

Consolidated Financial Statements of

EGI FINANCIAL HOLDINGS INC.

December 31, 2010 and 2009

Management's Responsibility for Financial Reporting

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

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

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

Role of Appointed Actuary

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

Role of External Auditor

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

Toronto, Ontario
February 24, 2011

(Signed) Steve Dobronyi
Chief Executive Officer

(Signed) Hemraj Singh
Chief Financial Officer

APPOINTED ACTUARY'S REPORT

To the Shareholders of EGI Financial Holdings Inc.

I have valued the policy liabilities of the subsidiary insurance operations of EGI Financial Holdings Inc. for its consolidated balance sheets as at December 31, 2010 in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

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

Toronto, Ontario
February 24, 2011

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

February 24, 2011

Independent Auditor's Report

To the Shareholders of EGI Financial Holdings Inc.

We have audited the accompanying consolidated financial statements of EGI Financial Holdings Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of income and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of EGI Financial Holdings Inc. and its subsidiaries as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) “PricewaterhouseCoopers LLP”

Chartered Accountants, Licensed Public Accountants

EGI FINANCIAL HOLDINGS INC.
Consolidated Balance Sheets
(in \$ thousands)

	December 31 2010	December 31 2009
Assets		
Cash and short-term deposits	17,033	46,885
Investments (note 3)	353,643	294,365
Reinsurers' share – unearned premiums (note 4)	6,471	4,972
– provision for unpaid claims (note 5)	36,152	38,736
Accounts receivable	31,712	32,950
Due from insurance companies	7,352	5,545
Deferred policy acquisition costs	15,979	14,807
Property and equipment (note 8)	414	838
Intangible assets (note 9)	531	468
Future income taxes (note 13)	4,135	3,952
Prepaid expenses and other assets	1,361	2,947
	474,783	446,465
Liabilities		
Bank indebtedness (note 14)	–	19,550
Provision for unpaid claims (note 5)	239,036	207,220
Unearned premiums (note 4)	78,335	72,643
Unearned commission	728	513
Income taxes payable	2,394	4,151
Accounts payable and accrued liabilities	4,824	6,312
Payable to insurance companies	2,093	1,829
Other liabilities	1,007	816
	328,417	313,034
Shareholders' Equity		
Share capital (note 10)	69,087	68,618
Contributed surplus (note 11)	532	403
Retained earnings	64,534	60,301
Accumulated other comprehensive income	12,213	4,109
	146,366	133,431
	474,783	446,465

On Behalf of the Board of Directors:

(Signed) Paul F. Little
Director

(Signed) Robert Purves
Director

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Income and Comprehensive Income
for the years ended December 31

(in \$ thousands)
(except per share amounts)

	2010	2009
Revenue		
Direct written and assumed premiums	185,671	163,862
Net written and assumed premiums	167,066	149,745
Net earned premiums	162,873	149,379
Investment income (note 3)	17,581	17,771
	180,454	167,150
Expenses		
Incurred claims	119,130	108,194
Acquisition costs	35,834	34,429
Operating costs	17,732	16,095
Interest expense	568	1,212
	173,264	159,930
Income before income taxes	7,190	7,220
Income tax expense (note 13)	2,957	2,705
Net income	4,233	4,515
Other comprehensive income (loss), net of taxes		
Change in unrealized gains on available-for-sale securities:		
Net unrealized gains (losses) on available-for-sale investments	12,183	14,344
Reclassification of net realized (gains) losses to net income	(3,487)	(4,250)
Unrealized losses on translation of financial statements of self-sustaining foreign operations	(592)	(525)
Other comprehensive income (loss)	8,104	9,569
Total comprehensive income (loss)	12,337	14,084
Earnings per share (note 19)		
Net income per share – basic	\$0.35	\$0.38
Net income per share – diluted	\$0.33	\$0.36

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Changes in Shareholders' Equity
for the years ended December 31
(in \$ thousands)

	2010	2009
Share capital		
Balance, beginning of year	68,618	67,056
Common shares issued	469	1,562
Balance, end of year	69,087	68,618
Contributed surplus		
Balance, beginning of year	403	403
Stock options – granted (net of forfeitures)	263	191
– exercised	(134)	(191)
Balance, end of year	532	403
Retained earnings		
Balance, beginning of year	60,301	56,605
Net income	4,233	4,515
Dividends – Common shares	–	(819)
Balance, end of year	64,534	60,301
Accumulated other comprehensive income (loss)		
Balance beginning of year	4,109	(5,460)
Other comprehensive income (loss)	8,104	9,569
Balance, end of year	12,213	4,109
Shareholders' equity, end of year	146,366	133,431

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Cash Flows
for the years ended December 31
(in \$ thousands)

	2010	2009
Cash provided by (used in):		
Operating activities		
Net income	4,233	4,515
Items not involving cash:		
Amortization	953	1,326
Amortization of premiums on bonds	900	736
Realized and unrealized (gains) losses on investments	(5,065)	(6,860)
Increase (decrease) in accrued investment income	(135)	97
Other	356	191
	1,242	5
Cash flow from changes in		
Reinsurers' share of unearned premiums	(1,499)	(1,260)
Reinsurers' share of unpaid claims	2,584	3,165
Accounts receivable	1,238	(5,385)
Income taxes recoverable	–	7,202
Due from insurance companies	(1,807)	3,518
Accounts payable and accrued liabilities	(818)	1,682
Provision for unpaid claims	31,816	21,965
Unearned premiums	5,692	1,489
Income taxes payable	(5,617)	(742)
Future income taxes	(183)	(780)
Prepaid expenses and other assets	1,586	1,258
Deferred policy acquisition costs	(1,172)	(104)
	33,062	32,013
Financing activities		
Repayment of bank indebtedness	(19,550)	–
Issue of common shares	242	1,371
Common share dividends	–	(819)
	(19,308)	552
Investing activities		
Acquisition of subsidiary, net of cash acquired	22	–
Purchases of property and equipment and intangible assets	(592)	(260)
Purchase of investments	(382,899)	(256,454)
Sale/maturity of investments	339,863	241,923
	(43,606)	(14,791)
Increase in cash and short-term deposits	(29,852)	17,774
Cash and short-term deposits, beginning of year	46,885	29,111
Cash and short-term deposits, end of year	17,033	46,885
Supplementary information		
Income taxes paid	9,095	4,392
Interest paid	684	1,215

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

1 Organization and Basis of Presentation

The Company was incorporated on August 18, 1997, under the Business Corporations Act (Ontario). The Company is principally engaged, through its subsidiaries, in property and casualty insurance in Canada and the U.S.

The Company purchased American Colonial Insurance Company (ACIC) during the first quarter of the year for a purchase price of \$4,541. Net assets of \$4,541 consisting primarily of cash and insurance licenses, valued at \$200, were received. The insurance licenses have been recorded at cost as intangible assets. Effective March 31, 2010, Echelon Insurance Company of America (EICA) and ACIC were amalgamated into one entity and continue to operate under the name ACIC.

The Company's wholly-owned subsidiaries are EGI Insurance Managers Inc., Echelon General Insurance Company (Echelon), EGI Insurance Services, Inc., American Colonial Insurance Company (ACIC), EGI Insurance Services (Florida), Inc., and CIM Reinsurance Company Ltd. (CIM Re).

EGI Insurance Services, Inc., ACIC and EGI Insurance Services (Florida), Inc., are U.S.-based subsidiaries whose functional and reporting currency is U.S. dollars. Each U.S subsidiary operating outside of Canada are self-sustaining foreign subsidiaries and are therefore subject to foreign currency translation adjustments upon consolidation.

The Company's Barbados based subsidiary, CIM Re changed its functional currency from U.S. dollars to Canadian dollars effective January 1, 2010. The change was accounted for on a prospective basis, as a result CIM Re's opening 2010 balance sheet was translated to Canadian dollars using the rate of exchange as at January 1, 2010.

2 Summary of significant accounting policies

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

Cash and short-term deposits

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

Investments

Investments are carried at fair value or cost. Fair value is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values are determined by reference to quoted bid or

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

asking prices, as appropriate, in the most advantageous active market available. All bonds and common equities are carried at fair value and have been classified as available-for-sale (AFS) investments. Preferred shares, designated as held-for-trading (HFT) investments are carried at fair value, and those designated as AFS investments are held at cost. Any change during the year in the fair values of investments classified as AFS are recognized in other comprehensive income (loss) (OCI). The cumulative change in the fair values of investments previously recognized in accumulated other comprehensive income (loss) (AOCI) is reclassified to net income when gains and losses are realized or the decline in value is considered to be other than temporary. Changes in fair values of investments classified at HFT are recognized in income (loss) in the year.

Transaction costs related to AFS investments are capitalized on initial recognition and, where applicable, are amortized to interest income using the effective yield method.

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

Provision for unpaid claims

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

Reinsurance

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

Revenue recognition

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

Deferred policy acquisition costs

Commissions and premium taxes incurred in the writing of premiums are deferred only to the extent that they are expected to be recovered from unearned premiums and are amortized to income over the terms of the related insurance policies. If unearned premiums are not sufficient to pay expected claims and expenses, including policy maintenance expenses and unamortized policy acquisition costs, a premium deficiency is said to exist. Premium deficiencies are recognized initially by writing down deferred policy acquisition costs.

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

Property and equipment

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

Furniture and equipment	3 years
Computer hardware	3 years

Intangible assets

Intangible assets are recorded at cost less accumulated amortization. Amortization is provided over the estimated useful life of the asset (2 years) using the straight-line method.

Employee benefits

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

Income taxes

The Company follows the asset and liability method of accounting for income taxes, whereby future income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the carrying values of existing assets and liabilities and their respective income tax bases and taxable losses and tax credit carry-forwards. Future income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income in the year which includes the date of enactment or substantive enactment. Future income tax assets are recognized to the extent the realization of such assets is more likely than not.

Foreign currency translation

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

Unrealized foreign currency translation gains and losses from net investments in self-sustaining foreign operations are recorded in OCI.

Stock-based compensation

The Company has a stock option plan that is described in note 11. Stock options granted under the plan are accounted for using the fair value method. Under this method, the compensation cost of stock options granted is measured at estimated fair value at the grant date and recognized as an expense over the vesting period with a corresponding offset to contributed surplus.

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

3 Investments

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

The following table provides a comparison as at December 31:

	2010	2009
Available-for-sale	Carrying and fair values	Carrying and fair values
Bonds		
Canadian		
Federal	91,664	83,777
Provincial	48,130	44,696
Municipal	5,855	6,254
Corporate	111,789	90,024
	257,438	224,751
United States		
Federal	3,585	–
Corporate	8,377	6,819
	11,962	6,819
Total bonds	269,400	231,570
Preferred shares	–	7,567
Common shares		
Canadian	69,535	52,210
United States	1,254	1,072
	70,789	53,282
Total Available-for-sale	340,189	292,419
Held for trading		
Preferred shares	9,373	–
Investment income due and accrued	2,081	1,946
Total investments at fair value	351,643	294,365
Preferred shares – at cost	2,000	–
Total investments	353,643	294,365

Fair value

The Company is responsible for determining the fair value of its investment portfolio by utilizing market-driven fair value measurements from active markets, where available, by considering other observable and unobservable inputs and by employing valuation techniques which make use of current market data. Considerable judgement may be required in interpreting market data used to develop the estimates of fair value. Accordingly, the estimates presented in these consolidated financial statements are not necessarily indicative of the amounts that could be realized in a current market exchange. The Company uses a fair-value hierarchy to categorize

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

the inputs used in valuation techniques to measure fair value. A description of the inputs used in the valuation of financial instruments is as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities. The fair value, of the Company’s common and preferred shares are, determined based on quoted prices in active markets obtained from external pricing sources.

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

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

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

The following table provides the classification of the Company’s investments carried at fair value, as outlined above, as at December 31, 2010 and December 31, 2009:

2010	Investments at fair value			
	Level 1	Level 2	Level 3	Total
Bonds	–	269,090	310	269,400
Equities	80,162	–	–	80,162
	80,162	269,090	310	349,562

2009	Investments at fair value			
	Level 1	Level 2	Level 3	Total
Bonds	–	231,120	450	231,570
Equities	60,849	–	–	60,849
	60,849	231,120	450	292,419

The fair value of the Company’s investments, determined without the use of observable market information as inputs (approximately 0.1% (2009 – 0.1%) of the total investment portfolio required to be measured at fair value) consists of corporate bonds with a fair value of \$310 (2009 – \$450).

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

A reconciliation of financial instruments measured at fair value on a recurring basis with the use of significant unobservable inputs from January 1 to December 31 follows:

	2010	2009
Balance at beginning of year	450	457
Less: Disposals during period – bonds	308	–
Net unrealized gains (losses) included in other comprehensive income	168	(7)
Balance at end of year	310	450

Preferred shares of \$2,000 recorded at cost are not included in the fair value tables above.

Impaired assets and provisions for losses

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. 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.

No impairment losses were recorded in 2010 or 2009.

A remaining gross unrealized loss of \$1,719 (2009- \$3,277) on investments held as at December 31, 2010, is recorded, net of tax, in the amount of \$1,186 (2009-\$2,208) as Accumulated Other Comprehensive Loss. The Company concluded during its review, that these fair value deficiencies are considered temporary in nature.

Investment income

Investment income was derived from the following:

	2010	2009
Interest income	12,454	11,661
Dividend income	1,669	1,470
Net realized gains	5,089	6,860
Fair value increase (decrease) on HFT investments	(24)	–
Foreign exchange gain (loss) ⁽¹⁾	(273)	(1,116)
Investment expenses	(1,334)	(1,104)
	17,581	17,771

(1) The foreign exchange loss of \$273 (2009 – loss of \$1,116) arises primarily from cash balances held during the year, denominated in U.S. dollars, used to fund U.S. dollars denominated claims liabilities and other corporate purposes.

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

4 Unearned premiums

	2010		2009	
	Gross	Ceded	Gross	Ceded
Personal Lines:				
Automobile				
– accident benefits	16,802	1,220	17,471	1,100
– liability	28,130	1,900	24,901	1,499
– other	12,219	185	11,776	167
Total Personal Lines	57,151	3,305	54,148	2,766
Niche Products:				
Property				
– commercial	4,683	1,316	4,376	1,105
– personal	9,883	841	6,627	551
Liability	5,073	491	5,180	539
Accident and sickness	236	2	502	11
Commercial auto	958	516	452	–
Other	351	–	1,358	–
Total Niche Products	21,184	3,166	18,495	2,206
	78,335	6,471	72,643	4,972

5 Provision for unpaid claims

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

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

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

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

The Company discounts its best estimate of claim provisions at a rate of interest of 2.55% (2009 – 2.56%) for all lines of business. The Company determines the discount rate based on the

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

expected return on its investment portfolio of assets with appropriate assumptions for interest rates relating to reinvestment of maturing investments.

The Company has recorded a \$4,091 (2009 – \$712) reduction to the net provision for unpaid claims relating to redundancies in prior years' estimates.

To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience, and to provide greater comfort that the actuarial liabilities are adequate to pay future claims, the Company includes provisions for adverse deviations (PFADs) in some assumptions relating to claim development, reinsurance recoveries and future investment income. The PFADs selected are in the mid-range of those recommended by the Canadian Institute of Actuaries.

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

	Undiscounted	Effect of present value	PFADs	APV
2010				
Provision for unpaid claims and adjustment expenses	232,262	(18,786)	25,560	239,036
Reinsurers' share of unpaid claims	34,253	(1,247)	3,146	36,152
	198,009	(17,539)	22,414	202,884
2009				
Provision for unpaid claims and adjustment expenses	201,459	(16,927)	22,688	207,220
Reinsurers' share of unpaid claims	36,378	(1,135)	3,493	38,736
	165,081	(15,792)	19,195	168,484

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

	2010		2009	
	Gross	Ceded	Gross	Ceded
APV basis				
Personal Lines:				
Accident benefits	101,194	21,274	86,805	19,290
Liability	97,692	6,378	92,311	15,169
Other	4,052	422	3,914	667
Total Personal lines	202,938	28,074	183,030	35,126
Niche Products:				
Property				
Commercial	4,098	640	3,278	266
Personal	367	78	307	109
Liability	22,338	2,670	16,291	2,903
Accident and sickness	2,647	696	3,222	332
Commercial auto	5,774	3,994	–	–
Other	874	–	1,092	–

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

APV basis	2010		2009	
	Gross	Ceded	Gross	Ceded
Total Niche	36,098	8,078	24,190	3,610
	239,036	36,152	207,220	38,736

Claims Development

	2010	2009
Unpaid claims, beginning of year, net	168,484	143,354
Change in undiscounted estimates for losses of prior years	(4,258)	144
Change in discount rate	488	(9)
Change in PFADs	(5,971)	(4,759)
Interest cost	5,650	3,911
Provision for claims occurring in current year	123,003	108,682
Paid on claims occurring during		
Current year	(38,296)	(39,939)
Prior year	(46,216)	(42,900)
Unpaid claims, end of year, net	202,884	168,484
Reinsurers' share	36,152	38,736
	239,036	207,220

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

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

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

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As at December 31	2005	2006	2007	2008	2009	2010
GROSS BASIS						
Provision for claims including LAE	129,173	146,101	169,091	185,255	207,220	239,036
Cumulative payments as of:						
One year later	25,855	30,491	44,790	53,253	57,465	
Two years later	46,409	53,520	73,853	92,567		
Three years later	62,210	74,402	105,567			
Four years later	78,562	97,824				
Five years later	92,958					
Reserve re-estimated as of:						
One year later	113,839	138,483	163,465	186,446	203,920	
Two years later	113,817	134,769	162,916	189,093		
Three years later	112,224	133,932	164,290			
Four years later	110,157	134,173				
Five years later	110,577					
Favourable (unfavourable) Development	18,596	11,928	4,801	(3,838)	3,300	
CEDED BASIS						
Provision for claims including LAE	54,043	48,385	48,461	41,901	38,736	36,152
Cumulative payments as of:						
One year later	10,017	9,649	11,178	10,353	11,157	
Two years later	19,481	19,489	20,454	21,313		
Three years later	27,606	28,514	31,334			
Four years later	36,352	39,379				
Five years later	44,320					
Reserve re-estimated as of:						
One year later	50,779	52,757	47,935	43,805	39,527	
Two years later	53,124	53,570	49,956	45,113		
Three years later	54,518	54,462	51,695			
Four years later	54,063	56,379				
Five years later	55,252					
(Favourable) unfavourable Development	(1,209)	(7,994)	(3,234)	(3,212)	(791)	
Net favourable (unfavourable) development	19,805	19,922	8,035	(626)	4,091	

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6 Underwriting policy and reinsurance ceded

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

During 2010, the Company followed the policy of underwriting and reinsuring contracts of insurance, which limits the net exposure of the Company to a maximum amount on any one loss to \$1,500 (2009 – \$1,500). In addition, the Company obtained catastrophe reinsurance which limits the loss from a series of claims arising from a single occurrence to \$2,000 (2009 – \$2,000), to a maximum coverage of \$23,000 (2009 – \$23,000).

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

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

Reinsurance recoverables

The following table summarizes the balances outstanding from reinsurers as at December 31, 2010 and 2009, by risk rating:

Credit rating	Gross reinsurance recoverable		Less: Deposits held		Net exposure	
	2010	2009	2010	2009	2010	2009
A	41,936	44,590	–	–	41,936	44,590
Not rated	4,487	1,201	5,845	4,637	–	–
	46,423	45,791	5,845	4,637	41,936	44,590

Included in gross reinsurance recoverable is reinsurers' share of unearned premiums of \$6,471 (2009 – \$4,972), reinsurers' share of provision for unpaid claims of \$36,152 (2009 – \$38,736), and receivables from reinsurers presented as due from insurance companies of \$3,800 (\$2,083 – 2009). No balances due from reinsurers are considered past due as at December 31, 2010.

7 Risk management

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

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interest rate risk, equity market fluctuation risk, credit risk, liquidity risk, and to a lesser extent foreign exchange risk.

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

Product and pricing

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

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

Underwriting and claims

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

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

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

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Unpredictable catastrophic events

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

Catastrophes can cause losses in a variety of business lines. Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in the Company's financial results and could materially reduce the Company's profitability or harm the Company's financial condition. The Company manages the impact of losses which may result from catastrophic events by purchasing excess of loss and catastrophe reinsurance to share all or part of the insurance risks originally accepted by the Company (note 6).

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

Asset and liability matching

The Company is exposed to:

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

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

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

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Notes to Consolidated Financial Statements (continued)
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Market risk

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

Interest rate risk

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

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

Change in interest rates	As at December 31, 2010			As at December 31, 2009		
	Fair value of fixed income portfolio	Hypothetical change on fair value	Effect on OCI	Fair value of fixed income portfolio	Hypothetical change on fair value	Effect on OCI
200 basis point rise	240,205	(11%)	(20,194)	209,222	(10%)	(14,302)
100 basis point rise	254,069	(6%)	(10,604)	219,883	(5%)	(7,830)
No change	269,400	–	–	231,570	–	–
100 basis point decline	286,394	6%	11,755	244,428	6%	8,615
200 basis point decline	305,208	13%	24,768	258,510	12%	18,050

As discussed in note 5, the discount rate used in the determination of the provision for unpaid claims is based on the expected return of assets on its investment portfolio with appropriate assumptions for interest rates relating to reinvestment of maturing investments. Fluctuations in market interest rates will therefore have an impact on the discount rate used in the valuation of the net provision for unpaid claims. The table below shows the potential impact of interest rate fluctuations on the net provision for unpaid claims and income statement:

Change in discount rate	As at December 31, 2010			As at December 31, 2009		
	Net provision for unpaid claims	Hypothetical change in value	Effect on net income	Net provision for unpaid claims	Hypothetical change in value	Effect on net income
100 basis point rise	198,267	(2%)	3,193	164,529	(2%)	2,650
No change	202,884	–	–	168,484	–	–
100 basis point decline	207,752	2%	(3,367)	172,691	2%	(2,819)

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Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet cash flow requirements associated with financial instruments. The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. To manage cash flow requirements, the Company maintains a portion of invested assets in liquid investments.

The maturity profile of bonds as at December 31, 2010 and 2009 are as follows:

2010	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	15,613	45,563	53,853	154,371	269,400
Percentage of total	6%	17%	20%	57%	100%

2009	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	16,796	36,058	61,473	117,243	231,570
Percentage of total	7%	16%	26%	51%	100%

The following tables summarize the expected timing of cash flows arising from insurance obligations, on an undiscounted basis (note 5), as at December 31, 2010 and 2009:

2010	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	73,607	82,892	46,518	29,214	232,231
Less: Reinsurance recoverable	12,412	13,073	5,868	2,805	34,158
Net actuarial liabilities	61,195	69,819	40,650	26,409	198,073

2009	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	62,995	71,130	39,645	27,687	201,457
Less: Reinsurance recoverable	12,815	12,879	6,934	3,750	36,378
Net actuarial liabilities	50,180	58,251	32,711	23,937	165,079

All other financial liabilities are for a duration of one year or less. The contractual maturities for lease commitments are listed in note 15.

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Equity price risk

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

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

The table below summarizes the potential impact of a 20% change in the value of the equity investments (common and preferred shares) on OCI for the years ended December 31, 2010 and 2009. Certain shortcomings are inherent in the method of analysis presented, as the analysis is based on the assumptions that all equity holdings increased/decreased by 20%, with all other variables held constant.

Change in equity holdings	Effect on Net Income		Effect on OCI	
	2010	2009	2010	2009
20% rise	1,297	–	9,793	8,153
20% decline	(1,297)	–	(9,793)	(8,153)

Credit risk

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

The Company's maximum exposure to credit risk, without taking into account amounts held as collateral, is \$332,598 (2009 – \$295,284) comprised of \$269,400 (2009 – \$231,570) of bonds, \$41,936 (2009 – \$44,590) of gross reinsurance recoverables, \$2,518 (2009 – \$3,462) of amounts due from insurance companies, \$5,174 (2009 – \$5,994) of accounts receivables and \$13,570 (2009 – \$9,668) in structured settlements.

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

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Fixed income portfolio

	As at December 31, 2010		As at December 31, 2009	
	Fair value	Fair value	Fair value	Fair value
AAA	113,197	42%	111,702	48%
AA	68,438	25%	64,446	28%
A	72,602	27%	48,090	21%
BBB	12,708	5%	6,882	3%
BB	962	–	–	–
B	1,183	1%	321	–
CCC	310	–	129	–
Total	269,400	100%	231,570	100%

Foreign exchange risk

Foreign exchange risk is the possibility that changes in foreign exchange rates produce an unintended effect on earnings and equity when measured in domestic currency.

A portion of the Company's premiums are written in U.S. dollars and a portion of loss reserves are also in U.S. dollars. In addition, premiums relating to the Emergency Travel Health line of business are remitted in Canadian dollars however a significant portion of the claims incurred for this line of business is in U.S. dollars. A portion of the Company's cash and investments is also held in U.S. dollars.

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

The table below illustrates the expected impact on net income and OCI of a 10% change in the Canadian dollar ("CAD") compared to the U.S. dollar ("USD") as at December 31, 2010 and 2009. Computations of the prospective effects of hypothetical foreign exchange changes are based on numerous assumptions, including the maintenance of the existing level and composition of financial assets and financial liabilities, and should not be relied on as indicative of actual or future results.

Change in CAD/USD rate	Effect on Net Income		Effect on OCI	
	2010	2009	2010	2009
10% rise	(57)	(360)	(1,217)	(1,360)
10% decline	57	360	1,217	1,360

Capital management

Capital is comprised of the Company's shareholders' equity and bank indebtedness. As at December 31, 2010, the Company's shareholders' equity was \$146,366 (2009 – \$133,431) and bank indebtedness was \$nil (2009 – \$19,550). The Company's objectives when managing capital are to maintain financial strength and protect its claims paying abilities, to maintain creditworthiness and to maximize returns to shareholders over the long term.

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A common measure of capital adequacy in the property and casualty industry used by management is the ratio of premiums to surplus (or shareholders' equity). A lower ratio implies a higher measure of capital adequacy. The Company's ratio as at December 31, 2010, was 1.1:1 (2009 – 1.2:1). This level is well below the 2.5:1 ratio considered by management to be the maximum acceptable ratio.

The Company's Canadian insurance subsidiary, Echelon, is required to maintain minimum capital levels as required by the Office of the Superintendent of Financial Institutions. As at December 31, 2010 and 2009, the Company exceeded the minimum regulatory capital requirement. Legislation applicable to insurance companies imposes certain restrictions on the Company's ability to pay dividends.

8 Property and equipment

	2010			2009		
	Cost	Accumulated amortization	Net	Cost	Accumulated amortization	Net
Furniture and equipment	1,835	1,456	379	1,806	1,043	763
Computer hardware	418	383	35	415	340	75
	2,253	1,839	414	2,221	1,383	838

9 Intangible assets

	2010			2009		
	Cost	Accumulated amortization	Net	Cost	Accumulated amortization	Net
Computer software	3,498	2,967	531	2,938	2,470	468

10 Share capital

	2010	2009
Authorized		
Unlimited common shares		
Unlimited special shares issuable in Series		
Issued		
12,059,582 common shares (2009 – 12,000,582 common shares)	69,087	68,618

During 2010, 47,000 (2009 – 324,500) common shares were issued pursuant to the exercise of employee stock options, with an issue cost of \$8.00 (2009 – \$4.82).

An additional 12,000 common shares (2009 – 0) were issued pursuant to the share unit plan for eligible employees.

11 Employee stock option plan

The Company sponsors a stock option plan. The stock option plan provides for the issuance of shares of the Company's common stock not exceeding 10% of the total issued and outstanding shares (on a non-diluted basis) and shares reserved for issuance under employee stock option

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plans, options for services and employee stock purchase plans. The Board of Directors determines the terms and conditions of the awards under the stock option plan as well as any award allocations.

For the year ended December 31, 2010, the Company recorded a compensation expense of \$263 (2009 – \$191), with an offsetting credit to contributed surplus. During 2010, 47,000 (2009 – 324,500) stock options were exercised and 35,750 were forfeited (2009 – 94,500). All stock options granted are for a term of five years with varying vesting periods.

The following is a continuity schedule of stock options outstanding as at December 31:

	Number of shares		Weighted average exercise price per share	
	2010	2009	2010	2009
Outstanding, beginning of year	788,500	902,750	10.94	8.18
Granted during year	143,125	304,750	8.14	6.56
Exercised during year	(47,000)	(324,500)	8.00	4.23
Forfeited during year	(35,750)	(94,500)	10.65	9.66
Outstanding, end of year	848,875	788,500	10.20	10.94

As at December 31, 2010, the outstanding stock options consist of the following:

Stock Option price per share	Number	Remaining contractual life	Number of options exercisable
\$10.61	63,000	0.3 years	63,000
\$10.31	6,750	0.3 years	–
\$ 9.26	63,000	0.8 years	–
\$11.68	30,000	1.6 years	18,000
\$12.80	26,750	1.6 years	12,000
\$12.34	45,000	1.7 years	27,000
\$14.26	84,500	1.8 years	12,000
\$11.80	6,750	2.4 years	–
\$10.65	6,000	2.6 years	–
\$10.47	6,750	2.7 years	–
\$ 8.03	67,500	2.8 years	–
\$ 7.25	8,000	3.3 years	2,000
\$ 8.93	6,750	3.4 years	–
\$ 8.59	20,000	3.4 years	4,000
\$ 9.00	6,000	3.6 years	–
\$ 9.26	6,750	3.7 years	–
\$10.06	154,750	3.8 years	15,500
\$10.25	97,500	3.8 years	19,500
\$ 9.91	6,750	4.4 years	–
\$ 8.82	3,000	4.6 years	–
\$ 8.55	20,000	4.6 years	–
\$ 7.75	6,000	4.6 years	–
\$ 7.76	10,125	4.7 years	–

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Stock Option price per share	Number	Remaining contractual life	Number of options exercisable
\$ 8.12	3,000	4.8 years	–
\$ 8.07	59,625	4.8 years	–
\$ 7.80	34,625	4.8 years	–

The fair values of the stock options issued in 2010 were determined using the Black-Scholes option pricing model with the following assumptions: (i) risk-free rate of 2.0%; (ii) life expectancy of four years; and (iii) estimated volatility of 30%. The grant-date fair value of total options granted is estimated at \$2,261. The weighted average grant-date fair value of stock options granted to date is \$1.52.

12 Related party transactions

The Co-operators Group Limited and Co-operators General Insurance Company (collectively Co-operators), significant shareholders of the Company, provide services to the Company, including but not limited to product distribution and investment management services. Direct written premiums derived from Co-operators' agents were \$11,065 (2009 – \$10,797), commissions paid were \$1,273 (2009 – \$1,242) and investment management fees were \$249 (2009 – \$218).

The Company holds deposits of \$493 (2009 – \$1,126) under the terms of a 2001 100% Quota Share reinsurance treaty with Co-operators General Insurance Company, with income resulting from the investment of these deposits for their account. Reinsurers' share of unpaid claims includes a recoverable of \$900 (2009 – \$1,690) from Co-operators General Insurance Company. The payable to insurance companies balance includes amounts due to Co-operators General Insurance Company of \$604 (2009 – \$1,126).

Key management

Key management comprises directors and senior management of the Company and of Group subsidiaries. Key management includes named executive officers and directors. Compensation of, and loans to these individuals are summarized in the following table:

Compensation

	2010	2009
Salaries, directors' fees and other short-term benefits	1,658	1,770
Equity-settled and cash-settled compensation benefits	115	736
	1,773	2,506

13 Income taxes

The income tax expense (recovery) is as follows:

	2010	2009
Current	1,641	3,531
Future	1,316	(826)
	2,957	2,705

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

	2010	2009
Combined basic federal and provincial income tax rate	29.8%	32.68%
Income tax expense at statutory rates	2,021	2,360
Permanent differences	(397)	(57)
Future income tax rate changes	665	153
Other	668	249
	2,957	2,705

Future income taxes are comprised of the following:

	2010	2009
Losses carried forward	502	1,083
Provision for unpaid claims	3,349	3,083
Investments	(196)	(336)
Deferred policy acquisition costs	310	–
Property and equipment and intangible assets	170	122
	4,135	3,952

Income taxes included in OCI

The amounts included in the consolidated statements of changes in shareholders' equity and comprehensive (loss) income for the years ended December 31 are shown net of the following tax benefit:

Income tax impact on:

	2010	2009
Change in unrealized gains (losses)	5,461	6,998
Reclassification to net income of (gains) and losses	(1,601)	(2,534)
Total income tax benefit included in OCI	3,860	4,464

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

14 Bank indebtedness

On October 11, 2007, the Company entered into a non-revolving, term loan facility with a major Canadian bank in the amount of \$19,550. The facility had a term of three years, bearing an interest rate of 6.20%. During the term of the loan, monthly payments included interest only and on maturity a balloon payment of \$19,550 was to be made to settle the principal amount.

In the second quarter of 2010 the loan was repaid in full, funded with internal funds. The Company had no bank indebtedness as at December 31, 2010.

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15 Lease commitments

The Company is committed under lease agreements for office premises and computer equipment with minimum lease payments of \$7,420 as follows:

2011	1,141
2012	1,054
2013	1,013
2014	983
2015	965
2016 and thereafter	2,264
	7,420

16 Structured settlements

In the normal course of claims adjudication, the Company may settle certain long-term losses through the purchase of annuities (structured settlements) from life insurance companies. The fair value of these annuity contracts amounts to \$13,570 (2009 – \$9,668) using a discount rate of 3.61% (2009 – 4.09%). It is the policy of the Company to purchase annuities from life insurers with proven financial stability. The net risk to the Company is the credit risk related to the life insurance companies and this risk is reduced to the extent of coverage provided by Assuris, the life insurance compensation insurance plan. The Company has determined that no credit risk provision is required.

17 Contingencies

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

18 Rate regulations

The Company writes business subject to rate regulation, including non-standard automobile and motorcycle insurance, which comprises approximately 70% of net premiums written. The Company's automobile insurance premiums can be impacted by mandatory rate rollbacks and mandatory rate assessments as legislated by provincial law and by regulation in certain provinces. This could result in lower future premium rates or reductions to premium rates charged by the Company in prior years. In addition, the Company is required, under certain provincial legislation, to participate in risk sharing pools, which may impact positively or negatively on underwriting results. Certain benefit payments are also subject to provincial government regulation, including automobile accident benefits.

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

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

19 Earnings per share

	2010	2009
Basic earnings per share:		
Net income available to shareholders	4,233	4,515
Average number of common shares (in thousands)	12,032	11,808
Basic earnings per share	\$0.35	\$0.38
Diluted earnings per share:		
Average number of common shares (in thousands)	12,032	11,808
Average number of common shares obligation under employee stock option plan (in thousands)	774	803
Average number of diluted common shares (in thousands)	12,806	12,611
Diluted earnings per share	\$0.33	\$0.36

20 Segmented information

The Company operates through three segments. The Personal Lines and Niche Products divisions operate in Canada while the International division assumes premiums from U.S. resident companies that specialize in the non-standard automobile market. Through its Personal Lines division, the Company is engaged primarily in the underwriting of high premium, non-standard automobile insurance. Through its Niche Products division, the Company designs and underwrites specialized non-auto insurance programs, such as higher premium property, primary and excess liability, legal expense, accident and health insurance and warranty coverage.

The effect of reinsurance is reflected in the revenue and results of the three divisions. The investment activities consist of managing the investment portfolio for the Company as a whole. Investment income is shown net of investment expenses. The corporate and other activities include holding company expenses not attributable to a division. Interest expense represents interest on bank indebtedness.

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

	Year ended December 31	
	2010	2009
Revenue		
Earned premiums and other revenue		
Property and casualty insurance		
Canada – Personal Lines	123,525	104,978
– Niche Products	39,190	39,104
	162,715	144,082
International (United States)	158	5,297
	162,873	149,379
Interest and dividends, net of investment expense	12,789	12,027
Realized investment gains (losses)	5,089	6,860
Fair value decrease on HFT investments	(24)	–
Foreign exchange gains (losses)	(273)	(1,116)
Total revenue	180,454	167,150
Income (loss) before income taxes		
Property and casualty insurance		
Canada – Personal Lines	(7,461)	(717)
– Niche Products	181	(3,366)
	(7,280)	(4,083)
International (United States)	(1,316)	(3,930)
Corporate and other	(1,227)	(1,326)
Underwriting income (loss)	(9,823)	(9,339)
Interest and dividends, net of investment expense	12,789	12,027
Realized investment gains (losses)	5,089	6,860
Fair value decrease on HFT investments	(24)	–
Foreign exchange gains (losses)	(273)	(1,116)
Interest expense	(568)	(1,212)
Total income before income taxes	7,190	7,220

21 Comparative figures

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