



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

EGI FINANCIAL HOLDINGS INC.

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AND RESULTS OF OPERATIONS**

For the period ending December 31, 2007

References to "EGI" in this management's discussion and analysis of financial condition and results of operations refer to EGI Financial Holdings Inc. on a consolidated basis, both now and in its predecessor forms.

The following discussion should be read in conjunction with EGI's audited consolidated financial statements and the related notes. The following commentary is current as of March 14, 2008. Additional information relating to EGI is available on SEDAR at www.sedar.com. Certain totals, subtotals and percentages may not reconcile due to rounding.

EGI uses both Canadian generally accepted accounting principles (GAAP) and certain non-GAAP measures to assess performance. Securities regulators require that companies caution readers about non-GAAP measures that do not have a standardized meaning under GAAP and are unlikely to be comparable to similar measures used by other companies. EGI analyzes performance based on underwriting ratios such as combined, expense and loss ratios.

The following discussion contains forward-looking information that involves risk and uncertainties based on current expectations. This information includes, but is not limited to, statements about the operations, business, financial condition, priorities, targets, ongoing objectives, strategies and outlook of EGI for 2007 and subsequent periods.

This information is based upon certain material factors or assumptions that were applied in drawing a conclusion or making a projection as reflected in the forward-looking information. By its nature, this information is subject to inherent risks and uncertainties that may be general or specific. A variety of material factors, many of which are beyond EGI's control, affect the operations, performance and results of EGI and its business and could cause actual results to differ materially from the expectations expressed in any of this forward-looking information. See "Risk Factors".

EGI's actual results could differ materially from those anticipated in this forward-looking information as a result of various factors, including those discussed in this management's discussion and analysis. Forward-looking information is provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that such information may not be appropriate for other purposes. Additional information about the risks and uncertainties about EGI's business is provided in its disclosure materials, including its annual information form, filed with the

securities regulatory authorities in Canada, available at www.sedar.com. EGI does not undertake to update any forward-looking information.

The following summary of financial information includes, for the year ended December 31, 2004, an unaudited pro forma income statement which gives effect to the acquisition of the remaining 50% of EGI Financial Holdings Inc. (EGI Financial (2003), which held 100% of Echelon General Insurance Company), as if it had occurred at January 1, 2004. Such pro forma information is provided for the sole purpose of providing a comparison to the financial information for the years ended December 31, 2005, 2006 and 2007. For 2007 the financial information has changed to give effect to the new accounting standards for financial instruments (refer to “Impact of New Financial Instrument Standards”).

Financial Highlights

Years ended December 31

(IN \$ THOUSANDS EXCEPT PER SHARE AMOUNTS)	2007	2006	2005	Pro Forma 2004	2004	2003
Revenue						
Direct written and assumed premiums						
Personal Lines/Auto	109,870	97,932	105,567	109,251	54,626	37,660
Niche Products	48,065	19,902	11,439	3,765	2,614	270
Total direct written premiums	157,935	117,834	117,006	113,016	57,240	37,930
Net written premiums	146,511	106,047	91,783	69,230	35,217	28,208
Net earned premiums	119,606	103,942	76,344	65,890	33,615	28,347
Other revenue	-	1	227	298	298	154
Total underwriting revenue	119,606	103,943	76,571	66,188	33,913	28,501
Underwriting expenses						
Incurred claims	71,179	59,503	45,997	44,075	22,400	21,490
Acquisition costs	26,143	19,499	12,073	10,832	5,638	4,320
Operating expenses	12,043	10,431	9,083	7,762	4,506	4,243
Interest expense	259	-	-	-	-	-
Total underwriting expense	109,624	89,433	67,153	62,669	32,544	30,053
Underwriting income (loss)	9,982	14,510	9,418	3,519	1,369	(1,552)
Investment income	12,954	11,033	7,527	6,591	3,419	2,080
Income before the following:	22,936	25,543	16,945	10,110	4,788	528
Gain on reorganization	-	-	-	-	-	1,140
Income before income taxes	22,936	25,543	16,945	10,110	4,788	1,668
Income tax expense (recovery)						
Current	7,839	9,832	7,505	2,310	1,155	227
Future	32	(1,270)	(1,768)	(1,143)	(1,085)	145
	7,871	8,562	5,737	1,167	70	372
Income from continuing operations	15,065	16,981	11,208	8,943	4,718	1,296
Income from discontinued operations, net of income taxes	-	-	-	1,308	1,308	2,072
Extraordinary gain	-	-	5,669	-	-	-
Net income	15,065	16,981	16,877	10,251	6,026	3,368
Net income per share – basic	1.56	1.76	2.09	1.29	1.31	0.74
– diluted	1.45	1.67	1.96	1.28	1.30	0.74

(IN \$ THOUSANDS)	Years ended December 31				
	2007	2006	2005	2004	2003
Balance Sheet Data					
Cash and short-term deposits	22,785	17,153	15,899	7,327	7,712
Investments	238,310	179,383	152,736	57,098	49,711
Goodwill	-	-	-	-	125
Total assets	370,084	288,439	260,731	110,737	93,959
Provision for unpaid claims	169,091	146,101	129,173	54,149	42,890
Unearned premiums	69,190	43,154	39,973	17,933	16,214
Bank indebtedness	19,550	-	-	1,590	2,350
Total shareholders' equity	101,671	86,041	72,585	25,309	19,283

The following table shows the Company's selected financial ratios and return on equity (ROE) data. These ratios are defined in the "Glossary of Selected Insurance Terms".

Selected Financial Ratios ⁽¹⁾ and ROE Data (%)	2007	2006	2005	2004	2003
Loss ratio	59.5	57.2	60.3	66.6	75.8
Expense ratio	32.2	28.8	27.7	30.2	30.2
Combined ratio	91.7	86.0	88.0	96.8	106.0
ROE	16.1	21.4	30.1	27.0	19.1
Adjusted ROE ⁽²⁾	16.1	21.4	25.9	23.0	13.1

(1) The underwriting ratios (the loss and expense ratios and the combined ratio) are all non-GAAP measures which are common insurance industry measures of performance.

(2) Excludes the after tax effects resulting from acquisitions and divestitures including the corresponding adjustments to shareholders' equity. See "Significant Transactions".

Overview of EGI

EGI operates in the property and casualty (P&C) insurance industry in Canada and, commencing in 2007, in the United States, primarily focusing on non-standard automobile insurance and other niche and specialty general insurance products. Founded in 1997 as an insurance and reinsurance broker and marketer, EGI has since developed its business to focus on underwriting opportunities not served by many of the larger, standard insurers.

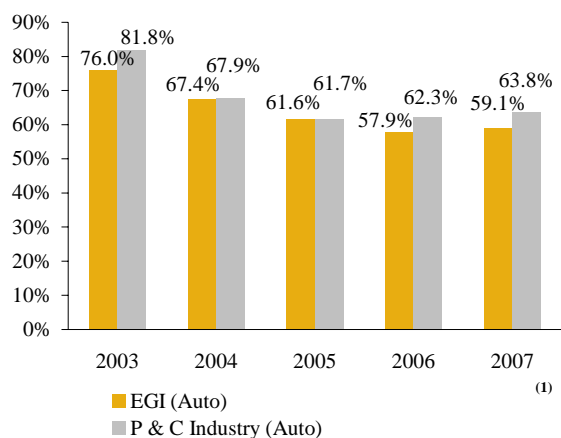
EGI operates through two Strategic Business Units (SBUs), the Personal Lines Division and the Niche Products Division. The Personal Lines Division was created in 2006 to transition the Automobile Division into a multi-product, multi-line SBU. Currently the Personal Lines Division continues to focus on the underwriting of non-standard automobile insurance and motorcycle business but will expand into other non-standard products and specialty lines of business. In 2007 EGI entered the U.S. non-standard auto insurance market under a reinsurance agreement with AssuranceAmerica Insurance Company (AAIC). AAIC provides

property and casualty insurance to the non-standard private passenger automobile segment of the industry. AAIC currently operates in several states in the southeastern part of the U.S., receiving business through both independent and owned retail agencies.

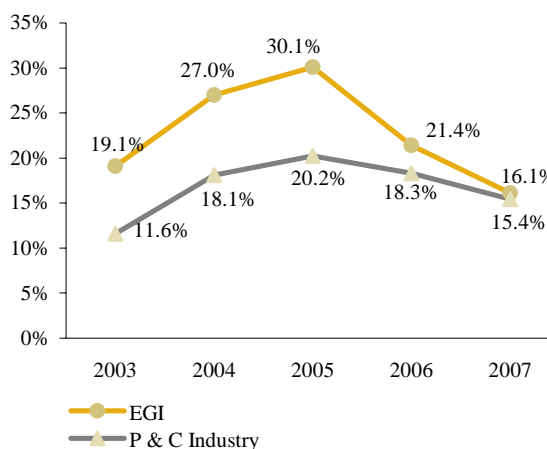
Through its Niche Products Division, EGI designs and underwrites specialized non-auto insurance programs, such as higher premium property, primary and excess liability, legal expense and accident and health insurance for a variety of businesses and consumers and extended warranty coverage for homes and consumer products. By pursuing this focused strategy, EGI’s objective is to produce an ROE superior to the Canadian P&C insurance industry average. A key factor for EGI’s ROE outperforming the industry is the fact that its loss ratio is below the industry average.

The charts illustrate EGI’s and the P&C insurance industry’s automobile loss ratios and return on equity.

Loss Ratio (%)



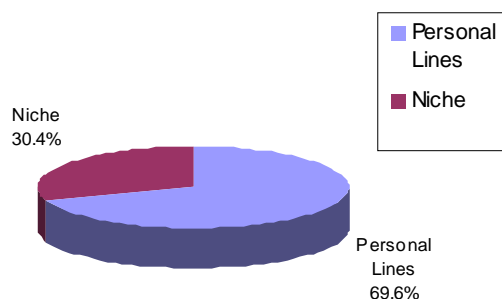
ROE (%) ⁽²⁾



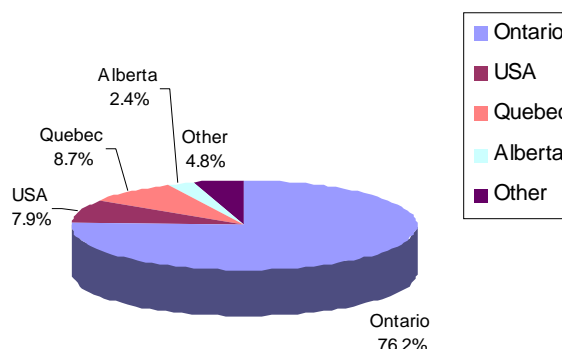
- (1) Source for P&C industry data: OSFI website (federally regulated insurers as at September 30, 2007 representing approximately 64% of the P&C market).
- (2) EGI results for 2003 and 2004 include net income from discontinued operations. 2005 results include extraordinary gain.

Approximately 70% of EGI’s written premium revenue in 2007 was from its Personal Lines business in Canada with approximately 76% of total premiums underwritten in Ontario. A further 8% of premiums were written in the U.S. pursuant to assumed reinsurance arrangements. The breakdown of direct written premiums by category of business and by region during 2007 is illustrated below.

2007 Direct Written Premium by Category



2007 Direct Written Premium by Region



Net earned premiums from the sale of Personal Lines policies (Canada and U.S. combined), accounts for 80% of net earned premiums. One of EGI's diversification strategies is the growth of the non-auto business in the Niche Products Division, which currently accounts for approximately 20% of net earned premiums, and the growth of the newly created Personal Lines Division.

The financial performance of EGI is determined by two main factors: (i) the level of premiums earned in relation to claims and operating costs incurred; and (ii) the returns generated from the investment portfolio. Premiums collected are ultimately used to pay claims and operating expenses. However, there is a time lapse between the collection of premiums and the payment of claims and certain operating expenses. This allows EGI to invest premiums collected and earn an investment return until claims and operating expenses are paid. EGI also earns an investment return on invested capital.

EGI's results also include fees for consulting, and income from one-time gains from acquisitions and divestitures and from corporate and other activities. The income from the non-operating transactions is discussed within the "Significant Transactions" section.

Outlook

As we have noted in prior years' reports, the above-average results which the Canadian P&C insurance industry experienced from 2004 to 2006 led to a more competitive market phase. These positive results encouraged automobile insurers to implement rate reductions and loosen underwriting guidelines in order to gain market share. As a result of the actions taken in pursuit of market share opportunities, standard insurers were writing business that would traditionally have been underwritten by non-standard insurers.

In 2007 the impact of past actions taken by the standard insurers began to surface in the form of

escalating industry auto loss ratios, in part because of inadequate pricing that the standard writers were offering for the non-standard auto business. The erosion of underwriting margins in the P&C industry in 2007 and potentially 2008 will likely cause the standard insurers to reverse their actions taken earlier to gain market share. EGI management feels that this situation will create an opportunity for non-standard insurers as standard insurers' margins erode on this higher risk business, leading them to return to their traditional standard risk markets. Through the contracting market phase EGI has preserved its capital and focused on profitable lines of business and so is well positioned to take advantage of the opportunities that the changing market cycle may offer.

In addition to the attractive opportunities that EGI management expects for the non-standard auto business, it also sees similar opportunities to grow the Niche business and to continue to pursue its diversification strategy. EGI has laid the groundwork in the past three years to aggressively expand the Niche line of business. As part of that expansion process the Company started to underwrite Emergency Travel Health (ETH) insurance in 2007. ETH is a multi-billion dollar segment of the Accident and Sickness insurance business that is growing due to aging of the Canadian population.

Effective January 1, 2007, EGI entered the U.S. non-standard auto insurance market through a reinsurance arrangement with AAIC, a property and casualty insurer operating in the non-standard private passenger automobile market in the southeastern portion of the U.S. The Company will continue to pursue opportunities to grow its U.S. business, in a tax effective manner, by utilizing its wholly owned subsidiary, CIM Reinsurance Company Ltd. (CIM Re), which is domiciled in Barbados. In 2007 the Company established a wholly owned subsidiary, EGI Insurance Services, Inc., based in Atlanta, Georgia. This subsidiary is staffed with a small team of experts in U.S. niche and specialty lines of business that will perform the initial due diligence and ongoing monitoring of CIM Re's existing and potential reinsurance clients.

EGI will also continue to seek out opportunities for profitable growth either through expansion of its existing business or by select acquisitions in Canada and the United States.

Strategy

EGI's business strategies and actions are guided by its vision: "Strives to be the pre-eminent writer of specialized, niche insurance products". EGI's objective is to continue to deliver an ROE superior to the average of the Canadian P&C insurance industry through a comprehensive specialized insurance offering. EGI's focus is on non-standard auto and targeted niches that are currently underserved by the market and which require the high level of underwriting and claims expertise of EGI's management team and staff.

For 2008 EGI's strategic goals remain focused on driving profitable business growth by leveraging and building on its strengths.

In order to achieve this objective, EGI intends to:

Maintain and grow its core non-standard auto insurance offering. EGI concentrates on what it considers to be the best accounts from the non-standard segment, which has resulted in above-average underwriting margins. EGI will continue to provide superior policy issuance and underwriting capabilities to its brokers and agents to support and expand its offering in this market segment. In addition, focusing primarily on return on equity, EGI will consider returning to markets which it previously exited if long-term profitable opportunities arise.

Introduce new and innovative niche insurance products and programs. Working closely with Managing General Agents (MGAs) and other producers, EGI will continue to design niche and specialty programs that are not offered by traditional insurers. As many brokers need specialty insurers to cover all of their customers' insurance requirements, EGI's Niche Products Division continues to respond to this market opportunity.

Provide industry-leading service. EGI strives to provide optimum service to its policyholders and producers. EGI has created and implemented written service standards in all departments interfacing with policyholders or producers. Staff members in these departments are thoroughly trained in the delivery of quality service to achieve these standards at a minimum. This service commitment ensures its policyholders and producers continue to be served by knowledgeable employees in a responsive manner.

Continue to invest in technology. EGI invests in technology where opportunities exist to enhance producers' ease of doing business, create operating efficiencies and improve EGI's data analysis capabilities. EGI developed and introduced its proprietary ADAPT[®] policy and claims management data processing system to streamline the management of its niche programs and will continue to employ leading technology solutions to serve its customers. With recent technological advancements, EGI has implemented a program to internalize its claims administration processes to enhance customer service and decrease administration costs. Claim forms are available to claimants immediately over the Internet from a computerized forms library that allows greater efficiencies in dealing with claimants directly. Much of the historical duplication of process and expense has been eliminated.

Pursue acquisitions. EGI intends to continue to grow its business by seeking attractively priced acquisitions of insurers or books of business in markets and business lines that are compatible with EGI's strategic objectives. EGI recently confirmed the extension for 2008 of its reinsurance arrangement with AAIC, which agreement provided the Company's first step to expanding in the United States.

Competitive Strengths

EGI believes that it is uniquely positioned to compete in the P&C insurance industry for the following reasons:

Comprehensive Specialized Insurance Offering. EGI offers its producers, both directly and through MGAs, a comprehensive line of insurance products comprised of non-standard automobile insurance and specialized non-auto insurance products and programs. Responding to a market need, EGI thoroughly researches a product opportunity and develops underwriting procedures and ratings that will meet both the customers' requirements and earn an attractive ROE for EGI. EGI then arranges for distribution through its distribution channels.

Entrepreneurial Culture. EGI fosters an entrepreneurial environment which encourages innovation in the development of new niche programs and the flexibility to allow for unique, tailor-made solutions to meet market demand.

Strong Customer Service Focus. EGI believes that it has a strong reputation for customer service with its producers and policyholders from both an underwriting and a claims standpoint. Automobile policies are typically issued in five business days or less from receipt of the completed application. In the latest Automobile Claims Satisfaction Survey (2005) of insurers, EGI ranked highest among its non-standard auto competitors. Also in a recent survey of brokers by the Insurance Brokers Association of Ontario, EGI ranked the highest among non-standard auto writers. Because of limited competition in niche markets, EGI believes that its strong customer service focus provides stability to the existing business and future growth opportunities with existing and new producers.

Financial Strength. EGI has a strong capital base relative to its current underwriting commitments, as evidenced by its strong Minimum Capital Test ratio. Echelon's Minimum Capital Test ratio as at December 31, 2007 was 292% compared to the P&C insurance industry average Minimum Capital Test ratio of 238% (as per OSFI's third-quarter information). EGI intends to preserve and grow its underwriting capital through appropriate pricing, underwriting discipline and conservative loss reserving practices.

Experienced Management Team. EGI has a seasoned group of owner-managers who have worked together successfully for years. With an average of over 20 years of experience in senior positions within the insurance industry, the executive management team has extensive knowledge in non-standard and niche insurance products together with an entrepreneurial thrust and a decisive, collegial management style.

Personal Lines Division

As part of its strategic planning and analysis process, EGI has moved to diversify its writings – both geographically and by product line. With respect to the latter, this now includes creation, development, marketing and processing of new personal lines product offerings.

These new offerings, in conjunction with the Company's core, non-standard automobile product, will provide distributors with a wider array of personal lines products (historically underserved by the standard market). This will be accomplished by utilizing the same “niche underwriting mentality” that has been the hallmark of EGI's activities.

Although the non-standard automobile segment will remain as the largest, single component of EGI's activities, the additional personal lines products will facilitate additional production and diversification and make the Company an even more important partner for its distributors. In this manner, the non-standard automobile segment will form a critical component of the recently formed Personal Lines Division.

The non-standard automobile segment currently targeted by EGI's Personal Lines Division is high premium insurance for drivers who, because of inexperience or a poor driving record, are not able to obtain insurance from standard insurers. EGI provides coverage for private passenger vehicles as well as single commercial vehicles and small commercial and farm fleets. Management believes that EGI's systems, underwriting discipline and claims expertise, strict controls and an experienced management team (who are well versed in the nuances of non-standard auto) enable the Company to select those drivers in the higher premium categories who have a proportionally lower potential claims risk.

For applicants paying the higher premiums for non-standard automobile insurance, price is the single most important consideration. EGI provides selected drivers with a lower premium option to the higher premium coverage offered by the Facility Association (or the Groupement in Quebec), the industry-operated pools that serve as the “market of last resort.” EGI targets drivers most likely to be “reformers” not “repeaters”. These non-standard auto risks fall between Facility and the standard risks normally targeted by standard market insurers. The likely reformer expresses concern with respect to his or her poor driving record and will exhibit a sincere desire to improve (so as to re-enter the standard market at standard rates). EGI trains its brokers and agents to select qualifying risks. EGI then employs the experience of its underwriting personnel to ensure that complete and accurate underwriting and rating information has been developed.

In recent years, EGI has focused on appointing brokers and agents in “rural” and “smaller urban” centres in its markets due to concerns regarding growth in the number of fraudulent claims in the largest urban centres. This strategy has resulted in enhanced underwriting margins that, on average, exceed the industry average.

In July 2005, EGI withdrew from the Alberta personal lines automobile insurance market. The Alberta government's auto insurance reform package (introduced in October 2004) imposed a capping of insurance premiums, particularly those of inexperienced and other higher risk drivers, through the implementation of a mandated rating grid and clearly defined risk selection rules. The grid subsidizes the premiums of higher risk drivers and has resulted in the overcharging of lower risk drivers in Alberta. The size of this subsidy is quite large, making it in the opinion of management uneconomical for a non-standard automobile insurer to underwrite the higher risk business for its own account. EGI continues to underwrite motorcycle, commercial, small fleet and farm vehicle insurance in Alberta.

In September 2005, EGI also withdrew from the Newfoundland and Labrador private passenger automobile insurance market. This decision was made as a result of the introduction of Bill 26 which eliminated an insurer's ability to use statistically valid rating factors (such as number of years licensed) which are essential to the proper underwriting of non-standard risks. The regulatory changes make it, in the opinion of management, uneconomical for a non-standard automobile insurer to underwrite the higher risk, private passenger business for its own account in Newfoundland and Labrador.

As part of the strategy to develop business in other vehicle types, EGI entered into an exclusive arrangement with a specialist broker (in the first quarter of 2006) to write motorcycle business in Ontario. Direct written premiums from this arrangement and producers of motorcycle business in other jurisdictions totaled \$13.9 million in 2007 and \$7.6 million in 2006.

EGI will maintain and grow its personal lines business by employing the following strategies:

- Expand non-standard auto writings in jurisdictions where EGI earlier withdrew or restricted its premium writing – such as Prince Edward Island, Nova Scotia and New Brunswick – by filing new rates to reactivate distribution of EGI's automobile insurance products. The Atlantic relaunch commenced in the first quarter of 2007. EGI continues to monitor and participate in the review of Alberta's grid rating system by the Alberta Automobile Insurance Rate Board, with a view to reactivating distribution of EGI's private passenger automobile insurance coverages in that province (should a viable opportunity arise). In addition, EGI is monitoring the impact of recent government reforms in Ontario aimed at further reducing fraudulent claims, which may allow EGI to increase its business activities in additional urban markets.
- Continue to build the Company's profitable personal and commercial auto lines of business in the province of Quebec.
- Use EGI's non-standard underwriting expertise to add other lines of specialty personal lines insurance products such as coverage for motorcycles (Alberta), snowmobiles, all terrain vehicles, antique autos and recreational vehicles.

- In addition to the assumption of business from selected U.S. insurers, consider acquiring a suitable existing non-standard automobile insurance company domiciled in the United States and licensed in one or more states which EGI believes constitute attractive markets, to contribute to EGI's goal of earning superior returns. EGI's management team has past experience with the acquisition and operation of U.S., non-standard auto carriers. Any such acquisitions could also serve as an entry point, for the personal lines product offerings (noted above), into the U.S. market.

Niche Products Division

EGI's Niche Products Division, established in 2003, provides specialized commercial and personal insurance products and programs covering areas of the market that are considered underserved. This division works with property and casualty insurance brokers, managing general agents (MGAs), benefit consultants, warranty product distributors and third party administrators (TPAs) to design insurance and warranty product solutions that respond to gaps in the insurance market created by traditional insurers' focus on standardized coverage. The division is focused on satisfying its distributors' need for customized consumer oriented solutions that differentiate them from the product offerings provided by standard market insurers. Staffed with highly knowledgeable and experienced insurance professionals, the division researches and designs specialty insurance programs in response to market demand. These programs are then distributed and administered by the initiating broker, MGA, TPA or other intermediary who has worked closely with the division to design the insurance solution. EGI believes that the direct written premiums for its target specialized niche product insurance segment are approximately 8% to 10% of the non-auto P&C insurance market and 5% of the accident and health insurance market.

EGI has identified niche market segments within five product areas that offer opportunities for profitable growth: property insurance; general and professional liability insurance; casualty insurance; accident and health insurance; and warranty products. Within each of these areas, EGI concentrates its underwriting within the sub-segments where the risk characteristics of the business offer an opportunity to obtain a higher rate relative to the specific exposure than would be available within the broader segment of that niche market. This focus allows EGI to seek a per-risk margin that exceeds what is available in the standard market.

An important component of the niche products market is the degree to which significant expertise often resides at the broker and distributor level. The distribution partners we select have highly specialized knowledge of the product and the market and have administration systems to service the customer before and after the sale. They provide highly effective distribution capability for EGI's programs. Their market knowledge and technical design capability are used in product design and, combined with EGI's expertise in pricing, underwriting structures, and financial management, create a sustainable product offering. Many of our distribution partners are interested in sharing in future underwriting profits through retention of risk.

Accordingly, in certain circumstances, EGI will enter into a risk-sharing agreement with a distribution partner.

In response to the growth experienced in niche products, the ADAPT® system was developed to enable the administrator of each program to provide customer information to EGI in an electronic format on contracts and policies sold by the distributor. The ADAPT® system software uploads customer data provided by the administrator of the program in preset formats supplied by EGI. The ability to export data avoids costly duplication and allows the distributors to use their own internal systems to supply the required information to EGI rather than being forced to re-enter data on EGI's systems. Once the data transfer is received, EGI is able to immediately create customer policy records on the ADAPT® system and can use the claims portion of the ADAPT® system to manage claims and provide customer service.

EGI intends to maintain and grow the niche programs business by employing the following strategies:

- Continue to broaden market awareness of the existence and capabilities of EGI's Niche Products Division (including EGI's risk retention structuring capabilities) by directly contacting and making presentations to qualified brokers and other insurance product distributors.
- Ensure that the Niche Products Division grows organically by continuing to provide unique expertise and superior service in response to all business inquiries.
- Seek opportunities for the Niche Products Division to grow through select acquisitions of books of business, distributors, administrators or an insurance company.
- Attract high quality profitable program business by offering a unique opportunity for distribution partners to enter into risk-sharing arrangements with EGI.

Segmented Financial Information

The segmented information shows significant growth in underwriting revenue for both the Personal Lines Division and the Niche Products Division. The growth in Personal Lines premium resulted from the entry into the U.S. market by the Company's participation in a quota share reinsurance treaty with a non-standard auto insurer writing business in the southeastern states. The growth in Niche premium resulted from continued growth in this part of our business, particularly related to our entry into ETH insurance in 2007. The Niche line has started to mature into a significant portion of EGI's book of business.

The segmented information shows the Personal Lines Division also contributed \$10.8 million or 97% of the total underwriting income while Niche Products contributed \$0.3 million or 3% of the total in 2007.

(IN \$ THOUSANDS)	2007				2006	
	Personal Lines		Total	Niche Products Canada	Personal Lines Canada	Niche Products Canada
	Canada	U.S.				
Underwriting revenue	87,700	8,005	95,705	23,900	91,016	12,927
Underwriting income	10,664	148	10,812	297	15,141	248
Loss ratio	59.1%	73.9%	60.4%	56.1%	57.9%	52.6%
Expense ratio	28.7%	24.3%	28.3%	42.7%	25.5%	45.5%
Combined ratio	87.8%	98.2%	88.7%	98.8%	83.4%	98.1%

The table above shows continued underwriting income in both business segments, with an increase in the combined ratio for both segments in 2007 as compared to 2006. The Personal Lines business segment recorded slight increases in both the loss and expense ratios in 2007. This line continued to experience favourable loss development of claims related to prior years, with total net positive development of prior year claims of \$11.8 million in 2007 compared to \$12.0 million in 2006. However, consistent with industry trends in 2007, the current year automobile loss ratio increased slightly in the year compared to 2006. The Personal Lines expense ratio increased as a result of a significant decrease in the reinsurance commission recorded in 2007 from prior year sliding scale arrangements as compared to 2006. The Niche loss ratio increased to 56.1% in 2007 primarily due to a higher than expected loss ratio incurred in the ETH insurance business. The loss ratio on this new line of business was 94%, while the loss ratio from all other Niche programs was 48% in 2007, which compares very favourably to the 2006 loss ratio from this business segment of 52.6%. While the results from the ETH business represent only a portion of the travel season, management is monitoring this business closely and will take corrective action as events warrant in 2008 to improve the contribution of this line of business. The Niche expense ratio decreased to 42.7% in 2007 compared to 45.5% in 2006 despite an allocation of shared services expenses in 2007 due to significant growth in premium and management of expenses.

Revenue

Revenue reflected in the consolidated financial statements includes net earned premiums, investment income, realized gains and losses on the sale of investments, and other revenue.

(IN \$ THOUSANDS)	2007	2006
Gross premiums written	157,935	117,834
Net premiums written	146,511	106,047
Net premiums earned	119,606	103,942
Net interest and dividends	9,759	8,410
Net realized gains on investments	<u>3,195</u>	<u>2,624</u>
Total revenue	<u>132,560</u>	<u>114,976</u>

The main source of revenue was earned premiums from the sale of insurance policies. Gross written premiums totaled \$157.9 million, 34% above the \$117.8 million level last year. This significant increase was attributable to our entry into the U.S. non-standard auto insurance market through participation in a quota share reinsurance treaty (\$12.5 million) and continued premium growth in Niche Products, primarily due to the introduction of ETH business (\$19.4 million). Net earned premiums rose \$15.7 million or 15.1% in 2007 from \$103.9 million last year to \$119.6 million. This increase was lower than the percentage increase in premiums written due to the significant amount of ETH insurance premiums written in the last quarter of 2007 but unearned as at December 31, 2007; this unearned premium of \$14.9 million will earn in the first half of 2008.

The second largest source of revenue was investment income, which constituted approximately 10% of EGI's total revenue in 2007. EGI recognizes revenue from interest, dividends, and realized capital gains and losses on the invested assets. Market fluctuations in interest rates affect EGI's returns on, and the market value of, fixed income and short-term investments. The fair market value of EGI's exposure to preferred and common shares and other equity investments fluctuates as a result of changes in the overall level of the equity markets. Pursuant to the financial instrument accounting standards effective January 1, 2007, investments are carried at fair value on the Balance Sheet, and changes in fair value of investments held are recorded in Other Comprehensive Income (OCI) and accumulated in Accumulated Other Comprehensive Income (AOCI) until realized.

Expenses

EGI's expenses consist of incurred claims, acquisition costs and operating expenses, including interest on borrowed funds.

(IN \$ THOUSANDS)	2007	2006
Expenses		
Incurring claims	71,179	59,503
Acquisition expense	26,143	19,499
Operating expense	12,043	10,431
Interest expense	259	-
	<u>109,624</u>	<u>89,433</u>
Selected Underwriting Ratios	2007	2006
Incurring claims ratio	59.5%	57.2%
Acquisition expense ratio	21.9%	18.8%
Operating expense ratio	<u>10.3%</u>	<u>10.0%</u>
Combined ratio	<u>91.7%</u>	<u>86.0%</u>

The combined ratio for EGI increased in 2007 to 91.7% from 86.0% in 2006. As noted in the table above, the primary reason for the increase was the higher loss and acquisition expense ratios in 2007 as compared to 2006. The increased loss ratio was primarily due to the adverse experience in ETH claims and a slight increase in Personal Lines loss ratio, while the increase in the acquisition expense ratio was due to the cancellation of the auto quota share treaty at the end of 2005, resulting in a reduction of reinsurance commission recorded pursuant to sliding scale arrangements in 2007 compared to 2006. Acquisition costs also increased due to the change in the mix of EGI business, with a greater emphasis on Niche lines, which attract a larger commission rate compared to Personal Lines products. The slight increase in the operating expense ratio was due to interest expense of \$0.3 million recorded pursuant to bank indebtedness, which has been recorded in operating expenses in 2007. This expense reflects the 2007 interest cost related to the credit facility which EGI entered into in October 2007.

Incurring claims, also referred to as losses, are the amounts payable under insurance policies relating to insured events. Loss adjustment expenses, also referred to as claim expenses, are the expenses of settling claims, including allocated (i.e. external) loss adjustment expenses and unallocated (i.e. internal) loss adjustment expenses (together, LAE). Achieving profitable results depends on EGI's ability to manage future claims and other costs through innovative product design, strict underwriting criteria and efficient claims management.

Acquisition costs consist mainly of commissions and premium taxes which are directly related to the acquisition of premiums. Commissions are the amounts paid to producers for selling insurance policies. The amount of commission is generally a percentage of the premium of the insurance policy sold. Contingent commissions are paid to brokers and MGAs on an annual basis if they meet certain targets. In general, these producers have to meet or exceed certain criteria, including written premium targets and profitability on average over three years, to qualify for this compensation. Premium taxes are taxes paid by EGI to provincial governments calculated as a percentage of direct written premiums.

Operating expenses are the non-commission selling, underwriting, administrative and interest expenses incurred to support EGI's business. A significant portion of these expenses is related to employee compensation and benefits. The effective control and management of these expenses can enhance the underwriting results from the operation.

Significant Transactions

Credit Facility to fund U.S. Expansion

In October 2007 EGI entered into a non-revolving term credit facility with a major Canadian bank in the amount of US\$20 million, converted to CDN\$19.55 million, the equivalent Canadian dollar amount as of the closing date. The aggregate commitments under the credit facility may be increased to an aggregate amount of up to US\$40 million, subject to certain conditions. The facility bears interest of 6.2% which is payable monthly over the three-year term of the agreement. After three years EGI is obligated to repay the amounts drawn as at the termination of the agreement. Pursuant to the credit facility agreement, EGI is required to comply with various financial covenants and financial information reporting requirements.

The initial drawdown of US\$20 million or CDN\$19.55 million was used to increase the capital of CIM Reinsurance Company Ltd., EGI's Barbados-based subsidiary reinsurance company, which will be used to reinsure selected niche and specialty line insurers, which underwrites business in the United States.

Initial Public Offering

EGI completed an initial public offering (IPO) on December 8, 2005, pursuant to the filing of a prospectus dated November 30, 2005. As a result of the offering, 1.67 million common shares were issued at \$10.50 per share for proceeds of \$16.1 million net of underwriters' fees and other expenses.

Acquisition of Echelon

On January 5, 2005, EGI acquired the 50% of Echelon General Insurance Company (Echelon) that it did not already own from Co-operators Group in a share exchange transaction (the “Echelon Transaction”). Since January 5, 2005, EGI includes 100% of Echelon’s operating results. As a result of this transaction, EGI recognized an extraordinary gain of \$5.7 million after tax, which was recorded in the results for the year ended December 31, 2005.

Divestiture of Trent Health and Trent Financial

In February 2004, EGI sold its 50% ownership in both Trent Health and Trent Financial (together, the Trent Companies) to Co-operators Life Insurance Company. EGI’s proportionate share of these companies’ net results for the 2004 stub period and the after tax gain of \$1.3 million from the sale have been included in the financial statements as results from discontinued operations.

Regulation

The industry in which EGI operates is regulated for the sale of P&C insurance. Changes in these regulations may significantly affect the operations and financial results of EGI.

Impact of New Financial Instrument Standards

On January 1, 2007 the Company adopted, on a retrospective basis without restatement of prior periods, two new accounting standards related to financial instruments, which were issued by the Canadian Institute of Chartered Accountants (CICA). The new standards, as they apply to EGI, result in the recording of all investments at fair value in the Consolidated Balance Sheets as at December 31, 2007. In addition, cumulative changes in the fair value of investments are reported in AOCI, a new component of Shareholders’ Equity.

Upon adoption of these standards, total investments of EGI increased by \$8.0 million to reflect the adjustment to fair value of investments as at January 1, 2007 previously measured at cost or amortized cost. Also on January 1, 2007, AOCI was credited an amount of \$5.3 million, representing the adjustment to fair value of investments, as noted above, net of income tax.

During 2007, other comprehensive losses were incurred, totaling \$3.1 million, resulting in an AOCI balance of \$2.2 million as at December 31, 2007. Other comprehensive losses in the year consisted of two components: (1) a decline in fair value of investments designated as available for sale of \$0.9 million, net of income tax; (2) a reclassification for gains realized in 2007 of \$2.2 million, net of income tax, from AOCI to net income. For further details, refer to note 2 of our audited Consolidated Financial Statements for the year ended December 31, 2007.

Critical Accounting Estimates and Assumptions

EGI's significant accounting policies are disclosed in note 3 to the consolidated financial statements for the financial year ended December 31, 2007. The preparation of EGI's financial statements in accordance with Canadian GAAP requires EGI to make estimates and assumptions that affect the amounts reported in the financial statements. These estimates and assumptions principally relate to the establishment of reserves for claims and expenses, impairments of investment securities, amounts recoverable from reinsurers and certain other assets. As more information becomes known, these estimates and assumptions could change and impact future results. The most significant estimates and assumptions made in preparing the financial statements are in respect of policy liabilities, investments, reinsurance and income taxes.

Policy Liabilities

Policy liabilities consist of provisions for claim liabilities and premium liabilities.

Claim liabilities are maintained to cover EGI'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). Reserves do not represent an exact calculation of liability, but instead represent estimates developed using projection techniques in accordance with Canadian accepted actuarial practice. These reserve estimates are expectations of the ultimate cost of settlement and administration of claims based on EGI'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.

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. Reserve 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 statement of income of the period in which such estimates are updated.

The provision for unpaid claims and adjustment expenses is discounted to take into account the time value of money. It also includes a provision for adverse deviation, as required by Canadian accepted actuarial practice. The appointed actuary of EGI's subsidiaries, using appropriate actuarial techniques, evaluates the adequacy of the policy liabilities.

Premium liabilities are considered adequate when the unearned premium reserve (after deducting any deferred acquisition cost asset) is at least equal to the present value, at the balance sheet date, of cash flow of the claims, expenses and taxes to be incurred after that date on account of the policies in force at that date or at an earlier date. Deferred acquisition costs are comprised of commissions, premium taxes and expenses directly related to the acquisition of premiums. They are deferred to the extent that they are recoverable from unearned premiums, after considering the related anticipated claims, expenses and investment income in respect of these premiums. Deferred acquisition costs are amortized on the same basis as the premiums are recognized in income.

A premium deficiency would be recognized immediately by a charge to the statement of income as a reduction of deferred acquisition costs to the extent that the unearned premium reserve, plus anticipated investment income, is not adequate to recover all deferred acquisition costs and related claims and expenses. If the premium deficiency was greater than unamortized deferred acquisition costs, a liability would be accrued for the excess deficiency.

Investments

EGI obtains values for all publicly traded securities in its investment portfolio from external pricing services.

Impairment of investment securities results in a charge to earnings when a market decline in the value of an investment to below cost is other than temporary. EGI's methodology to identify potential impairments requires professional judgment and places particular emphasis on those securities with unrealized losses of 10% or greater of the book value where the unrealized loss has been outstanding for more than six months. Assessment factors include, but are not limited to, the financial condition and rating of the issuer of the security, any collateral held and the length of time the market value of the security has been below cost. Any impairments are recognized when the assessment concludes that there is objective evidence of impairment. On a timely basis, any security with an unrealized loss that is determined to have been other than temporarily impaired is written down to its expected recoverable amount, with the amount of the write-down reflected in the statement of income for that period. Previously impaired securities continue to be monitored quarterly, with an additional write-down taken if necessary.

There are inherent risks and uncertainties involved in making these judgments. Changes in circumstances and critical assumptions such as a weak economy, a pronounced economic downturn or unforeseen events which affect one or more companies or industry sectors could result in additional write-downs in future periods for impairments that are deemed to be other than temporary. See also note 5 to the consolidated financial statements for a description of the impairment policies.

Reinsurance

Reinsurance recoverables include amounts for expected recoveries related to claims liabilities as well as the portion of the reinsured premiums which has not yet been earned by the reinsurer. The cost of reinsurance is accounted for over the terms of the underlying reinsured policies, using assumptions consistent with those used to account for the policies. Amounts recoverable from reinsurers are estimated in a manner consistent with claim and claim adjustment expense reserves and are reported in the consolidated balance sheet. The ceding of insurance to a reinsurer does not discharge EGI's primary liability to the insureds. 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, management's experience and current economic conditions.

Income Taxes

EGI uses the liability method whereby income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of financial statement assets and liabilities compared with their respective tax bases. Accordingly, a future tax asset or liability is determined for each temporary difference, based on the income tax rates that are expected to be in effect when the underlying items of revenue and expenses are expected to be realized.

Future income taxes, accumulated as a result of temporary differences, are included in the consolidated balance sheet. In addition, the consolidated statement of income contains items that are non-taxable or non-deductible for income tax purposes, which cause the income tax provision to differ from what it would be if based on statutory rates.

SUMMARY OF QUARTERLY RESULTS

	2007				2006			
	(IN \$ THOUSANDS EXCEPT PER SHARE DATA)							
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Direct written and assumed premiums	43,098	42,343	42,299	30,196	25,936	29,184	36,622	26,092
Total revenues (excluding investment income)	34,161	30,847	29,808	24,790	24,190	28,490	26,189	25,075
Underwriting income	609	3,536	4,533	1,304	3,493	6,228	3,859	930
Income before income taxes	5,658	6,772	6,601	3,905	7,949	8,371	5,660	3,563
Net income	3,727	4,462	4,349	2,527	5,200	5,489	3,857	2,434
Earnings per adjusted share								
Basic	0.39	0.46	0.45	0.26	0.54	0.57	0.40	0.25
Diluted	0.35	0.44	0.42	0.24	0.51	0.54	0.38	0.24

Selected financial ratios (%)

Loss ratio	65.1	58.2	53.2	61.0	61.0	48.9	54.3	66.1
Expense ratio	<u>33.1</u>	<u>30.3</u>	<u>31.6</u>	<u>33.7</u>	<u>24.6</u>	<u>29.2</u>	<u>31.0</u>	<u>30.2</u>
Combined	98.2	88.5	84.8	94.7	85.6	78.1	85.3	96.3

Quarter Ended December 31, 2007 Compared to Quarter Ended December 31, 2006

The following financial information compares the fourth quarter 2007 results with the fourth quarter 2006 results.

(IN \$ THOUSANDS)	Q4 2007	Q4 2006	Variance	Variance %
Direct written premiums	43,098	25,936	17,162	66.2
Net written premiums	39,257	22,949	16,308	71.1
Net earned premiums	34,161	24,190	9,971	41.2
Claims incurred	22,253	14,766	7,487	50.7
Acquisition costs	7,483	3,689	3,794	102.8
Operating expenses	3,816	2,242	1,574	70.2
Underwriting income	609	3,493	(2,884)	(82.6)
Investment income	5,049	4,456	593	13.3
Net income before income taxes	5,658	7,949	(2,291)	(28.8)
Income taxes	1,931	2,749	(818)	(29.8)
Net income	3,727	5,200	(1,473)	(28.3)

Insurance Operation

Written Premiums

In the fourth quarter of 2007, direct written premiums increased \$17.2 million, or 66.2%, to \$43.1 million compared to \$25.9 million in the same period last year. This increase was primarily the result of EGI's entry into the U.S. non-standard auto insurance market, effective January 1, 2007, and significant premium growth generated by our Niche Products Division, particularly in the ETH line of business, which generated \$11.5 million of additional premiums written as compared to the final quarter of 2006. This significant increase in premiums was achieved despite the continuing competition from standard insurance carriers who continue to pursue what have traditionally been seen as non-standard risks. In our Personal Lines Division direct written and assumed premiums increased \$3.3 million or 16% to \$23.9 million compared to \$20.6 million in the fourth quarter of 2006. In the Niche Products Division direct written and assumed premiums increased \$13.9 million or 262% to \$19.2 million compared to \$5.3 million in the last quarter of 2006.

For the three months ended December 31, 2007, net written premiums increased \$16.3 million or 71.1% to \$39.2 million compared to \$22.9 million for the last quarter of 2006. This increase was consistent with the increase in direct written and assumed premiums noted above.

Earned Premiums

Net earned premiums for the three months ended December 31, 2007 were \$34.1 million, an increase of \$9.9 million, or 41.2%, compared to the fourth quarter of 2006. The growth in net earned premiums was lower than the increase in net premiums written due to the significant amount of ETH premiums written in the last quarter of 2007. This premium is earned primarily during the period November 2007 through April 2008, resulting in a significant unearned premium as at December 31, 2007 in the amount of \$14.9 million. This premium will be earned in the first half of 2008.

Incurred Claims Expense

For the quarter ended December 31, 2007, net claims expense increased \$7.4 million or 50.7% to \$22.2 million compared to \$14.8 million for the fourth quarter of 2006. This resulted in a loss ratio of 65.1% for the three months ended December 31, 2007 compared to 61.0% for the same period in 2006. The increase was primarily attributed to the increase in the Niche Products Division's loss ratio to 73.4% in the quarter due to adverse loss experience recorded in the ETH line of business. Overall, favourable development of prior year claims continued to be experienced in the last quarter of 2007, as was the case in 2006. As a result of the favourable development, prior year reserves of \$2.0 million and \$2.5 million were released in the final quarter of 2007 and 2006, respectively.

Acquisition Costs

Net acquisition costs, which consist mainly of commissions and premium taxes, increased \$3.8 million or 102.8% to \$7.5 million in the quarter ended December 31, 2007, compared to \$3.7 million in the same period in 2006. This significant increase, in relation to the increase in net earned premiums of 41%, compared to 2006, was the result of the reduction in sliding scale reinsurance commission adjustments recorded in the fourth quarter of 2007 compared to 2006. Additional reinsurance commission of \$0.3 million was recorded in the fourth quarter of 2007 related to the 2005 policy year, as compared to \$1.6 million in the fourth quarter of 2006.

Operating Expenses

For the fourth quarter of 2007, operating expenses, including interest expense, were \$3.8 million compared to \$2.2 million in the same period in 2006 or an increase of 70.2%. This increase was larger than the 41% increase in net earned premiums in the quarter compared to 2006. The primary reasons for the increase are (1) increase in employee salaries and benefits (\$637) due to head count growth; (2) interest

expense incurred on the EGI bank indebtedness (\$259) in the last quarter of 2007; (3) an accrual of rent and operating costs associated with EGI's intention to relocate office premises in 2008 (\$280); and (4) start-up expenses incurred in our new U.S. subsidiary, EGI Insurance Services, Inc. (\$165).

Underwriting Income

Underwriting results reflect the revenues from net earned premiums less claims, acquisition and operating expenses. In the quarter ended December 31, 2007, total underwriting income was \$0.6 million, compared to \$3.5 million in the same quarter of 2006. The decline was attributable to the increase in the loss ratio, primarily resulting from adverse claims experience incurred in the ETH line of business, and acquisition ratios noted above.

Investment Income

In the final quarter of 2007 investment income increased \$0.6 million, or 13.3%, to \$5.1 million compared to \$4.5 million in the final quarter of 2006. This increase in 2007 compared to 2006 was primarily due to the increase in invested assets resulting from additional cash flow generated from 2007 operations.

Net Income before Income Taxes

For the quarter ended December 31, 2007, net income before income taxes was \$5.7 million compared to \$8.0 million for the final quarter of 2006, resulting from a higher 2007 combined ratio of 98.2%, compared to 85.6% for the same period in 2006, partially offset by additional investment income in 2007. In the final quarter of 2007, underwriting income of \$0.6 million plus investment income of \$5.1 million comprised net income before income taxes of \$5.7 million. This compares to an underwriting income of \$3.5 million plus investment income of \$4.5 million in the fourth quarter of 2006.

Income Taxes

For the quarter ended December 31, 2007, the provision for income taxes was \$1.9 million compared to \$2.7 million for the same period last year. The approximate effective tax rate was 34% for the last quarter of 2007 and 34% for the same period last year.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Insurance Operation

Written Premiums

Direct written and assumed premiums increased \$40.1 million or 34.0% to \$157.9 million for the year ended December 31, 2007 compared to \$117.8 million for 2006. A significant increase has been achieved in both business segments. The increase in Personal Lines premiums was primarily the result of EGI's entry into the U.S. non-standard auto insurance market, effective January 1, 2007 through a reinsurance arrangement with AssuranceAmerica. Our Niche Products Division continued to record significant premium growth in 2007, maintaining our track record of steady growth in this business segment. The increase in premiums generated by our Personal Lines Division has been achieved despite continued competitive pressures from standard auto insurers who continue to pursue what have been traditionally perceived as non-standard risks. Offsetting the shrinkage in the Ontario non-standard auto business was the premium growth achieved in assumed business from the U.S.-based quota share treaty participation, an increase in Ontario motorcycle premiums and increases in Quebec automobile business. Quebec automobile insurance premiums grew 42.1% to \$9.1 million for the year ended December 31, 2007, compared to \$6.4 million in 2006. Quebec is viewed as a strategic growth area for geographic diversification and the focus there is on contracting new brokers and introducing new products such as the motorcycle program. With an exclusive arrangement with a specialist broker, EGI began to write motorcycle business in Ontario during the first quarter of 2006; during 2007 direct premiums from this jurisdiction totaled \$13.9 million compared to \$7.6 million in 2006.

Direct written premiums for Niche Products increased 142% to \$48.1 million for the year ended December 31, 2007, compared to \$19.9 million in 2006. Formed in 2003, the Niche Products Division has experienced significant growth in the last three years due to continued marketing efforts.

Net written premiums increased \$40.5 million or 38.2% to \$146.5 million for the year ended December 31, 2007, compared to \$106 million for the same period last year. The increase in net premiums written was consistent with the percentage increase in gross premiums written noted above.

Earned Premiums

Net earned premiums for the year ended December 31, 2007, were \$119.6 million, an increase of \$15.7 million or 15.1% from 2006. This increase was significantly lower than the net premiums written increase due to the impact of significant ETH premiums written primarily in the fourth quarter of 2007, the majority of which will not be earned until the first half of 2008.

Incurred Claims Expense

Net incurred claims expense increased \$11.7 million or 19.7% to \$71.2 million for the year ended December 31, 2007, compared to \$59.5 million for 2006. The resulting loss ratio of 59.5% for the year ended December 31, 2007 represents an increase of 2.3% over the 2006 year loss ratio of 57.2%. As noted in the analysis above for the fourth quarter of 2007, the primary reason for the increase in the 2007 loss ratio was an increase in the Niche Products Division's loss ratio to 56.1% for the year. ETH recorded a loss ratio of 94% while all other Niche programs recorded an excellent 48% loss ratio in 2007. The Personal Lines Division incurred a loss ratio of 60.4% in 2007 compared to 57.9% in 2006. This increase was attributed to a higher than expected loss ratio in the motorcycle line of business of 76.6%. EGI entered the Ontario motorcycle insurance market in 2006, and as this relatively new line of business grows and matures, loss ratios are expected to decline.

Positive development of prior year claims continued in 2007, resulting in a release of \$11.8 million of net reserves that were accrued for the prior accident years. The favourable development can be distributed as \$6.7 million for liability claims, \$3.2 million for accident benefits claims, and \$1.9 million for all other lines of business. In 2006, favourable prior year claims development of \$12.0 million was recorded.

Acquisition Costs

Net acquisition costs, which consist mainly of commissions and premium taxes, increased \$6.6 million or 33.8% to \$26.1 million for the year ended December 31, 2007, compared to \$19.5 million in 2006. This increase, in relation to the increase in net earned premiums of 15.1%, compared to 2006, was the result of the reduction in sliding scale reinsurance commission adjustments recorded in 2007 compared to 2006. Additional reinsurance commission of \$0.6 million was recorded in 2007 related to the 2005 policy year, as compared to \$2.7 million in 2006.

Operating Expenses

Operating expenses, which include interest expense, increased \$1.9 million or 18.2% to \$12.3 million for the year ended December 31, 2007 compared to \$10.4 million for 2006. This increase was higher than the 15.1% increase in net earned premiums noted above. This was primarily due to (1) an increase in employee salaries and benefits of \$1.37 million due to head count growth; (2) the interest expense recorded pursuant to bank indebtedness of \$259,000; (3) an accrual of rent and operating costs associated with EGI's intention to relocate in 2008 of \$280,000; and (4) expenses incurred in our new U.S. subsidiary, EGI Insurance Services, Inc., of \$165,000.

Underwriting Income

Underwriting results reflect the revenues from net earned premiums less claims, acquisition and operating expenses. The overall underwriting income decreased \$4.5 million to \$10.0 million for the year ended December 31, 2007 compared to \$14.5 million for 2006. The underwriting income for 2007 and 2006 was net of \$1.1 million and \$0.9 million of corporate and other expenses, respectively.

Underwriting income from the Personal Lines Division for the year ended December 31, 2007 was \$10.8 million, representing a decline of \$4.3 million compared to an income of \$15.1 million for 2006. This result was due to an increase in the combined ratio to 88.7% in 2007 compared to 83.4% in 2006.

The results for the year ended December 31, 2007 include the release of actuarial reserves for prior accident years' claims of \$11.8 million as compared to a release of \$12 million in 2006, both the result of positive claims development related to prior year reserves.

Underwriting income from the Niche Products Division for the year ended December 31, 2007 was \$0.3 million, a slight increase of \$0.1 million compared to an income of \$0.2 million in 2006. This result was achieved despite the adverse loss ratio experienced in the ETH business and allocation of shared services expenses to this division in 2007 of \$0.7 million. Allocation of shared expenses commenced in 2007.

Investment Income

Investment income increased \$1.9 million, or 17.2%, to \$12.9 million for the year ended December 31, 2007 compared to \$11.0 million for 2006.

The significant increase in investment income compared to 2006 resulted from two primary factors: EGI's investment portfolio reflected a \$57.3 million or 25.6% increase in fair value as at December 31, 2007 compared to December 31, 2006, due to positive cash flows from operations during the period; and an increase in realized gains recorded in 2007 to \$3.2 million, compared to \$2.6 million of realized gains in 2006. The gains were derived from the sale of investments totaling \$204.1 million in 2007 and \$169.7 million in 2006.

Note that a significant portion of the increase in the investment portfolio as compared to 2006 resulted from the additional funds drawn from the credit facility of \$19.6 million, established in October 2007, arranged to fund U.S. business expansion.

Net Income before Income Taxes

Net income before income taxes decreased \$2.6 million, or 10.2%, to \$22.9 million for the year ended December 31, 2007 compared to \$25.5 million for 2006, as a result of a higher combined ratio partially offset by the increase in investment income.

For the year ended December 31, 2007, underwriting income of \$10.0 million plus investment income of \$12.9 million comprise net income before income taxes of \$22.9 million. This compares to an underwriting income of \$14.5 million plus investment income of \$11.0 million in 2006.

Income Taxes

The provision for income taxes for the year ended December 31, 2007 was \$7.9 million compared to \$8.6 million for 2006. This reflected lower pre-tax income as a result of lower underwriting profits and increased investment income year over year. The approximate effective tax rate was 34% for 2007 and 34% for the previous year.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Insurance Operation

Written Premiums

Direct written premiums increased \$0.8 million or 0.7% to \$117.8 million for the year ended December 31, 2006 compared to \$117.0 million for 2005. EGI has realized an increase in premiums despite current market conditions which resulted in a reduction of Ontario non-standard auto business. Despite the shrinkage in the Ontario non-standard auto business, the growth overall was achieved due to the growth in Niche Products and the Quebec automobile business, and the addition of Ontario motorcycle business. Direct written premiums for Niche Products increased 74.5% to \$19.9 million for the year ended December 31, 2006, compared to \$11.4 million in 2005. Formed in 2003, the Niche Products Division had modest growth in 2004, and due to the continued marketing efforts to grow this division, it has experienced significant growth in 2005 and 2006. Quebec automobile insurance premiums grew 30.6% to \$6.4 million for the year ended December 31, 2006, compared to \$4.9 million in 2005. Quebec is viewed as a strategic growth area for geographic diversification and the focus there has been on contracting new brokers and introducing new products such as the motorcycle program. With an exclusive arrangement with a specialist broker, EGI began to write motorcycle business in Ontario during the first quarter of 2006; during 2006 direct premiums from this arrangement totaled \$7.6 million.

Despite the modest growth in direct written premiums, net written premiums increased by \$14.2 million or 15.5% to \$106 million for the year ended December 31, 2006, compared to \$91.8 million for last year. EGI achieved this significant growth in net written premiums because of its ability to more effectively utilize its capital through managing its reinsurance arrangements. Net written premiums increased over 2005 because the Company terminated its quota share reinsurance arrangement effective December 31, 2005. Therefore, no quota share reinsurance arrangement was put in place for auto policies written in 2006. (See additional detail under “Reinsurance” on page 39.)

Earned Premiums

Net earned premiums for the year ended December 31, 2006, were \$103.9 million, an increase of \$27.6 million or 36.2% from 2005. The withdrawal of the 2005 quota share treaty at December 31, 2005, and the reduction in the amount of reinsurance purchased by EGI in 2006 compared to 2005 are the primary reasons for the growth in net earned premiums. In addition, earned premiums for the Niche Products Division increased to \$12.9 million in 2006 compared to \$6.7 million in 2005.

Incurred Claims Expense

Net incurred claims expense increased by \$13.5 million or 29.3% to \$59.5 million for the year ended December 31, 2006 compared to \$46.0 million for 2005. This compares favourably to the 36.2% increase in net earned premiums, which indicates that the expense did not increase at the same rate as the revenue. One of the main reasons for this was the continued positive development in prior accident year claims reserve estimates as at December 31, 2006. The positive development in 2006 resulted in a release of \$12.0 million of net reserves that were accrued for the prior accident years. This favourable development at December 31, 2006 occurred because reported accident benefits and liability claims were lower than expected in the 2003, 2004 and 2005 accident years. The favourable development of \$12.0 million can be distributed as \$7.1 million for liability claims and \$4.9 million for accident benefits claims. In 2005, favourable prior year claims development of \$6.5 million was recorded.

The loss ratio of 57.2% in 2006 was a noticeable improvement over the loss ratio of 60.3% for 2005. The frequency of claims in 2006 also continued to decrease compared to 2005 and 2004, largely in line with industry trends.

Acquisition Costs

Net acquisition costs, which consist mainly of commissions and premium taxes, increased by \$7.4 million or 61.1% to \$19.5 million for the year ended December 31, 2006, compared to \$12.1 million in 2005. It should be noted that the year-over-year variance was distorted by the effect of the withdrawal of quota share reinsurance arrangements at the end of 2005.

Increases to these costs in 2006 are primarily due to the withdrawal of quota share reinsurance effective December 31, 2005. In 2005, gross commissions paid to EGI's producers were offset by the commissions received from reinsurers on the portion of business that was ceded to them, on a quota share basis, to calculate the net commission. No reinsurance commission has been received or recorded in 2006 on the Auto line of business, except for additional reinsurance commission occurring from swing rate arrangements for the 2004 and 2005 policy years, totaling \$2.9 million.

Operating Expenses

Operating expenses increased by \$1.3 million or 14.1% to \$10.4 million for the year ended December 31, 2006 compared to \$9.1 million for 2005. This compared favourably to the 36.2% increase in net earned premiums. This was due to the quota share reinsurance reduction and the resulting increase in net earned premiums and expense controls, as noted above.

Underwriting Income

Underwriting results reflect the revenues from net earned premiums less claims, acquisition and operating expenses. Industry underwriting profitability reached record levels in recent years, reflecting strong market conditions and a favourable claims environment. The overall underwriting income increased \$5.1 million to \$14.5 million for the year ended December 31, 2006 compared to \$9.4 million for 2005. The underwriting income for 2006 and 2005 was net of \$0.9 million and \$0.4 million of corporate and other expenses, respectively.

Underwriting income from non-standard automobile insurance for the year ended December 31, 2006 was \$15.1 million, an improvement of \$5.7 million compared to an income of \$9.4 million for 2005. This improvement was attributable to a decrease in the loss ratio to 57.9% in 2006 compared to 61.6% in 2005.

The results for the year ended December 31, 2006 include the release of actuarial reserves for prior accident years claims of \$12.0 million as compared to a release of \$6.5 million in 2005, both the result of positive claims development related to prior year reserves. The combined underwriting ratio for Auto for 2006 was 83.4% compared to 86.5% in 2005. The expense ratio, consisting of acquisition and operating expenses as compared to earned premiums, was 25.5% for 2006, compared to 24.9% for 2005.

Underwriting income from Niche Products for the year ended December 31, 2006 was \$0.2 million, a decrease of \$0.3 million compared to an income of \$0.5 million in 2005. This decrease was primarily due to an increase in the loss ratio to 52.6%, compared to 46.1% in 2005. Due to significant growth in this line of business our actuary increased IBNR claims reserves, which was the primary cause of the increase in the loss ratio. The combined ratio for the Niche Products Division increased to 98.1% in 2006, compared to 96.4% in 2005.

Investment Income

Investment income increased \$3.5 million, or 46.7%, to \$11.0 million for the year ended December 31, 2006 compared to \$7.5 million for 2005.

The significant increase in investment income compared to 2005 resulted from two primary factors: EGI's investment portfolio reflected a \$27.8 million or 14.6% increase in size as at December 31, 2006,

compared to December 31, 2005, due to positive cash flows from operations during the period; and the investment of additional funds raised in our IPO which closed on December 8, 2005.

Included in investment income are realized gains of \$2.6 million in 2006 as compared to \$1.2 million in 2005. The gains were derived from the sales of investments totaling \$169.7 million in 2006 and \$39.6 million in 2005.

Net Income before Income Taxes

Net income before income taxes increased by \$8.6 million, or 50.9%, to \$25.5 million for the year ended December 31, 2006, compared to \$16.9 million for 2005, as a result of improved underwriting results and higher investment income.

For the year ended December 31, 2006, underwriting income of \$14.5 million plus investment income of \$11.0 million comprise net income before income taxes of \$25.5 million. This compares to an underwriting income of \$9.4 million plus investment income of \$7.5 million in 2005.

Income Taxes

The provision for income taxes for the year ended December 31, 2006 was \$8.6 million, compared to \$5.7 million for 2005. This reflected higher pre-tax income as a result of increased underwriting profits and investment income year over year.

Extraordinary Gain

In 2005 an extraordinary after-tax gain of \$5.7 million arose due to the share exchange which formed part of the January 2005 Echelon Transaction. The gain was the result of the write off of negative goodwill arising from the transaction.

Balance Sheet Analysis

Investments

EGI has an investment policy that seeks to provide a stable income base to support EGI's liabilities without incurring an undue level of investment risk. All investment decisions are made with this risk-return trade-off in mind. The two most important methods used to reduce the level of risk without reducing the rate of return in EGI's portfolio are diversification and the use of proven investment professionals.

EGI's Board of Directors has established an Investment Committee to develop and implement detailed strategies consistent with EGI's objectives and to report regularly to the Board of Directors on its activities. EGI has outsourced all buy/sell decisions on individual securities to a small number of reputable professional investment managers. Using the "prudent person" approach, the Investment Committee monitors the performance of each manager, measuring his or her performance against an appropriate market index benchmark.

Each of EGI's investment managers (with the exception of Savoy Capital Management Ltd.) operates under an investment management agreement which provides the investment manager with a discretionary mandate to hold one or more types of securities and/or cash. The investment manager receives an annual fee (payable quarterly) based on a negotiated percentage of the market value of the portfolio being managed. The investment manager's engagement is subject to immediate cancellation by EGI, without penalty, upon giving written notice. Savoy Capital Management Ltd. manages the Gladiator Limited Partnership (Gladiator LP), an equity investment currently held by EGI. See "Common Shares" below.

EGI's investment portfolio is invested in well-established, active and liquid markets in Canada and the United States. Fair value for most investments is determined by reference to quoted market prices. The external investment managers invest on a total return basis, which views realized gains and losses as important and recurring components of the return on investments and consequently of income. The timing of the realization of gains and losses may be unpredictable, and changes in the overall levels of fixed income or equity markets generally result in corresponding changes in realized gains and losses.

To assess impairments, the Investment Committee and management review all holdings with a fair value below their carrying values and, in consultation with the appropriate investment manager, ascertain whether the carrying amounts are expected to be recovered. EGI's investment managers provide advice as to whether the fair value of these securities is adversely affected other than on a temporary basis.

The following table sets forth EGI's invested assets as at December 31, 2007 and 2006.

Investment Portfolio

(IN \$ THOUSANDS)	December 31, 2007	December 31, 2006	
	Fair value and carrying amount	Fair value	Carrying amount
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	1,758	1,332	1,332
	<u>238,310</u>	<u>187,548</u>	<u>179,383</u>

EGI's portfolio is constructed in a manner which seeks to ensure that its objectives of producing a competitive rate of return are met, while at the same time protecting and enhancing statutory underwriting capital on a long-term basis. This is achieved through diversification principles to ensure each asset class has limited exposure by region, industry, issuer and type of underlying security. Target ranges are set for each asset class and economic sector and are monitored by the Investment Committee to ensure that EGI's investment managers comply with these guidelines, and all regulatory requirements and liquidity needs are adhered to by each manager.

Fixed Income Securities

EGI holds fixed income securities to provide a steady predictable level of income and reasonable liquidity with minimum risk of loss and a fixed sum at maturity. EGI's portfolio is diversified by selecting various types of government and corporate bonds. Constraints on types of issuers take liquidity, diversification and risk into account by limiting the portfolio mix by issuer.

EGI maintains a high overall credit quality level as measured by Dominion Bond Rating Service (DBRS). Constraints are placed on the percentage of bonds which can be held in the rating classes as follows: Class A or better – no maximum; Class BBB or lower – maximum 10%. EGI's policy is to purchase only corporate bond issues which are rated BBB or better at the time of purchase. In the event of subsequent downgrades the Investment Committee will consider whether to continue to hold the bonds.

The following table sets forth EGI's fixed income portfolio by credit quality according to DBRS as at December 31, 2007 and 2006.

Fixed Income Portfolio

(IN \$ THOUSANDS)

	As at December 31, 2007		As at December 31, 2006		
	Fair value and carrying amount	% of fair value	Fair value	% of fair value	Carrying value
AAA	100,388	54	75,634	51	75,496
AA	43,015	23	32,076	22	31,577
A	37,631	20	31,578	21	31,306
BBB	5,018	3	6,642	5	6,580
BB	-	-	-	-	-
B	-	-	1,360	1	1,358
Total	186,052	100	147,290	100	146,317

Common Shares

Common shares are a key component of EGI's portfolio to enhance the capital appreciation opportunities of EGI's invested assets. EGI's investment managers, using a conservative approach to equity selection, ensure that equities of companies with a reputation for strong management and a proven track record of success are selected for EGI's portfolio. Diversification by country and industry sector also reduces the overall risk level inherent in EGI's common share portfolio.

EGI generally limits its total exposure to common shares at any one time to a maximum of 16% of the total of its invested assets and premium financing receivables, which is slightly below the average exposure to equities for Canadian owned P&C insurers.

Canadian Common Share Portfolio

Included in the common shares held by the Company is an investment in Gladiator LP, which is managed by Savoy Capital with a cost of \$1.2 million and a fair value of \$1.2 million at December 31, 2007. In August 2006, subsequent to a notice provided by Savoy to terminate the investment management services agreement with the Gladiator fund, Savoy ceased actively investing in the fund and immediately began to employ a defensive position. Equity exposures were reduced significantly and the cash position increased.

As part of the process to wind up the fund, in November 2006 Savoy redeemed EGI's cash position in the fund, thereby lowering EGI's cost value to \$1.9 million as at December 31, 2006. In July 2007, Savoy issued a cash redemption to EGI in the amount of \$0.4 million, representing EGI's share of cash held in the fund as at June 30, 2007, which was primarily generated from the sale of four private holdings in the second quarter of 2007. These sales generated a realized loss of \$0.2 million, which has been reflected in investment income in 2007. As at December 31, 2007 the Gladiator Fund consists of one private holding, representing approximately 81% of the total fund, with the remaining assets in cash and short-term investments. EGI continues to work with Savoy to secure an effective monetization of the fund and Savoy has advised that it was necessary to extend the monetization period to after December 31, 2007. EGI expects full monetization of the fund in the first half of 2008.

Restrictions as to the amount of common shares held in any industry sector are also part of EGI's risk diversification methodology. The following table outlines EGI's Canadian common share exposure to industry sectors as at December 31, 2007 and 2006.

(IN \$ THOUSANDS)	<u>As at December 31, 2007</u>		<u>As at December 31, 2006</u>		
	Fair value and carrying amount	% of fair value	Fair value	% of fair value	Carrying value
Energy	7,736	18	6,495	23	5,151
Financial services	14,275	34	8,565	30	6,470
Materials	4,852	11	2,972	10	1,625
Gladiator LP	1,238	3	2,630	9	1,921
Other	14,049	34	7,712	28	6,407
Total	<u>42,150</u>	<u>100</u>	<u>28,374</u>	<u>100</u>	<u>21,574</u>

Recoverable from Reinsurers

(IN \$ THOUSANDS)	As at December 31	
	2007	2006
Reinsurers' share of unpaid claims	48,461	48,385
Reinsurers' share of unearned premiums	3,602	3,831
Total	52,063	52,216

As at December 31, 2007 the amount recoverable from reinsurers decreased by \$0.1 million or 0.2% to \$52.0 million, from \$52.2 million at December 31, 2006. The slight decrease was due to reduced reliance on reinsurance particularly for the 2006 and 2007 policy years.

Accounts Receivable

(IN \$ THOUSANDS)	As at December 31	
	2007	2006
Premium financing receivables	19,569	18,621
Facility Association	(90)	315
Agents and brokers	5,807	3,124
Other	96	122
Total	25,382	22,182

Premium financing receivables was the largest component of this asset as at December 31, 2007 and represents approximately 77% or \$19.6 million of total receivables. Premium financing receivables increased to \$19.6 million at December 31, 2007 from \$18.6 million at December 31, 2006. The majority of the automobile business is billed directly to policyholders and remitted on a monthly basis.

Facility Association receivable results reflect the pro rata sharing by EGI of business written by Facility. There was a reduction in 2007 from 2006 due to the depopulation of Facility Association's business commencing in 2006 due to industry initiatives to reduce reliance on this pool. This resulted in a decline in Facility premiums transferred to EGI.

Agents and brokers receivables grew by 87% in 2007 compared to 2006, largely due to the significant growth in the Niche business segment. EGI also experienced significant growth in business in Quebec where broker billing is offered as a mode of payment.

Provision for Unpaid Claims

EGI establishes loss reserves to provide for future amounts required to pay claims related to insured events that have occurred and been reported but have not yet been settled, and related to events that have occurred but have not yet been reported to the insurer. Claims provisions (i.e. reserves for claims liability) are established at the individual file level by the "case method" as claims are reported. The provisions are

subsequently adjusted as additional information affecting the estimated amount of a claim becomes known during the course of its settlement. With the assistance of EGI's consulting actuary, a reserve provision is also made for management's calculation of factors affecting the future development of claims, including a provision for IBNR claims, based on the volume of business currently in force and the historical experience on claims. Reserves are also established for the estimated internal and external loss adjustment expenses which will be incurred during the claims settlement process.

The provision for unpaid claims and adjustment expenses is discounted to take into account the time value of money as required by EGI's primary insurance regulator. It also includes a provision for adverse deviation as required by accepted Canadian actuarial practice. EGI's consulting actuary reports on the adequacy of EGI's claims reserves on a quarterly basis. As time passes, more information about the claims becomes known and provisional estimates are appropriately adjusted upward or downward. Adjustments to reserves are reflected in the results of operations in the periods in which the estimates are changed.

The development of the provision for claims is shown by the difference between estimates of reserves as of the initial year-end and the re-estimated liability at each subsequent year-end. This is based on actual payments in full or partial settlement of claims, plus re-estimates of the reserves required for claims still open or claims still unreported. Favourable development means that the original reserve estimates were higher than subsequently indicated. Unfavourable development means that the original reserve estimates were lower than subsequently indicated.

For further discussion of EGI's reserving methods and underlying assumptions, see "Critical Accounting Estimates and Assumptions – Policy Liabilities".

Provision for unpaid claims consists of the gross amount of individual case reserves established and management's estimate of claims incurred, but not reported, based on the volume of business currently in force and historical claims experience. In order to ensure as far as possible that EGI's provision for unpaid claims (often called "reserves") is adequate, management has retained the services of an independent consulting actuary. EGI strives to establish adequate provisions at each quarter-end.

EGI estimates its reserves on a quarterly basis and this is supported by quarterly assessments by the independent consulting actuary. Every quarter, for each line of business, EGI 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 EGI 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 EGI's financial statements. To the extent provisions prove to be inadequate, EGI would have to increase such provisions and incur a charge to earnings in the future.

The table below shows the development of the provision for claims reserves including loss adjustment expenses as at December 31 in each year of the four-year period and for the year ended December 31, 2007,

for Echelon (on a 100% basis).

(IN \$ THOUSANDS)	Years ended December 31				
	2006	2005	2004	2003	2002
Reserve carried (actuarial present value basis) ⁽¹⁾	145,691	129,041	107,196	79,191	66,545
Reserve at December 31, 2003					43,754
Cumulative paid to December 31, 2003					24,122
Cumulative redundancy (deficiency)					(1,331)
Reserve at December 31, 2004				56,226	31,213
Cumulative paid to December 31, 2004				24,184	39,619
Cumulative redundancy (deficiency)				(1,219)	(4,287)
Reserve at December 31, 2005			70,620	37,802	21,682
Cumulative paid to December 31, 2005			24,922	38,802	48,033
Cumulative redundancy (deficiency)			11,654	2,587	(3,170)
Reserve at December 31, 2006		88,029	49,557	25,214	14,964
Cumulative paid to December 31, 2006		25,817	41,158	49,592	54,050
Cumulative redundancy (deficiency)		15,195	16,481	4,385	(2,469)
Reserve at December 31, 2007	107,992	67,408	36,129	17,569	10,278
Cumulative paid to December 31, 2007	30,432	46,413	55,306	28,217	60,338
Cumulative redundancy (deficiency)	7,267	15,220	15,761	3,405	(4,071)

(1) Amounts include provision for adverse deviation (PFAD) of \$14,756 for 2006; \$12,473 for 2005; \$8,613 for 2004; \$6,137 for 2003; and \$5,226 for 2002.

The uncertainties regarding EGI's reserves could result in a liability exceeding the reserves by an amount that would be material to EGI's financial condition or results of operations in a future period. Future development could be significantly different from the past due to many unknown factors. See "Risk Factors".

Reinsurance

EGI has reinsurance treaties with several unaffiliated reinsurers, all of whom are selected on the basis of their creditworthiness. EGI purchases reinsurance to reduce its exposure to the insurance risks that it assumes in writing business. For 2007 the maximum net retention on a single risk was \$1.15 million (2006 – \$0.95 million).

In accordance with industry practice, EGI's reinsurance recoverables with licensed Canadian reinsurers are generally unsecured, because Canadian regulations require these reinsurers to maintain minimum asset and capital balances in Canada to meet their Canadian obligations. However, policy liabilities rank in priority to any subordinate creditors a reinsurer may have. For reinsurance recoverables with non-licensed reinsurers, EGI maintains security against reinsurance recoverables in the form of cash, letters of credit and/or assets held in trust accounts. At December 31, 2007, EGI was the assigned beneficiary of such trust accounts totaling \$2.5 million (2006 – \$2.1 million) in guarantees from unlicensed reinsurers.

Excess of loss and catastrophe reinsurance is used to limit an insurer's exposure to a maximum dollar value per claim and per occurrence. Quota share is a form of proportional reinsurance often used by an insurer to build a book of business larger than can be supported by the insurer's own capital. When used on established, profitable lines of business, quota share is an expensive substitute for equity capital. The insurer is essentially borrowing capital from the reinsurer by transferring unearned premium and claims liabilities from its books to the books of the reinsurer. Within the range of expected loss ratios, this transfer is done at a direct cost to the insurer, which happens through the ceding commission (expense allowance) paid by the reinsurer.

The ceding commission paid to the insurer by the reinsurer varies depending on the gross loss ratio. As the gross loss ratio increases, the amount of ceding commission decreases, subject to agreed limits. Above the maximum loss ratio on the ceding commission scale, there is full risk transfer (i.e. the potential to lose money) to the reinsurer. Below the minimum loss ratio on the ceding commission scale, the reinsurer's profit increases. The reinsurer also retains the investment income on the cash balances that develop between the dates premiums are received and the dates claims are paid.

EGI purchases renewable excess of loss and catastrophe reinsurance from third party reinsurers, covering its automobile and general liability business. In 2007, such coverage was for a total of \$13.9 million and in 2006 was for \$19.1 million. Other than general liability, coverages for the programs of the Niche Products Division are reinsured on a program by program basis.

For 2007, EGI's liability after all excess of loss and quota share reinsurance recoveries was limited to a maximum of \$1.15 million, and in 2006 \$0.95 million on any one claim. Using reinsurance, EGI's policy is to limit its loss exposure in any one claim to not more than 2% of its shareholders' equity.

EGI depends upon the financial stability of its reinsurers in the same way that EGI's insureds rely upon EGI. Accordingly, EGI carefully selects its reinsurers and only deals with creditworthy reinsurers. Reinsurers are selected based on their financial strength ratings, services, reputation and prices offered on the required reinsurance. As reported to EGI by AON Re Canada Inc., EGI's reinsurance broker, at December, 2007, all reinsurers providing coverage under EGI's treaties were rated B++ or better by A.M. Best. EGI's Reinsurance Committee is responsible for evaluating and approving companies to which EGI cedes reinsurance. The committee consults with AON Re Canada Inc. regarding the financial ratings of EGI's reinsurers.

As EGI's insurance and reinsurance company subsidiaries increase their equity (and therefore regulatory capital), they can retain more insurance business for their own account and therefore purchase less reinsurance. The marginal return on this new capital can be very substantial. Each dollar of new equity allows EGI to retain up to two and one-half dollars of additional premium (and the potential downside risk thereon) each year for its own account.

EGI believes that there is currently adequate reinsurance capacity in the marketplace for those classes of business which EGI underwrites, and management is not aware of any developments that might cause a serious shortage of capacity in the future. EGI believes that, through its reinsurance program, it is adequately protected against major underwriting losses arising from a large claim under a single policy or claims under a group of policies arising from a single event.

Share Capital

As of March 14, 2008, there were 9,709,152 common shares issued and outstanding. Also see note 11 to the consolidated financial statements.

Liquidity and Capital Resources

The purpose of liquidity management is to ensure there is sufficient cash to meet all of EGI's financial commitments and obligations as they come due. The Company pays quarterly dividends to common shareholders. The dividend payment for the fourth quarter was made on December 28, 2007, to common shareholders of record on December 14, 2007, in the amount of \$0.5 million. EGI believes that it has the flexibility to obtain, from internal sources, the funds needed to fulfill its cash requirements, including quarterly dividend payment commitments to shareholders, during the following financial year and to satisfy regulatory capital requirements. EGI's principal sources of funds are premiums collected, investment income and proceeds from investments that have been sold or have matured. However, such funds may not provide sufficient capital to enable EGI to pursue additional market opportunities.

In October 2007, EGI entered into a non-revolving term credit facility with a major Canadian bank in the amount of US\$20 million, converted to CDN\$19.55 million, the equivalent Canadian dollar amount as of the closing date. The aggregate commitments under the credit facility may be increased to an aggregate amount of up to US\$40 million, subject to certain conditions. The facility bears interest of 6.2% which is payable monthly over the three-year term of the agreement. After three years EGI is obligated to repay the amounts drawn as at the termination of the agreement. Pursuant to the credit facility agreement EGI is required to comply with various financial covenants and financial information reporting requirements.

During the three-year term, EGI has agreed to various financial covenants, of which the key ones require EGI to maintain a minimum tangible net worth of \$80.0 million and a maximum debt-to-capital ratio of 0.30:1.00.

The initial drawdown of US\$20 million, or CDN\$19.55 million, was used to increase the capital of CIM Reinsurance Company Ltd., EGI's Barbados-based reinsurance company, which will be used to reinsure selected niche and specialty line insurers which underwrite business in the United States.

Contractual obligations include operating leases, for which \$1 million is due in less than a year and \$4.1

million is due over the next five years. In addition, EGI has commitments under a contractual agreement with a third party computer software provider totaling \$3.7 million over the next four years. Under this agreement EGI has retained the right to use an integrated insurance policy administration system which is expected to improve operating efficiencies related to the administration of Personal Lines products.

EGI is primarily a holding company and, as such, has limited direct operations of its own. EGI's principal assets are the shares of its insurance, reinsurance and insurance management subsidiaries. Accordingly, its future cash flows depend in part upon the availability of dividends and other statutorily permissible distributions from the insurance subsidiaries. The ability to pay such dividends and to make such other distributions is limited by applicable laws and regulations of the jurisdictions in which the insurance subsidiaries are domiciled, which subject the insurance subsidiaries to significant regulatory restrictions. These laws and regulations require, among other things, that the insurance subsidiaries maintain minimum solvency requirements and may also limit the amount of dividends that the insurance subsidiaries can pay to EGI.

Transactions with Related Parties

EGI has entered into transactions with two related parties, Co-operators and Purves Redmond Limited (Purves Redmond). These transactions are carried out in the normal course of operations and are measured at cost which approximates fair value. The transactions involving Co-operators, which is a significant shareholder of EGI, consist principally of the agent channel of distribution, support services and investment management. Purves Redmond is involved in arranging insurance coverage for the companies within the EGI group. Robert Purves, a shareholder and director of EGI, is also a shareholder and the chairman of Purves Redmond.

Risk Management

EGI has developed a comprehensive process of risk management and internal control which emphasizes the proactive identification of risks facing the organization and the effective management and control of these risks. The foundation of the process is the ongoing thorough operational analysis by senior management committees and a structured oversight process undertaken by the Board of Directors and appointed committees. Underlying this structure are strong internal control procedures which are designed to safeguard EGI's assets and protect the organization and its stakeholders from risk.

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.

Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency 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 assets are traded.

The primary market risk to the investment portfolio is interest rate risk associated with investments in fixed income securities. EGI's exposure to foreign exchange risk is not significant and is limited to the common equity portfolio.

For EGI's investment portfolio, there were no significant changes in the primary market risk exposures or in how those exposures are managed compared to the year ended December 31, 2006. Management does not currently anticipate significant changes in EGI's primary market risk exposures or in how those exposures are managed in future reporting periods based upon what is known or expected to be in effect in future reporting periods.

Interest Rate and Equity Market Fluctuation

Movements in short- and long-term interest rates, as well as fluctuations in the value of equity securities, affect the level and timing of recognition of gains and losses on securities EGI holds, and cause changes in realized and unrealized gains and losses. Generally, EGI investment income will be reduced during sustained periods of lower interest rates as higher yielding fixed income securities are called, mature, or are sold and the proceeds are reinvested at lower rates. During periods of rising interest rates, the market value of EGI's existing fixed income securities will generally decrease and the realized gains on fixed income securities will likely be reduced. Realized losses will be incurred following significant increases in interest rates.

Generally, declining interest rates result in unrealized gains in the value of the fixed income securities EGI continues to hold, as well as realized gains to the extent the relevant securities are sold. General economic conditions, political conditions and many other factors can also adversely affect the stock markets and, consequently, the value of the equity securities EGI owns.

Credit Risk

Credit risk is the possibility that counterparties may not be able to meet payment obligations when they become due. EGI assumes counterparty credit risk in many forms. A counterparty is any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation to EGI. The credit risk exposure is concentrated primarily in the fixed income and preferred share investment portfolios and, to a lesser extent, in the reinsurance recoverables.

EGI's risk management strategy and investment policy is to invest in debt instruments of high credit quality issuers and to limit the amount of credit exposure with respect to any one issuer. EGI attempts to limit its credit exposure by imposing fixed income portfolio limits on individual corporate issuers based upon credit quality. See "Investments – "Fixed Income Securities" and "Reinsurance".

Foreign Exchange Risk

Foreign exchange risk is the possibility that changes in exchange rates may produce an unintended effect on earnings and equity when measured in domestic currency. This risk is largest when assets backing liabilities are payable in one currency and are invested in financial instruments of another currency.

EGI is exposed to some foreign exchange risk arising from claims on the ETH insurance business, the investment in U.S. dollar denominated investments and business assumed from the U.S. Total invested assets denominated in U.S. dollars were less than 4.0% of the total invested assets at December 31, 2007. EGI's general policy is to minimize foreign currency exposure.

Risk Factors

Careful consideration should be given to the following factors, which must be read in conjunction with the detailed information appearing elsewhere in this annual report. Any of the matters highlighted in these risk factors could have a material adverse effect on EGI's results of operations, business prospects or financial condition.

Nature of Industry

The P&C insurance business in Canada is affected by many factors which can cause fluctuations in the results of operations of EGI. Many of these factors are beyond EGI's control. An economic downturn in those jurisdictions in which EGI writes business could result in less demand for insurance and lower policy amounts. As a property and casualty insurer, EGI is subject to claims arising out of catastrophes, which may have a significant impact on its results of operations and financial condition. These factors, together with the industry's historically cyclical competitive pricing, could result in fluctuations in the underwriting results and net income of EGI. A significant portion of the earnings of insurance companies is derived from the income from their investment portfolios. EGI's investment income will fluctuate depending on the returns and values of securities in its investment portfolio.

Regulation

EGI is subject to the laws and regulations of the jurisdictions in which it carries on business. These laws and regulations cover many aspects of its business, including premium rates for automobile insurance; the assets in which it may invest; the levels of capital and surplus and the standards of solvency that it must maintain; and the amount of dividends which it may declare and pay.

Changes to laws or regulations are impossible to predict and could materially adversely affect EGI's business, results of operations and financial condition. Where the Office of the Superintendent of Financial Institutions (OSFI) is concerned about an unsafe course of conduct or an unsound practice in conducting the business of a federally regulated insurance company, OSFI may direct the insurance company to refrain from a course of action or to perform acts necessary to remedy the situation. OSFI may, in certain circumstances, take control of the assets of an insurance company or take control of the company itself. More restrictive laws, rules or regulations may be adopted in the future that could make compliance more difficult and/or expensive. Specifically, recently adopted legislation addressing privacy issues, among other matters, is expected to lead to additional regulation of the insurance industry in the coming years, which could result in increased expenses or restrictions on EGI's operations.

Industry Growth

EGI is subject to, and dependent on, fluctuations within the P&C insurance industry. According to *Canadian Underwriter*, from 2001 to 2004 direct written premiums in the P&C insurance industry in Ontario, Alberta and Quebec grew at an abnormally high compound annual growth rate of 12.3%. However, in 2005 and 2006 the growth in direct written premiums slowed significantly to approximately 1%. EGI believes that soft market conditions will continue in the short term and believes that the performance of the P&C insurance industry will trend toward the industry's historic norms.

Competition

The P&C insurance business is highly competitive with pricing being a primary means of competition. Other elements of competition include availability and quality of products, quality and speed of service, financial strength, distribution systems and technical expertise.

EGI competes with many other insurance companies. Certain of these competitors are larger and have greater financial resources than EGI has. In addition, certain competitors have from time to time decreased their prices in an apparent attempt to gain market share.

As competitors introduce new products and as new competitors enter the market, the Company and its insurance subsidiaries may encounter additional and more intense competition. There can be no assurance that EGI will continue to increase revenues or be profitable. To a large degree, future revenues of EGI are dependent upon its ability to continue to develop and to market its products and to enhance the capabilities of its products to meet changes in customer needs.

EGI expects to encounter competition from other entities having a business objective similar to that of EGI. Many of these entities are well established and have extensive experience in connection with identifying and effecting business acquisitions directly or through affiliates. Many of these competitors possess greater financial resources, technical personnel and other resources than EGI and there can be no assurance that EGI will have the ability to compete successfully. EGI's financial resources will be relatively

limited when contrasted with those of many of its competitors. Although EGI's business strategy assumes that the industry will generate competition, there can be no assurance on how any level of competition may impact the future revenues of EGI.

Cyclical

Historically, the results of companies in the P&C insurance industry have been subject to significant fluctuations and uncertainties. The profitability of P&C insurers can be affected significantly by many factors, including regulatory regimes, developing trends in tort and class action litigation, adoption of consumer initiatives regarding rates or claims handling procedures, and privacy and consumer protection laws that prevent insurers from assessing risk, or factors that have a high correlation with risks considered, such as credit scoring.

The financial performance of the P&C insurance industry has historically tended to fluctuate in cyclical patterns of "soft" markets characterized generally by increased competition, resulting in lower premium rates and underwriting standards, followed by "hard" markets characterized generally by lessening competition, stricter underwriting standards and increasing premiums rates. EGI's profitability tends to follow this cyclical market pattern with profitability generally increasing in hard markets and decreasing in soft markets. These fluctuations in demand and competition could produce underwriting results that would have a negative impact on EGI's results of operations and financial condition.

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 P&C insurance lines. For example, the ice storm in eastern Canada in 1998 caused P&C insurance losses in several lines of business, including business interruption, personal property, automobile and commercial property. 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. 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. If EGI's business continuity plans cannot be put into action or do not take such events into account, losses may further increase.

Interest Rates

An increase in interest rates may result in lower values for EGI's bond portfolio and increased costs of borrowing for EGI on future debt instruments or credit facilities. Such increased costs would negatively affect EGI's operating results.

Negative Publicity in Industry

EGI's products and services are ultimately distributed to individual consumers. From time to time, consumer advocacy groups or the media may focus attention on EGI's products and services, thereby subjecting its industry to periodic negative publicity. EGI also may be negatively impacted if its industry engages in practices resulting in increased public attention to its business. Negative publicity may also result in increased regulation and legislative scrutiny of practices in the P&C insurance industry as well as increased litigation. Such consequences may increase EGI's costs of doing business and adversely affect EGI's profitability by impeding its ability to market its products and services or increase the regulatory burdens under which EGI operates.

Reliance on Brokers

EGI distributes its products primarily through a network of brokers. These brokers sell EGI's competitors' products and may stop selling EGI products altogether. Strong competition exists among insurers for brokers with demonstrated ability to sell insurance products. Premium volume and profitability could be materially adversely affected if there is a material decrease in the number of brokers that choose to sell EGI products. In addition, some P&C insurance companies offer their products through dedicated, captive sales organizations. If the number of such P&C insurance companies increases, EGI's revenues may decrease, which could have a material adverse effect on EGI's business, financial condition and results of operations. EGI's strategy of distributing through Co-operators' agent channel may also adversely impact its relationship with brokers who distribute EGI products.

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.

However, pricing for automobile insurance must be submitted to each provincial government regulator and in certain provinces pre-approved by the regulator. It is possible that, in spite of EGI's best efforts, regulator 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 intense 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 success depends upon its ability to accurately assess the risks associated with the insurance policies that EGI writes.

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 (i.e. a combined ratio below 100%). 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.

Loss Reserves and Claims Management

The amounts established and to be established by EGI for loss and loss adjustment expense reserves are estimates of future costs based on various assumptions, including actuarial projections of the cost of settlement and the administration of claims, estimates of future trends in claims severity and frequency, and the level of insurance fraud. Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact EGI's ability to accurately assess the risks of the policies that it writes. In addition, future adjustments to loss reserves and loss adjustment expenses that are unanticipated by management could have an adverse impact upon the financial condition and results of operations of EGI. Although EGI's management believes its overall reserve levels as at December 31, 2007 are adequate to meet its obligations under existing policies, actual losses may deviate, perhaps substantially, from the reserves reflected in EGI's financial statements. To the extent reserves prove to be inadequate, EGI would have to increase such reserves and incur a charge to earnings.

Errors and Omissions Claims

Where EGI acts as a licensed insurance agency, it is subject to claims and litigation in the ordinary course of business resulting from alleged errors and omissions in placing insurance and handling claims. The placement of insurance and the handling of claims involve substantial amounts of money. Since errors and omissions claims against EGI may allege EGI's potential liability for all or part of the amounts in question, claimants may seek large damage awards and these claims can involve significant defense costs. Errors and omissions could include, for example, EGI's employees or sub-agents failing, whether negligently or intentionally, to place coverage or file claims on behalf of customers, to appropriately and adequately

disclose insurer fee arrangements to its customers, to provide insurance providers with complete and accurate information relating to the risks being insured or to appropriately apply funds that it holds for its customers on a fiduciary basis. It is not always possible to prevent or detect errors and omissions, and the precautions EGI takes may not be effective in all cases.

EGI's business, financial condition and/or results may be negatively affected if in the future its errors and omissions insurance proves to be inadequate or unavailable. In addition, errors and omissions claims may harm EGI's reputation or divert management resources away from operating the business.

Investments

EGI's investment assets are exposed to any combination of risks related to interest rates, foreign exchange rates, and changing market values.

EGI's investment portfolio consists of diversified investments in fixed-income securities and preferred and common stocks. Investment returns and market values of investments fluctuate from time to time. A decline in returns could reduce the overall profitability of EGI. A change in interest rates, market values, or foreign exchange rates may affect Echelon's regulatory strength tests.

Reinsurance

Consistent with industry practice, EGI utilizes reinsurance to manage its claims exposure and diversifies its business by types of insurance and geographic area. The availability and cost of reinsurance are subject to prevailing market conditions that are generally beyond the control of EGI and may affect EGI's level of business and profitability. There can be no assurance that developments may not occur in the future which might cause a shortage of reinsurance capacity in those classes of business which EGI underwrites, which could result in curtailment of the issuing of policies in a certain line of business or containing limits above a certain size.

Reinsurer Credit Risk

EGI's reinsurance arrangements are with a limited number of reinsurers. This reinsurance may cause an adverse effect on EGI's results of operations if one or more of its reinsurers are unable to meet its financial obligations. Although all of its reinsurers were rated "B++" or higher by A.M. Best at the time of entering into the reinsurance arrangements, these ratings are subject to change and may be lowered.

Although reinsurance makes the assuming reinsurers liable to EGI to the extent of the risk each reinsurer assumes, EGI is not relieved of its primary liability to its insureds as the direct insurer. As a result, EGI bears credit risk with respect to its reinsurers. EGI cannot ensure that its reinsurers will pay all reinsurance claims on a timely basis or at all. EGI evaluates each reinsurance claim based on the facts of the case, historical experience with the reinsurer on similar claims, and existing law and includes in its reserve for uncollectible reinsurance any amounts deemed uncollectible. The inability to collect amounts due to EGI

under reinsurance arrangements would reduce EGI's net income and cash flow.

Technology

EGI is heavily dependent on systems technology to process large volumes of transactions and there would be a risk if the technology employed is inadequate or inappropriate to support current and future business needs and objectives. EGI continues to implement new computer applications, as part of a comprehensive approach to improve systems technology. EGI regularly tests and improves its Business Recovery Emergency Plan to protect itself, its producers and policyholders in the event of a technology failure; however, there is no assurance that EGI will be able to respond to technology failures effectively and with minimal disruption.

Liquidity

EGI manages its cash and liquid assets in an effort to ensure there is sufficient cash to meet all of EGI's financial obligations as they fall due. As a federally regulated insurance company, Echelon is required to maintain an asset base comprised of liquid securities that can be used to satisfy its ongoing commitments. EGI believes that internally generated funds provide the financial flexibility needed to fulfill cash commitments on an ongoing basis. EGI has no material commitments for capital expenditures. However, there can be no assurances that EGI's cash on hand and liquid assets will be sufficient to meet any future obligations that may come due.

Future Capital Requirements

EGI's future capital requirements will depend upon many factors, including the expansion of EGI's sales and marketing efforts and the status of competition. There can be no assurance that any additional financing will be available to EGI on acceptable terms, or at all. If additional funds are raised by issuing equity securities, further dilution to the existing stockholders will result. If adequate funds are not available, EGI may be required to delay, scale back or eliminate its programs. Accordingly, the inability to obtain such financing could have a material adverse effect on EGI's business, financial condition and results of operations.

Corporate Governance

Active oversight remains a priority for the Board of Directors. The board is directly involved, through its committees, in overseeing all aspects of EGI's operation. The objective of the board is to meet or exceed best practices in corporate governance. There is independent oversight from the board and respective committees to key corporate functions such as financial reporting, compliance, risk assessment and management, as well as human resources and succession planning.

EGI's Board of Directors has established the following committees to ensure that risks are effectively

identified, monitored, controlled and reported on:

Audit Committee: This committee of directors of the Company reviews all financial information, monitors internal controls and provides oversight of management's risk control processes, specifically focusing on financial related risks. Echelon also has an audit committee of its directors in accordance with requirements of the Insurance Companies Act (Canada).

Conduct Review & Compensation Committee: The Conduct Review & Compensation Committee of directors of the Company monitors related party transactions affecting EGI and reviews and approves officer compensation and benefit plans. The Conduct Review Committee of directors of Echelon is responsible for the identification and reporting of related party transactions to Echelon's board of directors and the monitoring of regulatory compliance and market conduct programs put in place by management to ensure their effectiveness.

Investment Committee: This committee, composed of directors and supported by senior executives, ensures that risks associated with the investment of corporate and policyholder funds are effectively managed to accomplish EGI's investment objectives of prudent, conservative management of funds and compliance with regulatory restrictions while achieving competitive rates of return.

Reinsurance Committee: This committee of senior executives works closely with AON Re Canada Inc., EGI's reinsurance brokers, to ensure that effective reinsurance programs are in place which facilitate desired growth of EGI's business and provide EGI with protection against the occurrence of significant and unusual claims risk and development.

In addition to these committees, management has formed a number of working committees which have been assigned the responsibility of identifying and managing specific corporate risks, including (i) a strategic initiatives committee to consider the strategic risks faced by EGI; (ii) underwriting and claims committees to manage the risks associated with the development and pricing of EGI's products, claims adjudication and reserving; (iii) a technology committee and a system prioritization committee to implement effective technology solutions; and (iv) a compliance committee to ensure that the appropriate processes and procedures are in place to ensure compliance with all applicable regulatory requirements. EGI has also established a Business Recovery Emergency Plan with the objectives of protecting life, securing critical infrastructure and facilities from a catastrophic event and resuming business operations in a timely effective manner, minimizing loss to the organization.

Except for May and June of 2005, when it self-insured, EGI has maintained liability insurance covering errors or omissions which may occur while acting in its role as an insurance consultant. The annual premium for this coverage during fiscal 2007 was \$4,728. The coverage has an aggregate limit of liability of \$2,000,000.

Controls and Procedures

Disclosure Controls and Procedures

Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by EGI is recorded, processed, summarized and reported in a timely manner. This includes controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2007 an evaluation was carried out, under the supervision of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as defined under Multilateral Instrument 52-109. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design of these disclosure controls and procedures was effective.

Internal Controls over Financial Reporting

As at the financial year ended December 31, 2007, the Chief Executive Officer and the Chief Financial Officer evaluated the design of the Company's internal control over financial reporting. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design of internal controls was effective as at December 31, 2007 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

There have been no changes in the Company's internal control over financial reporting during the year ended December 31, 2007, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Capital Resources

The total capitalization of EGI at December 31, 2007 was \$101.7 million compared to \$86.0 million at December 31, 2006. As noted earlier in this report under "Impact of New Financial Instrument Standards", this increase was impacted by the implementation of this new accounting standard. Effective January 1, 2007 a transition adjustment of \$5.3 million, reflecting the after-tax adjustment to fair value of EGI's investments, was recorded. The amount was offset by other comprehensive loss of \$3.1 million in 2007, reflecting (i) a decline in fair value of investments designated as available-for-sale investments, of \$0.9 million, net of income tax; and (ii) a reclassification for gains realized in 2007 of \$2.2 million, net of income tax, and included in net income in the year. Other components of the increase in shareholders' equity were net income in the year of \$15.1 million, the issuance of common shares of \$0.2 million and the cost of granting employee stock options of \$0.1 million. Offsetting these increases is the payment of common share

dividends of \$1.9 million in 2007.

The continued growth in capitalization reflects the strengthening of EGI's balance sheet and provides for better capital adequacy as a property and casualty insurance company. A common measure of capital adequacy is the net written premium ratio to surplus (or common shareholders' equity). This ratio was 1.44 as at December 31, 2007 compared to 1.23 at December 31, 2006, due to the significant growth in premium in 2007. This level of leverage, however, continues to be well below the 2.5:1 ratio which management feels is fully leveraged capital. Therefore, EGI's current capitalization provides it with adequate financial resources for planned growth.

Shareholders' Equity (IN \$ THOUSANDS)	As at December 31	
	2007	2006
Common shares	46,040	45,833
	(9,682,152 shares)	(9,639,152 shares)
Retained earnings	53,193	40,059
Contributed surplus	247	149
Accumulated other comprehensive income	2,191	-
Total capitalization	101,671	86,041

Future Adoption of New Accounting Policies

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 standards will expand disclosure of information about the nature and extent of risks arising from financial instruments and how those risks are managed. As these new standards will be adopted prospectively, prior period information will not be presented for all analyses.

GLOSSARY OF SELECTED INSURANCE TERMS

“**Case method**” means establishing a reserve liability equal to the most probable expected outcome for an individual claim.

“**Cede**” means the act of an insurer transferring or assigning part or all of the risk on an insurance policy written by it to a reinsurer by purchasing insurance from such reinsurer to cover the risk or part thereof.

“**Combined ratio**” of an insurer for any period means the sum of the loss ratio and the expense ratio of the insurer for such period.

“**Direct written premiums**” of an insurer for any period means the total premiums on insurance, including assumed reinsurance, written by the insurer during such period.

“**Expense ratio**” for any period means the sum of expenses, including commissions, premium taxes and operating expenses incurred, expressed as a percentage of net earned premiums.

“**Facility Association**” or “**Facility**” refers to an organization of the Canadian automobile insurance industry which exists to ensure that all drivers can obtain basic insurance, even if their application fails to meet the criteria of individual insurance companies.

“**Groupement**” refers to a Quebec organization of the automobile insurance industry which exists to ensure that all drivers in Quebec can obtain basic insurance, even if their application fails to meet the criteria of individual insurance companies.

“**Loss adjustment expenses**” or “**LAE**” means the expense of settling claims, including certain legal and other fees and the expense of administering the claims adjustment process.

“**Loss ratio**” for any period means the sum of claims and claims adjustment expenses incurred, net of reinsurance, expressed as a percentage of net earned premiums.

“**Minimum Capital Test**” means the OSFI’s Minimum Capital Test Guideline under which a federally regulated insurer is measured for the adequacy of its capital.

“**Net earned premiums**” of an insurer means the portion of the written premium equal to the expired portion of the time for which insurance or reinsurance was in effect.

“**Net written premiums**” of an insurer means direct written premiums less amounts ceded to reinsurers.

“**Producers**” refers to, collectively, insurance brokers, agents and managing general agencies.

“**Quota share**” means a type of reinsurance where the reinsurer agrees to assume the risk on a fixed portion of a specified line of business in return for the same portion of the ceding company’s premium for that line of business.

“**Reinsurance**” means an arrangement in which an insurance company, the reinsurer, agrees to indemnify another insurance or reinsurance company, the ceding company, against all or a portion of the insurance or reinsurance risks underwritten by the ceding company under one or more policies.

“**Retention**” means the amount of liability for which an insurance company will be responsible after it has completed its reinsurance arrangements.

“**Return on equity**” or “**ROE**” for a period means net income expressed as a percentage of the average shareholders’ equity in that period.

“**Risk**” means a person or thing insured on an insurance policy.

“**Underwriting**” means the assumption of risk for designated loss or damage by issuing a policy of insurance in respect thereof..

“**Unearned premiums**” means the portion of premiums received relating to the period of risk in subsequent accounting periods and which is deferred to such subsequent accounting periods.