

2010

Annual

Report

THE GUARANTEE
COMPANY OF
NORTH AMERICA



THE GUARANTEE COMPANY OF NORTH AMERICA

Directors

Bruno Desjardins, Q.C.
Chairman of the Board
Lawyer

Jules R. Quenneville
Chief Executive Officer

Robert A. Dempsey
President and
Chief Operating Officer

Richard R. Brock
Chairman and CEO
Brock Solutions Inc.

André Bureau, O.C.
Chairman of the Board
Astral Media
Counsel, Heenan Blaikie

Maureen Cowan
Chairman and
Co-Chief Executive Officer
Princeton Holdings Limited

Colin H. H. McNairn
Corporate Director
Lawyer

Thomas C. MacMillan
Chairman
CIBC Mellon

Michael C. Peters
President
Safeco Surety, Retired

John Quinlan
Vice President
Princeton Holdings Limited

THE GUARANTEE COMPANY OF NORTH AMERICA

Officers

Jules R. Quenneville
Chief Executive Officer

Robert A. Dempsey
President and
Chief Operating Officer

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Vice President
Information Technology

Dean M. Bast
Vice President
Marketing and Business
Development

Guy Bonin
Vice President
Personal Lines
Quebec Region

Ron Burns
Vice President
Personal Lines
Central Region

Alex Campbell
Vice President
Regional General Manager
Western Region

Christopher Campbell
National Vice President
Corporate Risk

Michael J. Conlon
Vice President
Claims
Woodstock Branch

Patrick Cowan
Vice President
Finance and
Chief Financial Officer

John R. Emory
Vice President,
Regional Manager,
Quebec & National Vice
President, Personal Lines

Frank Faieta
Vice President
Claims
Toronto Branch

François Forget
Vice President
Claims
Montreal Branch

Bob Gallimore
Vice President, Surety
Prairie Region

Stephen Halfpenny
Vice President
Corporate

Michael Kosmalski
Vice President
Investments

Richard Longland
Vice President
Surety
Central and Atlantic Region

Michael B. Mallett
Vice President
Underwriting
Public Authority Lines

Randall L. Musselman
Vice President
Risk Management and
Government Regulation
Corporate Secretary

Norman Nemetz
Vice President
Reinsurance and Business
Analysis

G rard Philippon
Vice President
Credit Insurance

Richard Pouliot
National Vice President
Claims
Regional General Manager
Central and Atlantic Region

Yves Raymond
Vice President
Actuarial Services

Robert Smith
National Vice President
Surety Underwriting Standards

THE GUARANTEE COMPANY OF NORTH AMERICA USA

Officers

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Chief Executive Officer

Robert A. Dempsey
President

Stephen Ruschak
Vice President
Chief Operating Officer

Stephen Dullard
National Vice President
Surety Underwriting
Standards

Randall L. Musselman
Corporate Secretary

Gregory G. O'Mahony
Vice President
Claims

Sara J. Schrauben
Treasurer and
Chief Financial Officer

Joseph A. Sprys
Vice President
Regional Surety Manager

Executive Report

Gross written premiums increased by 3.7% to \$356 million for the year 2010. Retained earnings increased \$12 million to \$413 million at December 31, 2010. Net Earnings for the year were \$19.5 million while total comprehensive income was \$9.6 million.

Our Surety business reported positive underwriting results for the year even though certain of our regional operations experienced increased frequency and severity in claims reflecting the downturn in their local construction economies. We were able to continue to successfully grow our commercial surety business extending the use of our web-based technology platform. We continue to establish ourselves as a solid provider of surety bonds in the United States. Both A.M. Best and Standard & Poor's have reaffirmed our ratings.

Guarantee Gold Centres in Toronto, Montreal, Quebec and Woodstock, which underwrite high value personal lines, generated solid growth and positive underwriting results. Our residential portfolio results improved significantly from the prior year through focused underwriting, rate adequacy, improved property valuations and less severe weather patterns. Changes in coverage options promulgated by the Ontario regulator of auto insurance, together with adequate rates, improved our auto underwriting results.

Our Corporate Insurance Division which underwrites Fidelity and Directors and Officers Liability insurance achieved profitable growth despite a continuing soft insurance market for these products.

The investment portfolio performed well despite ongoing volatility in today's financial markets. Again in 2010, historically low investment yields adversely affected investment income.

Our company's strength continues to be our strong capital position, expertise in our specialty lines, and continuing strong support from our broker/agency force. With the continuing dedication and focused efforts of our employees, we will deliver the level of service that is expected of us as a strong and stable insurer and business partner.



Jules R. Quenneville
Chief Executive Officer



Robert A. Dempsey
President and
Chief Operating Officer

Consolidated Balance Sheet

December 31, 2010

(in thousands of Canadian dollars)	2010	2009
ASSETS		
Cash and cash equivalents	37,610	62,611
Investments (note 3)	792,800	748,640
Accounts receivable (note 5)	93,123	84,816
Deferred premium acquisition costs	47,994	45,607
Provision for recoverable portion of unpaid claims	73,596	45,888
Unearned premiums – ceded	26,673	22,744
Future income taxes	13,966	13,352
Capital assets (note 6)	9,116	9,914
	1,094,878	1,033,572
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Accounts payable	22,455	35,602
Deferred commissions	8,871	7,587
Unpaid claims – gross	481,123	416,574
Unearned premiums - gross	169,106	162,473
	681,555	622,236
SHAREHOLDERS' EQUITY		
Capital stock (note 8)	936	936
Contributed surplus	811	811
Accumulated other comprehensive (loss) income	(1,659)	8,209
Retained earnings	413,235	401,380
	413,323	411,336
	1,094,878	1,033,572

See accompanying notes to consolidated financial statements.

On behalf of the Board of Directors:


Director


Director

Consolidated Statement of Comprehensive Income Year ended December 31, 2010

(in thousands of Canadian dollars, except net earnings and comprehensive income per common share)	2010	2009
GROSS PREMIUMS WRITTEN	356,043	343,266
NET PREMIUMS WRITTEN	286,669	281,423
REVENUE		
Net premiums earned	283,531	274,450
Net investment income (note 3)	28,423	31,471
	311,954	305,921
EXPENSES		
Claims incurred (note 7)	185,695	198,196
Commissions	60,970	60,114
Premium taxes	8,815	7,602
Other underwriting and administrative	43,148	41,370
	298,628	307,282
EARNINGS (LOSS) BEFORE GAIN (LOSS) ON SALE OF INVESTMENTS	13,326	(1,361)
GAIN (LOSS) ON SALE OF INVESTMENTS – net (note 3)	5,992	(6,250)
EARNINGS (LOSS) BEFORE INCOME TAXES	19,318	(7,611)
INCOME TAX RECOVERY		
Current	825	(10,112)
Future	(1,035)	(7,141)
	(210)	(17,253)
NET EARNINGS	19,528	9,642
CHANGE IN UNREALIZED INVESTMENT GAINS	675	88,726
UNREALIZED FOREIGN EXCHANGE LOSSES ON CONSOLIDATION	(10,755)	(30,407)
OTHER COMPREHENSIVE (LOSS) INCOME BEFORE INCOME TAXES	(10,080)	58,319
INCOME TAX (RECOVERY) EXPENSE	(212)	25,544
OTHER COMPREHENSIVE (LOSS) INCOME AFTER INCOME TAXES	(9,868)	32,775
COMPREHENSIVE INCOME	9,660	42,417
NET EARNINGS PER COMMON SHARE (\$)	104.35	51.52
COMPREHENSIVE INCOME PER COMMON SHARE (\$)	51.62	226.65

See accompanying notes to consolidated financial statements.

Statement of Retained Earnings and Accumulated Other Comprehensive (Loss) Income Year ended December 31, 2010

(in thousands of Canadian dollars)	2010	2009
Consolidated Statement of Retained Earnings		
RETAINED EARNINGS – BEGINNING OF YEAR	401,380	399,411
NET EARNINGS	19,528	9,642
	420,908	409,053
DIVIDENDS	7,673	7,673
RETAINED EARNINGS – END OF YEAR	413,235	401,380

Consolidated Statement of Accumulated Other Comprehensive (Loss) Income

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) – BEGINNING OF YEAR		
Unrealized investment gains (losses), net of taxes	29,964	(33,218)
Unrealized foreign exchange (losses) gains on consolidation	(21,755)	8,652
	8,209	(24,566)
OTHER COMPREHENSIVE (LOSS) INCOME BEFORE INCOME TAXES		
Unrealized investment gains (losses), net of taxes	887	63,182
Unrealized foreign exchange (losses) on consolidation	(10,755)	(30,407)
	(9,868)	32,775
ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME – END OF YEAR		
Unrealized investment gains, net of taxes	30,851	29,964
Unrealized foreign exchange (losses) on consolidation	(32,510)	(21,755)
	(1,659)	8,209

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows Year ended December 31, 2010

(in thousands of Canadian dollars)	2010	2009
CASH FLOWS PROVIDED BY (USED IN)		
OPERATING ACTIVITIES		
Receipts (payments) of		
Premiums received, net of commissions	294,152	274,027
Interest and dividends	29,272	32,159
Claims - net of salvage and subrogation	(144,223)	(153,970)
Reinsurance premiums net of claims paid	(66,146)	(60,807)
Expenses	(42,023)	(39,145)
Income taxes	(30,420)	35,187
Other taxes	(9,401)	(17,144)
	<u>31,211</u>	<u>70,307</u>
INVESTING ACTIVITIES		
Sales of investments	185,107	271,410
Purchases of investments	(232,701)	(457,527)
Purchases of capital assets	(410)	(826)
	<u>(48,004)</u>	<u>(186,943)</u>
FINANCING ACTIVITIES		
Dividends paid	(7,673)	(7,673)
	<u>(7,673)</u>	<u>(7,673)</u>
DECREASE IN CASH AND CASH EQUIVALENTS	(24,466)	(124,309)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	62,611	204,963
ADJUSTMENT FOR FOREIGN CURRENCY EXCHANGE	(535)	(18,043)
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>37,610</u>	<u>62,611</u>

See accompanying notes to consolidated financial statements.

Notes to consolidated financial statements

Year ended December 31, 2010

(in thousands of Canadian dollars)

1. NATURE OF BUSINESS OPERATIONS

The Guarantee Company of North America (the "Company") and its subsidiary, The Guarantee Company of North America USA, underwrite property and casualty insurance in both Canada and the United States of America.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, The Guarantee Company of North America (US) Holdings, Ltd, The Guarantee Company of North America USA, and QDM Insurance Agency Inc.

General

Preparation of financial statements for an insurer in accordance with Canadian generally accepted accounting principles entails the use by management of estimates and assumptions respecting all related assets and liabilities with the result that actual outcomes may differ from the estimates.

Financial instruments

Held-for-trading investments, which comprise financial derivatives and cash equivalents, that is, cash and short-term investments maturing within 90 days of the date of purchase, are recorded on the consolidated balance sheet at fair value with realized gains and losses and changes in unrealized gains and losses recorded in investment income in the consolidated statement of comprehensive income.

Management has designated as available-for-sale all financial assets, other than cash and short-term investments, loans and receivables, and bonds and money-market notes held by its US operating subsidiary.

Accounts receivable, which are classified as loans and receivables, and accounts payable and accrued liabilities, which are classified as financial liabilities, are measured at amortized cost using the effective interest rate method.

Available-for-sale financial assets, which comprise equities and bonds other than those designated as held-to-maturity, with quoted prices in an active market, are carried at fair value, inclusive of purchase costs, on the consolidated balance sheet from the trade date. Changes in fair value of equities are recorded, net of income taxes, in other comprehensive income until the financial asset has been sold or has become other-than-temporarily impaired. Changes in the difference between the fair value of available-for-sale bonds and the amortized value of such bonds is recorded, net of income taxes, in other comprehensive income until the financial asset has been sold or has become other-than-temporarily impaired, after which time the full amount of gain or loss is recorded in net earnings. Changes in the amortized value of bonds is recorded as interest income. The amortization of premiums and discounts on the purchase of bonds is calculated using the effective interest rate method.

When an asset classified as available-for-sale is disposed of, or has become impaired, the accumulated fair-value adjustments, net of income taxes, recognized in accumulated other comprehensive income are transferred to net earnings and, accordingly, a corresponding adjustment is made to other comprehensive income.

Bonds held by the Company's regulated US subsidiary have been designated as held-to-maturity and are recorded initially at fair value and subsequently are measured at amortized cost less any provisions for impairments in value that are other-than-temporary. All held-to-maturity investments have fixed, determinable payments and management has the positive intention and ability to hold them to maturity.

The Company's financial instruments are priced using quoted, unadjusted bid prices in active markets for identical assets or liabilities.

At each reporting period, the Company assesses its investments for possible impairment by reviewing each security individually in order to ensure that the credit rating of the issuer remains investment grade and that the issuer has not defaulted on any interest or dividend payments due. The Company estimates the extent of impairment and, when there is objective evidence that the investment is impaired and the impairment is other-than-temporary, records the corresponding charge separately in net earnings.

Notes to consolidated financial statements, continued

Year ended December 31, 2010

(in thousands of Canadian dollars)

Capital assets

Land, property, and equipment are stated at cost. Amortization is provided over the estimated useful lives of depreciable assets using the declining balance and straight-line methods at rates ranging from 4% to 33%.

Deferred premium acquisition costs

These costs, including primarily brokers' commissions and premium taxes, are, to the extent that they are considered recoverable, deferred and amortized over the terms of the related insurance contracts.

Unpaid claims

Liabilities for unpaid claims include the Company's estimates of loss and adjustment expenses for reported and unreported claims less estimated recoveries expected on these claims. These estimates are calculated in accordance with accepted, current actuarial practice for Canadian property and casualty insurers and are based upon past claims experience modified for current trends as well as prevailing economic, legal and social conditions. They are discounted at rates, presently 4.3% (2009 – 4.2%), that are determined by reference to the Company's rate of return on its invested assets, which adjustment reduces the stated liability by approximately 14% (2009 - 13%), and increased by actuarially determined provisions intended to allow for uncertainty inherent in the estimation process which adjustment increases the stated liability by approximately 13% (2009 - 13%). Such estimates are continually reviewed and updated and all resulting adjustments, which can be material, are reflected in current operating results. Methods of estimation have been used which the Company believes produce reasonable results given current information.

Unearned premiums

Premiums are earned over the terms of the related insurance contracts. Accordingly, an unearned premium provision is established for the portion of net premiums written, which is applicable to the unexpired portion of policies. Unearned premiums are carried on an undiscounted basis.

Comprehensive income

Comprehensive income comprises net earnings and other comprehensive income and includes all changes in equity during the year, except those resulting from investments by and distributions to owners. Changes in unrealized gains and losses on available-for-sale investments are recorded in other comprehensive income and in accumulated other comprehensive income on the balance sheet until such time as the underlying asset is sold at which time the appropriate balances are transferred to net earnings and to retained earnings. The changes in valuation of assets held by the Company's self-sustaining foreign subsidiaries that occur as a result of translation of these amounts into Canadian currency are recorded in other comprehensive income and in accumulated other comprehensive income.

Future income taxes

Future income taxes are provided in respect of assets and liabilities for which book values differ from tax values at rates expected to be enacted when differences reverse. They result principally from provisions of the Income Tax Act (Canada) requiring discounting of claims and permitting application of prior year losses against taxable income of future years.

Goodwill

Goodwill represents the excess of consideration paid for the Company's operating companies in the United States over the value of net tangible assets and licences acquired. Annually, the Company assesses the value of this asset for impairment and, to the extent of any such impairment, immediately charges the amount of any excess goodwill to net earnings. The year-end balance of goodwill is translated to Canadian dollars at the year-end rate.

Foreign-currency exchange transactions

The Company and its subsidiaries are accounted for as self-sustaining operations. Accordingly, the values in foreign currency of all assets and liabilities are translated at year-end rates. Revenues and expenses are translated at rates prevailing when the transactions occur.

Notes to consolidated financial statements, continued

Year ended December 31, 2010

(in thousands of Canadian dollars)

Foreign-currency exchange transactions (continued)

Realized gains or losses on foreign-exchange transactions and unrealized gains and losses on the translation of monetary assets and liabilities not classified as available-for-sale are recognized in net earnings. Unrealized gains and losses on translation of monetary assets and liabilities classified as available for sale are recognized in other comprehensive income.

Employee future benefits

The Company maintains pension plans for the benefit of its employees. Every three years, and most recently in respect of the 2007 year end, the Company obtains an actuarial valuation where required for these plans and the Company administers and invests the plan assets primarily in equities (17% to 82%) and fixed income securities (25% to 90%). The Company updates these valuations, using up-to-date estimates of plan yields and discount rates, at each of the two subsequent year ends. At each fiscal year end, the Company estimates the present value of all plan obligations and calculates its net pension liability by subtracting the fair value of assets in the plans from the value of all obligations. The present value of all obligations is determined as the present value of all future inflows of employee contributions and outflows of plan benefits and expenses, discounted using rates of return consistent with those earned on high-quality commercial bonds. All actuarial gains and losses arising in the determination of these estimates are recorded immediately in net earnings.

3. INVESTMENTS

	Average annual yield %	2010		2009	
		Carrying value	Fair value at market	Carrying value	Fair value at market
Held-for-trading					
Short-term investments		106,835	106,835	77,978	77,978
Written call options		(1,346)	(1,346)	-	-
Total held-for-trading		<u>105,489</u>	<u>105,489</u>	<u>77,978</u>	<u>77,978</u>
Held-for-maturity					
Bonds and debentures:	1.32				
Maturing within 1 year		21,540	21,673	21,573	21,774
Maturing in 1 to 10 years		99,868	104,704	115,004	119,080
Total held-to-maturity		<u>121,408</u>	<u>126,377</u>	<u>136,577</u>	<u>140,854</u>
Available-for-sale					
Bonds and debentures:	1.40				
Maturing within 1 year		30,921	30,921	10,156	10,156
Maturing in 1 to 10 years		108,912	108,912	112,301	112,301
		<u>139,833</u>	<u>139,833</u>	<u>122,457</u>	<u>122,457</u>
Shares:					
Preferred		246,461	246,461	296,398	296,398
Common		179,609	179,609	115,230	115,230
		<u>426,070</u>	<u>426,070</u>	<u>411,628</u>	<u>411,628</u>
Total available-for-sale		<u>565,903</u>	<u>565,903</u>	<u>534,085</u>	<u>534,085</u>
		<u>792,800</u>	<u>797,769</u>	<u>748,640</u>	<u>752,917</u>

Notes to consolidated financial statements, continued

Year ended December 31, 2010

(in thousands of Canadian dollars)

3. INVESTMENTS (continued)

Management reviewed currently available information for all available-for-sale investments with unrealized pre-tax losses, amounting to \$2,890 (2009 - \$3,763), which losses have already been charged to other comprehensive income, net-of-tax, and determined that the impairment is not other-than-temporary.

Net investment income and realized investment gains (losses) are as follows:

	Available for-sale	Held-to maturity	Held-for trading	2010 Total	2009 Total
Interest income	1,568	5,121	889	7,578	8,657
Dividend income	21,439	-	-	21,439	23,418
Investment expenses	(594)	-	-	(594)	(604)
Net investment income	<u>22,413</u>	<u>5,121</u>	<u>889</u>	<u>28,423</u>	<u>31,471</u>
Realized net gains (losses)	<u>6,436</u>	<u>-</u>	<u>(444)</u>	<u>5,992</u>	<u>(6,250)</u>

4. FINANCIAL RISK MANAGEMENT

Credit risk

The Company is exposed to the risk of credit losses, that is the failure of its debtors to pay amounts owed when due, on its investment portfolio and on amounts owed to it by its policyholders, reinsurers, and intermediaries. In order to mitigate this risk, management regularly reviews the Company's investment portfolio to ensure that it complies with the Company's investment policy which includes appropriate concentration limits and requirements for diversification, including a prohibition against holding more than 5% of its assets in the securities of any one issuer. Management also regularly assesses the creditworthiness of its principal debtors, including its reinsurers. The Company's exposure to credit losses from any one individual policyholder or related group of policyholders is not material.

The Company estimates its aggregate exposure to credit risk as the sum of its reported fixed-income investments, accrued investment income, and insurance balances owing from policyholders and reinsurers recorded on the balance sheet.

All investment securities held by the Company at year end are rated investment grade or better.

Market risk

The value of the Company's investments fluctuates with changes in credit spreads, movements in interest rates and equity markets, and changes in the prices of foreign currencies. The Company mitigates these risks by adopting a conservative asset mix and holding a well diversified portfolio.

The Company owns operations in the United States of America and accounts for these as self-sustaining operations. The value of these investments fluctuates depending on the relative value of Canadian and US dollars. This risk is mitigated by the fact that the Company's operations in the United States and all its obligations there are denominated in US dollars.

Should the relevant composite index increase/decrease by 100 basis points, the Company's portfolio of equity instruments will increase/decrease in value by between nil and \$900, net of tax, with all this change going to other comprehensive income. Should the yield curve for investment quality, fixed-income securities shift upward/

Notes to consolidated financial statements, continued

Year ended December 31, 2010

(in thousands of Canadian dollars)

Market risk (continued)

downward by 100 basis points, the Company's debt instruments would suffer a temporary decrease/increase in value of between nil and \$7,500, net of tax, with this change going to other comprehensive income. This change will gradually dissipate, again through other comprehensive income, as the Company's existing debt instruments mature within the next five years. The same upward shift in the yield curve would enhance the yield on short-term money-market instruments, adding between nil and \$1,400 before tax to net earnings each year.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet obligations associated with financial liabilities. The Company mitigates this risk by always holding sufficient cash equivalents to meet its ongoing claims and other obligations.

The Company estimates that its financial liabilities at December 31, 2010 will be paid or otherwise discharged according to the following schedule:

	2010	2009
Within 1 year	158,942	160,933
2 – 5 years	224,783	190,286
6 – 10 years	88,813	75,512
11 or more years	<u>31,040</u>	<u>25,445</u>
	<u>503,578</u>	<u>452,176</u>

5 ACCOUNTS RECEIVABLE

	2010	2009
Accrued investment income	2,864	3,301
Brokers and policyholders	60,223	57,694
Other insurers	5,830	13,427
Income taxes recoverable	13,960	-
Other	<u>10,246</u>	<u>10,394</u>
	<u>93,123</u>	<u>84,816</u>

Notes to consolidated financial statements, continued

Year ended December 31, 2010

(in thousands of Canadian dollars)

6 CAPITAL ASSETS

	Cost	Accumulated amortization	2010 Net book value	2009 Net book value
Land, property and equipment:				
Land	162	-	162	162
Buildings	3,213	1,646	1,567	1,789
Equipment	9,564	8,295	1,269	1,498
	<u>12,939</u>	<u>9,941</u>	2,998	3,449
Intangible assets:				
Licenses			3,874	4,094
Goodwill – not amortized			2,244	2,371
			<u>9,116</u>	<u>9,914</u>

7 POLICY LIABILITIES

Policy liabilities include unpaid claims and unearned premiums net of deferred premium acquisition costs. At year end, the Company's net policy liabilities amounted to \$510,837 (2009 - \$472,395) as follows:

	Gross	Reinsurance	2010 Net	2009 Net
Automobile	170,026	6,223	163,803	156,859
Liability	237,469	17,963	219,506	200,185
Property	53,577	7,135	46,442	49,156
Surety	74,506	28,098	46,408	38,511
Other	35,537	859	34,678	27,684
	<u>571,115</u>	<u>60,278</u>	<u>510,837</u>	<u>472,395</u>

The values ascribed to policy liabilities are estimated in accordance with current, accepted actuarial practice for North American property and casualty insurers and are continually revised as new information respecting individual claims and the overall economic, social, and judicial environment become evident. As a result, revised estimates can differ substantially from the corresponding estimates made a year earlier. Based on accepted actuarial practice, a reasonable estimate of the fair value of unpaid claims is approximately equal to its carrying value.

Notes to consolidated financial statements, continued

Year ended December 31, 2010

(in thousands of Canadian dollars)

7 POLICY LIABILITIES (continued)

Analysis to year-to-year change in net unpaid claims is as follows:

	2010	2009
Unpaid claims - beginning of year, net	<u>370,686</u>	<u>324,019</u>
Current accounting year losses incurred on current accident year	157,363	151,270
Discounting on current year losses	(11,241)	(10,286)
Provision for adverse deviation on current year losses	9,903	9,577
Current accounting year losses incurred on prior accident years	30,913	23,213
Change in discounting on prior year losses	3,270	27,531
Change in provision for adverse deviation on prior year losses	<u>(4,513)</u>	<u>(3,109)</u>
Total losses incurred	<u>185,695</u>	<u>198,196</u>
Paid losses on prior accident years	87,143	95,357
Paid losses on current accident year	<u>61,711</u>	<u>56,172</u>
Total paid losses	<u>148,854</u>	<u>151,529</u>
Unpaid claims, end of year, net	<u>407,527</u>	<u>370,686</u>

8 CAPITAL STOCK

	2010	2009
Authorized		
Unlimited number of preferred shares		
Unlimited number of common shares		
Issued:		
187,147 common shares	<u>936</u>	<u>936</u>

9 RELATED-PARTY TRANSACTIONS

The Company conducts normal business transactions through related insurance intermediaries. All such business is transacted on a basis consistent with other similar intermediaries and represents net premiums written of \$63,312 (2009 - \$61,992).

Notes to consolidated financial statements, continued

Year ended December 31, 2010

(in thousands of Canadian dollars)

10 EMPLOYEE FUTURE BENEFITS

	2010	2009
Present value of future pension obligations	14,937	11,184
Less: fair value of plan assets	<u>12,198</u>	<u>10,406</u>
Accrued pension liability in accounts payable	<u>2,739</u>	<u>778</u>
Net pension plan costs recognized	<u>3,471</u>	<u>961</u>
Assumptions:		
Discount rate	5.5%	6.5%
Expected annual yield on plan assets	6.5%	7.0%
Future annual salary increase	3.5%	3.5%
Future pension increases	0%	0%
Life expectancy for male pensioners	83.9 years	83.9 years
Life expectancy for female pensioners	86.9 years	86.9 years

11 RATE REGULATION

Automobile insurance, which accounts for approximately 28% (2009 - 30%) of the Company's net written premium volume, is subject to rate regulation for all insurers in most jurisdictions. With respect to individually rated, private-passenger, automobile insurance, the Company is subject to provincial, prior-approval rate regulation that can result in the imposition of government mandated, retrospective rate reductions or modifications to standard policy terms and conditions.

12 MANAGEMENT OF CAPITAL

The Company is subject to regulatory supervision by the Office of the Superintendent of Financial Institutions Canada (OSFI). OSFI imposes on all property and casualty insurers a capital management regime called the Minimum Capital Test, which requires the Company to determine its available capital, required capital, and excess capital, being the difference between available and required capital. The Company monitors these measures quarterly and consistently maintains its excess capital at levels in excess of 150% of required capital.

13 FUTURE ACCOUNTING CHANGES

The Company plans to adopt international financial reporting standards (IFRS) in place of Canadian generally accepted accounting principles under the Accounting Standards Board timeline presently in place. Beginning January 1, 2011, the Company will prepare financial statements in accordance with IFRS for the current financial year and the preceding financial year.

Role of the Actuary and the Auditors

The actuary is appointed by the Board of Directors. With respect to preparation of the annual financial statements, the actuary is required to carry out a valuation of the policy liabilities and to report thereon to the policyholders and shareholders. The valuation is carried out in accordance with accepted actuarial practice and regulatory requirements. The scope of the valuation encompasses the policy liabilities as well as any other matter specified in any direction that may be made by the Superintendent of Financial Institutions. The policy liabilities consist of a provision for unpaid claims and adjustment expenses on the expired portion of policies and of future obligations on the unexpired portion of policies. In performing the valuation of the liabilities for these contingent future events, which are by their very nature inherently variable, the actuary makes assumptions as to future rates of claim frequency and severity, inflation, reinsurance recoveries, expenses and other contingencies, taking into consideration the circumstances of the Company and the nature of the insurance policies. The valuation is necessarily based on estimates, and consequently, the final values may vary significantly from those estimates. The actuary also makes use of management information provided by the Company and relies on the work of the auditors with respect to the verification of the underlying data used in the valuation.

The external auditors are appointed by the shareholders pursuant to the Insurance Companies Act. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with generally accepted auditing standards and report thereon to the shareholders regarding the fairness of presentation of the Company's financial statements in accordance with Canadian generally accepted accounting principles.

In carrying out their audit, the auditors make use of the work of the actuary and the actuary's report on the claim and premium liabilities. The auditors' report outlines the scope of their audit and their opinion.

Opinion of the Actuary

I have valued the policy liabilities of The Guarantee Company of North America for its balance sheet at December 31, 2010 and their change in the statement of income for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

I am satisfied that the data utilized for the valuation of these liabilities are reliable and sufficient. I verified the consistency of the valuation data with the Company's financial records.

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

André Racine

André Racine
Fellow, Canadian Institute of Actuaries

Montreal, Quebec
23 February 2011

Independent Auditors' Report

To the Shareholders of The Guarantee Company of North America

We have audited the accompanying consolidated financial statements of The Guarantee Company of North America (the "Company"), which comprise the balance sheet as at December 31, 2010 and the statements of comprehensive income and retained earnings, accumulated comprehensive income and cash flows for the year then ended, and 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 generally accepted accounting principles, 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 an 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 company'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 company'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, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

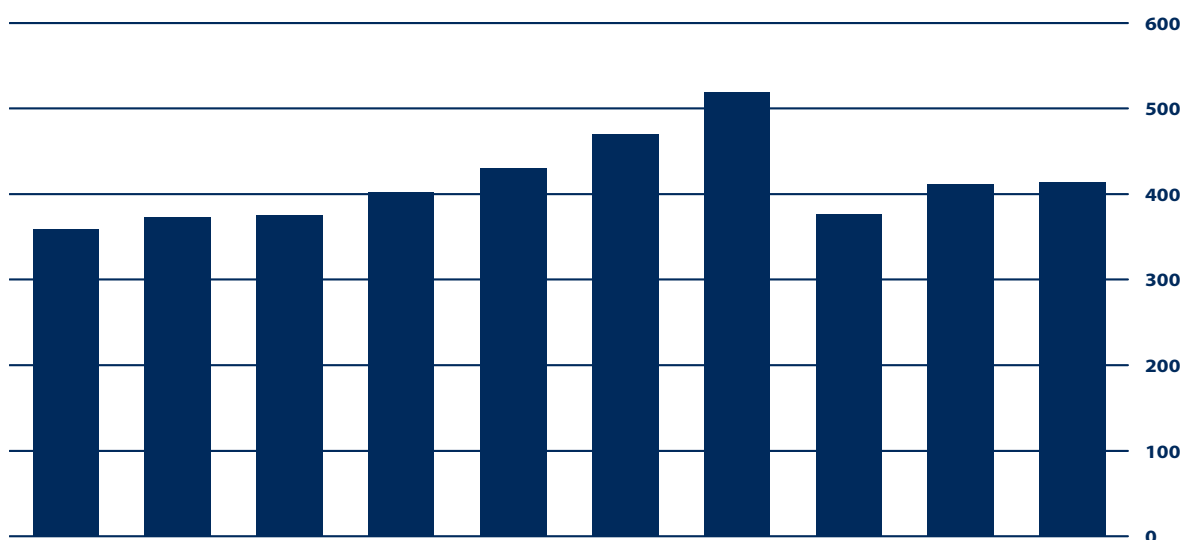


Chartered Accountants, Licensed Public Accountants
Toronto, Canada
February 23, 2011

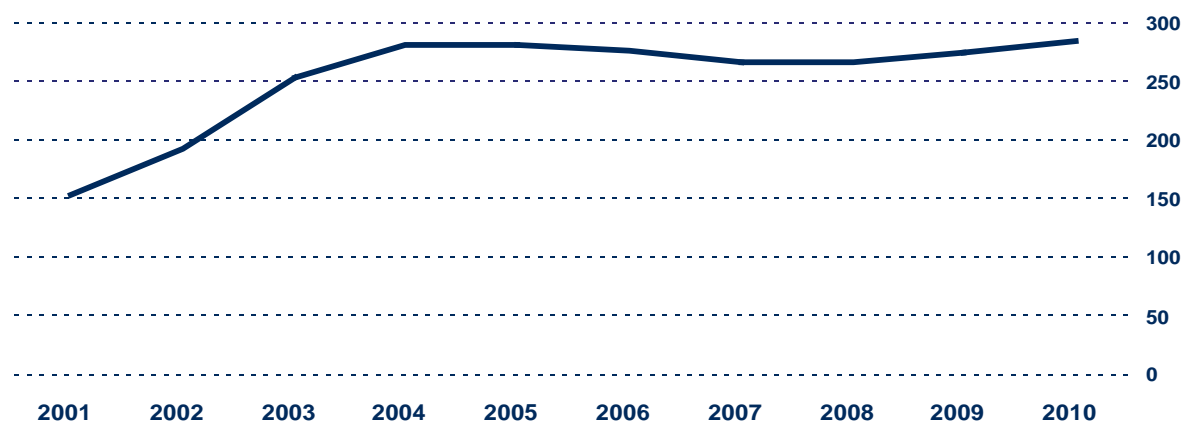
Ten-Year Review

(\$ 000)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Gross premiums written	200,220	252,093	316,669	334,216	333,837	337,462	309,458	325,342	343,266	356,043
Net premiums earned	151,816	191,927	252,685	281,136	280,418	276,184	266,425	264,706	274,450	283,531
Loss ratio	73.7%	66.5%	64.2%	56.9%	56.9%	54.1%	53.1%	57.5%	72.2%	65.5%
Underwriting profit (loss)	(19,451)	(7,057)	(5,493)	22,660	23,098	27,933	28,408	7,961	(32,832)	(15,097)
Net earnings and comprehensive income*	27,422	21,720	17,742	41,176	37,580	46,997	22,192	21,372	42,417	9,960
Dividends	7,673	7,673	7,673	7,673	7,673	7,673	7,673	163,941	7,673	7,673
Shareholders' equity	359,661	373,708	375,235	402,876	430,045	469,639	519,161	376,592	411,336	413,323

SHAREHOLDERS' EQUITY (\$ 000,000)



NET PREMIUMS EARNED (\$ 000,000)



* Net earnings from 2001 to 2006 and comprehensive income thereafter

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