



Consolidated Financial Statements of

The Independent Order of Foresters

Year ended December 31, 2019

Consolidated Financial Statements and Notes - Table of Contents

| | Page # |
|--|---------------|
| Management Statement On Responsibility For Financial Reporting | 2 |
| Independent Auditors' Report | 3 |
| Appointed Actuary's Report | 6 |
| Consolidated Statement of Comprehensive Income (Loss) | 7 |
| Consolidated Statement of Financial Position | 8 |
| Consolidated Statement of Changes in Surplus | 9 |
| Consolidated Statement of Cash Flows | 10 |
| Description of business | 11 |
| Note 1 - Significant accounting policies | 11 |
| Note 2 - Accounting and reporting changes | 29 |
| Note 3 - Invested assets | 33 |
| Note 4 - Investments for account of segregated fund unit holders | 41 |
| Note 5 - Other assets | 43 |
| Note 6 - Property and equipment | 44 |
| Note 7 - Employee benefit plans | 46 |
| Note 8 - Goodwill and intangible assets | 53 |
| Note 9 - Financial risk management | 56 |
| Note 10 - Other liabilities | 66 |
| Note 11 - Insurance contract liabilities and reinsurance assets | 68 |
| Note 12 - Investment contract liabilities | 76 |
| Note 13 - Leases | 76 |
| Note 14 - Capital management | 78 |
| Note 15 - Premiums | 79 |
| Note 16 - Fee revenue and other operating income | 80 |
| Note 17 - Benefits | 80 |
| Note 18 - Operating expenses | 81 |
| Note 19 - Income taxes | 82 |
| Note 20 - Segmented information | 86 |
| Note 21 - Discontinued operations | 90 |
| Note 22 - Disposal group held for sale | 92 |
| Note 23 - Related party transactions | 92 |
| Note 24 - Contractual obligations and commitments | 94 |
| Note 25 - Contingent liabilities | 94 |
| Note 26 - Principal subsidiaries | 95 |
| Note 27 - Subsequent event | 95 |
| Note 28 - Comparative information | 95 |

MANAGEMENT STATEMENT ON RESPONSIBILITY FOR FINANCIAL REPORTING

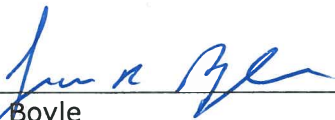
The consolidated financial statements have been prepared by management, who are responsible for their integrity, objectivity and reliability. International Financial Reporting Standards ("IFRS") including the accounting requirements of the Office of the Superintendent of Financial Institutions Canada ("OSFI") have been applied and management has exercised its judgement and made best estimates where deemed appropriate. In the opinion of management, the consolidated financial statements fairly reflect the financial position, results of operations and cash flows of The Independent Order of Foresters ("Foresters Financial") within reasonable bounds of materiality.

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

The Board of Directors, acting through the Audit and Compliance Committee, which comprises directors who are not officers or employees of Foresters Financial, oversees management responsibility for the financial reporting and internal control system.

The Appointed Actuary is appointed by the Board of Directors to carry out an annual valuation of liabilities for future benefits. In performing this valuation, the Appointed Actuary is responsible for ensuring that the assumptions and methods used in the valuation of insurance contract liabilities are in accordance with accepted actuarial practice and requirements. The Appointed Actuary is required to provide an opinion regarding the appropriateness of insurance and investment contract liabilities at the balance sheet date to meet all certificate holders' obligations. Examination of supporting data for accuracy and completeness and analysis of assets for their ability to support the amount of insurance and investment contract liabilities are important elements of the work required to form this opinion. The Appointed Actuary is also required each year to analyze the financial condition of Foresters Financial and prepare a report for the Board of Directors. The analysis tests Foresters Financial's capital adequacy under several adverse but plausible conditions using the relevant Standards of Practice of the Canadian Institute of Actuaries. In carrying out his work the Appointed Actuary makes use of the work of the internal audit department and KPMG LLP Chartered Professional Accountants ("Auditors"). The Appointed Actuary's Report outlines the scope of the valuation and the Actuary's opinion.

Foresters Financial engages external Auditors to express an opinion on the financial statements. The responsibility of these Auditors is to carry out an independent and objective audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards and report regarding the fairness of presentation of Foresters Financial's consolidated financial statements in accordance with IFRS, including the accounting requirements of OSFI. In carrying out their audit, the Auditors also make use of the work of the Appointed Actuary and her report on the insurance and investment contract liabilities. The Auditors' report outlines the scope of their audit and their opinion.



James Boyle
President and Chief Executive Officer



Alvin Sharma
Global Chief Financial Officer

Toronto, Canada
February 19, 2020



KPMG LLP
Bay Adelaide Centre
333 Bay Street, Suite 4600
Toronto ON M5H 2S5
Canada
Tel 416-777-8500
Fax 416-777-8818

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of The Independent Order of Foresters

Opinion

We have audited the consolidated financial statements of The Independent Order of Foresters (the Entity), which comprise:

- the consolidated statement of financial position as at December 31, 2019
- the consolidated statement of comprehensive income (loss) for the year then ended
- the consolidated statement of changes in surplus for the year then ended
- the consolidated statement of cash flows for the year then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.



Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.



Page 3

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group Entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Canada

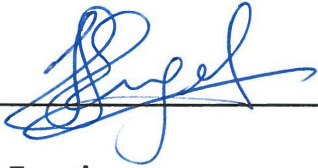
February 19, 2020

APPOINTED ACTUARY'S REPORT

To the Board of Directors of The Independent Order of Foresters

I have valued the policy liabilities and reinsurance recoverables of The Independent Order of Foresters for its consolidated statement of financial position as at December 31, 2019 and their changes in the consolidated statement of comprehensive income (loss) for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods.

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



Trudy Engel
Fellow, Canadian Institute of Actuaries
Toronto, Canada

February 19, 2020

THE INDEPENDENT ORDER OF FORESTERS
Consolidated Statement of Comprehensive Income (Loss)
For the year ended December 31
(in thousands of Canadian dollars)

| | Note | 2019 | 2018 <i>Re-presented</i> |
|---|------|-------------------------|-----------------------------|
| REVENUE | | | |
| Gross premiums | 15 | \$1,167,991 | \$1,280,817 |
| Ceded premiums | 15 | <u>(139,039)</u> | <u>(112,206)</u> |
| Net Premiums | | 1,028,952 | 1,168,611 |
| Net Investment Income | | | |
| Interest and dividends (net) | 3 | 297,667 | 290,326 |
| Net realized gains (losses) | 3 | 99,393 | 33,713 |
| Net change in unrealized gains (losses) on fair value through profit and loss investments | 3 | 600,273 | (461,258) |
| Net foreign currency gains (losses) on available-for-sale assets | 3 | <u>(238)</u> | <u>4,892</u> |
| Total Investment Income (Loss) | | 997,095 | (132,327) |
| Fee revenue | 16 | 130,519 | 126,659 |
| Other operating income | 16 | <u>11,426</u> | <u>11,668</u> |
| TOTAL REVENUE | | <u>2,167,992</u> | <u>1,174,611</u> |
| BENEFITS & EXPENSES | | | |
| Gross benefits | 17 | 887,567 | 817,679 |
| Ceded benefits | 17 | (80,867) | (53,589) |
| Gross change in insurance contract liabilities | 11 | 752,429 | (117,380) |
| Ceded change in insurance contract liabilities | 11 | (115,095) | (38,636) |
| Policy dividends | | 50,068 | 48,666 |
| Commissions | | 286,313 | 352,541 |
| Operating expenses | 18 | 296,300 | 270,396 |
| Ceded commissions and operating expenses | 18 | (54,043) | (29,945) |
| Fraternal investment | 1 | <u>20,542</u> | <u>19,195</u> |
| TOTAL BENEFITS & EXPENSES | | <u>2,043,214</u> | <u>1,268,927</u> |
| Income (Loss) before income taxes | | 124,778 | (94,316) |
| Income Taxes | | | |
| Current | 19 | (919) | (6,487) |
| Deferred | 19 | <u>35,928</u> | <u>(6,359)</u> |
| Total Income Taxes | | 35,009 | (12,846) |
| NET INCOME (LOSS) FROM CONTINUING OPERATIONS | | <u>89,769</u> | <u>(81,470)</u> |
| NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX | 21 | <u>2,980</u> | <u>(35,461)</u> |
| TOTAL NET INCOME (LOSS) | | <u>92,749</u> | <u>(116,931)</u> |
| OTHER COMPREHENSIVE INCOME (LOSS) | | | |
| <i>Items that will not be reclassified to net income</i> | | | |
| Remeasurement gains (losses) on employee benefit plans, net of income tax expense of \$71 (2018: \$18) | 7 | (2,110) | 11,046 |
| Net change in unrealized gains (losses) on property | 6 | <u>729</u> | <u>1,489</u> |
| Total items that will not be reclassified to net income | | <u>(1,381)</u> | <u>12,535</u> |
| <i>Items that are or may be reclassified subsequently to net income</i> | | | |
| Net change in unrealized gains (losses) on available-for-sale assets, net of income tax expense of \$741 (2018: \$115) | | 55,200 | (32,256) |
| Reclassification of net realized gains (losses) on available-for-sale assets net of income tax recovery (expense) of \$289 (2018: (\$457)), to net income | | (185) | 1,002 |
| Net unrealized foreign currency translation gains (losses) | | <u>(78,803)</u> | <u>125,800</u> |
| Total items that or may be reclassified subsequently to net income | | <u>(23,788)</u> | <u>94,546</u> |
| TOTAL OTHER COMPREHENSIVE INCOME (LOSS) | | <u>(25,169)</u> | <u>107,081</u> |
| TOTAL COMPREHENSIVE INCOME (LOSS) | | <u>\$67,580</u> | <u>\$(9,850)</u> |

THE INDEPENDENT ORDER OF FORESTERS
Consolidated Statement of Financial Position
As at December 31
(in thousands of Canadian dollars)

| | Note | 2019 | 2018 |
|--|------|---------------------|---------------------|
| ASSETS | | | |
| Invested Assets | | | |
| Cash, cash equivalents and short-term securities | 3 | \$305,679 | \$278,170 |
| Bonds | 3 | 6,616,543 | 7,528,999 |
| Equities | 3 | 835,763 | 748,341 |
| Derivative financial instruments | 3 | 5,020 | 190 |
| Other invested assets | 3 | 143,699 | 140,552 |
| Loans to certificate holders | 3 | 261,360 | 404,357 |
| Total Invested Assets | | 8,168,064 | 9,100,609 |
| Reinsurance assets | 11 | 501,767 | 398,562 |
| Accrued investment income | | 56,073 | 73,306 |
| Deferred acquisition costs | 5 | 22,800 | 73,546 |
| Prepaid commissions | | 67,766 | 82,105 |
| Current income taxes | 19 | 12,391 | 29,212 |
| Deferred tax assets | 19 | 15,027 | 32,512 |
| Other assets | 5 | 70,193 | 79,226 |
| Property and equipment | 6 | 59,758 | 69,340 |
| Right of use assets | 13 | 27,462 | - |
| Employee benefit assets | 7 | - | 3,267 |
| Goodwill and intangible assets | 8 | 46,763 | 207,680 |
| Assets classified as held for sale | 22 | 1,735,777 | - |
| | | 10,783,841 | 10,149,365 |
| Net investments for accounts of segregated fund unit holders | 4 | 5,795,825 | 7,635,014 |
| Net investments for accounts of segregated fund unit holders held for sale | 22 | 1,940,753 | - |
| TOTAL ASSETS | | \$18,520,419 | \$17,784,379 |
| LIABILITIES | | | |
| Insurance contract liabilities | 11 | 6,481,105 | 7,398,428 |
| Investment contract liabilities | 12 | 144,291 | 161,109 |
| Derivative financial instruments | 3 | 26,774 | 34,669 |
| Benefits payable and provision for unreported claims | | 183,877 | 184,086 |
| Lease liabilities | 13 | 35,541 | - |
| Current income taxes | 19 | 25,575 | 6,256 |
| Deferred tax liabilities | 19 | 9,371 | 2,604 |
| Other liabilities | 10 | 233,007 | 260,001 |
| Employee benefit obligations | 7 | 90,825 | 83,757 |
| Liabilities classified as held for sale | 22 | 1,467,440 | - |
| | | 8,697,806 | 8,130,910 |
| Liabilities for accounts of segregated fund unit holders | 4 | 5,795,825 | 7,635,014 |
| Liabilities for accounts of segregated fund unit holders held for sale | 22 | 1,940,753 | - |
| TOTAL LIABILITIES | | 16,434,384 | 15,765,924 |
| SURPLUS | | | |
| Retained earnings | | 1,746,684 | 1,654,394 |
| Accumulated other comprehensive income | | 339,351 | 364,061 |
| | | 2,086,035 | 2,018,455 |
| TOTAL LIABILITIES AND SURPLUS | | \$18,520,419 | \$17,784,379 |

Contractual obligations and commitments (note 24)
Contingent liabilities (note 25)

On behalf of the Board:



Director



Director

THE INDEPENDENT ORDER OF FORESTERS
Consolidated Statement of Changes in Surplus
For the year ended December 31
(in thousands of Canadian dollars)

| | Retained earnings | Accumulated Other Comprehensive Income | | | | Total |
|--|--------------------|--|--------------------------------|---|--|------------------|
| | | Non-permanent | | Permanent | | |
| | | Unrealized gains (losses) on available-for-sale assets | Cumulative translation account | Net unrealized gains (losses) on property | Remeasurement gains (losses) on employee benefit plans | |
| Balance as at December 31, 2018 | \$1,654,394 | \$6,011 | \$371,851 | \$16,590 | \$ (30,391) | \$364,061 |
| Total net income (loss) | 92,749 | - | - | - | - | - |
| Other comprehensive income (loss): | | | | | | |
| Pre-tax balance | - | 55,941 | (78,803) | 729 | (2,039) | (24,172) |
| Reclassification of net realized losses on available for sale assets | - | (474) | - | - | - | (474) |
| Income tax expense | - | (452) | - | - | (71) | (523) |
| Total other comprehensive income (loss) | - | 55,015 | (78,803) | 729 | (2,110) | (25,169) |
| Total comprehensive income (loss) for the period | 92,749 | 55,015 | (78,803) | 729 | (2,110) | (25,169) |
| Transfer to retained earnings | (459) | - | - | - | 459 | 459 |
| Balance as at December 31, 2019 | \$1,746,684 | \$61,026 | \$293,048 | \$17,319 | \$(32,042) | \$339,351 |
| Balance as at December 31, 2017 | \$1,773,598 | \$37,265 | \$246,051 | \$15,101 | \$(41,437) | \$256,980 |
| Adoption of IFRS 15 | (2,273) | - | - | - | - | - |
| Total net income (loss) | (116,931) | - | - | - | - | - |
| Other comprehensive income (loss): | | | | | | |
| Pre-tax balance | - | (32,141) | 125,800 | 1,489 | 11,064 | 106,212 |
| Reclassification of net realized gains on available-for-sale assets | - | 1,459 | - | - | - | 1,459 |
| Income tax expense | - | (572) | - | - | (18) | (590) |
| Total other comprehensive income (loss) | - | (31,254) | 125,800 | 1,489 | 11,046 | 107,081 |
| Total comprehensive income (loss) for the period | (119,204) | (31,254) | 125,800 | 1,489 | 11,064 | 107,081 |
| Balance as at December 31, 2018 | \$1,654,394 | \$6,011 | \$371,851 | \$16,590 | \$(30,391) | \$364,061 |

**The Independent Order of Foresters
Consolidated Statement of Cash Flows
For the years ended December 31
(in thousands of Canadian dollars)**

| | 2019 | 2018 |
|--|-----------------|------------------|
| | \$ | \$ |
| Cash flow from operating activities | | |
| Total net income (loss) income per statements of comprehensive income | 92,749 | (116,931) |
| Items not affecting cash: | | |
| Depreciation and amortization | 29,852 | 36,249 |
| Net increase (decrease) in insurance contract liabilities | 752,429 | (117,380) |
| Net increase in reinsurance assets | (115,095) | (38,636) |
| Net realized and change in unrealized losses (gains) on invested assets | (701,047) | 421,531 |
| Net foreign currency (losses) gains on available-for-sale assets | 238 | (4,892) |
| Net foreign currency gains (losses) on other assets and other liabilities | (2,461) | 528 |
| Employee benefit provision | 16,270 | 19,070 |
| Amortization of premium and discount on bonds | 15,045 | 16,164 |
| Impairment loss on measurement of goodwill and intangibles | - | 40,765 |
| Gain on sale of discontinued operations | (72,574) | - |
| Income tax on sale of discontinued operations | (71,091) | - |
| Deferred income tax expense (recovery) | 44,311 | (8,285) |
| Net change in other assets and other liabilities | (5,177) | (15,531) |
| Increase due to operating activities | (16,551) | 232,652 |
| Cash flow from investing activities | | |
| Investments sold or matured: | | |
| Bonds | 2,649,978 | 2,558,461 |
| Equities | 247,763 | 493,687 |
| Disposal of discontinued operations | 293,088 | - |
| Investments acquired: | | |
| Bonds | (2,876,198) | (2,811,549) |
| Equities | (235,523) | (507,974) |
| Other items, net | 10,477 | (2,936) |
| Increase (decrease) due to investing activities | 89,585 | (270,311) |
| Cash flow from financing activities | | |
| Lease liability payment | (11,651) | - |
| Decrease due to financing activities | (11,651) | - |
| Foreign exchange gains (losses) on cash held in foreign currencies | (11,733) | 19,105 |
| Net increase (decrease) in cash, cash equivalents and short-term securities for the year | 49,650 | (18,554) |
| Net cash, cash equivalents and short-term securities for entities classified as held-for-sale | (22,141) | - |
| Cash, cash equivalents and short-term securities, beginning of year | 278,170 | 296,724 |
| Cash, cash equivalents and short-term securities, end of year | 305,679 | 278,170 |
| Cash, cash equivalents and short-term securities consist of: | | |
| Cash | 197,658 | 169,521 |
| Cash equivalents | 61,217 | 13,824 |
| Short-term securities | 46,804 | 94,825 |
| | 305,679 | 278,170 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

DESCRIPTION OF BUSINESS

The Independent Order of Foresters ("Foresters Financial") is a Fraternal Benefit Society, which provides fraternal benefits to its members as well as individual life insurance, savings and retirement products, through its branch and subsidiary operations in the United States ("U.S."), Canada and the United Kingdom ("U.K.").

Foresters Financial commenced business in Canada in 1881. It is incorporated under the Insurance Companies Act – Canada ("the Act"), and is regulated by the Office of the Superintendent of Financial Institutions Canada ("OSFI"). In addition, Foresters Financial foreign branch and subsidiary operations are regulated by statutory authorities in the U.S. and the U.K. Foresters Financial's registered office is located at 789 Don Mills Road, Toronto, Ontario M3C 1T9, Canada.

1. SIGNIFICANT ACCOUNTING POLICIES

Foresters Financial has consistently applied the following accounting policies to all periods presented in these consolidated financial statements. Certain comparative amounts in the consolidated statement of comprehensive income (loss) and the notes to the consolidated financial statements have been re-presented as a result of discontinued operations during the current year as described in Note 21.

1.1 Basis of Presentation

a) Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These consolidated financial statements also comply with the accounting requirements of OSFI.

These consolidated financial statements were authorized for issue by the Board of Directors on February 19, 2020.

b) Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis except for the following material items in the consolidated statement of financial position:

- Financial assets at fair value through profit and loss ("FVTPL"), available-for-sale ("AFS") financial assets and derivative financial instruments are measured at fair value;
- Employee benefit assets and obligations represent the funded status of these plans which is calculated as the difference between plan assets at fair value and the present value of defined benefit obligations;
- Reinsurance assets and insurance contract liabilities are calculated using the Canadian Asset Liability Method ("CALM");
- Owned land and buildings are measured at fair value;
- Disposal group consisting of assets and liabilities held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This definition applies to all assets and liabilities measured at fair value except for impairment provisions using value in use to determine the recoverable amount of the asset.

c) Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is Foresters Financial's functional currency.

d) Critical accounting estimates and judgments

The preparation of the consolidated financial statements requires management to make estimates, judgments and underlying assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised. The areas where the use of estimates and assumptions have the most significant effect are: the measurement and classification of insurance and investment contract liabilities, the calculation of fair value of financial instruments, impairment testing of intangible assets and goodwill, amortization of deferred acquisition costs, determination of employee benefit assets and liabilities, income taxes, provisions for unreported claims, impairment provisions and the determination of contingencies.

Some of these depend on assessment of the future economic environment and the U.K.'s future prospects and performance. Brexit is one of the most significant economic events for the U.K. and at the date of the financial statements its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible outcomes unknown.

The use of estimates, judgments and assumptions is discussed in more detail in the relevant notes to these consolidated financial statements.

1.2 Basis of consolidation

The consolidated financial statements include the results of operations and the financial position of all entities controlled by either Foresters Financial or its subsidiaries. Control exists when Foresters Financial or one of its subsidiaries has power to direct the activities that significantly affect returns, exposure or rights to variable returns based on the subsidiary's performance and the ability to use its power to affect returns. Subsidiaries are fully consolidated from the date on which control is transferred to Foresters Financial until the date that control ceases. The accounting policies of subsidiaries have been changed where necessary to align with the policies of the group. Intra group transactions are eliminated on consolidation. Foresters Financial's principal subsidiaries are listed in note 26.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

1.3 Segmented reporting

Operating segments have been identified based on internal management reports which are used by senior management to assess performance and make decisions. Foresters Financial has three operating segments and a corporate segment (there were four operating segments up until October 2019).

The three operating segments are:

- North American Insurance sells insurance, annuities and segregated fund products;
- U.K. Savings, Investments and Protection ("UKSIP") sells protection, pension, unit linked savings and investment products through subsidiary operations;
- Membership works closely with the other operating segments to develop and administer member benefits through Foresters Financial's operations in each country. Membership has no external source of income and its operations are fully funded by the corporate segment;

The Corporate segment holds surplus investments above those required to satisfy management's internal capital targets for each of the four segments.

In 2019, Foresters Financial sold assets from its North American Asset Management ("NAAM") segment (see Note 21) including the sale of its Canadian subsidiary in the same segment. Management committed to a plan to exit this segment following a strategic decision to place greater focus on the company's core business of life insurance. As a result, NAAM's financial results are disclosed as discontinued operations in the consolidated statement of comprehensive income (loss).

1.4 Foreign currency

Foreign operations

For Foresters Financial foreign operations, the local currency is the currency used to transact business and has been defined as the functional currency. Foresters Financial's U.S. and U.K. operations prepare their financial statements in U.S. dollars and the British pound sterling, which are their respective functional currencies. These operations transact business only in their functional currencies.

In preparing these consolidated financial statements, the functional currencies of the foreign subsidiaries and branch operations have been translated into Canadian dollars which is the presentation currency. All assets and liabilities are translated at the closing exchange rate at the reporting date, and income and expenses are translated using the average exchange rate for the year. The accumulated gains or losses arising from translation of functional currencies to the presentation currency are presented separately in the currency translation account, a separate component of accumulated other comprehensive income ("AOCI"). When a foreign operation has been sold, these unrealized foreign currency translation gains and losses are recognized in net income.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Monetary and non-monetary assets

Foreign exchange differences arising from the translation of monetary items and non-monetary items held at FVTPL are included in net income on the consolidated statement of comprehensive income (loss).

Foreign exchange translation gains and losses attributable to monetary AFS assets are recognized in net income, while translation differences related to non-monetary AFS assets are recognized in other comprehensive income ("OCI"). On the derecognition of non-monetary AFS assets, any exchange gains or losses relating to these items are then recognized in net income.

Foreign currency transactions

Foreign currency transactions are converted to the appropriate functional currency on the date of the transaction.

1.5 Invested assets

At initial recognition, invested assets are designated or classified as FVTPL, AFS or loans and receivables as follows:

| | FVTPL assets | AFS assets | Loans and receivables |
|----------------------------------|-------------------------|-----------------------|----------------------------------|
| Short-term securities | | | X |
| Bonds | X | X | |
| Equities | X | X | |
| Derivative financial instruments | X | | |
| Other invested assets | X | X | X |
| Loans to certificate holders | | | X |

Invested assets can be classified as FVTPL assets if they are acquired principally for the purpose of selling or repurchasing in the near term.

Invested assets supporting insurance and investment contract liabilities are designated as FVTPL in order to reduce measurement or recognition inconsistencies that would otherwise arise as a result of measuring assets and the corresponding liabilities on different bases.

Invested assets supporting surplus are classified as AFS assets.

a) Cash, cash equivalents and short-term securities

Cash and cash equivalents are comprised of cash balances, overnight deposits, and fixed income securities that are highly liquid and have original maturities of three months or less.

Short-term securities are comprised of notes and commercial paper, carried at amortized cost, and include highly liquid investments with original maturities of more than three months, but less than one year.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

The carrying value of cash, cash equivalents and short-term securities approximates their fair value.

b) Bonds

Bonds are designated as either FVTPL or AFS and are initially recorded at fair value on the trade date.

The fair value of publicly traded bonds is determined using quoted market mid prices. For non-publicly traded bonds, fair value is determined using a discounted cash flow approach that includes provisions for credit risk and the expected maturities of the securities. Foresters Financial does not have any bonds for which the fair value is determined using a valuation technique based on assumptions that are not supported by observable market prices or rates.

Interest income is recorded as interest and dividends (net) on the consolidated statement of comprehensive income (loss) on an accrual basis using the effective interest method and realized gains and losses on the sale of bonds are recorded as net realized gains (losses), both of which are components of net income on the consolidated statement of comprehensive income (loss).

Changes in the fair value of FVTPL bonds are recorded as net change in unrealized gains (losses) on fair value through profit and loss investments, a component of net income on the consolidated statement of comprehensive income (loss).

Changes in the fair value of AFS bonds are recorded as net change in unrealized gains (losses) on available-for-sale assets, a component of OCI on the consolidated statement of comprehensive income (loss).

c) Equities

Equities are designated as either FVTPL or AFS and are initially recorded at fair value on the trade date.

The fair value of publicly traded equities is determined using quoted market closing prices. For non-publicly traded equities, fair value is estimated on the basis of dealer quotes or recent transactions of similar investments. Transaction costs on FVTPL equities are expensed. Directly attributable transaction costs on AFS equities are capitalized as part of the original cost of the equity.

Dividend income is recorded as interest and dividends (net) on the ex-dividend date and realized gains and losses on the sale of equities are recorded as net realized gains (losses), both of which are components of net income on the consolidated statement of comprehensive income (loss).

Changes in the fair value of FVTPL equities are recorded as net change in unrealized gains (losses) on fair value through profit and loss investments, a component of net income on the consolidated statement of comprehensive income (loss). Changes in the

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

fair value of AFS equities are recorded as net change in unrealized gains (losses) on available-for-sale assets, a component of OCI on the consolidated statement of comprehensive income (loss).

d) Derivative financial instruments

Foresters Financial utilizes certain derivative financial instruments in portfolios supporting actuarial liabilities in order to hedge against fluctuations in foreign exchange rates and stock market indices. These derivative financial instruments are classified as FVTPL assets or liabilities and are initially recorded at fair value. The fair value of derivative financial instruments is based on quoted market prices, unless they are non-publicly traded in which case fair value is estimated on the basis of models and includes an element of credit risk.

Foresters Financial has presented derivative financial instruments on a net basis where Foresters Financial has the right and intent to offset. When the net fair value is positive, a net asset is reported and when the net fair value is negative, a net liability is reported. Where Foresters Financial does not have the right and intent to offset, derivative financial instruments with a positive fair value are recorded as an asset while derivative financial instruments with a negative fair value are recorded as a liability.

Realized gains and losses on the sale of these instruments are recorded as net realized gains (losses) and changes in the fair value of these contracts are recorded as net change in unrealized gains (losses) on fair value through profit and loss investments, both of which are components of net income on the consolidated statement of comprehensive income (loss).

An embedded derivative is a component of a host contract that modifies the cash flows of the host contract in a manner similar to a derivative, according to a specified interest rate, financial instrument price, foreign exchange rate, underlying index or other variable. Foresters Financial is required to separate embedded derivatives from the host contract, if an embedded derivative has economic and risk characteristics that are not closely related to the host contract, meets the definition of a derivative, and the combined contract is not measured at fair value with changes recognized in income. If an embedded derivative is separated from the host contract, it will be accounted for as a derivative.

e) Other Invested Assets

Limited partnerships

Limited partnerships classified as AFS assets are recorded at fair value. Foresters Financial does not have joint control or any significant influence over these partnerships. Fair value is based on the net asset value of the investment where Foresters Financial is a limited partner. Changes in fair value are recorded as net change in unrealized gains (losses) on available-for-sale assets, a component of OCI on the consolidated statement of comprehensive income (loss). Realized gains or losses on sale are recorded as net realized gains (losses), a component of net income on the consolidated statement of comprehensive income (loss).

Limited partnerships supporting insurance contract liabilities are classified as FVTPL assets

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

and recorded at fair value. Foresters Financial does not have joint control or any significant influence over these partnerships. Fair value is based on the net asset value of the investment where Foresters Financial is a limited partner. Changes in fair value are recorded as net change in unrealized gains (losses) on fair value through profit and loss investments and realized gains or losses on sale are recorded as net realized gains (losses), both of which are components of net income on the consolidated statement of comprehensive income (loss).

The difference between the proceeds on sale and outstanding principal balance is recorded as net realized gains (losses), a component of net income, on the consolidated statement of comprehensive income (loss).

Seed money investment in segregated funds

Seed money represents Foresters Financial's initial investment in its segregated funds and is measured at fair value. Fair value is based on the net asset value of the segregated investment fund. Changes in fair value are recorded as net change in unrealized gains (losses) on available-for-sale assets, a component of OCI on the consolidated statement of comprehensive income (loss).

f) Loans to certificate holders

Loans to certificate holders are classified as loans and receivables and are carried at their unpaid balance. These loans are fully secured by the cash surrender value of the certificates on which the respective loans are made.

g) Derecognition

Foresters Financial derecognizes an invested asset only when the contractual rights to the cash flows from the instrument expire, or when substantially all of the risks and rewards of ownership of the asset are transferred.

h) Invested asset impairments

Invested assets other than FVTPL assets are assessed individually for impairment on a quarterly basis. Foresters Financial considers various factors in assessing impairments, including but not limited to, the financial condition and near term prospects of the issuer, specific adverse conditions affecting an industry or region, a significant and prolonged decline in fair value below the cost of an asset, bankruptcy or default of the issuer, and delinquency in payments of interest or principal. Investments are deemed to be impaired when there is no longer reasonable assurance of timely collection of the full amount of the principal and interest due.

FVTPL assets are carried at fair value and all realized and change in unrealized gains and losses are recorded in net income, therefore no further impairment decision is necessary. Additionally, insurance contract liabilities include a margin to account for future asset impairments which will reduce future cash flows.

AFS assets are carried at fair value, however change in unrealized gains and losses are recorded in OCI and accumulated in AOCI. When an AFS asset is identified as impaired, the

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

net loss in AOCI is reclassified to net realized gains (losses), a component of net income on the consolidated statement of comprehensive income (loss). Any further reduction in value subsequent to the initial recognition of impairment is also included in net income in the period in which the change occurs.

An impairment loss on AFS bonds and loans and receivables is reversed if there is objective evidence of a permanent recovery in the value of the asset based on an event occurring after the impairment loss was initially recognized. Such a reversal is reflected in net income.

Any subsequent recovery in the fair value of impaired AFS equity securities is recognized in OCI.

1.6 Property and equipment

Property

Property consists of land and buildings, which are predominantly occupied by Foresters Financial or its subsidiaries.

Land is carried at fair value and is not depreciated. The buildings are carried at fair value. The fair value of property is appraised annually by external independent appraisers and is based on an income approach combining the discounted cash flow method and the direct capitalization method using as inputs rental income from current leases, expenses incurred and other assumptions that market participants would use when pricing property under current market conditions. The changes in fair value are recognized as net change in unrealized gains (losses) on property, a component of OCI in the consolidated statement of comprehensive income (loss).

Equipment

Equipment includes leasehold improvements, furniture and computer equipment, which are carried at historical cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is recognized in net income on a straight-line basis over the estimated useful life of the asset as follows:

| Asset type | Useful life |
|------------------------|-----------------------|
| Buildings | 15 - 30 years |
| Furniture | 10 years |
| Computer equipment | 3 - 5 years |
| Leasehold improvements | the term of the lease |

Under IFRS, componentization is required when parts of property and equipment have different useful lives and each component is accounted for as a separate item. Depreciation methods, useful lives and residual values are reviewed at each year end and adjusted if appropriate. Any changes in estimates are accounted for in the current period.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Depreciation and repair and maintenance costs are expensed during the period in which they are incurred, and are included in operating expenses on the consolidated statement of comprehensive income (loss). The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits, in excess of the most recently assessed standard of performance of the existing asset, will flow to Foresters Financial and the renovation replaces an identifiable part of the asset, which is derecognized. Major renovations are depreciated over the remaining useful life of the related asset.

Impairment

At each reporting date, Foresters Financial reviews the carrying amounts of its property and equipment to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. The recoverable amount is the greater of the asset's value in use and its fair value less costs of disposal. An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount.

Revaluation loss on property is recorded in OCI in the current period to the extent that all previously recorded net change in unrealized gains in AOCI have been offset. Any losses not absorbed in this manner are recorded in net income. Impairment loss on equipment is recognized in net income.

1.7 Goodwill and intangible assets

a) Recognition and measurement

Goodwill

Acquisitions of businesses where Foresters Financial obtains control are accounted for using the purchase method. This involves allocating the purchase price paid for a business to the assets acquired, including identifiable intangibles and the liabilities assumed, based on their fair values at the date of acquisition. Any excess is recorded as goodwill.

Goodwill is initially measured as the excess of the purchase price of an acquisition of a subsidiary over the fair value of net identifiable assets acquired. After initial recognition, goodwill is carried at cost less any accumulated impairment losses. If the cost of an acquisition is less than the fair value of the net assets acquired, the difference is recognized directly in net income for the year. All goodwill is considered to have an indefinite life and therefore, not amortized.

Intangible assets

i) Acquired intangibles

Intangible assets acquired through business combinations are comprised of mutual fund, separate accounts, and children's trust fund savings plan asset management contracts, a distribution network, computer software, unit cost reductions and customer relationships.

The initial cost of intangible assets acquired in a business combination is fair value at the date of acquisition. The fair value of acquired identifiable intangible assets is based on an

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

analysis of discounted cash flows. After the date of acquisition, these intangibles are carried at cost less accumulated amortization and impairment losses.

ii) Computer software

Computer software is carried at cost less accumulated amortization and impairment losses.

b) Amortization

Amortization is calculated to write off the cost of intangible assets less their estimated residual values using the straight-line method over their estimated useful lives and is recognized as Operating expenses on the consolidated statement of comprehensive income (loss).

The estimated useful lives for current and comparative periods are as follows:

| Asset type | Useful life |
|---|--------------|
| Unit cost reductions | 10 years |
| Management contracts and customer relationships | 5 - 12 years |
| Software | 1 - 5 years |

Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

The mutual fund and separate account asset management contracts in the U.S. have indefinite useful lives and are not amortized. These contracts were disposed in 2019, see Note 21.

c) Impairment

For the purpose of impairment testing, goodwill acquired in business combinations is allocated, from the acquisition date, to each of the cash-generating units ("CGUs") that are expected to benefit from the business combination. A CGU is the smallest identifiable group of assets that generates cash inflows that are independent of cash inflows from other groups of assets.

Goodwill is reviewed at least annually, to assess whether the recoverable amount is in excess of the CGU's carrying amount. Any impairment loss is expensed and allocated against the carrying amount of goodwill. Impairment losses on goodwill are not reversed.

Given the variability of future-oriented financial information, goodwill impairment tests are subjected to sensitivity analysis. The critical estimates pertain to those CGUs where there is little difference between the recoverable amount and the related carrying amount. Details of goodwill are presented in note 8.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Intangibles with indefinite useful lives are reviewed annually for impairment. Intangibles with finite useful lives are reviewed only if there is an indication of impairment. Impairment losses are recognized immediately in net income.

1.8 Insurance and investment contracts

Product contracts are classified as insurance or investment contracts based on the level of insurance and financial risk Foresters Financial accepts from the certificate holder.

a) Insurance contract liabilities

Insurance contract liabilities include life, health and annuity lines of business. Insurance contracts are those contracts that transfer significant insurance risk to Foresters Financial. Significant insurance risk exists when Foresters Financial agrees to compensate certificate holders or beneficiaries of an insurance contract for specified future events such as death or disability, that may adversely affect the certificate holder and whose amount and timing are uncertain. Insurance contracts are shown as insurance contract liabilities on the consolidated statement of financial position.

Insurance contract liabilities are calculated using CALM which is based on accepted actuarial practices according to standards established by the Actuarial Standards Board and the requirements of OSFI. This method involves the projection of future events in order to determine the amount of assets that must be set aside currently to provide for all future obligations, including the provision of fraternal benefits, and involves a significant amount of judgment. Valuation assumptions are based on current best estimate assumptions plus a margin for uncertainty for each material contingency. Any change in insurance contract liabilities is recorded in the gross change in insurance contract liabilities on the consolidated statement of comprehensive income (loss).

Insurance contract liabilities less reinsurance assets represent an estimate of the amount, net of future premiums and investment income, which will be sufficient to pay future benefits, dividends, commissions and expenses on in-force insurance and annuity certificates.

b) Reinsurance assets

Foresters Financial enters into reinsurance arrangements with reinsurers in order to limit its exposure to significant losses, manage capital and reduce volatility of financial results. Maximum limits have been established for the retention of risks associated with life insurance certificates by line of business. Risks in excess of these limits are reinsured with well-established, highly rated reinsurers. Foresters Financial enters into two types of reinsurance arrangements:

- quota share reinsurance arrangements whereby Foresters Financial retains a percentage of the risk associated with life insurance certificates, and
- excess of loss reinsurance arrangements whereby risks in excess of established retention limits are ceded to reinsurers.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Reinsurance transactions do not relieve Foresters Financial of its primary obligation to certificate holders. Losses could result if a reinsurer fails to honour its obligations.

Reinsurance assets are measured consistently with the amounts associated with the underlying insurance contracts and in accordance with the terms of each reinsurance arrangement and with accepted actuarial practice in Canada. Reinsurance assets are reviewed for impairment on a regular basis for any events that may trigger impairment. Impairment occurs when there is objective evidence that Foresters Financial will not be able to collect amounts due under the terms of the contract. Any impairment loss is recorded in net income on the consolidated statement of comprehensive income (loss).

Premiums for reinsurance ceded are presented as ceded premiums, reinsurance recoveries on claims incurred are recorded as ceded benefits and commissions and expenses related to reinsured contracts are recorded as ceded commissions and operating expenses on the consolidated statement of comprehensive income (loss). The net amount due from reinsurers with respect to ceded premiums, paid claims and expenses is recorded either as an amount receivable from or payable to reinsurers and included in other assets or other liabilities, respectively, on the consolidated statement of financial position.

c) Investment contract liabilities

Investment contracts are those contracts that transfer financial risk, with no significant insurance risk, to Foresters Financial. Investment contracts include deferred annuities with no guarantees, settlement options with no life contingency and various amounts on deposit.

Investment contracts are recorded at fair value less any directly attributable transaction costs. Deposits to and withdrawals from investment contracts increase or decrease the liability respectively.

d) Segregated funds

Foresters Financial issues Separate Accounts in the U.S., Segregated Funds in Canada and Unit Linked contracts in the U.K. These contracts are collectively referred to as segregated funds. The value of these contracts is directly linked to the fair value of the underlying investments supporting these contracts. The unit holder bears the risks and rewards of the performance of these investments.

Foresters Financial presents segregated fund net assets, which are in the legal name and title of Foresters Financial but are held on behalf of unit holders, as a single line item in the consolidated statement of financial position.

Market value movement in the underlying segregated fund net assets along with any investment income earned and expenses incurred are directly attributed to unit holders. Foresters Financial does not present these amounts as revenue on the consolidated statement of comprehensive income (loss); however, they are disclosed in note 4.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Deposits to and withdrawals from, segregated funds increase or decrease the liability, respectively. For services provided to unit holders, Foresters Financial receives investment management and guarantee fees which are directly charged by the segregated funds to unit holders. This revenue is recorded as fee revenue on the consolidated statement of comprehensive income (loss).

Investment income and changes in the fair value of the segregated fund investments are offset by a corresponding change in the segregated fund liabilities.

Net investments for account of segregated fund unit holders

These investments are carried at fair value. Fair value is determined using quoted market values unless quoted market values are not available, in which case estimated fair values are determined by Foresters Financial, based on dealer quotes or recent transactions of similar investments.

Liabilities for account of segregated fund unit holders

These liabilities are measured at fair value reflecting the fair value of the underlying net assets. Certain segregated fund products provide death and maturity benefit guarantees to the unit holder. The liability for these guarantees is recorded under insurance contract liabilities.

e) Derecognition

The liabilities under insurance and investment contracts are derecognized when the obligation is discharged or cancelled.

1.9 Other liabilities

Other liabilities primarily consist of accounts payable, reinsurance financing provision, accrued expenses, and current and deferred income tax liabilities.

A provision for onerous contracts is recognized when the expected benefits to be derived from a contract are lower than the cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of completing the contract.

1.10 Income taxes

The tax expense for the year is comprised of current and deferred taxes. Tax is usually recognized as an expense or income in the consolidated statement of comprehensive income (loss), except when it relates to an item included in OCI or directly in surplus, in which case tax is recognized in other comprehensive income or surplus, respectively.

The current tax expense (recovery) is based on taxable income (loss) for the year under local tax regulations and the enacted or substantively enacted tax rate for the year for each taxable entity and any adjustment to tax payable in respect of previous years.

Deferred income taxes are accounted for using the liability method, whereby tax expected to be payable or recoverable is calculated on temporary differences arising between the

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

carrying amounts of assets and liabilities under IFRS and the tax assets and liabilities calculated under the regulations of the relevant tax authority. Deferred tax is not recognized for temporary differences relating to investments in subsidiaries to the extent that it is probable that it will not reverse in the foreseeable future. Temporary differences, tax losses and tax loss carry-forwards are measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred income tax assets are recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable income will be available against which these tax assets can be utilized.

The carrying amount of recognized deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that the related tax benefit will be realized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it becomes probable that future taxable income will allow the deferred tax assets to be recovered.

Deferred income tax assets and liabilities are offset if a legally enforceable right to offset current income tax assets and liabilities exists, and deferred income taxes relate to the same legal entity and the same taxation authority.

1.11 Employee benefits

Foresters Financial maintains contributory and non-contributory defined benefit pension and post retirement plans, as well as defined contribution pension plans for eligible employees and agents.

a) Defined benefit and post retirement plans

The defined benefit pension plans offer benefits based on length of service and final average earnings and certain plans offer some indexation of benefits. The specific features of these plans vary in accordance with the employee group and countries in which employees are located. In addition, Foresters Financial maintains supplementary non-contributory pension arrangements for eligible employees, primarily for benefits which do not qualify for funding under the various registered pension plans.

Foresters Financial also provides certain post retirement medical and dental benefits to eligible qualifying employees and to their dependents if certain requirements are met. These post retirement benefits are not pre-funded.

Foresters Financial net obligation in respect of defined benefit pension plans and post retirement benefits is calculated separately for each plan. Plan assets are measured at fair value. The cost of pensions and post retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary projections, retirement ages of employees and other variables.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Remeasurements arising from defined benefit plans are made up of actuarial gains, the return excluding interest on plan assets and adjustments for the effect of the asset ceiling. All remeasurements are recognized immediately in OCI and all other expenses are reflected in employee benefits within operating expenses on the consolidated statement of comprehensive income (loss).

Employee benefit assets arise from pension plans that are in a surplus position (plan assets are greater than the plan obligations). Employee benefit obligations arise from unfunded plans for supplementary pension and post retirement benefits and pension plans that are in a deficit position.

The value of any employee benefit asset arising from a defined benefit pension plan is restricted to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

b) Defined contribution plans

A defined contribution plan is a post employment benefit plan under which Foresters Financial pays fixed contributions into a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an operating expense in the consolidated statement of comprehensive income (loss) in the periods during which services are rendered by employees.

c) Long-term disability benefits

For claims made under long term disability plans for benefits that are not insured, an obligation is recognized from the date the event occurred that caused the disability. The amount of the obligation which is included under other liabilities is based on the estimated present value of the benefits expected to be paid by Foresters Financial in providing the benefit. The change in the obligation during the year together with any actuarial gains or losses is recognized in net income as an operating expense. Where the claims are fully insured, there is no obligation to recognize and the premiums paid under the insurance policy are recognized as an operating expense.

1.12 Revenue recognition

Revenue is recognized as follows, after eliminating intra group transactions:

a) Insurance contracts

Premiums are recognized as revenue when they come due and collection is reasonably assured. On recognition, the insurance contract liability is calculated and recorded with the result that benefits and expenses are matched to premium revenue.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

b) Fee revenue

Fee revenue is recognized when Foresters satisfies its performance obligations for the related service as follows:

| Services | Nature, timing of satisfaction of performance obligations and significant payment terms |
|------------------------------------|--|
| Investment management fees | Investment management fees are earned on the management of segregated fund, proprietary mutual fund and institutional assets. Foresters recognizes revenue in the amount it has the right to invoice, as services are provided. Investment services are billed and paid for on a monthly or quarterly basis. |
| Brokerage fees | Brokerage fees are earned on the sale of proprietary and third party mutual fund products. The performance obligation to execute the trade is satisfied on the trade date, at which point revenue is recognized. |
| Distribution fees | Distribution fees are earned on the distribution of mutual fund shares. Foresters recognizes revenue in the amount it has the right to invoice, as services are provided. The services are billed on a monthly basis. |
| Servicing and transfer agency fees | Service fees are earned for maintaining mutual fund shareholder accounts. Foresters recognizes revenue in the amount it has the right to invoice, as services are provided. The services are billed on a monthly or quarterly basis. |

In 2019, Foresters Financial sold its entire NAAM segment (see Note 21). As a result, fee revenue from NAAM is included under income from discontinued operations in the consolidated statement of comprehensive income (loss).

c) Net investment income

Investment income, net of investment expenses, realized gains (losses) on the sale of investments and changes in the fair value of FVTPL assets are recorded in net investment income on the consolidated statement of comprehensive income (loss).

Changes in the fair value of AFS assets are recognized in OCI on the consolidated statement of comprehensive income (loss).

1.13 Deferred acquisition costs

Deferred acquisition costs are contract costs on the acquisition of contracts with customers, excluding insurance contracts, consisting mainly of incremental commissions and fees paid to intermediaries. These costs are capitalized to the extent that they can be recovered through future expected margins on these contracts, and are reviewed for impairment annually.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

Contract costs on the acquisition of other contracts with customers are amortized over the estimated duration of the contracts on a straight-line basis. Foresters Financial recognizes contract costs as an expense when incurred if the amortization period of the assets that it would have recognized is one year or less.

1.14 Leases

a) Policy applicable from January 1, 2019 - as a lessee

At inception of a contract, Foresters Financial assesses whether a contract is, or contains, a lease, if the contract involves the use of an identified asset and conveys the right to control the use of the asset for a period of time in exchange for consideration.

Foresters Financial recognizes a right-of-use asset and a lease liability at the commencement date of the lease. The right-of-use asset is initially measured at cost, which comprises the amount of lease liability, plus or minus adjustments, such as lease incentives received. The lease liability is initially measured at the present value of the lease payments, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, Foresters Financial's incremental borrowing rate. Foresters Financial generally uses its incremental borrowing rate as the discount rate.

Subsequently, the right-of-use asset is depreciated to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property and equipment. In addition, the carrying amount of the right-of-use asset is reduced by any impairment losses and adjusted for certain remeasurements of the lease liability.

The lease liability is subsequently measured at amortized cost using the effective interest method. It is remeasured to reflect any lease modifications or reassessments.

Foresters Financial has elected not to recognize right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. Foresters Financial recognizes the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

b) Policy applicable from January 1, 2019 - as a lessor

Where Foresters Financial is the lessor, all leases are classified as operating leases, because each of these leases do not transfer substantially all of the risks and rewards incidental to ownership of the underlying asset. Lease payments from operating leases are recognized as income on a straight-line basis over the lease term and are included in other operating income.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

c) Policy applicable before January 1, 2019

Leases are classified as operating leases when a significant portion of the risks and rewards of ownership are retained by the lessor. Payments made under operating leases are expensed on a straight-line basis over the period of the lease.

Where Foresters Financial is the lessor, the income is recognized on a straight-line basis over the lease term.

1.15 Contingent liabilities

Contingent liabilities are recognized as liabilities on the consolidated statement of financial position when it is probable that Foresters Financial will incur a future expense and the amount can be reliably measured. If the event resulting in a future obligation is less than probable but greater than remote or, the amount cannot be reliably estimated, the contingency is disclosed in the notes to the consolidated financial statements.

1.16 Fraternal investment

Fraternal investment represents the contribution made by Foresters Financial to support its members, their families and the communities in which they live. These contributions include donations to charities for supporting various community causes, sponsorships for various fund raising programs, support for the volunteer branch system, the provision of scholarships and other benevolent activities. These contributions are recognized as an expense when they are incurred under fraternal investment within the consolidated statement of comprehensive income (loss).

1.17 Discontinued operations

A discontinued operation is a component of Foresters Financial's business, the operations and cash flows of which can be clearly distinguished from the rest of the company and which:

- Represents a separate major line of business or geographic area of operations;
- Is part of a single co-ordinated plan to dispose of a separate major line of business or geographic area of operations; or
- Is a subsidiary acquired exclusively with a view to resale.

Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held-for-sale.

When an operation is classified as a discontinued operation, the comparative consolidated statement of comprehensive income (loss) is re-presented as if the operation had been discontinued from the start of the comparative year. Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as net income (loss) from discontinued operations, net of tax in the consolidated statement of comprehensive income (loss).

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

1. Significant accounting policies (continued)

1.18 Assets held for sale

Non current assets, or disposal groups comprising assets and liabilities, are classified as held-for-sale if it is highly probable that they will be recovered primarily through sale rather than through continuing use.

Such assets, or disposal groups, are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group is allocated first to goodwill, and then to the remaining assets and liabilities on a pro-rata basis, except that no loss is allocated to financial assets, deferred tax assets and employee benefit assets. Impairment losses on initial classification as held-for-sale and subsequent gains and losses on remeasurement are recognized in net income.

Once classified as held-for-sale, intangible assets and property and equipment are no longer amortized or depreciated.

2. ACCOUNTING AND REPORTING CHANGES

New and Amended International Financial Reporting Standards Adopted in 2019

a) IFRS 16 Leases

As at January 1, 2019, Foresters Financial adopted IFRS 16 Leases ("IFRS 16") as issued by the IASB in January 2016. In accordance with the transitional provisions in IFRS 16, the new standard has been adopted using the modified retrospective approach by recognizing the cumulative effect of initially applying IFRS 16 as an adjustment to the opening balance of retained earnings (i.e. January 1, 2019). Therefore, the comparative information has not been re-presented and continues to be reported under IAS 17, Leases ("IAS 17"). Accounting policies for comparative information reported using IAS 17 are disclosed separately where they significantly differ from those under IFRS 16.

On transition, the following practical expedients were applied by Foresters Financial:

- IFRS 16 requirements were only applied to contracts that were previously identified as leases under IAS 17 and related interpretations. Contracts that were not identified as leases under IAS 17 and related interpretations were not reassessed for whether there is a lease. Therefore, the definition of a lease under IFRS 16 was applied only to contracts entered into, or changed on or after, January 1, 2019.
- A single discount rate was applied to a portfolio of leases with reasonably similar characteristics.
- The right-of-use assets were adjusted by the amount of IAS 37 onerous contract provisions immediately before the date of initial application, as an alternative to an impairment review.
- Foresters Financial applied the exemption not to recognize right-of-use assets and liabilities for leases with lease terms of 12 months or less.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

2. Accounting and reporting changes (continued)

Impact on financial statements

On transition, Foresters Financial recognized an additional \$51.8 million of right-of-use assets and \$59.9 million of lease liabilities adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the consolidated statement of financial position immediately before the date of initial application. When measuring lease liabilities, Foresters Financial discounted lease payments using its incremental borrowing rate as at January 1, 2019. The weighted-average rate applied ranges from 2.52% to 3.02%.

| | 1-Jan-19 |
|---|-----------------|
| Operating lease commitment at December 31, 2018 as disclosed in the consolidated statement of financial position | \$66,907 |
| Recognition exemption for short-term leases | (684) |
| Lease payments remaining at December 31, 2018 to be discounted using incremental borrowing rate as at January 1, 2019 | \$ 66,223 |
| Lease liabilities recognized at January 1, 2019 | \$59,915 |

b) IFRIC 23 Uncertainty over Income Tax Treatments

In June 2017, the IASB issued IFRIC 23 Uncertainty over Income Tax Treatments ("IFRIC 23"). The standard is effective for annual reporting periods beginning on or after January 1, 2019, to be applied retrospectively. IFRIC 23 provides guidance on applying the recognition and measurement requirements of IAS 12 Income Taxes ("IAS 12") when there is uncertainty over income tax treatments including whether uncertain tax treatments should be considered together or separately based on which approach better predicts resolution of the uncertainty. Foresters Financial adopted the standard in its financial statements for the annual period beginning January 1, 2019. The adoption of this standard did not have a material impact on the consolidated financial statements.

c) Income Tax Consequences of Payments on Instruments Classified as Equity (Amendments to IAS 12)

In December 2017, the IASB issued amendments to IAS 12 as part of the *Annual Improvements to IFRS Standards 2015-2017 Cycle*. These amendments are effective for annual reporting periods beginning on or after January 1, 2019. They clarify that a company accounts for all income tax consequences of dividends in the same way, regardless of how the tax arises.

Foresters Financial adopted these amendments in its financial statements for the annual period beginning January 1, 2019. The adoption of these amendments did not have a material impact on the consolidated financial statements.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

2. Accounting and reporting changes (continued)

New and Amended International Financial Reporting Standards to be Adopted in 2020 or Later

d) IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 Insurance Contracts ("IFRS 17") which is effective for years beginning on or after January 1, 2021. However, in June 2019, the IASB deferred the effective date to January 1, 2022. IFRS 17 is required to be applied retrospectively.

If full retrospective application to a group of contracts is impractical, the modified retrospective or fair value methods may be used. IFRS 17 will replace IFRS 4 Insurance Contracts and will change the fundamental principles used by Foresters Financial for recognizing and measuring insurance contract liabilities. The standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires a company to recognize profits as it delivers insurance services, rather than when it receives premiums. It will also change the presentation and disclosures of Foresters Financial's consolidated financial statements.

Foresters Financial intends to adopt IFRS 17 in its financial statements for the annual period beginning on its effective date. Foresters Financial is assessing the impact of this standard and expects that it will have a significant impact on the consolidated financial statements. However, Foresters Financial is not able at this time to estimate reasonably the quantitative impact that IFRS 17 will have on its financial statements.

e) IFRS 9 Financial Instruments

In July 2014 the IASB issued the final version of IFRS 9 *Financial Instruments* ("IFRS 9"), which replaces IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 includes guidance on the classification and measurement of financial instruments, impairment of financial assets, and hedge accounting. Financial asset classification is based on the cash flow characteristics and the business model in which an asset is held. The classification determines how a financial instrument is accounted for and measured. IFRS 9 also introduces an impairment model for financial instruments not measured at fair value through profit or loss that requires recognition of expected losses at initial recognition of a financial instrument and the recognition of full lifetime expected losses if certain criteria are met. In addition, a new model for hedge accounting was introduced to achieve better alignment with risk management activities.

In September 2016, the IASB issued amendments to IFRS 4, to allow insurance entities whose predominant activities are to issue insurance contracts within the scope of IFRS 4, an optional temporary exemption from applying IFRS 9 until the effective date of IFRS 17 (the "deferral approach") to align with Foresters Financial's adoption of IFRS 17. Foresters Financial qualifies and intends to elect the deferral approach permitted under the amendments. Consequently, Foresters Financial will continue to apply IAS 39, the existing financial instrument standard until its expiry.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

2. Accounting and reporting changes (continued)

Foresters Financial is currently assessing the impact the adoption of these amendments will have on its consolidated financial statements.

f) Amendments to References to the Conceptual Framework for Financial Reporting in IFRS Standards

In March 2018, the IASB issued the revised version of the Conceptual Framework for Financial Reporting ("the Framework"), that underpins IFRS Standards. The IASB also issued Amendments to References to the Conceptual Framework in IFRS Standards ("the Amendments") to update references in IFRS Standards to previous versions of the Conceptual Framework.

Both documents are effective from January 1, 2020 with earlier application permitted.

Some IFRS Standards include references to the 1989 and 2010 versions of the Framework. The IASB has published a separate document which contains consequential amendments to affected standards so that they refer to the new Framework, with the exception of IFRS 3 Business Combinations which continues to refer to both the 1989 and 2010 Frameworks.

Foresters Financial does not intend to adopt the Amendments in its financial statements before the annual period beginning on January 1, 2020. The extent of the impact of the change has not yet been determined.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. INVESTED ASSETS

a) Summary of invested assets

The carrying values and fair values of invested assets were as follows:

| | Fair value through profit and loss | Available- for-sale | Loans and receivables | Total carrying value | Total fair value |
|---|---|------------------------|--------------------------|----------------------------|---------------------|
| As at December 31, 2019 | \$ | \$ | \$ | \$ | \$ |
| Cash, cash equivalents and short-term securities | - | - | 327,820 | 327,820 | 327,820 |
| Bonds | 6,900,512 | 1,202,740 | - | 8,103,252 | 8,103,252 |
| Equities | 702,872 | 132,891 | - | 835,763 | 835,763 |
| Derivative financial instruments | 5,020 | - | - | 5,020 | 5,020 |
| Other invested assets | 114,526 | 29,173 | - | 143,699 | 143,699 |
| Loans to certificate holders | - | - | 405,632 | 405,632 | 405,632 |
| Net investments for account of segregated fund unit holders | 7,736,578 | - | - | 7,736,578 | 7,736,578 |
| Less: investments of operations classified as held for sale (note 22) | | | | | |
| - general assets | (1,481,917) | (4,792) | (166,413) | (1,653,122) | (1,653,122) |
| - segregated fund assets | (1,940,753) | - | - | (1,940,753) | (1,940,753) |
| Total investments | 12,036,838 | 1,360,012 | 567,039 | 13,963,889 | 13,963,889 |
| As at December 31, 2018 | | | | | |
| Cash, cash equivalents and short-term securities | - | - | 278,170 | 278,170 | 278,170 |
| Bonds | 6,333,476 | 1,195,523 | - | 7,528,999 | 7,528,999 |
| Equities | 594,584 | 153,757 | - | 748,341 | 748,341 |
| Derivative financial instruments | 190 | - | - | 190 | 190 |
| Other invested assets | 107,485 | 32,989 | 78 | 140,552 | 140,556 |
| Loans to certificate holders | - | - | 404,357 | 404,357 | 404,357 |
| Total invested assets | 7,035,735 | 1,382,269 | 682,605 | 9,100,609 | 9,100,613 |
| Net investments for account of segregated fund unit holders | 7,635,014 | - | - | 7,635,014 | 7,635,014 |
| Total investments | 14,670,749 | 1,382,269 | 682,605 | 16,735,623 | 16,735,627 |

Also held are derivative financial liabilities recorded as FVTPL with a carrying value and fair value of \$26,774 (2018: \$34,669).

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

b) Fair value hierarchy

Foresters Financial follows a fair value hierarchy to categorize the inputs to the valuation techniques used to measure the fair value of financial assets. The three levels of the hierarchy are:

Level 1

Fair value is based on quoted market prices in active markets for identical assets or liabilities.

Level 2

Fair value is based on observable inputs other than Level 1 prices, such as quoted market prices for similar, but not identical, assets or liabilities in active markets, quoted market prices for identical assets or liabilities in markets that are not active, and other inputs that are observable, such as interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment spreads, credit risks, and default rates.

Level 3

Fair value is based on non-observable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 financial instruments are initially fair valued at their transaction price. After initial measurement, the fair value of Level 3 assets and liabilities is determined using valuation models, discounted cash flow methodologies, or similar techniques.

Private placements are valued using a discounted cash flow analysis. The inputs to the valuation include the current credit rating for the bonds and credit spreads to treasury securities. Limited partnerships are valued using discounted cash flow methodologies, direct capitalization methods, comparable private company transactions and the income approach. Significant unobservable inputs include assumed future market conditions, projected income and expense scenarios, discount rates, terminal EBITDA and exit multiples used in the calculations.

For certain financial assets which are of a short term nature, the carrying value approximates fair value, and therefore no separate fair value is disclosed. The most significant category for fair value measurement is invested assets and the hierarchy level is based upon the following guidelines:

Bonds including short-term securities

Government bonds and treasury bills (classified as short-term securities) are valued using prices received from external pricing providers (such as dealers, brokers, industry groups, pricing services or regulatory agencies) who generally base the price on quotes received from a number of market participants.

Level 1 corporate bonds listed or quoted in an established over-the-counter market are valued using prices received from external pricing providers who generally consolidate quotes received from a panel of investment dealers into a composite price. As the market becomes less active, the quotes provided by some investment dealers may be based on modeled prices rather than on actual transactions. These sources are based largely on

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

observable market data, and therefore these instruments are treated as Level 2 within the fair value hierarchy. When prices received from external pricing providers are based on a single broker indicative quote, the instruments are treated as Level 3.

Other corporate bonds and non-government based short-term securities such as unquoted bonds, commercial paper ("CP") and certificates of deposit ("CDs") are valued using models. For CP and CDs, the model inputs such as LIBOR yield curves, FX rates, volatilities and counterparty spreads comprise observable market data. For unquoted bonds, the model includes credit spreads which are obtained from brokers or estimated internally. The classification of these instruments within the fair value hierarchy will be either Level 2 or 3, depending upon the nature of the underlying pricing information used for valuation purposes.

Equity securities

Listed securities are treated as Level 1 within the fair value hierarchy and are valued using prices sourced from the primary exchange or dealer, broker, industry group, pricing service or regulatory agency and so quoted in an active market. The quoted market price is the current closing price.

Unlisted securities are treated as Level 2 within the fair value hierarchy and a valuation technique is used for these instruments with the inputs coming from observable market data.

Derivative financial instruments

Exchange traded futures and options are valued using prices sourced from the relevant exchange and are treated as Level 1 within the fair value hierarchy. The other derivative financial instruments are valued using valuation techniques based on observable market data and are classified as Level 2 within the fair value hierarchy.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

The following tables present the invested assets measured at fair value and classified by the fair value hierarchy:

| | Level 1 | Level 2 | Level 3 | Total fair value |
|---|-------------|-------------|---------|------------------|
| December 31, 2019 | \$ | \$ | \$ | \$ |
| Bonds | 358,537 | 7,499,547 | 245,168 | 8,103,252 |
| Equities | 214,153 | 621,610 | - | 835,763 |
| Derivative financial instruments | 763 | 4,257 | - | 5,020 |
| Other invested assets | - | 2,106 | 141,593 | 143,699 |
| Net investments for account of segregated fund unit holders | 6,630,460 | 1,106,118 | - | 7,736,578 |
| Less: investments of operations classified as held for sale (note 22) | | | | |
| - general assets | - | (1,486,709) | - | (1,486,709) |
| - segregated fund assets | (1,940,753) | - | - | (1,940,753) |
| | 5,263,160 | 7,746,929 | 386,761 | 13,396,850 |
| December 31, 2018 | | | | |
| Bonds | 373,009 | 6,909,751 | 246,239 | 7,528,999 |
| Equities | 199,201 | 549,140 | - | 748,341 |
| Derivative financial instruments | 190 | - | - | 190 |
| Other invested assets | - | 1,956 | 138,518 | 140,474 |
| Net investments for account of segregated fund unit holders | 6,737,010 | 898,004 | - | 7,635,014 |
| | 7,309,410 | 8,358,851 | 384,757 | 16,053,018 |

Also held are derivative financial liabilities measured at fair value and classified as Level 2 on the fair value hierarchy of \$26,774 (2018: \$34,669).

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

The following table represents the movement in Level 3 invested assets.

| | FVTPL | | AFS | |
|--|----------------|-----------------------|-----------------------|----------------|
| | Bonds | Other invested assets | Other invested assets | Total |
| 2019 | | | | |
| Balance, beginning of year | \$ 246,239 | \$ 107,472 | \$ 31,046 | \$ 384,757 |
| Changes during the year: | | | | |
| Purchases | 17,199 | 7,906 | - | 25,105 |
| Sales and redemptions | (19,959) | (159) | - | (20,118) |
| Net change in unrealized gains/losses included in: | | | | |
| Other comprehensive income | - | - | (3,980) | (3,980) |
| Net income (loss) | 1,690 | (693) | - | 997 |
| Balance, end of year | 245,169 | 114,526 | 27,066 | 386,761 |
| 2018 | | | | |
| Balance, beginning of year | 228,520 | 98,897 | 31,516 | 358,933 |
| Changes during the year: | | | | |
| Purchases | 15,024 | 15,515 | - | 30,539 |
| Sales and redemptions | (8,674) | (5,701) | - | (14,375) |
| Net change in unrealized gains/losses included in: | | | | |
| Other comprehensive income | - | - | (470) | (470) |
| Net income (loss) | 11,369 | (1,239) | - | 10,130 |
| Balance, end of year | 246,239 | 107,472 | 31,046 | 384,757 |

There were no material transfers between Level 1, 2 and 3 during 2019 or 2018. The fair value of level 3 assets includes a number of investments that are impacted by different market sensitivities. The significant assumptions used to assess the market sensitivity of these assets include: changes in interest rates, real estate capitalization rates, and in the global infrastructure index. The analysis was based on a 1% increase and a 1% decrease in the relevant sensitivity. The following table shows the impact of this analysis on the fair value of the related assets at December 31:

| | 2019 | | 2018 | |
|---|-------------|-------------|-------------|-------------|
| | 1% increase | 1% decrease | 1% increase | 1% decrease |
| FVTPL assets: | \$ | \$ | \$ | \$ |
| Interest rate sensitivity | (17,091) | 17,091 | (17,468) | 17,468 |
| Real estate capitalization rates | (10,836) | 16,154 | (9,997) | 14,797 |
| AFS assets: | | | | |
| Global infrastructure index sensitivity | 85 | (85) | (342) | 342 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

c) Derivative financial instruments

Foresters Financial utilizes derivative financial instruments, including options and foreign exchange forward contracts, when appropriate, to hedge against fluctuations in foreign exchange rates and changes in stock market indices. Foresters Financial does not enter into these financial instruments for trading or speculative purposes. Foresters Financial only enters into derivative financial contracts with approval from the Board of Directors and policies are established to limit counterparty exposure. Adherence to these policies is monitored regularly and reported to the Risk and Investment Committee.

The fair value of Foresters Financial's foreign exchange forward contracts can be positive or negative. Gross derivative counterparty exposure is measured as the total fair value of all outstanding contracts in a gain position (excluding any offsetting contracts in negative positions). Foresters Financial limits the risk of credit losses from derivative counterparties by establishing minimum acceptable counterparty credit ratings of AA, entering into master netting arrangements (based on standard ISDA agreements) and holding collateral to limit credit exposures. Foresters Financial's derivative financial instruments were held with counterparties rated AA or higher as at December 31, 2019 and 2018. At December 31, 2019, the largest single counterparty exposure was \$4,080 (2018: \$3,521).

Foresters Financial is exposed to credit risk resulting from the potential default of counterparties to the foreign exchange forward contracts that are in a net gain position. For contracts in a net gain position, the counterparty may be required to post collateral to Foresters Financial. As at December 31, 2019, no collateral was held in 2019 or 2018 against a net asset of \$5,020 (2018: \$190). For contracts in a net liability position, the counterparties are exposed to credit risk from the potential default by Foresters Financial. Foresters Financial may be required to post collateral to the counterparty for contracts in a net liability position. As at December 31, 2019, Foresters Financial posted collateral with an estimated market value of \$26,790 (2018: \$23,880) against a net liability of \$26,774 (2018: net liability of \$34,669). Foresters Financial and the counterparties have the right to sell, pledge, invest, or use any posted collateral. During 2019 and 2018, Foresters Financial did not sell, pledge, invest or use any posted collateral.

Credit quality of the collateral received and posted is monitored regularly. Eligible collateral includes Canadian Federal and Provincial Government fixed income securities, some of which have credit ratings of AAA, and all of which have investment grade ratings.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

The following table summarizes derivative financial instruments outstanding:

| | Notional amount by remaining term to maturity | | | | Fair value | | |
|------------------------------------|---|----------------|----------------|----------------|---------------|-----------------|-----------------|
| | Under 1 year | 1 to 5 years | Over 5 years | Total | Positive | Negative | Net |
| As at December 31, 2019 | | | | | | | |
| Foreign exchange forward contracts | 452,267 | 118,868 | 158,462 | 729,597 | 10,643 | (33,160) | (22,517) |
| Options purchased | - | - | - | - | 3,781 | - | 3,781 |
| Options written | - | - | - | - | - | (3,018) | (3,018) |
| | <u>452,267</u> | <u>118,868</u> | <u>158,462</u> | <u>729,597</u> | <u>14,424</u> | <u>(36,178)</u> | <u>(21,754)</u> |
| As at December 31, 2018 | | | | | | | |
| Foreign exchange forward contracts | 266,563 | 128,752 | 183,695 | 579,010 | 5,642 | (40,311) | (34,669) |
| Options purchased | - | - | - | - | 480 | - | 480 |
| Options written | - | - | - | - | - | (290) | (290) |
| | <u>266,563</u> | <u>128,752</u> | <u>183,695</u> | <u>579,010</u> | <u>6,122</u> | <u>(40,601)</u> | <u>(34,479)</u> |

Notional amount represents the face amount of derivative financial instruments to which a rate or price is applied to determine the amount of cash flows to be exchanged. It represents the volume of outstanding derivative financial instruments and does not represent the potential gain or loss associated with market risk or credit risk of such instruments.

Fair value of a derivative financial instrument is equivalent to the replacement cost based on quoted market prices. Positive fair value, representing an unrealized gain to Foresters Financial, is the maximum credit risk measured as at the reporting date if the counterparties were to default on their obligations to Foresters Financial.

d) Impairments

There were no invested assets classified as available for sale or loans and receivables that were impaired and therefore required an impairment loss provision.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

e) Net investment income

Interest and dividends (net) from continuing operations were derived from the following sources:

| | 2019 | | | | 2018 (Re-presented) | | | |
|--|----------------|---------------|---------------|----------------|---------------------|---------------|---------------|----------------|
| | FVTPL | AFS | Other | Total | FVTPL | AFS | Other | Total |
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Interest from: | | | | | | | | |
| Cash, cash equivalents and short-term securities | - | - | 1,871 | 1,871 | - | - | 1,445 | 1,445 |
| Bonds | 225,590 | 45,973 | - | 271,563 | 217,392 | 43,579 | - | 260,971 |
| Loans to certificate holders | - | - | 20,780 | 20,780 | - | - | 19,737 | 19,737 |
| | 225,590 | 45,973 | 22,651 | 294,214 | 217,392 | 43,579 | 21,182 | 282,153 |
| Dividend income from equities | 6,877 | 8 | - | 6,885 | 8,849 | 732 | - | 9,581 |
| Income from other invested assets | 8,761 | 4,246 | - | 13,007 | 11,448 | 4,539 | - | 15,987 |
| Less: Investment expenses | (15,397) | (1,042) | - | (16,439) | (16,489) | (906) | - | (17,395) |
| Total interest and dividends (net) | 225,831 | 49,185 | 22,651 | 297,667 | 221,200 | 47,944 | 21,182 | 290,326 |

No interest income was accrued on impaired invested assets in 2019 or 2018.

The following table shows the net realized gains (losses) from continuing operations on invested assets during the year:

| | 2019 | | | 2018 (Re-presented) | | |
|------------------------------------|---------------|---------------|---------------|---------------------|----------------|---------------|
| | FVTPL | AFS | Total | FVTPL | AFS | Total |
| | \$ | \$ | \$ | \$ | \$ | \$ |
| Bonds | 65,264 | 17,206 | 82,470 | 31,539 | (7,329) | 24,210 |
| Equities | 13,720 | 2,847 | 16,567 | 13,578 | 2,361 | 15,939 |
| Derivative financial instruments | 338 | - | 338 | (7,606) | - | (7,606) |
| Other invested assets | - | 18 | 18 | - | 1,170 | 1,170 |
| Net realized gains (losses) | 79,322 | 20,071 | 99,393 | 37,511 | (3,798) | 33,713 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

3. Invested assets (continued)

The following table shows the net change in unrealized gains (losses) from continuing operations on FVTPL investments recorded in net income for the year ended December 31:

| | 2019 | 2018 |
|--|----------------|------------------|
| | \$ | \$ |
| Bonds | 512,986 | (343,415) |
| Equities | 77,247 | (73,733) |
| Derivative financial instruments | 10,734 | (42,871) |
| Other invested assets | (694) | (1,239) |
| Net change in unrealized gains (losses) on FVTPL instruments | <u>600,273</u> | <u>(461,258)</u> |

The net foreign currency gains (losses) on AFS assets, recognized in net investment income (loss) was (\$238) (2018: \$4,892).

4. INVESTMENTS FOR ACCOUNTS OF SEGREGATED FUND UNIT HOLDERS

a) Segregated fund net assets

The following table shows the breakdown of segregated fund assets by category of asset:

| | 2019 | 2018 |
|---|------------------|------------------|
| | \$ | \$ |
| Cash equivalents and short-term securities | 116,213 | 84,092 |
| Bonds | 1,352,393 | 1,170,104 |
| Equities | 6,245,544 | 6,391,133 |
| Other assets net of liabilities | 24,535 | (8,371) |
| Total net assets | 7,738,685 | 7,636,958 |
| Less: Segregated fund seed money investment (note 23) | (2,107) | (1,944) |
| Less: Investments of operations classified as held for sale (note 22) | (1,940,753) | - |
| Net investments for account of segregated fund unit holders | <u>5,795,825</u> | <u>7,635,014</u> |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

4. Investments for account of segregated fund unit holders (continued)

b) Changes in segregated funds

The following table presents the change in investments for accounts of segregated fund unit holders:

| | 2019 | 2018 |
|---|------------------|------------------|
| | \$ | \$ |
| Balance, beginning of year | 7,635,014 | 7,832,864 |
| Additions to the accounts of the unit holders: | | |
| Deposits received from unit holders | 497,532 | 652,533 |
| Investment income | 200,193 | 142,542 |
| Net realized gains on sale of investments | 18,698 | 11,658 |
| Net change in unrealized gains on investments | 162,572 | - |
| | <u>878,995</u> | <u>806,733</u> |
| Deductions to the accounts of the unit holders: | | |
| Amounts withdrawn or transferred by unit holders | 497,481 | 430,052 |
| Net change in unrealized losses on investments | - | 745,200 |
| Management fees and other operating costs | 131,170 | 118,856 |
| | <u>628,651</u> | <u>1,294,108</u> |
| Less: (Income) Losses on segregated fund seed money investment | (345) | 190 |
| Less: Investments of operations classified as held for sale (note 22) | (1,940,753) | - |
| Effect of change in foreign exchange rates | (148,435) | 289,335 |
| | <u>5,795,825</u> | <u>7,635,014</u> |

The change in investment contract liabilities for accounts of segregated fund unit holders had an equal and offsetting change during the year.

c) Investment risks associated with segregated funds

Segregated fund net assets may be exposed to a variety of financial and other risks. These risks are primarily mitigated by investment guidelines that are actively monitored by professional and experienced portfolio managers. Investment returns on these products belong to the unit holders, accordingly, Foresters Financial does not bear the risk associated with these assets outside of guarantees offered on certain variable annuity products. For information regarding the risks associated with the annuity and segregated funds guarantees see note 9.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

5. OTHER ASSETS

a) Other assets

Other assets are comprised of the following:

| | 2019 | 2018 |
|--|---------------|---------------|
| | \$ | \$ |
| Accounts receivable | 23,577 | 36,703 |
| Amounts due from reinsurers | 38,212 | 22,365 |
| Prepaid expenses | 15,541 | 17,609 |
| Other | 1,558 | 2,549 |
| Less: reclassification to held for sale assets (note 22) | (8,695) | - |
| | <u>70,193</u> | <u>79,226</u> |

The carrying value of these assets approximates their fair value. Other assets of \$63,272 (2018: \$73,188) will be realized within 12 months from the reporting date.

b) Deferred acquisition costs

The following table shows changes in costs related to contracts with customers, excluding insurance contracts, during the year:

| | 2019 | 2018 |
|--|---------------|---------------|
| | \$ | \$ |
| Beginning of year | 73,546 | 75,132 |
| Adoption of IFRS 15 | - | (2,273) |
| Additions | 5,188 | 13,492 |
| Reversal (recognition) of impairment | 2,733 | (827) |
| Amortization | (1,203) | (16,519) |
| Disposal on sale | (1,460) | - |
| Derecognition of deferred sales charges | (490) | - |
| Effect of change in foreign exchange rates | (2,689) | 4,541 |
| Less: reclassification to held for sale assets (note 22) | (52,825) | - |
| End of year | <u>22,800</u> | <u>73,546</u> |

Amortization consists of \$473 (2018: \$1,214) relating to deferred sales charges and \$730 (2018: \$15,259) relating to deferred acquisition costs included in commissions on the consolidated statement of comprehensive income (loss).

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

6. PROPERTY AND EQUIPMENT

The following table shows changes in the property and equipment balances during the year:

| | Property | | Equipment | | Total |
|---|---------------|---------------|-------------------------------|---------------------------|---------------|
| | Land | Buildings | Furniture and Equipment | Leasehold Improvements | |
| | | | \$ | \$ | |
| Net carrying value as at December 31, 2018 | 15,822 | 30,375 | 17,623 | 5,520 | 69,340 |
| Additions | - | 301 | 5,641 | - | 5,942 |
| Gains (losses) included in OCI changes in fair value | 2,360 | (1,631) | - | - | 729 |
| Disposals | - | - | (5,446) | - | (5,446) |
| Depreciation expense | - | (1,133) | (5,323) | (3,396) | (9,852) |
| Reclassification to assets held for sale (note 22) | - | - | (55) | (18) | (73) |
| Effect of change in foreign exchange rates | (36) | (76) | (579) | (191) | (882) |
| Net carrying value as at December 31, 2019 | 18,146 | 27,836 | 11,861 | 1,915 | 59,758 |
| Net carrying value as at December 31, 2017 | 15,404 | 29,782 | 14,498 | 4,762 | 64,446 |
| Additions | - | 354 | 6,210 | 856 | 7,420 |
| Gains (losses) included in OCI changes in fair value | 342 | 1,147 | - | - | 1,489 |
| Disposals | - | - | (180) | - | (180) |
| Depreciation expense | - | (1,072) | (4,022) | (521) | (5,615) |
| Effect of change in foreign exchange rates | 76 | 164 | 1,117 | 423 | 1,780 |
| Net carrying value as at December 31, 2018 | 15,822 | 30,375 | 17,623 | 5,520 | 69,340 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

6. Property and equipment (continued)

The following table shows the gross and net carrying values of property and equipment:

| | Gross carrying value | Accumulated depreciation | Net carrying value |
|--|----------------------|--------------------------|--------------------|
| | \$ | \$ | \$ |
| December 31, 2019 | | | |
| Land | 18,146 | - | 18,146 |
| Buildings | 27,836 | - | 27,836 |
| Furniture and equipment | 44,478 | 32,562 | 11,916 |
| Leasehold improvements | 10,138 | 8,205 | 1,933 |
| Less: reclassification to assets held for sale (note 22) | (2,280) | (2,207) | (73) |
| | <u>98,318</u> | <u>38,560</u> | <u>59,758</u> |
| December 31, 2018 | | | |
| Land | 15,822 | - | 15,822 |
| Buildings | 30,375 | - | 30,375 |
| Furniture and equipment | 50,725 | 33,102 | 17,623 |
| Leasehold improvements | 10,973 | 5,453 | 5,520 |
| | <u>107,895</u> | <u>38,555</u> | <u>69,340</u> |

The land and buildings were revalued at December 31, 2019 by an independent appraiser. The fair value of land and buildings was \$18,146 and \$27,836 respectively (\$15,822 and \$30,375 respectively on December 31, 2018). When a building is revalued, any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount. The net amount is re-presented to the revalued amount of the asset.

The land and buildings are situated in Canada and the U.K. The appraisal on the land and building in Canada was based on an income approach combining the discounted cash flow method and the direct capitalization method. The key assumptions for rental rates were based on existing market rates and a discount and capitalization rate of 7.00% and 7.00% (2018: 7.25% and 7.00%). A 1% increase in the discount and capitalization rate would result in a \$5,800 decrease (2018: \$5,420 decrease) in the fair value. The U.K. land and building was appraised on the basis of existing use as defined in the practice statements set out in the Royal Institution of Chartered Surveyors ("RICS") valuation standards. The U.K. land component was valued using an assumption that consent to a change of use for residential would be forthcoming.

Land and buildings are measured at fair value using the revaluation model. They are treated as Level 3 in the fair value hierarchy and unobservable inputs are used in the determination of the fair value, such as having an annual external appraisal by an independent property appraiser with appropriate recognized professional qualifications.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

7. EMPLOYEE BENEFIT PLANS

Foresters Financial has a number of funded and unfunded defined benefit pension, defined contribution pension, post retirement and post employment benefit plans and long term disability benefits in the U.S., Canada and the U.K. The defined benefit pension plans provide benefits to employees based on an average earnings formula. Foresters Financial also provides post retirement health benefits to certain employee groups in the U.S. and Canada.

All registered pension plans are in funds that are legally separate from Foresters Financial. In the U.S. and Canada, the pension funds are governed by a Management Pension Committee ("MPC") made up of representatives from Foresters Financial. The MPC is responsible for setting policies around investments and contributions.

Actuarial valuations of the pension and post retirement benefit plans are performed periodically for accounting purposes, based on a market-related discount rate and management's best estimate assumptions.

Foresters Financial measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the pension plans for funding purposes was December 31, 2018 for the U.S. plan, December 31, 2018 for the Canadian plan and April 1, 2017 and July 1, 2017 for the U.K. plans. The effective date of the next required valuation is December 31, 2021 for the Canadian plan and April 1, 2020 and July 1, 2020 for the U.K. plans.

In 2019, Foresters Financial settled the remaining liabilities of its U.S. defined benefit pension plan by using the plan assets to purchase an annuity for the remaining participants in the plan. The remaining surplus assets from the plan were returned to Foresters Financial upon the wind-up of the plan.

a) Defined benefit pension plans

Employee benefit assets and obligations include any surplus or deficit positions on defined benefit pension plans. The surplus or deficit position is calculated as the difference between plan assets and the accrued benefit obligation.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

7. Employee benefit plans (continued)

The following table shows the changes in the defined benefit pension plans assets and obligations during the year:

| | 2019 | 2018 |
|---|------------------------|------------------------|
| | \$ | \$ |
| Change in plan assets: | | |
| Fair value of plan assets at January 1 | 310,975 | 309,561 |
| Interest income | 11,299 | 9,632 |
| Return on plan assets excluding interest income | 31,413 | (8,430) |
| Employer contributions | 8,441 | 8,419 |
| Employee contributions | 1,053 | 1,086 |
| Benefits paid | (13,546) | (11,064) |
| Surplus paid out to employer | (3,492) | - |
| Settlement payments | (303) | - |
| Effect of change in foreign exchange rates | (569) | 1,771 |
| Fair value of plan assets at December 31 | <u>345,271</u> | <u>310,975</u> |
| Change in projected benefit obligations: | | |
| Accrued benefit obligations at January 1 | 338,920 | 342,334 |
| Current service cost | 6,693 | 7,314 |
| Employee contributions | 1,053 | 1,086 |
| Interest cost | 11,951 | 11,321 |
| Benefits paid | (13,868) | (11,071) |
| Remeasurements | | |
| - experience adjustments | (5,720) | 68 |
| - actuarial (gains) losses from changes in financial assumptions | 42,352 | (18,052) |
| - actuarial (gains) losses from changes in demographic assumptions | (620) | 385 |
| - changes in the effect of the asset ceiling | (2,189) | 3,628 |
| Effect of change in foreign exchange rates | (742) | 1,907 |
| Accrued benefit obligations at December 31 | <u>377,830</u> | <u>338,920</u> |
| Balance as at December 31 | <u>(32,559)</u> | <u>(27,945)</u> |
| Amounts recognized on consolidated statement of financial position | | |
| Employee benefit assets | - | <u>3,267</u> |
| Employee benefit obligations (note 7b) | <u>32,559</u> | <u>31,212</u> |

Foresters Financial has reviewed both the terms and conditions of the defined benefit plans and the statutory requirements (such as minimum funding requirements) in each jurisdiction, and whether the employee benefit asset exceeded the economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. For the U.K. plan, Foresters Financial has a liability for \$10,971 (2018: \$16,703) in respect of future contributions where there will be no economic benefit to Foresters Financial.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

7. Employee benefit plans (continued)

For the plans in Canada and the U.S., no decrease in the employee benefit assets was necessary as the economic benefits available were not lower than the assets recognized.

The breakdown of defined benefit plan assets is shown in the following table:

| | <u>2019</u> % | <u>2018</u> % |
|---|------------------|------------------|
| Cash and cash equivalents | | |
| Canada | 1 | 4 |
| U.K | 1 | 1 |
| Bonds and other fixed income securities | | |
| U.S | - | 1 |
| Canada | 41 | 40 |
| U.K | 8 | 6 |
| Equities | | |
| Canada | 32 | 35 |
| U.K | 6 | 5 |
| Real Estate | | |
| Canada | 7 | 3 |
| U.K | 1 | 1 |
| Other | | |
| U.K | 3 | 4 |
| | <u>100</u> | <u>100</u> |

All bonds and other fixed income securities and equities have quoted prices in active markets.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

7. Employee benefit plans (continued)

b) Employee benefit obligations

The following table shows changes in unfunded post retirement benefit obligations during the year and the total employee benefit obligations recognized in the consolidated statement of financial position:

| | 2019 | | 2018 | |
|---|---------------|-------------------------|---------------|-------------------------|
| | Pension \$ | Other benefits \$ | Pension \$ | Other benefits \$ |
| Change in projected benefit obligation: | | | | |
| Accrued benefit obligations at January 1 | 38,971 | 13,574 | 34,276 | 14,506 |
| Current service cost | 2,520 | - | 8,767 | - |
| Interest cost | 1,274 | 503 | 1,193 | 478 |
| Plan amendments | 4,555 | - | - | - |
| Benefits paid | (1,323) | (947) | (1,623) | (1,021) |
| Remeasurements | | | | |
| - experience adjustments | (2,855) | (149) | (2,511) | (50) |
| - actuarial (gains) losses from changes in financial assumptions | 2,981 | 559 | (1,402) | (1,061) |
| - actuarial (gains) losses from changes in demographic assumptions | - | (540) | - | (47) |
| Effect of change in foreign exchange rates | (455) | (402) | 271 | 769 |
| Accrued benefit obligations at December 31 | 45,668 | 12,598 | 38,971 | 13,574 |
| Net obligation for defined benefit pension plans (note 7a) | 32,559 | - | 31,212 | - |
| Amounts recognized on consolidated statement of financial position | 78,227 | 12,598 | 70,183 | 13,574 |

The weighted average duration of all the defined benefit obligations was 16 years (2018: 15 years).

The maturity analysis of benefit payments as at December 31 is shown in the following table:

| | 2019 \$ | 2018 \$ |
|-----------------------|------------|------------|
| Within 1 year or less | 12,709 | 13,691 |
| 2 - 5 years | 57,106 | 53,246 |
| 6 - 15 years | 184,281 | 174,187 |
| Over 15 years | 332,043 | 476,716 |
| Total | 586,139 | 717,840 |

Foresters Financial expects to pay \$9,200 in contributions to its defined benefit plans in 2020.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

7. Employee benefit plans (continued)

The table below provides the funded status of the combined defined benefit pension and post retirement plans:

| | 2019 \$ | 2018 \$ |
|---|------------|------------|
| As at December 31 | | |
| Fair value of defined benefit plan assets (note 7a) | 345,271 | 310,975 |
| Present value of obligations | 436,096 | 391,549 |
| Funded status – deficit | (90,825) | (80,574) |

Additionally, long-term disability obligations amounted to \$2,118 (2018: \$2,145) and are recorded in other liabilities on the consolidated statement of financial position. The benefits provided under the long-term disability plan are income replacement based on a percentage of base wages and a continuation of existing dental and medical coverage. In providing these benefits, Foresters Financial has in certain cases insured the benefit with a third party provider, while in other cases the benefits are paid by Foresters Financial. The obligation relates to claims under the non-insured component of the benefits payable.

c) Employee benefit expenses

The following amounts were charged to operating expenses on the consolidated statement of comprehensive income (loss) for expenses related to employee benefit plans:

| | 2019 | | 2018 | |
|---|---------------------------|-------------------------|---------------------------|-------------------------|
| | Pension benefits \$ | Other benefits \$ | Pension benefits \$ | Other benefits \$ |
| Defined benefit pension and post retirement plan expenses: | | | | |
| Current service cost (income) | 13,946 | - | 8,694 | - |
| Net interest cost | 1,925 | 503 | 2,882 | 478 |
| | <u>15,871</u> | <u>503</u> | <u>11,576</u> | <u>478</u> |
| Defined contribution pension plans: | | | | |
| Employer contributions | <u>4,159</u> | | <u>5,299</u> | |

Long-term disability benefit expense amounted to \$25 and \$150 during December 31, 2019 and December 31, 2018 respectively and was included in gross benefits on the consolidated statement of comprehensive income (loss).

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

7. Employee benefit plans (continued)

d) Overview of assumptions

The weighted average actuarial assumptions used in the measurement of Foresters Financial's benefit obligations and expenses were as follows:

| | 2019 | | 2018 | |
|--|--------------------|------------------|--------------------|------------------|
| | Pension benefits % | Other benefits % | Pension benefits % | Other benefits % |
| Assumptions used to calculate benefit obligations | | | | |
| Discount rate | 3.0 | 2.9 | 3.7 | 3.4 |
| Future pension growth | 2.1 | 7.2 | 2.2 | 7.4 |
| Rate of compensation increase | 3.5 | - | 3.5 | - |
| Inflation | 2.1 | - | 2.1 | - |
| Assumptions used to calculate benefit expenses | | | | |
| Discount rate | 3.7 | 3.9 | 3.3 | 3.3 |
| Future pension growth | 2.2 | 7.4 | 2.2 | 7.4 |
| Rate of compensation increase | 3.9 | - | 3.9 | - |
| Inflation | 2.1 | - | 2.1 | - |

The discount rate is based on current market interest rates of high-quality bonds for a term to reflect the duration of expected future cash outflows for pension benefit payments.

Reasonable possible changes to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below:

| December 31, 2019 | Defined benefit obligation | |
|---|----------------------------|----------|
| | Increase | Decrease |
| | \$ | \$ |
| Discount rate (1% movement) | (61,814) | 81,803 |
| Future pension growth (0.25% movement) | 691 | (9,997) |
| Future compensation growth (0.25% movement) | 2,979 | (2,877) |
| Inflation rate (0.25% movement) | 1,198 | (10,283) |
| Life expectancy (movement by 1 year) | 14,310 | (12,240) |

| December 31, 2018 | Defined benefit obligation | |
|---|----------------------------|----------|
| | Increase | Decrease |
| | \$ | \$ |
| Discount rate (1% movement) | (54,619) | 71,922 |
| Future pension growth (0.25% movement) | 1,093 | (9,538) |
| Future compensation growth (0.25% movement) | 3,464 | (3,343) |
| Inflation rate (0.25% movement) | 822 | (9,289) |
| Life expectancy (movement by 1 year) | 12,423 | (12,212) |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

7. Employee benefit plans (continued)

The weighted average remaining working lives of the active employees covered by defined benefit pension plans was 11 years (2018: 11 years) and for other retirement benefit plans was 0 years (2018: 0 years).

Assumptions regarding future mortality were based on published statistics and mortality tables. The current longevities underlying the values of the defined benefit obligation at the report date were as follows:

| | 2019 | | | 2018 | | |
|--|------|--------|-----|------|--------|-----|
| | U.S | Canada | U.K | U.S | Canada | U.K |
| Longevity at age 65 for current pensioners | | | | | | |
| Males | - | 24 | 22 | 21 | 24 | 22 |
| Females | - | 24 | 24 | 22 | 24 | 24 |
| Longevity at age 65 for current members aged 45 | | | | | | |
| Males | - | 25 | 24 | 21 | 25 | 24 |
| Females | - | 25 | 26 | 22 | 25 | 26 |

The Medicare (post 65 years of age) inflation assumption for U.S. benefits is 6.2% for 2019 (2018: 6.6%) decreasing to 4.5% by 2037 and thereafter. The healthcare cost inflation assumption for Canadian benefits is 5.2% for 2019 (2018: 5.4%), decreasing to 4.0% in 2040 and thereafter.

A 1.0% change in the assumed healthcare trend rate would have the following effects for 2017:

| December 31, 2019 | 1.0% increase | 1.0% decrease |
|---|---------------|---------------|
| | \$ | \$ |
| Effect on service cost plus interest cost | 50 | (43) |
| Effect on accrued benefit obligations | 1,385 | (1,195) |

| December 31, 2018 | 1.0% increase | 1.0% decrease |
|---|---------------|---------------|
| | \$ | \$ |
| Effect on service cost plus interest cost | 47 | (41) |
| Effect on accrued benefit obligations | 1,322 | (1,145) |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

8. GOODWILL AND INTANGIBLE ASSETS

a) Reconciliation of carrying amount

| | Indefinite useful life | | Finite useful life | | | Total |
|---|------------------------|----------------------------|----------------------|---|----------|-----------|
| | Goodwill | Asset management contracts | Unit cost reductions | Management contracts and customer relationships | Software | |
| | \$ | \$ | \$ | \$ | \$ | |
| Net carrying value as at December 31, 2018 | 3,168 | 153,962 | 1,706 | 39,835 | 9,009 | 207,680 |
| Additions – internally developed | - | - | - | - | 3,744 | 3,744 |
| Amortization | - | - | (508) | (3,879) | (1,940) | (6,327) |
| Disposals | (3,083) | (149,807) | (58) | (549) | - | (153,497) |
| Impairment losses | - | - | - | - | (1,522) | (1,522) |
| Effect of change in foreign exchange rates | (85) | (4,155) | 32 | 79 | 814 | (3,315) |
| Net carrying value as at December 31, 2019 | - | - | 1,172 | 35,486 | 10,105 | 46,763 |
| Net carrying value as at December 31, 2017 | 35,880 | 146,961 | 2,174 | 45,295 | 14,317 | 244,627 |
| Additions – internally developed | - | - | - | - | 4,249 | 4,249 |
| Amortization | - | - | (519) | (4,529) | (10,147) | (15,195) |
| Impairment losses | (33,771) | (5,035) | - | (1,959) | - | (40,765) |
| Effect of change in foreign exchange rates | 1,059 | 12,036 | 51 | 1,028 | 590 | 14,764 |
| Net carrying value as at December 31, 2018 | 3,168 | 153,962 | 1,706 | 39,835 | 9,009 | 207,680 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

8. Goodwill and intangible assets (continued)

The following table shows the gross and net carrying values of intangibles with a finite useful life:

| | Gross carrying value | Accumulated depreciation | Accumulated impairment losses | Net carrying value |
|---|----------------------------|-----------------------------|-------------------------------------|--------------------------|
| | \$ | \$ | \$ | \$ |
| December 31, 2019 | | | | |
| Unit cost reductions | 5,685 | (4,513) | - | 1,172 |
| Management contracts and customer relationships | 57,295 | (19,850) | (1,959) | 35,486 |
| Software | 93,224 | (83,119) | - | 10,105 |
| | 156,204 | (107,482) | (1,959) | 46,763 |
| December 31, 2018 | | | | |
| Unit cost reductions | 5,743 | (4,037) | - | 1,706 |
| Management contracts and customer relationships | 57,765 | (15,971) | (1,959) | 39,835 |
| Software | 91,002 | (81,993) | - | 9,009 |
| | 154,510 | (102,001) | (1,959) | 50,550 |

Included in software was \$4,648 (2018: \$3,569) that was still under development and had not been amortized. During the year, software costs amounting to \$20,698 (2018: \$13,071) were expensed and recorded in operating expenses.

b) Recoverable amount of goodwill and intangible assets with an indefinite life

In the U.S., Foresters Financial Holding Company, Inc.'s ("FFHC") asset management operation is classified as a cash-generating unit ("CGU"). In Canada, Foresters Asset Management Inc. ("FAM")'s asset management operation is classified as a CGU. Both of these CGUs are part of the previous NAAM reporting segment. Goodwill and the intangible assets consisting of asset management contracts, distribution network and software are allocated to these cash-generating units. These CGUs are tested for impairment at least annually until the end of 2018. In 2019, both asset management operations were discontinued as described in Note 21.

The recoverable amounts were based on the value in use which was determined by using discounted cash flow projections based on a 5 year medium term plan and applying a terminal value multiple based on the last year of the projection. The terminal value multiple was determined using the discount rate and the terminal growth rate.

In 2019, the remaining goodwill in FFHC was derecognized due to the disposal of FFHC's asset management contracts as described in Note 21. The derecognition was included in discontinued operations in the consolidated statement of comprehensive income (loss). In 2018, an impairment loss of \$27.2 million and \$13.6 million was recognized to write the carrying value of FFHC and FAM's goodwill down to its recoverable amount of \$3.2

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

8. Goodwill and intangible assets (continued)

million and \$0 respectively. The impairment losses were reclassified to discontinued operations (note 21).

In determining the key assumptions management completed an extensive review and the key assumptions identified were:

| | 2019 | | 2018 | |
|-----------------------------|---------|-------------|-------------|-------------|
| | US % | Canada % | US % | Canada % |
| Growth rate for revenue | N/A | N/A | -1.7 - 5.89 | -3.5 - 19.4 |
| Terminal period growth rate | N/A | N/A | 2.00 | 2.00 |
| Discount rate (after-tax) | N/A | N/A | 14.67 | 16.00 |

The discount rate is the cost of capital based on the Capital Asset Pricing Model specific to the activity of the CGU and the industry. The discount rate is based on a 20 year treasuries yield and includes factors for specific risks such as transaction size and forecasting risk.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. FINANCIAL RISK MANAGEMENT

Foresters Financial offers insurance, wealth and asset management products and services, which subject the organization to a broad range of financial risks. Foresters Financial has specific policies in place to manage these risks such as the enterprise-wide Risk Management Policy, Change Management Policy, Investment Policy, Pricing Policy, Dividend Policy, Policy on the Criteria for Changing Adjustable Certificates, Reinsurance Risk Management Policy and Capital Management Policy, all of which are annually approved by the Board. Foresters Financial's goal in managing financial risk is to ensure that the outcomes of activities involving elements of risk are consistent with Foresters Financial's objectives and risk appetite, and to maintain an appropriate risk/reward balance while protecting Foresters Financial's consolidated statement of financial position from events that have the potential to impair its financial strength.

Foresters Financial's Risk Management Policy sets out the standards of practice related to the governance, identification, measurement, monitoring, control and mitigation of risks. Foresters Financial manages risk taking activities against an overall risk appetite, which defines the amount and type of risks it is willing to assume. The risk appetite reflects Foresters Financial's financial condition, risk tolerance and business strategies. Financial risk appetite measures are defined in relation to internal and regulatory capital requirements, liquidity and earnings sensitivities.

The key financial risks related to financial instruments, including derivative financial instruments are credit risk, market risk (currency risk, interest rate risk and equity market risk), insurance risk and liquidity risk. The following sections describe how Foresters Financial manages each of these risks.

a) Credit risk

Credit risk is the risk of loss resulting from the failure of a borrower or counterparty to fulfill its payment obligations. Worsening or continued poor economic conditions could result in borrower or counterparty defaults or downgrades, and could lead to increased provisions or impairments related to Foresters Financial's general fund invested assets and an increase in provisions for future credit impairments which are included in insurance contract liabilities.

The Board approved Investment Policy sets out the policies and procedures to manage credit risk. Specific guidelines have been established to minimize undue concentration of exposure to a single debtor or a group of related debtors; to limit the purchase of fixed income securities to investment-grade assets; and to specify minimum and/or maximum limits for fixed income securities by credit quality ratings.

Asset portfolios are monitored continuously and reviewed regularly with the Risk and Investment Committee of the Board.

Credit risk also arises from reinsurance activities. The inability or unwillingness of reinsurance counterparties to fulfill their contractual obligations related to the liabilities ceded to them could lead to an increase in insurance contract liabilities. The Reinsurance

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

Risk Management Policy sets out the minimum risk rating criteria that all reinsurance counterparties are required to meet. Reinsurance is placed with counterparties that have an AM Best financial strength rating of A- (excellent) or better and concentration of credit risk is managed by following guidelines approved each year by the Board of Directors. Management regularly monitors the creditworthiness of reinsurers to ensure compliance with Foresters Financial guidelines.

i) Maximum exposure to credit risk

Foresters Financial's maximum exposure to credit risk related to financial instruments and other assets is the carrying value of those assets, net of any allowances for losses.

Foresters Financial's maximum credit exposure was as follows:

| | 2019 | 2018 |
|---|------------------|------------------|
| | \$ | \$ |
| Short-term securities | 46,804 | 94,825 |
| Bonds | 6,616,543 | 7,528,999 |
| Derivative financial instruments | 5,020 | 190 |
| Other invested assets | 143,699 | 140,552 |
| Loans to certificateholders | 261,360 | 404,357 |
| Reinsurance assets | 501,767 | 398,562 |
| Accrued investment income | 56,073 | 73,306 |
| Amounts due from reinsurers | 36,657 | 22,365 |
| Accounts receivable and other receivables | 17,296 | 39,249 |
| Maximum exposure to credit risk | 7,685,219 | 8,702,405 |

ii) Concentration of credit risk

Concentration of credit risk arises from exposures to a single debtor, a group of related debtors or groups of debtors that have similar credit risk characteristics.

Foresters Financial establishes enterprise-wide investment portfolio level targets and limits to ensure that portfolios are widely diversified across asset classes and individual investment risks.

Foresters Financial limits its exposure to a single issuer, including total exposure to a parent company, its subsidiaries and any other entity for which the parent acts as a guarantor. Total exposure includes the sum of Foresters Financial's investment in bonds, equities, money market instruments and derivative financial instruments. Limits are based on the senior consolidated debt ratings of the parent company and range from 5% of total assets for AAA rated companies to 1% of total assets for BBB rated companies. Segment specific guidelines further restrict Foresters Financial investments in a single issuer.

Foresters Financial had no exposure in excess of the limits specified above to any single investee or its related group of companies.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

Bonds and other fixed-term securities

Investment concentration in any one investee or its related group of companies, except for securities issued by or guaranteed by the U.S., Canadian, U.K. and certain foreign governments and government agencies, is limited to 3.5% of the bond portfolio for the U.S., 5.0% of the bond portfolio for Canada and 5.0% of the bond portfolio for the U.K. These limits apply to AAA rated bonds and other fixed-term securities, and are further constrained for lower rated bonds in all three countries of operation.

The following table provides details of the carrying value of bonds by industry sector and country of residence of the issuer:

| | 2019 | | | 2018 | | |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| | FVTPL | AFS | Total | FVTPL | AFS | Total |
| Bonds issued or guaranteed by: | | | | | | |
| U.S treasury and other U.S agencies | \$1,502,845 | \$220,908 | \$1,723,753 | \$1,488,222 | \$189,727 | \$1,677,949 |
| Canadian federal government | 59,995 | 37,724 | 97,719 | 69,161 | 56,422 | 125,583 |
| Canadian provincial and municipal government | 634,471 | 115,615 | 750,086 | 471,371 | 42,236 | 513,607 |
| U.K government | 208,538 | - | 208,538 | 325,554 | - | 325,554 |
| Other foreign governments | 119,398 | 3,420 | 122,818 | 162,873 | 4,828 | 167,701 |
| Total government bonds | 2,525,247 | 377,667 | 2,902,914 | 2,517,181 | 293,213 | 2,810,394 |
| By industry sector | | | | | | |
| Financial | 1,732,832 | 453,150 | 2,185,982 | 1,470,873 | 466,050 | 1,936,923 |
| Industrial | 497,936 | 64,659 | 562,595 | 487,576 | 54,031 | 541,607 |
| Utilities | 486,025 | 41,960 | 527,985 | 389,166 | 63,778 | 452,944 |
| Energy | 433,831 | 85,131 | 518,962 | 300,908 | 67,035 | 367,943 |
| Consumer Staples | 194,918 | 40,167 | 235,085 | 245,558 | 75,286 | 320,844 |
| Consumer | 190,404 | 38,618 | 229,022 | 208,794 | 43,518 | 252,312 |
| Communications | 246,580 | 37,678 | 284,258 | 182,567 | 71,116 | 253,683 |
| Technology | 227,543 | 20,663 | 248,206 | 206,883 | 31,300 | 238,183 |
| Health Care | 217,455 | 28,686 | 246,141 | 159,614 | 2,721 | 162,335 |
| Basic materials | 65,875 | 10,834 | 76,709 | 93,294 | 23,039 | 116,333 |
| Other | 81,866 | 3,527 | 85,393 | 71,062 | 4,436 | 75,498 |
| Total corporate bonds | 4,375,265 | 825,073 | 5,200,338 | 3,816,295 | 902,310 | 4,718,605 |
| Less: reclassification to assets held for sale (note 22) | (1,481,917) | (4,792) | (1,486,709) | - | - | - |
| | \$5,418,595 | \$1,197,948 | \$6,616,543 | \$6,333,476 | \$1,195,523 | \$7,528,999 |
| Allocation by country of issuer: | | | | | | |
| United States | \$4,516,696 | \$876,091 | \$5,392,787 | \$4,057,953 | \$843,732 | \$4,901,685 |
| Canada | 1,652,404 | 270,693 | 1,923,097 | 1,417,883 | 311,690 | 1,729,573 |
| U.K. | 296,418 | 9,015 | 305,433 | 430,732 | 10,389 | 441,121 |
| Other | 434,994 | 46,941 | 481,935 | 426,908 | 29,712 | 456,620 |
| Less: reclassification to assets held for sale (note 22) | (1,481,917) | (4,792) | (1,486,709) | - | - | - |
| | \$5,418,595 | \$1,197,948 | \$6,616,543 | \$6,333,476 | \$1,195,523 | \$7,528,999 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

The credit rating of the bond portfolio was as follows:

| Bond quality | 2019 | | 2018 | |
|-------------------|-----------|-------|-----------|-------|
| | \$ | % | \$ | % |
| Investment grade: | | | | |
| AAA | 1,198,809 | 14.8 | 1,111,623 | 14.8 |
| AA | 2,289,504 | 28.3 | 2,217,215 | 29.4 |
| A | 2,699,661 | 33.2 | 2,519,987 | 33.5 |
| BBB | 1,844,695 | 22.8 | 1,614,755 | 21.4 |
| | 8,032,669 | 99.1 | 7,463,580 | 99.1 |
| BB and lower | 70,583 | 0.9 | 65,419 | 0.9 |
| Total bonds | 8,103,252 | 100.0 | 7,528,999 | 100.0 |

Equities

Investments in common and preferred stocks are limited to 22.0% and 3.0% respectively of Foresters Financial's total assets. 100.0% of Foresters Financial's equity portfolio is invested in publicly listed corporations.

Own-use and investment property

Investments in real estate are limited to 15.0% of Foresters Financial's total assets.

iii) Impairments

An allowance for losses on AFS assets and loans and receivables is established when the asset becomes impaired as a result of deterioration in credit quality, to the extent there is no longer assurance of timely realization of the carrying value of the asset and related investment income. The carrying value of an impaired asset is reduced to its estimated net realizable value at the time of recognition of impairment. Impairment losses on invested assets are shown in note 3e.

Insurance contract liabilities include an asset default provision for credit losses for future asset defaults as outlined in note 11.

b) Market risk

Market risk is the risk that the fair value of a financial instrument will fluctuate because of changes in future cash flows. Market risk comprises at least three types of risk:

- Currency risk
- Interest rate risk
- Equity market risk

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

i) Currency risk

Currency risk for financial instruments arises from a mismatch between the currency of the insurance and investment contract liabilities and the currency of the assets designated to support those liabilities. Foresters Financial matches the currency of its assets with the currency of the liabilities they support to mitigate economic exposure to changes in exchange rates.

Administrative expenses

Foresters Financial incurs the majority of its U.S. branch administrative expenses in Canadian dollars and is therefore exposed to foreign exchange rate fluctuations between the Canadian and U.S. dollars. Foresters Financial enters into foreign exchange forward contracts (see note 3c) to reduce a portion of the impact of foreign exchange rate fluctuations on the calculation of U.S. branch insurance contract liabilities. This calculation includes a provision for future certificate maintenance expenses, which are incurred in Canadian dollars. The exchange rate assumed in this calculation is based on exchange rates implicit in these contracts. While these foreign exchange forward contracts effectively offset the impact of foreign exchange rate fluctuations on a significant portion of U.S. branch insurance contract liabilities, Foresters Financial is exposed to foreign exchange rate fluctuations on expenses in excess of those covered by the foreign exchange forward contracts. A 10.0% increase in the U.S. dollar against the Canadian dollar would be expected to reduce U.S. branch insurance contract liabilities by \$7,138 (2018: \$5,175). A 10.0% decrease in the U.S. dollar against the Canadian dollar would be expected to increase U.S. branch insurance contract liabilities by \$7,945 (2018: \$5,740).

Foreign operations

A substantial portion of Foresters Financial's operations is denominated in currencies other than Canadian dollars. If the Canadian dollar strengthened relative to non-Canadian currencies, the translated value of reported earnings and surplus from the non-Canadian denominated operations would decline. Foresters Financial uses financial measures such as constant currency calculations to monitor the effect of such currency fluctuations.

The following table shows the impact on net income and surplus of a 1.0% strengthening in the Canadian dollar relative to the U.S. dollar and the U.K. pound:

| | <u>Change in net income</u> | | <u>Change in surplus</u> | |
|---|-----------------------------|-------------|--------------------------|-------------|
| | <u>2019</u> | <u>2018</u> | <u>2019</u> | <u>2018</u> |
| | <u>\$</u> | <u>\$</u> | <u>\$</u> | <u>\$</u> |
| Impact of 1.0% strengthening in the Canadian dollar | | | | |
| U.S. dollar | (947) | 703 | (15,049) | (14,670) |
| U.K. pound | (315) | 8 | (2,084) | (1,763) |

A 1.0% weakening in rates would have an equal and opposite impact to that displayed above.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

ii) Interest rate risk

Interest rate risk exists if asset and liability cash flows are not matched and interest rates change, causing a change in the projected asset cash flows or, in some cases, a change in liability cash flows. Foresters Financial mitigates its exposure to interest rate risk by utilizing a formal process for managing the matching of assets and liabilities which involves grouping general fund assets and liabilities into segments. Assets in each segment are managed in relation to the liabilities in that segment.

For products with fixed and highly predictable benefit payments, investments are made in fixed income assets that closely match the product liability cash flows or durations. Protection against interest rate change is achieved as any change in the fair market value of the assets will be offset by a similar change in the fair market value of the liabilities.

For products with less predictable timing of benefit payments, investments may be made in equities or fixed income assets with cash flows of a shorter duration than the anticipated timing of benefit payments as described below.

The risks associated with the mismatch in portfolio duration, cash flow and asset prepayment exposure are quantified and reviewed regularly.

Under CALM, projected cash flows from current assets and liabilities, along with future reinvestment rate assumptions, are used to determine insurance contract liabilities. Asset depreciation assumptions are made when projecting future asset cash flows appropriate to each asset class. Testing is performed under several prescribed interest rate scenarios (including increasing and decreasing rates) to make appropriate provision for reinvestment or disinvestment risk.

Many annuity and universal life insurance certificates have minimum credited interest rate guarantees ranging from 0.25% to 4.5% (2018: 0.25% to 4.5%). Other products have implicit guarantees. Dividend paying products are sensitive to a sustained decline in interest rates to the extent dividends cannot be reduced below zero. The profitability of non-dividend paying products depends in part on the relationship between interest rates assumed in pricing compared to investment returns currently available.

One method of measuring interest rate risk is to determine the effect on insurance contract liabilities and surplus of an immediate increase or decrease in the level of interest rates.

A 1.0% reduction in interest rates would result in an increase in insurance contract liabilities of approximately \$116,607 (2018: \$92,367) while the effect of a 1.0% increase in interest rates would result in a decrease in insurance contract liabilities of approximately \$77,638 (2018: \$73,437).

Bonds designated as AFS generally do not support insurance contract liabilities or investment contract liabilities. Changes in the fair value of AFS bonds are recorded in OCI

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

and cause a corresponding change in surplus. For Foresters Financial AFS bonds, an immediate 1.0% parallel increase in interest rates at December 31, 2019 would result in an estimated after-tax decrease in OCI of \$53,000 (2018: \$44,938). Conversely, an immediate 1.0% parallel decrease in interest rates would result in an estimated after-tax increase in OCI of \$49,774 (2018: \$39,355).

iii) Equity market risk

Some insurance contract liabilities and investment contract liabilities such as products with long duration are supported in part by equities. There will be impacts on these liabilities, with related changes in surplus, as equity market values fluctuate. A 10.0% increase in equity markets would be expected to decrease insurance contract liabilities by approximately \$42,707 (2018: \$34,371). A 10.0% decrease in equity markets would be expected to increase insurance contract liabilities by approximately \$49,097 (2018: \$39,873).

Equities designated as AFS generally do not support insurance contract liabilities or investment contract liabilities. Changes in the fair value of AFS equities are recorded in OCI and cause a corresponding change in surplus. For AFS equities, an immediate 10.0% increase in stock prices at December 31, 2019, would result in an estimated after-tax increase in OCI of \$12,402 (2018: \$14,130). Conversely, an immediate 10.0% decrease in stock prices would have an equal and opposite effect.

c) Insurance risk

Insurance risk is the risk of loss due to actual experience differing from the experience assumed when a product was designed and priced with respect to claims, certificate holder behavior and expenses.

Foresters Financial sells participating and non-participating insurance and financial investment products. The types of products include life, health and annuity. Each product can have a number of contingencies associated with it, including mortality, lapse and expense risk. Assumptions are made based on company and industry past experience, current internal data, external market indices and benchmarks which reflect current observable market prices and other published information as outlined in the Pricing Policy.

These assumptions are used to develop the initial measurement of insurance contract liabilities and form the insurance risk. The setting of these assumptions requires a significant amount of professional judgment and therefore, actual experience may be materially different from assumed experience which results in the nature of the insurance risk exposure.

To the extent that emerging experience is more favorable than assumed in the measurement of insurance contract liabilities, income will emerge. If emerging experience is less favorable, losses will result. Foresters Financial's objective is to ensure that sufficient insurance contract liabilities have been set up to cover these obligations.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

The following risk factors are components of insurance risk:

Mortality risk – is the risk that death claims are different than assumed in pricing or the most recent valuation of actuarial liabilities, adversely impacting income. This risk includes both mis-estimation in pricing, and adverse experience resulting from any combination of weak underwriting, anti-selection by certificate holders or agents, or improper claims adjudication.

Lapse risk – is the risk that withdrawals and lapse rates are different than assumed. This risk can occur on both insurance and investment contracts. Lapses that are higher than assumed are often detrimental to profit especially if they occur prior to recovering costs to issue a certificate. Lapses that are lower than assumed can also reduce profits on certificates that have generous interest rate guarantees or on certificates where the increasing cost of insurance benefits exceeds the level contractual charges.

Expense risk – is the risk that maintenance expense levels will be higher than assumed. This can arise from an increase in the unit costs or an increase in expense inflation relating to economic conditions. This risk can occur on insurance and investment contracts.

Foresters Financial manages insurance risk at an enterprise-wide level by establishing Board approved policies and guidelines for product development and product pricing which require that all material risks be provided for at the time of product design and pricing of new products. Additionally, experience studies are performed annually, the outcome of which is used to update the valuation of insurance contract liabilities and the pricing of new and existing products. Foresters Financial also uses reinsurance to transfer risks as specified in its Reinsurance Risk Management Policy.

The actuarial assumptions used in the measurement of insurance contract liabilities take insurance risk factors into account as discussed in note 11d. Annually, as part of Dynamic Capital Adequacy Testing (“DCAT”), Foresters Financial measures the effects of large and sustained adverse movements in insurance risk factors on the calculation of insurance contract liabilities. Sensitivities to changes in actuarial assumptions are provided in note 11d.

d) Liquidity risk

Liquidity risk is the risk that Foresters Financial will not be able to meet all cash outflow obligations as they come due. Foresters Financial liquidity requirements are closely managed through approximate cash flow matching of assets and liabilities and forecasting earned and required yields to ensure consistency between certificate holder requirements and asset yields.

Operating and strategic liquidity levels are managed against established guidelines.

Foresters Financial ensures adequate liquidity on a day-to-day operational basis by maintaining a specified minimum level of highly liquid assets (defined as all short-term

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

investments issued by major banks and the governments of the U.S., Canada and the U.K.). Strategic liquidity is measured under both immediate (within one month) and ongoing (within one year) stress scenarios. Foresters Financial's target liquidity ratio under both scenarios is 200.0%, a ratio that would more than support the highest claims-paying ratings for Foresters Financial, in addition to providing a significant margin above management's expected liquidity requirements. Foresters Financial's liquidity ratio is defined as allowable liquid assets divided by the risk-adjusted liquidity of liabilities. The risk-adjusted liquidity of liabilities is calculated by assessing the probability of a certificate holder surrendering a certificate for cash under each of the two scenarios, adjusted for the ability of the certificate holder to surrender under its contractual provisions.

The following chart shows Foresters Financial's strategic liquidity ratio:

| | 2019 | | 2018 | |
|--|--------------------|------------------|--------------------|------------------|
| | Immediate scenario | Ongoing scenario | Immediate scenario | Ongoing scenario |
| Allowable liquid assets | \$ 8,562,370 | \$ 8,873,531 | \$ 7,877,370 | \$ 8,135,604 |
| Risk-adjusted liquidity of liabilities | 2,827,658 | 3,446,861 | 2,705,883 | 3,292,057 |
| Liquidity ratio | 302.81% | 257.44% | 291.1% | 247.1% |

Based on Foresters Financial's historical cash flows and current financial performance, management believe that the cash flow from Foresters operating activities will continue to provide sufficient liquidity for Foresters Financial to satisfy debt service obligations and to pay other expenses.

Contractual maturities

The contractual maturities of Foresters Financial's significant financial assets and liabilities, insurance contract liabilities, investment contract liabilities and net investments for account of segregated fund unit holders as at December 31 are shown in the following table:

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

| | On demand or within 1 year or less | 2-5 years | 6-15 years | Over 15 years | Total |
|---|--|-------------|-------------|------------------|-------------|
| | \$ | \$ | \$ | \$ | \$ |
| 2019 | | | | | |
| Cash, cash equivalents and short-term securities | 327,820 | - | - | - | 327,820 |
| Bonds | 276,080 | 1,145,246 | 2,795,100 | 3,886,826 | 8,103,252 |
| Derivative financial instruments | 6,538 | 2,830 | (23,937) | (7,185) | (21,754) |
| Reinsurance assets | (287) | 17,576 | 166,607 | 321,604 | 505,500 |
| Less: reclassification to held for sale assets (note 22) | (56,531) | (311,233) | (687,280) | (457,539) | (1,512,583) |
| Insurance contract liabilities | (172,271) | (890,653) | (2,623,147) | (4,221,245) | (7,907,316) |
| Investment contract liabilities | (153,704) | - | - | - | (153,704) |
| Benefits payable | (123,263) | (67,060) | - | - | (190,323) |
| Net investments for account of segregated fund unit holders | 7,736,578 | - | - | - | 7,736,578 |
| Liabilities for account of segregated fund unit holders | (7,736,578) | - | - | - | (7,736,578) |
| Less: reclassification to held for sale liabilities (note 22) | 2,022,019 | 378,706 | 531,821 | 450,277 | 3,382,823 |
| | 2,126,401 | 275,412 | 159,164 | (27,262) | 2,533,715 |
| 2018 | | | | | |
| Cash, cash equivalents and short-term securities | 278,170 | - | - | - | 278,170 |
| Bonds | 301,127 | 1,299,853 | 2,817,702 | 3,110,317 | 7,528,999 |
| Derivative financial instruments | (5,805) | 378 | (22,951) | (6,101) | (34,479) |
| Reinsurance assets | 2,004 | 31,253 | 145,565 | 219,740 | 398,562 |
| Insurance contract liabilities | (198,048) | (1,087,493) | (2,979,152) | (3,133,735) | (7,398,428) |
| Investment contract liabilities | (161,109) | - | - | - | (161,109) |
| Benefits payable | (110,194) | (73,892) | - | - | (184,086) |
| Net investments for account of segregated fund unit holders | 7,635,014 | - | - | - | 7,635,014 |
| Liabilities for account of segregated fund unit holders | (7,635,014) | - | - | - | (7,635,014) |
| | 106,145 | 170,099 | (38,836) | 190,221 | 427,629 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

9. Financial risk management (continued)

Almost all investment contracts may be surrendered or transferred on demand. For such contracts, the earliest contractual maturity date is therefore the current statement of financial position date and the surrender amount would be approximately equal to the liability shown on the current statement of financial position. The cash flows are shown in the "On demand or within 1 year or less" column.

Investment contract liabilities for the account of segregated fund unit holders are payable or transferable on demand. The offsetting net investments for the account of segregated fund unit holders is shown on the same basis as these assets would be liquidated when necessary to settle the liability. These cash flows are shown in the "On demand or within 1 year or less" column.

Actual maturities for bonds may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties. Both contractual and operating lease commitments are disclosed in note 24.

10. OTHER LIABILITIES

Other liabilities were comprised of the following:

| | 2019 | 2018 |
|---|---------|---------|
| | \$ | \$ |
| Accounts payable and accrued liabilities | 155,742 | 157,408 |
| Payroll, other compensation and benefits | 31,079 | 63,843 |
| Premiums paid in advance | 13,961 | 17,878 |
| Provision for deferred gain on sale | 13,510 | - |
| Provisions | 14,897 | 12,435 |
| Due to reinsurers | 5,910 | 6,568 |
| Other liabilities | 2,078 | 1,868 |
| | 237,177 | 260,000 |
| Less: reclassification to held for sale liabilities (note 22) | (4,170) | - |
| | 233,007 | 260,000 |

The carrying value of these liabilities approximates their fair value. Within 12 months from the reporting date, \$194,903 (2018: \$213,699) will be realized.

[Reinsurance financing](#)

In 2016, Foresters entered into a 10 year reinsurance arrangement (note 14), the objective of which is to enhance US statutory solvency levels. There is no risk transfer under the arrangement and this has been accounted for as such resulting in a financial liability included in provisions.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

10. Other liabilities (continued)

Restructuring

During 2019, Foresters Financial committed to a plan to restructure its operations due to the sale of the asset management operating segments and recorded a restructuring provision of \$7,200 (note 18). The restructuring includes activities aimed at achieving planned expense reductions through reduction in staff and cost efficiencies which began in 2019 and is expected to be completed in 2020.

Provision for deferred gain on sale

A deferred gain on sale of \$13,510 was established during the year and relates to investment management fee guarantees that Foresters Financial has provided. The deferral is for the anticipated shortfall between the fees charged over an annual basis and the annual fee guarantees for the next five years until the guarantees expire in 2024. The provision will be assessed annually and released as the guarantees become certain.

Financial guarantee

As part of the sale of the asset management segment, Foresters Financial through its subsidiary, has made financial guarantees relating to various office leases that continue to be used by the purchaser but does not anticipate that any obligation exists nor can it be estimated reliably at this time so no provision has been established. The guarantee will end in 2025.

| | 2019 | | |
|-----------------------------------|--------------------------|---------------|--------------------------|
| | Provisions | | Deferred gain on sale |
| | Reinsurance financing | Restructuring | |
| | \$ | \$ | \$ |
| Balance, beginning of year | 12,435 | - | - |
| Provisions made during the year | - | 7,200 | 13,510 |
| Provisions used during the year | (2,938) | (1,800) | - |
| Balance, end of year | <u>9,497</u> | <u>5,400</u> | <u>13,510</u> |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. INSURANCE CONTRACT LIABILITIES AND REINSURANCE ASSETS

a) Nature and composition of insurance contract liabilities and related reinsurance assets

Insurance contract liabilities include life, health and annuity lines of business. Insurance contract liabilities have been calculated using CALM and are reported gross of ceded reinsurance which is recorded as Reinsurance assets. CALM requires assumptions to be made about future cash flows, thus there is risk that actual results will vary from those estimates. The risk varies in proportion to the length of the estimation period and the potential volatility of each assumption. To recognize uncertainty in establishing these estimates and to allow for possible deviation in experience, the Appointed Actuary is required to include a margin in each assumption, which has the effect of increasing the insurance contract liabilities. A range of allowable margins is prescribed by the Canadian Institute of Actuaries ("CIA") Standards of Practice. For interest rate risk, the Appointed Actuary projects multiple cash flow scenarios for each material product line to determine the appropriate margin for adverse deviation. In general, in setting these margins for adverse deviation, the Appointed Actuary has aimed for a level of conservatism in keeping with the risk profile of the organization and its operation. With the passage of time, and resulting reduction in estimation risk, these margins will be included in future income to the extent they are not required to cover adverse experience. If estimates of future conditions change throughout the life of a certificate, the effect of those changes is recognized in income immediately.

Foresters Financial limits the amount of loss on any one policy by reinsuring certain levels of risk with third party reinsurers. Maximum limits have been established for the retention of risks associated with life insurance certificates by line of business. Foresters Financial's gross exposure to insurance contract liabilities is partially offset by reinsurance assets on account of certain risks ceded to reinsurers.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. Insurance contract liabilities and reinsurance assets (continued)

b) Reconciliation of changes in insurance contract liabilities

| | 2019 | |
|---|---|---------------------------------------|
| | Gross insurance contract liabilities | Net insurance contract liabilities |
| | \$ | \$ |
| Beginning of year – Insurance contract liabilities | 7,398,428 | 6,999,866 |
| New business | 58,351 | 8,356 |
| Refinement of actuarial assumptions | 21,527 | (75) |
| Refinement of actuarial methods and models | 33,268 | 29,045 |
| Change in inforce due to changes in interest rates | 638,310 | 587,647 |
| Change in inforce from other movements | 973 | 12,361 |
| Change in contract liability | 752,429 | 637,334 |
| Reclassification to held for sale liabilities (note 22) | (1,426,211) | (1,422,478) |
| Change in contract liability including held for sale | (673,778) | (785,144) |
| Effect of change in foreign exchange rates | (243,545) | (235,384) |
| End of year – Insurance contract liabilities | 6,481,105 | 5,979,338 |
| | | |
| | 2018 | |
| | Gross insurance contract liabilities | Net insurance contract liabilities |
| | \$ | \$ |
| Beginning of year – Insurance contract liabilities | 7,128,783 | 6,780,125 |
| New business | 184,035 | 143,238 |
| Refinement of actuarial assumptions | 77,380 | 67,706 |
| Refinement of actuarial methods and models | (19,727) | (26,291) |
| Change in inforce due to changes in interest rates | (342,634) | (316,648) |
| Change in inforce from other movements | (32,349) | (24,016) |
| Change in contract liability | (133,295) | (156,011) |
| Effect of change in foreign exchange rates | 402,940 | 375,752 |
| End of year – Insurance contract liabilities | 7,398,428 | 6,989,866 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. Insurance contract liabilities and reinsurance assets (continued)

The significant movements during the year resulted from the change in interest rates and the change in foreign exchange rates relative to the Canadian dollar.

Changes resulting from refinements of assumptions and refinement of methods and models in the above tables are shown in more detail as follows:

| | 2019 | 2019 |
|---|---------------|---------------|
| | Gross | Net |
| | \$ | \$ |
| Refinement of assumptions: | | |
| Maintenance expense assumptions | (39,167) | (39,130) |
| Mortality and lapse assumptions for recent experience | 67,876 | 45,416 |
| Dividend assumptions | 5,382 | 5,360 |
| Fraternal experience assumptions | (1,235) | (1,235) |
| Future asset returns | (27,131) | (24,250) |
| Investment expense assumptions | 15,802 | 13,764 |
| | <u>21,527</u> | <u>(75)</u> |
| Refinement of methods and models: | | |
| Regulation and standards changes | 22,138 | 19,466 |
| Other model improvements | 11,130 | 9,579 |
| | <u>33,268</u> | <u>29,045</u> |

| | 2018 | 2018 |
|---|-----------------|-----------------|
| | Gross | Net |
| | \$ | \$ |
| Refinement of assumptions: | | |
| Maintenance expense assumptions | (34,626) | (34,610) |
| Mortality and lapse assumptions for recent experience | 100,662 | 93,969 |
| Dividend assumptions | 5,367 | 5,364 |
| Credit spread assumptions | (2,322) | 1,673 |
| Investment expense assumptions | 5,319 | 2,335 |
| Other | 2,980 | (1,025) |
| | <u>77,380</u> | <u>67,706</u> |
| Refinement of methods and models: | | |
| Liability model enhancements | (24,017) | (24,062) |
| Other model improvements | 4,290 | (2,229) |
| | <u>(19,727)</u> | <u>(26,291)</u> |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. Insurance contract liabilities and reinsurance assets (continued)

The presentation above is consistent with the method used in valuing actuarial liabilities. Refinements of methods and models include reinsurance and other model enhancements.

Asset default provisions made for anticipated future losses of principal and interest on investments and included as a component of actuarial liabilities are shown in the table below:

| | 2019 | 2018 |
|---|----------|---------|
| | \$ | \$ |
| Balance, beginning of year * | 134,217 | 130,379 |
| Net (release) strengthening of provision | 34,902 | (2,617) |
| Effect of change in foreign exchange rates | (4,375) | 6,455 |
| Reclassification to liabilities held for sale | (16,079) | - |
| Balance, end of year * | 148,665 | 134,217 |

* Provisions are net of losses expected to be passed-through via credited interest rates and dividends.

c) Composition of assets supporting liabilities and surplus

Foresters Financial segments its business taking into account the different liability profiles of its products. Based on these profiles, Foresters Financial has invested in fixed income securities, equities and financial derivatives with characteristics that closely match the characteristics of the related liability. The liabilities are matched with assets denominated in the same currency in order to avoid unintended exposure to foreign currency fluctuations. The fair value of insurance contract liabilities is determined by reference to the value of assets supporting these liabilities. Therefore, changes in the fair value of insurance contract liabilities primarily offset changes in the fair value of the invested assets supporting these liabilities.

The following chart shows the details of assets supporting liabilities and surplus by segment and by line of business:

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. Insurance contract liabilities and reinsurance assets (continued)

Assets supporting liabilities and surplus by segment

Composition of assets supporting all liabilities and surplus

| | December 31, 2019 | | | | | |
|---|--|-------------|------------|-------------------------|------------|-----------------|
| | Cash, cash equivalents and short-term securities | Bonds | Equities | Other invested assets * | Other | Total |
| North American Insurance | \$ 119,657 | \$7,289,784 | \$ 244,160 | \$ 544,698 | \$ 814,531 | \$ 9,012,830 |
| North American Asset Management (discontinued – note 21) | 142,144 | - | - | - | 31,951 | 174,095 |
| U.K. Savings, Investments and Protection | 34,558 | 567,009 | 591,603 | 8,881 | 111,353 | 1,313,404 |
| Membership ** | 1,827 | 175,493 | - | - | 4,820 | 182,140 |
| Corporate | 29,634 | 70,966 | - | 772 | - | 101,372 |
| Subtotal | 327,820 | 8,103,252 | 835,763 | 554,351 | 962,655 | 10,783,841 |
| Reclassification to held for sale assets (note 22) | 22,141 | 1,486,709 | - | 144,272 | 82,655 | 1,735,777 |
| | \$ 305,679 | \$6,616,543 | \$ 835,763 | \$ 410,079 | \$ 880,000 | \$ 9,048,064841 |

* Other invested assets includes loans to certificateholders, limited partnership investments and investment properties.

** Membership includes membership operations in the U.S., Canada and the U.K., as well as membership surplus.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. Insurance contract liabilities and reinsurance assets (continued)

Assets supporting liabilities and surplus by segment- continued

Composition of assets supporting all liabilities and surplus

| | December 31, 2018 | | | | | |
|---|--|---------------------|-------------------|-------------------------|---------------------|----------------------|
| | Cash, cash equivalents and short-term securities | Bonds | Equities | Other invested assets * | Other | Total |
| North American Insurance | \$ 127,457 | \$ 6,637,444 | \$ 212,269 | \$ 535,862 | \$ 863,571 | \$ 8,376,603 |
| North American Asset Management | 115,069 | - | 12,591 | 13 | 67,409 | 195,082 |
| U.K. Savings, Investments and Protection | 27,969 | 690,228 | 500,212 | 9,018 | 113,202 | 1,340,629 |
| Membership ** | 894 | 192,009 | - | - | 4,574 | 197,477 |
| Corporate | 6,781 | 9,318 | 23,269 | 206 | - | 39,574 |
| | \$ 278,170 | \$ 7,528,999 | \$ 748,341 | \$ 545,099 | \$ 1,048,756 | \$ 10,149,365 |

* Other invested assets includes loans to certificateholders, limited partnership investments and investment properties.

** Membership includes membership operations in the U.S., Canada and the U.K., as well as membership surplus.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. Insurance contract liabilities and reinsurance assets (continued)

d) Assumptions

The nature and method of determining the more significant assumptions made by Foresters Financial in valuing its insurance contract liabilities are described in the following paragraphs. These valuation assumptions are based on best estimates of future experience together with a margin for adverse deviation. Actual experience is monitored to assess whether the assumptions remain appropriate. Best estimates are reviewed at least annually and are changed as warranted. Margins are necessary to provide for possibilities of mis-estimation and/or future deterioration in the best estimate assumptions and provide reasonable assurance that policy liabilities cover a range of possible outcomes. Margins for adverse deviations are reviewed periodically for continued appropriateness.

Mortality and morbidity

Mortality relates to the occurrence of death. Mortality is a key assumption for life insurance and certain forms of annuities. Mortality assumptions are differentiated by factors such as gender, underwriting class, policy type and geographic market.

Morbidity relates to the occurrence of accidents and sickness for insured risks. Morbidity is a key assumption for long-term care insurance, disability insurance, critical illness and other forms of health benefits. Morbidity assumptions are established for each type of morbidity risk and geographic market.

Mortality and morbidity assumptions are based on Foresters Financial's internal experience as well as industry past and emerging experience. Although the pattern of claims and benefit payments may be close to that indicated by past experience, some deviation in that pattern is probable. Annual studies are performed to examine mortality and morbidity experience where Foresters Financial's actual experience is compared to both its expected assumptions and industry expected values to confirm that appropriate assumptions are being made about the projected benefit patterns. Consistent with actuarial standards, projected improvements in mortality experience are reflected where appropriate.

Lapse rates

Certificate holders may either surrender their certificates for cash value, where applicable or allow their certificates to lapse by choosing to discontinue payment of their premiums. Foresters Financial performs annual studies to review lapse and surrender experience, and bases its estimate of future lapse rates on previous experience for each block of business.

Foresters Financial relies on industry experience where its own experience lacks statistical credibility. Selection of certain lapse rates, especially for long duration lapse supported business, are based on professional guidance.

Investment returns

Foresters Financial segments assets supporting insurance contract liabilities by geographic market and by line of business and establishes investment strategies for

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

11. Insurance contract liabilities and reinsurance assets (continued)

each liability segment. The computation of actuarial liabilities takes into account projected cash flows of net investment income on assets supporting these liabilities, as well as income expected to be earned (or foregone) on reinvestments (or financing) of mismatched cash flows. Uncertainties exist with respect to projections of risk-free interest rates, credit spreads and the magnitude of credit losses resulting from asset depreciation. Foresters Financial accounts for such uncertainties by incorporating provisions for credit losses into projections of investment income (in addition to the allowances for impairment applied as direct reductions to the carrying values of invested assets).

Maintenance expenses

In 2019, an internal review was performed around governance related expenses to be included in the actuarial liabilities supporting the Membership segment which led to a reduction of maintenance expenses included in actuarial liabilities. Amounts are included in actuarial liabilities to provide for the costs of administering inforce certificates, including the costs of premium collection, adjudication and processing of claims, periodic actuarial calculations, preparation and mailing of certificate statements, and related indirect expenses and overhead. Annual expense studies are conducted to assess current cost structures by product and region. The process of forecasting expenses requires estimates to be made of factors such as inflation, salary rate increases, productivity changes, business volumes and indirect tax rates. Estimates of future certificate maintenance expenses are based on Foresters Financial's experience.

Foreign currency

Currency risk is addressed in note 9b.

In note 9b market risk is addressed and also includes the sensitivity of the insurance contract liabilities to changes in the types of market risk that most significantly impact Foresters Financial.

Dividends

Future certificate holder dividends are included in the determination of actuarial liabilities for participating certificates, with the assumption that certificate holder dividends will change in the future to reflect the experience of the respective participating accounts, consistent with the annual Board approved dividend policy.

The following table shows the decrease in after-tax net income which would result if there were changes in key assumptions relating to insurance contract liabilities net of reinsurance:

| | Change | 2019 | 2018 |
|--------------------------------|---------------|-------------|-------------|
| | | \$ | \$ |
| Mortality Rates | | | |
| Adversely impacted by increase | +2% | (81,936) | (73,592) |
| Adversely impacted by decrease | -2% | (3,200) | (3,050) |
| Lapse Rates | 10% Adverse | (224,980) | (104,315) |
| Maintenance Expense Level | +10% | (81,960) | (76,656) |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

12. INVESTMENT CONTRACT LIABILITIES

Reconciliation of changes in investment contract liabilities

The reconciliation of changes in investment contract liabilities during the year is shown in the table below:

| | 2019 \$ | 2018 \$ |
|---|----------------|----------------|
| Balance, beginning of year | 161,108 | 162,189 |
| Deposits received during the year | 2,478 | 4,125 |
| Surrenders and withdrawals | (6,423) | (10,649) |
| Interest credited and other | (953) | 476 |
| Effect of change in foreign exchange rates | (2,506) | 4,967 |
| | 153,704 | 161,108 |
| Less: Reclassification to liabilities held for sale (note 22) | (9,413) | - |
| Balance, end of year | 144,291 | 161,108 |

13. LEASES

a) Information about leases for which Foresters Financial is a lessee:

Foresters Financial leases office space, vehicles and equipment for its use. Office space leases have a non-cancellable term with an option to extend the lease at the end of the lease term. Some office space and equipment leases have variable lease payments that vary with the use of the leased asset.

| | Office space \$ | Vehicles \$ | Equipments \$ | Total \$ |
|---|--------------------|----------------|------------------|---------------|
| Right-of-use assets | | | | |
| Balance at January 1, 2019 | 47,886 | 1,829 | 2,079 | 51,794 |
| Additions | 654 | 857 | - | 1,511 |
| Depreciation | (6,040) | (1,108) | (615) | (7,763) |
| Impairment loss | (1,035) | - | (412) | (1,447) |
| Disposals | (14,668) | (98) | - | (14,766) |
| Effect of change in foreign exchange rate | (1,819) | (25) | (23) | (1,867) |
| Balance at December 31, 2019 | 24,978 | 1,455 | 1,029 | 27,462 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

13. Leases (continued)

| | 2019 |
|--|----------------------|
| | \$ |
| Lease liabilities maturity analysis - contractual undiscounted cash flows | |
| Less than one year | 6,579 |
| 1-5 years | 23,363 |
| Over 5 years | <u>11,922</u> |
| Total undiscounted lease liabilities at December 31 | <u>41,864</u> |
| Amounts recognized in profit or loss | |
| Interest on lease liabilities | 91 |
| Expenses relating to short-term, low-value and variable lease payments | <u>2,749</u> |
| | <u>2,840</u> |
| Amounts recognized in statement of cash flows | |
| Total cash outflow for leases | <u>11,651</u> |

b) Information about leases for which Foresters Financial is a lessor:

Foresters Financial leases out its owner-occupied property under operating leases to third-parties. The non-cancellable lease term varies by tenant and some leases include options to extend at the end of the lease term. Lease income is included in other operating income.

The following table sets out a maturity analysis of lease payments, showing the undiscounted lease payments to be received after the reporting date.

| | 2019 |
|--|---------------------|
| | \$ |
| Maturity analysis - contractual undiscounted cash flows | |
| Less than 1 year | 1,041 |
| 1 to 2 years | 811 |
| 2 to 3 years | 641 |
| 3 to 4 years | 554 |
| 4 to 5 years | 380 |
| More than 5 years | <u>801</u> |
| Total undiscounted lease payments | <u>4,228</u> |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

14. CAPITAL MANAGEMENT

Foresters Financial's capital base consists of retained earnings and AOCI as shown on the consolidated statement of changes in surplus.

Foresters Financial's objective with respect to capital management is to maintain a consistently strong capital position, to comply with local solvency requirements in all jurisdictions in which Foresters Financial operates and to build on Foresters Financial's value by taking advantage of business and investment opportunities as they arise.

In accordance with the Board approved Capital Management Policy, Foresters Financial has established internal capital targets for capital adequacy at both a consolidated and segment level. These targets exceed local minimum statutory capital requirements in each jurisdiction in which Foresters Financial operates. Foresters Financial projects its capital requirements over a five year period. On a quarterly basis, management monitors performance against internal capital targets and its capital plans, and initiates action when appropriate.

Annually, as part of DCAT, Foresters Financial assesses the strength of its capital position under plausible adverse scenarios including mitigating management actions. These scenarios reflect Foresters Financial's plans and risk profile.

In Canada, OSFI has established a capital adequacy measure for life insurance companies incorporated under the Act and their subsidiaries, known as the Life Insurance Capital Adequacy Test ("LICAT"). OSFI requires life insurance companies to maintain a minimum Core ratio of 55% and a Total ratio of 90%. OSFI has established supervisory target levels of 70% for Core and 100% for Total Capital.

The LICAT ratios as at December 31 shown below, were above the levels that would require any regulatory or corrective action.

| | | 2019 | 2018 |
|--|---|---------------------|---------------------|
| Available capital (A+B) | | \$ 1,989,948 | \$ 1,738,085 |
| Tier 1 Capital | A | 1,604,397 | 1,367,321 |
| Tier 2 Capital | B | 385,551 | 370,764 |
| Surplus allowance and eligible deposits | C | 1,031,017 | 936,363 |
| Base solvency buffer | D | 1,754,955 | 1,755,049 |
| Total ratio (%) | | | |
| ([A+B+C] / D) x 100 | | 172.14% | 152.39% |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

14. Capital management (continued)

Other capital management considerations

In 2016, Foresters entered into a 10 year reinsurance arrangement, the objective of which is to enhance US statutory solvency levels. There is no risk transfer under the arrangement and this has been accounted for as such resulting in a financial liability included in other liabilities (note 10) on the statement of financial position and a reinsurance financing fee included in operating expenses on the consolidated statement of comprehensive income.

Foresters Financial had a number of forward contracts to hedge against currency fluctuations to minimize the impact of U.S. dollar foreign currency gains and losses on the capital ratio. These instruments are accounted for as derivative financial instruments on the consolidated statement of financial position.

15. PREMIUMS

The following table provides a breakdown of gross premiums and premiums ceded under reinsurance arrangements from continuing operations by line of business:

| | 2019 | | | 2018 | | |
|-----------------|-------------|-------------|-----------|-------------|-------------|-----------|
| | Gross \$ | Ceded \$ | Net \$ | Gross \$ | Ceded \$ | Net \$ |
| Life and health | 1,094,333 | (139,050) | 955,283 | 1,047,565 | (112,195) | 935,370 |
| Annuities | 73,658 | 11 | 73,669 | 233,252 | (11) | 233,241 |
| | 1,167,991 | (139,039) | 1,028,952 | 1,280,817 | (112,206) | 1,168,611 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

16. FEE REVENUE AND OTHER OPERATING INCOME

Fee revenue and other operating income from continuing operations were comprised of the following:

| | 2019 | 2018 |
|---|----------------|----------------------|
| | \$ | (Re-presented) \$ |
| Fee revenue: | | |
| Management fees on segregated fund assets | 129,823 | 126,651 |
| Distribution and brokerage fees | 696 | 8 |
| Total fee revenue | 130,519 | 126,659 |
| Other operating income: | | |
| Transfers from accounts of segregated fund unit holders | 8,799 | 9,114 |
| Supplementary contract deposits (with life contingency) | 1,586 | 2,210 |
| Foreign currency gains (losses) | 2,461 | (528) |
| Net rental expense | (3,259) | (3,157) |
| Other | 1,839 | 4,029 |
| Total other operating income | 11,426 | 11,668 |

17. BENEFITS

The following table provides a breakdown of gross and ceded benefits from continuing operations by line of business:

| | 2019 | | | 2018 | | |
|---------------|----------------|-----------------|----------------|----------------|-----------------|----------------|
| | Gross | Ceded | Net | Gross | Ceded | Net |
| | \$ | \$ | \$ | \$ | \$ | \$ |
| Life & health | 750,390 | (80,190) | 670,200 | 697,294 | (53,217) | 644,077 |
| Fraternal | 3,711 | - | 3,711 | 4,033 | - | 4,033 |
| Annuities | 133,466 | (677) | 132,789 | 116,352 | (372) | 115,980 |
| | 887,567 | (80,867) | 806,700 | 817,679 | (53,589) | 764,090 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

18. OPERATING EXPENSES

A breakdown of operating expenses by nature is provided below:

| | 2019 | 2018 |
|--|----------------|-----------------------|
| | | <i>(Re-presented)</i> |
| | \$ | \$ |
| Employee benefits: | | |
| Salaries and benefits | 128,208 | 125,951 |
| Defined benefit pension and post-retirement plan expenses (note 7) | 16,374 | 12,054 |
| Defined contribution plan expenses (note 7) | 4,159 | 3,788 |
| | <u>148,741</u> | <u>141,793</u> |
| Service fees | 26,549 | 27,564 |
| Technology related fees | 39,099 | 36,280 |
| Professional and consulting fees | 17,458 | 18,322 |
| Software costs expensed during the year | 19,058 | 11,416 |
| Depreciation and amortization of property, equipment, leased assets and intangibles | 19,891 | 20,189 |
| Restructuring costs (note 10) | 7,200 | - |
| Other expenses | 18,304 | 14,832 |
| Total operating expenses | <u>296,300</u> | <u>270,396</u> |

Foresters Financial recovered commissions and operating expenses from reinsurers in the amount of \$52,995 (2018: \$28,842) and \$1,048 (2018: \$1,103) respectively.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

19. INCOME TAXES

Current and deferred taxes, included in income taxes on the consolidated statement of comprehensive income (loss), were as follows:

| | 2019 | 2018 <i>(Re-presented)</i> |
|---|---------------|--------------------------------------|
| | \$ | \$ |
| Current income tax recovery: | | |
| Current year | (919) | (6,487) |
| Deferred income tax expense (benefit): | | |
| Relating to the origination and reversal of temporary differences | 31,480 | (18,290) |
| Change in unrecognized deductible temporary differences | 4,448 | 11,931 |
| | <u>35,928</u> | <u>(6,359)</u> |
| Total income taxes expense (recovery) | <u>35,009</u> | <u>(12,846)</u> |

Cash taxes paid were \$54,183 (2018: \$41,745). Cash tax refunds received during the year were \$20,198 including \$83 in interest. (2018: Tax refunds of \$23,801 including \$77 in interest).

a) Income taxes included in OCI

Other comprehensive income (loss) is presented net of income taxes. The following current and deferred income tax amounts were included in each component of OCI:

| | 2019 | 2018 <i>(Re-presented)</i> |
|--|--------------|--------------------------------------|
| | \$ | \$ |
| Income tax expense on net change in unrealized gains and losses on AFS assets | (741) | (115) |
| Income tax recovery (expense) on reclassification of realized gains and losses on AFS Assets | 289 | (457) |
| Income tax expense on remeasurement gains and losses on employee benefit plans | (71) | (18) |
| Total income tax expense | <u>(523)</u> | <u>(590)</u> |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

19. Income taxes (continued)

b) Reconciliation of effective tax rate

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory tax rates to income before taxes for the following reasons:

| | 2019 | | 2018 (Re-presented) | |
|--|----------------|--------------|------------------------|--------------|
| | \$ | % | \$ | % |
| Net income (loss) after taxes | 89,769 | | (81,470) | |
| Income tax (recovery) expense | 35,009 | | (12,846) | |
| Income (Loss) from continuing operations before income taxes | 124,778 | | (94,316) | |
| Combined federal and provincial statutory income tax rate for the current year | 33,218 | 26.6% | (25,164) | 26.7% |
| Amounts not subject to tax | (8,159) | (6.5%) | 12,102 | (12.8%) |
| Unrecognized tax losses | 5,595 | 4.5% | 4,972 | (5.3%) |
| Tax adjustments related to prior years | (85) | (0.1%) | 3,589 | (3.8%) |
| Difference between Canadian and foreign statutory rates | (8,047) | (6.5%) | (1,862) | 2.0% |
| Policyholder taxes on U.K Ring Fenced Funds | 5,776 | 4.6% | (10,202) | 10.8% |
| De-recognition of deferred taxes | 4,448 | 3.6% | - | 0.0% |
| Other taxes | 2,263 | 1.8% | 3,719 | (3.9%) |
| Income tax (recovery) expense | 35,009 | 28.0% | (12,846) | 13.6% |

For 2019, income tax expense is equal to 28.0% of income before income taxes from continuing operations. For 2018, income tax recovery is equal to 13.6% of loss before income taxes from continuing operations.

c) Deferred income taxes

In certain instances, the tax basis of assets and liabilities differs from the carrying amount in the consolidated financial statements. These differences will give rise to deferred income tax assets and liabilities.

Deferred tax assets and liabilities were shown on the consolidated statement of financial position. The following table shows net deferred tax assets at December 31:

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

19. Income taxes (continued)

| | 2019 | 2018 |
|---|--------------|---------------|
| | \$ | \$ |
| Deferred tax assets | 15,027 | 32,512 |
| Deferred tax liabilities | 30,571 | 2,603 |
| Subtotal | (15,544) | 29,909 |
| Less: Reclassification to liabilities held for sale (note 22) | (21,200) | - |
| Net deferred tax assets | 5,656 | 29,909 |

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when deferred tax assets and liabilities relate to income taxes levied by the same taxation authority on the taxable entity.

The following chart shows the underlying assets and liabilities corresponding to net deferred income tax assets and liabilities:

| | 2019 | | | 2018 | | |
|---|---------------|-----------------|--------------|---------------|-----------------|---------------|
| | Asset \$ | Liability \$ | Net \$ | Asset \$ | Liability \$ | Net \$ |
| Bonds | - | (20,456) | (20,456) | 1,021 | - | 1,021 |
| Loans to certificate holders | | | | | | (10,790) |
| Other invested assets | - | (10,666) | (10,666) | - | (10,790) |) |
| Property and equipment | 199 | (767) | (568) | - | (2,972) | (2,972) |
| Employee benefit assets and obligations | 2,246 | - | 2,246 | 6,496 | (2,684) | 3,812 |
| Insurance contract liabilities | 15,427 | - | 15,427 | 8,119 | - | 8,119 |
| Other liabilities | 539 | (6,930) | (6,391) | 10,208 | - | 10,208 |
| Tax loss carry-forwards | 18,803 | - | 18,803 | 23,407 | - | 23,407 |
| Subtotal | 37,214 | (52,758) | (15,544) | 49,251 | (19,342) | 29,909 |
| Less: reclassification to held for sale liabilities (note 22) | (2,259) | 23,459 | (21,200) | - | - | - |
| Recognized deferred tax assets (liabilities) | 34,955 | (29,299) | 5,656 | 49,251 | (19,342) | 29,909 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

19. Income taxes (continued)

The net movement in the deferred tax assets and liabilities was as follows:

| | 2019 | 2018 |
|---|--------------|---------------|
| | \$ | \$ |
| Beginning of year | 29,909 | 21,694 |
| (Charges) credits included in net income | (44,311) | 8,285 |
| (Charges) credits included in OCI | (104) | (669) |
| | (14,506) | 29,310 |
| Exchange rate differences | (1,038) | 599 |
| Less: Reclassification to held for sale liabilities (note 22) | (21,200) | - |
| End of year | 5,656 | 29,909 |

Recognized deferred tax assets

There were accumulated tax losses in the U.K. amounting to \$13,765 (2018: \$17,403) which have been recognized in these consolidated financial statements. These losses do not expire.

Unrecognized deferred tax assets

Deferred tax assets have not been recognized in respect of the following items:

| | 2019 | 2018 |
|--|-------------|-------------|
| | \$ | \$ |
| Deductible temporary differences | - | 369 |
| Tax losses, credits and unclaimed deductions | 40,213 | 32,857 |
| | 40,213 | 33,226 |

Deferred income tax assets are recognized for tax losses, credits and unclaimed deductions carried forward to the extent that the realization of the future tax benefit through future taxable profits is probable.

There were unclaimed tax deductions in Canada amounting to \$132,722 (2018: \$106,281) which have not been recognized in these consolidated financial statements as it is not probable that future taxable income will be available against which to apply these deductions. These unclaimed deductions do not expire.

There were unclaimed tax credits amounting to \$4,451 (2018: \$0) that have not been recognized in the consolidated financial statements as it is not probable that future taxable income will be available against which to apply these deductions. These unclaimed deductions expire beginning in 2035 through 2040.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

19. Income taxes (continued)

d) Taxable income in Canada

The Canada Revenue Agency ("CRA") reassessed Foresters 2014 taxation year to add approximately \$25.4 million in additional income by increasing the level of assets it considers to be used in Foresters Canadian insurance business and consequently adding to income the gross investment revenue on these assets. In December 2018, Foresters filed a Notice of Appeal to this reassessment with the Tax Court of Canada. This matter is now in litigation. It is possible that subsequent years may be reassessed in a similar manner. Foresters intends to defend its tax filing positions vigorously. Accordingly, no amounts have been accrued in the consolidated financial statements.

20. SEGMENTED INFORMATION

Foresters Financial has four reportable segments - three operating segments and a corporate segment - which reflect Foresters Financial's internal management structure and basis for internal financial reporting. Each operating segment includes branch operations and/or subsidiary companies, is organized to meet the needs of local markets and is responsible for developing its own products. The Corporate segment manages surplus assets, provides certain administrative services for the operating segments and is responsible for capital management. NAAM was discontinued during 2019 as described in note 21. The primary sources of revenue from the operating segments in North American Insurance and UKSIP are:

- premium income derived from life and health insurance products that provide protection against mortality and morbidity risks, as well as annuity products that provide asset accumulation or wealth management benefits,
- net investment income (note 3), and
- fee and other income derived primarily from investment management services (note 16).

The primary source of revenue in the Corporate segment is investment income derived from managing the surplus assets. In addition, Foresters Financial has a membership operation which works closely with the insurance operations in all three countries to develop and administer member benefits.

Segment profits are based on internal management statements and are used to measure performance as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries. All transactions between reporting segments are completed on an arm's length basis and consist of operational services provided. Consolidated segmented statements of comprehensive income and financial position are shown below.

There is a widely diversified certificate holder base and therefore no reliance on any individual customers.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

20. Segmented information (continued)

Segmented statement of comprehensive income

| | 2019 | | | | Total Continuing Operations | North American Asset Management (discontinued) |
|--|--------------------------|--|------------|-----------|-----------------------------|--|
| | North American Insurance | U.K. Savings, Investments and Protection | Membership | Corporate | | |
| Revenue | | | | | | |
| Gross written premiums | \$ 1,125,091 | \$ 42,148 | \$ 752 | \$ - | \$ 1,167,991 | \$ - |
| Ceded premiums | (137,960) | (1,079) | - | - | (139,039) | - |
| Net written premiums | 987,131 | 41,069 | 752 | - | 1,028,952 | - |
| Net investment income | 883,426 | 77,821 | 21,094 | 14,754 | 997,095 | 2,033 |
| Fee revenue | 42,634 | 87,885 | - | - | 130,519 | 180,962 |
| Other operating income (loss) | 7,579 | 1,386 | - | 2,461 | 11,426 | 2,348 |
| Total revenue | 1,920,770 | 208,161 | 21,846 | 17,215 | 2,167,992 | 185,343 |
| Total benefits and expenses | 1,857,077 | 165,548 | 15,901 | 4,688 | 2,043,214 | 256,233 |
| Net income (loss) before income taxes | 63,693 | 42,613 | 5,945 | 12,527 | 124,778 | (70,890) |
| Income taxes | 20,287 | 14,722 | - | - | 35,009 | (1,296) |
| Net income (loss) | 43,406 | 27,891 | 5,945 | 12,527 | 89,769 | (69,594) |
| Gain on sale of discontinued operations | - | - | - | - | - | 72,574 |
| Other comprehensive income (loss) | (28,786) | 7,539 | (1,639) | (2,283) | (25,169) | - |
| Total comprehensive income (loss) | \$ 14,620 | \$ 35,430 | \$ 4,306 | \$ 10,244 | \$ 64,600 | \$ 2,980 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

20. Segmented information (continued)

| | 2018 | | | | Total Continuing Operations | North American Asset Management (discontinued) |
|--|--------------------------|--|-------------|-------------|-----------------------------|--|
| | North American Insurance | U.K. Savings, Investments and Protection | Membership | Corporate | | |
| Revenue | | | | | | |
| Gross written premiums | \$ 1,230,363 | \$ 49,659 | \$ 795 | \$ - | \$ 1,280,817 | \$ - |
| Ceded premiums | (110,967) | (1,239) | - | - | (112,206) | - |
| Net written premiums | 1,119,396 | 48,420 | 795 | - | 1,168,611 | - |
| Net investment income | (88,066) | (26,594) | (2,742) | (14,925) | (132,327) | (904) |
| Fee revenue | 42,047 | 84,701 | - | (89) | 126,659 | 295,738 |
| Other operating income (loss) | 10,592 | 1,604 | - | (528) | 11,668 | 1,963 |
| Total revenue | 1,083,969 | 108,131 | (1,947) | (15,542) | 1,174,611 | 296,797 |
| Total benefits and expenses | 1,153,707 | 84,038 | 21,996 | 9,186 | 1,268,927 | 325,692 |
| Net income (loss) before income taxes | (69,738) | 24,093 | (23,943) | (24,728) | (94,316) | (28,895) |
| Income taxes | (14,389) | 1,543 | - | - | (12,846) | 6,566 |
| Net income (loss) | (55,349) | 22,550 | (23,943) | (24,728) | (81,470) | (35,461) |
| Other comprehensive income (loss) | 111,416 | (2,623) | 5,219 | (6,931) | 107,081 | - |
| Total comprehensive income (loss) | \$ 56,067 | \$ 19,927 | \$ (18,724) | \$ (31,659) | \$ 25,611 | \$ (35,461) |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

20. Segmented information (continued)

Segmented statement of financial position

| | North American Insurance | North American Asset Management (discontinued) | U.K. Savings, Investments and Protection | Membership | Corporate | Total | Held for Sale Assets |
|---|--------------------------------|--|--|------------|-----------|------------|-------------------------|
| As at December 31, 2019 | | | | | | | |
| Total general fund assets | 7,277,053 | 174,095 | 1,313,404 | 182,140 | 101,372 | 9,048,064 | 1,735,777 |
| Net investments for accounts of segregated fund unit holders | 83,049 | - | 5,712,776 | - | - | 5,795,825 | 1,940,753 |
| Total general fund liabilities | 5,830,697 | 132,554 | 1,074,217 | 188,402 | 4,226 | 7,230,366 | 1,467,440 |
| As at December 31, 2018 | | | | | | | |
| Total general fund assets | 8,376,603 | 195,082 | 1,340,629 | 197,477 | 39,574 | 10,149,365 | - |
| Net investments for accounts of segregated fund unit holders | 1,870,042 | - | 5,764,972 | - | - | 7,635,014 | - |
| Total general fund liabilities | 6,664,171 | 115,258 | 1,121,458 | 218,981 | 11,042 | 8,130,910 | - |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

20. Segmented information (continued)

The following table shows revenue from continuing operations for Foresters Financial by country:

| | 2019 | 2018 |
|--------------|------------------|------------------|
| | \$ | \$ |
| U.S | 1,549,955 | 860,092 |
| Canada | 408,987 | 206,028 |
| U.K | 209,050 | 108,491 |
| Total | 2,167,992 | 1,174,611 |

21. DISCONTINUED OPERATIONS

In 2019, Foresters Financial sold assets from the NAAM segment including the sale of its Canadian subsidiary, Foresters Asset Management Inc. ("FAM"). Management committed to a plan to exit this segment following a strategic decision to place greater focus on the company's core business of life insurance. As a result, NAAM's financial results are disclosed as discontinued operations in the consolidated statement of comprehensive income (loss). There were 3 separate transactions:

- 1) Select assets from the broker dealer and advisory business of Foresters Financial Services, Inc. ("FFS") were sold to Cetera Financial Group.
- 2) 100% of the outstanding shares of Foresters Canadian asset management business, FAM, were sold to Fiera Capital.
- 3) Foresters sold assets related to its investment management business through Foresters Investment Management Company, Inc. ("FIMCO") to Macquarie Investment Management.

The NAAM segment was not previously classified as held-for-sale or as a discontinued operation. The comparative consolidated statement of comprehensive income (loss) has been re-presented to show the discontinued operation separately from continuing operations.

a) Results of discontinued operations

| | 2019 | 2018 |
|---|-----------------|-----------------|
| | \$ | \$ |
| Fee revenue | 185,343 | 296,797 |
| Expenses | 256,233 | 284,927 |
| Impairment on goodwill and intangibles | - | 40,765 |
| Results from operating activities | (70,890) | (28,895) |
| Income tax | (1,296) | 6,566 |
| Results from operating activities, net of tax | (69,594) | (35,461) |
| Gain on sale of discontinued operations | 143,665 | - |
| Income tax on gain on sale of discontinued operations | 71,091 | - |
| Net income (loss) from discontinued operations, net of tax | 2,980 | (35,461) |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

21. Discontinued operations (continued)

b) Cash flows from (used in) discontinued operations

The net cash flows from discontinued operations included in the consolidated statement of cash flows were as follows:

| | 2019 | 2018 |
|--|---------------|----------------|
| | \$ | \$ |
| Net cash used in operating activities | (274,334) | (7,705) |
| Net cash from investing activities | 305,353 | 2,903 |
| Net cash used in/from financing activities | (7,155) | - |
| Net cash flows for the year | 23,864 | (4,802) |

c) Effect of disposal of a subsidiary on the financial position

The sale of FAM had the following impact on the consolidated statement of financial position:

| | 2019 |
|-----------------------------------|--------------|
| | \$ |
| Cash | 4,499 |
| Deferred sales charges | 1,460 |
| Other assets | 1,557 |
| Employee benefit obligations | (3,046) |
| Other liabilities | (2,288) |
| Net assets and liabilities | 2,182 |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

22. DISPOSAL GROUP HELD FOR SALE

On October 17, 2019, Foresters Financial entered into a definitive agreement with Nassau Financial Group, L.P. for the sale of Foresters Financial Holding Company, Inc. ("FFHC Holdco") and its subsidiary Foresters Life Insurance and Annuity Company ("FLIAC"). Accordingly, FFHC Holdco and FLIAC are presented as a disposal group held for sale. FFHC Holdco and FLIAC are part of continuing operations and fully consolidated in the consolidated statement of comprehensive income (loss). The transaction is expected to close in the first half of 2020 and is subject to customary closing conditions including regulatory approval by the New York State Department of Financial Services. FLIAC is part of Foresters Financial's North American Insurance reporting segment that focuses on selling life insurance products.

Assets and liabilities of disposal group held for sale

At December 31, 2019, the disposal group was stated at carrying value and comprised the following assets and liabilities.

| | 2019 |
|---|------------------|
| | \$ |
| Cash | 22,141 |
| Investments | 1,486,709 |
| Loans to certificate holders | 144,272 |
| Reinsurance assets | 3,733 |
| Deferred acquisition costs | 52,825 |
| Accruals and receivables | 17,329 |
| Property and equipment | 73 |
| Other assets | 8,695 |
| Subtotal | <u>1,735,777</u> |
| Net investments for accounts of segregated fund unit holders | <u>1,940,753</u> |
| Assets held for sale | <u>3,676,530</u> |
| Insurance contract liabilities | 1,426,211 |
| Investment contract liabilities | 9,413 |
| Deferred tax liabilities | 21,200 |
| Benefit payable & provision for unreported claims | 6,446 |
| Other liabilities | 4,170 |
| Subtotal | <u>1,467,440</u> |
| Investment contract liabilities for accounts of segregated fund unit holders | <u>1,940,753</u> |
| Liabilities held for sale | <u>3,408,193</u> |
| Accumulated other comprehensive income | <u>20,332</u> |

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

23. RELATED PARTY TRANSACTIONS

Foresters Financial's broker-dealer and insurance subsidiaries provide distribution services to Foresters Financial. Additionally, Foresters Financial provides certain administrative services to some of its subsidiaries in the normal course of business. All fees paid and costs incurred for the transactions are determined on an arm's length basis. Transactions between Foresters Financial and its subsidiaries, which are related parties have been eliminated on consolidation and have not been disclosed in this note.

Management has established procedures to review and approve transactions with related parties and reports annually to various committees of the Board on the procedures followed and the results of the review.

There are no loans or guarantees provided by Foresters Financial to related parties.

a) Compensation of key management personnel

Foresters Financial's key management personnel are those individuals that have the authority and responsibility for planning, directing and controlling the activities of the organization. Key management personnel are comprised of directors and executive officers of Foresters Financial. The remuneration of key management personnel was as follows:

| | 2019 | 2018 |
|---|---------------|---------------|
| | \$ | \$ |
| Salaries and other short-term employee benefits | 27,351 | 24,371 |
| Post-employment benefits | 1,587 | 1,426 |
| Other long-term benefits | 2,076 | 2,374 |
| Termination benefits | 4,890 | 4,279 |
| Total compensation of key management personnel | 35,904 | 32,450 |

b) Interests in investment funds managed by Foresters Financial

Foresters Financial, through its subsidiary FFHC, managed a number of proprietary mutual funds originating in the U.S. FFHC is considered an agent in accordance with the guidance under IFRS 10 as there are substantive removal rights under the advisory agreement and the management fee received by FFHC is commensurate with the services provided. During 2019, all investment funds managed by FFHC were sold as discussed in Note 21.

c) Seed money in segregated funds

Foresters Financial manages and administers segregated funds established by The Independent Order of Foresters. As manager, Foresters Financial is responsible for the provision of all general management and administrative services required by the segregated funds in their day-to-day operations, including providing or arranging for the provision of investment advice, bookkeeping, recordkeeping and other administrative services.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

23. Related party transactions (continued)

In 2019, Foresters Financial redeemed seed investment units totaling \$194 (2018: \$29,403).

24. CONTRACTUAL OBLIGATIONS AND COMMITMENTS

In the normal course of business, Foresters Financial enters into contracts that give rise to obligations fixed by agreement as to the timing and dollar amount of payment. As at December 31, 2019, Foresters Financial's contractual obligations and commitments were as follows:

| | 1 year or less | 2 -5 years | Over 5 years | Total |
|-------------------------------------|----------------|------------|--------------|---------|
| | \$ | \$ | \$ | \$ |
| Obligations under service contracts | 35,084 | 59,478 | 3,117 | 97,679 |
| Investment commitment | 9,338 | 2,759 | - | 12,097 |
| Total contractual obligations | 44,422 | 62,237 | 3,117 | 109,776 |

25. CONTINGENT LIABILITIES

From time to time in connection with its operations, Foresters Financial and its subsidiaries are named as defendants in actions for damages and costs allegedly sustained by the plaintiffs. Based on information presently known, it is not expected that existing legal actions, either individually or in the aggregate, will have a material adverse effect on Foresters Financial's consolidated statement of financial position.

Notes to consolidated financial statements

For the year ended December 31, 2019 (amounts in thousands of Canadian dollars except where otherwise stated)

26. PRINCIPAL SUBSIDIARIES

The table below provides a list of Foresters Financial's principal subsidiaries, all of which have been fully consolidated.

| Name | Country of incorporation | Primary business operation | Ownership and control interest (%) | |
|---|--------------------------|---|------------------------------------|------|
| | | | 2019 | 2018 |
| Foresters Financial Holding Company, Inc. | U.S | Insurance Operations | 100% | 100% |
| Foresters Equity Services Inc. | U.S | Investment broker | - | 100% |
| Foresters Life Insurance Company | Canada | Insurance Operations | 100% | 100% |
| Sylvan Agency (Canada) Inc. | Canada | Insurance broker | 100% | 100% |
| Forester Holdings (Europe) Limited | U.K | Insurance and asset management operations | 100% | 100% |

There is no non-controlling interest in any of the subsidiaries and there are no significant restrictions that affect the ability to access or use the assets and settle the liabilities of any subsidiary. Foresters Financial is not obligated contractually to provide financial support to these entities.

Foresters Equity Services Inc. ceased to operate and was dissolved during 2019.

27. SUBSEQUENT EVENT

On January 17, 2020, Foresters Financial, through its subsidiary Forester Holdings (Europe) Limited, signed an agreement to acquire the Child Trust Fund business of Halifax, a member of the Lloyds Banking Group. The transaction will add approximately 470,000 policyholders and increase the assets under management by an estimated \$1.3 billion. The transaction is expected to close on April 10, 2020.

28. COMPARATIVE INFORMATION

Certain comparative amounts have been reclassified to conform to the financial statement presentation adopted in 2019.