

> ANNUAL REPORT 2004



OPTIMUM REASSURANCE INC.  
*Strength in Expertise*





## EXECUTIVE MESSAGE

### THE INDUSTRY

The demand for reinsurance by the Canadian insurers did not slow down in 2004. Indeed, recurring new business ceded volumes even increased a little last year, reaching more than \$120 billion of life insurance. This represents, this year again, more than 80% of the new individual life insurance risks issued by the Canadian industry in 2004.

Optimum Reassurance has seen its own new business volume grow substantially to reach almost \$4 Billion as of year-end 2004.

The reinsurance industry has therefore been successful in filling the gap created by Employers Reassurance Corporation's (ERC) departure from the market late in 2003. However, the absorption of ERC's volumes by existing players has significantly increased the concentration of risks ceded among some reinsurers.

The consolidation trend in the reinsurance industry has continued during the last twelve months. Scottish Re has acquired the individual US Life reinsurance business of ING Re, while Sun Life assumed the Canadian individual Life business of Reliastar, ING's affiliate. More consolidation is expected in 2005 following the announcement by Met Life of the potential sale of RGA.

Despite this strong demand and reduction in the number of players, individual life reinsurance rates did not strengthen in 2004. Critical Illness rates, on the other hand, have increased substantially.

Although life reinsurance rates have not increased, reinsurance capacity is provided today to insurers with more restrictive conditions like reduced automatic capacity, lower binding authority, stricter underwriting guidelines and tighter administrative requirements.

During the last decade, reinsurance rates have continuously decreased while the proportion of risks ceded increased from 20% to 80% over the same period. These two trends, together with the introduction of preferred categories, forced reinsurers to be more sensitive to underwriting and the adequacy and concordance between pricing and risk classification.

This phenomenon initiated in the US market has now reached Canada and will likely intensify in the future.

### OPTIMUM REASSURANCE – LARGER CAPITAL AND SURPLUS

Optimum Reassurance was celebrating its 30th anniversary as a life and health reinsurer in 2003.

In order to solidify its presence as the only Canadian owned professional Life Reinsurer, the Optimum Group, the parent company of Optimum Reassurance Inc., will inject \$5 million in the capital of the company at the beginning of 2005.

Optimum Reassurance's capital and surplus as of year-end 2004 well exceed the requirements of both the federal and provincial authorities.

The first goal of that capital injection is to support the accelerated growth of the company expected over the next few years, both in individual and group business lines.

Note 11 of the attached financial statements indicates that a sum of \$5 million was received by the company in 2004. To convert this advance into capital, requires the approval of the modification to the Articles of incorporation under Part IA of the Companies Act. Confirmation from the authorities was received too late in 2004 to allow for the capital injection to be completed.

With this increased capital and surplus, Optimum Reassurance will be in an even better position to fulfill the diversification needs of Canadian insurers in their reinsurance programs.

Meanwhile, Optimum Reassurance will continue to constantly adapt its products and services to the changing needs of the industry.



#### RESULTS 2004

Optimum Reassurance had another excellent year in 2004.

Our after-tax net income reached just over \$3 million this year, slightly lower than last year's, nevertheless generating a return on equity of 13.7%.

Total premiums were \$119.7 million, a 12% increase from 2003 when compared to the recurring premiums. The 2003 results included a significant single premium on a disability closed block.

Individual reinsurance grew by 8.3% including a growth in individual health reinsurance of 47.1% while group reinsurance premiums increased by 20.8%.

Total assets have reached \$244.3 million, increasing by 4.7%, a growth rate similar to the trend of the last few years. More than 90% of our invested assets are in bonds with 88.5% of the latter in government or government backed bonds and 11.5% in corporate bonds.

Shares of publicly traded companies account for 4.0% of invested assets, up from 2.4% in 2003.

Finally, short-term investments totalled \$4.2 million at year-end representing 2% of invested assets.

A major portion of our long-term assets is matched with long-term liabilities and the market value of these assets is sensitive to fluctuations in interest rates. The market value of our investments exceeded their book value by \$24.7 million as of year-end, a 12% increase over last year, despite the fact that our deferred realized gains increased substantially due to \$7.5 million of realized capital gains during the year. The excess of the market value over the book value of our invested assets could decrease significantly in 2005 should interest rates increase.

Our shareholders' equity grew to \$23.4 million, up by 5.1%. The decrease in the US dollar generated a significant unrealized loss due to foreign exchange fluctuation affecting our capital and surplus in 2003 and again in 2004.

#### 2005 FORECAST

Optimum Reassurance expects to maintain the current growth in its individual life business in 2005. New reinsurance agreements entered into the later part of 2004 and early 2005 quoting activities are a good indication of this trend.

Group premiums should also experience solid growth in 2005, mainly due to the higher renewal rate of our various agreements, the inherent increases due to inflationary pressure of health costs and the addition of new business.

The introduction of new health related products, both group and individual, should support these developments.

#### CONCLUSION

I would like, first of all, to extend my thanks to all of our clients, new and existing, for their confidence in Optimum Reassurance.

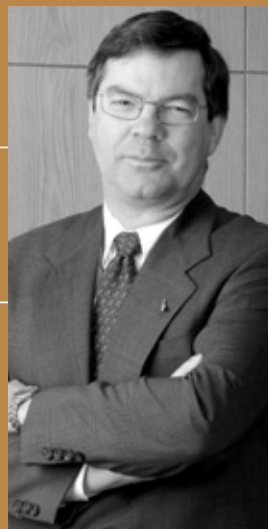
Our company is proud to be a privileged partner of a solid, dynamic and healthy industry.

I would also like to congratulate all of our employees for their continuous efforts and dedication in servicing our clients, the company's success being a direct result of their work.

Finally, I want to sincerely thank the members of Optimum Reassurance Board of Directors for their ongoing support and their active participation in the sound governance of our company.

2004 was an excellent year and 2005 offers many growth opportunities.

Mario Georgiev  
President



## NON-CONSOLIDATED STATEMENT OF INCOME

## NON-CONSOLIDATED STATEMENT OF INCOME

Year ended December 31, 2004

	2004	2003
<b>Revenue</b>		
Assumed premiums	\$119,763,092	\$116,140,062
Ceded premiums	(77,162,690)	(75,888,754)
	<b>42,600,402</b>	<b>40,251,308</b>
Net commissions and allocations (Note 9)	(1,076,625)	(769,068)
Investment income - net (Note 5)	12,301,700	13,027,673
Other income	83,812	85,871
	<b>53,909,289</b>	<b>52,595,784</b>
<b>Expenses</b>		
Policy benefits		
Net claims (Note 9)	19,426,992	18,276,055
Modified coinsurance adjustment (Note 13)	9,800,437	4,299,017
(Decrease) increase in actuarial reserve	(5,920,474)	10,547,457
Cash surrender benefits (Notes 9 and 16)	7,048,412	524,636
Interest (received from) paid out to policyholders and insureds (Note 9)	(2,621)	59,032
Experience rating refunds	8,219,304	4,407,480
	<b>38,572,050</b>	<b>38,113,677</b>
Other expenses		
Salaries and fringe benefits	4,026,253	3,695,266
General administration	7,133,119	5,981,017
	<b>11,159,372</b>	<b>9,676,283</b>
	<b>49,731,422</b>	<b>47,789,960</b>
<b>Income before income taxes</b>	<b>4,177,867</b>	<b>4,805,824</b>
Income taxes (Note 14)	1,128,778	1,640,083
<b>Net income</b>	<b>\$3,049,089</b>	<b>\$3,165,741</b>

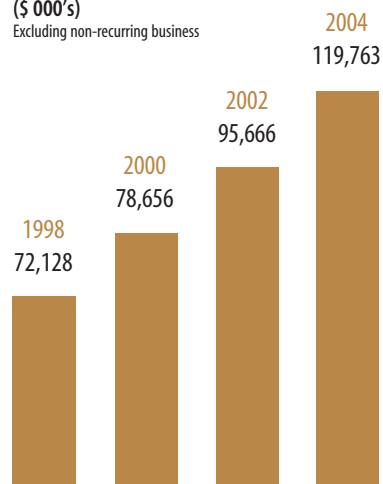
## Reference

Amortization (Note 15)

## GROSS PREMIUM INCOME

(\$ 000's)

Excluding non-recurring business



## NON-CONSOLIDATED BALANCE SHEET

## AUDITORS' REPORT

To the Shareholders of  
Optimum Reassurance Inc.

We have audited the non-consolidated balance sheet of Optimum Reassurance Inc. as at December 31, 2004 and the non-consolidated statements of income, retained earnings and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

As explained in Notes 2 and 6, the investment in the subsidiary is recorded at equity as required by regulatory requirements. Under Canadian generally accepted accounting principles, the accounts of the subsidiary must be consolidated. Had consolidated financial statements been prepared, certain accounts and disclosures in the accompanying financial statements would have been different.

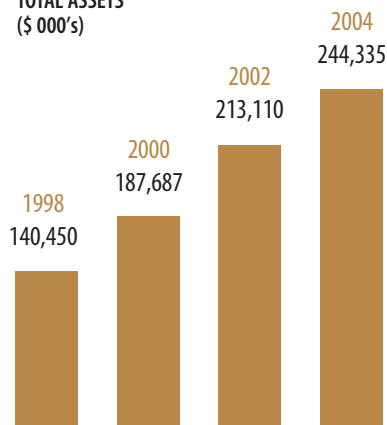
In our opinion, except that they are not prepared on a consolidated basis, as explained in the preceding paragraph, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Samson Bélair/ Deloitte & Touche s.e.n.c.r.l.  
Montreal, Canada  
Chartered Accountants  
February 10, 2005

## NON-CONSOLIDATED BALANCE SHEET

As at December 31, 2004

	2004	2003
<b>Assets</b>		
Investments (Note 5)		
Short-term investments	\$4,228,259	\$7,450,065
Bonds	190,465,266	179,474,583
Shares of public companies and equity funds	8,484,595	4,730,218
Other	5,607,003	5,387,782
	<b>208,785,123</b>	<b>197,042,648</b>
Investment in a subsidiary (Note 6)	<b>3,225,571</b>	<b>3,382,650</b>
Cash	1,886,648	1,686,789
Due and accrued investment income	1,619,865	1,615,686
Premiums receivable	8,623,286	9,066,012
Accounts receivable from ceding companies and reinsurers	13,163,360	16,430,968
Income taxes receivable	-	407,236
Capital assets (Note 7)	450,572	500,830
Deferred data processing costs (Note 8)	6,435,921	3,027,445
Balances receivable from affiliated companies	-	1,459
Other assets	144,704	139,672
	<b>32,324,356</b>	<b>32,876,097</b>
	<b>\$244,335,050</b>	<b>\$233,301,395</b>

TOTAL ASSETS  
(\$ 000's)

## NON-CONSOLIDATED BALANCE SHEET

**APPOINTED ACTUARY'S REPORT**  
**To the Policyholders and Shareholders of**  
**Optimum Reassurance Inc.**

I have valued the policy liabilities of Optimum Reassurance Inc. for its non-consolidated balance sheet as at December 31, 2004 and their change in the non-consolidated statement of income for the year then ended in accordance with accepted actuarial practice, including the selection of appropriate assumptions and methods.

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

Harvey Campbell  
 Fellow, Canadian Institute of Actuaries  
 Montreal, Quebec  
 February 10, 2005

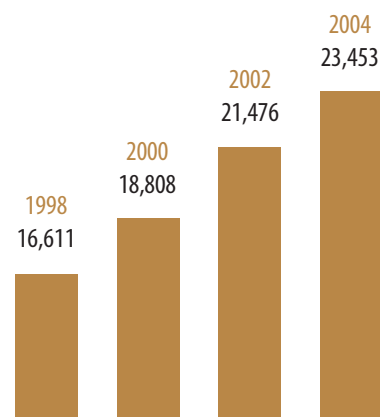
**NON-CONSOLIDATED BALANCE SHEET**

As at December 31, 2004

	2004	2003
<b>Liabilities</b>		
<b>Policy Liabilities</b>		
Actuarial reserve (Note 10)	\$148,729,116	\$154,649,590
Provision for unpaid or unreported claims	14,458,088	16,142,591
	<b>163,187,204</b>	<b>170,792,181</b>
<b>Other Liabilities</b>		
Premiums due to reinsurers	13,637,300	13,920,601
Balance due to ceding companies	12,027,089	4,688,516
Income taxes payable	2,128,494	-
Balance due to related companies	265,027	623,583
Promissory note due to a related company (Note 11)	5,000,000	-
Other liabilities	1,458,413	560,015
	<b>34,516,323</b>	<b>19,792,715</b>
<b>Deferred net gains on disposal of investments</b>	<b>21,543,457</b>	<b>16,653,419</b>
<b>Future income tax liabilities (Note 14)</b>	<b>1,635,076</b>	<b>3,755,215</b>
<b>Shareholders' Equity</b>		
Capital stock (Note 12)	10,170,000	10,170,000
Contributed surplus	1,094,165	1,094,165
Retained earnings	13,061,867	11,662,778
	<b>24,326,032</b>	<b>22,926,943</b>
Unrealized foreign currency translation adjustment on investment in a subsidiary (Note 6)	(873,042)	(619,078)
	<b>23,452,990</b>	<b>22,307,865</b>
	<b>\$244,335,050</b>	<b>\$233,301,395</b>

Approved by the Board,

Gilles Blondeau, Director  
 Mario Georgiev, Director

**TOTAL SHAREHOLDER'S EQUITY**  
 (\$ 000s')


## NON-CONSOLIDATED STATEMENT OF RETAINED EARNINGS

### NON-CONSOLIDATED STATEMENT OF RETAINED EARNINGS

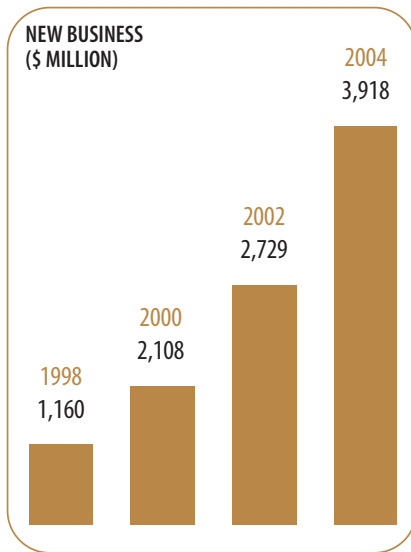
Year ended December 31, 2004

	Appropriated	Unappropriated	2004 Total	2003 Total
<b>Retained earnings, beginning of year</b>	<b>\$9,074,260</b>	<b>\$2,588,518</b>	<b>\$11,662,778</b>	\$10,097,037
Net income	-	3,049,089	3,049,089	3,165,741
Transfer (appropriation)	(476,831)	476,831	-	-
	<b>8,597,429</b>	<b>6,114,438</b>	<b>14,711,867</b>	13,262,778
<b>Dividends</b>				
Common shares	-	(725,328)	(725,328)	(675,328)
Class A preferred shares	-	(580,000)	(580,000)	(580,000)
Class B preferred shares	-	(344,672)	(344,672)	(344,672)
	-	<b>(1,650,000)</b>	<b>(1,650,000)</b>	(1,600,000)
<b>Retained earnings, end of year</b>	<b>\$ 8,597,429</b>	<b>\$4,464,438</b>	<b>\$13,061,867</b>	<b>\$11,662,778</b>

The appropriated surplus represents exclusively a negative actuarial reserve.

OPTIMUM REASSURANCE INC., ANNUAL REPORT 2004

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## NON-CONSOLIDATED STATEMENT OF CASH FLOWS

## NON-CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended December 31, 2004

	2004	2003
<b>Cash flows from operating activities</b>		
Net income	\$3,049,089	\$3,165,741
Adjustments for:		
Future income taxes	(2,120,139)	475,054
(Decrease) increase in actuarial reserve	(5,920,474)	10,547,457
Amortization, net (Note 15)	(3,925,263)	(3,740,537)
Equity in earnings of a subsidiary	(96,885)	8,021
Equity in earnings of a limited partnership	-	(43,027)
Net changes in non-cash operating working capital items	12,148,923	4,352,251
	<b>3,135,251</b>	<b>14,764,960</b>
<b>Cash flows from investing activities</b>		
Acquisition of capital assets	(101,525)	(102,279)
Increase in deferred data processing costs	(4,629,111)	(1,915,980)
Distribution of capital gain on investment	134,786	84,792
Acquisition of investments	(187,980,560)	(199,437,903)
Disposal of investments	186,291,018	188,481,543
	<b>(6,285,392)</b>	<b>(12,889,827)</b>
<b>Cash flows from financing activities</b>		
Dividends	(1,650,000)	(1,600,000)
Promissory note due to a related company	5,000,000	-
	<b>3,350,000</b>	<b>(1,600,000)</b>
Net increase in cash	199,859	275,133
Cash, beginning of year	1,686,789	1,411,656
<b>Cash, end of year</b>	<b>\$1,886,648</b>	<b>\$1,686,789</b>
<b>Supplemental information</b>		
Income taxes paid	\$713,187	\$1,498,104
Interest paid	41,781	-



## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 1. DESCRIPTION OF THE COMPANY

During the year, the Company modified its Articles of incorporation and since December 23, 2004, it has been governed by Part 1A of the Companies Act and the Act respecting insurance (Quebec). Its principal business activity is life reinsurance in Canada.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### Presentation of non-consolidated financial statements

The Insurance Act (Quebec) requires that the financial statements be prepared on a non-consolidated basis. The non-consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles except for the fact that they are not consolidated.

The investment in the subsidiary is recorded on an equity basis. The subsidiary is wholly owned. Consolidated financial statements have not been prepared as the shareholders of the Company have access to all pertinent information concerning the resources and operations of the Company and its subsidiary.

#### Bonds and short-term investments

Bonds and short-term investments are carried at cost, adjusted for amortization of premiums and discounts, using the effective interest method. Gains and losses on the disposal of bonds are recorded as "deferred net gains on disposal of investments" and are amortized on a straight-line basis over the remaining terms of the securities, up to a maximum of 20 years. Where a decline in the value of a bond or debenture is considered to be other than temporary, the book value is written down to reflect this impairment and the write-down is charged immediately to income.

#### Shares, bond funds and equity funds

Shares, bond funds and equity funds are carried at a moving average market value, whereby the carrying value is adjusted towards market price at 5% per quarter. The adjustment is recorded in the statement of income. Gains and losses on the disposal of shares, bond funds and equity funds, as well as distribution of gains and losses, are recorded as "deferred net gains on disposal of investments" and amortized on a declining balance basis at a rate of 15% per annum. Where a decline in the value of a share, bond fund or an equity fund is considered to be other than temporary, the book value is written down to reflect this impairment and the write-down is charged immediately to income.

#### Units in a limited partnership

The units in a limited partnership are carried at a moving average market value, whereby the carrying value is adjusted towards market price at 5% per quarter. The adjustment is recorded in the statement of income.

#### Capital assets

The capital assets are accounted for at cost less accumulated amortization. Amortization of capital assets is calculated using the following methods and rates or terms :

Office furniture	Declining balance	20%
Office equipment	Straight-line	3 years
Leasehold improvements	Straight-line	Terms of the leases
Telephone system	Declining balance	20%
Generator	Straight-line	20 years

#### Deferred data processing costs

Deferred data processing costs represent costs incurred for analysis and development and are amortized on a straight-line basis over five years. Deferred data processing costs related to software in development will start being amortized once in service.

Deferred data processing costs are reviewed for impairment when events or changes in the situation indicate that the book value may no longer be recoverable. An impairment loss is recorded when the book value exceeds the undiscounted cash flows resulting from their use and eventual disposition. The impairment loss is measured by the excess of book value over fair value.

#### Actuarial reserve

The actuarial reserve for insurance and annuity contracts is recorded according to the Appointed Actuary's report. It is calculated using the Canadian Asset and Liability Method. Together with future premiums and interest income, this reserve will provide for the future benefits payable by the Company.

#### Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the currently enacted or substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Income tax expense or benefit is the sum of the Company's provision for current income taxes and the difference between the opening and closing balances of future income tax assets and liabilities.

#### Use of estimates

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

#### Foreign currency translation

Monetary balance sheet accounts are translated into Canadian dollars using the current exchange rate in effect at the balance sheet date. Revenue, expense and non-monetary balance sheet accounts are translated at the rate of exchange at the date of the transaction. Gains and losses from such translations are recognized into income when incurred, except for the gains and losses from the translation of the investment in subsidiary which is reported in the account "Unrealized foreign currency translation adjustment on investment in a subsidiary" on the balance sheet.

#### Derivative financial instruments

The Company uses derivative financial instruments to manage exposure to interest rate risks associated with certain assets. The derivative financial instruments are accounted for on the balance sheet at fair value with realized and unrealized gains and losses recognized in income. The balances on derivative financial instruments are included with other assets and other liabilities respectively. The Company uses exclusively bond futures as derivative financial instruments.



## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 3. CHANGE IN ACCOUNTING POLICY

#### Shares, bond funds and equity funds

On January 1<sup>st</sup>, 2004, the Company adopted prospectively the recommendations from the Office of Superintendent of Financial Institutions ("OSFI") regarding the moving average market value method. This recommendation modified the market value amortization, whereby the carrying value was adjusted towards market price at 15% per annum to 5% per quarter. This new method did not have any significant impact on net income.

### 4. ROLE OF THE APPOINTED ACTUARY AND THE EXTERNAL AUDITORS

The Appointed Actuary is appointed by the Board of Directors pursuant to the Insurance Act (Québec). The Actuary's responsibility is to carry out an annual valuation of the Company's policy liabilities in accordance with the standards of the Canadian Institute of Actuaries and the requirements of the Insurance Act (Québec). In performing the valuation, the Actuary makes assumptions as to future rates of interest, mortality, morbidity, policy termination, inflation, expenses and other contingencies taking into consideration the circumstances of the Company. The Actuary's report outlines the scope of the valuation and the Actuary's opinion. The Actuary is required each year to analyze the financial condition of the Company and prepare a report for the Board of Directors. The analysis tests the capital adequacy of the Company under adverse economic and business conditions.

The external auditors are appointed by the shareholders pursuant to the Insurance Act (Québec). Their responsibility is to express an opinion whether the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the Company in accordance with Canadian generally accepted accounting principles.

In performing their audit, the auditors make use of the work of the Appointed Actuary and the Actuary's report on the policy liabilities. The auditors' report outlines the scope of their audit and their opinion.

### 5. INVESTMENTS

Book values and fair values of investments as at December 31, were as follows:

	2004		2003	
	Book Value	Fair Value	Book Value	Fair Value
<b>Short-term investments</b>	<b>\$4,228,259</b>	<b>4,228,293</b>	<b>\$7,450,065</b>	<b>\$7,450,065</b>
<b>Bonds</b>				
Federal	4,480,930	4,498,231	7,628,346	7,643,227
Provincial	97,806,083	113,478,982	94,475,546	109,848,436
Municipal	25,587,257	25,949,185	23,559,624	23,935,338
Public authorities	40,594,269	48,316,875	26,903,344	32,158,054
Canadian corporations	21,996,727	22,531,333	26,907,723	27,751,131
	<b>190,465,266</b>	<b>214,774,606</b>	<b>179,474,583</b>	<b>201,336,186</b>
<b>Shares of public companies and equity funds</b>				
Preferred shares of Canadian public companies	924,158	899,356	1,983,743	2,072,720
Common shares of Canadian public companies	7,396,751	7,829,376	2,486,022	2,497,258
Equity funds	163,686	190,956	260,453	296,363
	<b>8,484,595</b>	<b>8,919,688</b>	<b>4,730,218</b>	<b>4,866,341</b>
<b>Others</b>				
Units in a limited partnership	1,963,752	1,956,883	2,065,258	2,065,258
Policy loans	228,494	228,494	248,983	248,983
Bond funds	3,414,757	3,407,044	3,073,541	3,165,686
	<b>5,607,003</b>	<b>5,592,421</b>	<b>5,387,782</b>	<b>5,479,927</b>
	<b>\$208,785,123</b>	<b>\$233,515,008</b>	<b>\$197,042,648</b>	<b>\$219,132,519</b>

## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 5. INVESTMENTS (CONT'D)

The fair value of bonds, shares of public companies, equity funds, futures, short-term investments and bond funds were obtained using quoted market prices. Management believes that the fair value of the investment in a limited partnership approximates book value.

"Short-term investments" are essentially composed of Treasury bills and commercial papers.

"Equity funds" and "bond funds" are essentially composed of units of funds administered, managed and distributed by companies under common control.

The Company invests according to the investment policy established by the Company's Investment Committee.

The Company has deposited Treasury bills totalling \$850,000 (none in 2003) and \$912,564 (none in 2003) of cash with the fiduciary of the derivative financial instruments to secure the execution of these contracts.

#### Liquidity and interest rate risk

Maturities as at December 31, 2004:

	Less than 1 year	1 to 5 years	5 to 10 years	10 to 20 years	More than 20 years	Book Value
Bonds	\$11,684,630	\$78,932,221	\$13,724,770	\$48,750,746	\$37,372,899	\$190,465,266
Total percentage	6%	41%	7%	26%	20%	100%

The effective interest rate of bonds is 5.31% (5.55% in 2003) and the duration of the portfolio is 10.94 years (10.66 years in 2003). Most of the preferred shares have no specific maturity.

#### Investment income

	2004	2003
Interest	\$8,007,992	\$8,134,310
Amortization of bond discounts/premiums, net	2,618,202	2,241,660
Dividends	296,633	603,982
Amortization of deferred net gains on disposal of investments	2,560,876	2,276,160
Amortization of unrealized gains and losses on shares, equity funds and bond funds	118,603	40,283
Equity in earnings of a limited partnership	—	43,027
Distribution of capital gain on investments held by the limited partnership	281,386	—
Equity in earnings of a subsidiary	96,885	(8,021)
Unrealized loss on bond futures	(484,461)	—
Realized loss on bond futures	(799,425)	—
	<b>12,696,691</b>	<b>13,331,401</b>
<b>Expenses</b>		
Carrying charges	394,991	303,728
<b>Total investment income</b>	<b>\$12,301,700</b>	<b>\$13,027,673</b>



## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 5. INVESTMENTS (CONT'D)

#### Derivative financial instruments

The Company uses derivative financial instruments in the normal course of managing exposure to fluctuations in interest rates and market values. The following table summarizes the Company's portfolio and fair value:

	2004 Bond Futures	2003
Nominal amount by term to maturity of underlying bonds:		
30 years	\$23,286,402	\$-
10 years	12,002,909	-
	<u>\$35,289,311</u>	<u>\$-</u>
Fair value	<u>\$(484,461)</u>	<u>\$-</u>

These bond futures mature on February 28, 2005.

### 6. INVESTMENT IN A SUBSIDIARY

As indicated in Note 2, the investment in a subsidiary is recorded on an equity basis as required by regulatory requirements.

The Company did not invest any new capital in 2004 nor in 2003 in its American subsidiary, Optimum International (US) Inc., which wholly owns an American life insurance company, Windsor Life Insurance Company. The unaudited condensed consolidated financial statements of the subsidiary prepared in accordance with Canadian generally accepted accounting principles are as follows as at December 31:

	2004	2003
<b>Assets</b>		
Investments	\$2,877,455	\$3,253,222
Cash	423,289	136,354
Future income tax assets	83,663	155,074
Other assets	309,821	718,810
	<u>\$3,694,228</u>	<u>\$4,263,460</u>
<b>Liabilities and Shareholders' Equity</b>		
Actuarial reserve	\$125,816	\$98,481
Other liabilities	321,128	757,509
Deferred net gains on disposal of investments	21,713	24,820
Shareholders' equity	3,225,571	3,382,650
	<u>\$3,694,228</u>	<u>\$4,263,460</u>
Revenue	\$688,776	\$701,804
Expenses	526,557	720,339
Net income (loss) before income taxes	162,219	(18,535)
Income tax expense (benefit)	65,334	(10,514)
<b>Net income (loss)</b>	<b>\$96,885</b>	<b>\$(8,021)</b>

The equity value of the investment as at December 31 is as follows:

	2004	2003
Acquisition cost	\$940,000	\$940,000
Capital injection	3,074,620	3,074,620
	<u>4,014,620</u>	<u>4,014,620</u>
Equity in earnings of the subsidiary	83,993	(12,892)
Unrealized foreign currency translation adjustment	(873,042)	(619,078)
	<u>\$3,225,571</u>	<u>\$3,382,650</u>

## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 7. CAPITAL ASSETS

	Cost	Accumulated Amortization	2004	2003
			Net Book Value	Net Book Value
Office furniture	\$628,896	\$427,135	\$201,761	\$202,808
Office equipment	295,903	220,630	75,273	75,354
Leasehold improvements	583,308	435,269	148,039	194,058
Telephone system	40,754	30,313	10,441	12,581
Generator	19,429	4,371	15,058	16,029
	<b>\$1,568,290</b>	<b>\$1,117,718</b>	<b>\$450,572</b>	<b>\$500,830</b>

### 8. DEFERRED DATA PROCESSING COSTS

	2004	2003
Costs	\$6,415,316	\$6,279,252
Accumulated amortization	(5,618,353)	(4,397,718)
Software in development	5,638,958	1,145,911
<b>Net Book Value</b>	<b>\$6,435,921</b>	<b>\$3,027,445</b>

No amortization was calculated on the software in development.

The Company wrote off an amount of \$506,756 of unamortized deferred data processing costs representing software that is no longer of future value to the Company.

### 9. REINSURANCE

Part of the risks assumed by the Company is transferred to other reinsurers. The retrocession of reinsured risks does not relieve the Company of its responsibilities to the ceding companies. However, it allows the Company to recover a portion of paid claims from the reinsurers. The Company determines its retention limit on each assumed risk, either as a fixed amount or as a share, for each line of business. Consequently, at December 31, the Company retained nearly 25% (23% in 2003) of its assumed risks.

Reinsurance is ceded to various reinsurers. As at December 31, 2004, 46% (41% in 2003) of the reinsurance was ceded to a single reinsurer. In order to monitor the related risk, the Company continuously evaluates the financial position of its reinsurers.

The amounts shown in the statement of income are net of the following amounts related to reinsurance ceded:

	2004	2003
Commissions and allowances	\$30,931,555	\$26,299,086
Claims	46,054,940	39,895,043
Cash surrender benefits	7,122,821	8,443,390
Interest (received from) paid out to policyholders and insureds	67,047	165,937

Furthermore, the Company holds letters of credit from reinsurers totalling \$500,000 as of December 31, 2004 (\$500,000 in 2003) to settle liabilities ceded under these retrocession agreements.

### 10. ACTUARIAL RESERVE

#### Nature of the liability

The actuarial reserve represents an amount which, together with estimated future premiums and investment income, will be sufficient to settle estimated future claims, expenses and taxes on policies in force. The actuarial reserve is established according to accepted actuarial practices and the standards of the Canadian Institute of Actuaries.

The actuarial reserve and the increase in actuarial reserve by line of business are as follows:

	2004			2003	
	Reinsurance Business			Total	Total
	Individual	Group	Other		
Actuarial reserve, beginning of year	\$111,204,677	\$41,594,777	\$1,850,136	\$154,649,590	\$144,102,133
Changes due to new business	6,671,074	346,794	–	7,017,868	11,286,013
Normal annual changes	1,471,490	(6,852,014)	(55,038)	(5,435,562)	(738,556)
Changes due to recapture of business	(7,502,780)	–	–	(7,502,780)	–
<b>Actuarial reserve, end of year</b>	<b>\$111,844,461</b>	<b>\$35,089,557</b>	<b>\$1,795,098</b>	<b>\$148,729,116</b>	<b>\$154,649,590</b>

The Company does not segment its assets by line of business.



## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 10. ACTUARIAL RESERVE (CONT'D)

#### Assumptions

The calculation of the actuarial liability requires assumptions as to the future course of events, which will give rise to payments by the Company. These assumptions are established on the basis of best estimates of mortality, morbidity, rates of return on invested assets, lapse rates, administrative expenses, inflation and taxation.

Each assumption is then strengthened by a margin for adverse deviation in order to recognize the uncertainty associated with the estimation of future events and to create a provision for possible deterioration in experience. The following paragraphs describe the nature of the assumptions and the methods used in determining them.

#### i) Mortality and morbidity

The Company conducts experience studies of mortality and morbidity on a regular basis. These studies compare the actual claims to expected claims based on industry tables. The assumptions for mortality and morbidity are established using the Company experience combined with industry experience averaged over several years. Given the size of the Company and the statistical nature of claims, the Company may experience a level of claims different than that expected in a particular year.

#### ii) Economic assumptions

The Canadian Asset and Liability Method requires the determination of an amount of the Company's assets which will be sufficient without being excessive, to allow the Company, throughout the term of the liability, to honor the commitments it undertook in subscribing its insurance contracts and pay the administrative expenses relating to these contracts. The determination of the sufficiency of the amount of assets requires assumptions for:

- (i) future cash flows generated by existing assets
- (ii) estimated future cash flows generated by policies in force
- (iii) the Company's investment policy
- (iv) estimated credit loss from asset defaults
- (v) range of scenarios of future reinvestment rates

There are several scenarios prescribed by the Canadian Institute of Actuaries in addition to those formulated by the actuary. The actuarial reserve is based on the amount of assets required in the most unfavorable scenario.

#### iii) Lapse rates

The policyholder has the right to cease payment of premiums at any time, which may result in the cessation of the insurance contract. The lapse rate has an important effect on the amount of the actuarial reserve for certain types of policies.

The Company undertakes annual studies of lapse rates by type of policy. The assumptions for lapse rates are established based on these studies. For some types of policies where there is little or no experience, the Company uses conservative estimates of lapse rates.

#### iv) Administrative expenses and inflation

The calculation of the actuarial reserve requires an estimate of the expenses associated with the administration of the policies in force. The Company periodically undertakes expense studies which establish the current level of administrative expenses. These administrative expenses are projected based on the expected future in-force and on estimated future inflation rates. Estimated future inflation rates are linked directly to the projection of the future rates of reinvestment.

Although the Company's expense studies have shown continuous gains in productivity over the last several years, no future improvement in productivity has been assumed.

### 11. PROMISSORY NOTE DUE TO A RELATED COMPANY

	2004	2003
Promissory note payable to a related company, interest rate of 2.5%, payable on or before December 31, 2005	\$5,000,000	—

With regards to a capital injection of \$5,000,000, which will occur in 2005, a related company advanced the sum to the Company awaiting approval of the modification to the Articles of incorporation as described in note 1.

### 12. CAPITAL STOCK

On December 23, 2004, the Company recapitalized its class "B" preferred shares, modified and redesignated its authorized capital stock and converted all of its issued and fully paid preferred shares into newly created class "A" common shares.

Authorized, unlimited number of

Class A voting common shares, with a par value of \$100 per share

Class B voting common shares, with no par value

Class P-A preferred shares, 8% of the redemption price, non-cumulative, non-voting, with a par value of \$100 per share, redeemable by the Company

	2004	2003
<b>Issued and fully paid</b>		
101,700 common shares, class A	\$10,170,000	\$—
200 voting common shares, with a par value of \$100 per share	—	20,000
72,500 non-voting Class A preferred shares, 8% of the redemption price, non-cumulative, redeemable for an amount equal to their par value of \$100	—	7,250,000
43,084 non-voting Class B preferred shares, 8% of redemption price, non-cumulative, par value \$67.31 redeemable for an amount equal to \$100	—	2,900,000
	<b>\$10,170,000</b>	<b>\$10,170,000</b>

## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 13. MODIFIED COINSURANCE ADJUSTMENT

The Company has modified coinsurance treaties with retrocessionaires. Under these treaties, the retrocessionaires receive their proportionate share of the gross premium, same as in coinsurance. The Company, however, maintains the entire reserve on reinsured policies. The retrocessionaires are required to return their share of the increase in statutory reserves, net of fluctuations in certain other elements. The modified coinsurance adjustment reflects the annual change in this account. In 2004, the Company recaptured some retrocession, resulting in a modified coinsurance adjustment compensated by a single premium adjustment of \$8,184,110 presented as a reduction of ceded premiums.

### 14. INCOME TAXES

The Company's income tax expense (benefit) for the year ended December 31 consists of the following:

	2004	2003
Current income taxes	\$3,248,917	\$1,165,029
Future income taxes	(2,120,139)	475,054
	<b>\$1,128,778</b>	<b>\$1,640,083</b>

The tax consequences of the temporary differences, which give rise to the following future income tax assets and liabilities as at December 31, are as follows:

	2004	2003
<b>Future income tax assets</b>		
Units in a limited partnership	\$39,890	\$17,173
Bond futures	155,851	–
Shares of public companies	131,197	–
Capital assets	8,859	9,386
Provision for unpaid or unreported claims	61,009	52,928
Deferred net gains on disposal of investments	3,449,035	1,448,152
	<b>3,845,841</b>	<b>1,527,639</b>

#### Future income tax liabilities

Equity funds	8,182	6,204
Shares of public companies	–	41,127
Policy loans	73,507	80,098
Deferred data processing costs	234,497	481,424
Actuarial reserve	5,164,731	4,674,001
	<b>5,480,917</b>	<b>5,282,854</b>

<b>Future income tax liabilities, net</b>	<b>\$1,635,076</b>	<b>\$3,755,215</b>
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Income tax expense (benefit) differs from the amount computed by applying the combined federal and provincial statutory rate to income before income taxes for the following reasons:

	2004	2003
Income before income taxes	\$4,177,867	\$4,805,824
Statutory income tax rate	32.17%	34.30%
Expected provision for income tax	<b>\$1,344,020</b>	<b>\$1,648,398</b>
Adjustment to future income tax assets and liabilities following changes in tax laws and tax rates	\$–	\$159,835
Deductible dividend income	(67,833)	(200,250)
Equity in earnings of a subsidiary	(31,168)	2,751
Non-deductible expenses	16,783	18,404
Large corporation tax	–	20,000
Non-taxable capital (gains) losses	(45,261)	6,421
Other	(87,763)	(15,476)
	<b>\$1,128,778</b>	<b>\$1,640,083</b>

No future tax liability has been calculated on the temporary difference created by the undistributed earnings of the Company's subsidiary, since the Company believes that this temporary difference will not reverse in the foreseeable future.

## NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

For the Year ended December 31, 2004

### 15. INCOME STATEMENT INFORMATION

The following items were accounted for in the Statement of Income:

	2004	2003
Amortization of capital assets	\$151,783	\$145,106
Amortization and write-off of deferred data processing costs	1,220,635	672,460
Amortization of bond discounts/premiums	(2,618,202)	(2,241,660)
Amortization of deferred net gains on disposal of investments	(2,560,876)	(2,276,160)
Amortization of unrealized gains/losses on shares, equity funds and bond funds	(118,603)	(40,283)
	<u>\$(3,925,263)</u>	<u>\$(3,740,537)</u>

### 16. RELATED PARTY TRANSACTIONS

The statement of income includes \$2,675,480 (\$4,307,395 in 2003) of claims and \$4,393,029 (\$3,972,110 in 2003) of expenses, including reimbursement of \$22,000 (none in 2003) for sublet space, resulting from transactions made with various related companies. In 2003, there were also \$100,335 of other income and \$2,944,100 of written premiums incurred with a related company.

During the year, a related party recaptured a reinsurance portfolio from the Company for an amount of \$6,527,419 net of commissions, included in the line "Cash surrender benefits" on the statement of income, thereby decreasing the actuarial reserve.

During the year, the Company acquired computer services from a related company, of which an amount of \$1,917,996 (\$1,149,041 in 2003) was recorded under deferred data processing costs. Shares of public companies include \$1,655,066 (\$965,160 in 2003) of shares of a related company with a fair value of \$1,714,620 (\$636,300 in 2003) of which \$681,543 (\$40,233 in 2003) was acquired during the year.

These transactions occurred in the normal course of business and were measured at values established and agreed to by the related parties. The related companies presented in these financial statements are companies under common control.

### 17. COMMITMENTS

- a) The Company has subscribed to 1,200 units of a limited partnership for a total cost of \$3,000,000. A cumulative amount of \$2,830,883 (\$2,625,000 in 2003) has been invested. This investment is recorded with other investments.
- b) The Company is committed to pay \$2,475,348, under non-cancelable operating leases for its business premises. This amount excludes the operating costs estimated based on actual costs incurred by the lesser of \$215,000 per annum. On the other hand, the Company sublet business premises to a related party for a total amount of \$99,382. This amount excludes operating costs estimated based on actual figures at \$28,000 per annum.

Minimum amounts payable over the next five years, net of sub-lease revenues, are as follows :

2005	<u>\$244,733</u>
2006	<u>\$221,763</u>
2007	<u>\$217,129</u>
2008	<u>\$241,046</u>
2009	<u>\$246,067</u>

- c) The Company has a line of credit of \$400,000 with a financial institution. This line of credit was not used by the Company as at December 31, 2004.

### 18. PENSION PLAN

The Company participates in a defined contribution plan. The Company's contributions equal those required from its employees. Contributions for the year were \$117,593 (\$105,560 in 2003).

### 19. FINANCIAL INSTRUMENTS

#### Fair value

The carrying value of financial assets and liabilities, other than the investments as described in note 5, approximates their fair value.

### 20. COMPARATIVE FIGURES

Certain 2003 figures have been reclassified to conform with the current year's presentation.

## OFFICERS

### OFFICERS

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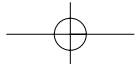
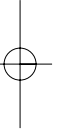
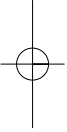
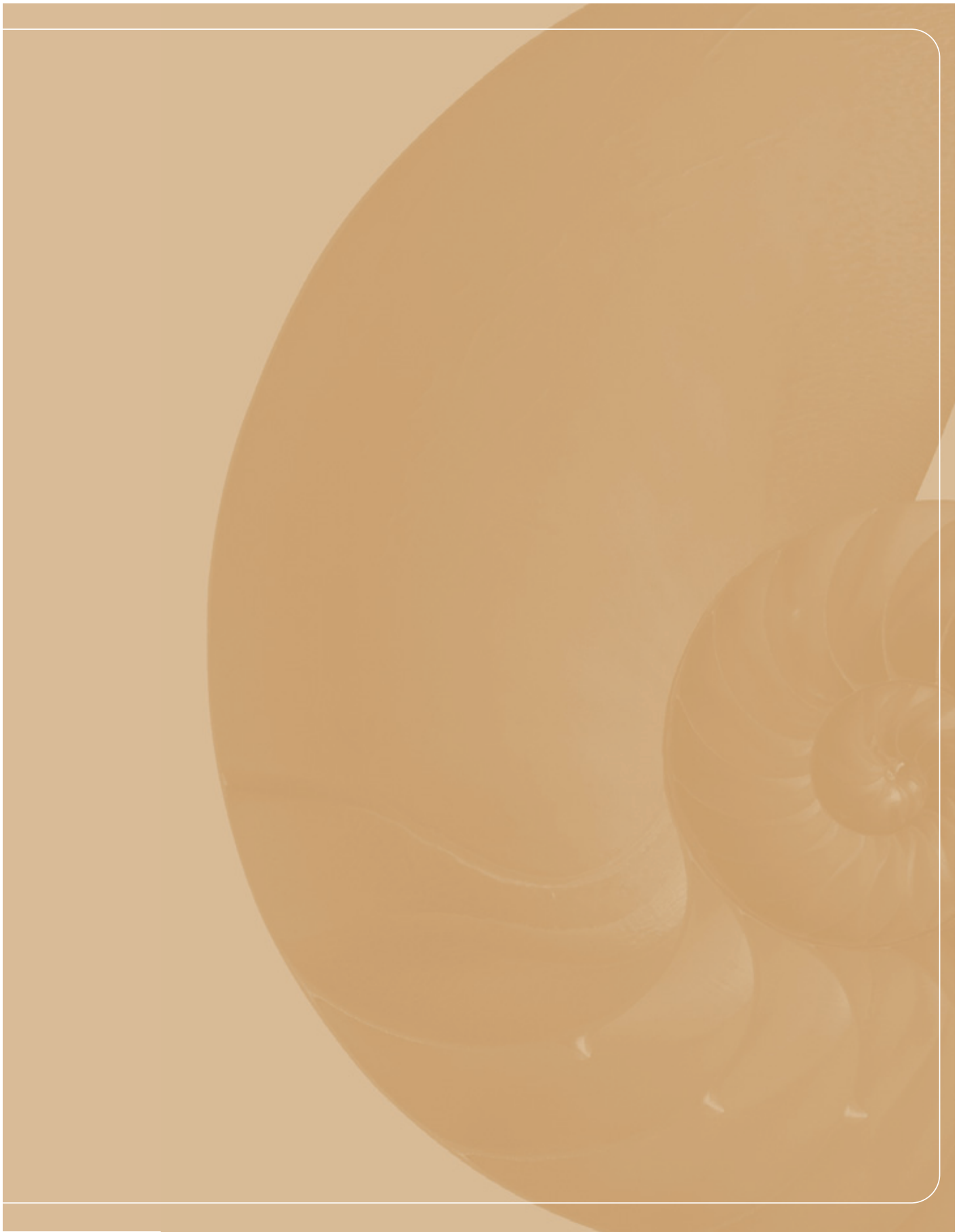
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