



Scottish & York

Annual Report

1985



Board of Directors

R. D. ABBOT
R. W. BROUGHTON
S. F. CHAPMAN
I. D. CROFT
W. G. HOLBROOK
A. D. McEWEN
K. R. THOMSON
R. W. TORRENS
J. A. TORY

Officers

R. W. BROUGHTON — *Chairman of the Board and Chief Executive Officer*
W. G. HOLBROOK — *President and Chief Operating Officer*
R. D. ABBOT — *Vice-President and Secretary-Treasurer*
D. A. BOYD — *Vice-President*

Transfer Agent

MONTREAL TRUST COMPANY

Auditors

THORNE RIDDELL

Bankers

THE ROYAL BANK OF CANADA

Executive Office

150 EGLINTON AVENUE EAST, TORONTO, CANADA

To The Shareholders

The effects of the longest depressed underwriting cycle experienced by the property casualty insurance industry continued to be felt in 1985 as underwriting results further deteriorated from record losses posted in 1984. Your Company, for the second year in a row, recorded a loss, having previously experienced twenty three years of uninterrupted earnings from continuing operations. The consolidated net loss before providing for dividends on preference shares and before extraordinary items was \$14.7 million for 1985 compared to a \$2.3 million loss for 1984. An extraordinary gain of \$1.0 million reduced the loss for the year to \$13.7 million. After providing for the preference dividends, which were all satisfied by the issuance of additional Class B preference shares, the loss attributable to each common share was \$2.27 before and \$2.14 after accounting for the extraordinary item, compared to a loss of 70¢ in 1984.

The extraordinary item represents a cash settlement arising out of an amendment to the Marketing Agreement between the Company and Eaton Bay Financial Services Limited. Since Hudson's Bay Company is not maintaining its interest in Eaton Bay Financial Services Limited, the Company will no longer market insurance products through Bay stores. The name of our subsidiary company, Eaton Bay Insurance Company, will be changed to Eaton Insurance Company and this company will continue to market insurance products through Eaton stores.

The growth in net premiums written for the year directly reflects the substantial rate increases implemented on all lines of business underwritten by your Company during 1985. Although the full impact of rate increases implemented in 1985 will not be felt until 1986, it is evident that further rate strengthening is needed. Your company initiated further increases early in 1986 to improve its underwriting performance.

Substantial reserve strengthening was made throughout the year on liability claims incurred in prior underwriting years in recognition of the significant changes that have taken place in our tort liability system of compensating for injuries.

Much publicity has been given to the spectacular compensation awarded by the courts to claimants who have suffered severe injuries. The roots of the problem go much deeper. The Family Law Act introduced in Ontario has widened both the class of those who may claim for monetary damages and the types of claims which may be made. Most relatives may now make a claim based on the loss of care, guidance and companionship suffered as a result of injury to or death of a family member. This has resulted in awards being made today many times in excess of those that would have been granted prior to this Act coming into effect. In addition, pre-judgement interest and the ability of claimants to obtain double recovery in certain circumstances add to the difficulties facing the industry. Rate increases alone are not the answer. Legislative reform of the present system of reparations for injuries is necessary.

During 1985, the Company's major shareholder, The Standard St. Lawrence Company Limited, purchased 1,500,000 Class A preference shares for cash consideration of \$15 million. Subsequent to December 31, 1985, an additional 650,000 Class A preference shares were purchased by The Standard St. Lawrence Company Limited for cash consideration of \$6.5 million. Proceeds from issuance of these shares will be used to support the underwriting activities of the Group.

On behalf of the Board of Directors, I would like to express our appreciation to our staff and clients for their loyalty and support during the year.

For the Board of Directors



R.W. BROUGHTON

Chairman of the Board and
Chief Executive Officer.

SCOTTISH & YORK HOLDINGS LIMITED

(Incorporated under the laws of Ontario)

CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 1985

	<u>1985</u>	<u>1984</u>
Cash.....		\$ 5,242,405
Marketable securities		
Term deposits.....	\$ 62,709,715	54,396,865
Bonds (market value 1985, \$56,270,847; 1984, \$37,291,760)	55,286,027	39,936,737
Stocks (market value 1985, \$6,098,151; 1984, \$5,872,352).....	6,316,554	6,731,047
Accrued interest on bonds and term deposits. . .	2,550,230	2,077,618
Accounts receivable	57,362,820	36,300,394
Notes receivable (note 2)	5,252,015	4,964,305
Income taxes recoverable.....	2,061,715	2,256,857
Fixed assets.....	557,307	755,673
Marketing agreement, net of amortization (note 4).....	<u>336,000</u>	<u>595,000</u>
	<u>\$192,432,383</u>	<u>\$153,256,901</u>

Approved by the Board

W.G. HOLBROOK, Director

R.D. ABBOT, Director

LIABILITIES

	<u>1985</u>	<u>1984</u>
Bank indebtedness	\$ 5,180,015	\$ 3,000,000
Accounts payable and accrued liabilities	34,027,229	22,395,706
Provision for outstanding claims.....	93,066,877	75,591,601
Income and premium taxes payable.....	2,683,431	1,502,144
Deferred revenue	23,696,918	18,347,428
Interest of minority shareholders.....	<u>8,450</u>	<u>8,450</u>
	<u>158,662,920</u>	<u>120,845,329</u>

SHAREHOLDERS' EQUITY

Capital stock (note 3)	70,939,800	52,552,600
Deficit	<u>(37,170,337)</u>	<u>(20,141,028)</u>
	<u>33,769,463</u>	<u>32,411,572</u>
	<u>\$192,432,383</u>	<u>\$153,256,901</u>

Commitments (note 6)
Subsequent event (note 8)

SCOTTISH & YORK HOLDINGS LIMITED

CONSOLIDATED STATEMENT OF INCOME

YEAR ENDED DECEMBER 31, 1985

	<u>1985</u>	<u>1984</u>
Net premiums earned.....	\$57,533,317	\$50,723,505
Claims incurred.....	70,597,259	54,523,723
Commissions and other underwriting expenses.....	13,918,599	13,116,945
	<u>84,515,858</u>	<u>67,640,668</u>
Underwriting loss.....	26,982,541	16,917,163
Investment income.....	12,309,147	12,577,262
Loss before income taxes and extraordinary item.....	14,673,394	4,339,901
Income taxes (recovery).....	3,336	(2,069,340)
Loss before extraordinary item.....	14,676,730	2,270,561
Extraordinary item (note 4).....	1,034,975	
LOSS FOR THE YEAR.....	13,641,755	2,270,561
Dividends on preference shares (note 3).....	3,452,360	3,339,962
LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS.....	<u>\$17,094,115</u>	<u>\$ 5,610,523</u>
LOSS PER COMMON SHARE BEFORE EXTRAORDINARY ITEM.....	<u>\$ 2.27</u>	<u>\$.70</u>
LOSS PER COMMON SHARE.....	<u>\$ 2.14</u>	<u>\$.70</u>

CONSOLIDATED STATEMENT OF DEFICIT

YEAR ENDED DECEMBER 31, 1985

	<u>1985</u>	<u>1984</u>
DEFICIT AT BEGINNING OF YEAR.....	\$20,141,028	\$14,473,156
Loss for the year.....	13,641,755	2,270,561
Dividends (note 3).....	3,387,554	3,397,311
DEFICIT AT END OF YEAR.....	<u>\$37,170,337</u>	<u>\$20,141,028</u>

SCOTTISH & YORK HOLDINGS LIMITED

CONSOLIDATED STATEMENT OF CHANGES IN CASH POSITION YEAR ENDED DECEMBER 31, 1985

	<u>1985</u>	<u>1984</u>
CASH PROVIDED BY (USED IN)		
OPERATING ACTIVITIES		
Loss for the year	\$(13,641,755)	\$(2,270,561)
Items not involving cash		
Depreciation and amortization.....	279,814	271,838
Amortization of marketing agreement.....	259,000	35,000
	<u>(13,102,941)</u>	<u>(1,963,723)</u>
Reduction (increase) in accounts receivable and accrued interest.....	(21,535,038)	3,423,854
Increase in notes receivable.....	(287,710)	(279,139)
Increase (decrease) in income and premium taxes payable, net.....	1,376,429	(1,658,801)
Increase in accounts payable and accrued liabilities.....	11,631,523	6,764,825
Increase in provision for outstanding claims.	17,475,276	6,444,403
Increase (decrease) in deferred revenue.....	5,349,490	(1,374,263)
	<u>907,029</u>	<u>11,357,156</u>
CASH PROVIDED BY (USED IN)		
FINANCING ACTIVITIES		
Proceeds from issuance of preference shares.....	15,000,000	
Increase (decrease) in bank loan.....	(3,000,000)	3,000,000
Dividends (note 3).....	(354)	(211)
	<u>11,999,646</u>	<u>2,999,789</u>
CASH PROVIDED BY (USED IN)		
INVESTMENT ACTIVITIES		
Increase in term deposits, net.....	(8,312,850)	(11,784,963)
Decrease (Increase) in bonds, net.....	(15,349,290)	1,331,128)
Decrease in stocks, net.....	414,493	1,191,739
Proceeds on sale of fixed assets.....	37,745	19,490
Increase in fixed assets, net.....	(119,193)	(179,628)
	<u>(23,329,095)</u>	<u>(9,422,234)</u>
INCREASE (DECREASE) IN CASH POSITION.....	(10,422,420)	4,934,711
CASH AT BEGINNING OF YEAR.....	<u>5,242,405</u>	<u>307,694</u>
CASH (BANK INDEBTEDNESS) AT END OF YEAR...	<u><u>\$(5,180,015)</u></u>	<u><u>\$ 5,242,405</u></u>

SCOTTISH & YORK HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEAR ENDED DECEMBER 31, 1985

1. ACCOUNTING POLICIES

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles and with respect to the subsidiary insurance companies differ in some respects from statutory accounting practices followed in the preparation of financial statements submitted to regulatory authorities.

(a) Basis of consolidation

The consolidated financial statements include all subsidiary companies.

Canada

Scottish & York Insurance Co. Limited
Central Canada Insurance Service Limited
Victoria Insurance Company of Canada
Eaton Bay Insurance Company

Bermuda

Scottish International Insurance Co. Ltd.

Netherlands

Scottish & York B.V.

Netherlands Antilles

Scottish & York N.V.

Except for directors' qualifying preference shares, all subsidiaries are wholly-owned.

(b) Translation into Canadian Dollars

The accounts of subsidiary companies have been translated into Canadian dollars on the following basis:

- (i) assets and liabilities of a monetary nature at the rate of exchange prevailing at December 31,
- (ii) all other assets and liabilities at the rate of exchange prevailing at the date the assets were acquired or the liabilities incurred,
- (iii) income and expenses at the average rate for the year. Foreign currency gains and losses are included in income when incurred.

(c) Marketable securities

- (i) Term deposits are recorded at cost.
- (ii) Bonds are recorded at cost.
Interest income is recorded on an accrual basis.
- (iii) Stocks are recorded at cost.
Dividend income is recorded on a cash received basis.
- (iv) Gains and losses on disposal of investments are included in investment income.

(d) Fixed assets

Fixed assets are recorded at cost, less accumulated depreciation and amortization. Fixed assets are depreciated over their useful lives on the following basis:

Data processing equipment and computer software are depreciated on a straight-line basis over a maximum of 5 years.

Automobiles are depreciated at the rate of 30% on a reducing balance basis.

Furniture and fixtures are depreciated at the rate of 20% on a reducing balance basis.

Leasehold improvements are amortized on a straight-line basis over a maximum of 5 years.

(e) Marketing agreement

The company is amortizing the Marketing Agreement with Eaton Bay Financial Services Limited over the remaining life of the agreement (note 4).

(f) Deferred revenue

(i) Premium income is deferred until it is earned. The basis for taking premiums into income is prescribed by the regulatory authorities under which the various companies operate.

(ii) Policy acquisition costs on profitable lines, net of reinsurance allowances, are deferred and amortized over the terms of the related policies.

(g) Provision for outstanding insurance claims

The liabilities for outstanding insurance claims and related adjustment expenses are determined using case basis evaluations plus a provision for unreported claims and are estimates of the ultimate net cost of all insurance claims incurred through December 31, 1985.

Since the provisions are necessarily based on estimates of future trends in claim severity and frequency and other factors, which could vary as the claims are settled, the ultimate liability may be more or less than the estimated amounts. These liabilities have been stated net of reinsurance recoverable from other companies. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the liabilities for insurance claims and related adjustment expenses are adequate. The estimates are continually reviewed and, as adjustments to these liabilities become necessary, they are reflected in current operations.

2. INVESTMENT IN SCOTTISH & YORK, INC. AND NOTES RECEIVABLE

In 1982 the company's investments in shares of Scottish & York, Inc. (S&YI) were written down to a nil value and, although the company retained the ownership of the common shares of S&YI, voting control was transferred to the company's major shareholder, The Standard St. Lawrence Company Limited (SSLCL) through an issue of voting preference shares of S&YI. The company retained the right to reacquire voting control of S&YI under certain conditions which included repayment to SSLCL of its total investment in the S&YI group.

It is now apparent to management that the magnitude of the losses of the S&YI group and the level of investment by SSLCL have resulted in a situation in which the company will be unable to reacquire the S&YI group. Therefore, subsequent to the end of 1985, the company has approved the transfer to SSLCL, for nominal consideration, of the shares of S&YI previously owned by each of the company and Scottish & York B.V. (S&YBV).

During 1984 and 1985 S&YBV advanced funds to SY&I to enable S&YI to repay amounts owing to the company. The Scottish & York Holdings group will continue to carry these amounts on its books at their face value of US \$3,756,000 (at current exchange rates at December 31, 1985, Cdn \$5,252,015) since it is the opinion of management that the S&YI group will ultimately be able to repay such amounts.

3. CAPITAL STOCK

Authorized

- Unlimited number of non-voting preference shares
- Unlimited number of Class A floating rate preference shares
- Unlimited number of Class B floating rate preference shares
- Unlimited number of common shares

Issued	<u>1985</u>	<u>1984</u>
5,700,000 Class A preference shares (1984, 4,200,000)	\$57,000,000	\$42,000,000
102,388 Class B preference shares (1984, 68,516)	10,238,800	6,851,600
8,000,000 Common shares	<u>3,701,000</u>	<u>3,701,000</u>
	<u>\$70,939,800</u>	<u>\$52,552,600</u>

Preference shares

The designation, rights, privileges, restrictions and conditions on the preference shares are to be determined by the directors before issuance.

Class A Floating Rate Preference Shares

The holders of Class A preference shares are entitled to receive cumulative dividends at a rate of one-half the prime rate charged by The Royal Bank of Canada plus 1%. Dividends are payable, at the option of the directors, either in cash or by way of stock dividends in Class B shares. These shares are retractable at the holders' option on September 1, 1987 at the price of \$10 per share plus accrued and unpaid dividends. The shares are redeemable at the company's option at a price equal to \$10 per share plus accrued and unpaid dividends.

Class B Floating Rate Preference Shares

The holders of Class B preference shares are entitled to receive cumulative dividends at a rate of one-half the prime rate charged by The Royal Bank of Canada plus 1%. These shares are retractable at the holders' option on September 1, 1987 at the price of \$100 per share plus accrued and unpaid dividends. The shares are redeemable at the company's option at a price equal to \$100 per share plus accrued and unpaid dividends.

During the year, 1,500,000 Class A preference shares were issued for cash consideration of \$15 million, to the company's major shareholder, The Standard St. Lawrence Company Limited.

All dividends paid in 1985 on the preference shares were in the form of stock dividends, except for small amounts of cash paid in lieu of fractional shares. For loss per common share calculations, dividends are accrued as earned on a daily basis. The following table shows the totals of the paid and accrued amounts.

	<u>1985</u>	<u>1984</u>
Stock dividends in Class B preference shares	\$3,387,200	\$3,397,100
Cash in lieu of fractional shares on stock dividends	<u>354</u>	<u>211</u>
	3,387,554	3,397,311
Dividends accrued to December 31, 1984	(305,992)	(363,341)
Dividends accrued to December 31, 1985	<u>370,798</u>	<u>305,992</u>
Dividends attributable to the year	<u><u>\$3,452,360</u></u>	<u><u>\$3,339,962</u></u>

4. EATON BAY INSURANCE COMPANY (EBIC)

(a) Acquisition and Marketing Agreement

Effective January 5, 1982 the company acquired for cash 100% of the outstanding shares of EBIC and entered into a Marketing Agreement which allowed the company the exclusive right to market general insurance products in both Eaton's and Hudson's Bay stores. The cost of the Marketing Agreement was previously being written off over a period of 20 years, but in 1985 the period has been shortened to 10 years.

The purchase agreement provides that to the extent that loss development on claims arising prior to January 1, 1982 exceeds the claims reserves established at that date, the company will be indemnified. To December 31, 1985 the company has been reimbursed in the amount of \$1.95 million.

In addition the purchase agreement requires the company to make payments equal to one-half of the amount by which Eaton Bay Insurance Company's future income taxes are reduced by non-capital losses which under the terms of the Agreement include timing differences attributable to loss provisions incurred prior to December 31, 1981. To date payments totalling \$130,000 have been made. As at December 31, 1985 the potential tax benefit of the loss carry forward amounted to approximately \$2.15 million.

(b) Amending Agreement

In 1985 the company and Eaton Bay Financial Services Limited entered into an Amending Agreement with respect to the Marketing Agreement, under which it was provided, amongst other matters, that, since Hudson's Bay Company's interest in Eaton Bay Financial Services Limited was to be acquired by Eaton's of Canada Limited, the company would no longer market insurance products through Bay stores.

Consideration for entering into the Amending Agreement has been accounted for as an extraordinary item, as follows:

Consideration for Amending Agreement	\$1,250,000
Less: Adjustment to unamortized balance of Marketing Agreement to reflect its revised life and discontinuance of business with Hudson's Bay Company	<u>215,025</u>
	<u><u>\$1,034,975</u></u>

5. INCOME TAXES

At December 31, 1985 the company has \$1.4 million of losses available until 1992 to reduce future years' income for tax purposes, the effect of which has not been recorded in the accounts.

In addition \$11 million of reserves relating to loss provisions and deferred revenue recorded in the accounts are available to reduce future years' income for tax purposes.

6. COMMITMENTS

(a) Cash and short-term deposits in the amount of \$36,031,000 (1984 - \$32,165,000) are assigned as partial security against letters of credit totalling \$47,743,000 (1984 - \$32,165,000) issued to ceding insurance companies to secure liabilities.

(b) The company leases certain office space under a lease agreement expiring in 1992 with an option to extend this to 2002. The following is a schedule of future minimum lease payments for the lease:

Year ending December 31,		
1986		\$ 597,276
1987		647,049
1988		796,368
1989		796,368
1990		796,368
1991 to remainder of lease term		1,393,644
		<u>\$5,027,073</u>

7. SEGMENTED INFORMATION

The company operates solely in the property and casualty insurance industry and conducts business in two geographic areas - Canada
- Bermuda and Other.

	1985			1984		
	Canada	Bermuda and Other	Consol- dated	Canada	Bermuda and Other	Consol- dated
	(000's omitted)			(000's omitted)		
Total assets	<u>\$112,626</u>	<u>\$79,806</u>	<u>\$192,432</u>	<u>\$83,028</u>	<u>\$70,229</u>	<u>\$153,257</u>
Net premiums earned and investment income	<u>\$28,314</u>	<u>\$41,528</u>	<u>\$ 69,842</u>	<u>\$25,929</u>	<u>\$37,372</u>	<u>\$ 63,301</u>
Loss from operations	\$ 4,723	\$ 9,853	\$ 14,576	\$ 1,836	\$ 361	\$ 2,197
Extraordinary item (note 4)	<u>1,035</u>		<u>1,035</u>			
	<u>\$ 3,688</u>	<u>\$ 9,853</u>	<u>13,541</u>	<u>\$ 1,836</u>	<u>\$ 361</u>	<u>2,197</u>
General corporate expenses			<u>101</u>			<u>74</u>
Loss for the year			<u>\$ 13,642</u>			<u>\$ 2,271</u>

8. SUBSEQUENT EVENT

Subsequent to December 31, 1985, the company's major shareholder, The Standard St. Lawrence Company Limited, purchased an additional 650,000 Class A preference shares for cash consideration of \$6,500,000. This additional share capital was invested in Scottish International Insurance Co. Ltd. in order to maintain a level of capitalization appropriate to its underwritings.



Thorne Riddell

Chartered Accountants

Auditors' Report

To the Shareholders of
Scottish & York Holdings Limited

We have examined the consolidated balance sheet of Scottish & York Holdings Limited as at December 31, 1985 and the consolidated statements of income, deficit and changes in cash 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 cash position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada
February 28, 1986

THORNE RIDDELL
Chartered Accountants

KMG International Firm Klynveld Main Goerdeler

SCOTTISH & YORK HOLDINGS GROUP

Five Year Performance Record of Operations

(SEE NOTE 2 TO THE FINANCIAL STATEMENTS)

YEAR	NET PREMIUMS WRITTEN	DEFERRED REVENUE	INCOME (LOSS) BEFORE TAXES	INCOME TAXES (RECOVERY)	NET INCOME (LOSS) FROM OPERATIONS	EARNINGS (LOSS) PER SHARE FROM OPERATIONS
1985	\$62,882,807	\$23,696,918	\$(13,638,419)	\$ 3,336	\$(13,641,755)	*\$(2.14)
1984	49,349,242	18,347,428	(4,339,901)	(2,069,340)	(2,270,561)	*(70¢)
1983	59,553,944	19,721,691	6,331,114	593,312	5,721,102	*35¢
1982	74,669,083	18,083,773	7,654,327	1,741,125	5,869,415	*62¢
1981	32,099,641	13,944,225	1,903,696	464,037	1,490,611	19¢

* After giving effect to the accrual of dividends on the Floating Rate Preference Shares.

