Financial Statements of

SISIP FS

Year ended December 31, 2013

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INDEPENDENT AUDITORS' REPORT

To the Non-Public Property Board

We have audited the accompanying financial statements of SISIP – FS, which comprise the balance sheet as at December 31, 2013, the statements of operations, cash flows and surplus for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian accounting standards for private enterprises, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of SISIP – FS as at December 31, 2013, and its results of operations and cash flows for the year then ended in accordance with Canadian accounting standards for private enterprises.

Comparative information

The financial statements of SISIP – FS as at and for the year ended December 31, 2012 are unaudited. Accordingly, we do not express an opinion on them.

KPMG LLP

Chartered Accountants

October 21, 2014

Halifax, Canada

SISIP FS

Balance Sheet
(in thousands of dollars)

December 31, 2013, with comparative information for 2012

	2013	2012
		(Unaudited)
Assets		
Current Assets		
Cash	21	38
Trade accounts receivable	60	6
Work in progress	4	1
Prepaid expenses	64	60
	149	105
Other Assets		
Segregated funds (note 4)	322,039	303,678
Net plan assets (note 3)	53,549	12,304
	375,737	316,087
Property and equipment, net of amortization (note 5)	194	219
Total Assets	**$ 375,931**	**$ 316,306**
Liabilities and Surplus		
Current Liabilities		
Accounts payable and accrued liabilities (note 6)	3,509	3,547
Surplus (note 7)	372,422	312,759
Commitments (note 12)		
Total Liabilities and Surplus	**$ 375,931**	**$ 316,306**

See accompanying notes to financial statements.

SISIP FS

Statement of Operations
(in thousands of dollars)

Year ended December 31, 2013, with comparative information for 2012

	2013	2012
		(Unaudited)
Revenues:		
Financial Planning services (Schedule A)	$ 6,135	$ 6,163
Gain on segregated funds	19,192	15,409
Change in value of net plan assets (Schedule B)	44,980	21,711
	70,307	43,283
Expenses:		
Financial Planning services and administration (Schedule A)	6,663	6,857
Investment management fees	831	788
Grant to Morale and Welfare programs	3,150	3,200
	10,644	10,845
Net Income	**$ 59,663**	**$ 32,438**

See accompanying notes to financial statements.

SISIP FS

Statement of Cash Flows
(in thousands of dollars)

Year ended December 31, 2013, with comparative information for 2012

	2013	2012
		(Unaudited)
Cash provided by (used in):		
Operations:		
Income for the year	$ 59,663	$ 32,438
Items not involving cash:		
Unrealized segregated fund income, net of expense	(18,361)	(14,621)
Unrealized income from net plan assets	(44,980)	(21,711)
Amortization	51	57
Change in non-cash operating working capital:		
Decrease (increase) in trade accounts receivable	(54)	5
Increase in work in progress	(3)	
Increase in prepaid expenses	(4)	(1)
Decrease in accounts payable and accrued liabilities	(38)	(205)
	(3,726)	(4,038)
Investments:		
Proceeds from withdrawal of net assets	3,735	3,889
Purchase of property and equipment	(26)	(32)
	3,709	3,857
Decrease in cash	(17)	(181)
Cash, beginning of year	38	219
Cash, end of year	**$ 21**	**$ 38**

See accompanying notes to financial statements.

SISIP FS

Statement of Surplus
(in thousands of dollars)

Year ended December 31, 2013, with comparative information for 2012

	2013	2012
		(Unaudited)
Surplus, beginning of year	$ 312,759	$ 280,321
Net income	59,663	32,438
Surplus, end of year	**$ 372,422**	**$ 312,759**

See accompanying notes to financial statements.

SISIP FS

Schedule A - Statement of Operations of Financial Planning
(in thousands of dollars)

Year ended December 31, 2013, with comparative information for 2012

	2013	2012 (Unaudited)
Revenues:		
Financial counseling and education	$ 3,093	$ 3,602
Commissions	2,108	1,744
Subscriptions	786	696
Income tax returns	122	113
Interest income	26	8
	6,135	6,163
Expenses:		
Payroll and benefits	5,488	5,717
Mutual fund management fees	346	317
Lease payments	304	309
Office expenses	112	114
Communications	70	73
Travel	67	65
Amortization	51	58
Cleaning services	48	49
Temporary work contracts	37	18
Advertising and printing	36	32
Other expenses	32	30
License fees	29	31
Insurance liabilities and property	18	17
Training	12	9
Repairs and maintenance	7	12
Personnel education program	6	6
	6,663	6,857
Loss for the year	**$ (528)**	**$ (694)**

See accompanying notes to financial statements.

SISIP FS

Schedule B – Change in Net Assets – SISIP Proper
(in thousands of dollars)

Year ended December 31, 2013, with comparative information for 2012

	2013	2012
		(Unaudited)
Premium income (note 2)	$ 65,734	$ 63,090
Interest credited (notes 2 and 3)	18,040	11,957
Total revenues	83,774	75,047
Operating expenses:		
Claims and related expenses	44,429	39,822
Other operating expenses	3,796	4,291
Reinsurance	2,813	4,176
Policy administrations expenses	1,564	1,507
Premium and sales tax	1,426	1,400
Reserve increase – plan experience	1,006	3,440
Prior year adjustment	9	(151)
Premium tax adjustment	(926)	21
Total operating expenses	54,117	54,506
Income from operations	29,657	20,541
Other items:		
Reserve decrease – assumption changes (note 2 and 3)	15,323	1,170
Net change in assets	**$ 44,980**	**$ 21,711**

See accompanying notes to financial statements.

1. Nature of operations:

Service Income Security Insurance Financial Services ("SISIP FS") is a commercial activity of the Canadian Forces Morale and Welfare Services ("CFMWS") operating under the authority of the Chief of the Defence Staff ("CDS") in his Non-Public Property ("NPP") capacity. Responsibility for directing the affairs of SISIP FS rests with the Director General Morale and Welfare Services as delegated by the CDS. Operations are divided between SISIP FS–Proper ("SISIP Proper") and SISIP FS – Financial Planning ("SISIP FP") (see schedule A).

SISIP Proper provides financial products and services to Canadian Forces' members and their families to enhance the financial well-being of the Canadian Forces community through tailored and unbiased financial solutions; thereby contributing to operational readiness and effectiveness. SISIP Proper, provides the following products: Survivor Income Benefit (SIB), Dependent Life (DL), Optional Group Term Insurance (OGTI), Insurance for Released Members (IRM), Coverage After Release (CAR), Reserve Term Insurance Plan (RTIP), Spousal Disability Plan (SDP) and Optional General Officers Insurance Plan (Opt GOIP) (the "Plans"). The Plans are managed by The Manufactures Life Insurance Company ("Manulife") based on a Financial and Operations Agreement (the "Agreement") between the Chief of the Defence Staff of the Canadian Forces ("CDS") and Manulife. The CDS has surplus under the Plans with Manulife for the purpose of funding the payment of claims under the plans. Should these funds not be sufficient to discharge all claims, CDS is responsible for funding the deficit.

Manulife is the Insurer of the insurance program and provides administration services such as premium review, claims adjudication and the payment of lump-sum and monthly benefits for the Plans. However SISIP FS and the CDS have the right to make adjudication decisions as they determine needed.

SISIP FS is responsible for managing the program and working with the various stakeholders to ensure excellence in customer service to their Canadian Forces clients. Along with some administration functions, SISIP FS is responsible to ensure that the Plans are being administered in accordance with contractual provisions and they are on a sound financial footing.

1. Nature of operations (continued):

SISIP FP provides military personnel and their families with:

1. nationwide access to the services of a Certified Financial Planner (CFP), including access to a complete financial plan and investment services;

2. financial counseling services to help the Canadian Forces (CF) members to develop and manage budgets, alleviate a difficult financial situation or simply provide advice when members have to make important financial decisions; and

3. professional personal financial education services to military recruits and officer cadets so they become familiar with key financial management principles, such as using credit with the help of a budget, and also provides training to those attending junior and intermediate leadership schools.

The Canadian Forces Central Fund ("CFCF") is a separate entity under the directional responsibility of the NPP Board, provides banking services and financial assistance to NPP entities and has responsibility for SISIP FS.

The plans are exempt from paying income taxes under Part 1 of the Income Tax Act.

2. Significant accounting policies:

(a) Basis of presentation:

The financial statements are prepared in accordance with the Canadian generally accepted accounting principles for private enterprises with the exception of the Coverage After Release (CAR) paid-up policy and Supplementary Survivor Benefit (SSB) for which no future premium payment will be made. Under Canadian generally accepted accounting principles for private enterprises these are liabilities in determining the net plan assets or liabilities. SISIP FS does not recognize a liability for these coverages until the plan member is entitled to an issued policy. This is consistent with the treatment of the benefits under the Agreement. The estimated value of these claims has been disclosed as a commitment in note 12.

2. Significant accounting policies (continued):

(b) Financial Instruments:

(i) Initial measurement:

Financial instruments are measured at fair value on origination or acquisition. Transaction costs are recognized in net income in the period incurred.

(ii) Subsequent to initial recognition:

Investments in segregated funds are measured at fair value. Changes in fair value are recognized in net income in the period incurred. Fair value of the segregated funds is determined based on its net asset value which approximates fair value. Accounts payable are measured at cost.

(c) Property and equipment:

Property and equipment are stated at cost, less accumulated amortization. Amortization is provided using the following methods and annual rates:

Asset	Basis	Rate
Furniture and fixtures	Straight-line	12%
Computer equipment	Straight-line	24%
Leasehold improvements	Straight-line	9%

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and exceeds its fair value.

2. Significant accounting policies (continued):

(d) Revenue recognition:

Revenues are recorded in the period in which they are earned, collection of any related amounts receivable is probable, per service evidence of an arrangement exists and the sales price is fixed and determinable. Unearned amounts for which material program benefits or services have yet to be delivered are recorded as deferred revenue.

(e) Employee future benefits:

Substantially all employees of SISIP FS are entitled to a defined benefit pension plan. The cost of the defined benefit plan is recognized based on the contributions required during each period.

(f) Net plan assets and liabilities

Under the terms of the Agreement, SISIP Proper is required to fund all liabilities associated with the Plans. Funds are held on deposit by Manulife which are used to discharge these liabilities. Funds held on deposit are required to be held until all liabilities are discharged and Manulife has the legal right under the Agreement to use these funds in discharging the liabilities before SISIP Proper can withdraw the funds. As a result, the difference between the estimated liabilities and funds held on deposit presented net as either assets or liabilities.

The net plan assets and liabilities are measured at each reporting period as the difference between the plan reserves and plan investments.

The Plan reserves are measured by estimating the actuarial determined liabilities for the Plans plus an amount for a Claims Fluctuations Reserve (“CFR”) (note 3) required under the Agreement. Canadian standards for private enterprises do not have guidance in determining these liabilities. As a result SISIP Proper follows IFRS 4, Insurance Contracts in determining the measurement plan reserves. The Plan reserves were determined in accordance with the standards established by the Canadian Institute of Actuaries. Manulife’s plan reserves have been determined using the Canadian Asset Liability Method (“CALM”). Changes in the liabilities are recorded in the statement of operations when incurred.

The Plan investments represent the cumulative of incomes in excess of expenditures before considering Plan reserves.

2. Significant accounting policies (continued):

(g) Premium income and related expenses:

Gross premiums for all types of insurance contracts, and contracts with limited mortality or morbidity risk, are recognized as revenue when due.

Expenses are recognized when incurred. Plan assets and liabilities are computed at the end of each year, resulting in benefits and expenses being matched with the premium income.

(h) Interest credited:

Interest is credited to the Plans for plan investments based on an interest crediting formula defined in the Agreement. The formula is based on the actual return of a predetermined asset mix.

(i) Use of estimates:

The preparation of these financial statements requires Manulife and SISIP FS to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Significant items subject to such estimates and assumptions include the net funds on deposit/net plan liability. Actual results could differ from those estimates.

3. Net plan assets and liabilities:

The net plan assets represent the following held by Manulife:

	2013	2012
Plan reserves	$ (204,401)	$ (218,717)
Plan investments	257,950	231,021
Net plan assets	$ 53,549	$ 12,304

SISIP FS is entitled to any surplus once all obligations under the Plan have been paid. Also, should the Plan be in a deficit position, SISIP FS is responsible to fund the liability.

Actuarial reserves used in the determination of plan liabilities are calculated by Manulife based on the methodology described in note 2(f). Assumptions used by Manulife to determine the reserves are only changed after proper notice has been given to SISIP FS.

3. Net plan assets and liabilities (continued):

The determination of the actuarial reserves included in plan liabilities involves the use of estimates and assumptions which are comprised of two major components; a best estimated amount and a provision for adverse deviation. In conjunction with prudent business practices to manage both business and investment risks, the selection and monitoring of appropriate assumptions are designed to minimize SISIP Proper's exposure to measurement uncertainty.

Best estimate assumptions are made with respect to mortality and morbidity, investment returns, rates of policy termination, operating expenses and certain taxes. Actual experience is monitored to ensure that the assumptions remain appropriate and assumptions are changed as warranted.

The assumptions made in establishing actuarial reserves reflect expected best estimates of future experience. To recognize the uncertainty in these best estimate assumptions, to allow for possible under or over estimation of and deterioration in experience and to provide a greater degree of assurance that actuarial reserves are adequate to pay future benefits, SISIP Proper is required to include a margin in each assumption.

Minimum requirements are prescribed by the Canadian Institute of Actuaries for determining margins related to interest rate risk. Specific guidance is also provided for other risks such as market, credit, mortality and morbidity risks. For other risks which are not specifically addressed by the Canadian Institute of Actuaries, a range is provided of five per cent to 20 per cent of the expected experience assumption. Annual assumptions used are within the permissible ranges, with the determination of the level set taking into account the risk profile of the business. On occasion, in specific circumstances for additional prudence, a margin may exceed the high end of the range, which is permissible under the Standards of Practice. Each margin is reviewed annually for continued appropriateness.

The Agreement defines the requirements for SISIP Proper to fund any Plan shortfalls and when SISIP Proper is entitled to withdraw the plan assets. SISIP Proper is required to maintain a CFR up to 25% of the Plan premiums. The CFR restricts SISIP Proper from withdrawing surplus from the Plan.

(in thousands of dollars)

4. Segregated funds:

SISIP Proper's surplus assets are held in a segregated fund. The fund value is presented at fair value and any unrealized gains or losses are recorded in the statement of income in the period in which the change occurs. The segregated assets are invested in accordance with the guidelines set out in the investment policy developed by SISIP FS. The investment policy has set targeted investment mix of cash 5%, bonds 70%, Canadian equity 15%, US large equity 3.3% and international equity 6.7%. The actual allocation of the funds is as follows:

	2013	2012
Cash	**1.7%**	1.8%
Bonds	**64.4**	69.1
Canadian Equity	**22.2**	19.8
US Large Equity	**4.7**	3.6
International Equity	**7.0**	5.7
	100.0%	100.0%

5. Property and equipment:

			2013	2012
	Cost	Accumulated amortization	Net book value	Net book value
Furniture and fixtures	$ 168	$ 127	$ 41	$ 47
Computer equipment	101	68	33	24
Leasehold improvement	432	312	120	148
	$ 701	$ 507	$ 194	$ 219

6. Accounts payable:

Accounts payable in the amounts of $3,400 are due to CFMWS and have not set terms of repayment. The remaining $109 represents trade payables.

7. Surplus:

SISIP FS is restricted from the withdrawal of surplus funds under the Agreement. In addition to the restriction required for the CFR (note 3), SISIP Proper is required under the Reinsurance Funding Agreement to maintain a minimum of $260,000 of surplus and CFCF has committed $100,000 to cover claims in excess of reinsurance coverage made in relation to hostile events (as defined under the Agreement). SISIP FS must provide Manulife with at least nine months notice should it intend to reduce the surplus below $260,000.

8. Pension plans:

Substantially all employees of SISIP FS are eligible to be members of the Non-Pulic Funds Employees Pension Plan (“The Plan”), The Plan is a defined benefit pension plan which provides retirement benefits related to contributions and years of service. The Plan is considered a multi-employer defined benefit plan for accounting purposes. Contributions to the plan are made by non-public funds (NPF) on behalf of SISIP FS and SISIP FS reimburses NPF for the full cost of the contributions. These payments are included in payroll and benefits expense and are expensed as incurred.

9. Related party transactions:

In 2013, the SISIP FS paid lease expenses of $184 (2012 - $182) to CANEX, an entity part of Canadian Forces Morale and Welfare Services. All revenue in 2013 and 2012 from financial counseling and education services is received from the Department of National Defence, operating under the authority of the Chief of the Defence Staff.

All transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

10. Risk management:

SISIP FS faces a variety of risks in conducting its businesses. Management has developed policies and procedures to enable it to respond to these risks. Management approves the overall risk management policies including insurance policy limits and reinsurance limits. Management also approves policies related to product design; reviews policies with respect to marketing, pricing, and customer service level. In addition, management reviews policies covering investment risk including asset mix, interest rate risk, and asset/liability matching. Finally, management reviews the regulatory and the compliance processes. Compliance with policies is monitored by executive management.

Pricing Risk

Pricing involves estimates and assumptions of such factors as mortality, morbidity, future investment yields, and expenses. Pricing risk is the risk that actual experience will not develop as estimated in the pricing. Management of the pricing risks includes careful product design, extensive use of modeling, and sensitivity testing as well as monitoring through the experience studies. The pricing analyses are carried-out by SISIP Proper's consulting actuaries at Mercer and further corroborated by the subject matter experts at Manulife. Pricing reviews are conducted yearly.

Claims Risks

Claims risk is the risk that actual mortality and morbidity experience exceeds underwriting expectations. Management works closely with Manulife to manage its claims risk through comprehensive underwriting and claims payment guidelines. Reinsurance is used to mitigate excessive exposure to certain risks. Several reinsurance treaties are in place to protect SISIP Proper against war risk and terrorism claims and to protect SISIP Proper against catastrophic claims situations involving multiple lives in a single event. In addition to these risk management insurance arrangements, there are stop loss coverage underwritten by Manulife with respect to several of the SISIP Proper insurance plans which provide an additional measure of protection if claims experience is worse than expected.

Interest Rate Risk

SISIP Proper financial position may be affected by its exposure to interest-rate risk. Interest rate risk refers to the risk of economic losses or gains arising from reinvestments or disinvestments of assets. If cash flow from assets supporting claim liabilities does not match the timing and amount of the claim cash flows, interest rate losses or gains may occur due to changing interest rates in the future. The quality of the asset liability-matching program is reviewed quarterly at Manulife using duration measures and cash flow testing under alternative economic scenarios. An investment policy was implemented and this policy is structured to provide much better matching of assets and liabilities.

10. Risk management (continued):

Market Risk

Market risk is the exposure to investment loss from general economic and stock market fluctuations. SISIP Proper's Investment Policy guidelines as managed by the NPP Investment Committee identify limits on the amount and quality of investments and prescribe limits as to the percentage investment mix of all of the authorized investment classes for investments held by the segregated fund. Compliance with these limits is reviewed frequently and reported quarterly to the Investment Committee. Performance is monitored against outside benchmarks and external consulting pensions actuaries have been engaged to review plan performance and costs.

Operational Risks

SISIP Proper is exposed to other operations risks including legal, regulatory, human resource, technology, and the market conduct risks. Senior management has mitigated these risks through the operational procedures implemented as required under the Agreement with Manulife, and through compliance reviews.

11. Financial risks:

Liquidity risk

Liquidity risk is the risk that SISIP FS will be unable to fulfill its obligations on a timely basis or at a reasonable cost. SISIP FS manages its liquidity risk by monitoring its operating requirements. SISIP FS prepares budget and cash forecasts to ensure it has sufficient funds to fulfill its obligations. There has been no change to the risk exposures from 2012.

Credit risk

Credit risk refers to the risk that a counterparty may default on its contractual obligations resulting in a financial loss. SISIP FS deals with creditworthy counterparties to mitigate the risk of financial loss from defaults. SISIP FS monitors the credit risk of customers through credit rating reviews.

12. Commitments:

SISIP Proper have estimated future liabilities not yet recognized related to the CAR paid-up policy and SSB for which no futures premium payment will be made. The terms of the Agreement do not include these amounts in the determination of plan reserves. The estimated present value of these future liabilities has been assessed at $125,789 as of December 31, 2013.

12. Commitments (continued):

SISIP FS is committed to payments under an operating lease for the premise at 234 Laurier Avenue West, Ottawa through 2015. Annual payments for the next two years are as follows:

2014	$	75
2015		69
	$	144