

Consolidated Financial Statements of

EGI FINANCIAL HOLDINGS INC.

December 31, 2007 and 2006

Management's Responsibility for Financial Reporting

Roles of Management, Board of Directors and Audit Committee

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

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

Role of Appointed Actuary

The actuary is appointed by the Board of Directors, pursuant to the Insurance Companies Act. The appointed actuary is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives. The appointed actuary is also required to provide an opinion regarding the appropriateness of the policy liabilities at the consolidated balance sheet dates to meet all policyholder obligations of the Company. 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 auditors 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 Auditors

PricewaterhouseCoopers LLP, external auditors, have 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 auditors consider the work of the appointed actuary in respect of policy liabilities included in the consolidated financial statements, on which the appointed actuary has rendered an opinion.

Toronto, Ontario
February 21, 2008

(signed) Douglas E. McIntyre,
Chief Executive Officer

(signed) Hemraj Singh,
Chief Financial Officer

APPOINTED ACTUARY'S REPORT

To the Shareholders of EGI Financial Holdings Inc.:

I have valued the policy liabilities of the subsidiary insurance operations of EGI Financial Holdings Inc. in its consolidated balance sheets as at December 31, 2007 and 2006, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

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

Toronto, Ontario
February 21, 2008

(signed) Joe S. Cheng, FCIA
J. S. Cheng & Partners Inc.

February 21, 2008

Auditors' Report

**To the Shareholders of
EGI Financial Holdings Inc.**

We have audited the consolidated balance sheet of **EGI Financial Holdings Inc.** as at December 31, 2007 and 2006 and the consolidated statements of income, changes in shareholders' equity and comprehensive income, and cash flows for each of the years in the two-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Accountants, Licensed Public Accountants

EGI FINANCIAL HOLDINGS INC.
Consolidated Balance Sheets
as at December 31

(in \$ thousands, except share amounts)

Assets	2007	2006
Cash and short-term deposits	22,785	17,153
Investments (note 5)	238,310	179,383
Reinsurers' share - unearned premiums (note 7)	3,602	3,831
- provision for unpaid claims (note 8)	48,461	48,385
Accounts receivable	25,382	22,182
Income taxes recoverable	3,278	572
Due from insurance companies	6,199	3,996
Deferred policy acquisition costs	15,530	7,465
Capital assets (note 10)	1,250	799
Future income taxes (note 14)	2,674	4,403
Prepaid expenses and other assets	2,613	270
	<u>370,084</u>	<u>288,439</u>
 Liabilities		
Bank indebtedness (note 15)	19,550	-
Provision for unpaid claims (note 8)	169,091	146,101
Unearned premiums (note 7)	69,190	43,154
Unearned commission	291	733
Accounts payable and accrued liabilities	5,444	4,746
Payable to insurance companies	3,894	4,428
Income taxes payable	-	3,151
Other liabilities	953	85
	<u>268,413</u>	<u>202,398</u>
 Shareholders' Equity		
Share capital (note 11)	46,040	45,833
Contributed surplus (note 12)	247	149
Retained earnings	53,193	40,059
Accumulated other comprehensive income	2,191	-
	<u>101,671</u>	<u>86,041</u>
	<u>370,084</u>	<u>288,439</u>

On Behalf of the Board of Directors:

(signed) Douglas E. McIntyre, Director

(signed) Paul F. Little, Director

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Income
For the Years Ended December 31
(in \$ thousands, except share amounts)

	2007	2006
Revenue:		
Direct written and assumed premiums	<u>157,935</u>	<u>117,834</u>
Net written and assumed premiums	<u>146,511</u>	<u>106,047</u>
Net earned premiums	119,606	103,942
Investment income (note 5)	<u>12,954</u>	<u>11,034</u>
	<u>132,560</u>	<u>114,976</u>
Expenses		
Incurred claims	71,179	59,503
Acquisition costs	26,143	19,499
Operating costs	12,043	10,431
Interest expense	<u>259</u>	<u>-</u>
	<u>109,624</u>	<u>89,433</u>
Income before income taxes	22,936	25,543
Income tax expense (note 14)	<u>7,871</u>	<u>8,562</u>
Net income	<u>15,065</u>	<u>16,981</u>
Earnings per share (note 20)		
Basic net income per share	\$1.56	\$1.76
Diluted net income per share	\$1.45	\$1.67

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Changes in Shareholders' Equity
and Comprehensive Income
For the Years ended December 31
(in \$ thousands, except share amounts)

	2007	2006
Share capital		
Balance, beginning of year	45,833	47,660
Common shares issued	207	328
Redemption of Series F special shares	-	(2,155)
Balance, end of year	<u>46,040</u>	<u>45,833</u>
Contributed surplus		
Balance, beginning of year	149	80
Stock options – granted	123	97
– exercised	(25)	(28)
Balance, end of year	<u>247</u>	<u>149</u>
Retained earnings		
Balance, beginning of year	40,059	24,845
Net income	15,065	16,981
Dividends – Series F special shares	-	(229)
– Common shares	(1,931)	(1,538)
Balance, end of year	<u>53,193</u>	<u>40,059</u>
Accumulated other comprehensive income		
Balance beginning of year	-	
Transition adjustment – financial instruments, net of income taxes of \$2,723	5,301	
Other comprehensive loss	(3,110)	
Balance, end of year	<u>2,191</u>	
Shareholders' equity, end of year	<u>101,671</u>	<u>86,041</u>
Comprehensive income		
Net income	15,065	
Other comprehensive loss, net of income taxes		
Net unrealized losses on available-for-sale securities	(957)	
Reclassification of net realized gains to net income	(2,153)	
Other comprehensive loss	<u>(3,110)</u>	
Total comprehensive income	<u>11,955</u>	

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Cash Flows
For the Years Ended December 31
(in \$ thousands, except share amounts)

	2007	2006
Cash provided by (used in):		
Operating activities		
Net income	15,065	16,981
Items not involving cash		
Amortization of capital assets	406	433
Amortization of premium on bonds	368	386
Realized gains on investments	(3,195)	(3,489)
Other	123	97
	<u>12,767</u>	<u>14,408</u>
Cash flow from changes in		
Reinsurers' share of unearned premiums	229	(1,070)
Reinsurers' share of unpaid claims	(76)	5,658
Accounts receivable	(3,200)	89
Income taxes recoverable	(2,706)	(299)
Due from insurance companies	(2,203)	(1,492)
Accounts payable and accrued liabilities	590	(3,300)
Provision for unpaid claims	22,990	16,928
Unearned premiums	26,036	3,181
Income taxes payable	(3,151)	(2,557)
Future income taxes	(58)	(1,270)
Prepaid expenses and other assets	(2,343)	(8)
Deferred policy acquisition costs	(8,065)	(1,176)
	<u>40,810</u>	<u>29,092</u>
Financing activities		
Increase in bank indebtedness	19,550	-
Issue of common shares	182	300
Series F special share dividends	-	(229)
Redemption of Series F special shares	-	(2,155)
Common share dividends	(1,931)	(1,538)
	<u>17,801</u>	<u>(3,622)</u>
Investing activities		
Purchase of capital assets	(857)	(672)
Purchase of investments	(256,245)	(193,256)
Sale/maturity of investments	204,123	169,712
	<u>(52,979)</u>	<u>(24,216)</u>
Increase in cash and short-term deposits	5,632	1,254
Cash and short-term deposits, beginning of year	17,153	15,899
Cash and short-term deposits, end of year	<u>22,785</u>	<u>17,153</u>
Supplementary information		
Income taxes paid	13,095	12,713
Interest paid	196	-

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

1 Organization

EGI Financial Holdings Inc. (“the Company” or “EGI”) was incorporated on August 18, 1997 under the Business Corporations Act (Ontario). The Company is a holding company which, through its subsidiaries, is involved primarily in the underwriting of non-standard automobile and other niche and specialty general insurance products and the management of investment funds derived from its insurance operations.

The Company’s wholly owned subsidiaries are EGI Insurance Managers Inc., Echelon General Insurance Company (“Echelon”), EGI Insurance Services, Inc., and CIM Reinsurance Company Ltd.

2 Change in accounting policies

On January 1, 2007, the Company adopted the following new accounting standards that were issued by The Canadian Institute of Chartered Accountants (CICA): CICA Handbook Section 1530, “Comprehensive Income”; Section 3855, “Financial Instruments – Recognition and Measurement”; Section 3861, “Financial Instruments – Disclosure and Presentation”; and Section 3865, “Hedges”. The Company adopted these new accounting standards retrospectively and without restatement of prior periods.

Prior to the adoption of these new standards, financial assets and liabilities within the scope of Section 3855 comprising cash and short term deposits, investments, accounts receivable, accounts payable and accrued liabilities and payable to insurance companies were recorded at cost or amortized cost. Under the new standards, all financial assets and liabilities, except for policy liabilities, are recorded on the consolidated balance sheet at fair value on initial recognition and are subsequently accounted for based on their classification, as described below.

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. Under Section 3855, financial assets are designated as either loans and receivables or financial instruments which must be classified as held for trading (HFT), held to maturity (HTM), or available for sale (AFS). All financial assets, including derivatives, are measured on the consolidated balance sheet at fair value, except for those classified as loans and receivables, HTM investments and other financial liabilities, which are measured at amortized cost using the effective interest rate method. Changes in fair value of HFT financial instruments are recorded in net income. Changes in fair value of AFS investments are recorded in other comprehensive income (OCI) until the investment is sold or impaired, at which time the realized gain or loss is recorded in net income.

Section 1530 establishes standards for reporting and presenting comprehensive income. Comprehensive income comprises net income and OCI and includes all changes in equity (net assets) of the Company during the year except those resulting from investment by and distribution to owners. Changes in unrealized gains and losses on AFS investments are recorded in OCI and included in accumulated other comprehensive income (AOCI) until recognized in the consolidated statement of income.

Section 3861 establishes standards for the presentation of financial instruments and non-financial derivatives and identifies the related information that should be disclosed.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Section 3865 describes when and how hedge accounting can be applied. The Company does not have any hedging relationships.

On adoption of the new standards as at January 1, 2007, the Company classified all of its investments as AFS. The adjustment to increase the carrying value of these investments from amortized cost of \$179,383 to fair value of \$187,407 has been recorded as an opening adjustment to AOCI of \$5,301 net of income taxes. Accounts receivable are classified as loans and receivables, while bank indebtedness, accounts payable and accrued liabilities and payable to insurance companies are classified as other financial liabilities, all of which are measured at amortized cost.

The impact of recording investments at fair value on the selection of the discount rate and the measurement of policy liabilities as at January 1, 2007 was immaterial.

A summary of the impact on the consolidated balance sheet of adopting the new standards is as follows:

	As at December 31, 2006	Adjustment on adoption of new standards	As at January 1, 2007
Bonds and debentures	147,649	903	148,552
Preferred shares	6,277	69	6,346
Common shares	25,457	7,052	32,509
Future income taxes	4,403	(2,723)	1,680
AOCI	-	5,301	5,301

There was no impact on reported net income for the year ended December 31, 2006.

3 Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the reporting date of the financial statements. Estimates also affect the reported amounts of revenue and expenses for the reporting period of the consolidated statements of income. Actual results could differ from those estimates.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated upon consolidation.

Cash and short-term deposits

Cash and short-term deposits include cash on hand, cash balances with banks and investments in money market instruments maturing in 90 days or less from the date of acquisition.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Investments

Prior to 2007, bonds and debentures were stated at amortized cost. Premiums and discounts arising on the purchase of bonds and debentures were amortized to investment income on a yield-to-maturity basis. When the value of any bond, debenture or term deposit was identified as impaired, the carried amount was adjusted to an estimated realizable amount, and the adjustment was deducted from investment income.

Prior to 2007, common and preferred shares were recorded at cost. Provision was made for any reductions in value of common and preferred shares that were considered other than temporary and any such amounts were deducted from investment income.

Subsequent to 2006, investments are accounted for as described in note 2.

Investment income is recorded as it accrues. Dividend income on shares is accrued on the ex-dividend date. Gains and losses on disposal of investments are determined and recorded as at the transaction date and are calculated on the basis of the average cost of the investments held.

Provision for unpaid claims

Provision for unpaid claims includes adjustment expenses, which represent the estimated amounts required to settle all outstanding and unreported claims incurred to the end of the year. Unpaid claims liabilities are carried on a discounted basis. Expected reinsurance recoveries on unpaid claims and adjustment expenses, net of any required provision for doubtful amounts, are recognized as assets at the same time, using principles consistent with the Company's method for establishing the related liability.

Reinsurance

The Company reflects third party reinsurance balances on the consolidated balance sheets on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a net basis in the consolidated statements of income to indicate the results of the retention of premiums written.

Revenue recognition

Insurance premiums written are deferred as unearned premiums and taken into income pro rata primarily over the terms of the underlying policies. The portion of the premium related to the unexpired term of the policy at the end of the fiscal year is reflected in unearned premiums.

Deferred policy acquisition costs

Commissions and premium taxes incurred in the writing of premiums are deferred only to the extent that they are expected to be recovered from unearned premiums and are amortized to income over the terms of the related insurance policies. 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 deficiencies are recognized initially by writing down deferred policy acquisition costs.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Capital assets

Capital assets are recorded at cost less accumulated amortization. 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
Computer software	2 years

Employee benefits

The Company contributes to a group registered savings plan for employees as services are incurred. There are no other post-employment benefits.

Income taxes

The Company follows the asset and liability method of accounting for income taxes, whereby future income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases and operating loss and tax credit carry-forwards. Future 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 on future income tax assets and liabilities of a change in income tax rates is recognized in income in the year that includes the date of enactment or substantive enactment.

Foreign currency translation

Foreign currency transactions are translated into Canadian dollars using the exchange rates in effect at the time the transactions occurred. Monetary assets and liabilities are translated into Canadian dollars using the exchange rates in effect at the consolidated balance sheet dates. Exchange gains and losses are included in income, except unrealized gains or losses related to investments designated as AFS, which are recorded in AOCI.

Stock-based compensation

The Company has a stock option plan that is described in Note 12. Stock options granted under the plan are accounted for using the fair value method. Under this method, the compensation cost of stock options granted is measured at estimated fair value at the grant date and recognized over the vesting period.

4 Future accounting policy changes

Effective January 1, 2008, the Company is required to adopt CICA Handbook sections 1535 "Capital Disclosures", 3862 "Financial Instruments - Disclosures" and 3863 "Financial Instruments-Presentation". The adoption of these new financial instrument standards will expand disclosure of information about the nature and extent of risks arising from financial instruments and how those risks are managed. Capital disclosures will provide information relating to the Company's objectives, policies and processes for managing capital.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

5 Investments

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

Carrying value and fair value of Investments

As a result of the adoption of the new accounting standards in 2007, investments carried at fair value which were previously carried at cost or amortized cost are as follows:

	December 31, 2007	December 31, 2006	
	Fair value and carrying value	Fair value	Carrying value
Bonds			
Canadian			
Federal	80,378	65,928	65,918
Provincial	30,948	27,883	27,249
Municipal	3,908	3,954	3,914
Corporate	67,864	49,525	49,236
	<u>183,098</u>	<u>147,290</u>	<u>146,317</u>
United States			
Federal	2,288	-	-
Corporate	666	-	-
	<u>2,954</u>	<u>-</u>	<u>-</u>
Total bonds	<u>186,052</u>	<u>147,290</u>	<u>146,317</u>
Preferred shares	<u>6,106</u>	<u>6,369</u>	<u>6,277</u>
Common shares			
Canadian	42,150	28,374	21,574
United States	2,244	4,183	3,883
	<u>44,394</u>	<u>32,557</u>	<u>25,457</u>
Investment income due and accrued	<u>1,758</u>	<u>1,332</u>	<u>1,332</u>
	<u>238,310</u>	<u>187,548</u>	<u>179,383</u>

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Fair values of bonds and stocks are determined based on quoted bid prices.

The effective interest rate for bonds ranges from 3.5% to 4.0% (2006 – 4.0% to 4.6%).

Impaired assets and provisions for losses

The Board of Directors has established a policy to write down or make provision for any investments with an “other than temporary” impairment. There was no investment provision recorded in 2007 and 2006.

Management has reviewed currently available information regarding those investments whose fair value is less than amortized cost. Debt securities whose amortized cost exceeds market value can be held until maturity. All investments have been reviewed to ensure that corporate performance expectations have not changed significantly to adversely affect the market value of these investments other than on a temporary basis.

Interest rate and liquidity risk

Historical data and current information are used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. Fluctuations in interest rates could have a significant impact on the market value of the bond portfolio. Stock market values can be volatile. This could result in realized gains or losses if actual claims payment patterns require liquidation of investments.

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet cash flow commitments associated with financial instruments. To manage its cash flow requirements, the Company maintains a portion of its invested assets in liquid securities.

The maturity profile of bonds as at December 31, 2007 is as follows:

	<u>1 year</u>	<u>1 – 3 years</u>	<u>3 – 5 years</u>	<u>Over 5 years</u>	<u>Total</u>
Bonds	12,059	29,036	29,857	115,100	186,052
Percentage of total	6.5%	15.6%	16.0%	61.9%	100.0%

Investment income

Investment income was derived from the following:

	<u>2007</u>	<u>2006</u>
Dividend income	1,102	719
Interest income	9,653	8,773
Net realized gains/losses	3,195	2,479
Investment expenses	(996)	(937)
	<u>12,954</u>	<u>11,034</u>

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

6 Risk management

As a provider of insurance products, effective risk management is fundamental to EGI's ability to protect the interests of EGI's customers and shareholders. EGI is exposed to potential loss from various market risks, including interest rate and equity market fluctuation risk, credit risk, liquidity risk, and to a lesser extent foreign currency risk.

Product and pricing

EGI 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. EGI's pricing process is designed to ensure an appropriate return on capital and long-term rate stability avoiding wide fluctuations in rate, 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 EGI may wish to take. Also, during periods of intense competition for any product line, to gain market share, EGI's competitors may price their products below the rates EGI considers acceptable. Although EGI may adjust its pricing up or down to maintain EGI's competitive position, EGI strives to ensure its pricing will produce an appropriate return on invested capital. There is no assurance that EGI will not lose market share during periods of pricing competition.

Underwriting and claims

EGI 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.

EGI's underwriting objectives are to develop business within EGI's target markets on a prudent and diversified basis and to achieve profitable underwriting results. EGI underwrites automobile business after a review of the applicant's driving record reports and claims experience. There can be no assurances that EGI will properly assess the risks associated with the insurance policies that it writes and may, therefore, experience increased adjudication, settlement and claims costs.

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 EGI's financial results for any fiscal quarter or year and could materially reduce EGI's profitability or harm EGI's financial condition. The Company manages the impact of losses which may result from catastrophic events by purchasing excess of loss

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

and catastrophe reinsurance to share all or part of the insurance risks originally accepted by the Company. (See note 9).

EGI's ability to write new business also could be affected. EGI may experience an abrupt interruption of activities caused by unforeseeable and/or catastrophic events. EGI's operations may be subject to losses resulting from such disruptions. Losses can relate to property, financial assets, trading positions and also to key personnel. EGI 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.

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 which limit its exposure to individual reinsurers and regular review processes to assess the creditworthiness of reinsurers with whom it transacts business.

Equity price risk

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

Asset and liability matching

The Company is exposed to:

- changes in the value of its fixed income securities and policy liabilities to the extent that market interest rates change;
- the risk of losses to the extent that the sale of a security 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-dated investment securities; and
- foreign currency risks with respect to investments, receivables and policy liabilities denominated in foreign currencies.

To mitigate these risks, the Company has policies to ensure that assets and liabilities are broadly matched in terms of their duration and currency. The Company's exposures are monitored on a regular basis and actions are taken to balance investment positions when approved risk tolerance limits are exceeded.

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

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Fair value

Fair value is an amount that represents the estimated exchange value of a financial instrument between willing parties.

The fair value of the investments is considered to be the quoted value, less transaction costs, based on bid prices determined by external pricing services. The majority of the investment portfolio is fully invested in well-established, active, liquid markets.

The fair value of outstanding claims is reasonably considered to be the carrying value. Many claims are of short duration and the Company already discounts claims. There is not an active market for stand-alone policy liabilities, therefore a market value is not readily available. An actuarial approach to determine value is to discount estimated future cash flows and includes a margin called the provision for adverse deviation (PFAD). Both values are considered reasonable in the range of possible outcomes and the difference in the change year over year is not considered material.

The fair values of other financial assets and financial liabilities are considered to be the carrying values, as they are of short duration. The value of the Company as a whole on a going concern basis may be greater than the sum of the fair values of the individual assets and liabilities.

Interest rate risk

The sensitivity analysis for interest rate risk set out below illustrates the impact of a 1% (100 basis points) change in interest rates on the carrying value of provision for unpaid claims liabilities as at the reporting date. The sensitivity of the net provision for unpaid claims liabilities to changes in interest rates is dependent on the duration of the liability. Due to the time value of money, a reduction in the interest rates would normally produce a higher liability.

An increase of 100 basis points in the interest yields would result in a decrease to the net provision for unpaid claims liabilities of \$2,181. A decrease of 100 basis points in the interest yields would result in an increase to the net actuarial liabilities of \$2,264.

Future cash flows

The following table summarizes the expected timing of cash flows arising from insurance obligations, on an undiscounted basis (see note 8), as at December 31, 2007:

	Total	Less than 1 year	1-5 years	5-10 years	Greater than 10 years
Actuarial liabilities at carrying value	164,267	61,250	93,033	9,770	214
Less: Reinsurance recoverable	47,115	18,020	27,106	1,927	62
Net actuarial liabilities	<u>117,152</u>	<u>43,230</u>	<u>65,927</u>	<u>7,843</u>	<u>152</u>

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

7 Unearned premiums

	2007		2006	
	Gross	Ceded	Gross	Ceded
Personal Lines:				
Automobile				
- accident benefits	16,435	892	14,267	1,280
- liability	18,512	1,031	15,392	1,374
- other	9,836	185	7,591	139
Total Personal Lines	<u>44,783</u>	<u>2,108</u>	<u>37,250</u>	<u>2,793</u>
Niche:				
Property				
- commercial	5,341	576	3,660	403
- personal	311	41	61	30
Liability	2,963	646	1,883	601
Accident and sickness	14,939	220	34	4
Other	853	11	266	-
Total Niche	<u>24,407</u>	<u>1,494</u>	<u>5,904</u>	<u>1,038</u>
	<u>69,190</u>	<u>3,602</u>	<u>43,154</u>	<u>3,831</u>

8 Provision for unpaid claims

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables or quanta: development of claims, reinsurance recoveries and the effects of discounting, to establish a best estimate of the value of the respective liability or asset.

The provision for unpaid claims and adjustment expenses is an estimate subject to variability and the variability could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, significant changes in the severity or frequency of claims for historical trends, the timing of claim payments, the recoverability of reinsurance and future rates of investment return. The estimates are principally based on the Company's historical experience. Methods of estimation have been used, which the Company believes produce reasonable results given current information.

Unpaid claims, adjustment expenses and unreported losses consist of: (i) case reserves based on reports and estimates prepared by claims adjusters; and (ii) a reserve for incurred but unreported losses based on past experience. The provision for adjustment expenses reflects the estimated costs of investigating, settling and processing these claims. An actuary has been appointed by the Board of Directors of Echelon pursuant to the Act. With respect to the preparation of Echelon's financial statements, the appointed actuary is required to carry out a valuation of Echelon's policy liabilities. The adequacy of these estimates is evaluated by the appointed actuary using appropriate actuarial techniques based on prior experience. The appointed actuary is responsible for ensuring that the assumptions and methods used for the valuation of policy liabilities are in accordance with Canadian accepted actuarial practices, applicable legislation and associated regulations and directives. In performing the valuations of

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Echelon's liabilities, which are by their nature inherently variable, assumptions are made as to the future loss ratios, trends, rates of claims frequency and severity, inflation, reinsurance recoveries, investment rates of return and both internal and external adjustment expenses, taking into consideration the circumstances and the nature of the insurance policies in force.

All provisions are periodically reviewed and evaluated considering emerging claims experience and changing circumstances. The process of determining the provisions necessarily involves risks that actual results may differ, perhaps materially, from the best estimates made. The resulting changes in estimates of the ultimate liability are recorded as incurred claims in the current year.

The provision for unpaid claims includes a PFAD, as required by Canadian accepted actuarial practices. The aggregate impact of the PFAD is to increase the provision for unpaid claims on a gross basis by \$17,487 (2006 - \$14,794).

	2007		2006	
	Gross	Ceded	Gross	Ceded
Personal Lines:				
Automobile				
- accident benefits	64,794	23,526	50,750	19,473
- liability	86,919	22,509	86,473	27,226
- other	3,607	663	2,592	367
Total Personal Lines	155,320	46,698	139,815	47,066
Niche:				
Property				
- commercial	4,371	520	2,940	392
- personal	101	50	106	52
Liability	3,967	1,180	2,280	872
Accident and sickness	4,940	13	702	3
Other	392	-	258	-
Total Niche	13,771	1,763	6,286	1,319
	169,091	48,461	146,101	48,385

The Company has recorded \$11,807 (2006 - \$12,015) reduction to the net provision for unpaid claims relating to redundancies in prior period estimates.

The Company discounts its best estimate of claim provisions at a rate of interest of 2.8% (2006 – 2.8%) for all lines of business. The Company determines the discount rate based upon the expected return on its investment portfolio of assets with appropriate assumptions for interest rates relating to reinvestment of maturing investments.

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 benefits, the Company includes PFADs in some assumptions relating to claim development, reinsurance recoveries and future investment income. The PFADs selected are in the mid-range of those recommended by the Canadian Institute of Actuaries.

The following table shows the effects of discounting on unpaid claims and adjustment expenses.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

	<u>Undiscounted</u>	<u>Effect of present value</u>	<u>PFADs</u>	<u>Discounted</u>
2007				
Provision for unpaid claims and adjustment expenses	164,267	(12,663)	17,487	169,091
Reinsurers' share of unpaid claims	<u>47,115</u>	<u>(3,083)</u>	<u>4,429</u>	<u>48,461</u>
	<u>117,152</u>	<u>(9,580)</u>	<u>13,058</u>	<u>120,630</u>
2006				
Provision for unpaid claims and adjustment expenses	141,531	(10,223)	14,793	146,101
Reinsurers' share of unpaid claims	<u>47,072</u>	<u>(3,069)</u>	<u>4,382</u>	<u>48,385</u>
	<u>94,459</u>	<u>(7,154)</u>	<u>10,411</u>	<u>97,716</u>

9 Underwriting policy and reinsurance ceded

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

During 2007, the Company followed the policy of underwriting and reinsuring contracts of insurance which limits the net exposure of the Company to a maximum amount on any one loss to \$1,150 (2006 - \$950). In addition, the Company obtained catastrophe reinsurance which limits the loss from a series of claims arising from a single occurrence to \$1,150 (2006 - \$950) to a maximum coverage of \$13,850 (2006 - \$19,050).

The Company places all its automobile reinsurance with Canadian registered reinsurers. There are non-registered reinsurers participating on the specialty property and casualty program business. The Company has access to trust funds that, in the Company's judgment, are adequate to secure the liabilities that the Company has ceded to non-registered reinsurers.

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

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Reinsurance recoverables

The following table summarizes the balances outstanding from reinsurers as at December 31, 2007 by risk rating:

<u>Credit rating</u>	<u>Gross reinsurance recoverable</u>	<u>Less: Provisions and securities held</u>	<u>Net reinsurance recoverable</u>
A	52,764	-	52,764
Not rated	<u>1,259</u>	<u>2,475</u>	<u>-</u>
	<u>54,023</u>	<u>2,475</u>	<u>52,764</u>

Included in gross reinsurance recoverable is reinsurers' share of unearned premiums of \$3,602, reinsurers' share of provision for unpaid claims of \$48,461 and receivables from reinsurers' presented as due from insurance companies of \$1,960.

10 Capital assets

	<u>2007</u>			<u>2006</u>		
	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Net book value</u>	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Net book value</u>
Furniture and equipment	533	459	74	435	423	12
Computer hardware	253	153	100	171	100	71
Computer software	<u>2,318</u>	<u>1,242</u>	<u>1,076</u>	<u>1,640</u>	<u>924</u>	<u>716</u>
	<u>3,104</u>	<u>1,854</u>	<u>1,250</u>	<u>2,246</u>	<u>1,447</u>	<u>799</u>

11 Share capital

Authorized:

Unlimited common shares

Unlimited special shares issuable in series

Issued:

9,682,152 common shares
(2006 - 9,639,152)

<u>2007</u>	<u>2006</u>
46,040	45,833

On January 31, 2006, the outstanding Series F special shares were redeemed for cash of \$2,384, including cumulative dividends.

During 2007, 43,000 (2006 - 46,000) common shares were issued pursuant to the exercise of employee stock options, with an issue cost of \$4.82 (2006 - \$4.82) per share. During 2006, 10,000 common shares were issued to a new director, at a price of \$10.61 per share.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

12 Employee stock option plan

The Company sponsors a stock option plan. The stock option plan provides for the issuance of shares of the Company's common stock not exceeding 10% of the total issued and outstanding shares (on a non-diluted basis) and shares reserved for issuance under employee stock option plans, options for services and employee stock purchase plans. The Board of Directors determines the terms and conditions of the awards under the plan as well as any award allocations.

For the year ended December 31, 2007, the Company recorded a compensation expense of \$123 (2006 - \$97) with an offsetting credit to contributed surplus. During 2007, 43,000 (2006 - 46,000) stock options were exercised. All stock options granted are for a term of five years with varying vesting periods.

The following is a continuity schedule of stock options outstanding as at December 31, 2007 and 2006:

	Number of shares		Weighted average exercise price per share	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
Outstanding, beginning of year	681,750	515,000	6.07	4.30
Granted during year	186,750	212,750	13.26	9.95
Exercised during year	<u>(43,000)</u>	<u>(46,000)</u>	<u>4.23</u>	<u>4.23</u>
Outstanding, end of year	<u>825,500</u>	<u>681,750</u>	<u>7.79</u>	<u>6.07</u>

As at December 31, 2007, the outstanding stock options consist of the following:

<u>Option price per share</u>	<u>Number</u>	<u>Remaining contractual life</u>	<u>Number of options exercisable</u>
\$4.23	381,000	1.8 years	193,000
\$5.09	45,000	2.3 years	9,000
\$10.61	90,500	2.8 years	-
\$10.31	6,750	3.3 years	-
\$9.26	70,500	3.8 years	-
\$9.65	45,000	4.0 years	-
\$11.03	3,000	4.3 years	-
\$11.68	20,000	4.6 years	-
\$12.80	26,750	4.6 years	-
\$12.34	45,000	4.7 years	-
\$14.26	92,000	4.8 years	-

The fair value of the stock options issued was determined using the Black-Scholes option pricing model with the following assumptions: (i) risk-free rate of 3.75%; (ii) life expectancy of four years; (iii) estimated volatility of 1%; and (iv) dividend yield of 1.7%. The grant-date fair value of total options granted is estimated at \$766. The weighted average grant-date fair value of stock options granted to date is \$0.84.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

13 Related party transactions

The Co-operators Group Limited and Co-operators General Insurance Company (collectively "Co-operators"), significant shareholders of the Company, provide services to the Company including but not limited to product distribution and investment management services. Direct written premiums derived from Co-operators' agents was \$15,180 (2006 - \$20,866) and commissions paid were \$1,744 (2006 - \$2,223).

The Company holds deposits of \$2,781 (2006 - \$3,378) under the terms of a 2001 100% Quota Share reinsurance treaty with Co-operators General Insurance Company with income resulting from the investment of these deposits for the account of the Company. Reinsurers' share of unpaid claims includes a recoverable of \$2,058 (2006 - \$3,371) from Co-operators General Insurance Company. The due to insurance companies balance includes amounts due to Co-operators General Insurance Company of \$2,790 (2006 - \$3,766).

14 Income taxes

The provision (recovery of) for income taxes is as follows:

	<u>2007</u>	<u>2006</u>
Current	7,839	9,832
Future	32	(1,270)
	<u>7,871</u>	<u>8,562</u>

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

	<u>2007</u>	<u>2006</u>
Combined basic Canadian federal and provincial income tax rate	36%	36%
Income tax expense at statutory rates	8,257	9,363
Permanent differences	(226)	(685)
Future income tax rate changes	(2)	(5)
Other	(158)	(111)
	<u>7,871</u>	<u>8,562</u>

Future income taxes are comprised of the following:

	<u>2007</u>	<u>2006</u>
Losses carried forward	26	-
Provision for unpaid claims	2,774	2,095
Investments	(520)	1,741
Deferred costs	329	487
Capital assets	65	80
	<u>2,674</u>	<u>4,403</u>

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

Income taxes included in OCI

The amounts included in the consolidated statement of comprehensive income as at December 31, 2007 are shown net of the following tax benefit:

Tax impact on:

Change in unrealized gains and losses	(299)
Reclassification to earnings of gains	<u>(1,242)</u>
Total income tax benefit included in OCI	<u><u>(1,541)</u></u>

15 Bank indebtedness

On October 11, 2007, the Company entered into a non-revolving term loan facility with a major Canadian bank in the amount of \$19,550. The aggregate commitments under the credit facility may be increased to an aggregate maximum amount of up to U.S.\$40,000 (or the equivalent amount in Canadian dollars), subject to the satisfaction of certain conditions. The facility has a term of three years, bearing an interest rate of 6.20%. During the term of the loan, monthly payments will include interest only and on maturity a balloon payment of \$19,550 will be made to settle the principal amount.

16 Lease commitments

The Company is committed under lease agreements for office premises and computer equipment with minimum lease payments of \$8,236 as follows:

2008	949
2009	877
2010	742
2011	742
2012	742
2013 and thereafter	<u>4,184</u>
	<u><u>8,236</u></u>

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

17 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 value of these annuity contracts amounts to \$4,105 (2006 - \$3,914) using a discount rate of 5% (2006 - 5%). 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.

18 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.

19 Regulatory requirements

At December 31, 2007 and 2006, Echelon met the minimum regulatory capital requirement. Legislation applicable to insurance companies imposes certain restrictions on an insurance company's ability to pay dividends.

The Company writes business subject to rate regulation, including non-standard automobile and motorcycle insurance, which comprises approximately 59% of net premiums written. 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 upon underwriting results. Certain benefit payments are also subject to provincial government regulation, including automobile accident benefits.

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

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

20 Income per share

	<u>2007</u>	<u>2006</u>
Basic income per share:		
Net income	15,065	16,981
Dividends to Series F shareholders	-	(12)
Net income available to common shareholders	<u>15,065</u>	<u>16,969</u>
Average number of common shares (in thousands)	<u>9,655</u>	<u>9,603</u>
Basic income per share	1.56	1.76
Diluted income per share:		
Net income available to common shareholders	<u>15,065</u>	<u>16,969</u>
Average number of common shares (in thousands)	9,655	9,603
Average number of common shares obligation under employee stock option plan (in thousands)	<u>761</u>	<u>597</u>
Average number of diluted shares (in thousands)	<u>10,416</u>	<u>10,200</u>
Diluted income per share	1.45	1.67

21 Segmented information

The Company operates through two divisions. Through its Personal Lines (formerly the Automobile) Division, the Company is engaged in the underwriting of high premium, non-standard automobile insurance and other specialty individual personal lines of business. Through its Niche Products Division, the Company designs and underwrites specialized non-automobile insurance programs, such as higher premium property, primary and excess liability, legal expense, accident and health insurance and warranty coverage.

The effect of reinsurance is reflected in the revenue and results of the two divisions. The investment activities consist of managing the investment portfolio for the Company as a whole. Investment income is shown net of investment expenses. Non-property and casualty insurance segments include the corporate and other activities, as well as realized investment gains.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(in \$ thousands, except share amounts)

	2007	2006
Revenue		
Earned premiums		
Property and casualty insurance		
Personal Lines - Canada	87,700	91,016
- U.S.	<u>8,006</u>	<u>-</u>
	95,706	91,016
Niche	<u>23,900</u>	<u>12,926</u>
	119,606	103,942
Interest and dividends	10,017	8,410
Realized investment and other gains	<u>2,937</u>	<u>2,624</u>
Total revenue	<u>132,560</u>	<u>114,976</u>
Income before income taxes		
Property and casualty insurance		
Personal Lines - Canada	10,664	15,141
- U.S.	<u>148</u>	<u>-</u>
	10,812	15,141
Niche	297	248
Corporate and other	<u>(1,127)</u>	<u>(880)</u>
Underwriting income	9,982	14,509
Interest and dividends	10,017	8,410
Realized investment and other gains	<u>2,937</u>	<u>2,624</u>
Total income before income taxes	<u>22,936</u>	<u>25,543</u>

22 Comparative figures

Certain comparative figures have been reclassified to conform with the current financial statement presentation.