

EGI FINANCIAL HOLDINGS INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS
For the period ending June 30, 2009

References to "EGI" or "Company" in this Management's Discussion and Analysis 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 unaudited interim consolidated financial statements for the second quarter of fiscal 2009 and 2008, with the notes to the interim unaudited consolidated financial statements for the second quarter of fiscal 2009, with management's discussion and analysis (MD&A) set out on pages 4 to 48 of the Company's 2008 Annual Report and with the notes to the audited consolidated financial statements for fiscal 2008 set out on pages 55 to 75 of the Company's 2008 Annual Report. The following commentary is current as of August 4, 2009. 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 may not be comparable to similar measures used by other companies. EGI analyzes performance based on operating income and 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 2009 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.

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 MD&A. Additional information about the general risks and uncertainties regarding 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.

Overall Performance

The summary of financial data set forth in the following tables has been prepared in accordance with Canadian GAAP and has been derived from the unaudited interim consolidated financial statements for the three and six months ended June 30, 2009 and 2008.

Restatement of financial results for the six and three months ended June 30, 2008

As described in note 2 of the interim consolidated financial statements for the six months ended June 30, 2009 and 2008, the Company changed its accounting policy as at January 1, 2009, for determining the incurred but not reported reserve (IBNR) on motorcycle business. The change in accounting policy has been accounted for retrospectively, and the comparative statements for the six and three months ended June 30, 2008, have been restated. The change in accounting policy has no impact on the financial results for the year ended December 31, 2008. The 2007 quarterly results presented in the MD&A have not been restated as the adjustment is immaterial.

The effect of the change in the six months ended June 30, 2008 is an increase in incurred claims of \$1.4 million and a decrease in income tax expense of \$0.5 million, resulting in a decrease in net income and retained earnings as at June 30, 2008 of \$0.9 million. For the three months ended June 30, 2008, the effect of the change is a decrease in incurred claims of \$0.5 million and an increase in income tax expense of \$0.2 million, resulting in an increase in net income for the period of \$0.3 million.

(\$ THOUSANDS except per share amounts)	Quarter to June 30		6 months to June 30	
	2009	(Restated) 2008	2009	(Restated) 2008
Direct written and assumed premiums	48,487	49,784	80,103	84,720
Net earned premiums	35,486	35,999	77,059	81,558
Underwriting income (loss)	1,703	22	(169)	(2,243)
Interest expense	305	306	604	608
Investment income	6,017	4,718	7,891	9,305
Net income	4,831	3,019	4,601	4,344
Net income per share				
Basic	0.41	0.31	0.39	0.45
Diluted	0.38	0.28	0.36	0.41
Net operating income ⁽¹⁾	2,659	1,658	3,477	2,191
Net operating income per share – diluted	0.21	0.16	0.28	0.21
Return on equity (ROE) ⁽²⁾			5.4%	12.6%

(1) Net operating income is defined as net income excluding after-tax realized losses or gains on sale of investments.

(2) Represents EGI's net income for the twelve months ended on the date indicated, divided by the average shareholders' equity over the same twelve-month period.

	Quarter to June 30		6 months to June 30	
	2009	(Restated) 2008	2009	(Restated) 2008
Loss ratio	61.8%	66.3%	67.2%	69.8%
Expense ratio	33.4%	33.6%	33.0%	33.0%
Combined ratio	95.2%	99.9%	100.2%	102.8%

(\$ THOUSANDS except per share amounts)	As at June 30 2009	As at Dec 31 2008
Investments (excluding premium finance receivables)	251,784	259,774
Premium finance receivables	24,395	20,615
Total assets	418,985	402,780
Total shareholders' equity	129,748	118,604
Book value per share ⁽¹⁾	10.98	10.16

(1) Shareholders' equity divided by the number of shares issued and outstanding.

Financial Overview

Quarter ended June 30, 2009

Net income of \$4.8 million for the three months ended June 30, 2009, represents an increase of \$1.8 million, or 60% compared to net income of \$3.0 million in the second quarter of 2008. Underwriting income of \$1.7 million was recorded in the second quarter of 2009 compared to a break even underwriting result in the same period of 2008. In our Canadian operations, both divisions recorded underwriting profits in the quarter, with the Personal Lines division recording underwriting income of \$2.6 million in the second quarter of 2009 compared to income of \$5.0 million in the same period of 2008; and the Niche Products division earning underwriting income of \$1.0 million in the second quarter of 2009 compared to a loss of \$3.7 million in 2008. Our International division incurred an underwriting loss of \$1.4 million in the three months ended June 30, 2009 compared to a loss of \$0.8 million for the same period last year. There was \$0.5 million of corporate and other expenses in the second quarter of 2009 and \$0.4 million in 2008, which have not been allocated by division.

The significant improvement in the Niche division underwriting income in the second quarter of 2009, compared to the same period in 2008, was primarily the result of a decrease in the loss ratio of the Emergency Travel Health (ETH) line of business, compared to the same period in 2008. The loss ratio for this division was 47.2% in the three months ended June 30, 2009, a significant improvement compared to 97.0% for the same period in 2008. This positive result was due to a significant positive development of claims reserves recorded in the ETH line of business in the quarter.

The Personal Lines division loss ratio increased to 61.4% compared to 52.0% in the second quarter of 2008. The loss ratio in 2009, although higher than the excellent result in 2008, is better than management's expectations particularly in the current economic environment.

The underwriting loss incurred in the International division of \$1.4 million is the result of adverse claims development, as reflected in the division's loss ratio and primarily related to the run-off of reinsurance assumed treaties with U.S. non standard auto reinsurers, the largest of which was cancelled effective December 31, 2008. The remaining contract was cancelled effective March 31, 2009. As this discontinued business runs off, the impact on EGI's financial results for these contracts will be significantly reduced. The International division's expense ratio reflects the ongoing costs (primarily salaries) incurred to prepare for the launch of EGI's Florida-based subsidiary, Echelon Insurance Company of America (EICA) expected to occur in the near future.

In the second quarter of 2009 EGI recorded total positive development of \$0.8 million related to prior year claims reserves as compared to \$0.3 million for the same period in 2008.

Investment income increased to \$6.0 million in the second quarter of 2009 compared to \$4.7 million in the same period in 2008. The increase in investment income was due primarily to the realization of gains on the sale of investments of \$3.2 million in the second quarter of 2009 compared to net gains of \$2.0 million in the same period last year. No impairment provisions were recorded in the second quarter of 2009 or 2008.

The basic net income per share for the second quarter of 2009 was \$0.41 compared to income per share of \$0.31 for the same period in 2008. The fully diluted income per share was \$0.38 in the second quarter of 2009, compared to income per share of \$0.28 in the second quarter of 2008.

Net operating income, defined as net income excluding after-tax realized losses or gains, on the sale of investments, was \$2.7 million or \$0.21 per share on a diluted basis for the second quarter of 2009. This compares to net operating income of \$1.7 million or \$0.16 per share for the same period in 2008.

Six months ended June 30, 2009

For the six month period ended June 30, 2009, net income was \$4.6 million, an increase of \$0.3 million or 7% compared to net income of \$4.3 million in the same period last year. An underwriting loss of \$0.2 million was incurred in the first six months of 2009, a significant improvement over the underwriting loss of \$2.2 million incurred in the first half of 2008. The Personal Lines division recorded underwriting income of \$3.0 million compared to \$3.9 million in 2008. An underwriting loss of \$0.3 million was incurred by the Niche Products division, which represented a significant improvement over the loss of \$4.4 million incurred in the first half of 2008. The improvement is the result of the significant turnaround in the results of the ETH line of business compared to 2008. The loss ratio for this line of business was 68.8% in the six months ended June 30, 2009 compared to 100.5% in the same period in 2008. This result can be attributed to the corrective actions taken when renewing these programs for the 2008/09 season, including rate increases and the application of stricter underwriting requirements.

As a result of this improvement in the ETH line of business, the loss ratio for the Niche Products division improved to 61.7% in the first six months of 2009 compared to 76.0% for the same period in 2008. Excluding ETH, the loss ratio for all other Niche programs was 58.2% in the first half of 2009 compared to 41.7% for the first six months of 2008. The loss ratio for the Personal Lines division for the first half of 2009 was 65.7%, slightly higher than the 64.1% for the same period in 2008. The International division continued to experience adverse loss experience from assumed reinsurance treaties, which are now in run-off, from external insurers. This resulted in a loss ratio for this division of 111.1% for the first half of 2009 compared to 86.8% in the same period in 2008.

For the six months ended June 30, 2009 EGI recorded total positive development of \$2.2 million related to prior year claims reserves compared to \$3.4 million for the first half of 2008.

Investment income decreased to \$7.9 million in the first six months of 2009 compared to \$9.3 million in the same period in 2008. The decrease in investment income was due primarily to the decline in net realized gains on the sale of investments, which totaled \$1.7 million in the first half of 2009 compared to \$3.2 million in the same period in 2008.

The basic net income per share for the first six months of 2009 was \$0.39 compared to income per share of \$0.45 for the same period in 2008. The fully diluted income per share was \$0.36, compared to income per share of \$0.41 in the first six months of 2008.

Net operating income, defined as net income excluding after-tax realized losses and gains, including impairments, on the sale of investments, was \$3.5 million or \$0.28 per share on a diluted basis for the second quarter of 2009. This compares to net operating income of \$2.2 million or \$0.21 per share for the same period in 2008.

For the six months ended June 30, 2009 shareholders' equity increased to \$129.7 million, an increase of \$11.1 million from December 31, 2008. The elements which increased shareholders' equity consist of net income of \$4.6 million in the period, the issuance of common shares of \$0.7 million and other comprehensive income of \$6.6 million resulting from an increase in the fair value of investments held. The additions were offset by dividends of \$0.8 million paid to common shareholders during the period.

Segmented Financial Information

Three months ended June 30

(\$ THOUSANDS)	2009				(Restated) 2008			
	Canada			International	Canada			International
	Personal Lines	Niche Products	Total		Personal Lines	Niche Products	Total	
Net earned premiums	25,080	8,743	33,823	1,663	24,505	8,705	33,210	2,789
Underwriting income (loss)	2,588	1,003	3,591	(1,436)	4,973	(3,736)	1,237	(805)
Loss ratio	61.4%	47.2%	57.7%	145.0%	52.0%	97.0%	63.8%	96.6%
Expense ratio	28.3%	41.4%	31.7%	41.4%	27.8%	46.0%	32.5%	32.3%
Combined ratio	89.7%	88.6%	89.4%	186.4%	79.8%	143.0%	96.3%	128.9%

Note: The underwriting income per division noted above excludes corporate and other expenses of \$0.4 million for the second quarter of 2009 and 2008.

The segmented information, for the second quarter of 2009, shows that Personal Lines contributed an underwriting income of \$2.6 million and the Niche Products division recorded an underwriting gain of \$1.0 million, resulting in an underwriting income of \$3.6 million for the Canadian business segments combined. The International division, with business currently consisting of assumed reinsurance from U.S. insurers, recorded an underwriting loss of \$1.4 million due to continued adverse development of

claims related to assumed business on reinsurance treaties cancelled earlier this year. The International division's expense ratio reflects the ongoing costs (primarily salaries) incurred to prepare for the launch of EICA.

The loss ratio in Personal Lines was 61.4% for the quarter ended June 30, 2009, compared to 52.0% for the same period in 2008. Favourable prior year loss development related to Personal Lines claims reserves continued in the second quarter of 2009, totaling \$1.4 million compared to positive development of \$1.3 million in the same period in 2008.

The Niche Products division loss ratio was 47.2% in the second quarter of 2009 compared to 97% for the same period in 2008. As described above, the significant improvement was the result of a positive turnaround in claims experience in the ETH line of business. The strong ETH results were partially offset by higher than expected claims incurred in the Niche liability line of business in the quarter.

Six months ended June 30

(\$ THOUSANDS)	2009				(Restated) 2008			
	Canada			International	Canada			International
	Personal Lines	Niche Products	Total		Personal Lines	Niche Products	Total	
Net earned premiums	50,256	22,245	72,501	4,558	47,586	28,400	75,986	5,572
Underwriting income (loss)	2,994	(269)	2,725	(2,185)	3,939	(4,414)	(475)	(1,082)
Loss ratio	65.7%	61.7%	64.5%	111.1%	64.1%	76.0%	68.5%	86.8%
Expense ratio	28.3%	39.5%	31.7%	36.9%	27.7%	39.6%	32.1%	32.6%
Combined ratio	94.0%	101.2%	96.2%	148.0%	91.8%	115.6%	100.6%	119.4%

Note: The underwriting income per division noted above excludes corporate and other expenses of \$0.7 million for the first six months of 2009 and 2008.

The segmented information, for the first half of 2009, shows that Personal Lines contributed an underwriting income of \$3.0 million while the Niche Products division recorded an underwriting loss of \$0.3 million, resulting in combined underwriting income of \$2.7 million for the Canadian business segments. The International division, currently consisting of assumed business from U.S. insurers, recorded an underwriting loss of \$2.2 million. As noted previously, these contracts were cancelled effective December 31, 2008 and March 31, 2009 and are currently in run off as premiums from policies issued in 2008 are earned. The International division's expense ratio reflects the ongoing costs (primarily salaries) incurred to prepare for the launch of EICA.

The loss ratio in Personal Lines was 65.7% for the six month period ended June 30, 2009, compared to 64.1% for the same period in 2008. The slight increase is primarily attributable to an increase in current year claims occurrence in the non-standard auto line of business. Positive development of prior year claims in the first half of 2009 for this division was \$3.9 million compared to positive development of \$3.9 million last year.

The Niche Products division loss ratio was 61.7% for the six month period compared to 76.0% for the

same period in 2008. As noted in the second quarter only analysis above, the significant decrease was the result of an improvement in the loss ratio for the ETH line of business to 68.8% in the first half of 2009 compared to 100.5% in the same period in 2008. All other programs in the Niche Products division experienced a loss ratio of 58.2% in the six month period compared to a loss ratio of 41.7% in 2008. The increase resulted from higher than expected losses incurred in the Niche liability line of business.

The International division incurred a loss ratio of 111.1% in the first six months of 2009 compared to 86.8% in the first half of 2008. As noted above, this result pertains to claims experience related to the run-off of cancelled assumed reinsurance contracts effective December 31, 2008 and March 31, 2009.

The expense ratio for Personal Lines, in the first half of 2009, increased slightly to 28.3% compared to 27.7% for the same period in 2008. The Niche Products division expense ratio recorded a small decrease to 39.5% in 2009 compared to 39.6% for the first six months of 2008.

Critical Accounting Estimates and Assumptions

For a description of EGI's accounting policies, refer to notes 2 and 3 in the 2008 audited financial statements as set out on pages 55 to 58 of the Company's 2008 Annual Report. A further description of EGI's critical accounting estimates and assumptions is also detailed on pages 19 to 21 of the 2008 Annual Report.

There have been no changes to the Company's accounting policies or assumptions made in critical accounting estimates in this quarter, except as described in Note 2 of the interim financial statements for the quarter ended June 30, 2009, included in this report.

Future Changes in Accounting Policies and Disclosure

Transition to International Financial Reporting Standards (IFRS)

The CICA has announced that Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprise companies will be replaced with IFRS effective January 2011. EGI will begin reporting its financial statements in accordance with IFRS on January 1, 2011. EGI is planning its transition to IFRS. The impact on its consolidated financial position and results of operations has not yet been determined.

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 June 30, 2009 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 quarter ended June 30, 2009, 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 June 30, 2009, 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 quarter ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

Summary of Quarterly Results

A summary of the Company's last eight quarters is as follows:

	2009		2008				2007	
				(Restated)				
(\$ THOUSANDS EXCEPT PER SHARE DATA)	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Direct written and assumed premiums	48,487	31,616	39,948	46,067	49,784	34,936	43,098	42,343
Total revenues (excluding investment income)	35,486	41,573	39,547	36,150	35,999	45,559	34,161	30,847
Underwriting income (loss)	1,703	(1,872)	(489)	2,896	22	(2,265)	868	3,536
Income (loss) before income taxes	7,415	(297)	(3,272)	5,776	4,434	2,020	5,658	6,772
Net income (loss)	4,831	(230)	(2,322)	3,958	3,019	1,325	3,727	4,462
Earnings per adjusted share								
– Basic	\$0.41	\$(0.02)	\$(0.20)	\$0.36	\$0.31	\$0.14	\$0.39	\$0.46
– Diluted	\$0.38	\$(0.02)	\$(0.19)	\$0.33	\$0.28	\$0.13	\$0.35	\$0.44
Selected financial ratios (%)								
Loss ratio	61.8	71.9	68.7	60.2	66.3	72.5	65.1	58.2
Expense ratio	33.4	32.6	32.5	31.7	33.6	32.4	33.1	30.3
Combined	95.2	104.5	101.2	91.9	99.9	104.9	98.2	85.5

Quarter Ended June 30, 2009 Compared to Quarter Ended June 30, 2008

The following financial information compares the second quarter 2009 results with the second quarter of 2008.

(\$ THOUSANDS)	2nd Quarter 2009	(Restated) 2nd Quarter 2008	Variance \$	Variance %
Direct written and assumed premiums	48,487	49,784	(1,297)	(2.6)
Net written and assumed premiums	44,121	45,975	(1,858)	(4.0)
Net earned premiums	35,486	35,999	(513)	(1.4)
Claims incurred	21,931	23,873	(1,942)	(8.1)
Acquisition costs	8,078	8,562	(484)	(5.7)
Operating expenses	3,774	3,542	232	6.5
Underwriting income	1,703	22	1,682	8,009
Investment income	6,017	4,718	1,299	27.5
Interest expense	305	306	(1)	-
Net income before income taxes	7,415	4,434	2,981	67.2
Income taxes	2,584	1,415	1,169	82.6
Net income	4,831	3,019	1,812	60.0

Written and Assumed Premiums

Direct written and assumed premiums decreased \$1.3 million, or 2.6%, to \$48.5 million for the three months ended June 30, 2009, compared to \$49.8 million for the first three months of 2008. The primary reason for this decrease was the cancellation of U.S. assumed reinsurance contracts effective December 31, 2008 and March 31, 2009 and the planned reduction in premium volume for ETH business. Premiums will continue to be earned pursuant to U.S. assumed reinsurance arrangements in 2009, from policies issued in 2008, however no further premiums will be written in 2009. As a result assumed premiums in the International division declined by \$3.0 million compared to the second quarter of 2008.

Personal Lines premiums decreased slightly by \$0.3 million to \$35.8 million in 2009 compared to \$36.1 million in the second quarter of 2008. Despite ongoing competitive conditions in the market, non-standard auto premiums increased to \$26.5 million, an increase of \$0.7 million or 2.7% compared to \$25.8 million in the same period of 2008. Motorcycle direct written premiums decreased to \$8.5 million compared to \$9.8 million in 2008, due to a reduction in the number of policies written as the result of rate increases implemented to improve the underwriting performance of this product. Direct written premiums for the Niche Products division increased to \$13.2 million for the three months ended June 30, 2009, compared to \$11.2 million in the same period in 2008, in spite of the reduction in ETH premium. The growth in business is reflective of EGI's continued strategy to develop Niche programs at a consistent, controlled rate.

Net written and assumed premiums decreased \$1.9 million, or 4%, to \$44.1 million compared to \$46.0 in the same period last year. This decrease is slightly higher than the decrease in direct written premium, due to a change in the mix of business in 2009.

Earned Premiums

Net earned premiums for the three months ended June 30, 2009, totaled \$35.5 million, a decrease of \$0.5 million, or 1.4%, compared to \$36.0 million in 2008. The decrease is primarily attributable to the previously noted cancellation of U.S. assumed reinsurance contracts, which are in run-off in 2009 and as a result earned premium from this division will decline on a quarterly basis for the remainder of 2009. No premiums will be earned from this business in 2010.

Incurred Claims Expense

Net incurred claims expense decreased \$1.9 million, or 8.1%, to \$21.9 million for the quarter ended June 30, 2009, compared to \$23.8 million for the same period in 2008. The decrease is greater than the 1.4% decrease in net earned premiums, due to the significant decline in the ETH loss ratio in the quarter compared to 2008. The total Company loss ratio was 61.8% in the second quarter of 2009 compared to 66.3% for the three months ended June 30, 2008 despite the much higher than expected loss ratio on the U.S. assumed reinsurance business.

The ETH line of business experienced very favourable development of claims in the second quarter of 2009. As a result, the loss ratio recorded for the Niche division was 47.2% in the quarter compared to 97.0% for the same period last year.

The loss ratio in Personal Lines was 61.4% for the quarter ended June 30, 2009, compared to 52.0% in 2008. The increase in the loss ratio compared to 2008 reflects an unusually low ratio in the second quarter of 2008 due to the low incidence of reported claims that year. The result in the second quarter of 2009 exceeded management's expectations. Positive development of prior year claims, for this division, in the second quarter of 2009 was \$2.4 million compared to \$0.9 million last year.

The non-standard auto loss ratio was 65.9% in the second quarter of 2009 compared to 50.5 % in 2008. The loss ratio from the motorcycle line of business was 36.3% in this quarter, which compares to a restated loss ratio of 59.4% in the same period in 2008. As noted earlier, the Company changed the methodology of determining IBNR in motorcycle business in the first quarter of 2009. The new method is based on an annualized loss ratio and is intended to reduce the seasonal variation of results reported for this line of business experienced with the previous methodology. Financial results for the second quarter of 2008 have been restated to reflect the new methodology.

The International division incurred a loss ratio of 145% in the second quarter of 2009 compared to 96.6% in 2008. As noted above, this result pertains to claims experience related to the run-off of cancelled assumed reinsurance contracts effective December 31, 2008. The reinsured underwriter has advised that the adverse claims experience reported in the second quarter of 2009 partially pertains to changes in claims personnel and adoption of a more conservative reserving philosophy in late 2008 and early 2009, which may result in a reduction of EGI's carried IBNR reserve over time.

Acquisition Costs

Net acquisition costs, which mainly consist of commissions and premium taxes, decreased \$0.5 million, or 5.7%, to \$8.1 million for the three months ended June 30, 2009, compared to \$8.6 million in the same period in 2008. This relatively large decrease, compared to the decrease of 1.4% in net earned premiums, is the result of lower commission rates negotiated in the ETH line of business for the 2008/09 travel season. As a percentage of net earned premiums, acquisition expenses decreased to 22.8% in the second quarter of 2009 compared to 23.8% last year.

Operating Expenses

Operating expenses increased \$0.2 million, or 6.5%, to \$3.8 million for this quarter compared to \$3.6 million in the same period of 2008. The increase is related to general increases in salaries, system amortization and occupancy costs.

Underwriting Income

Underwriting results reflect revenues from net earned premiums less claims, acquisition and operating expenses. In the quarter ended June 30, 2009 total underwriting contribution improved by \$1.7 million to an underwriting gain of \$1.7 million, compared to an underwriting breakeven position for the comparable period in 2008. The underwriting results for 2009 and 2008 include \$0.4 million and \$0.4 million of corporate and other expenses, respectively, which have not been allocated to the operating divisions.

Underwriting income from the Personal Lines division for the three months ended June 30, 2009, was \$2.6 million, a decrease of \$2.4 million, compared to a gain of \$5.0 million for the same period in 2008. This decrease was primarily due to the increase in the loss ratio experienced in our Personal Lines division compared to the same period of 2008.

The underwriting gain from Niche Products was \$1.0 million, compared to an underwriting loss of \$3.7 million in the second quarter of 2008. This result is primarily due to the significant reduction in the loss ratio in the ETH line of business compared to 2008.

The International division experienced an underwriting loss of \$1.4 million in the second quarter of 2009, compared to a loss of \$0.8 million in the same period in 2008. This was due to adverse claims development of prior year claims related to cancelled, assumed reinsurance contracts from external U.S. reinsurers and the ongoing costs (primarily salaries) incurred to prepare for the launch of EICA.

Investment Income

Investment income for the three months ended June 30, 2009 was \$6.0 million compared to \$4.7 million for the same period in 2008. Income from interest and dividends increased to \$3.1 million compared to \$2.7 million last year, due to an increase in the size of the investment portfolio. Net realized gains on the sale of investments were \$3.2 million in the second quarter of 2009 compared to net gains of \$2.0 million in the prior year. No investment impairments were recorded in the second quarters of 2009 or 2008.

EGI's investment portfolio, including finance receivables, based on fair values, increased to \$276.2 million, or 3%, compared to total fair values of \$267.9 million as at June 30, 2008.

Interest Expense

During this quarter, interest expense related to bank indebtedness of \$0.3 million was incurred. The same amount of interest expense was incurred in the corresponding period of 2008.

Net Income before Income Taxes

Net income before income taxes for the three months ended June 30, 2009 was \$7.4 million, compared to income before income taxes of \$4.4 million in 2008.

For the three months ended June 30, 2009, an underwriting gain of \$1.7 million plus investment income of \$6.0 million, reduced by interest expense on bank indebtedness of \$0.3 million, comprised the net income before income taxes of \$7.4 million. This compares to an underwriting breakeven position, plus investment income of \$4.7 million, reduced by interest expense of \$0.3 million, in the same period of 2008.

Income Taxes

Income tax expenses were \$2.6 million in the second quarter of 2009 compared to an income tax expense of \$1.4 million in 2008. The effective tax rate was 34.8% in 2009 compared to 31.8% the previous year. The increase in the effective tax rate is the result of EGI's conservative decision to only record a portion of the entire future tax benefit related to taxable losses incurred in the International division in 2009 and 2008. The balance of this benefit may be recorded in subsequent periods based on recoverability.

Six Months Ended June 30, 2009 Compared to Six Months Ended June 30, 2008

Written and Assumed Premiums

Direct written premiums decreased \$4.6 million, or 5.4%, to \$80.1 million for the six months ended June 30, 2009, compared to \$84.7 million for the first half of 2008. Growth has been achieved in both Canadian divisions in 2009. Direct written premiums from Personal Lines totaled \$58.8 million in the first half of 2009 which represents a 0.3% increase compared to \$58.6 in 2008. Non-standard auto recorded growth of 2.7% to \$46.8 million, offset by a decline in the motorcycle line of 10.2% compared to the same period in 2008. The decline in the motorcycle line is due to premium rate increases implemented in the first half of 2009 and the prevailing economic conditions, resulting in a reduction in the number of policies written. The Niche Products division recorded written premiums of \$21.9 million in the first six months of 2009 compared to \$20.0 million for the same period of 2008 for a growth rate of 9.5%.

As noted earlier, in the International division, assumed reinsurance contracts in place in 2008 have been cancelled and minimal premiums have been written in the first half of 2009 compared to \$6.1 million for the same period in 2008.

Net written and assumed premiums decreased \$5.2 million, or 6.7%, to \$73.2 million compared to \$78.4 in the same period last year. This decrease is consistent with the decrease in direct written and assumed premiums in the period compared to 2008.

Earned Premiums

Net earned premiums for the six months ended June 30, 2009, totaled \$77.1 million, a decrease of \$4.5 million, or 5.5%, as compared to \$81.6 million in the first half of 2008. This decrease is consistent with the decline in net written premiums in the period.

Incurred Claims Expense

Net incurred claims expense decreased \$5.1 million, or 8.9%, to \$51.8 million for the first half of 2009, compared to \$56.9 million for the same period in 2008. This represents a greater decrease than the decline in net earned premiums, primarily due to the significant improvement in the loss ratio in the ETH line of business. The loss ratio incurred in the Emergency Travel Health line of business was 68.8% in the first half of the year compared to 100.5% for the previous year. The loss ratio for the total Niche division was 61.7% compared to 76.0% for the first six months of 2008.

The Personal Lines loss ratio for the first half of 2009 was 65.7% compared to 64.1% in the same period in 2008. Positive prior year loss development resulted in the release of \$2.4 million of reserves in the period compared to a release of \$2.5 million in the first six months of 2008. Non-standard auto recorded a loss ratio of 67.5% in the first half of 2009 compared to 63.7% in the same period last year. The motorcycle line of business incurred a year-to-date 2009 loss ratio of 56.3% compared to 66.1% for the six months ended June 30, 2008.

The International division recorded a loss ratio of 111.1% in the first half of 2009 from business assumed pursuant to quota share treaties which have been cancelled. The higher than expected loss ratio is the result of continued adverse loss development on prior year claims on this business.

For all lines of business combined, positive loss development on prior years' claim reserves was \$2.2 million in the first six months of 2009 compared to \$3.4 million in the same period of 2008.

Acquisition Costs

Net acquisition costs, which mainly consist of commissions and premium taxes, decreased \$2.2 million, or 10.9%, to \$18.0 million for the six months of 2009, compared to \$20.2 million in the same period in 2008. As noted in the second quarter analysis above, this relatively large decrease is due to lower commissions on the ETH line of business negotiated for the 2008/09 travel seasons.

Operating Expenses

Operating expenses increased \$0.6 million, or 8.8%, to \$7.4 million for the six months ended June 30, 2009, compared to \$6.8 million for the first two quarters of 2008. The increase is primarily the result of increases in salaries, IT amortization and occupancy costs associated with the new office location.

Underwriting Income (Loss)

Underwriting results reflect revenues from net earned premiums less claims, acquisition and operating expenses. In the first six months of 2009 total underwriting contribution increased \$2.0 million to an underwriting loss of \$0.2 million, compared to an underwriting loss of \$2.2 million for the comparable period in 2008. The underwriting results for 2009 and 2008 include \$0.7 million and \$0.7 million of corporate and other expenses, respectively, which have not been allocated to the operating divisions.

Underwriting income from the Personal Lines division for the six months of 2009 was \$3.0 million, a decrease of \$0.9 million, compared to income of \$3.9 million for the same period of 2008. This result was caused by the slightly higher loss ratio in Personal Lines in the first half of 2009 compared to 2008.

The underwriting loss in Niche Products for the first six months of 2009 was \$0.3 million, an improvement of \$4.1 million compared to an underwriting loss of \$4.4 million in the corresponding period of 2008. As noted earlier, this improvement was primarily the result of the positive turnaround in the ETH line of business.

The International division experienced an underwriting loss of \$2.2 million in the first half of 2009 compared to an underwriting loss of \$1.1 million in the same period in 2008.

Investment Income

Investment income for the six months ended June 30, 2009 was \$7.9 million compared to \$9.3 million for the same period in 2008. Income from interest and dividends increased to \$6.1 million compared to \$5.9 million in the same period last year, due to the growth in the investment portfolio. Net realized gains on the sale of investments decreased to \$1.7 million in the first half of 2009 compared to realized gains of \$3.2 million in the same period in 2008.

EGL's investment portfolio, including finance receivables, based on fair values, increased to \$276.2 million, or 3%, compared to total fair values of \$267.9 million as at June 30, 2008.

Interest Expense

During the first six months of 2009 and 2008, interest expense related to bank indebtedness of \$0.6 million was incurred on bank indebtedness of \$19.55 million.

Net Income before Income Taxes

Income before income taxes for the six months ended June 30, 2009, was \$7.1 million, an increase of \$0.6 million compared to income of \$6.5 million for the six months ended June 30, 2008.

For the six months ended June 30, 2009, an underwriting loss of \$0.2 million plus investment income of \$7.9 million, reduced by interest expense on bank indebtedness of \$0.6 million, comprised net income before income taxes of \$7.1 million. This compares to an underwriting loss of \$2.2 million, plus investment income of \$9.3 million, reduced by interest expense of \$0.6 million, in the same period of 2008.

Income Taxes

The provision for income taxes for the first half of 2009 was \$2.5 million compared to \$2.1 million for the same period in 2008. The effective tax rate was 35% for the first six months of 2009 compared to 33% in 2008.

BALANCE SHEET ANALYSIS

The Balance Sheet analysis that follows should be read in conjunction with the unaudited interim consolidated second quarter 2009 financial statements and notes therein, which include additional disclosures related to balance sheet risk management.

Investments

The following table sets forth EGI's invested assets as at June 30, 2009, and December 31, 2008.

(\$ THOUSANDS)	June 30, 2009	December 31, 2008
	Fair value	Fair value
Bonds		
Canadian		
Federal	\$ 68,071	\$ 82,078
Provincial	42,144	45,162
Municipal	6,956	6,935
Corporate	85,128	86,570
	<u>202,299</u>	<u>220,745</u>
United States		
Corporate	2,975	2,717
Total Bonds	<u>205,274</u>	<u>223,462</u>
Preferred shares	<u>5,052</u>	<u>4,042</u>
Common shares		
Canadian	38,716	29,049
United States	1,079	1,178
	<u>39,795</u>	<u>30,227</u>
Investment income due and accrued	<u>1,663</u>	<u>2,043</u>
	<u>\$251,784</u>	<u>\$259,774</u>

Due to the market improvement, particularly the equity markets in the second quarter of 2009, Accumulated Other Comprehensive Income (AOCI) was \$1,192 as at June 30, 2009 compared to a loss of \$(5,460) as at December 31, 2008. This balance represents the total net unrealized gains or losses in our investment portfolio (the difference between adjusted cost and fair value), net of income taxes. The change in the AOCI balance during the second quarter of 2009 is primarily attributable to the changes in unrealized net gains of \$7,463.

The Board of Directors has established a policy to write down or make a provision for any investment with “other than temporary” impairment.

Management has reviewed currently available information regarding those investments whose estimated fair values are less than carrying values. For those securities whose decline in fair value was other than temporary, the Company has recorded the difference between the cost of the investment and its fair value as an impairment change which reduces investment income in the year recorded.

The Company considers an impairment to be other than temporary if it is unlikely the Company will recover an investment’s amortized cost in a reasonable period of time. Factors considered by the Company include but are not limited to the impact of issuer specific events, industry specific events, current and expected future market and economic conditions, the nature of the investment and the severity and duration of the fair value deficiency.

An impairment loss of \$2,023, related to common shares, was recognized in net income in the first quarter of 2009. The investments in question were disposed of in the second quarter of 2009. No provisions for impairment were recorded in the second quarter of 2009.

Recoverable from Reinsurers

As at June 30, 2009, the recoverable from reinsurers decreased to \$44.4 million compared to \$45.6 million as at December 31, 2008. This decrease represents recoveries of amounts for claims which were reinsured pursuant to quota share arrangements related to policy years 2002 through 2005.

Accounts Receivable

Premium financing receivables are the largest component of this asset as at June 30, 2009, and represents approximately 74% of the \$33.0 million of total receivables. During the first six months of 2009 premium financing receivables increased to \$24.4 million from \$20.6 million at December 31, 2008. These premiums are primarily billed directly to policyholders who are provided with a monthly payment financing option.

Provision for Unpaid Claims

EGL 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 EGL. Claims provisions (i.e., reserves for claims liability) are established at the individual file level by the “case method” as claims are reported. Provision for unpaid claims consists of the aggregate 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 actuary. EGI strives to establish adequate provisions at each quarter end.

The table below shows the development of the provision for claims reserves for Echelon General Insurance Company (EGI's primary insurance subsidiary), including loss adjustment expenses as at December 31 in each year of the five years and for the six months ended June 30, 2009.

(\$ THOUSANDS)	Years ended December 31				
	2008	2007	2006	2005	2004
Reserve Carried (actuarial present value basis) ⁽¹⁾	178,694	168,257	145,691	129,041	107,196
Reserve at December 31, 2005					70,620
Cumulative paid to December 31, 2005					24,922
Cumulative Redundancy (Deficiency)					11,654
Reserve at December 31, 2006				88,029	49,557
Cumulative paid to December 31, 2006				25,817	41,158
Cumulative Redundancy (Deficiency)				15,195	16,481
Reserve at December 31, 2007			107,992	67,408	36,129
Cumulative paid to December 31, 2007			30,432	46,413	55,306
Cumulative Redundancy (Deficiency)			7,267	15,220	15,761
Reserve at December 31, 2008		117,541	81,172	50,013	25,237
Cumulative paid to December 31, 2008		44,265	53,325	62,210	66,181
Cumulative Redundancy (Deficiency)		6,450	11,194	16,818	15,778
Reserve at June 30, 2009	152,414	102,400	70,494	40,028	19,801
Cumulative paid to June 30, 2009	31,491	58,948	64,184	71,445	71,398
Cumulative Redundancy (Deficiency)	1,350	7,743	11,264	17,568	15,997

1) Amounts include Provision for Adverse Deviation (PfAD) of \$19,689 for 2008; \$17,401 for 2007; \$14,756 for 2006; \$12,473 for 2005; and \$8,613 for 2004.

The table above, which is reflected on a gross basis for all years, shows that for the first six months of 2009 the total prior year reserve redundancies released pursuant to the June 30, 2009 (Echelon General) actuarial report were \$1.3 million.

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.

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 2009 the maximum net retention on a single risk is \$1.5 million (2008 – \$1.5 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. Policy liabilities rank in priority to any subordinated 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 March 31, 2009, EGI was the assigned beneficiary of such trust accounts totaling \$2.3 million (December 31, 2008 – \$2.4 million) in guarantees from unlicensed reinsurers.

EGI purchases renewable excess of loss and catastrophe reinsurance from third party reinsurers, covering its automobile and general liability business. In 2009, excess of loss coverage on a single occurrence is for a total of \$23,500,000 and in 2008 it was for \$18,500,000. Total catastrophic coverage is \$23,000,000 in 2009 and \$18,000,000 in 2008. Other than general and professional liability, coverages comprising the programs of the Niche Products division are reinsured on a program-by-program basis.

Using reinsurance, EGI's policy is to limit its loss exposure on any one claim to not more than 2% of its shareholders' equity.

Share Capital

As of August 4, 2009, there were 11,824,582 common shares issued and outstanding. (See Note 7 to the unaudited interim consolidated second quarter 2009 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. EGI believes that it has the flexibility to obtain, from internal sources, the funds needed to fulfill its cash requirements 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 facility bears interest of 6.2% which is payable monthly over the 3 year term of the agreement. After 3 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 financial covenants which 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 \$19.55 million was used to increase the capital of CIM Re, EGI's Barbados based reinsurance company, which is currently used to reinsure selected niche and specialty line business.

EGI's contractual obligations relating to operating leases are \$1.0 million due in less than a year and \$4.1 million due in the next five years.

Capital Resources

For the first six months of 2009, shareholders' equity increased to \$129.7 million, an increase of \$11.1 million from December 31, 2008. The elements which increased shareholders' equity consist of net income of \$4.6 million in the period, the issuance of common shares of \$0.7 million and other comprehensive income of \$6.6 million resulting from an increase in the fair value of investments held. The foregoing additions were offset by dividends of \$0.8 million paid to common shareholders during the period

As at June 30, 2009, Echelon's Minimum Capital Test margin` was 321%, compared to 268% as at December 31, 2008, significantly exceeding the minimum regulatory capital level required by the Office of the Superintendent of Financial Institutions.