Consolidated Financial Statements of

EGI FINANCIAL HOLDINGS INC.

December 31, 2012

Management's Responsibility for Financial Reporting

Roles of Management, Board of Directors and Audit and Risk Committee

Management is responsible for the preparation and fair presentation of the consolidated financial statements, management's discussion and analysis and other information in the annual report. The consolidated financial statements of EGI Financial Holdings Inc. (the Company) were prepared in accordance with International Financial Reporting Standards. Where necessary, these consolidated financial statements reflect amounts based on the best estimates and judgment of management.

In meeting its responsibility for the reliability of the consolidated financial statements, management maintains the necessary system of internal controls. These controls are designed to provide management with reasonable assurance that the financial records are reliable for preparing consolidated financial statements and other financial information, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The Audit and Risk Committee, composed of directors who are not officers or employees of the Company, meets, as required, with management, the Appointed Actuary and the external auditor to review actuarial, accounting, reporting and internal control matters. The Audit and Risk Committee is responsible for reviewing the consolidated financial statements and management's discussion and analysis and recommending them to the Board of Directors for approval.

Role of Appointed Actuary

The actuary is appointed by the Board of Directors, pursuant to the Insurance Companies Act. The Appointed Actuary is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives. The Appointed Actuary is also required to provide an opinion regarding the appropriateness of the policy liabilities to meet all policyholder obligations of the Company at the consolidated balance sheet date. Examination of supporting data for accuracy and completeness and consideration of the Company's assets are important elements of the work required to form this opinion. The Appointed Actuary uses the work of the external auditor in verifying data used for valuation purposes. Policy liabilities include unearned premiums, provision for unpaid claims, reinsurers' share of unearned premiums and provision for unpaid claims and deferred policy acquisition costs.

Role of External Auditor

PricewaterhouseCoopers LLP, external auditor, has been appointed by the shareholders to conduct an independent audit of the consolidated financial statements of the Company in accordance with Canadian generally accepted auditing standards and report to the shareholders regarding the fairness of the annual consolidated financial statements. The external auditor considers the work of the Appointed Actuary in respect of policy liabilities included in the consolidated financial statements, on which the Appointed Actuary has rendered an opinion.

Toronto, Ontario
February 25, 2013

(Signed) Steve Dobronyi Chief Executive Officer	(Signed) Alvin Sharma Chief Financial Officer

February 25, 2013

Independent Auditor's Report

To the Shareholders of
EGI Financial Holdings Inc.

We have audited the accompanying consolidated financial statements of EGI Financial Holdings Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2012 and 2011 and the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

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Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of EGI Financial Holdings Inc. and its subsidiaries as at December 31, 2012 and 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Accountants, Licensed Public Accountants

APPOINTED ACTUARY'S REPORT

To the Shareholders of EGI Financial Holdings Inc.:

I have valued the policy liabilities of the subsidiary insurance operations of EGI Financial Holdings Inc. for its consolidated statement of financial position at December 31, 2012 and their changes in the consolidated statement of income for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods.

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

Toronto, Ontario
February 25, 2013

(Signed) Joe S. Cheng,
Fellow, Canadian Institute of Actuaries

EGI FINANCIAL HOLDINGS INC.
Consolidated Balance Sheets
(in thousands of Canadian dollars)

	December 31 2012	December 31 2011
Assets		
Cash and short-term deposits	19,578	30,839
Accounts receivable	35,577	26,047
Investments (note 5)	412,728	365,058
Due from insurance companies	3,326	3,777
Deferred policy acquisition costs (note 7)	21,588	15,566
Income taxes recoverable	–	435
Prepaid expenses and other assets	3,118	2,417
Reinsurers' share – unearned premiums (note 6)	9,169	5,089
– provision for unpaid claims (note 8)	30,283	33,269
Property and equipment	743	688
Intangible assets (note 11)	5,568	4,369
Deferred income taxes (note 15)	5,350	4,149
	547,028	491,703
Liabilities		
Income taxes payable	663	–
Accounts payable and accrued liabilities	13,078	8,141
Payable to insurance companies	3,449	1,550
Unearned premiums (note 6)	94,085	71,644
Unearned commission	1,770	1,029
Provision for unpaid claims (note 8)	268,580	254,519
	381,625	336,883
Equity		
Share capital (note 12)	68,244	69,133
Contributed surplus (note 13)	1,068	724
Retained earnings	91,237	71,410
Accumulated other comprehensive income (note 21)	6,054	13,766
Equity attributed to shareholders of the company	166,603	155,033
Non-controlling interest	(1,200)	(213)
Total Equity	165,403	154,820
	547,028	491,703

The accompanying notes are an integral part of these consolidated financial statements.

On Behalf of the Board of Directors:

(Signed) Paul F. Little
Director

(Signed) Robert Purves
Director

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Income and Comprehensive Income
for the years ended December 31
(in thousands of Canadian dollars, except per share amounts)

	2012	**2011**
Revenue		
Gross written and assumed premiums	220,149	174,892
Less: Premiums ceded to reinsurers	(23,545)	(14,764)
Net written and assumed premiums	196,604	160,128
(Increase) decrease in gross unearned premiums	(22,108)	6,701
Increase (decrease) in unearned premiums, reinsurers' share	4,079	(1,382)
Change in provision for unearned premiums	(18,029)	5,319
Net earned premiums	178,575	165,447
Investment income (note 5)	34,044	13,867
Total revenue	212,619	179,314
Expenses		
Gross claims incurred	118,532	110,354
Less: claims recoveries from reinsurers	(5,363)	(4,939)
Net incurred claims	113,169	105,415
Gross acquisition costs	46,842	41,491
Less: acquisition cost recoveries from reinsurers	(6,007)	(4,313)
Net acquisition costs	40,835	37,178
Operating costs (note 16)	27,842	22,266
Total expenses	181,846	164,859
(Increase) decrease in net claims discount rate (note 8)	(3,887)	(1,843)
Income before income taxes	26,886	12,612
Income tax expense (note 15)	7,520	5,092
Net income	19,366	7,520
Attributed to:		
Shareholders of the Company	20,353	7,733
Non-controlling interest	(987)	(213)
	19,366	7,520
Earnings per share attributable to shareholders of the Company (note 22)		
Net income per share – basic	$1.70	$0.64
Net income per share – diluted	$1.68	$0.64
Net income	19,366	7,520
Other comprehensive income (loss) (note 21)		
Available-for-sale securities:		
Change in net unrealized gains	9,081	926
Reclassification of net realized (gains) losses to net income	(20,989)	(144)
Cumulative translation gain (loss)	452	183
Tax Impact (note 15)	3,744	(256)
Other comprehensive income	(7,712)	709
Total comprehensive income	11,654	8,229
Attributed to:		
Shareholders of the Company	12,641	8,442
Non-controlling interest	(987)	(213)
	11,654	8,229

The accompanying notes are an integral part of these consolidated financial statements.

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Changes in Equity
for the years ended December 31
(in thousands of Canadian dollars)

	Share Capital	Contributed Surplus	Accumulated Other Comprehen-sive Income	Retained Earnings	Shareholders' Equity	Non-controlling interest	Total Equity
Balance at January 1, 2012	69,133	724	13,766	71,410	155,033	(213)	154,820
Net income (loss)	–	–	–	20,353	20,353	(987)	19,366
Other comprehensive income (loss)	–	–	(7,712)	–	(7,712)	–	(7,712)
Total comprehensive income (loss)	–	–	(7,712)	20,353	12,641	(987)	11,654
Common shares repurchased	(889)	–	–	(526)	(1,415)	–	(1,415)
Stock options – expense	–	344	–	–	344	–	344
Balance at December 31, 2012	68,244	1,068	6,054	91,237	166,603	(1,200)	165,403

	Share Capital	Contributed Surplus	Accumulated Other Comprehen-sive Income	Retained Earnings	Shareholders' Equity	Non-controlling interest	Total Equity
Balance at January 1, 2011	69,087	545	13,057	63,677	146,366	–	146,366
Net income (loss)	–	–	–	7,733	7,733	(213)	7,520
Other comprehensive income	–	–	709	–	709	–	709
Total Comprehensive Income (loss)	–	–	709	7,733	8,442	(213)	8,229
Common shares issued	46	–	–	–	46	–	46
Stock options – expense	–	179	–	–	179	–	179
Balance at December 31, 2011	69,133	724	13,766	71,410	155,033	(213)	154,820

The accompanying notes are an integral part of these consolidated financial statements.

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Cash Flows
For the years ended December 31
(in thousands of Canadian dollars)

	2012	**2011**
Cash provided by (used in):		
Operating activities		
Net income	19,366	7,520
Items not involving cash:		
Reinsurers' share of unearned premiums	(4,080)	1,382
Reinsurers' share of unpaid claims	2,285	1,827
Provision for unpaid claims	14,061	15,483
Unearned premiums	22,441	(6,691)
Deferred income taxes	(1,201)	(14)
Unearned Commissions	741	301
Deferred policy acquisition costs	(6,022)	413
Amortization on Property plant equipment and intangible assets	3,050	966
Amortization of premiums on bonds	1,853	1,226
Unrealized foreign exchange (gain) loss	32	(91)
Fair value change on FVTPL Investments	(227)	(209)
Options Expense	344	179
Currency translation	452	183
Other	18	(253)
	33,747	14,702
Cash flow from changes in		
Accounts receivable	(9,530)	7,746
Net Realized (gains) losses	(20,990)	(144)
Income taxes payable/recoverable	4,842	(2,573)
Due to related parties	2,350	3,032
Other Liabilities	4,937	2,310
Cash provided by operating activities	15,356	25,073
Financing activities		
Issue of common shares	–	46
Share Repurchase	(1,415)	–
Cash provided by (used in) financing activities	(1,415)	46
Investing activities		
Purchases of property and equipment and intangible assets	(4,338)	(5,078)
Sale of property and equipment & tangible assets	29	–
Purchase of investments	(643,305)	(486,702)
Sale/maturity of investments	603,046	472,947
Cash (used in) investing activities	(44,568)	(18,833)
Increase in cash and short-term deposits	(11,261)	13,806
Cash and short-term deposits, beginning of year	30,839	17,033
Cash and short-term deposits, end of year	19,578	30,839
Supplementary information		
Operating Activities		
Income taxes paid	4,827	8,248

The accompanying notes are an integral part of these consolidated financial statements.

1 Organization and Basis of Presentation

EGI Financial Holdings Inc. (the Company) was incorporated on August 18, 1997, under the Business Corporations Act (Ontario) and is incorporated and domiciled in Canada. The Company is principally engaged, through its subsidiaries, in property and casualty insurance in Canada, U.S. and Europe. The Company's head office is located at 2680 Matheson Blvd. East, Suite 300, Mississauga, Ontario.

The Company's wholly-owned subsidiaries are EGI Insurance Managers Inc., Echelon General Insurance Company (Echelon), EGI Insurance Services, Inc., American Colonial Insurance Company (ACIC), EGI Insurance Services (Florida), Inc., CIM Reinsurance Company Ltd. (CIM Re) and CUISA Managing General Agency Corporation ("CUISA MGA"). The Company also owns all of the preferred shares plus 51% of common shares of QIC Holdings ApS (QIC), which owns 100% of Qudos Insurance A/S (Qudos).

The Company acquired CUISA MGA a British Columbia specialty insurance operation on May 1, 2012.

CUISA MGA was established in 1996 and provides insurance services to 160 credit-union owned insurance broker offices in British Columbia. It provides brokers with access to insurance markets and unique products that they would have difficulty accessing individually. CUISA MGA has developed and offers a broad range of personal and commercial lines products, and has been an authorized distributor for EGI's subsidiary, Echelon, since 2006.

These consolidated financial statements have been authorized for issue by the Board of Directors, on February 25, 2013.

2 Basis of preparation

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). In 2010, the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook") was revised to incorporate IFRS and requires publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011.

These consolidated financial statements have been prepared in accordance with IFRS.

3 Summary of significant accounting policies

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets to fair value, including investments.

Balance sheet presentation

The Company does not classify its assets and liabilities as current and non-current on its balance sheets. As a financial institution, the Company provides insurance services over a period of years, rather than within a clearly identifiable short-term operating cycle. Classification of assets and liabilities in the balance sheets as current or non-current does not provide relevant information. The maturity profile of the investment portfolio is described in note 10. The estimated payment period for insurance claims, less related reinsurance recoverable, is provided in note 10. Property and equipment assets are charged to expense over their estimated useful lives of up to three years. Intangible assets with definite useful lives are charged to expense over their estimated useful lives of two years while an impairment analysis is done on all other intangible assets. Cash and short term deposits, accounts receivables, due from insurance companies, income taxes payable, accounts payable and accrued liabilities are expected to be recovered or settled within twelve months of the period end.

Consolidation

The consolidated financial statements of the Company consolidate the accounts of EGI Financial Holdings Inc. and its subsidiaries. All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Subsidiaries are those entities, including special purpose entities, which EGI Financial Holdings Inc. controls by having the power to govern the financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether EGI Financial Holdings Inc. controls another entity. Subsidiaries are fully consolidated from the date on which control is obtained by EGI Financial Holdings Inc. and are de-consolidated from the date that control ceases.

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity. Changes in the parent company's ownership interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions.

Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is responsible for allocating resources and assessing performance of the operating segments and has been identified as the chief executive officer of the Company.

Business Combinations

Consideration transferred in a business combination is measured at fair value at the date of acquisition and includes any cash paid plus the fair value of assets given, liabilities incurred and equity instruments issued by the Company. The consideration transferred also includes contingent consideration arrangements, if any, recorded at fair value. Directly attributable acquisition-related costs are expensed in the current period and reported within operating expenses. At the date of acquisition, the Company recognizes the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired business. The identifiable assets acquired and the liabilities assumed are initially recognized at fair value. The excess of the consideration paid over the fair value of net assets acquired is recorded as goodwill. Where the fair value of consideration paid is less than the fair value of net assets acquired, the difference is recognized in the income statement. Any pre-existing equity interests in an acquiree are re-measured to fair value at the date of the business combination and any resulting gain or loss is recognized in the income statement.

Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each consolidated entity of the Company are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency.

The financial statements of entities that have a functional currency different from the presentation currency of the Company ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the balance sheet, and income and expenses – at the average rate of the period (as this is considered a reasonable approximation to actual rates). All resulting changes are recognized in other comprehensive income (OCI) as cumulative translation adjustments.

QIC's and Qudos' functional currency is Danish Krone and is subject to foreign currency translation adjustments upon consolidation. EGI Insurance Services, Inc., ACIC and EGI Insurance Services (Florida), Inc., are U.S.-based subsidiaries whose functional currency is U.S. dollars. Each U.S. subsidiary operating outside of Canada is subject to foreign currency translation adjustments upon consolidation. CIM Re's functional currency is Canadian dollars.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in the income statement. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary are reallocated between controlling and non-controlling interests.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates in effect at the date the transactions occurred. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at period-end exchange rates of monetary assets and liabilities are recognized in investment income in the consolidated statements of income. Exchange gains and losses related to non-monetary investments classified as AFS are recorded in OCI.

Cash and short-term deposits

Cash and short-term deposits include cash-on-hand, cash balances with banks and short-term investments maturing in 90 days or less from the date of acquisition. These financial assets are classified as loans and receivables and are recorded at an amortized cost which approximates fair value.

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit or loss (FVTPL): A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term, or if it is designated at fair value through profit or loss by management. The Company has designated as fair value through profit and loss under the fair value option financial assets which contain embedded derivatives that significantly alter the cash flows of the underlying asset.

Financial instruments in this category are recognized initially and subsequently at fair value. Gains and losses arising from changes in fair value are presented in the consolidated statement of income within investment income in the period in which they arise.

(ii) Available-for-sale investments: Available-for-sale investments are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. The Company's available-for-sale assets comprise marketable securities and investments in debt and common equity securities.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in OCI.

Interest on available-for-sale investments, calculated using the effective interest method, is recognized in the consolidated statements of income within investment income. Dividends on available-for-sale equity instruments are recognized in the consolidated statements of income as part of investment income when the Company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the consolidated statements of income and included within investment income.

(iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of accounts receivables, due from insurance companies, and cash and short term deposits. Loans and receivables are initially recognized at fair value plus transaction costs. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less any provision for impairment.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities. Accounts payable are initially recognized at fair value. Subsequently, accounts payable are measured at amortized cost using the effective interest method.

Impairment of financial assets

The Company determines, at each reporting date, whether there is objective evidence that a financial asset is impaired. The criteria used to determine if objective evidence of an impairment loss include:

1) Significant financial difficulty of the obligor;
2) Delinquencies in interest, principal or dividend payments; and
3) It becomes probable that the borrower will enter bankruptcy or other financial reorganization.

For equity securities, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired.

If such evidence exists, the Company recognizes an impairment loss, as follows:

AFS: The impairment loss is the difference between the amortized cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the consolidated statement of income. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to the consolidated statements of income.

Loans and receivables carried at amortized costs: The loss is the difference between the amortized cost of the loan and receivables and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. If, in a subsequent period, the fair value of an AFS debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statements of income, the impairment loss is reversed through the consolidated statement of income. In contrast, impairment losses on AFS equity instruments are not reversed.

Insurance contracts

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk arises when the Company agrees to compensate a policyholder if a specified uncertain future event adversely affects the policyholder. Significant risk is defined as the possibility of having to pay significantly more in a scenario where the insured event occurs than when it does not occur.

Provision for unpaid claims

Provision for unpaid claims, including adjustment expenses, represents the estimated amounts required to settle all outstanding and unreported claims incurred to the end of the period. Unpaid claims liabilities are discounted to take into account the time value of money. It also includes a provision for adverse deviation. Expected reinsurance recoveries on unpaid claims and adjustment expenses, net of any required provision for doubtful amounts, are recognized as assets at the same time, using principles consistent with the Company's method for establishing the related liability.

Reinsurance

The Company reflects third party reinsurance balances on the consolidated balance sheets on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a gross basis in the consolidated statements of income to indicate the results of direct and ceded premiums written and the portion of gross claims expense that is recoverable from reinsurers.

Revenue recognition

Premiums and unearned premiums

Insurance premiums written are deferred as unearned premiums and recorded in income as the premium is earned on a straight line basis over the terms of the underlying policies, except for some long term policies for which premiums are earned using an actuarial risk assessment to match with claim expectations. The portion of the premiums related to the unexpired term of the policy at the end of the period is reflected in unearned premiums.

Ceded Premiums and reinsurers share of unearned premiums

The reinsurers share of unearned premiums is recognized as an asset at the same time and using subsequently carried principles consistent with the Company's method for determining the unearned premium liability.

Deferred policy acquisition costs

Commissions and premium taxes incurred in the writing of premiums are deferred only to the extent that they are expected to be recovered from unearned premiums and are amortized to income as the related premiums are earned. If unearned premiums are not sufficient to pay expected claims and expenses, including policy maintenance expenses and unamortized policy acquisition costs, a premium deficiency is said to exist. Premium deficiency is recognized by a charge to income initially by writing down deferred policy acquisition costs. If the premium deficiency is greater than the deferred policy acquisition costs, a liability would be accrued for the excess deficiency.

Property and equipment

Property and equipment are recorded at cost less accumulated amortization and impairment. Amortization is provided over the estimated useful lives of the assets using the straight-line method over the following terms:

Furniture and equipment	3 years
Computer hardware	3 years

Intangible assets

Intangible assets with definite useful lives, comprised primarily of computer software, are recorded at cost less accumulated amortization and impairment. Amortization is provided over the estimated useful life of the asset (2-3 years) using the straight-line method. Intangible assets with indefinite lives are recorded at lower of cost and recoverable amount.

Impairment of non-financial assets

Property, plant and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or 'CGUs'). Recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU, as determined by management).

The Company evaluates impairment losses, for potential reversals when events or circumstances warrant such consideration.

Employee benefits

The Company contributes to a group registered savings plan for employees as services are incurred. Contributions are charged to operating expenses. There are no other post-employment benefit expenses.

Income taxes

Income taxes are recognized in the consolidated statements of income except to the extent that it relates to items recognized in OCI or directly in equity. In those cases, the related taxes are also recognized in OCI or directly in equity, respectively.

Current income tax is based on the results of the operations, adjusted for items that are not taxable or not deductible, that is payable for the current year. Current income tax is calculated based on income tax laws and rates enacted or substantively enacted as at the balance sheet date.

The Company follows the asset and liability method of accounting for income taxes, whereby deferred income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the carrying values of existing assets and liabilities and their respective income tax bases and taxable losses and tax credit carry-forwards. Deferred income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income or other comprehensive income or equity in the year which includes the date of enactment or substantive enactment. Deferred income tax assets are recognized only to the extent the realization of such assets is probable. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is intention to settle the balances on a net basis.

Stock-based compensation

The Company has a stock option plan that provides for the issuance of shares of the Company's common stock not exceeding 10% of the total issued and outstanding shares (on a diluted basis) and shares reserved for issuance under the employee stock option plans, options for services and employee stock purchase plans.

The compensation cost of stock options granted is measured at estimated fair value at the grant date and recognized as an expense over the vesting period with a corresponding offset to contributed surplus.

Stock options which contain a graded vesting feature (the total options granted vest on a graded basis such as annually over 5 years) are accounted for separately based on the date of vesting. At the time the options are granted, expected forfeiture rates are estimated and used to reduce the amount expensed over the life of the options. The estimated forfeiture rate is adjusted to actual forfeiture experience as information becomes available.

The Company has established a Share Unit Plan, under which the Board of Directors may from time to time determine (i) those eligible employees (a "participant") who shall receive a grant of Restricted Share Units ("RSUs") and/or Performance Share Units ("PSUs") (RSUs and PSUs are collectively referred to as "Share Units"), (ii) the number of such RSUs and/or PSUs and (iii) the grant date(s) applicable to such RSUs and/or PSUs.

Each Share Unit granted under the Share Unit Plan will entitle the participant, upon satisfying all applicable vesting criteria, to receive one common share or, at the discretion of the Company, a cash payment equal to the market value of such share, calculated based on the weighted average trading price per common share on the Toronto Stock Exchange for the 5 trading days prior to a fixed date. The grant of a Share Unit will not entitle the participant to exercise any voting rights, receive any dividends or exercise any other right which attaches to ownership of common shares.

Grant date fair value of each Share Unit is calculated based on the weighted average trading price per common share on the Toronto Stock Exchange for the 5 trading days prior to a fixed date. The fair value of the Share Unit is re-measured each period for subsequent changes in the market value of common shares.

Certain members of the Board, who are not otherwise a employee of the Corporation or any affiliate and are not employed by a corporation that holds at least 100,000 Shares of the Corporation, are eligible to participate in a Deferred Share Unit Incentive Plan which allows them to elect to defer all or a portion of their annual retainer and meeting fees received in the form of deferred share units (DSUs), each of which is equivalent in value to one common share of the Company. The number of DSUs is established by dividing the amount of retainers not paid in cash by the weighted average trading price of the Common Shares for the last 5 trading days preceding the determination. Whenever cash dividends are paid on the common shares, the director's account under the DSU plan is credited with additional DSUs corresponding to the dividend paid on the common shares. The fair value of the DSUs is re-measured each period for subsequent changes in the market value of common shares.

Provisions

Provisions are recognized as liabilities when the Company has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material. The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

Share capital

Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity. The cost method is used to account for the shares purchased under a normal course issuer bid with the average cost of the shares reducing share capital and any excess recorded as a deduction to retained earnings.

Dividends

Dividends on common shares are recognized in the Company's consolidated financial statements in the period in which the dividends are approved by the Board of Directors.

Earnings per share

Basic earnings per share ("EPS") is calculated by dividing the net income (loss) for the period attributable to shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, and similar instruments is computed using the treasury stock method. The Company's potentially dilutive common shares comprise stock options and RSUs granted to employees.

Accounting standards issued but not yet applied

Management has assessed the following standards and expect they will not have a significant impact on the financial reporting of the Company, other than some changes in presentation.

Amendment to IAS 1 Presentation of Financial Statements

In June 2011, the IASB issued an amendment to IAS 1 that changes the presentation of items in the consolidated statements of comprehensive income. This amendment requires the components of other comprehensive income to be presented in two separate groups, based on whether or not the components may be recycled to the consolidated statements of earnings in the future. Companies will continue to have a choice of whether to present components of OCI before or after tax. Those that present components of OCI before tax will be required to disclose the amount of tax related to the two groups separately. This amendment is effective for annual periods beginning on or after July 1, 2012, is applied retrospectively, with early adoption permitted.

IFRS 13 Fair Value Measurement

IFRS 13, Fair Value Measurement, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Whereas IFRS 9 applied only to financial assets and liabilities measured at fair value.

IFRS 13 is effective for annual periods beginning on or after January 1, 2013, is applied prospectively as of the beginning of the annual period in which it is adopted, with early adoption permitted.

New and revised Reporting Entity standards

In May 2011 the IASB published a package of five new and revised standards that address the scope of the reporting entity. The new standards in the package are IFRS 10 C*onsolidated Financial Statements,* IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities.* The revised standards are IAS 28 *Investments in Associates and Joint Ventures* and *Joint Ventures and* IAS 27 *Separate Financial Statements.*

The requirements contained in the package of five standards are effective for annual periods beginning on or after January 2013, with early adoption permitted so long as the entire package is early adopted together. The five standards are described below.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 introduces a single consolidation model that uses the same criteria to determine control for entities of all types, irrespective of whether the investee is controlled by voting rights or other contractual arrangements. The principle that a consolidated entity presents a parent and its subsidiaries as a single entity remains unchanged, as do the mechanics of consolidation. IFRS 10 supersedes existing guidance under IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*.

IFRS 11 Joint Arrangements

IFRS 11 establishes principles for financial reporting by parties to a joint arrangement, and only differentiates between joint operations and joint ventures. The option to apply proportionate consolidation when accounting for joint ventures has been removed; equity accounting is now applied in accordance with IAS 28 *Investments in Associates and Joint Ventures.* IFRS 11 supersedes existing guidance under IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non Monetary Contributions by Venturers.*

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 sets out the disclosure requirements under IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements* and IAS 28 *Investments in Associates and Joint Ventures.* The enhanced disclosures in the new standard are intended to help financial statement readers evaluate the nature, risks and financial effects of an entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. Entities are permitted to incorporate any of the disclosure requirements in IFRS 12 into their financial statements without early adopting IFRS 12.

IAS 28 Investments in Associates and Joint Ventures

IAS 28 has been amended in line with the changes to accounting for joint arrangements in IFRS 11. The amended standard prescribes the accounting for investments in associates and provides guidance on the application of the equity method when accounting for investments in associates and joint ventures.

IAS 27 Separate Financial Statements

IAS 27 has been amended to provide guidance on the accounting and disclosure requirements for investments in subsidiaries, associates and joint ventures when an entity prepares separate financial statements. The amended standard requires an entity preparing separate financial statements to account for investments at cost or in accordance with IFRS 9 *Financial Instruments.*

Management is currently assessing the impact of the following standard on its consolidated financial statements.

IFRS 9 *Financial Instruments*

In November 2009 the IASB published IFRS 9. It addresses classification and measurement of financial assets and liabilities and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: Amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments are never recycled to profit and loss, but accumulated gains or losses can be transferred within shareholder's equity.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

This standard is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

4 Critical accounting estimates and assumptions

The preparation of the Company's consolidated financial statements requires management to use estimates that affect the amounts reported in the financial statements. These estimates principally relate to the establishment of reserves for claims and expenses, impairments of investment securities, amounts recoverable from reinsurers and income taxes. As more information becomes known, these estimates could change and impact future results.

Policy Liabilities

Provisions for unpaid claims.

Provision for unpaid claims are maintained to cover the Company's estimated ultimate liability for unpaid losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. The provision for unpaid claims and adjustment expenses is first determined on a case-by-case basis as claims are reported and then reassessed as additional information becomes known. The provision also accounts for the future development of these claims, including claims incurred but not reported (IBNR). Provision for unpaid claims do not represent an exact calculation of liability, but instead represent estimates developed using projection techniques in accordance with Canadian accepted actuarial practice. These estimates are expectations of the ultimate cost of settlement and administration of claims based on the Company's assessment of facts and circumstances then known, its review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors. The appointed actuary of EGI's subsidiaries, using appropriate actuarial techniques, evaluates the adequacy of the policy liabilities at the end of each reporting period.

Variables in the reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, economic inflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. Additionally, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the insurer. These estimates are refined in a systematic ongoing process as historical loss experience develops and additional claims are reported and settled. Because the establishment of reserves is an inherently uncertain process involving estimates, current reserves may not be sufficient. Adjustments to reserves, both positive and negative, are reflected in the consolidated statements of income for the period in which such estimates are updated.

Impairment of Financial Assets

The Company considers an impairment if there is objective evidence that an available-for-sale financial asset is impaired, including in the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its carrying value.

Factors considered by the Company include but are not limited to:

a) significant financial difficulty of the issuer or obligor;

b) a breach of contract, such as a default or delinquency in interest or principal payments;

c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;

d) it becoming probable that the borrower will enter bankruptcy or other financial reorganization;

e) the disappearance of an active market for that financial asset because of financial difficulties; or

f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

   (i) adverse changes in the payment status of borrowers in the group (e.g., an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or

   (ii) national or local economic conditions that correlate with defaults on the assets in the group (e.g., an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

Reinsurance

Reinsurer’s share of the provision for unpaid claims include amounts for expected recoveries related to provision for unpaid claims. Amounts recoverable from reinsurers are estimated in a manner consistent with claim and claim adjustment expense reserves. The ceding of an insurance liability to a reinsurer does not discharge the Company's primary liability to the policyholders. The Company's policy is to record an estimated allowance for doubtful accounts on the basis of periodic evaluations of balances due from reinsurers, reinsurer solvency, credit ratings of reinsurers, collateral held by the Company, management's experience and current economic conditions.

(in thousands of Canadian dollars, except per share amounts)

The Company is exposed to disputes on, and defects in, contracts with reinsurers and the possibility of default by reinsurers.

Income Taxes

Deferred income taxes, accumulated as a result of temporary differences, which are probable to reverse, are included in the consolidated balance sheet. In addition, the consolidated statements of income contains items that are non-taxable or non-deductible for income tax purposes, which cause the income tax provision to differ from what it would be if based on statutory rates. Recoverability of deferred tax assets is primarily based on current and expected profitability applicable to the Company and its ability to utilize any recorded tax assets taking into consideration of tax planning strategies and the expiry date of tax losses.

5 Investments

The Company's policy is to utilize the prudent person approach to asset management, as required by the Insurance Companies Act. An investment policy is in place and its application is monitored by the Board of Directors. Diversification techniques are employed to minimize risk. Policies limit investments in any entity or group of related entities to a maximum of 5% of the Company's assets. Limitations are also placed on the quality of investments, particularly relating to investment grade bonds.

The following table provides a comparison as at December 31, 2012 and 2011:

	Carrying and fair values	
Available-for-sale	**As at December 31, 2012**	**As at December 31, 2011**
Bonds		
Canadian		
Federal	111,034	97,337
Provincial	62,393	62,483
Municipal	16,851	10,357
Corporate	167,372	111,046
	357,650	281,223
United States		
Federal	2,262	2,635
Corporate	10,729	10,395
	12,991	13,030
Total bonds	370,641	294,253
Preferred shares	–	917
Common shares		
Canadian	11,889	57,591
United States	5,052	1,443
	16,941	59,034
Total available-for-sale	387,582	354,204
Fair value through profit or loss		

	Carrying and fair values	
Available-for-sale	**As at December 31, 2012**	**As at December 31, 2011**
Preferred shares	25,146	10,854
Total investments	412,728	365,058

Fair value

The Company is responsible for determining the fair value of its investment portfolio by utilizing market-driven fair value measurements from active markets, where available, by considering other observable and unobservable inputs and by employing valuation techniques which make use of current market data. The Company uses a fair-value hierarchy to categorize the inputs used in valuation techniques to measure fair value. A description of the inputs used in the valuation of financial instruments is as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities. The fair value, of the Company's common and preferred shares, except for preferred shares classified as available for sale, is determined based on quoted prices in active markets obtained from external pricing sources.

Level 2 – Inputs, other than quoted prices, that are observable for the investment either directly or indirectly. These inputs include quoted prices for similar instruments exchanged in active markets; quoted prices for identical or similar instruments exchanged in inactive markets; inputs other than quoted prices that are observable for the instruments, such as interest rates and yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates where available; and inputs that are derived principally from or corroborated by observable market data and correlation or other means.

The Company's investments in government securities (including federal, provincial and municipal bonds), corporate securities, private placements and infrequently traded securities are priced using publicly traded, over-the-counter prices or broker-dealer quotes which are based on market observable inputs. Observable inputs such as benchmark yields, reported trades, broker dealer quotes, issuer spreads and bids are available for these investments.

Level 3 – Inputs that are not based on observable market data. Management is required to use assumptions regarding unobservable inputs as there is little, if any, market activity in these investments or related observable inputs that can be corroborated at the measurement date. Unobservable inputs require management to make certain projections and assumptions about the information that would be used by market participants in pricing assets. To verify pricing, the Company assesses the reasonability of the fair values by comparing to industry-accepted valuation models, to movements in credit spreads and to recent transaction prices for similar assets where available.

The following table provides the classification of the Company's investments within the fair value hierarchy, as outlined above, as at December 31, 2012 and 2011:

December 31, 2012	**Investments at fair value**			
	Level 1	**Level 2**	**Level 3**	**Total**
Bonds	–	370,157	484	370,641
Equities	42,087	–	–	42,087
	42,087	370,157	484	412,728

(in thousands of Canadian dollars, except per share amounts)

December 31, 2011	Investments at fair value			
	Level 1	Level 2	Level 3	Total
Bonds	–	293,449	804	294,253
Equities	69,888	–	917	70,805
	69,888	293,449	1,721	365,058

The fair value of the Company's investments, determined with the use of unobservable market information as inputs is approximately 0.1% (December 31, 2011 – 0.5%) of the total investment portfolio required to be measured at fair value, and consists of corporate bonds and preferred shares with a fair value of $484 (December 31, 2011 – $804) and $nil (December 31, 2011 – $917) respectively.

During the year ended December 31, 2012 there was $111 transferred from level 3 to level 2 with no change in 2011.

A reconciliation of Level 3 investment for the years ended December 31, 2012, and 2011, with the use of significant unobservable inputs from January 1 to December 31 follows:

		2012	2011
Balance at beginning of year		1,721	2,310
Add: Additions during period	– bonds	–	520
Less: Disposals and write-down during period	– preferred shares	(917)	(1,083)
	– bonds	(229)	–
Reclassification in/(out) of level 3	– bonds	(111)	–
Net unrealized gains (losses) included in other comprehensive income		20	(26)
Balance at end of year		484	1,721

Impaired assets and provisions for losses

Management has reviewed currently available information regarding those investments where estimated fair values are less than amortized cost. For those investments that are considered impaired, the Company has recorded the difference between the cost, or amortized cost, of the investment and its fair value as an impairment, which reduces investment income recorded in the period.

A provision for impairments on investments of $2,222 was recognized in 2012 (2011 – $6,631).

A remaining gross unrealized loss of $549 on investments held as at December 31, 2012 (December 31, 2011 – $5,492) is recorded, net of tax, in the amount of $399 (December 31, 2011 – $3,799) in accumulated other comprehensive income.

Investment income

Investment income was derived from the following:

	2012	2011
Interest income	12,912	12,793
Dividend income	1,466	2,199
Net realized gains	23,212	6,775
Impairment loss	(2,222)	(6,631)
Fair value change on FVTPL investments	227	209

(in thousands of Canadian dollars, except per share amounts)

	2012	2011
Realized and unrealized foreign exchange gain (loss)	53	180
Investment expenses	(1,604)	(1,658)
	34,044	13,867

6 Unearned premiums

	As at December 31, 2012		As at December 31, 2011	
	Gross	Ceded	Gross	Ceded
Personal Lines:				
Automobile				
– accident benefits	18,451	1,927	13,471	890
– liability	27,691	2,504	23,605	1,483
– other	14,219	758	10,720	155
Total Personal Lines	60,361	5,189	47,796	2,528
Niche Products:				
Property				
– commercial	6,385	726	5,889	1,290
– personal	22,996	3,019	12,953	1,004
Liability	3,833	227	4,045	246
Accident and sickness	80	8	161	1
Commercial auto	–	–	292	20
Other	430	–	508	–
Total Niche Products	33,724	3,980	23,848	2,561
	94,085	9,169	71,644	5,089

Reconciliation of unearned premium as at December 31:

	2012		2011	
	Gross	Ceded	Gross	Ceded
Unearned premium at the beginning of the year	71,644	5,089	78,335	6,471
Premium written and ceded during the year	220,149	23,545	174,892	14,764
Premium earned in income	198,041	19,466	181,583	16,146
Currency translation difference	333	1	–	–
Unearned premium at the end of the year	94,085	9,169	71,644	5,089

7 Deferred policy acquisition costs

Reconciliation of deferred policy acquisition costs as at December 31:

	2012		2011	
	Gross	Ceded	Gross	Ceded
Balance at the beginning of the year	15,566	1,029	15,979	728
Acquisition costs during the year	52,765	6,735	41,078	4,614
Amortization of acquisition costs during the year	46,842	6,007	41,491	4,313
Currency translation difference	99	13	–	–
Acquisition costs deferred at end of the year	21,588	1,770	15,566	1,029

(in thousands of Canadian dollars, except per share amounts)

8 Provision for unpaid claims

The fair value of the provision for unpaid claims approximates the carrying value determined in accordance with generally accepted actuarial methods in Canada, which discount estimated future cash flows and include a margin for adverse deviation.

The Company discounts its best estimate of claim provisions at a rate of interest of 1.65% (2011 – 1.90%) for all lines of business. The Company determines the discount rate based on the expected return on its investment portfolio of assets with appropriate assumptions for interest rates relating to reinvestment of maturing investments.

The Company recorded a $6,059 reduction to the net provision for unpaid claims relating to redundancies in prior years' estimates (2011 – $6,370).

To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience, and to provide greater comfort that the actuarial liabilities are adequate to pay future claims, the Company includes provisions for adverse deviations (PFADs) in some assumptions relating to claim development, reinsurance recoveries and future investment income. The PFADs selected are in the mid-range of those recommended by the Canadian Institute of Actuaries. The aggregate impact of the provision for adverse deviation is to increase the provision for unpaid claims on a gross basis by $27,282 as at December 31, 2012 (December 31, 2011 – $28,291).

The provision for unpaid claims on an actuarial present value (APV) gross and ceded basis by line of business is as follows:

	December 31, 2012		December 31, 2011	
APV basis	**Gross**	**Ceded**	**Gross**	**Ceded**
Personal Lines:				
Accident benefits	91,049	16,182	95,612	16,925
Liability	128,820	10,145	115,946	12,017
Other	3,890	208	4,411	13
Total Personal Lines	223,759	26,535	215,969	28,955
Niche Products:				
Property				
Commercial	5,055	591	4,169	167
Personal	1,453	195	437	12
Liability	28,300	–	24,533	1,547
Accident and sickness	3,959	1,302	3,195	890
Commercial auto	5,256	1,569	4,991	1,608
Other	798	91	1,225	90
Total Niche Products	44,821	3,748	38,550	4,314
	268,580	30,283	254,519	33,269

(in thousands of Canadian dollars, except per share amounts)

Claims Development

Provision for unpaid claims analysis	**2012**	**2011**
Unpaid claims, beginning of year, net	221,250	202,884
Change in undiscounted estimates for losses of prior years	(5,113)	(7,864)
Change in discount rate	3,887	1,843
Change in PFADs	(8,557)	(5,704)
Interest cost	3,724	5,355
Provision for claims occurring in current year	123,115	113,627
Paid on claims occurring during		
Current year	(45,513)	(36,465)
Prior year	(54,496)	(52,426)
Unpaid claims, end of year, net	238,297	221,250
Reinsurers' share	30,283	33,269
	268,580	254,519

The development of insurance liabilities provides a measure of the Company's ability to estimate the ultimate value of claims.

The tables below illustrate how the Company's estimate of ultimate gross claims incurred and estimate of reinsurers' share of ultimate claims incurred for each accident year have changed at successive year-ends.

The tables also reconcile the most recent estimate of ultimate gross claims incurred and estimate of reinsurers' share of ultimate claims incurred to the claims liability and reinsurers' share of the claims liability recognized on the financial statements.

Assumptions used to develop the provision estimate for unpaid claims and adjustment expenses are selected by class of business and geographic location. Consideration is given to the characteristics of the risks, historical trends, the amount of data available on individual claims, inflation and any other pertinent factors. Some assumptions require a significant amount of judgment such as the expected impacts of future judicial decisions and government legislation. The diversity of these considerations result in it not being practical to identify and quantify all individual assumptions that are more likely than others to have a significant impact on the measurement of the Company's insurance contracts. There were no new assumptions identified in the year as having a potential or identifiable material impact on the overall claims estimate.

Claims development table, gross of reinsurance

The following tables show the estimates of cumulative incurred claims, including IBNR, for the seven most recent accident years, elected in year of adoption as permitted by IFRS 4, with subsequent developments during the periods and together with cumulative payments to date. The original reserve estimates are evaluated quarterly for redundancy or deficiency. The evaluation is based on actual payments in full or partial settlement of claims and current estimates of claims liabilities for claims still unreported.

(in thousands of Canadian dollars, except per share amounts)

	Calendar Year							
	2005 & prior	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Provision for claims including LAE	129,173	146,101	169,091	185,255	207,220	239,036	254,519	268,580
Reserve re-estimate as of:								
1 year later	113,839	138,483	163,465	186,446	203,920	232,472	246,972	
2 years later	113,817	134,769	162,916	189,093	201,044	239,117		
3 years later	112,224	133,932	164,290	186,429	206,039			
4 years later	110,157	134,173	161,852	190,342				
5 years later	110,577	131,660	163,440					
6 years later	107,647	133,355						
7 years later	109,096							
Cumulative favourable (unfavourable) development	$20,077	12,746	5,651	(5,087)	1,181	(81)	7,547	–

Claims development table, net of reinsurance

	Calendar Year							
	2005 & prior	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Provision for claims including LAE	75,130	97,716	120,630	143,354	168,484	202,884	221,250	238,297
Reserve re-estimate as of:								
1 year later	63,060	85,726	115,530	142,641	164,393	196,517	215,191	
2 years later	60,693	81,199	112,960	143,980	162,651	203,632		
3 years later	57,706	79,470	112,595	142,924	166,901			
4 years later	56,094	77,794	111,267	144,486				
5 years later	55,325	76,878	110,883					
6 years later	53,882	76,584						
7 years later	53,790							
Cumulative favourable (unfavourable) development	21,340	21,132	9,747	(1,132)	1,583	(748)	6,059	–

9 Underwriting policy and reinsurance ceded

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophes or other events that cause unfavourable underwriting results by purchasing reinsurance to share all or part of the insurance risks originally accepted by the Company in writing premiums. This reinsurance does not relieve the Company of its primary obligation to policyholders.

During 2012, the Company followed the policy of underwriting and reinsuring contracts of insurance, which limits the net exposure of the Company to a maximum amount on any one loss to $1,500 (2011 – $1,500). In addition, the Company obtained catastrophe reinsurance which limits the loss from a series of claims arising from a single occurrence to $2,000 (2011 – $2,000), to a maximum coverage of $23,000 (2011 – $23,000).

The Company places all its automobile reinsurance with Canadian registered reinsurers. There are non-registered reinsurers participating in the specialty property and casualty program business. The

(in thousands of Canadian dollars, except per share amounts)

Company has access to trust funds that, in the Company's judgment, are adequate to secure the liabilities that the Company has ceded to non-registered reinsurers.

Failure of reinsurers to honour their obligations could result in losses to the Company. Consequently, the Company continually evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses. There have been no defaults and no provision made in the accounts for defaults based on management's review of the creditworthiness of its reinsurers.

Reinsurance recoverable

The following tables summarize the balances outstanding from reinsurers as at December 31, 2012 and 2011, by risk rating:

December 31, 2012			
Credit rating	**Gross reinsurance recoverable**	**Less: Deposits held in trust**	**Net exposure**
A	38,058	–	38,058
Not rated	3,582	4,342	–
	41,640	4,342	38,058

December 31, 2011			
Credit rating	**Gross reinsurance recoverable**	**Less: Deposits held in trust**	**Net exposure**
A	38,031	–	38,031
Not rated	3,171	5,181	–
	41,202	5,181	38,031

Included in gross reinsurance recoverable is reinsurers' share of unearned premiums of $9,169 (December 31, 2011 – $5,089), reinsurers' share of provision for unpaid claims of $30,283 (December 31, 2011 – $33,269), and receivables from reinsurers presented as due from insurance companies of $2,188 (December 31, 2011 – $2,844). No balances due from reinsurers are considered past due as at December 31, 2012 and 2011. There is no valuation allowance or amounts written off during the years ended December 31, 2012 and 2011.

10 Risk management

As a provider of insurance products, effective risk management is fundamental to the Company's ability to protect the interests of its customers and shareholders. The Company is exposed to risks of loss pertaining to insurance products. These include risks surrounding product and pricing, underwriting and claims, catastrophic exposure, and matching of assets and liabilities. The Company is also exposed to potential loss from various risks, including interest rate risk, equity market fluctuation risk, credit risk, liquidity risk, and to a lesser extent foreign exchange risk.

The Company has written principles for overall risk management, as well as written policies covering specific areas such as underwriting, reinsurance, foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments and investment of excess liquidity.

(in thousands of Canadian dollars, except per share amounts)

Insurance risk

The risk under any one insurance contract is the possibility that the event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, the risk is random and therefore unpredictable. The principal risk that the Company faces under its insurance contract is that the actual claims payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or the severity of the claims is greater than estimated. Insurance events are random and the actual number and amount of claims will vary from year to year from the estimate.

A more diversified portfolio is less likely to be affected by a change in any subset of the portfolio. EGI has developed their insurance underwriting strategy to diversify the type of insurance risks accepted. As at December 31, 2012, direct written premiums were derived from Personal Lines 58.9% (December 31, 2011 – 72.2%), Niche Lines 22.0% (December 31, 2011 – 25.5%), International Lines 12.7% (December 31, 2011 – nil) and U.S. Auto 6.4% (December 31, 2011 – 2.3%). The regional split of direct written premiums was Ontario 54.8% (December 31, 2011 – 67.5%), Atlantic Canada 9.4% (December 31, 2011 – 10.9%), Quebec 8.6% (December 31, 2011 – 10.2%), Western Canada 8.0% (December 31, 2011 – 9.1%), International 12.7% (December 31, 2011 – nil) and U.S. 6.4% (December 31, 2011 – 2.3%).

Sensitivity to insurance risk

The table below shows the sensitivity of earnings from operations before income taxes and total equity after giving effect to a one percentage point increase in the loss ratio and claims settlement costs. The loss ratio is regarded as a non-IFRS measure and is calculated by the Company with respect to its ongoing insurance operations as losses on claims incurred (including losses and loss adjustment expenses) expressed as a percentage of net premiums earned. Such an increase could arise from higher frequency of losses, increased severity of losses, or from a combination of both. The sensitivity analysis presented below does not consider the probability of such losses to loss frequency or severity occurring or any non-linear effects of reinsurance and as a result, each additional percentage point increase in the loss ratio would result in a linear impact on earnings from operations before income taxes and total equity.

	2012		2011	
Sensitivity Factor	**Net income before income taxes**	**Shareholders' equity**	**Net income before income taxes**	**Shareholders' equity**
Increase of 1% to loss ratio	1,786	1,304	1,654	1,180
Increase of 1% to claims settlement costs	2,383	1,740	2,213	1,578

Product and pricing

The Company prices its products taking into account numerous factors, including claims frequency and severity trends, product line expense ratios, special risk factors, the capital required to support the product line, and the investment income earned on that capital. The Company's pricing process is designed to ensure an appropriate return on capital and long-term rate stability avoiding wide fluctuations in rates, unless necessary. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

Pricing for automobile insurance must be submitted to each provincial government regulator and, in certain provinces, pre-approved by the regulator. Regulatory decisions may impede automobile rate increases or other actions that the Company may wish to take. Also, during periods of intense competition for any product line, to gain market share, the Company's competitors may price their products below the rates the Company considers acceptable. Although the Company may adjust its pricing up or down to maintain a competitive position, the Company strives to ensure its pricing will produce an appropriate return on invested capital. There is no assurance that the Company will not lose market share during periods of pricing competition.

Underwriting and claims

The Company is exposed to loss resulting from the underwriting of risks being insured and the exposure to financial loss resulting from greater than anticipated adjudication, settlement and claims costs.

The Company's underwriting objectives are to develop business within target markets on a prudent and diversified basis and to achieve profitable underwriting results. The Company underwrites automobile business after a review of the applicant's driving record and claims experience. Specialty commercial and personal risks are selected by the Company, working with its external brokers, after consideration of various risk factors associated with these lines of business. Despite its best efforts, and consideration of all known risk factors, there can be no assurance that all risks associated with the insurance policies that it writes can be identified and assessed, and the Company may, therefore, experience increased adjudication, settlement and claims costs.

The Company estimates its claims reserves on a quarterly basis and this is supported by quarterly assessments by the independent appointed actuary. Every quarter, for each line of business, the Company compares actual and expected claims development. To the extent that actual results differ from expected development, assumptions are re-evaluated and new estimates are derived. Although the Company believes its overall provision levels to be adequate to satisfy its obligations under existing policies, actual losses may deviate, perhaps substantially, from the amounts reflected in the Company's consolidated financial statements. To the extent provisions prove to be inadequate, the Company would have to re-evaluate such provisions and may incur a charge to earnings in the future.

Unpredictable catastrophic events

Catastrophes can be caused by various natural and unnatural events. Natural catastrophic events include hurricanes, windstorms, earthquakes, hailstorms, explosions, severe winter weather and fires. Unnatural catastrophic events include hostilities, terrorist acts, riots, crashes and derailments. The incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes, windstorms and earthquakes may produce significant damage in large, heavily populated areas.

Catastrophes can cause losses in a variety of business lines. Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in the Company's financial results and could materially reduce the Company's profitability or harm the Company's financial condition. The Company manages the impact of losses which may result from catastrophic events by purchasing excess of loss and catastrophe reinsurance to share all or part of the insurance risks originally accepted by the Company as well as geographic diversification.

The Company's ability to write new business also could be affected. The Company may experience an abrupt interruption of activities caused by unforeseeable and/or catastrophic events. The Company's operations may be subject to losses resulting from such disruptions. Losses can relate to property, financial assets, trading positions and to key personnel. The Company has developed business continuity plans designed to allow the Company to continue operations in case of a catastrophic event; however, if these plans cannot be put into action or do not take such events into account, losses may further increase.

(in thousands of Canadian dollars, except per share amounts)

Asset and liability matching

The Company is exposed to:

- changes in the value of its fixed income investments and policy liabilities to the extent that market interest rates change;
- equity price fluctuations, which affect the fair values of equities held by the Company;
- the risk of losses to the extent that the sale of an investment prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows;
- the risk that future inflation of policyholder cash flows exceed returns on long-term investments; and
- foreign exchange risks with respect to investments, receivables and policy liabilities denominated in foreign currencies.

The Company's exposures are monitored on a regular basis and actions are taken to balance investment positions when approved risk tolerance limits are exceeded.

Risk management is carried out by the Investment Committee under policies approved by the Board of Directors.

Interest rate risk

Fluctuations in interest rates have a direct impact on the fair valuation and future cash flow of the Company's fixed income investment portfolio. Generally, the Company's investment income will be reduced during sustained periods of lower interest rates as higher yielding fixed income investments mature or are sold and the proceeds are reinvested at lower rates. During periods of rising interest rates, the fair value of the Company's existing fixed income investments will generally decrease and gains on fixed income securities will likely be reduced.

The sensitivity analysis for interest rate risk as set out in the table below illustrates the impact of changes in interest rates on OCI relating to the fixed income investment portfolio as at December 31, based on parallel 200 basis point shifts in interest rates up and down in 100 basis point increments.

Change in interest rates	Fair value of fixed income portfolio	Hypothetical change on fair value	Effect on OCI net of tax
As at December 31, 2012			
200 basis point rise	340,726	(8%)	(21,838)
100 basis point rise	355,099	(4%)	(11,345)
No change	370,641	–	–
100 basis point decline	387,426	5%	12,254
200 basis point decline	404,016	9%	24,364

(in thousands of Canadian dollars, except per share amounts)

Change in interest rates	Fair value of fixed income portfolio	Hypothetical change on fair value	Effect on OCI net of tax
As at December 31, 2011			
200 basis point rise	263,040	(11%)	(21,038)
100 basis point rise	277,893	(6%)	(11,026)
No change	294,253	–	–
100 basis point decline	312,340	6%	12,191
200 basis point decline	330,947	12%	24,732

As discussed in note 9, the discount rate used in the determination of the provision for unpaid claims is based on the expected return of assets on its investment portfolio with appropriate assumptions for interest rates relating to reinvestment of maturing investments. Fluctuations in market interest rates will therefore have an impact on the discount rate used in the valuation of the net provision for unpaid claims. The table below shows the potential impact of interest rate fluctuations on the net provision for unpaid claims and income statement:

Change in discount rate	Net provision for unpaid claims	Hypothetical change in value	Effect on net income
As at December 31, 2012			
100 basis point rise	232,483	(2%)	4,244
No change	238,297	–	–
100 basis point decline	244,422	3%	(4,471)
As at December 31, 2011			
100 basis point rise	216,106	(2%)	3,467
No change	221,250	–	–
100 basis point decline	226,663	2%	(3,648)

Liquidity risk

Liquidity risk is the risk that the Company may not have sufficient liquid financial resources to meet its obligations when they fall due, or would have to incur excessive costs to do so. The Company's liquidity management strategy is to ensure that there is sufficient cash to meet its financial commitments as they become due. To manage cash flow requirements, the Company maintains a portion of invested assets in liquid investments.

The maturity profile of bonds as at December 31, 2012 and 2011 are as follows:

December 31, 2012	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	28,342	81,864	120,066	140,369	370,641
Percentage of total	8%	22%	32%	38%	100%

December 31, 2011	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	24,042	39,484	63,769	166,958	294,253
Percentage of total	8%	13%	22%	57%	100%

The following tables summarize the expected timing of cash flows arising from insurance obligations, on an undiscounted basis, as at December 31, 2012 and 2011:

(in thousands of Canadian dollars, except per share amounts)

December 31, 2012	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	76,651	92,256	52,211	35,980	257,098
Less: Reinsurance recoverable	11,782	9,592	4,747	2,605	28,726
Net actuarial liabilities	64,869	82,664	47,464	33,375	228,372

December 31, 2011	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	73,211	89,616	50,991	30,167	243,985
Less: Reinsurance recoverable	11,001	11,760	5,462	2,901	31,124
Net actuarial liabilities	62,210	77,856	45,529	27,266	212,861

All other financial liabilities are a duration of one year or less. The contractual maturities for lease commitments are listed in note 17.

Equity price risk

Fluctuations in the value of equity investments affect the level and timing of recognition of gains and losses on securities held, and cause changes in realized and unrealized gains and losses. General economic conditions, political conditions and many other factors can also adversely affect the stock and bond markets and, consequently, the value of the equity and fixed income investments held.

The Company has policies to limit and monitor its exposure to individual issuers and classes of issuers of equity securities.

The table below summarizes the potential impact of a 10% change in the value of the equity securities (common and preferred shares) on net income and OCI for the years ended December 31, 2012, and 2011. Certain shortcomings are inherent in the method of analysis presented, as the analysis is based on the assumptions that all equity holdings increased/decreased by 10% with all other variables held constant.

Change in equity holdings	Effect on Net Income		Effect on OCI net of tax	
	2012	2011	2012	2011
10% rise	1,836	776	1,237	4,287
10% decline	(1,836)	(776)	(1,237)	(4,287)

Credit risk

The Company is exposed to credit risk principally through its investment securities and balances receivable from policyholders and reinsurers. The Company has policies to limit and monitor its exposure to individual issuers and classes of issuers of investment securities which do not carry the guarantee of a national or Canadian provincial government. The Company's credit exposure to any one individual policyholder is not material. The Company has policies that limit its exposure to individual reinsurers and regular review processes to assess the creditworthiness of reinsurers with whom it transacts business.

The Company's maximum exposure to credit risk, without taking into account amounts held as collateral, is \$491,881 (2011 – \$415,448) comprised of \$370,641 (2011 – \$294,253) of bonds, \$41,640 (2011 – \$41,202) of gross reinsurance recoverable, \$3,326 (2011 – \$3,777) of amounts due from insurance companies, $35,577 (2011 – $26,047) of accounts receivables, $21,119 (2011 – $19,330) in structured settlements and cash of $19,578 (2011 – $30,839).

(in thousands of Canadian dollars, except per share amounts)

The following table sets forth the Company's fixed income securities portfolio by credit quality according to DBRS as at December 31, 2012, and 2011.

Fixed income portfolio

	As at December 31, 2012		As at December 31, 2011	
	Fair value	**Fair value**	**Fair value**	**Fair value**
AAA	134,855	37%	117,433	40%
AA	76,636	21%	57,302	20%
A	108,801	29%	86,918	30%
BBB	39,718	10%	26,266	9%
BB	6,626	2%	4,285	1%
B	455	–	1,245	–
CCC	277	–	229	–
Unrated	3,273	1%	575	–
Total	370,641	100%	294,253	100%

Preferred share portfolio

	As at December 31, 2012		As at December 31, 2011	
	Fair value	**Fair value**	**Fair value**	**Fair value**
P1	9,179	36%	2,861	26%
P2	9,766	39%	6,541	61%
P3	6,201	25%	1,452	13%
Total	25,146	100%	10,854	100%

Foreign exchange risk

Foreign exchange risk is the possibility that changes in foreign exchange rates produce an unintended effect on earnings and equity when measured in Canadian dollars, the Company's functional currency. The Company is exposed to foreign currency risk through transactions conducted in currencies other than Canadian dollars, and through its investments in subsidiaries that have a functional currency other than the Canadian dollar.

A portion of the Company's premiums are written in U.S. dollars and Danish Kroner and a portion of loss reserves are also in U.S. dollars and Danish Kroner. A portion of the Company's cash and investments is also held in U.S. dollars.

In general, the Company attempts to manage foreign exchange risk on liabilities by investing in financial instruments denominated in the same currency as the financial liabilities which they back. The Company may, nevertheless, from time to time experience losses resulting from fluctuations in the value of the U.S. dollar and Danish Kroner, which could adversely affect operating results.

The table below illustrates the expected impact on net income after tax and OCI of a 10% change in the Canadian dollar ("CAD") compared to the U.S. dollar ("USD") and Danish Kroner ("DKK") as at December 31, 2012 and 2011. Computations of the prospective effects of hypothetical foreign exchange changes are based on numerous assumptions, including the maintenance of the existing level and composition of financial assets and financial liabilities, and should not be relied on as indicative of actual or future results.

(in thousands of Canadian dollars, except per share amounts)

Change in CAD/USD rate	**Effect on Net Income**		**Effect on OCI**	
	2012	**2011**	**2012**	**2011**
10% rise	(590)	(456)	(948)	(1,084)
10% decline	590	456	948	1,084
Change in CAD/DKK rate	**Effect on Net Income**		**Effect on OCI**	
	2012	**2011**	**2012**	**2011**
10% rise	–	–	(554)	(16)
10% decline	–	–	554	16

Capital management

Capital is comprised of the Company's total equity. As at December 31, 2012, the Company's equity was $165,403 (December 31, 2011 – $154,820). The Company's objectives when managing capital are to maintain capital above minimum regulatory levels, above internally determined risk management levels, for financial strength and protect its claims paying abilities, to maintain creditworthiness and to maximize returns to shareholders over the long term.

A common measure of capital adequacy in the property and casualty industry used by management is the ratio of net premiums to surplus (or equity). A lower ratio implies a higher measure of capital adequacy. The Company's ratio as at December 31, 2012, was 1.2:1 (2011 – 1.0:1). This level is well below the 2.5:1 ratio considered by management to be the maximum acceptable ratio.

The Company's Canadian insurance subsidiary, Echelon, is required to maintain minimum capital levels as required by the Office of the Superintendent of Financial Institutions. As at December 31, 2012, and December 31, 2011, the Company exceeded the minimum regulatory capital requirement. Legislation applicable to insurance companies imposes certain restrictions on Echelon's ability to pay dividends.

The Company's U.S. insurance subsidiary, ACIC, is required to maintain minimum capital levels as required by the National Association of Insurance Commissioners. As at December 31, 2012, and December 31, 2011, the Company exceeded the minimum regulatory capital requirement.

The Company's European insurance subsidiary, Qudos, is required to maintain minimum capital levels as required by the Danish Financial Service Authority. As at December 31, 2012, and December 31, 2011, the Company exceeded the minimum regulatory capital requirement.

The Company's Barbados insurance subsidiary, CIM Re, is required to maintain minimum capital levels as required by the Supervisor of Insurance. As at December 31, 2012, and December 31, 2011, the Company exceeded the minimum regulatory capital requirement.

(in thousands of Canadian dollars, except per share amounts)

11 Intangible assets

	Opening cost	Purchases	Sales	End of period cost	Accumulated amortization	Net
Software						
December 31, 2012	7,412	2,991	–	10,403	5,430	4,973
December 31, 2011	2,922	4,490	–	7,412	3,238	4,174
Goodwill						
December 31, 2012	195	400	–	595	–	595
December 31, 2011	195	–	–	195	–	195
Total intangible assets						
December 31, 2012	7,607	3,391	–	10,998	5,430	5,568
December 31, 2011	3,117	4,490	–	7,607	3,238	4,369

12 Share capital

	As at December 31, 2012	As at December 31, 2011
Authorized		
Unlimited common shares (no par value)		
Unlimited special shares issuable in Series (no par value)		
Issued		
11,914,932 common shares (December 31, 2011 – 12,066,013 common shares)	68,244	69,133

During 2012 and 2011 no common shares were issued from exercise of stock options. In 2012, 4,019 common shares (2011 – 6,431) were issued pursuant to the share unit plan for eligible employees. During 2012 155,100 shares were repurchased under the normal course issuer bid and subsequently cancelled (2011 – nil).

13 Employee stock option plan

For the year ended December 31, 2012, the Company recorded a compensation expense of $344 (2011 – $179), with an offsetting credit to contributed surplus in relation to its stock option plan. All stock options granted have varying vesting periods. It also recorded an expense of $131 (2011 - $100) in relation to its RSU's plan.

The following is a continuity schedule of stock options outstanding as at December 31 2012 and 2011.

(in thousands of Canadian dollars, except per share amounts)

	Number of options		Weighted average exercise price per share	
	2012	**2011**	**2012**	**2011**
Outstanding, beginning of year	864,125	848,875	9.66	10.20
Granted during year	225,750	163,000	8.59	7.35
Exercised during year	–	–	–	–
Cancelled during year	(183,297)	(147,750)	11.27	10.22
Outstanding, end of year	906,578	864,125	9.07	9.66

As at December 31, 2012, the outstanding stock options consist of the following:

Stock Option price per share	Number	Average Remaining contractual life	Number of options exercisable
$14.01 – $15.00	65,500	0.1 year	65,500
$11.01 – $12.00	6,750	0.4 year	–
$10.01 – $11.00	210,375	0.7 year	72,500
$9.01 – $10.00	26,250	2.8 years	–
$8.01 – $9.00	339,750	2.8 years	20,000
$7.00 – $8.00	257,953	2.9 years	18,000

The fair values of the stock options issued in 2012 were determined using the Black-Scholes option pricing model with the following assumptions: (i) risk-free rate of 1.25%; (ii) life expectancy of 2-5 years; and (iii) estimated volatility of 25%. The grant-date fair value of total options granted is estimated at $2,375. The weighted average grant-date fair value per share option to date is $2.62.

14 Related party transactions

The Co-operators Group Limited and Co-operators General Insurance Company (collectively Co-operators), significant shareholders of the Company, provide services to the Company, including but not limited to product distribution and investment management services under arms length contracts. Direct written premiums derived from Co-operators' agents were $11,027 (2011 – $11,121), commissions paid were $1,267 (2011 – $1,279) and investment management fees were $397 (2011 – $271).

The Company has a 2001 100% Quota Share reinsurance treaty with Co-operators General Insurance Company. Reinsurers' share of unpaid claims includes a recoverable of $316 (December 31, 2011 – $395) from Co-operators General Insurance Company. The payable to insurance companies balance includes amounts due to Co-operators General Insurance Company of $360 (December 31, 2011 – $304).

Key management

Key management includes named executive officers and directors. Compensation of and loans to these individuals are summarized in the following table:

(in thousands of Canadian dollars, except per share amounts)

Compensation

	2012	2011
Salaries, directors' fees and other short-term benefits	1,790	1,726
Equity-settled and cash-settled compensation benefits	787	162
	2,577	1,888

15 Income taxes

The income tax expense (recovery) is as follows:

	2012	2011
Current	8,800	5,136
Deferred	(1,280)	(44)
	7,520	5,092

The provision for income taxes reflects an effective rate, which differs from the corporate tax rate as follows:

	2012	2011
Combined basic federal and provincial income tax rate	27.0%	28.5%
Income tax expense at statutory rates	7,260	3,602
Permanent differences	(307)	(372)
Deferred income tax rate changes	28	107
Write down of deferred tax asset	–	502
Tax benefit not recognized on losses (100% expire 2032)	826	684
Other	(287)	569
	7,520	5,092

Deferred income taxes are comprised of the following:

	Losses Carried Forward	Provision for unpaid claims	Deferred Premium Acquisition Costs	Investments	Property, equipment and intangible assets	Total
Balance – January 1, 2012	235	3,678	373	(107)	(30)	4,149
Amounts recorded in the income statement	672	267	(51)	24	368	1,280
Amounts recorded in equity	–	–	–	(79)	–	(79)
Balance – December 31, 2012	907	3,945	322	(162)	338	5,350

(in thousands of Canadian dollars, except per share amounts)

	Losses Carried Forward	Provision for unpaid claims	Deferred Premium Acquisition Costs	Investments	Property, equipment and intangible assets	Total
Balance – January 1, 2011	502	3,349	310	(196)	170	4,135
Amounts recorded in the income statement	(267)	329	63	89	(200)	14
Amounts recorded in equity	–	–	–	–	–	–
Balance – December 31, 2011	235	3,678	373	(107)	(30)	4,149

Management reviews the recoverability of the deferred income tax asset on an ongoing basis and adjusts as necessary, to reflect its anticipated realization. Management expects that the recorded deferred income tax asset will be realized in the normal course of operations.

Income taxes included in OCI

The amounts included in the consolidated statements of comprehensive income for the years ended December 31 are shown net of the following tax benefit:

	2012	2011
Change in unrealized gains	1,990	174
Reclassification to net income of (gains) and losses	(5,734)	82
Total income tax expense included in OCI	(3,744)	256

Income taxes payable are expected to be settled within one year of the financial statement date.

16 Operating costs by nature

	2012	2011
Salaries and benefits	18,857	15,542
Systems costs	4,972	3,276
Professional fees	2,557	1,785
Printing and postage	1,603	1,119
Other expenses	(147)	544
	27,842	22,266

(in thousands of Canadian dollars, except per share amounts)

17 Lease commitments

The Company is committed under lease agreements for office premises and computer equipment with minimum lease payments of $6,831 as follows:

2013	1,480
2014	1,313
2015	1,252
2016	1,259
2017	1,177
2018 and thereafter	350
	6,831

18 Structured settlements

In the normal course of claims adjudication, the Company may settle certain long-term losses through the purchase of annuities (structured settlements) from life insurance companies. The fair estimated value of these annuity contracts amounts to $21,119 (December 31, 2011 – $19,330) using a discount rate of 2.51% (December 31, 2011 – 2.50%). It is the policy of the Company to purchase annuities from life insurers with proven financial stability. The net risk to the Company is the credit risk related to the life insurance companies and this risk is reduced to the extent of coverage provided by Assuris, the life insurance compensation insurance plan. The Company has determined that no credit risk provision is required.

19 Contingencies

From time to time, in connection with its insurance operations, the Company is named as a defendant in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome, such actions have generally been resolved with minimal damage or expense in excess of amounts provided as policy liabilities. The Company does not believe that it will incur any significant additional loss or expense in connection with such actions.

20 Rate regulations

The Company writes business subject to rate regulation, including non-standard automobile and motorcycle insurance, which comprises approximately 59% of gross premiums written and assumed. The Company's automobile insurance premiums can be impacted by mandatory rate rollbacks and mandatory rate assessments as legislated by provincial law and by regulation in certain provinces. This could result in lower future premium rates or reductions to premium rates charged by the Company in prior years. In addition, the Company is required, under certain provincial legislation, to participate in risk sharing pools, which may impact positively or negatively on underwriting results. Certain benefit payments are also subject to provincial government regulation, including automobile accident benefits.

The Company is not aware of any proposed or pending rate rollbacks related to prior years.

21 Accumulated Other Comprehensive Income

	2012	2011
Beginning Balance	13,766	13,057
Unrealized gains on fixed maturities and equity investments arising during the period	9,081	926
Reclassification adjustment for (gains) losses included in net income	(20,989)	(144)
Foreign currency translation adjustments	452	183
Tax impact	3,744	(256)
Balance at December 31	6,054	13,766

	As at December 31, 2012	As at December 31, 2011
Gross Unrealized gains (losses)	8,604	20,511
Foreign currency translation adjustments	41	(410)
Tax impact	(2,591)	(6,335)
Balance at December 31	6,054	13,766

22 Earnings per share

	2012	2011
Basic earnings per share:		
Net income available to shareholders	20,353	7,733
Average number of common shares (in thousands)	11,990	12,060
Basic earnings per share	$1.70	$0.64
Diluted earnings per share:		
Average number of common shares (in thousands)	11,990	12,060
Average number of dilutive common shares under employee stock option plan (in thousands)	95	92
Average number of diluted common shares (in thousands)	12,085	12,152
Diluted earnings per share	$1.68	$0.64

23 Segmented information

The Company operates through four segments: Personal Lines and Niche Products divisions in Canada, and non-standard automobile markets in the U.S. and Europe. Through its Personal Lines division, the Company is engaged primarily in the underwriting of high premium, non-standard automobile insurance. Through its Niche Products division, the Company designs and underwrites specialized non-auto insurance programs, such as higher premium property, primary and excess liability, legal expense, accident and health insurance and warranty coverage.

The effect of reinsurance is reflected in the revenue and results of each segment. The investment activities consist of managing the investment portfolio for the Company as a whole. Investment income is shown net of investment expenses. The corporate and other activities include holding company expenses not attributable to a division.

(in thousands of Canadian dollars, except per share amounts)

	12 months ended December 31	
	2012	**2011**
Revenue		
Earned premiums and other revenue		
Canada – Personal Lines	123,937	128,970
– Niche Products	34,636	34,201
	158,573	163,171
U.S.	12,567	2,276
International	7,435	–
Total earned premium and other revenue	178,575	165,447
Net Claims Incurred		
Canada – Personal Lines	72,051	83,995
– Niche Products	23,015	19,365
	95,066	103,360
U.S.	12,754	2,055
International	5,349	–
Total net claims incurred	113,169	105,415
Net Expenses		
Canada – Personal Lines	39,988	37,929
– Niche Products	17,671	16,080
	57,659	54,009
U.S.	4,366	3,520
International	5,222	422
Corporate Expenses	1,430	1,493
Total net expenses	68,677	59,444
Income (loss) before income taxes		
Canada – Personal Lines	11,898	7,046
– Niche Products	(6,050)	(1,244)
	5,848	5,802
U.S.	(4,553)	(3,299)
International	(3,136)	(422)
Corporate and other	(1,430)	(1,493)
Underwriting (loss) income	(3,271)	588
Impact of change in net claims discount rate	(3,887)	(1,843)
Investment Income	34,044	13,867
Total income (loss) before income taxes	26,886	12,612

(in thousands of Canadian dollars, except per share amounts)

Segmented Long Term Assets

	As at December 31	
	2012	**2011**
Canada – Personal Lines	5,362	4,680
– Niche Products	816	292
	6,178	4,971
U.S.	20	82
International	118	4
Total segmented long term assets	6,316	5,058