shareholders' Equity	73,198	44,021	148,869	236,848	200,025
Earnings (Loss) Per Common Share	\$0.74*	(\$8.69)	(\$8.55)***	(\$0.77)	\$0.78
Earnings (Loss) Per Common Share (Fully Diluted)	\$0.74	(\$8.69)	(\$8.55)	(\$0.77)	\$0.78
Common Dividends Paid	—	—	**	\$0.76	\$0.76

*\$0.72 before extraordinary item.

**Stock Dividend – One Common
Share for each Twenty Shares held.

***(\$6.63) before extraordinary item

CONTENTS

Financial Highlights	1
Message to Shareholders	2
Review of Operations	4
MICC Investments Limited	
Consolidated Financial Statements	12
Auditors' Report	21
The Mortgage Insurance Company of Canada (A wholly-owned subsidiary)	
Consolidated Financial Statements	22
Auditors' Report	29
Board of Directors	30
Organization	31



MESSAGE TO SHAREHOLDERS

A 63 percent decline in claims losses coupled with a 33 percent increase in new mortgage insurance business of our wholly-owned subsidiary The Mortgage Insurance Company of Canada resulted in a dramatic turnaround for MICC in 1985. Net earnings for the year after extraordinary items were \$19.3 million compared with a loss of \$87.7 million in 1984.

The improved results, which equate to \$0.74 per common share after extraordinary item versus a loss of \$8.69 per share in 1984, reflect

- a) a substantial reduction in claims during the last three quarters of 1985,
- b) the recovery of \$25.0 million previously set aside to provide for a premium deficiency, and
- c) improved equity earnings from the company's investment in Inter-City Gas Corporation.

The capital deficiency of \$59.0 million under the capital requirement formula of the Department of Insurance of Canada which we reported at the end of 1984 has now been eliminated.

The company's mortgage insurance claims losses declined during 1985 to \$49.2 million. This compares with \$132.1 million in 1984. Claims losses improved progressively throughout the year declining from \$29.1 million in the first quarter to \$2.5 million in the last quarter. Demographic factors, employment growth, and favourable mortgage interest rates should result in a healthy housing market during 1986 throughout most of Canada, however, the impact of lower oil prices on the Alberta housing market is difficult to quantify.

New mortgage insurance commitments totalled \$1,268 million, 33 percent above the 1984 total of \$956 million. Our commitment target for 1986 is \$1.65 billion.

Effective March 31, 1985 premium rates for homeownership mortgages were increased by an average of 50 percent. The current rate structure is more than double that which was in place when the company wrote 70 percent of its current insurance in force.

It is company policy to maintain reserves, not only for losses incurred but not paid, but also for the present value of estimated future losses on claims on policies in force. At the end of 1983, based on estimates that the present value of future losses on policies issued on or before December 31, 1983 would exceed deferred premiums, the reserves included a premium deficiency provision for the first time in the company's history. This provision was charged against earnings. During 1984 this provision was increased to \$45,000,000. In 1985, based on a review of all factors, the provision was reduced to \$20,000,000 with \$25,000,000 being taken into earnings.

Equity in the earnings of Inter-City Gas Corporation in 1985 totalled \$9.3 million compared with \$7.6 million during 1984. At the request of the Department of Insurance, the Mortgage Insurance Company of Canada, a wholly-owned subsidiary of MICC Investments, has agreed to reduce its investment in Inter-City securities to 15 percent of total assets by June 30, 1987. Our objective is to transfer the Inter-City investment to MICC Investments.

Total assets at December 31, 1985, were \$241.6 million, compared with \$326.9 million at December 31, 1984. We anticipate a stabilizing in our cash flow from operations in 1986. The proceeds from the new capital issue described below should therefore result in an increase in assets during the year.

REVIEW OF OPERATIONS

The mortgage industry benefited from a strong Canadian economy during 1985. Interest rates were stable in the 10-12 percent range for most of the year. Inflation remained under control and the unemployment rate reached its lowest level since 1981.

Mortgage activity broke all records in 1985, with institutional residential mortgage loan approvals reaching \$28.5 billion, an increase of 25 percent over the previous year's total of \$22.7 billion. This strength reflects the availability of mortgage funds at relatively low interest rate levels and the strong new and existing housing markets which prevailed in Canada during the year.

Housing starts rose 23 percent to 165,826 units during 1985 with all provinces experiencing an increase in activity. The resale market rose 30 percent, with more than 250,000 sales through the Canadian Real Estate Association MLS system. In addition, there are a number of exclusive and private sales which also occur each year. The chartered banks collectively were the major provider of residential mortgage funds, accounting for about 40 percent of the total.

The strength of the housing markets in Canada assisted MICC in achieving its new business target for 1985. New commitments issued by the company totalled \$1,268 million, 33 percent above the 1984 total of \$956 million.

Homeownership First and Second Mortgages

Homeownership housing is the largest segment of MICC's activity, accounting for 96.5 percent of all mortgage commitments issued during 1985. Commitment volume totalled \$1,224 million during 1985, 43.5 percent above the 1984 total of \$853 million. Existing housing accounted for 58.7 percent of total homeownership activity compared with 55.0 percent in 1984.

Effective March 31, 1985 the Company's premium rates were increased by an average of 50 percent. The new premium rate structure is 125 percent higher than the rate structure in place when the Company wrote 70 percent of its current insurance in force.

Premiums written during the year amounted to \$18.1 million, an increase of 77.7 percent over the 1984 total of \$10.2 million.

At the end of 1985, 311,000 mortgages were being insured by us and approximately 1.215 or 0.39 were reported by lenders as being three months or more in arrears. This default ratio compares favourably with a default ratio of 0.70 percent in 1984 and 1.11 percent in 1983.

A reserve to cover potential losses is established for each case as soon as it is determined that a claim may be anticipated. To assist in determining the reserve, it is necessary to obtain a report from the lender on the amount owing on the mortgage. We then make an estimate of the net realizable value of the real estate after disposal costs. Claims losses totalled \$42.3 million, 57.5 percent below the 1984 total of \$99.4 million.

While 80 percent of all claims losses in 1985 were in Alberta and 15 percent in British Columbia, actual claims losses were 50 percent below 1984's levels in these provinces.

Homeownership mortgage insurance claims resulting in the acquisition of real estate by MICC occurred in 8 percent of the cases in 1985 compared with about 14 percent during 1984. The balance were either cases where the lender sold the property and MICC paid the difference between the net sale proceeds and the claim amount (22%) or where we elected to settle the claim through payment under Option "B" (70%). Under this latter form of settlement, the lender receives 25 percent of the approved claim amount (20 percent on rental, commercial, and industrial properties) and retains ownership of the real estate.

During the year, 435 homeownership properties were acquired having a net realizable value of \$20.7 million compared with 733 properties valued at \$34.5 million during 1984. A total of 674 properties were sold with a book value of \$33.2 million during 1985. This compares with sales of 650 properties valued at \$32.7 million during 1984. At the end of 1985, homeownership real estate holdings totalled \$11.0 million, compared with \$23.5 million at the end of 1984. At December 31, 1985, an additional 42 properties valued at \$1.8 million had been sold but the sales had not yet closed.

Real estate is held on the books at estimated net realizable value which is estimated market value less estimated disposal costs (real estate commission, legal fees, appraisal, etc.). On acquisition each property is reviewed to determine if it should be held or sold. Company policy generally is to sell acquired real estate as soon as possible.

To assist in the sale of properties the Company has offered direct mortgage financing. These mortgages are subsequently offered for sale to institutional investors. The homeownership mortgage portfolio stood at \$8.9 million at the end of 1985 compared with \$11.7 million at the end of 1984.

**Income Properties
First and Second Mortgages**

Rental

The rental component of MICC's operations accounts for only 2.6 percent of total activity. Commitments to insure totalled \$33 million and premiums written totalled \$0.4 million.

There were 7,987 insured rental loans on repayment at the end of 1985. About 80 loans were reported one month or more in arrears, a default ratio of 1.01 percent. The comparable 1984 default ratio was 1.19 percent.

Claims losses declined 67 percent in 1985 to \$5.0 million compared with \$15.3 million in 1984. During the year, one property valued at \$9.9 million was acquired and two properties with a book value of \$10.8 million were sold. At the end of 1985, rental property holdings totalled \$4.1 million compared with \$4.8 million at the end of 1984.

Commercial and Industrial

Activity in this sector accounted for about one percent of MICC's commitments to insure in 1985. Commitments to insure totalled \$11 million during 1985, compared with \$22 million during 1984. Premiums written totalled \$0.3 million during 1985.

Of 5,448 loans on repayment at the end of 1985, 76 were reported one month or more in arrears or 1.40 percent. The comparable 1984 default ratio was 2.54 percent.

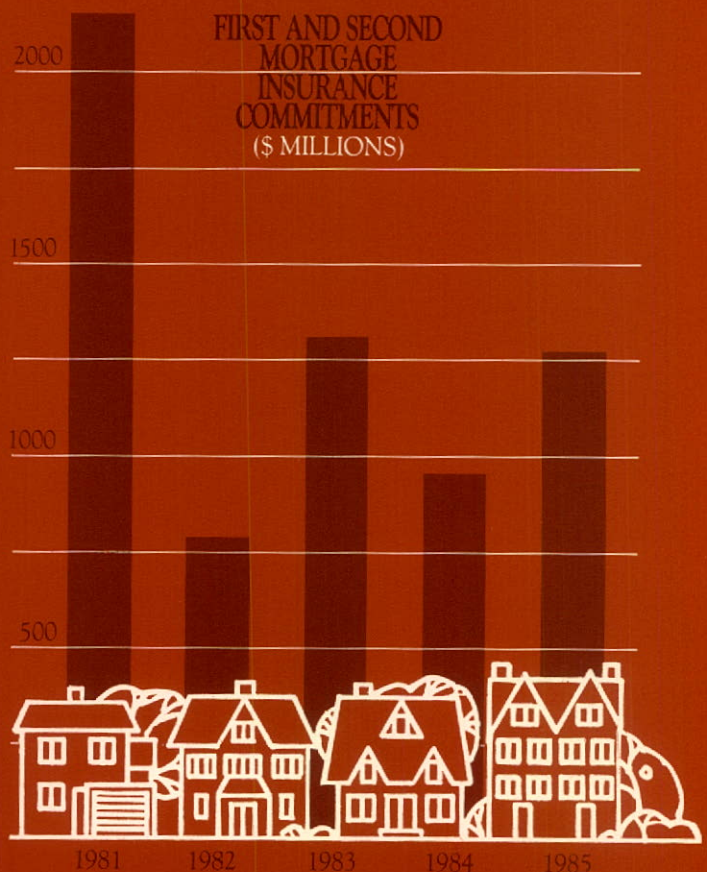
Claims losses totalled \$1.2 million during 1985, 84.4 percent below the comparable 1984 total of \$7.8 million.

During the year, two properties were acquired having a net realizable value of \$5.8 million, 11 properties were sold with a book value of \$10.8 million. At the end of 1985, real estate holdings totalled \$4.3 million compared with \$9.3 million at the end of 1984.

Other Programs

Surety

Since 1980, MICC has bonded or guaranteed the performance of contractors and developers in Canada for their construction or financial obligations. During 1985 construction activity generally was down; while demand for our services from real estate developers continued to be strong, particularly in Toronto and Ottawa. Condominium deposit insurance and qualifying bonds for the New Home Warranty Program in Ontario were also significantly in demand.



Condominium deposit insurance is offered only in Ontario and insures the deposits of condominium buyers before a condominium has been registered. MICC insurance is used when the deposits exceed the \$20,000 limit insured by the Ontario New Home Warranty Program.

The Company also participates in surety reinsurance and retrocession business through Lloyds of London.

A combination of improved economic conditions in 1985 and the impact of a favourable work-out situation on a condominium deposit claim which MICC had reserved for a loss during 1984 resulted in the following favourable results.

	Net Premiums Written (\$000's)		Claims Incurred \$000's	
	1985	1984	1985	1984
Contractors/Developers	\$1,955	\$2,041	(\$165)	\$ 928
Condominium Deposit	223	308	(957)	3,000
Reinsurance	866	375	241	511
TOTAL	\$3,042	\$2,724	(\$881)	\$4,439

New Home Warranty

The new home warranty programs of Ontario and Quebec have been insured by MICC since their inception. Subject to certain limitations, these warranty programs provide a guarantee to purchasers of new homes, against loss of deposit, defects in workmanship and materials during the first year of occupancy and structural defects during the first five years of occupancy. During 1985 both insurance agreements were terminated as the warranty programs had developed sufficient reserves to reduce their insurance requirements. A new agreement has been entered into with the Quebec program providing general financial coverage to the program rather than insuring each new home. During 1985 a similar policy was provided to the New Home Warranty Program of the Atlantic Provinces.

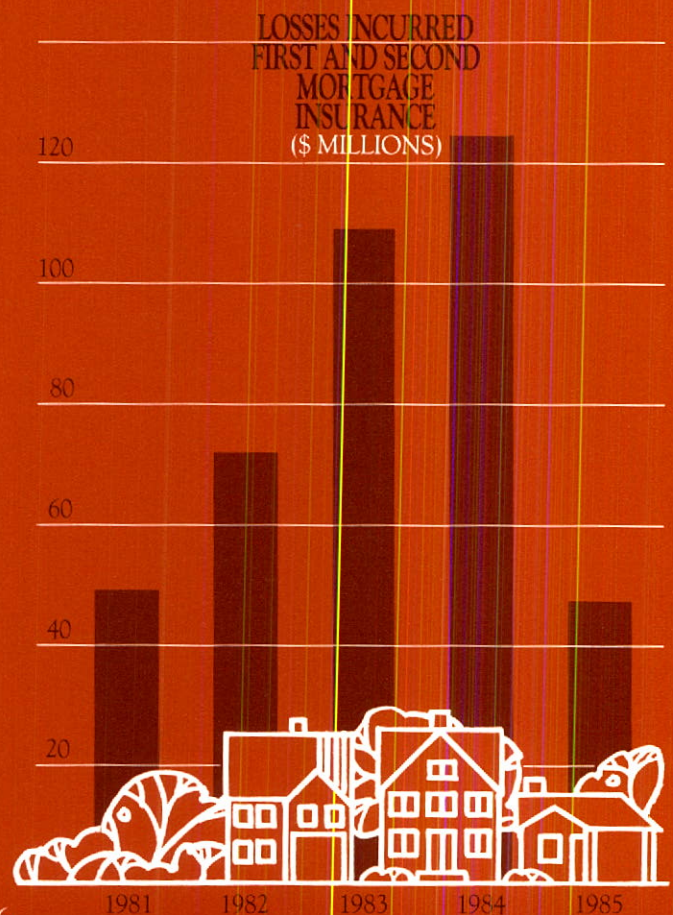
As a result of these changes MICC refunded \$9.7 million of unearned premiums during 1985 to reflect the elimination of risk under the Ontario program and the reduced risk under the Quebec program.

Premiums earned for all programs amounted to \$4.1 million in 1985, 64.0 percent above the \$2.5 million recorded during 1984.

Losses incurred for all programs totalled \$2.8 million during 1985, compared with \$2.2 million in 1984.

RenoLoan Renovation Financing Made Easier (Ontario)

RenoLoan is designed to assist homeowners thinking of improving their home or builders who specialize in contract or speculative renovation. RenoLoan was developed by MICC



with co-operation and support from the Ontario Ministry of Municipal Affairs and Housing. Mortgage financing under RenoLoan is funded by private sector lenders who are protected against default by MICC mortgage insurance. Usage of the program has been lower than expected.

Self-Directed Registered Retirement Savings Plan

The Department of National Revenue has confirmed that a taxpayer's self-directed registered retirement savings plan may lend to the annuitant, or any relation to the annuitant, funds secured by a mortgage on real estate in Canada. One of the conditions is that these mortgages be insured. MICC's program covers most types of properties and includes both first and second mortgages.

Investments

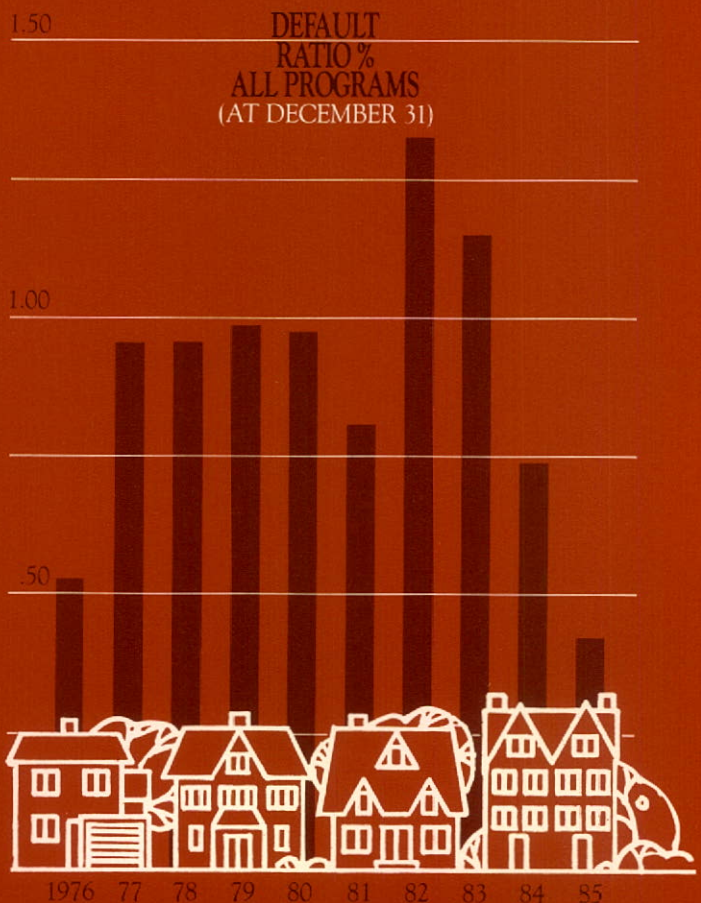
The investment portfolio of the insurance company experienced a 27 percent reduction in book value as it responded to the cash needs of the corporation, brought about by the settlement of claims including those reserved for in prior years.

Total pre-tax income was \$23.6 million compared with \$40.9 million in 1984. At year-end, the market value of the portfolio was 118.12 percent of book value compared to 91.72 percent at December 31, 1984. The average term of the bond portfolio decreased from 8.02 years in 1984 to 6.14 years in 1985 with continued emphasis on liquidity via Government of Canada issues. The asset allocation shows a significant reduction in the preferred category and resulted in our dividend income declining to \$3.3 million during the year compared with \$7.8 million in 1984. Interest and amortization income was \$14.6 million versus \$17.3 million in 1984. Equity in the earnings of Inter-City Gas Corporation was \$9.3 million during 1984 compared with \$7.6 million in 1984. The book value of the company's investment in Inter-City Gas Corporation common shares, warrants, and notes was \$116.6 million or 56.2 percent of total invested assets. Inter-City is a diversified Canadian energy company with revenues of \$1.5 billion in 1985 and is engaged directly and through subsidiaries in the exploration for and development and production of oil and natural gas; the transmission and distribution of natural gas; the distribution of propane, gasoline and industrial gases; the manufacture and

distribution of heating and air conditioning equipment and related products; and the fabrication of large diameter and corrugated steel pipe.

The sale of investments and options during the year resulted in a realized loss of \$3.5 million compared with a realized gain of \$7.9 million in 1984.

Total investment income, realized gains, and changes in unrealized gains as a percentage of average invested assets at market value employed during the year was 28.5 percent.



INVESTED ASSET CLASSIFICATION

of The Mortgage Insurance Company
of Canada at Book Value

(000's omitted)

December 31

% of Total

	1985	1985	1984
	572	0.3	0.1
	17,523	6.5	6.5
Liquid Assets	14,095	6.8	6.6
Bonds (Other)	67,512	30.1	27.2
	5,221	2.5	1.9
	176	0.1	0.3
	959	0.5	5.8
Preferred	6,356	3.1	8.0
	14,638	7.1	6.9
	98,799	46.2	45.7
Common & Convertible	110,437	53.3	52.6
	116,793	56.4	60.6
Mortgages	18,976	6.7	5.6
Total Portfolio	\$207,376	100.0	100.0

PROGRAMS

	Potential Premiums		Default Ratios	
	1985 (\$000's)	1984 (\$000's)	1985 %	1984 %
First & Second Mortgages				
Homeownership	\$22,764	\$12,236	.39	.70
Rental	666	1,538	1.01	1.19
Commercial/Industrial	193	470	1.40	2.54
Total	23,623	14,244	.43	.74

	Premiums Written		Claims Losses	
	1985 (\$000's)	1984 (\$000's)	1985 (\$000's)	1984 (\$000's)
First & Second Mortgages				
Homeownership	\$18,095	\$10,182	\$42,303	\$99,424
Rental	449	1,110	5,033	15,268
Commercial/Industrial	259	71	1,210	7,770
Unallocated Reserves	—	—	(1,441)	1,800
Total	18,803	11,363	47,106	124,262

Other Programs				
Surety	2,819	2,415	75	1,439
Lease Guarantee	59	118	90	1,195
New Home Warranty	(3,481) ⁽¹⁾	4,129	2,838	2,196
Condominium Deposit	223	308	(957)	3,000
U.S.A. Reinsurance	98	110	6	2
Total	(282)	7,081	2,052	7,832
Total	\$18,521	\$18,444	\$49,158	\$132,094

(1) This negative amount resulted from a refund of premiums
n.a. — not applicable

REAL ESTATE

(000's omitted)**	Single family*		Rental		Commercial/Industrial		Total	
	No.	\$	No.	\$	No.	\$	No.	\$
Activity								
Held at December 31, 1984	561	\$23,536	2	\$4,825	12	\$9,272	575	\$37,633
Acquired during 1985	435	20,655	1	9,875	2	5,837	438	36,367
Sales and adjustments during 1985	674	33,217	2	10,640	11	10,827	687	54,684
Held at December 31, 1985	322	10,974	1	4,060	3	4,282	326	19,316
Holdings								
as at December 31, 1985								
Newfoundland	94	2,285	—	—	—	—	94	2,285
Prince Edward Island	—	—	—	—	—	—	—	—
Nova Scotia	3	84	—	—	—	—	3	84
New Brunswick	1	32	—	—	—	—	1	32
Quebec	10	249	—	—	1	32	11	281
Ontario	2	136	—	—	2	4,250	4	4,386
Manitoba	5	89	—	—	—	—	5	89
Saskatchewan	5	203	—	—	—	—	5	203
Alberta	111	4,885	—	—	—	—	111	4,885
British Columbia	91	3,011	1	4,060	—	—	92	7,071
Total	322	\$10,974	1	\$4,060	3	\$4,282	326	\$19,316

*Includes condominium (strata title) units.

**Represents Book Value

HISTORICAL FINANCIAL ANALYSIS

THE MORTGAGE INSURANCE COMPANY OF CANADA

Issued Commitments to insure (Canadian Business, data are gross \$ millions)		1985	1984	1983	1982	1981
First and Second mortgage insurance programs — Total		1,268	956	1,307	796	2,145
	Homeownership loans	1,224	853	1,182	693	1,781
	Rental loans	33	81	75	81	255
	Commercial/industrial loans	11	22	50	22	109
	Lease guarantee	—	7	4	14	12
Insurance in Force (Canadian mortgage Insurance) At year end (\$ billions)		15.5	17.0	17.7	18.9	20.0
Average Values						
	Homeownership loans (high ratio)	63,884	61,826	61,517	60,369	61,807
	New Construction (per unit)	72,496	68,781	70,422	76,279	75,493
	Existing homes (per unit)	58,820	56,748	55,827	48,812	46,261
	Rental projects (per loan)	166,009	249,463	194,259	597,740	845,858
	Commercial/industrial (per loan)	339,605	338,413	391,273	297,531	459,936
GDS and TDS Ratios						
	Gross debt service ratio*	23.1%	23.4%	22.9%	24.2%	24.9%
	Total debt service ratio**	29.7%	29.5%	28.7%	30.2%	31.1%
Capital and Reserves (\$000's)						
	Policyholders reserves	126,896	153,241	152,518	161,016	181,643
	Capital	55,700	48,724	105,659	209,002	212,465
	Total	182,596	201,965	258,177	370,018	394,108
Active Lender Clients		168	180	200	194	255

*GDS — (Gross debt service ratio) the percentage of gross income used for mortgage payments and property taxes.

**TDS — (Total debt service ratio) the percentage of gross income used for mortgage payments, property taxes and all other instalment debts.

**MICC
INVESTMENTS
LIMITED
CONSOLIDATED
BALANCE SHEET**
AS AT DECEMBER 31, 1985

ASSETS

(thousands of dollars)	1985 \$	1984 \$
CASH AND ACCOUNTS RECEIVABLE		
Cash	2,064	217
Interest accrued and sundry receivables	4,590	9,285
Premiums receivable	1,758	1,093
Income taxes recoverable	150	210
Due from reinsurers	179	903
	8,741	11,708
REAL ESTATE	19,316	37,633
INVESTMENTS		
Treasury bills and other short-term securities – at cost	717	—
Bonds and debentures – at amortized value (market value \$42,712; 1984 – \$60,218)	39,150	58,573
Preferred stocks – at market value (cost \$20,663; 1984 – \$41,056)	21,185	38,687
Common stocks – at market value (cost \$15,335; 1984 – \$54,736)	15,600	47,332
Mortgages – at amortized value	15,942	17,915
INTER-CITY GAS CORPORATION (note 3)	119,490	113,364
	212,084	275,871
OTHER ASSETS		
Capital expenses – at amortized cost (note 5)	877	1,111
Other	582	550
	1,459	1,661
	241,600	326,873

LIABILITIES

	1985	1984
	\$	\$
ACCOUNTS PAYABLE		
Bank indebtedness	2,425	4,933
Secured loan	—	4,800
Due to reinsurers	74	127
Provision for claims	49,134	119,106
Premium taxes payable	80	167
Accounts payable and accrued liabilities	733	327
	52,446	129,460
DEFERRED REVENUE (note 4)	115,956	153,392
	168,402	282,852

SHAREHOLDERS' EQUITY (note 5)

CAPITAL STOCK	113,194	113,170
CONTRIBUTED SURPLUS	11,965	11,965
DEFICIT	(52,748)	(71,341)
	72,411	53,794
UNREALIZED GAIN (LOSS) ON STOCKS	787	(9,773)
	73,198	44,021
	241,600	326,873

SIGNED ON BEHALF OF THE BOARD



Director



Director

CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 1985

(thousands of dollars)	1985 \$	1984 \$
REVENUE		
Net premiums written	28,194	18,444
Special refund of premium (note 6)	(9,673)	—
Application fees	1,610	833
Inspection service and appraisal fees	—	86
	20,131	19,363
Decrease in unearned premiums	2,730	12,215
Special refund of premium (note 6)	9,673	—
Underwriting revenue	32,534	31,578
Investment income —		
Interest and amortization	14,560	17,298
Dividends	3,292	7,758
Equity in earnings of Inter-City Gas Corporation (note 3)	9,061	7,590
Realized gain (loss) on investments	(3,513)	7,888
Foreign exchange gain	216	375
	23,616	40,909
	56,150	72,487
EXPENSES		
Insurance underwriting and policy issuance expenses	3,657	3,441
Premium taxes	440	602
	4,097	4,043
Losses on claims	49,158	132,094
Other operating expenses (note 7)	8,709	8,271
	61,964	144,408
LOSS BEFORE INCOME TAXES, UNUSUAL AND EXTRAORDINARY ITEMS	(5,814)	(71,921)
PROVISION FOR CURRENT INCOME TAXES	105	77
LOSS BEFORE UNUSUAL AND EXTRAORDINARY ITEMS UNUSUAL ITEM	(5,919)	(71,998)
Recovery of (provision for) premium deficiency (note 8)	25,000	(15,700)
EARNINGS (LOSS) FOR THE YEAR BEFORE EXTRAORDINARY ITEM	19,081	(87,698)
EXTRAORDINARY ITEM		
Equity in extraordinary items of Inter-City Gas Corporation	248	—
NET EARNINGS (LOSS) FOR THE YEAR	19,329	(87,698)
Weighted daily average number of common shares outstanding	11,384,764	11,371,489
Earnings (loss) per common share before extraordinary item	\$0.72	(\$8.69)
Earnings (loss) per common share after extraordinary item	\$0.74	(\$8.69)

CONSOLIDATED STATEMENT OF UNREALIZED GAIN (LOSS) ON STOCKS

FOR THE YEAR ENDED DECEMBER 31, 1985

(thousands of dollars)	1985 \$	1984 \$
UNREALIZED GAIN (LOSS) ON STOCKS – BEGINNING OF YEAR	(9,773)	6,632
Unrealized gain (loss) on stocks for the year	10,560	(16,405)
UNREALIZED GAIN (LOSS) ON STOCKS – END OF YEAR	787	(9,773)

CONSOLIDATED STATEMENT OF DEFICIT

FOR THE YEAR ENDED DECEMBER 31, 1985

(thousands of dollars)	1985 \$	1984 \$
DEFICIT – BEGINNING OF YEAR	71,341	66,113
Restatement of common share capital (note 5)	—	(82,688)
(Net earnings) loss for the year	(19,329)	87,698
Gain on redemption of preferred shares	—	(67)
	52,012	71,056
Amortization of capital expenses, including equity share of capital expenses of Inter-City Gas Corporation (note 5)	736	285
DEFICIT – END OF YEAR	52,748	71,341

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1985

(thousands of dollars)	1985 \$	1984 \$
SOURCE OF FUNDS		
Common shares issued	23	22
Increase in accounts payable	—	6,580
Decrease in cash and accounts receivable	2,967	4,878
Decrease in real estate	18,317	—
Other	—	155
	21,307	11,635
USE OF FUNDS		
Operations —		
Net (earnings) loss for the year	(19,329)	87,698
Items not affecting investment funds —		
Decrease (increase) in deferred revenue	37,436	(3,239)
Depreciation and amortization	(121)	(152)
Funds used in operations	17,986	84,307
Increase in real estate	—	3
Purchase of fixed assets	113	29
Repayment of income debentures	—	3,333
Decrease in accounts payable	77,014	—
Redemption of preferred shares	—	481
Other	541	—
	95,654	88,153
FUNDS REQUIRED FROM INVESTMENTS	74,347	76,518
INVESTMENT FUNDS — BEGINNING OF YEAR	275,871	368,794
	201,524	292,276
Unrealized gain (loss) on stocks for the year	10,560	(16,405)
INVESTMENT FUNDS — END OF YEAR	212,084	275,871

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 1985

1. ACCOUNTING POLICIES

These financial statements are prepared in accordance with generally accepted accounting principles. The application of these principles is set out for the following significant items:

Principles of consolidation

The consolidated financial statements of MICC Investments Limited include the accounts of its subsidiaries. The company operates principally in the mortgage insurance business in Canada.

Premiums

Net premiums written are deferred and then taken into underwriting revenue as earned over the life of the related policies. The majority of policies have been written for twenty years. The rates or formulae under which premiums are earned relate to the amount of risk in each year of coverage as projected by management, based primarily on the past incidence of losses. The formulae under which premiums are earned are adjusted periodically in accordance with such estimates.

Application fees

Application fees received on insurance policies written are taken into income as received.

Underwriting and policy issuance expenses and premium taxes

Underwriting and policy issuance expenses and premium taxes in excess of application fees are deferred to the extent they are considered recoverable from future underwriting revenue and then amortized against premiums as the premiums are earned.

Losses on claims

Losses on claims represent the difference between the amounts claimed or estimated to be claimed and amounts recovered or estimated to be recoverable from the sale of real estate. Provisions for losses are made when it is considered probable that defaults by borrowers will result in claims. Provisions for losses on claims are updated regularly as information concerning claim amounts and real estate values becomes available.

Premiums deficiency provision

The premium deficiency provision is determined as the excess of the present value of estimated future losses on policies in force (using a discount rate of 9½% (1984-10%) over unearned premiums.

Foreign exchange

Amounts denominated in United States dollars have been translated to Canadian dollars at the following rates:

Monetary assets and liabilities — rate in effect at the balance sheet date.

Non-monetary assets — historical rates.

Revenues and expenses — average rates prevailing during the year.

Investment income

(a) Treasury bills and other short-term securities — Interest is recorded as income as it accrues. Gains and losses are taken into income when realized on disposition.

(b) Bonds, debentures and mortgages — Interest is recorded as income as it accrues. The premium or discount between cost and maturity value is amortized into income over the period to maturity. A gain or loss on the sale of a bond, debenture or mortgage is deferred and then amortized over the term to maturity of the security sold.

(c) Stocks — Dividends are recorded as income on the ex-dividend date. Gains and losses on disposal of stocks are taken into income when realized. When a decline in the value of a stock is considered to be other than temporary the investment is reduced to its net realizable value with the amount of the reduction recorded as a realized loss. Investments in common shares of companies where a degree of significant influence is present are accounted for on an equity basis. Unrealized gains and losses on stocks, excluding investments accounted for on an equity basis, are accounted for in the "Consolidated Statement of Unrealized Gain (Loss) on Stocks", the balance of which is included in shareholders' equity.

(d) Options — Premiums received on the sale of call options are deferred and amortized over the period to expiry of the option. If the option is exercised or repurchased prior to maturity, the unamortized premium is taken into income immediately.

Real estate

Real estate is carried in the accounts at its estimated realizable value after deduction of estimated real estate commissions and other sales related expenses.

2. DEPARTMENT OF INSURANCE REQUIREMENTS

The company's principal subsidiary, The Mortgage Insurance Company of Canada, is incorporated under the Canadian and British Insurance Companies Act ("the Act") and as such is subject to certain requirements and restrictions contained in the Act, including the solvency requirements of Section 103 of the Act. The subsidiary is also required to operate under a capital requirement formula, developed by the Department of Insurance of Canada, which establishes a minimum amount of capital required by the company to support outstanding insurance in force.

The following table sets out the surplus (deficiency) position of the subsidiary under Section 103 of the Act and the capital requirement formula:

	Section 103	Capital requirement formula
	(thousands of dollars)	
December 31, 1985	63,000	11,000
December 31, 1984	(39,000)	(59,000)

3. INTER-CITY GAS CORPORATION

(a) As at December 31, 1985, the unamortized excess of the cost of shares of Inter-City Gas Corporation ("ICG") over the underlying net book value of the investment amounted to approximately \$8,540,000 (1984 — \$9,055,000). The equity in earnings of ICG is being reduced by an amount sufficient to amortize this amount over the esti-

mated remaining productive life of proved oil and gas reserves at the date of acquisition of these shares, which in the aggregate is currently approximately 17 years.

- (b) The company owns 5,170,700 common shares of ICG, being 28% of that company's issued voting shares. ICG owns all of the company's issued first preferred Series G shares as well as the warrants described in note 5(b)(iii).
- (c) The company owns 3 million warrants entitling it to purchase 3 million common shares of ICG at a price of \$12 per share. These warrants expire on December 16, 1987.
- (d) As at December 31, 1985 this investment comprised:

	1985	1984
	(thousands of dollars)	
Common shares including equity in earnings since acquisition (market value \$86,609,225; 1984 - \$49,122,000)	75,064	68,785
Preferred shares - at cost (market value \$149,872; 1984 - \$259,000)	176	329
Warrants for purchase of common shares - at cost	8,250	8,250
14% note receivable	36,000	36,000
	119,490	113,364

The note receivable is due \$3,600,000 in each of the years 1988 to 1995 and the balance is due in 1996.

4. DEFERRED REVENUE

Deferred revenue consists principally of unearned premiums and a premium deficiency provision.

5. CAPITAL STOCK

The authorized, issued and fully paid capital stock of the company consists of:

Authorized -

- 3,951,600 (1984 - 3,951,600) first preferred shares issuable in series Unlimited (1984 - unlimited) second preferred shares issuable in series Unlimited (1984 - unlimited) common shares without par value

(a) Preferred shares

- i) First preferred shares Series A
800,000 first preferred shares were originally issued at \$25 per share as 10% cumulative redeemable first preferred shares Series A, of which 477,049 were outstanding at December 31, 1985.

The first preferred shares Series A are subject to mandatory sinking fund redemption at the issue price as to 56,000 shares on March 15, in each of the years 1985 to 1986 inclusive, and 72,000 shares on March 15, 1987 and on March 15 in each year thereafter.

The company may increase any annual sinking fund by 24,000 shares. The company is entitled to anticipate sinking fund requirements by purchasing shares in the market at prices not exceeding the redemption price. The company may redeem shares not required for sinking fund purposes at a premium of 3%, declining annually to the issue price on March 15, 1986.

The company did not acquire any shares under the sinking fund requirement in 1985 (1984 - 20,700 shares were acquired for \$464,945).

January 1, 1983 this dividend was increased to 8¾%.

The first preferred shares Series B are subject to mandatory sinking fund redemption at the issue price as to 66,800 shares on each of March 31, 1984 and March 31, 1985. The company did not acquire any shares under the sinking fund requirement in 1984 and 1985.

The company is entitled to anticipate sinking fund requirements by purchasing shares in the market at prices not exceeding the redemption price.

iii) First preferred shares Series C

1,000,000 first preferred shares were originally issued at \$25 per share as 8¾% cumulative first preferred shares Series C, of which 754,150 were outstanding at December 31, 1985.

The first preferred shares Series C are subject to a purchase fund under which the company shall make all reasonable efforts to purchase 10,000 shares in each calendar quarter, at a price not exceeding the issue price plus cost of purchase. This obligation is cumulative from quarter to quarter but to the extent not satisfied on December 31 of each calendar year, is extinguished. Subsequent to March 30, 1983, the company may redeem shares not required for purchase fund purposes at a premium of 5%, declining annually

	1985	1984
	\$	\$
Issued and fully paid -		
477,049 (1984 - 477,049) 10% first preferred shares Series A	11,926,225	11,926,225
133,200 (1984 - 133,200) 8¾% first preferred shares Series B	3,330,000	3,330,000
754,150 (1984 - 754,150) 8¾% first preferred shares Series C	18,853,750	18,853,750
13,320 (1984 - 13,320) 8% first preferred shares Series D	1,332,000	1,332,000
37,560 (1984 - 37,560) 8½% first preferred shares Series E	3,756,000	3,756,000
99,750 (1984 - 99,750) variable % first preferred shares Series F	9,975,000	9,975,000
342,000 (1984 - 342,000) 13% first preferred shares Series G	34,200,000	34,200,000
66,680 (1984 - 66,680) variable % first preferred shares Series H	6,668,000	6,668,000
62,440 (1984 - 62,440) variable % first preferred shares Series I	6,244,000	6,244,000
629,941 (1984 - 629,941) 8% second preferred shares Series A	15,748,525	15,748,525
	112,033,500	112,033,500
11,384,764 (1984 - 11,371,489) common shares	1,160,513	1,137,149
	113,194,013	113,170,649

thereafter to the issue price on April 1, 1988.

The company did not acquire any shares under the purchase fund requirements in 1985 (1984 – 1,200 shares were acquired for \$15,700).

- iv) First preferred shares Series D
80,000 first preferred shares were originally issued at \$100 per share as 8% cumulative redeemable and retractable first preferred shares Series D, of which 13,320 were outstanding at December 31, 1985. The first preferred shares Series D were retractable under certain circumstances or were convertible into floating rate first preferred shares at the holders' option on June 30, 1983. In accordance with the provision, 66,680 first preferred shares Series D were converted on a one-for-one basis into variable rate first preferred shares Series H.
The first preferred shares Series D are subject to mandatory pro-rata sinking fund redemption at the issue price as to 4,000 shares on June 30, 1989 and on June 30 in each year thereafter until full redemption has occurred.
- v) First preferred shares Series E
100,000 first preferred shares were originally issued at \$100 per share as 8½% cumulative redeemable and retractable first preferred shares Series E, of which 37,560 were outstanding at December 31, 1985.
The first preferred shares Series E are subject to mandatory pro-rata sinking fund redemption at the issue price as to 5,000 shares on December 31, 1989 and on December 31 in each year thereafter up to and including December 31, 2008.
The first preferred shares Series E were under certain circumstances retractable or were convertible into floating rate first preferred shares at the holders' option on December 31, 1983. In accordance with this provision, 62,440 first preferred shares Series E were converted on a one-for-one basis into variable rate first preferred shares Series I, as at January 1, 1984.
- vi) First preferred shares Series F
105,000 first preferred shares were originally issued at \$100 per share as variable rate cumulative redeemable and retractable first preferred shares Series F, of which

99,750 were outstanding at December 31, 1985. The annual rate of dividends payable on the first preferred shares Series F is one-half of the prime rate plus one and three-quarter percent.

The first preferred shares Series F are subject to mandatory pro-rata sinking fund redemption at the issue price as to 5,250 shares on September 30 in each year up to and including September 30, 1990. All shares outstanding on September 30, 1991 shall be redeemed on that date. The company did not acquire any shares under the sinking fund requirement in 1984 and 1985.

The first preferred shares Series F are retractable under certain circumstances at the issue price at the holders' option on September 30, 1986.

- vii) First preferred shares Series G
360,000 first preferred shares were originally issued at \$100 per share as 13% cumulative redeemable first preferred shares Series G, of which 342,000 were outstanding at December 31, 1985.
The first preferred shares Series G are subject to mandatory sinking fund redemption at the issue price as to 18,000 shares on December 31 in each year up to and including December 31, 1986. All shares outstanding on December 31, 1987 shall be redeemed on that date. The company did not acquire any shares under the sinking fund requirement in 1984 and 1985.
The company is entitled to anticipate sinking fund requirements by purchasing shares in the market at prices not exceeding the redemption price. Other than for sinking fund purposes, the corporation may not redeem the first preferred shares Series G prior to December 31, 1987.
- viii) First preferred shares Series H
66,680 first preferred shares were originally issued at \$100 per share as variable rate cumulative redeemable and retractable first preferred shares Series H, all of which were outstanding at December 31, 1985. The annual rate of dividends payable on the first preferred shares Series H is one-half of the prime rate plus two percent.
The first preferred shares Series H are subject to mandatory pro-rata sinking fund redemption at the issue price as to 3,334 shares on June 30, 1989 and June 30 in each

year thereafter up to and including June 30, 2008.

The first preferred shares Series H are retractable at the issue price at the holders' option on June 30, 1988.

- ix) First preferred shares Series I
62,440 first preferred shares were originally issued at \$100 per share as variable rate cumulative redeemable and retractable first preferred shares Series I, all of which were outstanding at December 31, 1985. The annual rate of dividends payable on the first preferred shares Series I is one-half of the prime rate plus two and one-quarter percent.
The first preferred shares Series I are subject to mandatory pro-rata sinking fund redemption at the issue price as to 3,122 shares on December 31, 1989 and December 31 in each year thereafter up to and including December 31, 2008.
The first preferred shares Series I are retractable at the issue price at the holders' option on December 31, 1988.
- x) Second preferred shares Series A
800,000 second preferred shares were originally issued at \$25 per share as 8% cumulative redeemable convertible second preferred shares Series A, of which 629,941 were outstanding at December 31, 1985.
The second preferred shares Series A are subject to a purchase fund under which the company shall make all reasonable efforts to purchase in each calendar quarter, commencing with the calendar quarter ending March 31, 1984, 0.75% of the difference between the number of second preferred shares Series A originally issued and the number of shares converted into common shares prior to such calendar quarter at a price not exceeding the issue price plus costs of purchase. This obligation is cumulative from quarter to quarter, but to the extent not satisfied on December 31 of each calendar year, is extinguished. Subsequent to December 31, 1983 the company may redeem shares not required for purchase fund purposes at a premium of 5%, declining annually thereafter to the issue price on December 31, 1988.
The second preferred shares Series A are convertible on or before December 31, 1988 into fully paid common shares, at the holders'

option, at a conversion price of \$10.370 per common share on the basis of approximately 2.41 common shares for each second preferred share held.

x) Preferred share dividends and sinking fund redemptions

Cumulative dividends in arrears and arrears in respect of sinking fund obligations as at December 31, 1985 on the outstanding preferred shares are as follows:

	Divi- dends	Sinking fund obliga- tions
	(thousands of dollars)	
First preferred shares Series A	2,385	526
First preferred shares Series B	583	3,330
First preferred shares Series C	3,252	—
First preferred shares Series D	213	—
First preferred shares Series E	639	—
First preferred shares Series F	1,481	1,050
First preferred shares Series G	8,892	3,600
First preferred shares Series H	1,026	—
First preferred shares Series I	989	—
Second preferred shares Series A	2,520	—
	21,980	8,506

xii) Preferred share voting privileges

As a result of the arrears in dividend payments, each issued preferred share of a class carries the right to one vote at all meetings of shareholders as long as there remain any dividends in arrears on any series of preferred shares within that class.

xiii) Issuance costs

Costs incurred in connection with the issuance of preferred shares have been capitalized and are being amortized against retained earnings over the estimated term of the shares on a weighted average basis.

(b) Common shares

i) On April 30, 1984, the shareholders approved a special resolution restating the amount of issued and outstanding common shares from \$91,290,922 to \$1,137,149. Of the net reduction of \$90,153,773 in the stated capital, \$82,688,440 was applied against the deficit and the balance of \$7,465,333 was credited to contributed surplus.

ii) Options to acquire a maximum of 100,000 of the company's common shares at \$7.20 per share on or before May 15, 1993, and 20,000

common shares at \$10 per share on or before November 30, 1986, are held by two officers and directors of the company.

iii) The company has 3,000,000 common share purchase warrants outstanding entitling the holders to purchase up to 3,000,000 common shares at \$12 per share on or before December 16, 1987.

iv) Under the employee Stock Purchase Plan, certain employees may purchase up to 300 common shares in January of each year at 90% of market price. Funds are loaned to the employee who repays this amount, together with interest thereon at 3% per annum, over a 12-month period. During the year, 13,275 (1984 — 4,150) common shares were issued for \$23,364 cash (1984 — \$22,410) under this plan.

6. SPECIAL REFUND OF PREMIUM

During 1985, the company's insurance agreement with the Ontario New Home Warranty Program was terminated and the company amended the terms of its insurance agreement with the Quebec New Home Warranty Program.

As a result of these changes the company refunded \$9,673,000 of premiums written under the agreements, which amount had been included in deferred revenue.

7. OTHER OPERATING EXPENSES

Included in other operating expenses are the following amounts of depreciation and amortization:

Year ended December 31,	(thousands of dollars)
1985	121
1984	152

8. PREMIUM DEFICIENCY PROVISION

As a result of falling property values in Alberta during 1983, the company experienced a high level of losses on claims incurred. It was estimated at December 31, 1983 that the present value of future losses (using a discount rate of 10¼%) on policies of insurance issued prior to December 31, 1983 may exceed deferred premiums. This estimate had been made in light of all relevant known factors.

Accordingly, a premium deficiency provision of \$29,300,000 together with a write-off of deferred policy acquisition costs of \$2,091,000 was charged against earnings in 1983.

During 1984, this provision was increased to \$45,000,000.

During 1985, this provision has been reduced to \$20,000,000.

It is the company's intention to continuously monitor this situation on a quarterly basis and to make further increases or reductions in the provision as may be necessary.

9. LEASE COMMITMENTS

Minimum annual commitments for premises and equipment under operating leases are as follows:

Year ending December 31,	(thousands of dollars)
1986	1,785
1987	1,651
1988	1,563
1989	1,358
1990	1,250
Thereafter	2,453
	10,060

10. FUTURE INCOME TAXES

As at December 31, 1985, the company has incurred losses for income tax purposes amounting to approximately \$88,000,000. These losses may be utilized to reduce income for tax purposes in future years up to and including 1992. In addition, differences between the timing of revenues and expenses recognized for income tax purposes and those recognized for accounting purposes have resulted in a net amount of approximately \$144,000,000 being available to reduce future years' income for tax purposes. The potential future income tax benefits of these amounts have not been recognized in the accounts.

11. RELATED PARTY TRANSACTIONS

Central Trust Company is a related party as a result of its ownership of shares of the company and because certain of the company's directors are directors and/or senior officers of Central Trust Company. Central Trust Company and its affiliates, from time to time, insure mortgage loans with The Mortgage Insurance Company of Canada, a wholly-owned subsidiary. The policies of insurance are issued under standard terms and conditions and the premiums written in 1985 from such policies represented less than 3% of the total premiums written for the year. Losses on claims incurred on this business and on business written in prior years are not considered material.

Inter-City Gas Corporation is a related party as a result of the interests described in note 3. The company has reimbursed ICG for certain expenses incurred on the company's behalf.

12. SUBSEQUENT EVENTS

- (a) On January 1, 1986, 10,725 common shares of the company were issued at a price of \$3.20 per share on behalf of 64 full time employees.
- (b) By resolution passed by the directors of The Mortgage Insurance Company of Canada on February 6, 1986, The Mortgage Insurance Company of Canada was authorized to issue 1,844,806 Series A Preference Shares and 600,500 Series B Preference Shares. The Series A Preference Shares are exchangeable, pursuant to an exchange agreement dated February 6, 1986, at the holders' option into common shares

of the company on the basis of eight common shares for one Series A Preference Share. The Series B Preference Shares are exchangeable at the holders' option into common shares of the company on a basis similar to the ratio for the Series A Preference Shares (the final ratio to be determined subsequent to the issue but not to exceed the ratio on the Series A Preference Shares). The exchange privilege extends from March 12, 1987 to March 31, 1993.

- (c) Pursuant to the resolution noted above The Mortgage Insurance Company of Canada issued to holders of MICC

Investments Limited common shares and of MICC Investments Limited Second Preferred Shares Series A of record at the close of business on February 19, 1986, one right per common share and 2.41 rights per Second Preferred Series A share to subscribe for the 1,844,806 Series A Preference Shares.

By means of a concurrent purchase agreement The Mortgage Insurance Company of Canada has agreed to issue to certain directors of the company the 600,500 Series B Preference Shares described above.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of MICC Investments Limited as at December 31, 1985 and the consolidated statements of operations, deficit, unrealized gain (loss) on stocks and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1985 and the results of its operations and the changes in its

financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand

CHARTERED ACCOUNTANTS
Toronto, Ontario
February 27, 1986

Transfer Agents

First preferred shares
National Trust Company
Limited

Second preferred shares
The Canada Trust Company

Common shares
The Canada Trust Company

Registrars

First preferred shares
National Trust Company
Limited

Second preferred shares
The Canada Trust Company

Common shares
The Canada Trust Company

Auditors

Coopers & Lybrand

**THE MORTGAGE
INSURANCE COMPANY
OF CANADA
(A WHOLLY-OWNED SUBSIDIARY)
BALANCE SHEET
AS AT DECEMBER 31, 1985**

ASSETS

(thousands of dollars)	1985 \$	1984 \$
CASH AND ACCOUNTS RECEIVABLE		
Cash	2,033	356
Premiums receivable	1,758	1,092
Interest accrued and sundry receivables	4,485	9,058
Due from reinsurers	179	904
Income taxes recoverable	150	210
	8,605	11,620
REAL ESTATE	19,316	37,632
INVESTMENTS		
Bonds and debentures – at amortized cost	40,607	59,664
Stocks – at cost (market value \$36,553; 1984 – \$85,560)	36,153	96,569
Mortgages – at amortized cost	13,976	15,754
INTER-CITY GAS CORPORATION (note 3)	116,640	110,515
	207,376	282,502
FIXED ASSETS – at cost, less accumulated depreciation	535	543
	235,832	332,297

LIABILITIES

	1985	1984
	\$	\$
ACCOUNTS PAYABLE		
Bank indebtedness	—	2,569
Secured loan	—	4,800
Due to reinsurers	73	127
Provision for claims	49,134	119,105
Premium taxes payable	80	168
Due to parent company	3,023	3,004
Due on securities	80	160
Accounts payable and accrued liabilities	590	138
	52,980	130,071
UNEARNED REVENUE	96,094	108,502
PROVISION FOR MORTGAGE INSURANCE POLICIES	31,058	45,000
	180,132	283,573

SHAREHOLDERS' EQUITY (note 4)

CAPITAL STOCK	1,804	33,679
CONTRIBUTED SURPLUS	70,010	70,010
DEFICIT	(16,114)	(54,965)
	55,700	48,724
	235,832	332,297

SIGNED ON BEHALF OF THE BOARD



Director



Director

STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 1985

(thousands of dollars)	1985 \$	1984 \$
REVENUE		
Net premiums written	28,194	18,444
Special refund of premium (note 6)	(9,673)	—
Application fees	1,609	981
	20,130	19,425
Decrease in unearned revenue	2,731	12,214
Special refund of premium (note 6)	9,673	—
Decrease (increase) in additional policy reserves	1,567	(563)
Underwriting revenue	34,101	31,076
Investment income —		
Interest and amortization	13,709	16,148
Dividends	3,292	7,758
Realized gain (loss) on investments	(3,982)	6,051
Gain on foreign exchange	216	375
Equity in earnings of Inter-City Gas Corporation (note 3)	9,061	6,495
	22,296	36,827
	56,397	67,903
EXPENSES		
Insurance underwriting and policy issuance expenses	3,656	3,441
Premium taxes	439	602
	4,095	4,043
Losses on claims	49,158	132,094
Other operating expenses (note 7)	8,241	7,688
	61,494	143,825
LOSS BEFORE INCOME TAXES, UNUSUAL AND EXTRAORDINARY ITEMS	(5,097)	(75,922)
PROVISION FOR CURRENT INCOME TAXES	105	77
LOSS BEFORE UNUSUAL AND EXTRAORDINARY ITEMS	(5,202)	(75,999)
UNUSUAL ITEM		
Recovery of (provision for) premium deficiency	12,375	(12,375)
EARNINGS (LOSS) BEFORE EXTRAORDINARY ITEM EXTRAORDINARY ITEM	7,173	(88,374)
Equity in extraordinary items of Inter-City Gas Corporation	248	—
NET EARNINGS (LOSS) FOR THE YEAR	7,421	(88,374)

STATEMENT OF DEFICIT

FOR THE YEAR ENDED DECEMBER 31, 1985

(thousands of dollars)	1985 \$	1984 \$
DEFICIT		
Balance — beginning of year	108,952	76,887
Restatement of preferred share capital (note 4)	—	(106,894)
Restatement of common share capital (note 4)	(31,876)	—
	77,076	(30,007)
Net (earnings) loss for the year	(7,421)	88,374
	69,655	58,367
Dividends —		
Preferred shares	—	1,704
Equity share of capital expenses of Inter-City Gas Corporation	445	—
	445	1,704
Transfer to (from) reserves required by the Department of Insurance	(48,133)	48,880
	(47,688)	50,584
	21,967	108,951
RESERVES REQUIRED BY THE DEPARTMENT OF INSURANCE (note 2)		
Balance — beginning of year	53,986	5,106
Transfer (to) from unappropriated retained earnings	(48,133)	48,880
	5,853	53,986
DEFICIT — END OF YEAR	16,114	54,965

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1985

For the year ended December 31, 1985 (thousands of dollars)	1985 \$	1984 \$
SOURCE OF FUNDS		
Issuance of preferred shares	—	33,144
Increase in accounts payable	—	9,689
Decrease in cash and accounts receivable	3,015	5,165
Decrease in real estate	18,316	—
	<u>21,331</u>	<u>47,998</u>
USE OF FUNDS		
Operations—		
Net (earnings) loss for the year	(7,421)	88,374
Items not affecting investment funds—		
Decrease in unearned revenue	12,408	12,696
Recovery of (provision for) premium deficiency	12,375	(12,375)
Decrease (increase) in provision for mortgage insurance policies	1,567	(563)
Depreciation and amortization	(121)	(152)
Funds used in operations	18,808	87,980
Increase in real estate	—	2
Purchase of fixed assets	113	29
Preferred share dividends	—	1,704
Decrease in accounts payable	77,091	—
Other	445	(6)
	<u>96,457</u>	<u>89,709</u>
FUNDS REQUIRED FROM INVESTMENTS	(75,126)	(41,711)
INVESTMENT FUNDS – BEGINNING OF YEAR	282,502	324,213
INVESTMENT FUNDS – END OF YEAR	207,376	282,502

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 1985

1. ACCOUNTING POLICIES

The company operates principally in the mortgage insurance business in Canada. These financial statements have been prepared in accordance with accounting policies prescribed or permitted by the Department of Insurance of Canada.

Premiums

Net premiums written are deferred and then taken into underwriting revenue as earned over the life of the related policies. The majority of policies have been written for terms of twenty years. The rates or formulae under which premiums are earned are as prescribed by the Department of Insurance of Canada.

Application fees

Application fees received on insurance policies written are taken into income as received.

Losses on claims

Losses on claims represent the difference between the amounts claimed or estimated to be claimed and amounts recovered or estimated to be recoverable from the sale of real estate. Provisions for losses are made when it is considered probable that defaults by borrowers will result in claims. Provisions for losses on claims are updated regularly as information concerning claim amounts and real estate values becomes available.

Provision for mortgage insurance policies

The provision for mortgage insurance policies is the greater of additional policy reserves calculated by a formula as required by the Department of Insurance and a premium deficiency provision if required. As at December 31, 1985 the provision was composed of additional policy reserves. In 1984, a premium deficiency provision was used since it exceeded the additional policy reserves.

Investment income

(a) Treasury bills and other short-term securities – Interest is recorded as income as it accrues. Gains and losses are taken into income when realized on disposition.

(b) Bonds, debentures and mortgages – Interest is recorded as income as it accrues. The premium or discount between cost and maturity value is amortized into income over the period to maturity.

(c) Stocks – Dividends are recorded as income on the ex-dividend date. Gains and losses on disposal of stocks are taken into income when realized. When a decline in the value of a stock is considered to be other than temporary the investment is reduced to its net realizable value with the amount of the reduction recorded as a realized loss. Investments in common shares of companies where a degree of significant influence is present are accounted for on an equity basis.

(d) Options – Premiums received on the sale of call options are deferred and taken into income at the earlier of the exercise, repurchase or expiry of the option.

Foreign exchange

Amounts denominated in United States dollars have been translated to Canadian dollars at the following rates:

Monetary assets and liabilities – rate in effect at the balance sheet date.

Non-monetary assets – historical rates.

Revenues and expenses – average rate prevailing during the year.

Income taxes

Income taxes are provided using the tax allocation method.

Real estate

Real estate is carried in the accounts at its estimated realizable value after deduction of real estate commissions and other sales related expenses.

Deferred policy acquisition costs

Deferred policy acquisition costs comprise underwriting and policy issuance expenses and premium taxes less application fees. These costs are deferred to the extent they are considered recoverable from future underwriting revenue and then amortized against premiums as the premiums are earned.

Fixed assets

Fixed assets are capitalized and are depreciated over their estimated useful lives as follows:

Furniture and fixtures – 20% declining balance
Leasehold improvements – 20% straight-line

2. DEPARTMENT OF INSURANCE REQUIREMENTS

The company is incorporated under the Canadian and British Insurance Companies Act ("the Act") and as such is subject to certain requirements and restrictions contained in the Act, including the solvency requirements of Section 103 of the Act. The company is also required to operate under a capital requirement formula, developed by the Department of Insurance of Canada, which establishes a minimum amount of capital required by the company to support outstanding insurance in force.

The following table sets out the approximate surplus (deficiency) position under Section 103 of the Act and the capital requirement formula:

	Section 103	Capital requirement formula
	(thousands of dollars)	
December 31, 1985	63,000	11,000
December 31, 1984	(39,000)	(59,000)

Reserves required by the Department of Insurance comprise:

(thousands of dollars)	December 31,	
	1985	1984
Non-admitted assets	1,532	652
Unregistered reinsurance	121	139
Claims contingency reserve	4,200	4,200
Investment valuation reserve	—	10,683
Foreign exchange reserve	—	107
Excess investment in common shares	—	38,205
	<u>5,853</u>	<u>53,986</u>

3. INTER-CITY GAS CORPORATION

(a) In 1984 the company acquired from its parent, MICC Investments Limited, an additional 2,600,000 common shares of Inter-City Gas Corporation ("ICG") in exchange for preferred shares of the company at a value of \$33,144,429. This amount has been allocated to the fair value of the net underlying assets of ICG on the same basis as the parent company's original acquisition. This transaction increases the company's investment to 5,170,700 common shares, being 28% of the outstanding voting shares of ICG.

(b) In 1984 the company acquired from its parent 3,000,000 common share warrants of ICG for \$2,400,000 cash and a \$3,000,000 demand note payable. These warrants entitle the company to purchase 3,000,000 common shares of ICG at \$12 per share on or before December 16, 1987.

(c) As at December 31, 1985 the un-amortized excess of the cost of shares of ICG over the underlying net book value of the investment amounted to approximately \$8,540,000 (1984-\$9,055,000). The equity in earnings of ICG is being reduced by an amount sufficient to amortize this amount over the estimated remaining productive life of proved oil and gas reserves at the date of acquisition of these shares, which in the aggregate is currently approximately 17 years.

(d) The investment in ICG is comprised as follows:

(thousands of dollars)	December 31,	
	1985	1984
Common shares including equity in earnings since acquisition — (market value \$85,317,000; 1984-\$51,707,000)	75,064	68,786
Preferred shares at cost (market value 1985 — \$167,000; 1984 — \$259,434)	176	329
14% note receivable	36,000	36,000
Warrants for purchase of common shares — at cost	5,400	5,400
	<u>116,640</u>	<u>110,515</u>

The note receivable is due \$3,600,000 in each of the years 1988 to 1995 and the balance is due in 1996.

(e) ICG owns 342,000, being 13%, of the issued preferred shares of the parent company, as well as warrants to acquire up to 3,000,000 common shares of the parent company.

4. CAPITAL STOCK AND CONTRIBUTED SURPLUS

(a) Authorized —

10,000,000 common shares with a par value of \$1 each

Issued and fully paid —

	December 31,	
	1985	1984
(thousands of dollars)		
Preferred shares		
(1985 — nil;		
1984 — 1,482,297)	—	1,482
Common shares		
(1985 — 1,804,272;		
1984 — 321,975)	1,804	32,197
	<u>1,804</u>	<u>33,679</u>

(b) The company's share capital was amended by supplementary letters patent on December 31, 1985 as follows:

i) The par value of the Company's common shares was reduced from \$100 to \$1 per share.

ii) The authorized number of common shares was increased from 550,000 to 10,000,000.

iii) Authorized preference shares of 2,150,000 including 1,482,297 issued and outstanding were re-designated as 2,150,000 common

shares, of which 1,482,297 represent issued and outstanding common shares.

iv) The deficit was reduced by the transfer of \$31,876,000 from paid-up capital.

(c) During 1984, the company issued 312,297 preferred shares as consideration for the purchase of the 2,600,000 common shares of ICG referred to in note 3. The excess of the fair value of the ICG shares acquired over the par value of the preferred shares issued, amounting to \$1,915,000, was credited to contributed surplus.

(d) Effective April 30, 1984, the par value of the preferred share capital was reduced from \$100 per share to \$1 per share. The net reduction of \$146,747,000 in the stated preferred capital was applied to eliminate the deficit of \$106,895,000 at March 31, 1984 and the balance of \$39,852,000 was credited to contributed surplus.

5. LEASE COMMITMENTS

Minimum annual commitments for premises and equipment under operating leases are as follows:

Year ending December 31,	(thousands of dollars)
1986	1,785
1987	1,651
1988	1,563
1989	1,358
1990	1,250
Thereafter	2,453
	<u>10,060</u>

6. SPECIAL REFUND OF PREMIUM

During 1985, the company's insurance agreement with the Ontario New Home Warranty Program was terminated and the company amended the terms of its insurance agreement with the Quebec New Home Warranty Program.

As a result of these changes the company refunded \$9,673,000 of premiums written under the agreements which had been included in unearned revenue.

7. OTHER OPERATING EXPENSES

Included in other operating expenses are the following amounts of depreciation and amortization:

Year ending December 31,	(thousands of dollars)
1985	121
1984	152

8. FUTURE INCOME TAXES

As at December 31, 1985, the company has incurred losses for income tax purposes amounting to approximately \$88,000,000. These losses may be utilized to reduce income for tax purposes in future years up to and including 1992. In addition, difference between the timing of revenues and expenses recognized for income tax purposes and those recognized for accounting purposes have resulted in a net amount of approximately \$144,000,000 being available to reduce future years' income for tax purposes. The potential future income tax benefit of these amounts has not been recognized in the accounts.

9. RELATED PARTY TRANSACTIONS

Central Trust Company is a related party as a result of its ownership of shares of the company's parent and certain of the parent company's directors are directors and/or senior officers of Central Trust Company. Central Trust company and its affiliates, from time to time, insure mortgage loans with the company. The policies of insurance are issued under standard terms and conditions and the premiums written in 1985 from such policies represented less than 3% of the total premiums written for the year. Losses on claims incurred on this business and on business written in prior years are not considered material.

Inter-City Gas Corporation is a related party as a result of the interests described in note 3. The company has reimbursed

ICG for certain expenses incurred on the company's behalf.

10. SUBSEQUENT EVENTS

(a) By supplementary letters patent dated February 6, 1986 the company created 10,000,000 preference shares of \$1.00 each issuable in series, and designated 1,844,806 of such shares as Variable Rate Exchangeable Preference Shares, Series A (the "Series A Preference Shares"), and 600,500 of such shares as Variable Rate Exchangeable Preference Shares, Series B (the "Series B Preference Shares").

(b) The company issued to holders of MICC Investments Limited common shares and of MICC Investments Limited Second Preferred Shares Series A of record at the close of business on February 19, 1986, one Right per common share, and 2.41 Rights per Second Preferred Series A share for the purchase of the company's Series A Preference Shares. The Rights are exercisable at the ratio of one Series A Preference Share for seven rights exercised at consideration of \$25 per share for total consideration of \$46,120,150. The Rights expire on March 12, 1986. Any Series A Preference Shares not purchased pursuant to this offering will be purchased by the standby purchasers. The standby purchasers include certain shareholders, directors and officers of the company or the parent company. The proceeds of this issue are to be received

on an instalment basis. The first instalment of \$12.50 per share is due on exercise of the Rights and the final instalment is due on March 12, 1987.

The company has also agreed to sell concurrently 600,500 Series B Preference Shares to the standby purchasers for consideration of \$15,012,500 due as follows:

	\$
April 11, 1986	7,506,250
March 12, 1987	7,506,250

The Series A Preference Shares are exchangeable at the holders' option into common shares of MICC Investments Limited on the basis of eight common shares for one Series A Preference Share. The Series B Preference Shares are exchangeable at the holders' option into common shares of MICC Investments Limited on a basis similar to the ratio for the Series A Preference Shares (the final ratio to be determined subsequent to the issue but is not to exceed the ratio on the Series A Preference Shares). The exchange privilege extends from March 12, 1987 to March 31, 1993.

Cumulative dividends are payable quarterly on the Series A and Series B Preference Shares at a rate of prime less ½ of 1% per annum. The Series A and Series B Preference Shares are subject to mandatory redemption over a period of five years, commencing on the eighth anniversary from the date of issue, at \$25 per share plus accrued and unpaid dividends.

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the balance sheet of The Mortgage Insurance Company of Canada as at December 31, 1985 and the statements of operations, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1985 and the results of its operations and the changes in its financial

position for the year then ended in accordance with the accounting policies described in note 1 to the financial statements applied on a basis consistent with that of the preceding year.

Coopers & Lybrand

CHARTERED ACCOUNTANTS
Toronto, Ontario
February 27, 1986

Transfer Agents
First Preferred Shares
The Canada Trust Company

Registrars
First Preferred Shares
The Canada Trust Company

BOARD OF DIRECTORS

The Board of Directors
MICC Investments
Limited
The Mortgage Insurance
Company of Canada

Michel F. Belanger
Chairman of the Board and
Chief Executive Officer
The National Bank of Canada
Montreal, Quebec

***Ron C. Brown,**
Partner
Blake, Cassels & Graydon
Toronto, Ontario

H. Reuben Cohen,
Barrister and Solicitor
Moncton, New Brunswick

***Harold Corrigan**
Consultant,
Company Director
Toronto, Ontario

Stanley Davison
Vice-Chairman
Bank of Montreal
Calgary, Alberta

Leonard Ellen
Chairman
Leonard Ellen Canada Inc.
Montreal, Quebec

Jock K. Finlayson
Chairman
The Royal Insurance
Company of Canada
Toronto, Ontario

***Robert G. Graham**
Chairman, President and
Chief Executive Officer
MICC Investments Limited
President and Chief
Executive Officer
The Mortgage Insurance
Company of Canada
Toronto, Ontario
and Inter-City Gas
Corporation
Winnipeg, Manitoba

Gordon P. Osler
Chairman
Slater Steels Corporation
Toronto, Ontario

***David Rattee**
President and
Chief Operating Officer
Continental Bank of Canada
Toronto, Ontario

***Reginald T. Ryan**
Chairman
The Mortgage Insurance
Company of Canada
Deputy Chairman
MICC Investments Limited
Toronto, Ontario

Marshall G. Smith
Executive Vice-President,
Investments
The Great West Life
Assurance Company
Winnipeg, Manitoba

Alan Sweatman,
Partner
Thompson, Dorfman and
Sweatman
Winnipeg, Manitoba

G.J. van den Berg
Company Director
Toronto, Ontario

B.G. Willis
Chairman
Shieldings Incorporated
Toronto, Ontario

***Audit Committee Member—**
MICC Investments Limited
and The Mortgage Insurance
Company of Canada

Executive Officers
MICC Investments
Limited

Robert G. Graham
Chairman, President and
Chief Executive Officer

Reginald T. Ryan
Deputy Chairman

James D. Hewitt
Executive Vice-President
and Chief Operating Officer

J. Donald Bergeron
Vice-President,
Legal Counsel and Secretary

The Mortgage Insurance
Company of Canada

Reginald T. Ryan
Chairman

Robert G. Graham
President and
Chief Executive Officer

James D. Hewitt
Executive Vice-President
and Chief Operating Officer

J. Donald Bergeron
Vice-President
Legal Counsel and
Secretary

Clair E. Shoemaker
Vice-President and
Chief Underwriter

Michael L. Stein
Vice-President,
Claims and Real Estate

As of April 1, 1986

