Challenges

2008 Annual Report

PEACE HILLS
INSURANCE

Challenges

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Chairman's Report

Marvin Yellowbird
Chairman of the Board

Just when you thought things couldn't get any worse, worse was yet to come. That pretty much sums up the last half of 2008. Firstly, we began to receive reports indicating an unusual number of large fire losses and then in October we witnessed the sudden plunge in the stock market, which has continued to tumble and recover day after day.

This soft market continues to have a negative impact on our underwriting results, and we should not delude ourselves, the insurance industry, including Peace Hills, is currently going through extraordinarily difficult times. Nonetheless, I am confident we have the capacity and know-how to successfully meet the challenges that our company will face.

How will we deal with these challenges? As the Chairman of the Board and the Chief of the Samson Cree Nation I have felt it necessary to reinforce the strong support of the shareholder and we did: in December we took the very bold step of disposing of over $10,000,000 in equity. This critical measure provided additional stability to our Capital.

Over the past 26 years we have seen several cycles in business and especially in the business of insurance. We the Board of Directors believe the company is well positioned to meet this cycle, especially with the support we receive from our Brokers and the strong dedication we see from our staff and management.

Challenges

President's Report

Diane Brickner, CIP
President & CEO

While writing this report I took the opportunity to reflect on my last comment from the 2007 Annual Report: "It really is wonderful when a plan comes together". Well, we certainly did not plan for the challenges we dealt with in 2008!

In 2008 we suffered from an unusual number of large fire losses and that is demonstrated in our Personal Lines Property loss ratio. Effective December 2008, we implemented approximately a 10% premium increase followed by a reduction in our net retention under our 2009 reinsurance program. We reduced the Excess of Loss net retention coverage to $650,000. These measures, coupled with a renewed focus on underwriting, will go a long way towards restoring this line of business to a profit.

The challenges of implementing a new computer system have been enormous and the commitment we received from management and the staff has been remarkable. Overtime and temporary help throughout the year certainly helped get through the work load, however, the burden this project placed on our staff did not go unnoticed. We kept the Brokers informed by sending out regular updates with the slogan "Bear with Us" and the response we have received from them was very positive. We have finished conversion of all the policies into the new system and most departments are back to regular service levels. Improvements to the new system are ongoing and we expect that it will forever be a work in progress.

Last year we believed we were ready to take Peace Hills to the next level and we were looking into expanding further east. That plan has been put on hold due to the change in the financial market. We believe that at times like this we need to "stick to what we know best" and therefore we will focus on the bottom line and returning the company to an underwriting profit.

The drop in the stock market has created a number of challenges. We reduced our equity portfolio substantially to improve our Minimum Capital Test and also to reduce the risk of further market deterioration. This in turn, subsequently reduced our investment income. We are pleased that A.M. Best reported a reaffirmation of our B+ rating.

The industry is still facing many challenges such as the Appeal Court's decision on the Charter Challenge. Once this decision is handed down we believe it will be appealed to the Supreme Court of Canada. Another challenge we are facing is the ongoing attempt to accurately calculate Insurance to Value. This is an industry challenge however finding a solution that meets everyone's concerns is a monumental task.

The cycles continue and for many of us this is just another business cycle that we must work through. It is challenging, frustrating and of course cause for concern, however, we are well positioned to meet these challenges. As I mentioned last year we have the strongest management team ever and our staff have worked hard to convert all business over to the new computer system. We are ready to move on to the "Next Challenge".

Challenges

Finance & Information Technology Report

Kathy Coogan, CMA
Vice President, Finance & Information Technology

2008 was a year we can best describe as interesting times. Poor underwriting results coupled with a meltdown in investment markets, along with service deficiencies due to our system conversion, combined to make 2008 one of our most challenging years and in turn one of our least profitable years on record.

The overall direct written premiums ended the year at $156,051,186, an 11.45% growth over the previous year. Net premiums earned increased by 19.78% to $101,262,449. This was driven by the changes to our reinsurance arrangements, which allowed us to retain more of our written premium. At the same time, the net loss ratio ended 2008 at 66.3% which was up 6.7% from the previous year. This increase caused our combined ratio to end the year at 104.8% which resulted in an underwriting loss of just over $3 million for the year.

In the midst of the worst market performance in decades, we watched as our investment portfolio slowly deteriorated to eventually end the year valued at $2.3 million under cost. The turmoil in the marketplace was unprecedented as we watched the entire marketplace dive in the last quarter. Our portfolio was quite heavily weighted in equities and so to preserve our capital, we disposed of a significant portion of our equity portfolio. As a result, we experienced a net investment loss for the year. After factoring in the investment loss for the year we ended with a net loss after tax of just over $3.4 million. We ended 2008 with a Minimum Capital Test ratio of 208.65% which is well above the regulatory minimum of 150%.

On top of all of this, we moved forward with our new computer system and that also brought about many challenges. All of our staff, brokers and business partners should be commended for their effort and patience in seeing this project through. We look forward to continued improvements and building upon our new technology.

We expect that 2009 will continue to present a challenge as we try to manage our growth at 9% and reduce costs to improve our underwriting results. All of this while remaining patient with the investment market. As the economy continues to take a downturn we will protect our capital and our people and look for process improvements to assist us through the year ahead. Our capital position remains strong going into the upcoming year and we are ready to face yet another challenging year ahead.

Challenges

Underwriting & Marketing Report

Jamie Hotte, FCIP
Vice President, Underwriting & Marketing

Gross Written Premiums

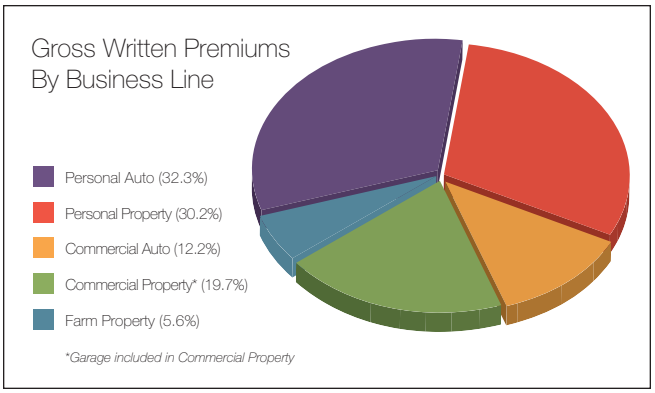
Gross Written Premiums totaled $146,320,007. (excluding Facility Association premiums) which was an increase of 12% over 2007.

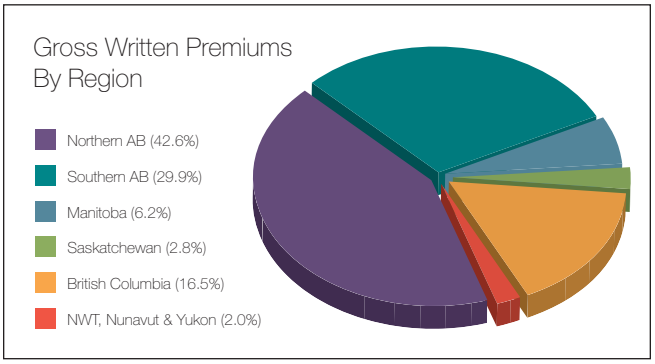
In Force Policies

Our policy count increased by 7% ending the year with 117,853 policies.

Underwriting Results

Underwriting results deteriorated in 2008 and we produced a net underwriting loss of $3,013,487. Our gross loss ratio increased by 1% ending the year at 65%.





Underwriting & Marketing Report (con't)

REVIEW OF EACH BUSINESS LINE

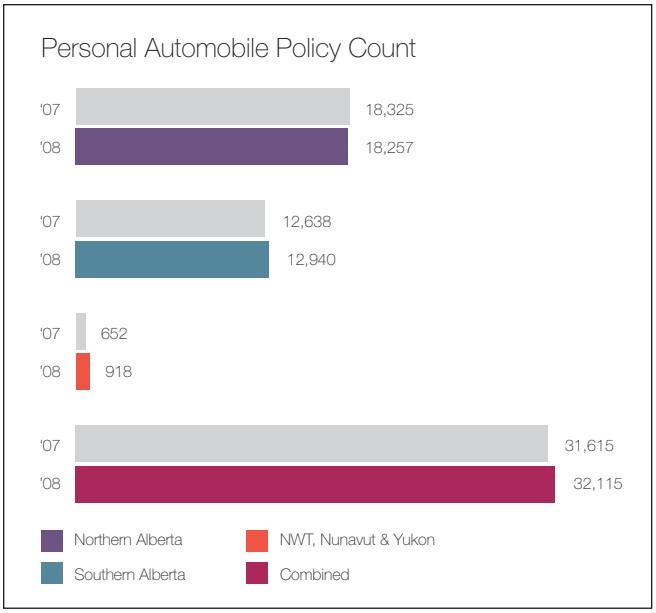
Personal Automobile

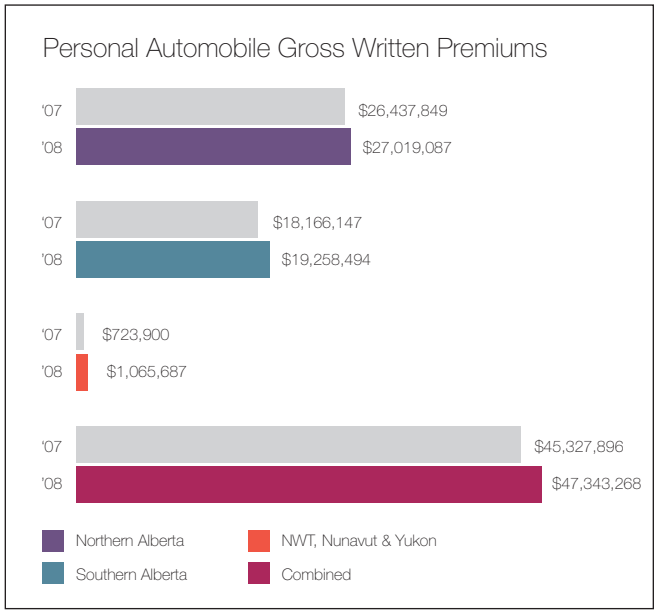
Gross written premiums (excluding Facility Association premiums) increased by 4% ending the year at $47,343,268. We ceded $8,867,319 to the Alberta Risk Sharing Pool.

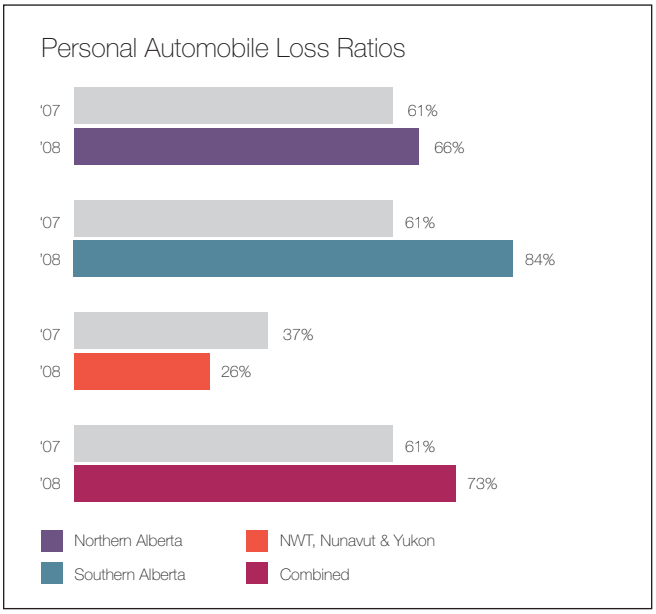
Our in force policies increased by just over 1.6% ending the year with 32,115 policies.

Our gross loss ratio increased by 12% ending the year at 73%.

The Alberta Automobile Rate Board approved an increase of 5% on mandatory coverages which we implemented on November 1, 2008. Overall this produced an increase of 2.7% on our Alberta personal automobile portfolio. There were no rate changes in other jurisdictions.







Challenges

Underwriting & Marketing Report (con't)

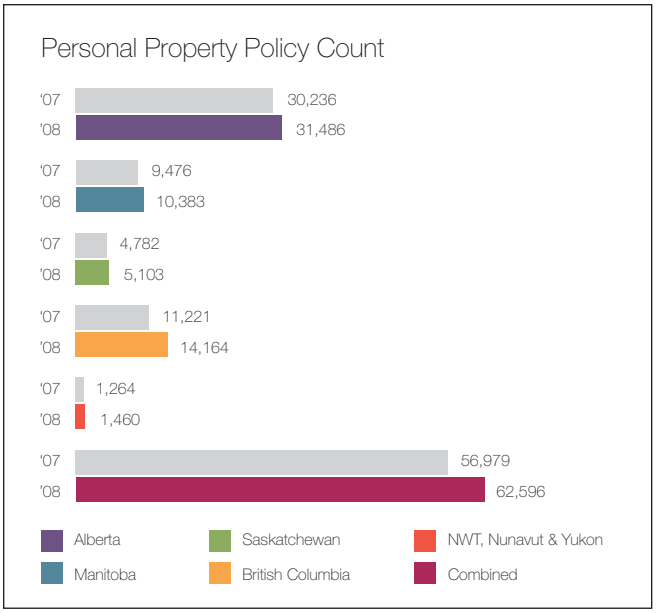
Personal Property

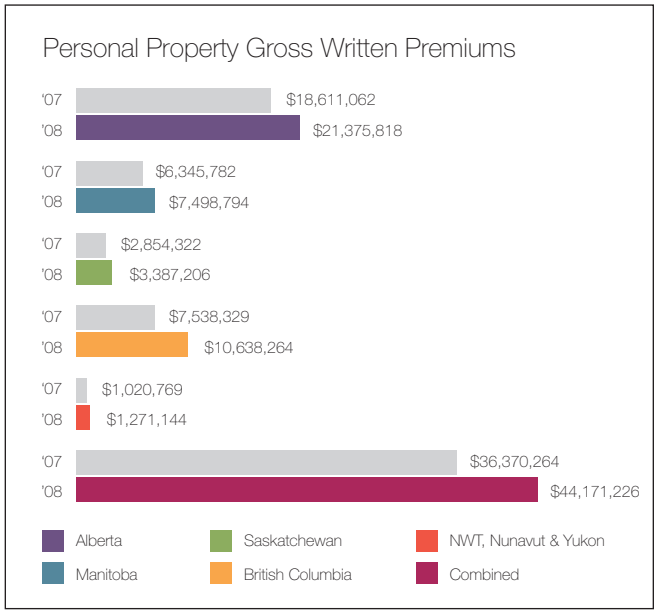
Gross written premiums increased by 21% ending the year at $44,171,226.

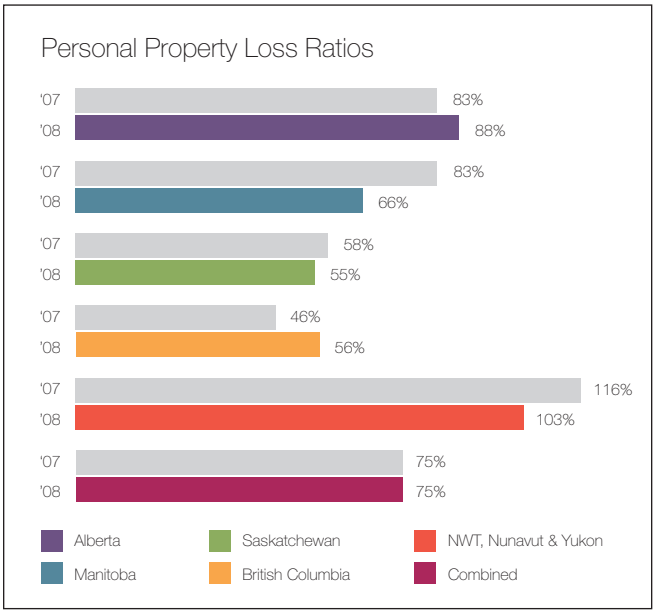
Our in force policies increased by almost 10% ending the year at 62,596 policies.

Our gross loss ratio remained the same ending the year at 75%.

On December 1, 2008 we implemented rate increases in all jurisdictions. The overall impact was an increase of 9.7%.







Challenges

Underwriting & Marketing Report (con't)

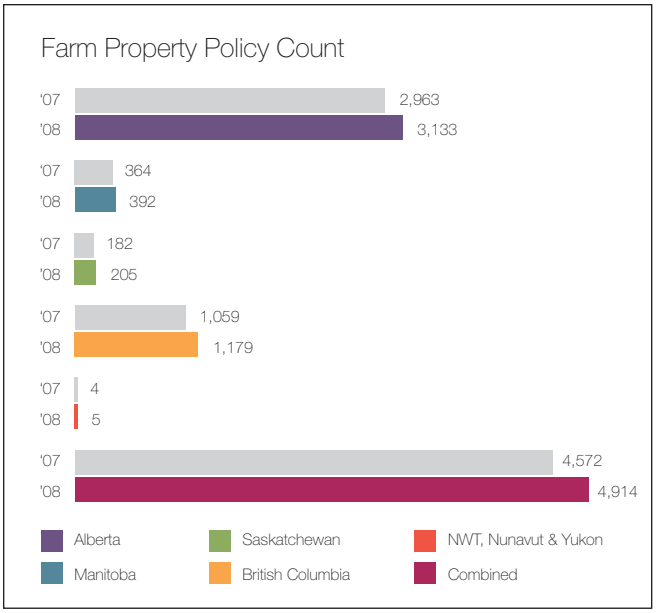
Farm Property

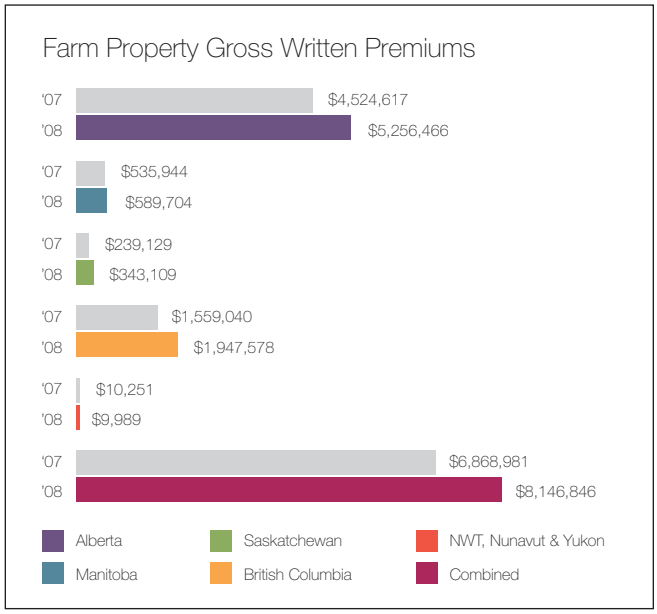
Gross written premiums increased by 19% ending the year at $8,146,846.

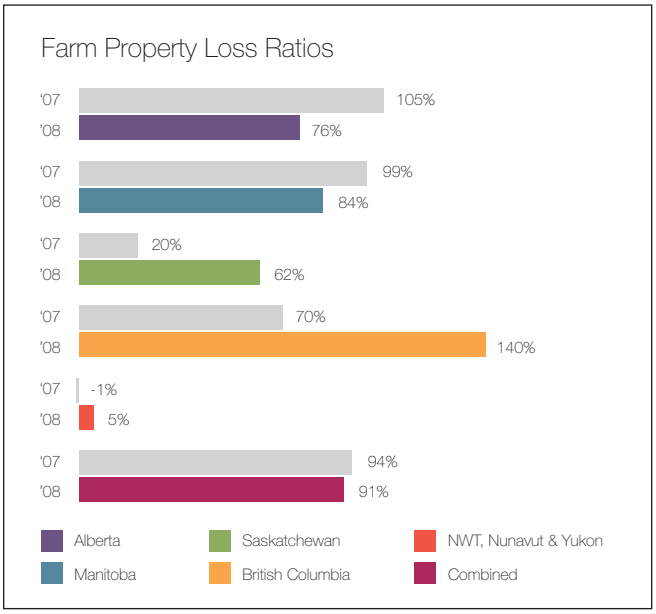
Our in force policies increased by just over 7% ending the year at 4,914 policies.

Our gross loss ratio decreased by 3% ending the year at 91%.

We implemented an increase on the dwelling portion of our farm package in all jurisdictions. The overall impact of this increase was 9.7%.







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Underwriting & Marketing Report (con't)

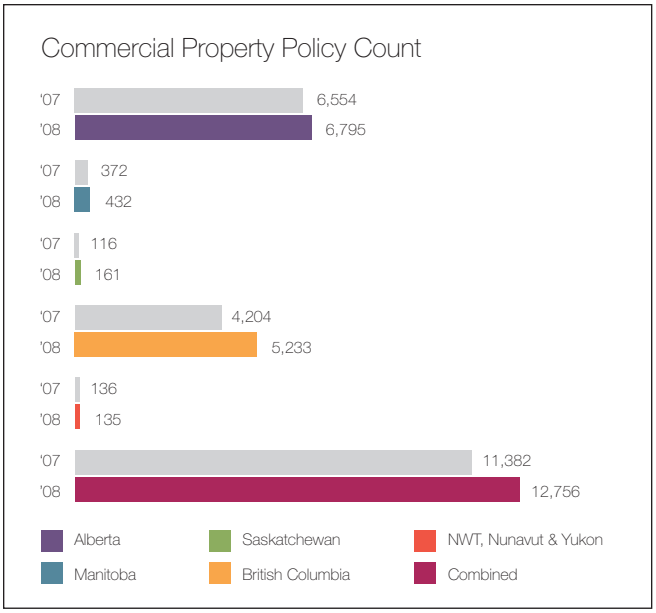
Commercial Property/Casualty

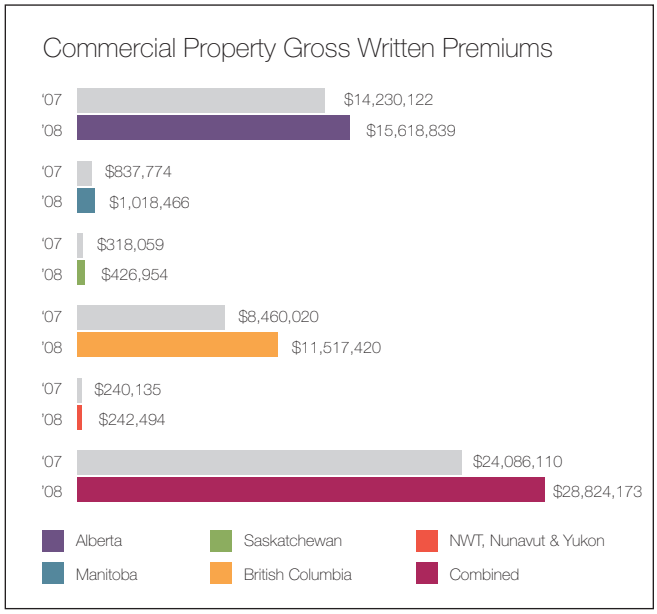
Gross written premiums increased by 20% to $28,824,173.

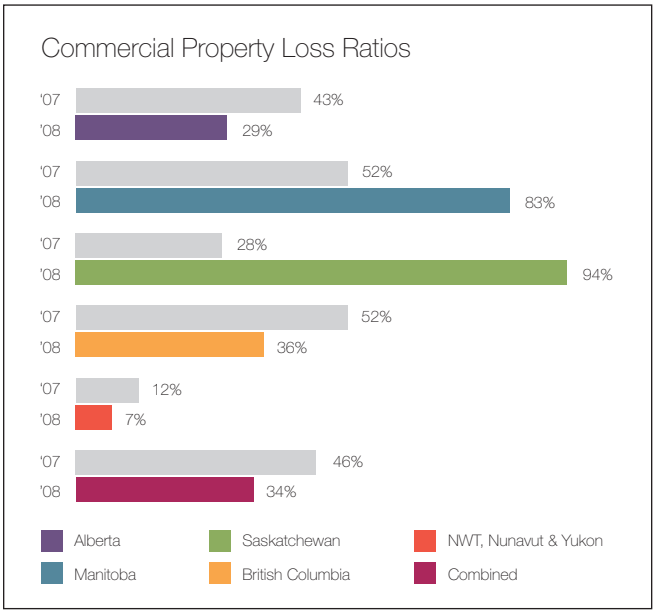
Our in force policies increased by almost 12% ending the year with 12,756 policies.

Our gross loss ratio decreased by 12% ending the year at 34%.

We continued to see a fairly soft market throughout 2008.







Challenges

Underwriting & Marketing Report (con't)

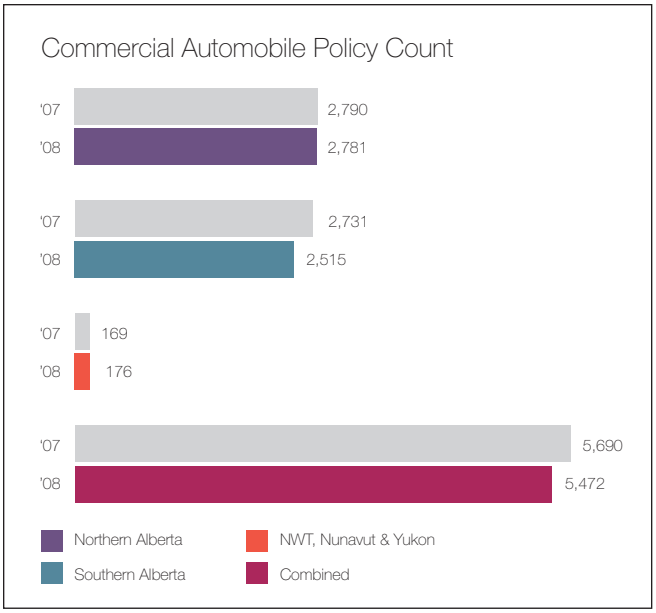
Commercial Automobile

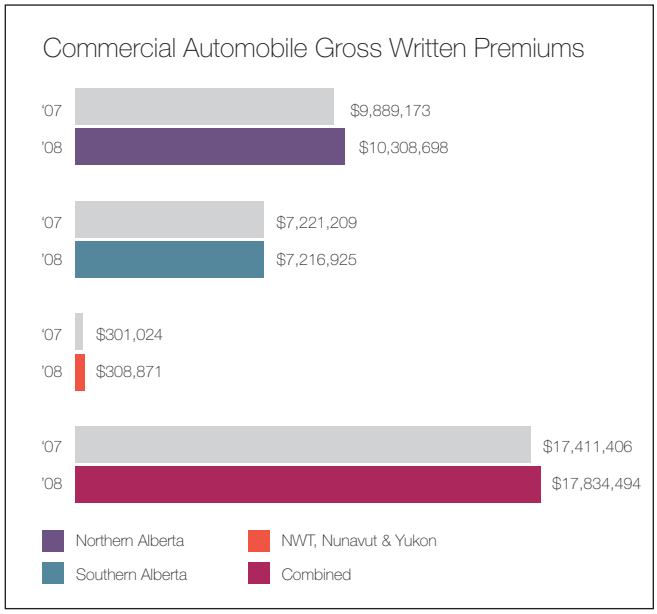
Gross written premiums increased by 2% to $17,834,494.

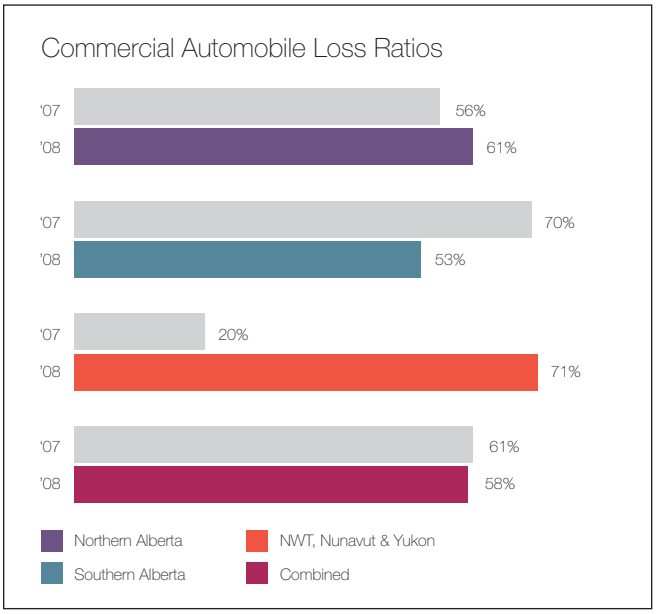
Our in force policies decreased 4% ending the year with 5,472 policies.

Our gross loss ratio decreased by 3% ending the year at 58%.

There were no rate changes during 2008.







Challenges

Underwriting & Marketing Report (con't)

PROVINCIAL REPORTS

Alberta
Gross written premiums increased by 7% to $106,054,327. Policies in force increased by 2% ending the year at 77,907. Our gross loss ratio increased by 2% ending the year at 67%.

Manitoba
Gross written premiums increased by 18% to $9,106,964. Policies in force increased by 10% ending the year at 11,207. Our gross loss ratio decreased by 11% ending the year at 69%.

Saskatchewan
Gross written premiums increased by 22% to $4,157,269. Policies in force increased by 8% ending the year at 5,469. Our gross loss ratio increased by 7% ending the year at 60%.

British Columbia
Gross written premiums increased by 37% to $24,103,262. Policies in force increased by 25% ending the year at 20,576. Our gross loss ratio increased by 3% ending the year at 54%.

Northwest Territories
Gross written premiums increased by 36% to $1,538,517. Policies in force decreased by 26% ending the year at 1,512. Our gross loss ratio increased by 37% ending the year at 100%.

Yukon
Gross written premiums increased by 16% to $908,482. Policies in force increased by 14% ending the year at 687. Our gross loss ratio increased by 42% ending the year at 52%.

Nunavut
Gross written premiums increased by 18% to $451,186. Policies in force increased by 18% ending the year at 495. Our gross loss ratio decreased by 226% ending the year at (-39%).

MARKETING AND OUR BROKERAGE FORCE

Our overall growth of 12% met our budgeted growth for 2008. We wrote 22,670 new policies during 2008 which was an increase of over 14% compared to the prior year.

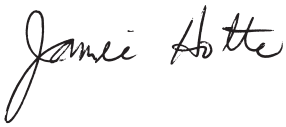
Retention
Even though we have seen some signs of the market becoming more competitive, our retention improved by 3% ending the year at 91.5%.

Independent Brokerage Network
Our commitment to broker distribution remains and we would like to thank all of our brokers for their continued support.

During 2008 we appointed 21 new brokers. Over the year there were some acquisitions and consolidation. Even though the number of brokers has remained the same, the number of locations has increased by 28. We were represented by 161 brokers with 368 locations throughout western Canada.

PROVINCE	BROKERS	LOCATIONS
British Columbia	25	99
Alberta	113	208
Saskatchewan	7	21
Manitoba	15	36
NWT, Yukon & Nunavut	1	4

Our Underwriting and Marketing Team
In conjunction with a year of 12% growth we have also implemented a new computer system in March 2008. In addition to their regular work, our staff were converting underwriting files on our new computer system, which was a monumental task for them. I would like to extend my gratitude and thanks to them for their dedication and hard work over the past year.



Challenges

Claims Report

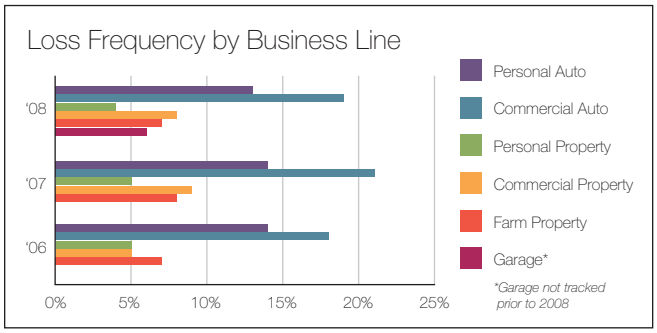
Robert Doiron, BA, CIP
Vice President, Claims

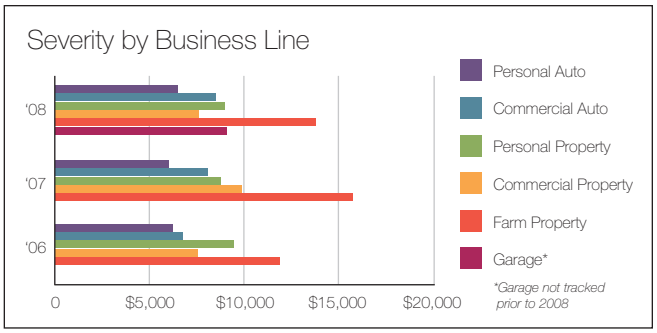
2008 was indeed a most challenging year with the biggest challenge being the melt down in the markets. On the claims front our catastrophe frequency was down to two, a direct contrast from the previous year in which we experienced the greatest number of catastrophe losses for one year. Our two losses were:

July 15 – 17 Southern Alberta (wind/hail)
243 claims
yielding $2,459,192 in losses

August 8 – 10 Red Deer, Alberta (hail)
150 claims
yielding $959,702 in losses

Our overall loss frequency relative to policy count dipped by 1% from prior years 2005 – 2007 to 8% for 2008. Our total year claims count decreased by 278 (10,140 – 9,862) from prior year. However, our severity increased by an average of $1,427/claim yielding an increase in overall gross loss ratio of 1% from 64% in 2007 to 65% in 2008. What we escaped with our low catastrophe count was made up by a series of larger individual losses.





In October 2004, as part of an overall attempt to curtail rapidly increasing auto insurance costs, the Alberta government instituted a cap on General Damages (pain and suffering) for Minor Injuries sustained in a motor vehicle accident. This cap was successfully defeated when Justice Wittmann declared the cap unconstitutional on February 8, 2008. The Alberta Government, State Farm Insurance and IBC appealed the matter on September 12, 2008. No decision has yet been rendered by the Alberta Court of Appeal.

The fallout from this decision was dramatic, particularly with regard to the reserving of cases affected by the cap. Peace Hills Insurance has adopted a conservative approach and provided for such losses as though the cap did not exist. We believe that this case in all probability will eventually be heard by the Supreme Court of Canada. This means we will likely be carrying a significant number of cases for at least two more years. We are making provisions with both existing and new cases to ensure they are properly reserved regardless of the outcome.

A review of 2008 would not be complete without a mention of the implementation of our new computer system in March. The effort from our staff was incredible. They persevered through all the trials and tribulations associated with any new system. We owe all our staff as well as our business partners who stuck with us a huge THANK YOU!

Challenges

Company Profile

HEAD OFFICE

300, 10709 Jasper Avenue
Edmonton, AB T5J 3N3 Canada
Phone: (780) 424-3986
or 1-800-272-5614

VANCOUVER OFFICE

Suite 2300, 1066 West Hastings St.
Vancouver, BC V6E 3X2 Canada
Phone: (604) 408-4708
or 1-877-408-4708

EDMONTON OFFICE

300, 10709 Jasper Avenue
Edmonton, AB T5J 3N3 Canada
Phone: (780) 424-3986
or 1-800-272-5614

CALGARY OFFICE

14th Flr, Encor Place, 645-7th Ave. S.W.
Calgary, AB T2P 4G8 Canada
Phone: (403) 262-7600
or 1-800-372-9295

AUDITORS

PricewaterhouseCoopers LLP
Suite 1501, TD Tower
10088 - 102 Avenue
Edmonton, AB T5J 3N5 Canada

ACTUARY

Barbara Addie, FCIA
Baron Insurance Services Inc.
206 Laird Drive
East York, ON M4G 3W4 Canada

Challenges

Board of Directors

Marvin Yellowbird
Chief & Chairman

Diane Brickner
President & CEO

Trevor Swampy
Vice Chairman

Pat Buffalo
Secretary/Treasurer

Raymond Lightning
Elder

Florence Buffalo

John Crier

Lena Cutknife

Bill Kordyback

Julian Koziak

Dennis Leonard

John Szumlas

AUDIT/CONDUCT REVIEW COMMITTEE:
Pat Buffalo (Chair), Florence Buffalo, Bill Kordyback, Julian Koziak, Dennis Leonard, John Szumlas

GOVERNANCE/COMPENSATION COMMITTEE:
Trevor Swampy (Chair), Pat Buffalo, John Crier, Bill Kordyback, Dennis Leonard, John Szumlas, Marvin Yellowbird

INVESTMENT/PHI PROPERTIES LTD. COMMITTEE:
John Crier (Chair), Pat Buffalo, Lena Cutknife, Bill Kordyback, Julian Koziak, Dennis Leonard, Trevor Swampy, Marvin Yellowbird

Challenges

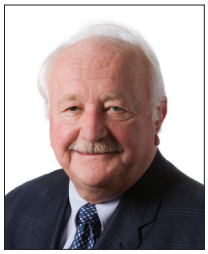
Management

Nazz Baksh
Controller

George Boulay
Underwriting Manager,
British Columbia

John Bud
Information Systems Manager

Jim Dyson
Underwriting Manager,
Southern Alberta



Fergus Kavanagh
VP & Branch Manager,
Southern Alberta

Neil Klawitter
Branch Manager,
Northern Alberta

Daryl Kochan
Branch Manager,
British Columbia

Mary Mattern
Human Resources Manager

Karri McCann
Commercial Lines Manager,
Southern Alberta

Joan McMillan
Administration Manager,
Head Office & Northern Alberta

Jeff Mowatt
Claims Manager, Northern Alberta,
MB, SK, NWT, Nunavut, Yukon

Carol Paul
Personal Lines Manager,
Northern Alberta

Gail Routh
Branch Manager,
MB, SK, NWT, Nunavut, Yukon

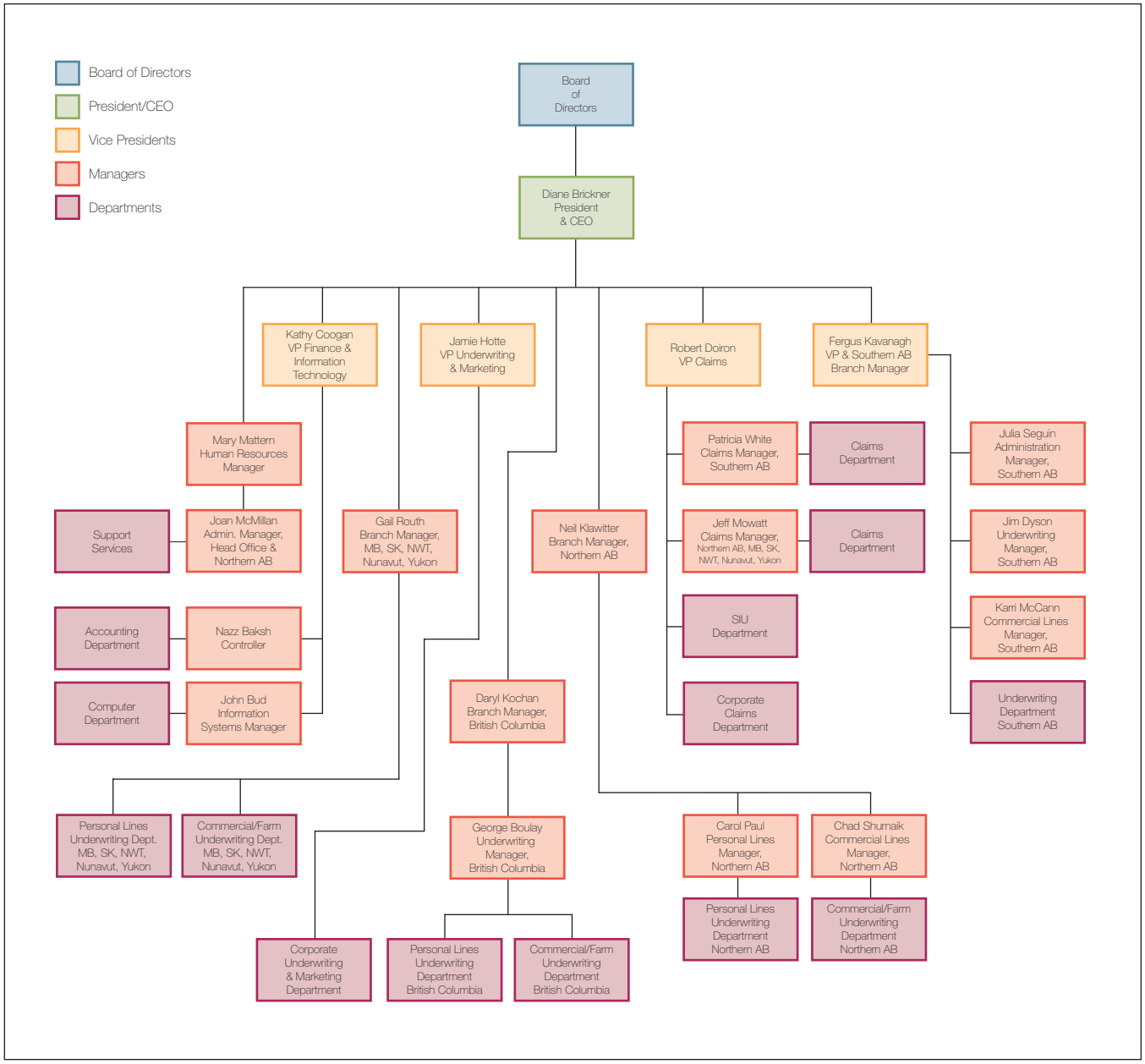
Julia Seguin
Administration Manager,
Southern Alberta

Chad Shurnaik
Commercial Lines Manager,
Northern Alberta

Pat White
Claims Manager,
Southern Alberta

Challenges

Corporate Structure



PEACE HILLS INSURANCE

Financials

PEACE HILLS
INSURANCE

Management Statement

Peace Hills General Insurance Company • Year Ended December 31, 2008

The consolidated financial statements are the responsibility of management and have been prepared in conformity with Canadian generally accepted accounting principles including the accounting requirements of the Superintendent of Insurance for Alberta. In the opinion of management, the consolidated financial statements fairly reflect the financial position, results of operations and cash flows of Peace Hills General Insurance Company within reasonable bounds of materiality.

Preparation of financial information is an integral part of management's broader responsibilities for the ongoing operations of the Company. Management maintains an extensive system of internal accounting controls to ensure that transactions are accurately recorded on a timely basis, are properly approved and result in reliable consolidated financial statements. The adequacy of operation of the control systems is monitored on an ongoing basis by management.

The Board of Directors is responsible for approving the financial statements. It has established an Audit Committee, comprised of directors who are neither officers nor employees of the Company who meet with management, internal auditors, the actuary and external auditors, all of whom have unrestricted access and the opportunity to have private meetings with the Audit Committee, to review the financial statements. The Audit Committee then submits its report to the Board of Directors recommending approval of the financial statements.

The Superintendent of Insurance for Alberta makes an annual examination and inquiry into the affairs of the Company as deemed necessary to ensure that the Company is in sound financial condition and that the interests of the policyholders are protected under the provisions of the Insurance Act (the "Act").

The actuary has been appointed by the Board of Directors pursuant to the Act. The actuary is required to carry out a valuation of the policy liabilities recorded by the Company in its financial statements and report thereon to the shareholder. Policy liabilities consist of the provisions for and reinsurance recovery of unpaid claims and adjustment expenses on insurance policies in force, including provisions for salvage and subrogation, and future obligations on the unearned portion of insurance policies in force, including deferred policy acquisition costs. The valuation is made in accordance with accepted actuarial practice, as well as any other matter specified in any direction that may be made by regulatory authorities. The actuary, in her verification of the management information provided by the Company used in the valuation, also makes use of the work of the external auditors. The actuary's report outlines the scope of her work and opinion.

The Company's external auditors have been appointed by the shareholder, pursuant to the Act, to conduct an independent and objective audit of the financial statements of the Company in accordance with Canadian generally accepted auditing standards and report thereon to the shareholder. In carrying out their audit, the auditors also make use of the actuary and her report on the Company's policy liabilities. The auditors' report outlines the scope of their audit and their opinion.

Diane Brickner, CIP
President and CEO

Kathy Coogan, CMA
Vice President, Finance and Information Technology

February 25, 2009
Edmonton, Canada

PEACE HILLS
INSURANCE

Auditors' Report

Peace Hills General Insurance Company • Year Ended December 31, 2008

To the Shareholder of Peace Hills General Insurance Company:

We have audited the consolidated balance sheet of **Peace Hills General Insurance Company** as at December 31, 2008 and the consolidated statements of operations, retained earnings, comprehensive (loss) income and accumulated other comprehensive (loss) income and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP
Chartered Accountants

February 25, 2009
Edmonton, Canada

PEACE HILLS
INSURANCE

Actuary's Report

Peace Hills General Insurance Company • Year Ended December 31, 2008

To the Shareholder of Peace Hills General Insurance Company:

I have valued the policy liabilities of Peace Hills General Insurance Company for its balance sheet as at December 31, 2008 and their changes in its statement of income for the year then ended, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of the policy liabilities makes appropriate provision for all policyholder obligations and the financial statements fairly present the results of the valuation.

Barbara Addie
Fellow, Canadian Institute of Actuaries

February 25, 2009
Toronto, Ontario

PEACE HILLS INSURANCE

Consolidated Balance Sheet

Peace Hills General Insurance Company • As at December 31, 2008

	2008 $	2007 $
Assets		
Cash and cash equivalents (note 2)	43,379,084	26,261,089
Accrued investment income	851,246	752,452
Investments (note 3)	71,379,225	90,593,352
Due from agents, brokers and policyholders	32,758,170	27,762,381
Due from other insurance companies	8,589,289	12,655,297
Income taxes recoverable	6,997,379	1,592,136
Other receivables	2,123,292	1,592,407
Amounts recoverable from reinsurers		
Unpaid claims and adjustment expenses (notes 5 and 6)	31,627,717	32,432,454
Unearned premiums	15,395,941	17,905,605
Salvage and subrogation	(244,226)	(193,665)
Deferred policy acquisition costs	18,130,709	16,627,672
Future income taxes	547,049	534,212
Prepaid expenses and other assets	164,599	155,816
Capital assets (note 4)	7,111,108	7,176,953
	238,810,582	235,848,161
Liabilities		
Due to agents, brokers and policyholders	3,218,781	3,226,834
Due to other insurance companies	249,798	2,161,922
Expenses due and accrued (note 10)	1,706,652	2,541,750
Other taxes due and accrued	5,913,286	5,926,087
Funds held for other insurance companies (note 17)	6,419,373	6,419,373
Bank loan payable (note 7)	1,956,500	2,118,500
Unearned premiums	73,885,401	66,192,351
Provision for unpaid claims and adjustment expenses (note 5)	97,548,254	87,718,691
Unearned reinsurance commissions	5,629,693	5,629,088
Other liabilities	30,258	152,745
	196,557,996	182,087,341
Commitments (note 11)		
Contingent liabilities (note 12)		
Shareholder's Equity		
Share capital (note 8)	2,000,000	2,000,000
Contributed surplus	9,362,250	9,362,250
Retained earnings	32,024,875	35,659,856
Accumulated other comprehensive (loss) income	(1,134,539)	6,738,714
	42,252,586	53,760,820
	238,810,582	235,848,161

See accompanying notes to consolidated financial statements.

Approved by the Board of Directors

Director

Director

PEACE HILLS INSURANCE

Consolidated Statement of Retained Earnings

Peace Hills General Insurance Company • Year Ended December 31, 2008

	2008 $	2007 $
Balance – Beginning of year	35,659,856	28,601,090
Net (loss) earnings for the year	(3,434,981)	7,358,766
Dividends paid	(200,000)	(300,000)
Balance – End of year	32,024,875	35,659,856

See accompanying notes to consolidated financial statements.

PEACE HILLS INSURANCE

Consolidated Statement of Operations

Peace Hills General Insurance Company • Year Ended December 31, 2008

	2008 $	2007 $
Gross premiums written	156,051,186	140,018,995
Direct premiums written	147,184,047	130,548,839
Net premiums written	111,296,650	88,245,456
Net premiums earned (note 6)	101,262,449	84,536,919
Earned service charge revenue	1,820,475	1,655,556
Underwriting revenue	103,082,924	86,192,475
Expenses incurred (note 6)		
Claims (note 5)	67,081,045	50,313,596
Administrative (note 10)	17,633,459	15,830,463
Commissions	16,723,079	13,149,773
Premium and other taxes	4,658,828	4,066,110
	106,096,411	83,359,942
Underwriting (loss) income	(3,013,487)	2,832,533
Investment income (expenses)		
Interest	3,049,336	3,327,927
Dividends	1,417,976	1,641,449
Write down of investments	(178,316)	(406,102)
General investment expenses	(345,789)	(334,955)
(Loss) gain on disposal of investments	(5,405,190)	3,379,568
	(1,461,983)	7,607,887
Loss from PHI Properties Limited (note 9)	(219,079)	(270,650)
(Loss) earnings before income taxes	(4,694,549)	10,169,770
Income taxes (recovery)		
Current	(1,277,883)	2,132,605
Future	18,315	678,399
	(1,259,568)	2,811,004
Net (loss) earnings for the year	(3,434,981)	7,358,766

See accompanying notes to consolidated financial statements.

PEACE HILLS INSURANCE

Consolidated Statement of Comprehensive (Loss) Income

Peace Hills General Insurance Company • Year Ended December 31, 2008

	2008 $	2007 $
Comprehensive (loss) income		
Net (loss) earnings for the year	(3,434,981)	7,358,766
Unrealized gains and losses on available for sale financial assets	(16,815,141)	1,274,923
Reclassification of realized gains and losses to operations	5,405,190	(3,379,568)
Net change in unrealized losses	(11,409,951)	(2,104,645)
Income taxes	(3,536,698)	(785,833)
Other comprehensive loss	(7,873,253)	(1,318,812)
Total comprehensive (loss) income	(11,308,234)	6,039,954
Accumulated other comprehensive (loss) income		
Balance – Beginning of year	6,738,714	-
Impact of fair value measurement of available for sale financial instruments, net of taxes of $3,324,163	-	8,057,526
Other comprehensive loss	(7,873,253)	(1,318,812)
Total accumulated other comprehensive (loss) income	(1,134,539)	6,738,714

See accompanying notes to consolidated financial statements.

PEACE HILLS INSURANCE

Consolidated Statement of Cash Flows

Peace Hills General Insurance Company • Year Ended December 31, 2008

	2008 $	2007 $
Cash provided by (used in)		
Operating activities		
Net (loss) earnings for the year	(3,434,981)	7,358,766
Items not affecting cash		
Future income taxes	18,315	678,399
Net realized loss (gain) on disposal of investments	5,405,190	(3,379,568)
Write down on investments	178,316	406,102
Amortization of bond premium (discount)	41,389	61,535
Amortization of capital assets	1,010,969	716,723
Loss (gain) on disposal of capital assets	185,513	(9,309)
	3,404,711	5,832,648
Change in non-cash working capital items		
Deferred policy acquisition costs	(1,503,037)	(2,002,224)
Unpaid claims and adjustments expenses, net of recoverable from reinsurers	10,634,300	1,112,631
Unearned premiums, net of recoverable from reinsurers	10,154,237	8,742,143
Unearned reinsurance commissions	605	(1,639,330)
Net change in other non-cash balances	(6,259,465)	(3,108,623)
	16,431,351	8,937,245
Financing activities		
Payment of dividends	(200,000)	(300,000)
Repayment of bank loan payable	(162,000)	(162,000)
	(362,000)	(462,000)
Investing activities		
Investments sold or matured		
Bonds and debentures	8,710,819	11,707,843
Common shares	18,169,765	15,667,258
Other investments	2,473,703	605,560
Investments acquired		
Bonds and debentures	(11,413,421)	(14,309,116)
Common shares	(14,487,195)	(8,948,723)
Other investments	(1,274,390)	(150,281)
Purchase of capital assets	(1,205,541)	(2,213,740)
Proceeds on disposal of capital assets	74,904	137,112
	1,048,644	2,495,913
Increase in cash and cash equivalents	17,117,995	10,971,158
Cash and cash equivalents – Beginning of year	26,261,089	15,289,931
Cash and cash equivalents	43,379,084	26,261,089

See accompanying notes to consolidated financial statements.

PEACE HILLS
INSURANCE

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

Peace Hills General Insurance Company (the "Company") is incorporated under the laws of Alberta. The Company is subject to the Insurance Act of Alberta (the "Act") and is licensed to write all classes of insurance other than life, accident, sickness and hail in British Columbia, Alberta, Saskatchewan, Manitoba and the Northwest, Yukon and Nunavut Territories. The Company has a concentration of business in automobile and property insurance in the Province of Alberta. The Company is subject to regulation by the Superintendent of Insurance in the Province of Alberta.

1 Significant accounting policies

a) Basis of presentation

These consolidated financial statements include the accounts of the Company and its wholly- owned subsidiary, PHI Properties Limited. All significant inter-company balances and transactions have been eliminated.

b) Rate regulation

The Company writes compulsory automobile business that is subject to rate regulation which comprises approximately 26.6% of net premiums written. The Company's automobile insurance premiums can be impacted by mandatory rate roll backs and mandatory rate assessments as legislated by provincial law and by regulation in certain provinces. This could result in lower future premium rates or reductions to premium rates charged by the Company. In addition, the Company is required, under certain provincial legislation, to participate in risk sharing pools which may impact positively or negatively upon underwriting results. Certain benefit payments are also subject to provincial government regulation including automobile accident benefits.

c) Cash and cash equivalents

The Company considers deposits in banks, certificates of deposit and short-term investments with original maturities of three months or less as cash and cash equivalents. Cash and cash equivalents are financial assets classified as held for trading, with changes in fair value recorded in net income.

d) Investments

i) General

Bonds and debentures, common shares, and other investments are all designated as available for sale ("AFS") financial assets and are carried at fair value. Changes in fair value of AFS financial assets are recorded in other comprehensive income ("OCI") until the investment is sold or impaired, at which time the realized gain or loss will be recorded in net income. The fair value of investments are based on quoted prices in active markets.

Purchase and sales of investments are recognized at the trade date.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

ii) Bonds and debentures

Transaction costs and premiums and discounts related to the purchase of bonds are recorded as part of the carrying value of the bonds at the date of purchase and amortized using the effective interest rate method. Interest income is recorded on an accrual basis over the term of the investment.

iii) Common shares and other investments

For common share and other investments, transaction costs are capitalized on initial recognition. Dividend income on common shares is accrued on the ex-dividend date.

iv) Impaired assets

Where there has been a reduction in the value of an investment below cost that is other than temporary, the investment is written down to the fair value, and such a provision is recorded as a loss against investment income.

e) Premiums earned and deferred policy acquisition costs

Insurance premiums are recorded as revenue on a straight-line basis over the terms of the policies. Unearned premiums represent the portion of premiums written that relate to the unexpired term of the policies in force.

Policy acquisition costs are those expenses incurred in the acquisition of business. Acquisition costs comprise commissions, premium taxes, health levies and an allocation of other variable policy issue and underwriting expenses, which relate directly to the acquisition of the business.

Policy acquisition costs related to unearned premiums are only deferred to the extent that they are expected to be recovered from the unearned premiums, and are amortized on a straight line basis over the periods during which the premiums are earned. If the unearned premiums and anticipated investment income are not sufficient to pay expected claims and expenses (including policy maintenance expenses and unamortized policy acquisition costs), a premium deficiency exists. Premium deficiencies are recognized by first writing down the deferred policy acquisition cost asset, with any excess being recognized against underwriting income.

f) Loans and receivables

Financial assets, other than cash and cash equivalents and investments, are classified as loans and receivables. Loans and receivables are initially recorded at fair value and subsequently measured at cost or amortized cost. Interest income is accrued and recognized in income as earned. Transaction costs relating to loans and receivables are expensed as incurred.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

g) Capital assets

Capital assets are carried at cost less accumulated amortization. Amortization is provided using the following methods and annual rates:

Building	Straight-line 3%
Building improvements	Straight-line 10%
Automotive equipment	Declining balance 30%
Leasehold improvements	Straight-line terms of leases
Office equipment	Declining balance 20%
Computer software	Straight-line 20%
System software	Straight-line 10%

h) Provision for unpaid claims and adjustment expenses

The provision for unpaid claims represents the amount needed to provide for the estimated ultimate expected cost of settling claims related to insured events (both reported and unreported) that have occurred on or before each balance sheet date. The provision for adjustment expenses represents the estimated ultimate expected cost of investigating, resolving and processing these claims. As permitted by the Superintendent of Insurance of Alberta, the provision estimations do not take into consideration the time value of money, or make explicit provision for adverse deviation. These estimates are necessarily subject to uncertainty and are selected from a wide range of possible outcomes.

As a result, all provisions are periodically reviewed and evaluated in the light of emerging claim experience and changing circumstances. Changes in estimates of the ultimate liability are recorded as incurred claims in the current period.

i) Salvage and subrogation

Salvage and subrogation recoverable are accrued on a specific case by case basis. The gross recoverable is recorded under "other receivables" and the estimated amount payable to reinsurers is recorded against "amounts recoverable from reinsurers".

j) Reinsurance ceded

Premiums, claims and expenses are recorded net of amounts ceded to, and recoverable from, reinsurers. Estimates of amounts recoverable from reinsurers on unpaid claims and adjustment expenses and on unearned premiums are recorded on a gross basis as "amounts recoverable from reinsurers".

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

k) Financial liabilities

Financial liabilities, other than the provision for unpaid claims and adjustment expenses, are classified as other liabilities. Other liabilities are initially recorded at fair value and subsequently measured at cost or amortized cost. Transaction costs relating to other liabilities are expensed as incurred.

l) Income taxes

Income taxes are accounted for using the asset and liability method. Under this method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment occurs.

m) Foreign currency translation

Monetary items denominated in foreign currencies are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at exchange rates in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in income.

n) Comprehensive income

Comprehensive income comprises net income and OCI and includes all changes in shareholder's equity of the Company during the year except those resulting from investment by and distribution to owners. Changes in unrealized gains and losses on AFS investments are recorded in OCI.

The cumulative changes in OCI are included in accumulated other comprehensive income ("AOCI") until recognized in the statement of income. AOCI is included on the balance sheet as a separate component of shareholder's equity (net of income taxes).

o) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

p) Change in accounting policies

Commencing on January 1, 2008, the Company adopted new accounting standards required by the CICA relating to Capital Disclosures – CICA Handbook section 1535, Financial Instruments Disclosures – CICA Handbook section 3862, and Financial Instruments Presentation – CICA Handbook section 3863 as well as other amendments to the CICA Handbook sections and accounting guidelines resulting from the issuance of these sections. The Company has adopted these sections prospectively.

Under CICA Handbook section 1535, the Company is required to disclose its objectives, policies and processes for managing capital; information about what it regards as capital; whether it has complied with any capital requirements, and the consequences of not complying with these capital requirements. These disclosures are provided in note 14.

CICA Handbook sections 3862 and 3863 replace section 3861 – Financial Instruments Disclosure and Presentation. Section 3863 carries forward unchanged the related presentation requirements of Section 3861 while Section 3862 requires enhanced financial instrument disclosures focusing on disclosures related to the nature and extent of risks arising from financial instruments and how the Company manages those risks. Updated disclosure incorporating the section 3862 and 3863 requirements has been made in these financial statements.

q) Future change in accounting policies

In 2008, the Goodwill and Intangible Assets – CICA Handbook section 3064 was issued, which replaces section 3062 – Goodwill and Intangible Assets and section 3450 – Research and Development Costs. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The standard requires that an intangible asset should be recognized only if the asset is identifiable, the entity has control of the asset, the asset is expected to generate future economic benefits and the costs can be reliably measured. The new standard is effective January 1, 2009 and adoption of the standard is not expected to have a material effect on the financial position or earnings of the Company.

During 2008, the CICA Accounting Standards Board confirmed that International Financial Reporting Standards ("IFRS") will replace Canadian GAAP effective January 1, 2011 for Canadian publicly accountable entities. The Company will be required to adopt IFRS for fiscal periods commencing January 1, 2011 and is currently assessing the potential impact of this change and developing a plan accordingly.

PEACE HILLS INSURANCE

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

2 Cash and cash equivalents

The major components of cash and cash equivalents are as follows:

	2008	2007
	$	$
Cash	928,297	1,192,065
Bank term deposits, maturing in three months or less, at rates of interest varying between 0.9% to 1.6%	42,450,787	25,069,024
	43,379,084	26,261,089

3 Investments

					2008
	Cost	Amortized discount/ premium	Gross unrealized gains	Gross unrealized losses	Fair value carrying amount
	$	$	$	$	$
Bonds and debentures	46,119,525	183,856	2,417,425	(466,307)	48,254,499
Common shares	26,014,055	-	1,055,246	(5,335,608)	21,733,693
Other investments	1,380,441	-	46,826	(36,234)	1,391,033
	73,514,021	183,856	3,519,497	(5,838,149)	71,379,225

					2007
	Cost	Amortized discount/ premium	Gross unrealized gains	Gross unrealized losses	Fair value carrying amount
	$	$	$	$	$
Bonds and debentures	43,258,854	195,180	1,163,523	(245,832)	44,371,725
Common shares	35,026,905	-	10,308,876	(2,656,058)	42,679,723
Other investments	3,436,649	-	212,694	(107,439)	3,541,904
	81,722,408	195,180	11,685,093	(3,009,329)	90,593,352

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

a) Bonds and debentures – principal amount and carrying amount

The principal amount and carrying amounts are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain issuers have the right to call or prepay certain obligations with or without call or prepayment penalties.

	2008		2007	
Term maturity	**Principal amount $**	**Fair value carrying amount $**	**Principal amount $**	**Fair value carrying amount $**
Government of Canada				
Due in one year or less	3,065,000	3,144,598	3,640,000	3,643,276
Between one and five years	9,225,000	9,952,003	10,105,000	10,101,197
After five years	8,510,000	8,704,009	11,245,000	10,724,292
Canadian provincial, municipal and public authorities				
Due in one year or less	2,015,000	2,049,940	-	-
Between one and five years	3,475,000	3,903,405	2,015,000	2,050,827
After five years	9,820,000	10,754,158	7,520,000	8,537,372
Canadian corporate				
Due in one year or less	1,520,000	1,519,792	3,410,000	3,408,215
Between one and five years	6,675,000	6,841,342	3,945,000	4,052,588
After five years	1,650,903	1,385,252	1,810,000	1,853,958

b) Bonds and debentures – interest rate risk

Details of significant terms and conditions and exposures to interest rate risk on investments are as follows:

		2008		2007	
	Interest receivable basis	**Effective rates (% range)**	**Coupon rates (% range)**	**Effective rates (% range)**	**Coupon rates (% range)**
Government of Canada	Semi-annual	3.43 to 10.38	3.75 to 5.75	3.36 to 10.38	3.75 to 5.75
Canadian provincial, municipal and public authorities	Semi-annual	2.70 to 6.87	3.30 to 7.50	2.70 to 6.87	3.30 to 7.50
Canadian corporate	Semi-annual	3.48 to 9.03	4.20 to 8.30	3.43 to 9.03	4.20 to 8.30

The Company holds $1,600,000 (2007 – $1,600,000) in bonds that have a variable rate of return.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

c) Common shares and other investments

The Company limits its investment concentration in any one investee or related group of investees to 5% of the Company's total assets, except as allowed by Section 418(1) of the Act.

4 Capital assets

			2008	2007
	Cost	Accumulated amortization	Net	Net
	$	$	$	$
Land	640,000	-	640,000	640,000
Building	2,741,434	564,651	2,176,783	2,023,567
Building improvements	1,386,472	969,625	416,847	555,796
Automotive equipment	459,236	287,183	172,053	310,212
Leasehold improvements	1,058,871	238,254	820,617	621,410
Office equipment and computer software	2,665,794	1,615,720	1,050,074	1,060,643
System software	2,038,593	203,859	1,834,734	1,965,325
	10,990,400	3,879,292	7,111,108	7,176,953

Amortization of capital assets of $896,777 (2007 – $635,054) is included in administrative expenses. Amortization of the building of $114,192 (2007 – $81,669) is included in rental expenses (note 9).

5 Unpaid claims and adjustment expenses

a) Nature of unpaid claims and adjustment expenses

The provision for unpaid claims and adjustment expenses is determined using expected future claims payments based on assumptions that reflect the expected set of economic conditions and planned courses of action. Uncertainty exists on reported claims in that all information may not be available at the reporting date. In addition, claims may not be reported to the Company immediately, therefore estimates are made as to the value of claims incurred but not yet reported, a value that may take years to finally determine. The determination of the provision is dependent on numerous significant assumptions and estimates, which are developed considering the characteristics of the class of business, historical trends, the amount of data available on individual claims and other pertinent factors.

Claims provisions are periodically reviewed and evaluated in light of emerging claims experience and changing circumstances. The resulting changes in the estimates of the ultimate liability are recorded as claims incurred in the period in which the change occurred.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

On February 8, 2008 the Alberta Court of Queen's Bench determined that the Alberta Minor Injury Regulation, which capped the amount of a claim for pain and suffering damages in the event of a minor injury at $4,000, was unconstitutional. The result of this decision was to in effect determine that the Minor Injury Regulation was of no force and effect. As a result of this decision, the Company has increased its provision for unpaid claims in anticipation of the possibility that these types of claims may now settle at increased amounts. This decision is currently under appeal by the Crown.

b) Activity in the provision for unpaid claims and claims adjustment expenses, by line of business, is summarized as follows:

	Property	Automotive	2008	2007
	$	$	$	$
Provision for unpaid claims and adjustment expenses – Beginning of year				
Gross	29,192,817	58,525,874	87,718,691	85,362,054
Reinsurance ceded	13,844,022	18,588,432	32,432,454	31,188,448
Net provisions – Beginning of year	15,348,795	39,937,442	55,286,237	54,173,606
Net incurred claims and claim adjustment expenses				
Provision for insured events of current year	29,496,797	35,142,280	64,639,077	54,466,452
Increase (decrease) in provision for insured events of prior years	(372,761)	2,814,729	2,441,968	(4,152,856)
Total net incurred	29,124,036	37,957,009	67,081,045	50,313,596
Net payments attributable to				
Current year events	(13,406,131)	(19,069,615)	(32,475,746)	(28,231,167)
Prior year events	(9,632,943)	(14,338,053)	(23,970,996)	(20,969,798)
Total net payments	(23,039,074)	(33,407,668)	(56,446,742)	(49,200,965)
Net provision for unpaid claims and adjustment expenses – End of year	21,433,757	44,486,783	65,920,540	55,286,237
Reinsurance ceded – End of year	13,478,426	18,149,291	31,627,717	32,432,454
	34,912,183	62,636,074	97,548,257	87,718,691

c) The Company estimates that the fair value of the gross provision for unpaid claims and adjustment expenses is $98,876,000 as determined on a discounted basis by the appointed actuary.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

6 Underwriting policy and reinsurance ceded

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophe or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers.

Failure of reinsurers to honour their obligations could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectible.

The Company follows the policy of underwriting and reinsuring contracts of insurance that limit the net exposure of the Company to a maximum amount on any one loss of $637,500 (2007 – $425,000) in the event of a claim or a catastrophe, excluding reinstatement fees when applicable.

In addition, the Company has catastrophe reinsurance having an upper limit of $65,000,000 (2007 - $40,000,000).

The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvency.

The figures shown in the consolidated statement of income are net of the following amounts relating to reinsurance ceded to other companies:

	2008 $	2007 $
Net premium earned reduced by	38,396,881	43,789,247
Claims incurred reduced by	19,644,511	15,869,350
Commissions and premiums taxes reduced by	8,508,639	9,238,458

7 Bank loan payable

PHI Properties Limited, the Company's wholly-owned subsidiary, owns an office building in Edmonton. The building purchase and the subsequent building improvements were financed by a loan from the Bank of Nova Scotia for a five year term, with twenty year amortization at a floating interest rate of prime plus 0.25%. The collateral for the loan is provided by hypothecation of federal and provincial government bonds and treasury bills equal to the amount of the outstanding principal. Annual principal payments of $162,000 are due until the maturity of the loan on May 31, 2011.

PEACE HILLS INSURANCE

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

8 Share capital

Authorized

20,000 common shares with a stated value of $100 per share

Issued

	2008	2007
	$	$
20,000 common shares	2,000,000	2,000,000

9 PHI Properties Limited

	2008	2007
	$	$
Rental income	783,843	773,092
Expenses		
Operations	728,592	671,100
Amortization	114,192	81,669
Interest	106,240	142,492
Other	53,898	148,481
	1,002,922	1,043,742
Net loss	(219,079)	(270,650)

10 Related party transactions

The Company donated $149,525 (2007 – $1,172,312) to individual members and organizations of the Samson Cree Nation, which is the ultimate shareholder of the Company. These donations are included in administrative expenses of which $nil (2007 – $1,000,000) is included in expenses due and accrued.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

11 Commitments

Operating lease commitments

The Company has contractual obligations expiring at various dates in 2009 to 2015 in respect of rents payable on leased premises and equipment as follows:

	$
2009	457,897
2010	475,759
2011	439,866
2012	425,236
2013 and thereafter	1,259,385

The Company is also responsible for its proportionate share of operating costs under the terms of the premises leases.

12 Contingent liabilities

In common with the insurance industry in general, the Company is subject to litigation arising in the normal course of conducting its insurance business. The Company is of the opinion that this litigation will not have a significant effect on the financial position, results of operations or cash flows of the Company.

The Company has provided loan guarantees of $900,000 (2007 – $900,000) to unrelated parties with terms ending in the year 2021. In the event of a default the Company will realize recovery on the assets of the entities for which guarantees have been made.

13 Financial risk management objectives and policies

Credit risk

Credit risk refers to the risk of financial loss from the failure of a counterparty/debtor to honour its obligation to the Company. The Company is exposed to credit risk through its investment securities and amounts receivable from policyholders and reinsurers. The Company's investment policy puts limits on the bond portfolio including portfolio composition limits, issuer type limits, bond quality limits and single issuer limits. Compliance with the investment policy is monitored by the Investment Committee of the Board of Directors. All of the Company's term deposits and bond and debentures are rated A or above.

The Company's credit exposure to any one individual policyholder is not material. However, the Company's policies are distributed by brokers who manage cash collection on its behalf. The Company monitors its exposure to brokers and has procedures to ensure that it works with only licensed firms in good standing with their regulatory bodies.

The Company also has policies which limit its exposures to individual reinsurers and regular review processes to assess the creditworthiness of reinsurers with whom it transacts business. All reinsurers are rated A- or above.

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Peace Hills General Insurance Company • Year Ended December 31, 2008

Interest rate risk

The Company is exposed to interest rate risk through investments in bonds and debentures, which are sensitive to changes in interest rates. The Company is also exposed to interest rate risk through the bank loan payable bearing interest at bank prime rate plus 0.25%.

At December 31, 2008, a 1% change in interest rates, with all other variables held constant, could impact the fair value of bonds and debentures by $2,436,550. The change would be recognized in other comprehensive income. In addition, a 1% change in interest rates would have an impact of $19,565 annually on interest expense and cash flow related to the bank loan payable.

Market risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as equity market fluctuations and foreign currency exchange rates. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying assets are traded.

At December 31, 2008, a 10% change in the equity holdings in the Company's investment portfolio, with all other variables held constant, would have an estimated effect on the fair values of common shares and other investments of $2,300,000. The change would be recognized in other comprehensive income.

The Company holds foreign currency denominated common shares and other investments in the amount of $7,680,616 (2007 – $14,001,032). A 10% change in the value of the United States Dollar would affect the fair value of the investments by $768,000.

To mitigate these risks, the Company's exposures are monitored on a regular basis and actions are taken to balance positions when approved risk tolerance limits are exceeded. Compliance with the investment policy is monitored by the Investment Committee of the Board of Directors. Diversification techniques are employed to minimize risk. The policy limits the investment in any entity or group of related entities to a maximum of 5% of the Company's total assets. External investment managers manage the Company's investment portfolio and asset mix based on the investment policy guidelines.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its cash obligations as they fall due. The Company does not have material liabilities that can be called unexpectedly. Claims and claims adjustment expenses and administrative expenses are funded by current operating cash flows which normally exceed cash requirements. The timing and amount of catastrophe claims events are inherently unpredictable and may create increased liquidity requirements. Liquidity risk is managed by maintaining a highly liquid investment portfolio. In addition, at December 31, 2008, the Company had $43,379,084 of cash and cash equivalents.

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Peace Hills General Insurance Company • Year Ended December 31, 2008

14 Capital management

The Company's capital management approach is designed to maintain adequate levels of capital in order to build long term shareholder value, meet regulatory capital requirements, and maintain an appropriate credit rating. Adequate capital acts as a safety net for possible losses and provides a basis for confidence in the company by shareholders, policyholders, creditors and others. Capital funds are managed with plans that are put in place by the senior executive management of the Company. Capital is comprised of common share capital, contributed surplus, accumulated other comprehensive income and retained earnings.

Reinsurance is purchased to protect the Company's capital from catastrophic losses which can arise. Both the incidence and severity of catastrophic losses can be unpredictable but the Company's reinsurance program limits the exposure to any single catastrophic loss.

The financial strength of property and casualty insurers is measured by regulators using the Minimum Capital Test ("MCT"). This test compares a company's capital which includes accumulated other comprehensive income against the risk profile of the company. Various factors are applied to many different elements including assets, policy liabilities, and the type of invested assets. The Company's regulators in the Province of Alberta require that each company attain a minimum MCT ratio of 150%. The Company was in compliance with this requirement as at December 31, 2008 with a ratio of 208.65% (2007 – 254.67%).

15 Supplemental cash flow information

	2008 $	2007 $
Cash paid for		
Interest	106,240	142,492
Income taxes	1,809,482	4,886,099
Cash received from		
Dividends	1,413,062	1,644,599
Interest	3,153,044	3,451,436
Income taxes	1,351,811	26,868

16 Alberta Risk Sharing Pool and Facility Association Residual Market

The Company is a participant in the Alberta Risk Sharing Pool and Facility Association Residual Market ("ARSP" and "FARM"). Both the ARSP and FARM are joint ventures of insurers which provide automobile insurance for owners and operators of motor vehicles who may otherwise have difficulty obtaining such insurance.

The Company proportionately consolidates its interests in the ARSP and FARM, which are restricted to the pool of business relating to Alberta (including Northwest, Yukon and Nunavut Territories).

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Peace Hills General Insurance Company • Year Ended December 31, 2008

The Company has included in its accounts the following aggregate amounts in respect of its interests in the ARSP and FARM:

	2008 $	2007 $
Assets		
Due from other insurance companies	7,042,789	7,613,791
Amounts recoverable from reinsurers	3,559,448	3,490,471
Deferred policy acquisition costs	1,387,125	1,554,879
	11,989,362	12,659,141
Liabilities		
Provision for unpaid claims and adjustment expenses	14,441,890	12,137,914
Unearned premiums	4,979,487	5,466,001
Due to other insurance companies	826,609	791,261
Other taxes due and accrued	73,064	96,445
	20,321,050	18,491,621
Revenues		
Premiums earned	8,692,158	9,112,249
Expenses		
Claims	8,111,755	3,539,180
Commissions	2,113,885	2,274,649
Premium and other taxes	588,954	719,933
Administrative	355,658	309,677
	11,170,252	6,843,439

17 Funds due to FARM

The Company holds its proportionate share of excess funds from FARM and they are currently held by the Company as part of its investment portfolio. These funds will be returned to FARM over time as needed to facilitate payment of the related policyholder claims.

Notes to Consolidated Financial Statements

Peace Hills General Insurance Company • Year Ended December 31, 2008

18 Variable interest entity

In 2008, the Company made a loan to one of its insurance brokers in the amount of $875,000. The loan bears interest at prime plus 1% (5.0% at December 31, 2008). Annual principal payments of $87,504 are due until maturity of the loan on February 28, 2013. Prepayment can occur without notice.

The Company has determined that the broker is a variable interest entity and that the loan agreement represents a variable interest in the broker. The Company has determined, however, that it is not the primary beneficiary under the loan agreement since the Company is not entitled to receive a majority of the broker's expected residual returns or absorb a majority of its expected losses. As the broker is a separate legal entity, the Company does not have direct access to the broker's assets and the broker's other creditors do not have recourse against the Company.

During the year ended December 31, 2008, the Company has written premiums from the broker of $1,548,161 (2007 – $1,292,813).

PEACE HILLS
INSURANCE