



MARKEL  
FINANCIAL  
HOLDINGS  
LIMITED

ANNUAL  
REPORT  
1985



## MARKEL FINANCIAL HOLDINGS LIMITED

500 University Avenue, Toronto, Canada M5G 1W1

### Directors

Milton L. Markel, Honorary Chairman of the Board  
†\*V. Prem Watsa, Chairman of the Board  
‡\*Steven A. Markel, President and Vice-Chairman  
‡‡Keith E. Ingoe, Executive Vice-President  
‡George Christoff, Salesman, Gardiner, Watson Limited  
Jack Herbert, Chairman Moto Internationale  
†\*Robbert Hartog, Chairman Waltec Enterprises  
\*Wilfred Kaneb, Chairman Fiberez of Canada Ltd.  
Anthony F. Markel, Executive Vice-President,  
Markel Corporation  
‡James R. Martin, Investment Vice-President,  
Confederation Life Insurance Co.  
Robert W. McDowell, Partner, Fasken & Calvin

### Officer

David W. Clark, C.A., Secretary-Treasurer

\*Audit Committee Member  
†Executive Committee Member  
‡Investment Committee Member

### Subsidiaries

Markel Insurance Company of Canada  
Markel Service Canada Limited

### Associate

Canadian Insurance Brokers Underwriters Limited

### Transfer Agent and Registrar

The Royal Trust Company  
Montreal Toronto Vancouver

### Share Listings

Toronto Stock Exchange  
Montreal Stock Exchange  
Exchange Symbol MFH

### General Counsel

Fasken & Calvin  
Toronto, Canada

### Auditors

Coopers & Lybrand  
Toronto, Canada

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## MARKEL INSURANCE COMPANY OF CANADA

Offices: Toronto (416) 598-4500; Montreal (514) 284-3124

### Directors and Executive Officers

Steven A. Markel, Chairman of the Board  
Keith E. Ingoe, President  
David W. Clark, C.A., Secretary-Treasurer  
Alan G. Bradford, Vice-President  
Anthony F. Markel, Executive Vice-President,  
Markel Corporation

Robert W. McDowell, Partner, Fasken & Calvin  
James R. Martin, Investment Vice-President,  
Confederation Life Insurance Co.  
Donald W. Ross, Claims Consultant  
V. Prem Watsa, Partner, Hamblin Watsa  
Investment Counsel Ltd.

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## MARKEL SERVICE CANADA LIMITED

### Directors and Executive Officers

Steven A. Markel, Chairman of the Board  
David W. Clark, C.A., Secretary-Treasurer  
V. Prem Watsa, Partner, Hamblin Watsa  
Investment Counsel Ltd.

Keith E. Ingoe, President  
Alan G. Bradford, Vice-President  
Donald W. Ross, Claims Consultant

**MARKEL FINANCIAL HOLDINGS LIMITED**  
and Subsidiaries

**Financial Summary ('000)**

For the years ended December 31

	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Gross Premiums Written	<b>23,415</b>	21,064	24,326	26,732	27,633	25,669	21,848	21,591	25,459	22,854
Reinsurance Ceded	<b>6,157</b>	4,899	4,134	10,990	16,277	17,696	15,433	15,011	15,198	12,391
Net Premiums Written	<b>17,258</b>	16,165	20,192	15,742	11,356	7,973	6,415	6,580	10,261	10,463
Net Premiums Earned	<b>14,049</b>	16,616	19,621	14,443	10,676	7,633	6,250	7,604	10,424	9,913
Net Incurred Losses	<b>13,533</b>	17,588	14,598	11,101	9,620	8,875	5,511	6,136	7,878	7,718
Net Commission Expense	<b>1,523</b>	2,020	2,306	820	360	(162)	(479)	(765)	(406)	(263)
Net Operating Expenses	<b>2,839</b>	4,182	4,593	4,144	3,656	3,101	2,694	2,703	2,592	2,011
Net Underwriting Profit (Loss)	<b>(3,727)</b>	(7,150)	(1,871)	(1,543)	(2,931)	(4,117)	(1,388)	(338)	480	535
Net Investment Income	<b>2,846</b>	2,296	2,179	2,045	2,117	2,116	1,750	1,464	1,222	986
Pre-Tax Income	<b>(880)</b>	(4,854)	308	476	(814)	(2,001)	362	1,105	1,701	1,521
Net Earnings	<b>(910)</b>	(4,775)	280	218	(326)	(785)	524	742	982	840
Cash and Investments	<b>32,728</b>	25,391	24,218	20,337	22,265	21,853	19,701	18,057	18,124	14,955
Total Assets	<b>41,786</b>	31,401	32,325	28,739	29,351	27,714	25,341	22,927	25,039	21,777
Shareholders' Equity	<b>10,682</b>	2,247	6,956	6,523	6,513	7,080	7,914	7,542	6,742	5,715
PER COMMON SHARE	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Net Earnings	<b>(1.89)</b>	(7.75)	0.45	0.35	(0.53)	(1.27)	0.85	1.20	1.60	1.24
Dividends	—	—	—	—	—	0.0625	0.25	0.25	0.232	0.20
Shareholders' Equity	<b>2.25</b>	3.65	11.29	10.59	10.57	11.49	12.85	12.24	10.95	8.46
Number of Common Shares	<b>623</b>	616	616	616	616	616	616	616	616	676
Return on Shareholders' Equity - %	—	—	4.3	3.3	—	—	7.0	11.0	17.2	15.9

	Net Earnings ('000)		Share Price High/low	
	1985	1984	1985	1984
1st Quarter	(1,324)	(776)	4.10/4.10	6.75/6.00
2nd Quarter	(38)	(595)	3.15/3.00	6.62/6.25
3rd Quarter	285	(338)	5.00/4.75	5.00/4.75
4th Quarter	167	(3,066)	6.00/6.00	5.00/5.00

**About Markel**

Markel was organised in Canada 35 years ago for the express purpose of writing motor carrier insurance. The holding company, Markel Financial, and the insurance subsidiary, Markel Insurance Company of Canada, were formed in 1972 after the original public offering.

Markel has provided the Canadian trucking industry with the longest continuous market for this very specialized class of insurance. Much larger, standard,

general insurance companies which lack the knowledge and expertise in this class of business will attempt to compete from time to time. Invariably, however, they withdraw when losses begin.

As a specialty company Markel has the talent to handle the unique nature of long haul truck insurance. In 1985 gross premium volume was \$23.4-million and at December 31, 1985 there were 44 employees.

# MARKEL FINANCIAL HOLDINGS LIMITED

and Subsidiaries

## To our Shareholders

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1985 was a very significant year for your company. As your new Chairman, I would like to review the major developments and also indicate to you our plans and objectives for the future.

In September 1985, Steven Markel and I concluded a private placement that resulted in \$9.1 Million in additional capital being raised for the company. The capital was raised through the issue of 11¼% voting, convertible, preferred stock, and warrants. The capital was raised as follows:

The Sixty-Two Investment Company Limited	\$5.0 MM
Markel Corp U.S.	2.6 MM
Private Investors	1.5 MM
	<u>\$9.1 MM</u>

This transaction resulted in The Sixty-Two Investment Company Limited acquiring voting control of Markel Financial Holdings Limited.

The Sixty-Two Investment Company Limited is an investment holding company consisting of prominent Canadian businessmen, Confederation Life Insurance Company and myself. With the closing of the private placement in September 1985, Markel Financial Holdings Limited became a Canadian controlled company. Your Board of Directors reflected this change as Robbert Hartog, Jack Herbert, Jim Martin and myself were added on the Board. Milton Markel graciously accepted to continue serving on the Board as Honourary Chairman. Steven Markel, Tony Markel, Fred Kaneb, George Christoff and Robert McDowell also agreed to continue. We are very fortunate to have an active, participating Board.

Why did we invest in Markel? The major reason we did was because of Steven Markel and the Markel family. Even though the company recently went through hard times, we were very impressed with the way the company had been run through the years. During the six months it took to put the deal together, I have personally experienced the high integrity displayed by Steve and the Markel family. You should be proud to have had them manage your company. In fact, if not for Steven and Tony Markel's untiring efforts during the past two years, your company may not have survived. We look on our association with Markel Financial Holdings Limited as a partnership with the Markel family which combines their insurance experience with our investment background.

We are very pleased to report that Keith Ingoe, after spending more than 20 years at Halifax Insurance Company, has joined us as President of Markel Insur-

ance Company of Canada and Markel Service Canada Limited. Additionally, he serves as Executive Vice-President of Markel Financial Holdings Limited. Keith will be running the day-to-day operations of the company. The longer term strategic decisions are made by Keith and Steve.

A word on our investment philosophy:

Our investment philosophy is based on the value approach as laid out by Ben Graham and practiced by his famous disciple, Warren Buffett. This means we buy stocks of financially sound companies at prices below their underlying long term values. We expect to make money over time, not in the next month or two. In fact, in the short term, stock prices could go well below our cost. In our purchases, we are always trying to first protect your capital from long term losses (as opposed to short term price fluctuations) before attempting to make money. We do not speculate with your money and thus, do not buy options, commodities, futures, gold and other short term trading instruments. Over time, our investment philosophy has served us well and we plan to stick with it. In future annual reports we plan on discussing individual purchases in greater detail.

What can you expect from Markel in the future? Our major objective will be to run the company for the long term benefit of all shareholders. As shareholders ourselves, we plan on providing you with the type of information that we ourselves would find useful. This annual report is our first stab at more complete disclosure.

How should you judge our performance? We think all companies should be measured on their after tax return on common shareholders equity. In Canada, the average company has earned about 13% on shareholders equity over many decades. Our objective is to earn a long term return averaging 20%, while maintaining the financial strength of the Company. In the next few years because of tax loss carryforwards, this is unlikely to be onerous. Over the years though, 20% after tax is a very challenging objective.

We are pleased to have you as shareholders and look forward to hearing from you if you have any questions.

*V. P. Watsa*

V. Prem Watsa,  
Chairman of the Board

# MARKEL FINANCIAL HOLDINGS LIMITED

and Subsidiaries

## Operating Review

1985 was an eventful year for your Company. While we are reporting a net loss for the year of \$910,414 or \$1.89 per share, our operating results have shown improvement throughout the year. Quarterly results were as follows:

1st Quarter:	\$(1,323,545)
2nd Quarter:	(38,467)
3rd Quarter:	284,902
4th Quarter:	166,696
	<u>\$ (910,414)</u>

While the insurance industry remained soft in late 1984, Markel established a policy to re-underwrite and re-price its entire book of business. In spite of the loss of much of our business, we held firm to this policy. In the first quarter of 1985 we lost 63% of the business on which we were increasing rates. The business which remained was with a 46% rate increase.

Unfortunately, the resulting decline in business caused our first quarter results to be quite poor. We reported a loss of \$1.3 million. The impact of our re-underwriting and re-pricing was not felt until the second quarter. Claims declined substantially in this quarter and we reported a net loss of \$38,467.

As we approached the third quarter, the insurance market was showing more signs of firming. More and more companies were increasing their pricing and several were refusing to write long haul truckers. Many of these companies were the same organisations which happily wrote business at inadequate pricing just months earlier. The third quarter results were finally profitable - we made \$284,902.

Our fourth quarter results show a net profit of \$166,696. While business was still very good, we made additional provisions for loss reserves and reinsurance costs.

Overall, we are proud of our operating results and accomplishments in 1985. While we began the year in a very soft, competitive market, concerned that our underwriting and pricing strategy would cause a severe decline in our business, we ended the year as one of the very few companies willing to write long haul truck insurance.

Most importantly, however, was that we held firm to our underwriting and pricing policy. We clearly cannot write insurance below our cost. Our competitors have now figured that out.

For the year our loss totals \$910,414. This loss has not been tax effected. The future tax benefits from this, as well as those tax benefits earned in 1984, are not lost and will benefit the Company as we return to profitability.

We enter 1986 with a much stronger and better priced book of business than a year ago. Our premiums are now at a level which we believe is adequate to meet our reinsurance cost, claims cost and operating expenses.

The very nature of the insurance business requires that we manage uncertainty. The passing of the Spills Bill by the Province of Ontario, as well as the continued increasing cost of claims, has made it more difficult to project the future.

On the positive side, we are seeing more business and have successfully written more business which meets our standards than ever before in the Company's history. We are extremely optimistic about 1986.

We have responded to the challenges of the past and are certain that we can respond positively to the present and future challenges. We are determined to provide quality insurance coverage to the trucking industry. However, we will not compromise our standards of underwriting and pricing.



STEVEN A. MARKEL  
President



KEITH E. INGOE  
Executive Vice President

### MARKEL INSURANCE COMPANY OF CANADA

Annually, in accordance with the regulation of the Federal Department of Insurance, the general insurance subsidiary of the group files a statutory sheet and the highlights of this report are outlined below:

<b>Assets</b>	
Cash, Accounts Receivable and Prepaid Expenses	\$ 8,118,000
Investments	\$29,805,000
Deferred Income Tax	\$ 2,192,000
	<u>\$40,115,000</u>
<b>Liabilities and Shareholders' Equity</b>	
Accounts Payable and Sundry Liabilities	\$ 8,036,000
Unearned Premiums and Provision for Claims	\$24,471,000
Capital Surplus	\$ 7,608,000
	<u>\$40,115,000</u>

### Report of the Property Casualty Valuation Actuary

We have made the valuation of the claims liabilities of Markel Insurance Company of Canada for its balance sheet at 31 December 1985 and its income statement for the year then ended. In our opinion,

- (i) the valuation conforms to the Recommendations for Property Casualty Insurance Company Financial Reporting of the Canadian Institute of Actuaries,
- (ii) the amount of the claims liabilities makes proper provision for the future payments under the company's policies,
- (iii) a proper charge on account of those liabilities has been made in the income statement.

THE WYATT COMPANY  
Actuaries and Consultants

Toronto, Canada  
March 13, 1986

## Goals and Strategies

Markel Financial Holdings, through its wholly-owned operating companies Markel Insurance Company of Canada and Markel Service Canada Limited – provides insurance for the long haul commercial truck industry. We are a specialty company in this class of business.

In conjunction with our new financing and re-organisation, we have begun to establish a framework for planning our future. In this regard we have established goals to help us better manage our business in several critical areas. These areas include: Financial, Underwriting, Reinsurance, Claims and Investment.

### Financial

We have established two major financial goals to help guide our future. We expect to achieve a return on equity of 20% and we plan to maintain a high level of financial security.

The necessity to operate profitably is quite apparent, especially since the Company has not done so in the past few years. We believe a 20% return on shareholders' equity over time is a level of profitability which will enable us to maintain reasonable growth and fairly reward shareholders' investment.

Maintaining a high level of financial security is absolutely critical in the insurance industry. Financial security is, after all, the product we sell. While insurance buyers often overlook this aspect of the insurance product, we believe in the long run it will prove its value.

### Underwriting

Our primary underwriting goal is to achieve a combined operating ratio no worse than 100%. The combined operating ratio is the total of incurred losses and operating expenses compared to earned premium. This ratio was at 143% in 1984 and at 127% in 1985. The industry average was approximately 112% in 1984 and is estimated to be 120% in 1985. When we achieve a combined ratio of 100% our underwriting operations will be breakeven and investment income will all flow to our bottom line.

Given the current industry position as well as our own combined ratio, achieving this goal will not be easy. As with our other goals, we have set them ambitiously and while we expect to achieve them over a period of time, we will not be successful every year.

Achieving our underwriting goals for 1986 will depend on the adequacy of our current pricing and underwriting selection, the frequency and severity of claims and the adequacy of our loss reserves. We have set more detailed objectives and strategies in each of these areas. One of our most important strategies is to further refine our data base so that we can more scientifically establish adequate pricing levels based on expected claims cost.

### Reinsurance

Our primary reinsurance goal is to maintain sound reinsurance with financially solid reinsurers. In order for us to achieve this goal we must continue to apply sound underwriting and pricing standards to our business and do our best to assure our reinsurers a reasonable profit. We provide the trucking industry with insurance limits of up to \$10,000,000. To do this requires that we develop and maintain good relationships with the reinsurance market worldwide. We're currently able to provide these limits with reinsurance treaties which protect us up to \$2,000,000. Whenever we need additional reinsurance we purchase it in the facultative market on a specific risk basis.

In 1985 we retained the first \$100,000 of any one loss. Because of our stronger financial base we have increased this retention to \$200,000 in 1986.

### Claims

Our claims operation has two critical goals. First is to investigate, negotiate and settle all claims as quickly and fairly as possible. Second is to establish adequate loss reserves on all open claims.

In recent years the cost of claims has grown very quickly, especially severe bodily injury claims. Whenever an insurance company under-reserves its outstanding losses, not only is it understating its prior results but in all likelihood it is also underpricing its existing business.

By closely monitoring claims activity and settlements we can better determine the adequacy of our outstanding losses and better project future losses.

To assist us in evaluating our outstanding loss reserves we have retained outside actuarial consultants. The report of The Wyatt Company confirming the adequacy of our loss reserves is included in this annual statement. Actuarial projections are based on assumptions about the future and involve a degree of uncertainty. We believe, as do our consultants, that we have adequately provided for our outstanding losses, and that the actuarial projections are based on reasonable assumptions.

Additionally, we have established a Loss Reserve Evaluation Committee to review and monitor our loss development on a quarterly basis.

### Investment

Our primary investment goal is to generate sufficient investment income to help achieve the company's financial objective of earning 20% after-tax on common shareholders' equity with a breakeven underwriting performance.

We attempt to get the best long term return on the assets of the Company within the regulations of the Department of Insurance. We plan to invest in common stocks, convertible preferreds and debentures to achieve long term capital gains. Unless special opportunities exist, we plan on limiting the term of our bond investments to less than 5 years.

At the end of December 31, 1985 our investments at market were as follows:

	\$MM	%
Cash	8,821	26
Bonds	16,652	49
Convertible Preferred Stocks and Debentures	4,783	15
Common Stock	3,454	10
Total Investment Portfolio	33,710	100

### The Future

Today we are a specialty company with one primary specialty – long haul commercial automobile insurance. The future in this specialty is particularly bright.

As a specialty company, we do not believe we can or should try to be "all things to all people". We intend to concentrate in areas where we have more knowledge and more expertise than others in the market.

However, we do not intend to remain passive in the marketplace. We will continually look at various opportunities which will be available to us. Areas for us to expand exist throughout the insurance industry.

# MARKEL FINANCIAL HOLDINGS LIMITED

## Consolidated statement of operations

For the year ended December 31, 1985

	1985	1984
	\$	\$
OPERATING INCOME		
Premiums earned	14,049,318	16,615,809
Other income	119,258	25,192
	<u>14,168,576</u>	<u>16,641,001</u>
INVESTMENT INCOME		
Interest and dividends	2,454,756	2,329,412
Associated company	160	(16,544)
Realized gains on disposal of investments	458,903	24,653
	<u>2,913,819</u>	<u>2,337,521</u>
Investment Expense	67,362	41,833
	<u>2,846,457</u>	<u>2,295,688</u>
	<u>17,015,033</u>	<u>18,936,689</u>
EXPENSES		
Losses on claims incurred	13,533,036	17,588,433
Operating expenses	2,838,754	4,182,238
Agents' commissions	2,112,104	2,264,196
Reinsurance commissions	(588,747)	(243,901)
	<u>17,895,147</u>	<u>23,790,966</u>
LOSS BEFORE INCOME TAXES	880,114	4,854,277
PROVISION FOR (RECOVERY OF) INCOME TAXES	30,300	(79,069)
LOSS FOR THE YEAR	<u>910,414</u>	<u>4,775,208</u>
LOSS PER SHARE (after giving effect to the preferred share dividend requirement of \$256,543; 1984 - nil)	<u>\$1.89</u>	<u>\$7.75</u>
WEIGHTED DAILY AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	<u>615,991</u>	<u>616,000</u>

## Consolidated statement of deficit

For the year ended December 31, 1985

	1985	1984
	\$	\$
DEFICIT (RETAINED EARNINGS) - BEGINNING OF YEAR	1,545,560	(3,229,648)
Loss for the year	910,414	4,775,208
Dividend on preference shares	256,543	—
Share issuance costs	46,789	—
DEFICIT - END OF YEAR	<u>2,759,306</u>	<u>1,545,560</u>

# MARKEL FINANCIAL HOLDINGS LIMITED

## Consolidated balance sheet

as at December 31, 1985

	1985	1984
	\$	\$
<b>ASSETS</b>		
<b>CASH, ACCOUNTS RECEIVABLE AND PREPAID EXPENSES</b>		
Cash, term deposits and short-term investments	8,821,143	12,231,460
Accounts receivable	6,034,208	3,534,487
Accrued interest	624,109	475,873
Prepaid expenses	62,927	63,451
Prepaid premium acquisition costs	833,730	164,000
Income taxes recoverable	1,575	84,679
	<u>16,377,692</u>	<u>16,553,950</u>
<b>INVESTMENTS</b>		
Bonds – at amortized cost (market value – \$20,140,248; 1984 – \$12,096,459)	19,152,998	11,622,776
Preferred stocks – at market (cost – \$1,259,949; 1984 – \$186,441)	1,294,751	157,950
Common stocks – at market (cost – \$3,083,782; 1984 – \$1,385,504)	3,453,629	1,373,384
Investment in associated company	5,901	5,741
	<u>23,907,279</u>	<u>13,159,851</u>
<b>OTHER ASSETS</b>		
Fixed assets – at cost, less accumulated depreciation (1985 – \$426,924; 1984 – \$385,968)	175,468	229,674
<b>DEFERRED INCOME TAXES</b>	<u>1,325,975</u>	<u>1,457,437</u>
	<u>1,501,443</u>	<u>1,687,111</u>
	<u>41,786,414</u>	<u>31,400,912</u>

SIGNED ON BEHALF OF THE BOARD

*V. P. Watson*

Director

*K. H. ...*

Director



	<u>1985</u>	<u>1984</u>
	\$	\$
<b>LIABILITIES</b>		
ACCOUNTS PAYABLE		
Bank loan	—	1,000,000
Accounts payable and accrued liabilities	972,654	303,939
Payable to reinsurers	2,617,545	541,855
Premium deposits	1,342,713	1,611,293
Provision for claims	16,839,112	18,955,036
Deposits from unlicensed reinsurers	<u>2,377,912</u>	<u>2,996,306</u>
	<u>24,149,936</u>	<u>25,408,429</u>
UNEARNED PREMIUMS	<u>6,954,224</u>	<u>3,745,954</u>
	<u>31,104,160</u>	<u>29,154,383</u>
<b>SHAREHOLDERS' EQUITY</b>		
CAPITAL STOCK (note 2)	13,138,073	3,832,700
DEFICIT	<u>2,759,306</u>	<u>1,545,560</u>
	<u>10,378,767</u>	<u>2,287,140</u>
UNREALIZED GAIN (LOSS) ON STOCKS	<u>303,487</u>	<u>(40,611)</u>
	<u>10,682,254</u>	<u>2,246,529</u>
	<u>41,786,414</u>	<u>31,400,912</u>

# MARKEL FINANCIAL HOLDINGS LIMITED

## Consolidated statement of changes in financial position

For the year ended December 31, 1985

	1985	1984
	\$	\$
<b>SOURCE OF FUNDS</b>		
Operations -		
Net loss for the year	(910,414)	—
Depreciation	53,682	—
Deferred income taxes	30,300	—
Increase in unearned premiums	3,208,270	—
Provided from operations	2,381,838	—
Proceeds from bank loan	—	1,000,000
Proceeds from disposal of fixed assets	5,070	10,804
Increase in accounts payable over cash, accounts receivable, and prepaid expenses	—	5,945,925
Proceeds from issuance of capital stock	9,305,373	—
	<u>11,692,281</u>	<u>6,956,729</u>
<b>USE OF FUNDS</b>		
Net loss for the year	—	4,775,208
Depreciation	—	(71,441)
Decrease in unearned premiums	—	450,893
Required for operations	—	5,154,660
Share issuance costs	46,789	—
Dividend on preference shares	256,543	—
Decrease in cash, accounts receivable and prepaid expenses and accounts payable	82,235	—
Purchase of fixed assets	4,546	124,175
Repayment of bank loan	1,000,000	—
	<u>1,390,113</u>	<u>5,278,835</u>
	<u>10,302,168</u>	<u>1,677,894</u>
<b>FUNDS GENERATED FOR INVESTMENTS</b>	<u>13,159,851</u>	<u>11,416,514</u>
<b>INVESTMENTS - BEGINNING OF YEAR</b>	<u>23,462,019</u>	<u>13,094,408</u>
<b>UNREALIZED GAIN ON STOCKS FOR THE YEAR</b>	<u>445,260</u>	<u>65,443</u>
<b>INVESTMENTS - END OF YEAR</b>	<u>23,907,279</u>	<u>13,159,851</u>

## Consolidated statement of unrealized gain (loss) on stocks

For the year ended December 31, 1985

	1985	1984
	\$	\$
<b>UNREALIZED LOSS - BEGINNING OF YEAR</b>	40,611	106,054
Unrealized gain during the year	445,260	65,443
	<u>404,649</u>	<u>(40,611)</u>
Deferred income taxes	101,162	—
<b>UNREALIZED GAIN (LOSS) - END OF YEAR</b>	<u>303,487</u>	<u>(40,611)</u>

# MARKEL FINANCIAL HOLDINGS LIMITED

## Notes to consolidated financial statements

For the year ended December 31, 1985

### 1. Summary of Significant Accounting Policies

The operations of the company and its subsidiaries relate principally to the insuring of property and casualty risks on commercial lines. The significant accounting policies followed by the company are as follows:

#### *Principles of consolidation*

The consolidated financial statements include the accounts of the subsidiaries, Markel Insurance Company of Canada and Markel Service Canada Limited. The investment in Canadian Insurance Brokers Underwriters Limited, an associated company subject to significant influence, is accounted for on the equity basis.

#### *Premiums*

Premiums are taken into income evenly throughout the terms of the related policies. As premium deposits secure the payment of premiums and are refundable, they are not taken into income unless default in payment of premiums occurs.

#### *Premium acquisition costs*

The costs incurred in acquiring premiums are deferred, to the extent that they are considered recoverable, and then amortized over the same period as the related premiums are taken into income.

#### *Investments*

Bonds are carried at amortized cost providing for the amortization of the discount or premium over the term of the investment to the maturity date. Preferred and common stocks are carried at market value with the unrealized gain or loss thereon included, as a separate account, in shareholders' equity.

#### *Investment income*

Interest is recorded as income as it accrues. The discount or premium on a bond or debenture is amortized on a straight-line basis to maturity. Dividends are recorded as income on the record date. Gains and losses realized on the disposal of investments are taken into income on the date of disposal.

#### *Claims*

Claim provisions are established by the "case basis" method as claims are reported. The provisions are subsequently adjusted as additional information on the estimated amount of a claim becomes known during the course of its settlement. A provision is also made for claims incurred but not reported based on the volume of business currently in force and the historical experience on such late reported claims.

#### *Translation of foreign currencies*

Assets acquired and liabilities incurred in foreign currencies are translated into Canadian dollars at December 31 exchange rates. Income and expenses are translated at the exchange rates in effect at the date incurred. Realized and unrealized gains and losses on foreign exchange are recognized in the statement of earnings except those related to unrealized gains or losses on stocks.

#### *Income taxes*

Income taxes are recorded using the tax allocation method. Differences between accounting income and taxable income can arise when the time of including items of revenue and expense in the computation of accounting income and the time of their inclusion in taxable income do not coincide. Deferred income taxes have been partially set up as an asset for timing differences which relate primarily to unearned premiums, outstanding losses on claims, prepaid premium acquisition costs, amortization income on bonds and depreciation of fixed assets (note 7). In addition, certain dividends and a portion of capital gains and losses are not taxable.

### 2. Capital Stock

#### (a) Authorized capital

The authorized capital of the company was amended during the year by redesignating the existing class of shares as an unlimited number of common shares and by creating an unlimited number of preferred shares issuable in series.

2,924,000 convertible, redeemable, cumulative, voting shares were designated during the year as Series 1 preferred shares.

#### (b) Issued capital

##### i) Preferred shares

2,924,000 Series 1 preferred shares were issued during the year for cash of \$9,444,520. Subsequent to their issue, 7,000 shares were converted to common shares, and 43,000 shares were purchased for cancellation. At December 31, 1985 there were 2,874,000 Series 1 preferred shares paid and outstanding.

##### ii) Common shares

7,000 common shares were issued during the year upon conversion of 7,000 Series 1 preferred shares; 74 shares were repurchased from a dissenting shareholder for cash of \$259. At December 31, 1985, there were 622,926 common shares paid and outstanding.

##### iii) Common share warrants

1,503,000 common share warrants were issued during the year for cash of \$2. The warrants enable a purchaser to acquire common shares of the company over a three year period at a price of \$3.80 per share.

### 3. Claims Development

During 1985, Markel Insurance Company of Canada experienced an adverse development of certain 1984 and prior years' claims which resulted in additional reinsurance premium charges of \$1,000,000 against 1985 operations.

### 4. Operating Leases

Aggregate future commitments under operating leases relating to premises are as follows:

	\$
1986	246,000
1987	186,000
1988	177,000
1989	141,000
1990	9,000
	<u>759,000</u>

### 5. Reinsurance

The company follows the policy of underwriting and reinsuring contracts of insurance which, in the main, limit the liability of the company to a maximum amount on any one loss of \$100,000. The company's reinsurance is generally placed on an excess of loss basis in several layers. Part of this coverage is subject to an annual aggregate deductible which amounted to \$1,277,000 in 1985 (1984 - \$1,348,000). In addition, the reinsurance cost is subject to adjustment based upon the ultimate loss experience incurred. Provision for claims reflects recoveries from reinsurers of \$8,749,484 (1984 - \$13,880,715).

### 6. Related Party Transactions

#### (a) Markel Corporation

During the year the company was charged a management and administration fee by Markel Corporation, amounting to \$95,792 (1984 - \$78,194).

# MARKEL FINANCIAL HOLDINGS LIMITED

## Notes to consolidated financial statements

For the year ended December 31, 1985

(b) **Affiliated company**

The company reinsures a portion of risks with an affiliated company. During the year the net premiums ceded amounted to approximately \$421,000 (1984 - \$124,000) and the net losses recovered amounted to approximately \$489,000 (1984 - \$316,000).

Included within deposits from unlicensed reinsurers is an amount due to the affiliated company of \$1,007,000 (1984 - \$681,000). The amount payable to reinsurers is offset by an amount due from the affiliated company of \$11,000 (1984 - amount due to the affiliated company of \$276,000 offset against due from reinsurers).

Included in accounts receivable is an amount of \$161,500 due from a shareholder with respect to the acquisition of 50,000 Series 1 preferred shares for resale to an officer appointed in 1986.

(c) **Investment counsel**

On July 2, 1985, Hamblin Watsa Investment Counsel Ltd. was retained as the investment counsellor for the Markel group. For the period July 2 to December 31, 1985 the investment counsel fee paid or payable to Hamblin Watsa amounted to \$41,049.

Mr. V. Prem Watsa is Chairman of the Board of Markel Financial Holdings Limited, and is a director of Markel Insurance Company of Canada. Mr. Watsa is a partner of Hamblin Watsa Investment Counsel Limited, and he is a shareholder of The Sixty-Two Investment Company Limited, the controlling shareholder of the Series 1 class of preferred shares of Markel Financial Holdings Limited.

(d) **Interest**

During the year the company paid interest in respect of debt assumed by Markel Corporation and a related party of approximately \$100,000.

### 7. **Income Tax Position**

The company has recorded unearned premium reserves and claims provisions of approximately \$5,832,000 in its accounts which have not been claimed for income tax purposes. The tax benefits of these reserves, approximately \$2,916,000, are in addition to the benefits of \$1,325,975 recorded on the balance sheet and have not been reflected in these financial statements.

### 8. **Solvency Position**

The company's principal subsidiary, Markel Insurance Company of Canada, is incorporated under the Canadian and British Insurance Companies Act (the "Act") and as such is subject to certain requirements and restrictions contained in the Act.

At December 31, 1984 the subsidiary had a deficiency under the solvency requirements of section 103 of the Act amounting to \$2,286,000.

At December 31, 1985 the subsidiary enjoys a surplus under the solvency requirements of section 103 of the Act of \$2,491,000, as a result of the injection of \$5 Million of new capital to the subsidiary during 1985, and much improved operating results for the 1985 year.

The subsidiary is presently limited in its ability to pay dividends under provisions of the above Act, as a result of the impact of prior years' results.

### **Auditors' Report to the Shareholders**

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

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Toronto, Canada  
March 7, 1986

COOPERS & LYBRAND  
Chartered Accountants