Consolidated Financial Statements of

Echelon Financial Holdings Inc.

December 31, 2016

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 financial statements, management's discussion and analysis and other information in the annual report. The financial statements of Echelon Financial Holdings Inc. ("the Company") were prepared in accordance with International Financial Reporting Standards. Where necessary, these financial statements reflect amounts based on the best estimates and judgement 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 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 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 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 financial statements. The external auditor considers the work of the Appointed Actuary in respect of policy liabilities included in the financial statements, on which the Appointed Actuary has rendered an opinion.

Toronto, Ontario
February 16, 2017

(Signed) Serge Lavoie
Chief Executive Officer

(Signed) Alvin Sharma
Chief Financial Officer

February 16, 2017

Independent Auditor's Report

To the Shareholders of
Echelon Financial Holdings Inc.

We have audited the accompanying consolidated financial statements of Echelon Financial Holdings Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2016 and 2015 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.

PricewaterhouseCoopers LLP
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Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Echelon Financial Holdings Inc. and its subsidiaries as at December 31, 2016 and 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

(Signed) “PricewaterhouseCoopers LLP”

Chartered Professional Accountants, Licensed Public Accountants

Willis Towers Watson

To the Shareholder of Echelon Financial Holdings Inc.

I have valued the policy liabilities and reinsurance recoverables of the following subsidiary insurance operations of Echelon Financial Holdings Inc.: Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc., for their statement of financial position at December 31, 2016 and their changes in the statements of income and comprehensive income for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods. Qudos Insurance Company's policy liabilities were valued by Qudos Insurance Company's management. The basis for the evaluation differs from Canadian standards. In my opinion, the amount of policy liabilities for Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc. make appropriate provision for all their policy obligations. The financial statements of Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc. fairly present the results of those companies. The consolidated financial statements are the sum of my valuation for Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc., and those of management with regard to Qudos Insurance.

Toronto, Ontario	(Signed) Pierre Laurin
February 16, 2017	Fellow, Canadian Institute of Actuaries

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

	Note	December 31, 2016	December 31, 2015
Assets			
Cash and short–term deposits	6	50,588	23,373
Accounts receivable		46,705	105,300
Investments	6	336,535	513,099
Due from insurance companies		1,587	1,821
Deferred policy acquisition costs	9	30,689	77,456
Income taxes recoverable		867	4,329
Prepaid expenses and other assets		2,270	4,596
Reinsurers' share – unearned premiums	10	8,975	89,953
– provision for unpaid claims	11	27,023	90,158
Property and equipment		881	1,032
Intangible assets	14	8,197	6,238
Deferred income taxes	15	5,860	6,440
Assets of the disposal group held for sale	26	280,042	—
Total assets		800,219	923,795
Liabilities			
Derivative financial instruments	7	268	—
Accounts payable and accrued liabilities		17,332	34,266
Payable to insurance companies		450	19,097
Unearned premiums	10	120,184	264,584
Unearned commission	9	2,288	23,689
Provision for unpaid claims	11	255,129	397,214
Liabilities of the disposal group held for sale	26	263,194	—
Total liabilities		658,845	738,850
Equity			
Share capital	16	70,227	69,653
Contributed surplus		322	436
Retained earnings		71,935	104,786
Accumulated other comprehensive income	24	(5,070)	6,060
Equity attributed to shareholders of the Company		137,414	180,935
Non-controlling interest	27	3,960	4,010
Total equity		141,374	184,945
Total liabilities and equity		800,219	923,795

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

On behalf of the Board of Directors:

(Signed) Serge Lavoie
Chief Executive Officer

(Signed) Robert Purves
Director

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Income and Comprehensive Income
(in thousands of Canadian dollars, except per share amounts)

	Note	2016	2015
Revenue			
Gross written and assumed premiums		217,486	199,473
Less: Premiums ceded to reinsurers		(17,885)	(19,137)
Net written and assumed premiums		199,601	180,336
(Increase) in gross unearned premiums		(19,338)	(5,787)
Increase in unearned premiums, reinsurers' share		797	1,919
Change in provision for unearned premiums		(18,541)	(3,868)
Net earned premiums		181,060	176,468
Investment income	6	16,507	12,613
Other income		—	748
Total revenue		197,567	189,829
Expenses			
Gross claims incurred		114,587	121,273
Less: claims recoveries from reinsurers		(3,815)	(11,446)
Net incurred claims		110,772	109,827
Gross acquisition costs		47,227	44,263
Less: acquisition cost recoveries from reinsurers		(5,682)	(4,815)
Net acquisition costs		41,545	39,448
Operating costs	19	33,423	27,640
Total expenses		185,740	176,915
Income before taxes and discount rate impact on claims		11,827	12,914
Impact of change in discount rate on claims[1]		(2,822)	1,024
Income before interest expense and income taxes		9,005	13,938
Interest expense	8	217	—
Income tax expense	15	1,670	1,676
Net income on continued operations		7,118	12,262
Net (loss) on discontinued operations	26	(36,646)	(5,677)
Net (loss) income		(29,528)	6,585
Attributed to:			
Shareholders of the Company - continued operations		6,606	12,254
Shareholders of the Company - discontinued operations		(36,414)	(5,629)
Non-controlling interest - continued operations	27	512	8
Non-controlling interest - discontinued operations		(232)	(48)
Net (loss) income		(29,528)	6,585
Other comprehensive income (loss), net of taxes that may be classified subsequently to net income			
Available-for-sale investments:			
Change in net unrealized (losses)		(459)	(170)
Reclassification of net realized (gains) to net income		(5,597)	(6,140)
Cumulative translation gain (loss)		(395)	1,379
Foreign exchange forward	7	4,314	—
Tax impact		291	1,408
Other comprehensive (loss) on continued operations		(1,846)	(3,523)
Other comprehensive (loss) income on discontinued operations		(9,459)	672
Other comprehensive (loss)		(11,305)	(2,851)

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Income and Comprehensive Income
(in thousands of Canadian dollars, except per share amounts)

Attributed to:			
Shareholders of the Company - continued operations		(1,794)	(3,512)
Shareholders of the Company - discontinued operations		(9,336)	655
Non-controlling interest - continued operation	27	(52)	(11)
Non-controlling interest - discontinued operation		(123)	17
Other comprehensive (loss)		(11,305)	(2,851)
Total comprehensive (loss) income		(40,833)	3,734
Attributed to:			
Shareholders of the Company - continued operations		4,812	8,742
Shareholders of the Company - discontinued operations		(45,750)	(4,974)
Non-controlling interest - continued operation	27	460	(3)
Non-controlling interest - discontinued operation		(355)	(31)
Total comprehensive (loss) income		(40,833)	3,734
Earnings per share attributable to shareholders of the Company	25		
Earnings per share continued operations - basic		$0.56	$1.05
(Loss) per share discontinued operations - basic		$(3.17)	$(0.48)
(Loss) earnings per share - basic		$(2.54)	$0.57
Earnings per share continued operations - diluted		$0.55	$1.02
(Loss) per share discontinued operations - diluted		$(3.17)	$(0.48)
(Loss) earnings per share - diluted		$(2.54)	$0.55
Net (loss) income		(29,528)	6,585

(1) As the interest rate changes every year there is an impact to the incurred claims. Management believes it is beneficial to the user to see the impact of this change separately in order to understand the true movement in claims incurred.

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

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Changes in Equity
(in thousands of Canadian dollars)

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Shareholders' Equity	Non-controlling Interest	Total Equity
Balance at January 1, 2016	69,653	436	6,060	104,786	180,935	4,010	184,945
Net (loss) income	—	—	—	(29,808)	(29,808)	280	(29,528)
Other comprehensive (loss)	—	—	(11,130)	—	(11,130)	(175)	(11,305)
Total comprehensive (loss) income	—	—	(11,130)	(29,808)	(40,938)	105	(40,833)
Common shares repurchased	(292)	—	—	(384)	(676)	—	(676)
Dividends paid	—	—	—	(2,814)	(2,814)	—	(2,814)
Investment in subsidiary - Qudos	—	—	—	155	155	(155)	—
Common shares issued on stock options exercised	866	(170)	—		696	—	696
Stock compensation expense	—	56	—	—	56	—	56
Balance at December 31, 2016	70,227	322	(5,070)	71,935	137,414	3,960	141,374

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Shareholders' Equity	Non-controlling interest	Total Equity
Amended balance at January 1, 2015	67,153	2,192	8,917	103,222	181,484	3,856	185,340
Net income (loss)	—	—	—	6,625	6,625	(40)	6,585
Other comprehensive income (loss)	—	—	(2,857)	—	(2,857)	6	(2,851)
Total comprehensive income (loss)	—	—	(2,857)	6,625	3,768	(34)	3,734
Common shares repurchased	(642)	—	—	(871)	(1,513)	—	(1,513)
Dividends paid	—	—	—	(5,171)	(5,171)	—	(5,171)
Investment in subsidiaries - ICPEI	—	—	—	—	—	250	250
- Qudos	—	—	—	62	62	(62)	—
Common shares issued on stock options exercised	3,142	(1,834)	—	919	2,227	—	2,227
Stock options expense	—	78	—	—	78	—	78
Balance at December 31, 2015	69,653	436	6,060	104,786	180,935	4,010	184,945

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

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Cash Flows
(in thousands of Canadian dollars)

	December 31, 2016	December 31, 2015
Cash provided by (used in):		
Operating activities		
Net income from continuing operations	7,118	12,262
Net loss from discontinued operations	(36,646)	(5,677)
Adjusted for:		
Reinsurers’ share of unearned premiums	(797)	(1,919)
Reinsurers’ share of unpaid claims	2,199	(5,463)
Provision for unpaid claims	(5,719)	(14,651)
Unearned premiums	19,338	5,788
Deferred income taxes	(639)	460
Unearned commissions	324	949
Deferred policy acquisition costs	(5,771)	(1,378)
Amortization on property plant equipment and intangible assets	4,136	4,478
Amortization of premiums on bonds	1,897	2,084
Fair value change on FVTPL investments	(3,870)	7,315
Options expense	56	78
Currency translation	(395)	1,379
Foreign exchange forward	4,314	—
Prepaid expenses & other assets	401	(357)
	15,474	(1,237)
Cash flow from changes in		
Accounts receivable	(12,739)	(3,285)
Net realized (gains)	(280)	(5,935)
Income taxes (recoverable) payable	2,817	(5,846)
Due to insurance companies	(409)	835
Other liabilities	5,408	961
Cash provided (used) by continuing operating activities	17,389	(2,245)
Cash provided in discontinued operating activities	488	27,660
Cash inflow from operating activities	17,877	25,415
Financing activities		
Proceeds from issue of common shares for stock options	696	2,227
Common share dividends	(2,814)	(5,171)
Share repurchases	(676)	(1,513)
Additional investment in ICPEI by minority interest	—	250
Cash (used) in continuing financing activities	(2,794)	(4,207)
Cash from discontinued financing activities	—	—
Cash outflow from financing activities	(2,794)	(4,207)
Investing activities		
Purchases of property, equipment and intangible assets	(6,397)	(4,015)
Purchases of investments	(344,787)	(402,673)
Sale/maturity of investments	406,975	420,050

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Cash Flows
(in thousands of Canadian dollars)

Cash provided by continuing investing activities	55,791	13,362
Cash provided (used) from discontinued investing activities	43,388	(38,523)
Cash inflow (outflow) from investing activities	99,179	(25,161)
Increase (decrease) in cash and short-term deposits	114,262	(3,953)
Cash and short-term deposits, beginning of period	23,373	27,326
Cash and short-term deposits, end of period	137,635	23,373
Supplementary information		
Operating activities		
Income taxes paid (recovered)	(1,712)	5,712

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

1 Nature of operations

Echelon 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 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 Echelon Insurance ("Echelon"), CIM Reinsurance Company Ltd. ("CIM Re") and CUISA Managing General Agency Corporation ("CUISA MGA"). The Company also owns 75% of The Insurance Company of Prince Edward Island ("ICPEI") and all of the preferred shares, in addition to 98.7% of the common shares of QIC Holdings ApS ("QIC"). QIC owns 100% of Qudos Insurance A/S ("Qudos") that is headquartered in Denmark and underwrites insurance products primarily in the United Kingdom, Ireland, and Denmark. The Company's ownership in QIC has increased to 98.7% from 97.5% at the beginning of the year due to capital injected to maintain its solvency ratio.

On August 4, 2016, the Company entered into a definitive share purchase agreement to sell its European operations and is awaiting regulatory approval.

2 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and IFRS Interpretations Committee (IFRS IC) interpretations applicable to companies reporting under IFRS.

These consolidated financial statements have been authorized for issue by the Board of Directors, on February 16, 2017.

3 Summary of significant accounting policies

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for investments and insurance contracts which are carried at fair value and in accordance with IFRS 4, respectively. Discontinued operations are held for sale as described below.

Discontinued Operations

Assets and liabilities are classified as held for sale (discontinued operations) if their carrying amounts are recovered through a sales transaction rather than through continuing use. This condition is satisfied when the asset is available for immediate sale in its present condition, management is committed to the sale and it is highly probable to occur within one year. Assets classified as held-for-sale are measured at their lower of their previous carrying amount and fair value, less costs to sell, and are presented separately from other assets on our Consolidated Balance Sheets.

A disposal group is classified as a discontinued operation if it meets the following conditions: (a) it is a component that can be distinguished operationally and financially from the rest of our operations, and (b) it represents either a separate major line of business or is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations.

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. The consolidated statement of financial position is presented in the order of liquidity, based on expectations regarding recovery or settlement within 12 months after the reporting date, and more than 12 months after the reporting date as presented in the respective notes.

The maturity profile of the investment portfolio is described in note 13 based on expected settlements. The estimated payment period for insurance claims, less related reinsurance recoverable, is provided in note 13. 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 receivables and 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 Echelon Financial Holdings Inc. and its subsidiaries. All inter-company transactions, balances and unrealized gains and losses from inter-company transactions are eliminated on consolidation.

Subsidiaries are those entities which Echelon Financial Holdings Inc., through its investment in the entity, are exposed or has rights to variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether Echelon Financial Holdings Inc. controls another entity. Subsidiaries are fully consolidated from the date on which control is obtained by Echelon 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 senior management, the Chief Executive Officer and Board of Directors 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 subsidiaries 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). The accumulated gains or losses arising from translation of functional currencies to the presentation currency are included as a separate component of OCI within equity.

QIC's, Qudos' and CIM Re's functional currency is Danish Krone and is subject to foreign currency translation adjustments upon consolidation.

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 OCI 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 OCI 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 and comprehensive income. Exchange gains and losses related to non-monetary investments classified as Available for Sale (AFS) are recorded in OCI. Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in carrying amount are recognized in OCI.

Cash and short-term deposits

Cash and short-term deposits include cash-on-hand, cash balances with banks and short-term investments. Short-term investments are defined as loans of less than one year to maturity at the time of acquisition. These financial assets are classified as loans and receivables and are recorded at an amortized cost which approximates fair value.

Investments under securities lending program

Securities lending transactions are entered into on a collateralized basis. The securities lent are not derecognized on the consolidated balance sheet given that the risks and rewards of ownership are not transferred from the Company to the counterparties in the course of such transactions. Securities received from counterparties as collateral are not recorded on the consolidated balance sheet given that the risks and rewards of ownership are not transferred from the counterparties to the Company in the course of such transactions.

In the event that any loan made pursuant to the securities lending agreement is terminated and the loaned Security, or any portion thereof, is not returned to the Company for any reason (including, without limitation, the insolvency or bankruptcy of the Borrower) within the time specified by the applicable Borrowing Agreement, the agent shall be jointly and severally liable, at its expense to:

(i) Promptly replace such Security, or any portion thereof, not so returned with other securities of the same issuer, class, and denomination and with the same interest/dividend rights and other economic benefits as such , should the security have been returned, or

(ii) If it is unable to purchase such Security on the open market, the agent will credit Echelon in cash with the market value of such unreturned security, such market value to be determined as of the close of business on the date on which such security was required to be returned, including any future economic benefits that the company would have earned on holding the security.

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 FVTPL by management. The Company has designated as FVTPL 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 statements of income and comprehensive income within investment income in the period in which they arise. The Company's investments in preferred shares are classified as FVTPL.

(ii) *Available-for-sale investments*: AFS 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 AFS assets comprise marketable securities and investments in debt and common equity securities.

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

The Company determines, at each reporting date, whether there is objective evidence that financial assets and accrued liabilities are 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 investments: 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 statements of income and comprehensive income. This amount represents the cumulative loss in accumulated OCI that is reclassified to the consolidated statements of income and comprehensive 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 and accrued liabilities carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases or the fair value of financial assets and accrued liabiliites carried at amortized cost increases and the decrease/increase can be related objectively to an event occurring after the impairment was recognized. 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.

Structured settlements

In the normal course of claims adjudication, the Company settles certain obligations to claimants through the purchase of annuities from third party life insurance companies under structured settlement arrangements (structured settlements). In accordance with OSFI Guideline D-5, these contracts are categorized as either Type 1 or Type 2 based on the characteristics of the claim settlement. When the Company does not retain a reversionary interest under the contractual arrangement to any current or future benefits of the annuity, and the Company has obtained a legal release of the obligation from the claimant, it will be classified as a Type 1 structured settlement. For such contracts, any gain or loss arising on the purchase of an annuity is recognized in the consolidated statement of income at the date of purchase and the related claims liabilities are derecognized. All other structured settlements that do not meet these criteria are classified as Type 2, with the Company recognizing the annuity contract in other investments within invested assets. A corresponding liability representing the outstanding obligation to the claimant is recognized in insurance contracts.

Reinsurance

Reinsurance assets include the reinsurers' share of claims liabilities and unearned premiums. The Company reports 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. The estimates for the reinsurers' share of claims liabilities are presented as an asset and are determined on a basis consistent with the related claims liabilities. Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting period.

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 on certain long term policies for which premiums are earned using an actuarial risk assessment that matches 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, net of a provision for doubtful amounts, is recognized as an asset at the same time and using principles consistent with the Company's method for determining the unearned premium liability.

Deferred policy acquisition costs

Commissions, premium taxes and general expenses 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.

Unearned commission

Unearned commissions are based on ceded premiums with a coverage period beyond the current year end. Unearned commissions are recognized as liabilities using principles consistent with the Company's method of determining policy acquisition costs.

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 and comprehensive 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 OCI 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 Company utilizes the fair-value-based method of accounting for stock based compensation. The fair value of stock based compensation determined using an option pricing model, is recorded over the vesting period as a charge to net earnings with a corresponding credit to contributed surplus. Awards are equity settled.

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 and directors (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. Compensation expense and the related liability are recorded equally over the vesting period, taking into account fluctuations in the market price of the Company's share price.

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, 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 an employee of the Company 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") are 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, DSUs and RSUs granted to employees and directors.

Standards, amendments and interpretations not yet adopted or effective

IFRS 9, Financial Instruments

In July 2014 the IASB published the complete version of IFRS 9 which is effective for annual periods beginning on or after January 1, 2018, with retrospective application. The new standard includes requirements on the classification and measurement of financial assets and liabilities, an expected credit loss model that replaces the existing incurred loss impairment model and new hedge accounting guidance. The Company is currently evaluating the impacts of IFRS 9 on its consolidated financial statements, as well as the implementation options for insurers set out in the September 2016 amendment to *IFRS 4 Insurance Contracts* which allows eligible insurers to defer the adoption of IFRS 9 until the new insurance contracts standard is adopted, or 2021 at the latest.

IFRS 15, Revenue from contracts with customers

IFRS 15, Revenue from contracts with customers deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 16, Leases

In January 2016, the IASB published IFRS 16 which is effective January 1, 2019. The new standard requires the capitalization of all leases by recognizing the present value of the lease payments and showing them as lease assets, and recognizing a financial liability representing an obligation to make future lease payments. The Company is currently evaluating the impact of IFRS 16 on its Consolidated Financial Statements.

4 Critical accounting estimates and judgements

The preparation of the Company's consolidated financial statements requires management to use estimates and judgements that affect the amounts reported in the financial statements. These estimates and judgements 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 and judgements could change and impact future results.

Valuation of 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 the Company'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 and comprehensive 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 AFS financial asset is impaired, including in the case of equity investments classified as AFS, 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).

Valuation of Reinsurer's share of provision for unpaid claims

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.

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

Valuation of deferred tax asset

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 and comprehensive 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 defer–red 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 Seasonality

The P&C insurance business is seasonal in nature. While net earned premiums are generally stable from quarter to quarter, net underwriting income can be driven by weather conditions which may vary significantly by quarter.

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

6 Investments

The following table provides a breakdown of the investment portfolio as at December 31, 2016, and December 31, 2015.

	Fair values	
Available-for-sale	**As at December 31, 2016**	**As at December 31, 2015**
Fixed income		
Canadian		
Federal	67,826	45,524
Provincial	44,147	55,976
Municipal	519	1,386
Corporate	136,984	171,789
	249,476	274,675
Fixed income lent through securities lending program		
Federal	15,390	14,231
Provincial	998	3,800
Municipal	845	—
Corporate	1,885	4,673
	19,118	22,704
Foreign fixed income		
Government	—	17,555
Corporate	—	114,399
	—	131,954
Total fixed income	268,594	429,333
Commercial mortgages pooled funds	17,423	17,017
Money market pooled funds	200	403
Short-term fixed income and mortgage pooled funds	17,229	16,934
Total pooled funds	34,852	34,354
Common shares		
Canadian	312	2,656
U.S.	—	8,012
Total common shares	312	10,668
Total available-for-sale	303,758	474,355
Fair value through profit or loss		
Preferred shares	32,678	38,400
Preferred shares lent through securities lending program	99	344
Total preferred shares	32,777	38,744
Total investments	336,535	513,099
Cash and short-term deposits	50,588	23,373
Total investments including cash and short-term deposits	387,123	536,472

In accordance with the securities lending agreement, the amount of the collateral must be at least 105% of the fair value of the securities loaned. As at December 31, 2016, the Company had collateral of $20,580 (December 31, 2015 – $24,507) for the loaned securities or approximately 105% of the fair value of the loaned securities.

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

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

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 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, commercial mortgage pooled funds, money market pooled funds 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, 2016, and December 31, 2015:

December 31, 2016				
	Level 1	**Level 2**	**Level 3**	**Total**
Fixed income	—	268,594	—	268,594
Commercial mortgages pooled funds	—	17,423	—	17,423
Money market pooled funds	—	200	—	200
Short-term fixed income and mortgage pooled funds	—	17,229	—	17,229
Equities	312	—	—	312
Preferred Shares	32,777	—	—	32,777
	33,089	303,446	—	336,535

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

December 31, 2015				
	Level 1	**Level 2**	**Level 3**	**Total**
Fixed income	—	429,333	—	429,333
Commercial mortgages pooled funds	—	17,017	—	17,017
Money market pooled funds	—	403	—	403
Short-term fixed income and mortgage pooled funds	—	16,934	—	16,934
Equities	10,668	—	—	10,668
Preferred Shares	38,744	—	—	38,744
	49,412	463,687	—	513,099

Investment in commercial mortgages pooled funds is valued using the Company's share of the net asset value of the commercial mortgage pooled fund as of December 31, 2016, and December 31, 2015.

The Company's policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. During the year ended December 31, 2015, the Company transferred bonds with carrying value of 2,173 from level 3 to level 2 as the Company is now receiving quoted prices for these bonds. There were no level 3 investments in 2016.

The fair values of cash and short-term deposits, account receivables and financial liabilities, other than the provision for unpaid claims, approximate their carrying values due to their short-term nature.

The Company has interests in unconsolidated structured entities, through investments in pooled funds, which are included in investments on the balance sheets. These entities are not controlled by the Company. The carrying value of pooled funds as of December 31, 2016 was $34,852 (2015 – $34,354), and the maximum exposure to loss as of December 31, 2016 was $34,852 (2015 – $34,354). Investments in pooled funds consist of units invested in underlying money market and mortgage securities managed by Addenda and other third-party managers. The pooled funds are perpetual private trusts created under trust agreements. Financing and support is only provided to the pooled funds through the purchase of units and is therefore limited to the investment made.

Impaired assets and provisions for losses

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

No impairments on AFS investments were recognized for the period ended December 31, 2016 (December 31, 2015 – $267). A remaining gross unrealized loss of $1,691 on AFS investments held as at December 31, 2016 (December 31, 2015 – $3,232) is recorded, net of tax, in the amount of $1,231 (December 31, 2015 – $2,506) in Accumulated Other Comprehensive Income.

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

Investment income

The table below provides additional details on net investment income:

	2016	2015
Interest income	10,597	12,531
Dividend income	1,771	2,605
Net realized gains	280	6,202
Impairment loss recognized on AFS investment	—	(267)
Fair value change on FVTPL investments	3,870	(7,315)
Realized and unrealized foreign exchange gains	855	(57)
Investment expenses	(866)	(1,086)
Investment income	16,507	12,613

7 Derivative financial instruments

On January 21, 2016, the Company entered into a three month forward contract to manage the foreign currency risk on its investment in European subsidiary by buying $47.8M (CAD) and selling €30 million (EUR). The contract matured on April 22, 2016, with a settled value of $4.3 million recognized in the OCI. This was an effective hedge.

The Company entered into forward contracts for hedging the sales proceeds of its European subsidiary. The gain of $0.4 million has been booked in the investment income in FX gains. The net payable on the outstanding contracts as at December 31, 2016 is $0.3 million. The details of the outstanding contracts for hedging the sales proceeds of European subsidiary is as follows:

Contract Party	Deal Date	Value Date	FX Contract Purchase Amount CAD$	FX Contract Sale Amount DKK	Contract Rate	Rate as at Dec. 31, 2016	Net Settlement Amount at Dec. 31, 2016 CAD$
RBC Royal Bank	8-Dec-16	6-Feb-17	6M	31.9M	5.3100	5.2386	(0.1) M
RBC Royal Bank	8-Dec-16	6-Jul-17	12M	63.4M	5.2850	5.2041	(0.2) M

8 Line of credit

The Company has a $10 million two-year secured revolving term credit facility effective June 30, 2015, maturing on July 1, 2017. This credit facility may be drawn at the prime rate plus a margin or at the bankers' acceptances rate plus a margin. This facility was undrawn as at December 31, 2016. As part of the covenants of the loans under the credit facilities, the Company is required to maintain certain ratios and financial limits. All financial limits and ratios have been met as at December 31, 2016.

For the year ending December 31, 2016, the Company has expensed $0.2 million on the income statement, below income before interest expense and income tax, related to the maintenance of the credit facility.

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

9 Deferred policy acquisition costs

Reconciliation of deferred policy acquisition costs (DPAC) at December 31:

	2016		2015	
	Gross	**Ceded**	**Gross**	**Ceded**
Balance at the beginning of the year	77,456	23,689	49,353	9,459
Acquisition costs during the year	52,998	6,006	139,920	42,059
Amortization of acquisition costs during the year	(47,227)	(5,682)	(117,013)	(28,945)
Currency translation	—	—	5,196	1,116
Discontinued operations (note 26)	(52,538)	(21,725)	—	—
Acquisition costs deferred at end of the year	30,689	2,288	77,456	23,689

10 Unearned premiums

The following table shows unearned premiums by line of business and nature of risk:

	2016		2015	
	Gross	**Ceded**	**Gross**	**Ceded**
Automobile				
– accident benefits	15,799	929	23,645	7,785
– liability	33,942	1,082	95,692	43,571
– other	22,448	555	52,015	21,486
Property				
– commercial	5,671	553	5,167	718
– personal	36,381	4,724	78,334	16,042
Liability	3,521	118	3,755	222
Accident and sickness	86	—	5,562	21
Commercial auto	—	—	—	50
Surety	1,949	890	—	—
Other	387	124	414	58
	120,184	8,975	264,584	89,953

A reconciliation of unearned premium is shown below:

	2016		2015	
	Gross	**Ceded**	**Gross**	**Ceded**
Unearned premium at the beginning of the year	264,584	89,953	168,555	37,528
Premium written and ceded during the year	217,486	17,885	495,091	156,789
Premium earned in income	(198,148)	(17,088)	(415,760)	(109,360)
Currency translation	—	—	16,698	4,996
Discontinued operations (note 26)	(163,738)	(81,775)	—	—
Unearned premium at the end of the year	120,184	8,975	264,584	89,953

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

11 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 discounts future cash flows and includes a margin for adverse deviation.

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 discounts its best estimate as follows for each entity, which is for all lines of business within reporting entity:

Entity	December 31, 2016	December 31, 2015
Echelon Insurance	1.90%	2.44%
ICPEI	1.75%	1.63%

The Company recorded a $17,409 reduction to the net provision for unpaid claims relating to redundancies in prior years' estimates (December 31, 2015 – $18,012).

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 claims 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 net basis by $21,388 as at December 31, 2016 (December 31, 2015 – $21,818).

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

	2016		2015	
	Gross	**Ceded**	**Gross**	**Ceded**
Automobile				
– accident benefits	95,810	16,334	102,467	23,153
– liability	113,334	7,897	193,368	43,125
– other	6,474	86	41,964	17,637
Property				
– commercial	4,928	951	5,750	1,243
– personal	9,155	989	17,799	3,308
Liability	23,063	362	30,720	910
Accident and sickness	1,858	381	4,636	682
Commercial Auto	53	10	257	100
Surety	211	—	—	—
Other	243	13	253	—
Total unpaid claims	255,129	27,023	397,214	90,158

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

Claims development

Provision for unpaid claims analysis	December 31, 2016	December 31, 2015
Unpaid claims, beginning of year, net	307,056	295,955
Favourable prior year claims development	(17,409)	(18,012)
Provision for claims occurring in current period	131,003	211,248
Paid on claims occurring during		
Current year	(56,642)	(79,113)
Prior year	(62,173)	(103,022)
Discontinued Operations	(73,729)	—
Unpaid claims, end of period, net	228,106	307,056
Reinsurers' share	27,023	90,158
Gross unpaid claims	255,129	397,214

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

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, and the amount of data available on individual claims, inflation and any other pertinent factors. Some assumptions require a significant amount of judgement such as the expected impacts of future judicial decisions and government legislation. The diversity of these considerations results 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 period 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 ten 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									
	2007 & prior	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Provision for claims including LAE	169,091	185,255	207,220	239,036	254,519	268,580	296,856	344,692	397,214	255,129
Reserve re-estimate as of:										
1 year later	163,465	186,446	203,920	232,472	246,972	269,499	284,934	326,083	377,570	
2 years later	162,916	189,093	201,044	239,117	245,331	252,279	276,565	295,495		
3 years later	164,290	186,429	206,039	239,338	232,772	250,266	263,289			
4 years later	161,852	190,342	205,646	228,612	230,271	244,385				
5 years later	163,440	189,297	197,841	228,628	229,741					
6 years later	163,069	183,341	199,637	230,487						
7 years later	159,402	187,392	201,049							
8 years later	163,480	189,298								
9 years later	165,003									
Cumulative favourable (unfavourable) development	4,088	(4,043)	6,171	8,549	24,778	24,195	33,567	49,197	19,644	

Claims development table, net of reinsurance

	Calendar Year									
	2007 & prior	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Provision for claims including LAE	120,630	143,354	168,484	202,884	221,250	238,297	264,094	295,955	307,055	228,106
Reserve re-estimate as of:										
1 year later	115,530	142,641	164,393	196,517	215,191	233,517	252,748	277,943	289,646	
2 years later	112,960	143,980	162,651	203,632	214,128	225,958	245,568	252,548		
3 years later	112,595	142,924	166,901	203,367	204,365	220,530	234,335			
4 years later	111,267	144,486	166,300	195,502	197,028	215,901				
5 years later	110,883	143,125	160,078	192,120	196,751					
6 years later	110,001	138,578	159,189	193,183						
7 years later	107,439	139,649	160,168							
8 years later	108,297	140,793								
9 years later	109,209									
Cumulative favourable (unfavourable) development	11,421	2,561	8,316	9,701	24,499	22,396	29,759	43,407	17,409	

The provision for unpaid claims relating to the International division, currently held for sale, was treated as paid in the development table above.

12 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 does not relieve the Company of its primary obligation to policyholders.

During 2016, 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 $2,000 (2015 – $1,500).

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

In addition, the Company obtained catastrophe reinsurance which limits the loss from a series of claims arising from a single occurrence to $2,000 (2015 – $2,000), to a maximum coverage of $58,000 (2015 – $35,000).

The Company places all its Canadian and European automobile reinsurance with registered reinsurers. There are non-registered reinsurers participating in the specialty property and casualty program business. The Company has access to trust funds that, in the Company's judgement, 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, 2016 and 2015, by risk rating:

December 31, 2016			
Credit rating	**Gross reinsurance recoverable**	**Less: Deposits held in trust**	**Net exposure**
A or higher	36,329	—	36,329
Not rated	1,256	1,263	—
	37,585	1,263	36,329

December 31, 2015			
Credit rating	**Gross reinsurance recoverable**	**Less: Deposits held in trust**	**Net exposure**
A or higher	180,011	1,308	178,703
Not rated	1,779	1,417	362
	181,790	2,725	179,065

Included in gross reinsurance recoverable is reinsurers' share of unearned premiums of $8,975 (December 31, 2015 – $89,953), reinsurers' share of provision for unpaid claims of $27,023 (December 31, 2015 – $90,158), and receivables from reinsurers presented as due from insurance companies of $1,587 (December 31, 2015 – $1,821). No balances due from reinsurers are considered past due as at December 31, 2016 and 2015. There is no valuation allowance or amounts written off during the years ended December 31, 2016 and 2015.

13 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 foreign exchange risk.

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

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.

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.

Direct Written Premium	December 31, 2016	December 31, 2015
Lines		
Personal Lines	71%	73%
Commercial Lines	29%	27%
Regions		
Ontario	47%	52%
Atlantic Canada	22%	22%
Quebec	12%	8%
Western Canada	19%	18%

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.

	2016		2015	
Sensitivity Factor	**Net income before income taxes**	**Shareholders' equity**	**Net income before income taxes**	**Shareholders' equity**
Increase of 1% to loss ratio	(1,811)	(1,322)	(1,765)	(1,288)
Increase of 1% to claims settlement costs	(2,281)	(1,665)	(3,071)	(2,242)

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.

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, derivatives, 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 Audit and Risk Committee under policies approved by the Board of Directors.

Market risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity market fluctuations, foreign exchange rates and other relevant market rate or price changes. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying financial assets are traded. Below is a discussion of the Company's primary market risk exposures and how these exposures are currently managed.

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, 2016, and December 31, 2015, based on parallel 200 basis point shifts in interest rates up and down in 100 basis point increments.

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

Change in interest rates	Fair value of fixed income	Hypothetical change on fair value	Effect on OCI net of tax
As at December 31, 2016			
200 basis point rise	252,340	(6)%	(11,865)
100 basis point rise	260,468	(3)%	(5,932)
No change	268,594	—	—
100 basis point decline	276,722	3%	5,931
200 basis point decline	284,850	6%	11,863

Change in interest rates	Fair value of fixed income	Hypothetical change on fair value	Effect on OCI net of tax
As at December 31, 2015			
200 basis point rise	404,244	(6)%	(18,315)
100 basis point rise	416,788	(3)%	(9,158)
No change	429,333	—	—
100 basis point decline	441,879	3%	9,159
200 basis point decline	454,425	6%	18,317

As discussed in note 11, 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 net of
As at December 31, 2016			
100 basis point rise	223,441	(2)%	(3,405)
No change	228,106	—%	—
100 basis point decline	233,024	2%	3,590
As at December 31, 2015			
100 basis point rise	300,563	(2)%	(4,740)
No change	307,056	—	—
100 basis point decline	313,755	2%	4,890

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, 2016, and December 31, 2015, are as follows:

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

December 31, 2016	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	18,190	76,090	100,469	73,845	268,594
Percentage of total	7%	28%	37%	28%	100%

December 31, 2015	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	36,949	121,892	125,709	144,783	429,333
Percentage of total	9%	28%	29%	34%	100%

The following tables summarize the expected timing of cash flows arising from insurance obligations, on an undiscounted basis, as at December 31, 2016, and December 31, 2015:

December 31, 2016	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	86,700	87,875	43,864	24,008	242,447
Less: Reinsurance recoverable (undiscounted)	9,251	8,928	3,608	4,660	26,447
Net actuarial liabilities	77,449	78,947	40,256	19,348	216,000

December 31, 2015	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	157,206	121,333	73,855	26,267	378,661
Less: Reinsurance recoverable (undiscounted)	45,441	24,209	16,700	2,518	88,868
Net actuarial liabilities	111,765	97,124	57,155	23,749	289,793

All other financial liabilities are for duration of one year or less. The contractual maturities for lease commitments are listed in note 20.

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 twelve months ended December 31, 2016, and the year ended December 31, 2015. Certain shortcomings are inherent in the method of analysis presented, as the analysis is based on the assumption that all equity holdings increased/decreased by 10% with all other variables held constant.

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

Change in equity holdings	Effect on net income (loss) net of tax		Effect on OCI net of tax	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
10% rise	2,393	2,828	23	779
10% decline	(2,393)	(2,828)	(23)	(779)

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:

	As at December 31, 2016	As at December 31, 2015
Bonds	268,594	429,333
Gross reinsurance recoverable	36,329	180,011
Accounts receivable	46,705	105,300
Structured settlements (note 21)	32,729	33,009
Cash	50,588	23,373
Total	434,945	771,026

Echelon has entered into FX contracts for its European subsidiary sales proceeds hedging. The FX contracts are with Royal Bank of Canada, a Canadian multinational financial services company and the largest bank in Canada.

The following table sets forth the Company's fixed income securities portfolio by credit quality as at December 31, 2016, and December 31, 2015.

Fixed income portfolio

A breakdown of the fixed income portfolio by credit rating is shown below:

	As at December 31, 2016		As at December 31, 2015	
	Fair value	Fair value	Fair value	Fair value
AAA	107,267	40%	132,195	31%
AA	52,728	20%	87,986	21%
A	67,360	25%	76,398	18%
BBB	41,239	15%	81,639	19%
BB	—	—%	25,888	6%
B	—	—%	14,717	3%
CCC	—	—%	537	0%
Unrated	—	—%	9,973	2%
Total	268,594	100%	429,333	100%

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

Preferred share portfolio

A breakdown of the preferred shares portfolio by credit rating is shown below:

	As at December 31, 2016		As at December 31, 2015	
	Fair value	Fair value	Fair value	Fair value
P2	29,600	90%	30,702	79%
P3	3,177	10%	8,042	21%
Total	32,777	100%	38,744	100%

Capital management

Capital is comprised of the Company's total equity. As at December 31, 2016, the Company's equity was $137,414 (December 31, 2015 – $180,935).

The Company's objectives when managing capital consists of:

- maintaining capital to be above minimum regulatory levels,
- ensuring capital is above internally determined risk management levels,
- financial strength and protect its claims paying abilities, to maintain creditworthiness
- maximizing returns to shareholders over the long term.

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 (CAD), the Company's functional currency. The Company is exposed to foreign currency risk through transactions conducted in currencies other than CAD, and through its investments in subsidiaries that have a functional currency other than the CAD.

A portion of the Company's premiums are written in Great British Pounds (GBP), Euros (EUR) and Danish Kroner (DKK) and a portion of loss reserves are also in GBP, EUR and DKK. A portion of the Company's cash and investments are also held in DKK, EUR and United States dollars (USD).

In general, the Company attempts to manage foreign exchange risk on liabilities by investing in financial instruments denominated in the same currency as the corresponding financial liabilities. The Company may, nevertheless, from time to time experience losses resulting from fluctuations in the value of the USD, GBP, EUR and DKK, which could adversely affect operating results.

The table below illustrates the expected impact on net income after tax and OCI after tax of a 10% change in CAD compared to the GBP and DKK as at December 31, 2016 and 2015. The impact to changes in USD is not significant. 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.

Change in CAD/DKK rate	Effect on Net Income		Effect on OCI	
	2016	2015	2016	2015
10% rise	(8,808)	(2,203)	4,805	2,078
10% decline	8,808	2,203	(4,805)	(2,078)
Change in CAD/GBP rate	**Effect on Net Income**		**Effect on OCI**	
	2016	2015	2016	2015
10% rise	(3,065)	(2,822)	3,603	3,124
10% decline	3,065	2,822	(3,603)	(3,124)

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

14 Intangible assets

	Opening cost	Purchases	Sales	End of period cost	Accumulated amortization	Net
Software						
December 31, 2016	23,014	5,698	—	28,712	20,915	7,797
December 31, 2015	19,430	3,584	—	23,014	17,176	5,838
Goodwill						
December 31, 2016	400	—	—	400	—	400
December 31, 2015	400	—	—	400	—	400
Total intangible assets						
December 31, 2016	23,414	5,698	—	29,112	20,915	8,197
December 31, 2015	19,830	3,584	—	23,414	17,176	6,238

15 Income taxes

The income tax (recovery) is as follows:

	2016	2015
Current	1,738	1,555
Deferred	(68)	121
	1,670	1,676

The effective income tax rates are different from the combined federal and provincial income tax rates.

The consolidated statements of income and comprehensive income contain items that are non-taxable or non-deductible for income tax purposes, which cause the income tax expense to differ from what it would have been if based on statutory rates.

The difference is broken down as follows:

	2016	2015
Income tax expense calculated at statutory rates	27.0 %	27.0 %
Increase (decrease) in income tax rates resulting from:		
Non-taxable dividend income	(6.1)%	(3.9)%
Non-taxable (income) loss	(5.7)%	(1.4)%
Non-deductible expenses	2.7 %	0.8 %
Tax benefit of losses not previously recognized	(0.1)%	(4.2)%
Tax benefit of losses not recognized	0.8 %	— %
Statutory rate differences	1.1 %	(0.6)%
Non-taxable portion of capital gains	(1.8)%	(3.7)%
Other	1.1 %	(3.2)%
Effective income tax rate	19.0 %	10.8 %

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

Deferred income taxes are comprised of the following:

	Losses Carried Forward	**Reserves**	**Investments**	**Property, equipment and intangible assets**	**Total**
Balance - January 1, 2016	1,146	4,758	(32)	568	6,440
Amounts recorded in discontinued operations	7,904	(131)	—	—	7,773
Amounts recorded in the income statement	(274)	62	7	273	68
Write-off	(8,421)	—	—	—	(8,421)
Balance - December 31, 2016	355	4,689	(25)	841	5,860

	Losses Carried Forward	**Reserves**	**Investments**	**Property, equipment and intangible assets**	**Total**
Balance - January 1, 2015	956	4,730	(55)	724	6,355
Amounts recorded in the income statement	190	28	23	(156)	85
Balance - December 31, 2015	1,146	4,758	(32)	568	6,440

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.

The Company has tax losses available resulting from capital losses of $3,499, temporary differences of $26,822 in respect of the discontinued operations and $258 in respect of unrealized losses in foreign exchange forward contracts for which no deferred tax assets have been set up. These capital losses have no expiry date.

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:

	2016	**2015**
Change in unrealized gains	739	(208)
Reclassification to net income of (gains) and losses	(1,030)	(1,200)
Total income tax expense included in OCI	(291)	(1,408)

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

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

16 Share capital

	As at December 31, 2016	As at December 31, 2015
Authorized		
Unlimited common shares (no par value)		
Unlimited special shares issuable in Series (no par value)		
Issued		
11,747,736 common shares (December 31, 2015 – 11,729,112 common shares)	70,227	69,653

In 2016, 52,600 common shares (2015 – 202,125) with a value of $866 (2015 – $3,142) were issued for the exercise of stock options. In 2016, 21,891 common shares (2015 – 21,530) were issued pursuant to the Share Unit Plan for eligible employees. During 2016, 55,867 shares or $676 were repurchased under the normal course issuer bid and subsequently cancelled (2015 – 103,600 shares or $1,513).

Dividends

During the year ended December 31, 2016, the Company has paid $0.24 per share (December 31, 2015 – $0.45 per share).

17 Employee stock option plan

For the year ended December 31, 2016, the Company recorded a compensation recovery of $56 (2015 – expense of $78), with an offsetting credit to contributed surplus in relation to its stock option plan. Stock options granted have varying vesting periods. It also recorded an expense of $344 (2015 – $629) in relation to its Share Unit Plan. No stock options were granted in 2016.

The following is a continuity schedule of stock options outstanding as at December 31, 2016 and 2015.

	Number of options		Weighted average exercise price per share	
	2016	2015	2016	2015
Outstanding, beginning of year	309,325	569,950	8.15	8.67
Granted during year	—	—	—	—
Exercised during year	(52,600)	(202,125)	7.71	9.51
Canceled during year	(39,750)	(58,500)	8.24	8.48
Expired during year	(14,625)	—	7.80	—
Outstanding, end of year	202,350	309,325	8.27	8.15

As at December 31, 2016, the outstanding stock options consist of the following:

Stock Option price per share	Number	Average remaining contractual life	Number of options exercisable
$8.01 - $8.89	128,525	3.25	52,000
$7.18 - $8.00	73,825	1.38	62,825

The fair values of the stock options issued in 2016 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 2.5%. The grant-date fair value of total options granted during the year is estimated at nil (2015 – $nil). The weighted average grant-date fair value per share option to date is $3.20.

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

Restricted share unit (RSU) plan

The restricted share units are share-settled awards for which the provision recorded as at December 31, 2016 was $360 (2015 – $727). The amount credited to operating expenses for 2016 was $367 (2015 – $9).

18 Related party transactions

Key management

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

Compensation	2016	2015
Salaries, directors' fees and other short-term benefits	1,626	2,220
Equity-settled and cash-settled compensation benefits	552	642
Termination benefits	2,067	—
	4,245	2,862

19 Operating Costs by nature

The table below presents operating costs by major category:

	2016	2015
Salaries and benefits	14,475	14,510
Systems costs	7,565	6,120
Professional fees	1,760	1,518
Occupancy	1,358	1,322
Severance	4,266	—
Other expenses	3,999	4,170
	33,423	27,640

Corporate expenses include $0.5 million (2015 – $1.0 million) relating to positive development on prior year claims reserves of ICPEI, that in accordance with terms of the share purchase agreement are payable to SGI Canada on January 1, 2019, up to a maximum of the lesser of $1.5 million or 75% of the surplus. The indemnification liability is offset by positive development of the reserve in ICPEI. In the event that prior period losses are greater than the reserves held at June 30, 2014, SGI Canada will be required to pay the Company the difference on January 1, 2019, to a maximum of the lesser of $1.5 million or 75% of the deficiency.

20 Lease commitments

The Company is committed under lease agreements for office premises and computer equipment with minimum lease payments of $11,533 as follows:

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

Lease commitments	
2017	1,622
2018	1,608
2019	1,482
2020	1,209
2021	1,233
2021 and thereafter	4,379
	11,533

21 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 $32,729 (December 31, 2015 – $33,009) using a discount rate of 2.31% (December 31, 2015 – 2.15%). 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.

22 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.

23 Rate regulations

The Company writes business subject to rate regulation, including non-standard automobile and motorcycle insurance in Canada, which comprises approximately 72% (2015 -— 74%) 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.

24 Accumulated other comprehensive income

A breakdown of the accumulated other comprehensive income is shown below.

	As at December 31, 2016	As at December 31, 2015
Gross unrealized gains	(459)	4,208
Foreign currency translation adjustments	(10,776)	2,151
Foreign exchange forward	4,314	—
Tax impact	1,851	(299)
Ending balance	(5,070)	6,060

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

25 Earnings per share

	2016	2015
Basic earnings per share on continued operations:		
Net income available to shareholders	6,606	12,254
Average number of common shares	11,738	11,669
Basic earnings per share on continued operations	$0.56	$1.05
Diluted earnings per share:		
Average number of common shares	11,738	11,669
Average number of dilutive common shares under employee stock compensation plan	261	300
Average number of diluted common shares	11,999	11,969
Diluted earnings per share on continued operations	$0.55	$1.02

	2016	2015
Basic earnings per share on discontinued operations:		
Net income available to shareholders	(36,414)	(5,629)
Average number of common shares	11,738	11,669
Basic earnings per share on discontinued operations	$(3.10)	$(0.48)
Diluted earnings per share:		
Average number of common shares	11,738	11,669
Average number of dilutive common shares under employee stock compensation plan	261	300
Average number of diluted common shares	11,999	11,969
Diluted earnings per share on discontinue operations	$(3.10)	$(0.48)

	2016	2015
Basic earnings per share:		
Net income available to shareholders	(29,808)	6,625
Average number of common shares	11,738	11,669
Basic earnings (loss) per share	$(2.54)	$0.57
Diluted earnings per share:		
Average number of common shares	11,738	11,669
Average number of dilutive common shares under employee stock compensation plan	261	300
Average number of diluted common shares	11,999	11,969
Diluted earnings (loss) per share	$(2.54)	$0.55

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

26 Held for sale classification and discontinued operations

During the second quarter, a decision was made to sell the company's European operations and all assets were recorded as "Held for Sale" at the lower of the fair value less cost to sell and the carrying value. This reclassification for the discontinued operations resulted in a $23.4 million impairment, including all transactions costs to dispose of the operations, being recorded against the unearned premiums included within the liabilities of the disposal group held for sale.

Assets and liabilities of the disposal group held for sale

The assets and liabilities of the disposal group classified as held for sale included in the consolidated balance sheet as at December 31, 2016 were as follows:

	As at December 31, 2016
Assets of the disposal group held for sale	
Cash and short-term deposits	87,047
Investments	67,174
Reinsurers' share of unpaid claims	97,636
All other assets	28,185
Total assets of disposal group held for sale	280,042
Liabilities of the disposal group held for sale	
Accounts payable and accrued liabilities	13,899
Unearned premiums	55,198
Provision for unpaid claims	190,433
All other liabilities	3,664
Total liabilities of disposal group held for sale	263,194

Net income (loss) from discontinued operations

The components of the net loss from discontinued operations included in the consolidated statements of income and comprehensive income are as follows:

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

	2016	2015
Revenue		
Gross written and assumed premiums	247,573	295,618
Net written premium	121,052	157,966
Decrease (increase) in provision for unearned premium	23,792	(25,156)
Net earned premiums	144,844	132,810
Investment income	2,643	1,274
Total revenue	147,487	134,084
Expenses		
Net incurred claims	108,677	83,817
Impact of change in discount rate on claims	—	616
Net acquisition costs	51,198	49,365
Operating costs	6,910	7,234
Total expenses	166,785	141,032
(Loss) income before income taxes	(19,298)	(6,948)
Income tax (recovery) expense	(6,031)	(1,271)
Net (loss) income on discontinued operations	(13,267)	(5,677)
Impairment of the net assets of disposal group held for sale	(23,379)	—
Net (loss) income on discontinued operations	(36,646)	(5,677)

Correction of an error

It was identified during the year that there was an error in the calculation of unearned premiums on select policies in the Company's discontinued operations for the year ended December 31, 2015. The error resulted in an overstatement of earned premiums and an understatement of unearned premiums as at December 31, 2015. The discontinued operations in 2015 had a premium deficiency which decreased DPAC, and it was identified that if unearned premiums were corrected in 2015, no deficiency would have been required. Thus the impact on the December 31, 2015 income statement is an increase in UPR offset by an increase in the DPAC. The company has adjusted the financial statements for the comparative year ended December 31, 2015 in these statements.

The following table presents the amounts previously reported and restated in the consolidated balance sheet and consolidated statement of income and comprehensive income for the year ended December 31, 2015.

Balance as at December 31, 2015	As Reported	Adjustment	As Amended
Unearned premium	260,073	4,511	264,584
Deferred policy acquisition costs	76,710	746	77,456
Opening retained earnings as at January 1, 2015	105,354	(2,132)	103,222
Net income (loss)	8,218	(1,633)	6,585
(Loss) per share discontinued operations - basic	$(0.34)	$(0.14)	$(0.48)
(Loss) per share discontinued - diluted	$(0.34)	$(0.14)	$(0.48)

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

27 Non-controlling interest

The Company has non-controlling interests attributable to the subsidiary of ICPEI, please refer to Note 1.

	2016	2015
Revenue		
Gross written and assumed premiums	7,409	6,869
Net earned premiums	6,482	6,413
Investment income	330	51
Total revenue	6,812	6,464
Expenses		
Net incurred claims	3,427	4,165
Net acquisition costs	1,636	1,479
Operating costs	1,035	867
Total expenses	6,098	6,511
Income (loss) before income taxes	714	(47)
Income tax expense (recovery)	202	(55)
Net income (loss) attributable to NCI	512	8
OCI attributable to NCI	(52)	(11)
Comprehensive income attributable to NCI	460	(3)

	As at December 31, 2016	As at December 31, 2015
Assets		
Cash and investments	9,421	8,337
Other assets	4,377	4,417
Total assets	13,798	12,754
Liabilities		
Unearned premium	3,699	3,428
Unpaid claims	5,709	5,682
Other liabilities	648	362
Total liabilities	10,056	9,472
Equity		
Share capital	—	—
AOCI	(43)	9
Retained earnings	3,785	3,273
Total equity	3,742	3,282
Total liabilities and equity	13,798	12,754

The equity balance above excludes discontinued operations and will therefore differ from the non controlling interest amount disclosed on the balance sheet of these financial statements.

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

	As at December 31, 2016	As at December 31, 2015
	ICPEI	ICPEI
Cash flow from operating activities	1,138	(581)
Cash flow from investing activities	(232)	(201)
Cash flow from financing activities	—	250
Net increase (decrease) in cash and short-term deposits	906	(532)

28 Segmented information

The Company operates through two segments: Personal Lines and Commercial Lines businesses. Through its Personal Lines segment, the Company is engaged primarily in the underwriting of high premium, non-standard automobile insurance.

Through its Commercial Lines, the Company designs and underwrites specialized non-auto insurance programs, such as higher premium property, primary and excess liability, legal expense, creditor insurance and warranty coverage.

The European operations are considered to be discontinued and not disclosed.

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)

	2016	2015
Revenue		
Earned premiums		
– Personal Lines	139,616	134,791
– Commercial Lines	41,444	41,677
Total earned premium	181,060	176,468
Net claims Incurred		
– Personal Lines	97,823	89,620
– Commercial Lines	12,949	20,207
Total net claims incurred	110,772	109,827
Net expenses		
– Personal Lines	44,970	41,862
– Commercial Lines	18,504	16,581
Total	63,474	58,443
Corporate Expenses	7,228	8,645
Total net expenses	70,702	67,088
Income (loss) before income taxes		
– Personal Lines	(3,177)	3,309
– Commercial Lines	9,991	4,889
Total Canada	6,814	8,198
Corporate and other	(7,228)	(8,645)
Underwriting (loss) income	(414)	(447)
Impact of change in net claims discount rate(1)	(2,822)	1,024
Other income	—	748
Severance expense	(4,266)	—
Investment income	16,507	12,613
Total income before income taxes	9,005	13,938

(1) As the interest rate changes every year, there is an impact to the incurred claims. Management believes it is beneficial to the user to see the impact of this change separately in order to understand the true movement in claims incurred.