

EGI FINANCIAL HOLDINGS INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS
For the period ending March 31, 2011

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.

Important Note:

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards (IFRS), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these interim consolidated financial statements. In this MD&A, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

The interim consolidated financial statements for the quarters ended March 31, 2011, and 2010 have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 5 of the interim financial statements, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010, and throughout all periods presented, as if these policies had always been in effect. Note 5 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010.

The policies applied in the interim consolidated financial statements are based on IFRS issued and outstanding as of May 5, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending December 31, 2011, could result in restatement of the interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The following discussion should be read in conjunction with EGI's unaudited interim consolidated financial statements for the first quarter of fiscal 2011 and 2010, with the notes to the interim unaudited consolidated financial statements for the first quarter of fiscal 2011, with management's discussion and analysis (MD&A) set out on pages 3 to 50 of the Company's 2010 Annual Report and with the notes to the audited consolidated financial statements for fiscal 2010 set out on pages 60 to 83 of the Company's 2010 Annual Report. The financial data in this discussion has been prepared in accordance with IFRS and has been derived from the unaudited interim consolidated financial statements for the three months ended March 31, 2011, and 2010.

The following commentary is current as of May 3, 2011. 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 IFRS and certain non-IFRS measures to assess performance. Securities regulators require that

companies caution readers about non-IFRS measures that do not have a standardized meaning under IFRS and are unlikely to 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 2011 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.

Company Overview

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

EGL operates through three strategic business units (SBU) – the Personal Lines and Niche Products divisions in Canada and the International division in the United States. The Personal Lines division focuses on the underwriting of non-standard automobile insurance and motorcycle business and other non-standard products and specialty lines of business. Through its Niche Products division, EGL designs and underwrites specialized insurance programs, such as higher premium property, primary and excess liability, legal expense and accident and health insurance for a variety of businesses and consumers and extended warranty coverage for homes and consumer products.

EGL's International division focuses on the development of non-standard automobile insurance in the Southeast United States. The Company acquired American Colonial Insurance Company in 2010 and subsequently commenced writing insurance premium in Florida and Texas. It also has licenses in Georgia, Louisiana and Alabama for possible future geographic expansion.

By pursuing its focused niche strategy, EGL's objective is to produce an ROE superior to the Canadian P&C insurance industry average. A key factor for EGL's ROE to outperform the industry is for its loss ratio to be below the industry average.

Overall Performance

P&C insurance companies continued to operate in a challenging environment in the first quarter of 2011. Escalating claims costs, particularly in the Ontario automobile market, and more specifically arising from the Accident Benefit coverage, continue to increase loss ratios and erode profitability. Auto reforms implemented by the Ontario government, effective September 1, 2010, were designed to address these claims cost increases; however, the extent to which the reform-related product changes will alleviate the situation cannot yet be determined.

Despite these ongoing challenges, EGL's results have improved significantly. The combined operating ratio improved to 100% in the first quarter of 2011 from 115% in the first quarter of 2010. Both divisions in Canada produced an underwriting profit, which was offset by startup costs in the United States.

The improvement in the Personal Lines division was primarily attributable to the performance of Ontario non-standard auto, which recorded a combined ratio of 96% in the first quarter compared to 122% in the first quarter of 2010. Remedial actions taken by the Company during 2010 have all contributed to the improved result – the reduction of exposure in the greater Toronto area, application of targeted rate increases, terminating selected broker relationships, judicious use of the industry's risk sharing pool and reducing broker commissions in selected jurisdictions.

Our specialty Niche Products division has also experienced a significantly improved result in the first quarter of the year, producing a combined operating ratio of 100% versus 113% in the same period in 2010. Improvements were realized across nearly all product lines, most notably in commercial property and commercial auto.

Investment income improved by 22% in the first quarter of 2011 compared the same period in 2010. Investment income, including unrealized gains on preferred shares designated as held for trading investments was \$4.4 million in the first quarter of 2011 compared to \$3.6 million in the same period in 2010.

Net book value per share increased to \$12.35 as at March 31, 2011, compared to \$12.14 as at December 31, 2010.

Financial Overview

(\$ THOUSANDS except per share amounts)	Three months ended March 31	
	2011	2010
Direct written and assumed premiums	30,850	43,990
Net earned premiums	40,344	38,224
Underwriting income (loss)	(113)	(5,810)
Interest expense	–	299
Investment income	4,402	3,574
Net income (loss)	3,028	(1,846)
Net income (loss) per share		
Basic	0.25	(0.15)
Diluted	0.24	(0.14)
Return on equity (ROE) ⁽¹⁾	6.4%	2.3%
Net operating income (loss) ⁽²⁾	2,156	(2,450)

(1) 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.

(2) Net operating income (loss) is defined as net income (loss) plus or minus after-tax realized losses or gains on sale of investments

	Three months ended March 31	
	2011	2010
Loss ratio	65.7%	83.4%
Expense ratio	34.6%	31.8%
Combined ratio	100.3%	115.2%

(\$ THOUSANDS except per share amounts)	As at	As at	As at
	March 31, 2011	Dec 31, 2010	Jan. 1, 2010
Investments (excluding premium finance receivables)	359,994	353,643	294,365
Premium finance receivables	18,827	26,564	27,007
Total assets	466,912	474,783	446,465
Total shareholders' equity	148,936	146,366	133,431
Book value per share ⁽¹⁾	12.35	12.14	11.12

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

Segmented Financial Information

Three months ended March 31								
2011					2010			
(\$THOUSANDS)	Canada			Inter-national	Canada			Inter-national
	Personal Lines	Niche Products	Total		Personal Lines	Niche Products	Total	
Net earned premiums	31,483	8,698	40,182	162	28,391	9,827	38,218	6
Underwriting income (loss) ⁽¹⁾	1,029	6	1,035	(767)	(3,982)	(1,257)	(5,239)	(291)
Loss ratio	68.1%	56.1%	65.5%	112.8%	87.4%	73.9%	83.9%	N/A ⁽²⁾
Expense ratio	28.6%	43.8%	31.9%	461.2%	26.6%	38.8%	29.8%	N/A ⁽²⁾
Combined ratio	96.7%	99.9%	97.4%	574.0%	114.0%	112.7%	113.7%	N/A ⁽²⁾

(1) Underwriting income (loss) does not include corporate and other expenses (see below).

(2) Due to the minimal earned premium in the International division the ratios are not meaningful.

The underwriting result in both of our Canadian divisions has improved significantly in the first quarter of 2011 compared to the same period in 2010. Underwriting income of \$1.0 million was earned in the Personal Lines division compared to a loss of \$4.0 million in the first quarter of 2010. The Niche Products division recorded a small underwriting profit compared to a loss of \$1.3 million in the same period in 2010.

The Personal Lines division benefited from improved results in its core non-standard auto business, which recorded a combined ratio of 95% in the first quarter of 2011 compared to 119% in the first quarter of 2010. The Personal Lines division loss ratio was 68%, a significant improvement compared to 87% last year. The loss ratio in our non-standard auto line of business improved to 67% for the period compared to 93% in 2010. As noted earlier, the improvement can be attributed to several initiatives taken by management in 2010, most notably the reduction of exposure in the GTA and surrounding area, which accounted for several large losses in the first quarter of 2010, and premium rate increases implemented throughout 2010 and early 2011.

The Niche Products division loss ratio improved to 56% in the first quarter of 2011 compared to 74% in the same period last year. Improvements were particularly evident in the commercial auto and liability lines primarily due to the cancellation and rehabilitation of unprofitable programs in late 2010 and early 2011.

The loss in the International division of \$0.8 million is primarily due to expenses associated with our U.S. startup operation.

Corporate and other expenses of \$0.4 million in the first quarter of 2011, and \$0.3 million in the same period in 2010, have not been allocated by division.

Investment income increased to \$4.4 million in the first quarter of 2011 compared to \$3.6 million in the same period in 2010. The increase in investment income was primarily due to an increase in total invested assets. An increase in the fair value of preferred shares designated as held-for-trading of \$0.2 million was also recorded in investment income in 2011. No investment impairments have been recorded in 2011.

EGI's expense ratio increased in the first quarter compared to the same period in 2010, primarily due to the reversal of a bonus accrual in the first quarter of 2010. The accrual recorded at the end of 2009, contingent on industry results, was not paid in 2010.

Critical Accounting Estimates and Assumptions

For a description of EGI's accounting policies, which are on an IFRS basis, refer to note 3 in the interim financial statements for the quarter ended March 31, 2011. A description of EGI's critical accounting estimates and assumptions is also detailed in note 4 of the interim financial statements.

First time adoption of International Financial Reporting Standards (IFRS)

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards, and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in these interim consolidated financial statements. In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

The interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 and IFRS 1. Subject to certain transition elections disclosed in note 5, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. Note 5 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010.

The policies applied in the interim consolidated financial statements are based on IFRS issued and outstanding as of May 5, 2011, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending December 31, 2011 could result in restatement of the interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

As previously disclosed in EGI's Management Discussion & Analyses, "MD&As", the adjustments related to the transition to IFRS had no impact on the total shareholders equity of EGI as at January 1 or December 31, 2010. The adjustments required are summarized as follows:

Cumulative translation differences

Adjustment to opening balance sheet as at January 1, 2010 and December 31, 2010

IFRS 1 provides an exemption which provides relief from retrospective application of the IAS 21 requirement to restate all financial statements of foreign operations from date of inception and determine the cumulative translation differences.

Management has elected to take this exemption and has therefore reset the cumulative translation differences related to foreign operation to zero as at January 1, 2010.

The effect of this election will be to reduce the cumulative translation loss of \$678 in accumulated other comprehensive income (AOCI) as at January 1, 2010, and December 31, 2010, therefore decreasing retained earnings by \$678. There is no impact to the total equity.

Foreign exchange

Adjustments required as at January 1, 2010, and December 31, 2010

Under IFRS changes in unrealized foreign exchange gains and losses related to investments designated as available-for-sale are recorded in net income in the current period. Under Canadian GAAP these unrealized gains and losses were recorded in OCI. Gross unrealized losses of \$127, recorded net of income tax in the amount of \$85 and \$239 (\$166 net of income tax), related to bonds denominated in US\$ held at January 1, 2010, and December 31, 2010, have been reflected as an adjustment to reduce retained earnings and increase AOCI as at January 1, 2010, and December 31, 2010, respectively. Gross unrealized losses of \$110 (\$76 net of income tax) and \$116 (\$81 net of income tax) have been recorded as adjustments to decrease investment income and increase OCI for the three month period ended March 31, 2010, and year ended December 31, 2010, respectively.

Share based compensation

For determination of compensation expenses and contributed surplus related to stock option grants, IFRS and Canadian GAAP differ in two respects which will impact EGI. Stock options which contain a graded vesting feature (the total options granted vest on a graded basis such as annually over 5 years) are accounted for separately based on the date of vesting. Under Canadian GAAP the total options granted are accounted for as one grant and one vesting period is used. Under IFRS at the time that options are granted expected forfeiture rates are estimated and used to reduce the amount expensed over the life of the options. The estimated forfeiture rate is adjusted to actual forfeiture experience as information becomes available. Under Canadian GAAP, EGI has recorded the impact of forfeitures in the period that the forfeiture occurred.

Management has determined that both of the differences noted above result in an adjustment to the opening balance sheet as at January 1, 2010 and the balance sheet as at December 31, 2010. As at January 1, 2010 and December 31, 2010, Contributed surplus was increased by \$13,000 and Retained earnings decreased by \$13,000.

Valuation of preferred shares designated as available-for-sale

Under IFRS, available-for-sale (AFS) equity investments not quoted in an active market must be measured at fair value, unless fair value cannot be reliably measured. Under Canadian GAAP, such assets were measured at cost. Preferred shares purchased in the first quarter of 2010 at a cost of \$2,000 are recorded at a fair value of \$2,000 as at March 31, 2010, and December 31, 2010.

Impact on future quarterly earnings

As noted, unrealized gains or losses related to the foreign currency translation of monetary investments designated as AFS will be recorded to income on a quarterly basis. Due to the relatively low amount of US\$ bonds expected to be held by EGI, it is expected that the amounts recorded to income on a quarterly basis will be immaterial. Similarly the differences in accounting for stock options under IFRS will result in an insignificant impact to the future quarterly results of EGI.

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 March 31, 2011, 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 March 31, 2011, 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 as at March 31, 2011, was effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

There have been no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2011, 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:

(\$ THOUSANDS EXCEPT PER SHARE DATA)	2011		2010		2009 (Canadian GAAP Basis)			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Direct written and assumed premiums	30,850	37,054	48,636	55,991	43,990	39,303	44,455	48,487
Total revenues (excluding investment income)	40,344	42,121	42,149	40,379	38,224	36,439	35,881	35,486
Underwriting income (loss)	(113)	2,057	(2,897)	(3,178)	(5,805)	(9,454)	284	1,703
Income (loss) before income taxes	4,289	5,678	1,079	2,804	(2,501)	(3,280)	3,381	7,415
Net income (loss)	3,028	3,253	729	2,018	(1,846)	(2,347)	2,261	4,831
Earnings per adjusted share								
– Basic	\$0.25	\$0.27	\$0.06	\$0.17	\$(0.15)	\$(0.20)	\$0.19	\$0.41
– Diluted	\$0.24	\$0.25	\$0.06	\$0.16	\$(0.14)	\$(0.19)	\$0.18	\$0.38
Selected financial ratios (%)								
Loss ratio	65.7	63.3	73.6	73.3	83.4	92.1	63.6	61.8
Expense ratio	34.6	31.8	33.3	34.6	31.8	33.8	35.6	33.4
Combined	100.3	95.1	106.9	107.9	115.2	125.9	99.2	95.2

Quarter Ended March 31, 2011, Compared to Quarter Ended March 31, 2010

The following financial information compares first quarter 2011 results with the first quarter of 2010.

(\$ THOUSANDS)	1 st Quarter 2011	1st Quarter 2010	Variance \$	Variance %
Direct written premiums	30,850	43,990	(13,140)	(29.9)
Net written premiums	27,919	38,216	(10,297)	(26.9)
Net earned premiums	40,344	38,224	2,120	5.5
Claims incurred	26,504	31,860	(5,356)	(16.8)
Acquisition costs	8,828	8,537	291	3.4
Operating expenses	5,125	3,637	1,488	40.9
Underwriting loss	(113)	(5,810)	5,697	(98.1)
Investment income	4,402	3,574	828	23.2
Interest expense	–	299	299	–
Net income (loss) before income taxes	4,289	(2,535)	6,824	270.2
Income tax expense (recovery)	1,261	(689)	1,950	283.0
Net income (loss)	3,028	(1,846)	4,874	264.0

Insurance Operation

Written Premiums

Direct written premium declined in both Canadian divisions compared to the first quarter of 2010. Personal Lines premiums decreased 25.6% to \$21.7 million in 2011 compared to the first quarter of 2010. The decline can be directly attributed to management's initiative to write and renew all Ontario private passenger automobile policies with a six-month term late in 2010. As a result, written premiums decreased due to shorter-term policies, as compared to policies with 12-month terms, however earned premiums are not affected. The initiative was undertaken to more efficiently implement premium rate increases at time of renewal and to increase administrative fee income associated with six-month policies. Premium volumes for recreational and miscellaneous vehicles continue to grow but are not yet material to the overall results.

Direct written premiums for the Niche Products division decreased 39.9% to \$8.9 million for the three months ended March 31, 2011. The decrease is primarily attributable to the cancellation of an unprofitable commercial auto program which had generated written premium of \$5.2 million in the first quarter of 2010.

Net written premiums decreased 26.9% to \$27.9 million compared to the same period last year. This decrease is in line with the decrease in direct premiums written.

Earned Premiums

Net earned premiums for the three months ended March 31, 2011, totaled \$40.3 million, an increase of 5.5% over the first quarter in the prior year. As noted above, despite the decline in net written premiums, caused largely by the issuance of six-month policy terms in the Ontario non-standard auto line of business, earned premium is not affected. As a result earned premiums have increased on a year-over-year basis due to the growth in direct premiums written in the last three quarters of 2010 which are now impacting earned premium in the first quarter of 2011.

Incurred Claims Expense

Net incurred claims decreased for the three months ended March 31, 2011, to \$26.5 million compared to \$31.9 million in the first quarter of 2010. The total Company loss ratio was 65.7% for the quarter compared to 83.4% in 2010. This significant improvement was the result of improved claims experience in both Canadian divisions.

The Personal Lines division recorded a loss ratio of 68.1% for the quarter ended March 31, 2011, compared to a loss ratio of 87.4% for the same period in 2010. The improvement was evident in the non-standard auto line which improved to 67.2% from 92.5% in 2010. As noted earlier, a number of management initiatives taken in 2010 contributed to the improved result. Reduced exposure to the GTA and surrounding area, premium rate increases and the transfer of selected risks to the Ontario Facility risk share pool were actions taken which were designed to reduce the loss ratio, particularly in the dominant Ontario non-standard auto line. In addition, positive prior year development of \$2.4 million for this division in the first quarter of 2011 compared to negative prior year development of \$2.0 million in the first quarter of 2010 also contributed to the improved result.

The loss ratio for the Niche Products division improved to 56.1% in the three month period ended March 31, 2011, compared to 73.9% for the same period last year. The cancellation of several unprofitable programs and more restrictive underwriting on other underperforming programs led to this improved result.

The International division experienced a loss ratio of 112.8% for the first quarter of 2010; however, earned premiums in this relatively new division are low and the impact of losses incurred in this division is minimal for the quarter.

On a total Company basis, positive development of prior year claims was \$4.0 million in the first quarter of 2011 compared to total negative development of \$2.0 million of the first three months of 2010.

Acquisition Costs

Net acquisition costs, which mainly consist of commissions and premium taxes, increased 3.4%, to \$8.8 million for the three months ended March 31, 2011, compared to \$8.5 million in the same period in 2010. The increase is closely in line with the increase in net earned premiums in the quarter compared to 2010.

Operating Expenses

Total operating expenses increased to \$5.1 million in the first quarter of 2011 compared to \$3.6 million in the same period in 2010. The significant increase was primarily due to a non-recurring reversal of a 2009 bonus accrual in the first quarter of 2010, which was not paid. In addition, in the first quarter of 2011, increased efforts to improve the system infrastructure of the Company in 2011 have contributed to the increase in expenses in the quarter compared to 2010.

Underwriting Income (Loss)

Underwriting results reflect revenues from net earned premiums less claims, acquisition and operating expenses. In the quarter ended March 31, 2011, total underwriting contribution increased \$5.7 million to an underwriting loss of \$0.1 million, compared to an underwriting loss of \$5.8 million for the comparable period in 2010. The underwriting result for 2011 and 2010 includes \$0.4 million and \$0.3 million, respectively, of corporate and other expenses which have not been allocated to the operating divisions.

Both of the Canadian divisions recorded underwriting gains in the first quarter of 2011. The underwriting gain from the Personal Lines division for the three months ended March 31, 2011, was \$1.0 million, a significant improvement of \$5.0 million, compared to loss of \$4.0 million for the first three months of 2010. This improvement was primarily due to improved claims experience.

The Niche Products division recorded a modest underwriting profit for the three months ended March 31, 2011, compared to an underwriting loss of \$1.3 million in the first three months of 2010. The improved loss ratio in the quarter was again the main factor in the improved result.

The International division experienced an underwriting loss of \$0.8 million in the first quarter of 2011, compared to a loss of \$0.3 million in the first three months of 2010. The result was due to continued operating expenses incurred in this newly created division. In addition in the first quarter of 2010, positive claims development of prior year claims related to cancelled, assumed reinsurance contracts from external U.S. reinsurers, contributed to the result.

Investment Income

Investment income for the three months ended March 31, 2011, was \$4.4 million compared to \$3.6 million for the same period in 2010. Income from interest and dividends net of investment expenses was \$3.2 million, compared to \$3.0 million in the same period last year. Net realized gains on the sale of investments were \$1.1 million in the first three months of 2011 compared to net gains of \$0.9 million in the same period in 2010.

Also during the first quarter of 2011, an increase of \$0.2 million in the fair value of preferred shares, designated as held-for-trading, was included in investment income. There were no investments designated as held-for-trading in the first quarter of 2010.

An unrealized foreign exchange loss of \$0.1 million was also recorded in the first quarter of both 2011 and 2010 related to the foreign exchange component of the decline in value of fixed income securities, denominated in U.S. dollars, designated as available-for-sale investments. No investment impairments were recorded in the first quarter of 2011 or 2010.

EGI's investment portfolio, including finance receivables, based on fair values, increased to \$378.8 million, or 12.6%, compared to total fair values of \$336.3 million as at March 31, 2010.

Interest Expense

During the first three months of 2011, the Company did not incur any interest expense. In the first three months of 2010, interest expense of \$0.3 million, related to bank indebtedness, was incurred.

Net Income before Income Taxes

Net income before income taxes of \$4.3 million was recorded in the three months ended March 31, 2011, compared to a loss before income taxes of \$2.5 million for the same period last year.

For the three months ended March 31, 2011, an underwriting loss of \$0.1 million plus investment income of \$4.4 million comprised the net gain before income taxes of \$4.3 million. This compares to an underwriting loss of \$5.8 million, plus investment income of \$3.7 million, less interest expense on bank indebtedness of \$0.3 million, in the first three months of 2010.

Income Taxes

Income tax expense of \$1.3 million was recorded in the quarter ended March 31, 2011, compared to a recovery of \$0.7 million recorded for the first quarter of 2010. The effective tax rate of 29% recorded in the first quarter of 2011 compares to 27% in the first quarter of 2010. Adjustments made in the first quarter of 2010 lowered the effective tax rate last year.

Net operating income (loss)

The net operating contribution increased to an income of \$2.2 million in the first three months of 2011 compared to a net operating loss of \$2.4 million in the same period last year. Net operating income or loss

excludes the after-tax impact of net realized and unrealized gains or losses recorded in investment income. Realized and unrealized gains of \$1.3 million and \$0.9 million have been excluded from the first quarter of 2011 and 2010 net loss, respectively.

Other comprehensive income

An other comprehensive loss of \$0.5 million was recorded in the first quarter of 2011 compared to income of \$2.0 million for the same period in 2010. The loss in the first quarter of 2011 represents the decrease in fair value of fixed income holdings designated as available-for-sale during the quarter, less the reclassification of realized gains to net income, and the unrealized gain/loss on translation of financial statements of self-sustaining foreign operations.

BALANCE SHEET ANALYSIS

The Balance Sheet analysis that follows should be read in conjunction with the unaudited interim consolidated first quarter 2011 financial statements and notes therein, which include additional disclosures related to balance sheet risk management.

Investments

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

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

Each of EGI's investment managers operates under an investment management agreement which provides the investment manager with a discretionary mandate to hold one or more types of securities and/or cash. The investment manager receives an annual fee (payable quarterly) based on a negotiated percentage of the market value of the portfolio being managed. The investment manager's engagement is subject to immediate cancellation by EGI, without penalty, upon giving written notice.

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

The following table sets forth EGI's invested assets as at March 31, 2011, December 31, 2010 and January 1, 2010.

Available-for-sale	Carrying and fair values		
	March 31, 2011	December 31, 2010	January 1, 2010
Bonds			
Canadian			
Federal	90,310	91,664	83,777
Provincial	42,153	48,130	44,696
Municipal	7,851	5,855	6,254
Corporate	118,980	111,789	90,024
	259,294	257,438	224,751
United States			
Federal	2,993	3,585	–
Corporate	8,237	8,377	6,819
	11,230	11,962	6,819
Total bonds	270,524	269,400	231,570
Preferred shares	2,000	2,000	7,567
Common shares			
Canadian	72,872	69,535	52,210
United States	1,260	1,254	1,072
	74,132	70,789	53,282
Total available-for-sale	346,656	342,189	292,419
Held for trading			
Preferred shares	10,201	9,373	–
Investment income due and accrued	3,137	2,081	1,946
Total investments	359,994	353,643	294,365

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

Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired, including in the case of equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost. If such evidence exists, the Company recognizes an impairment loss, as follows:

- (i) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.
- (ii) Available-for-sale financial assets: The impairment loss is the difference between the amortized cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of income. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to net income.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the

impairment was recognized.

If, in a subsequent period, the fair value of an available-for-sale debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income (AOCI), the impairment loss is reversed through the statement of income.

Impairment losses on available-for-sale equity instruments are not reversed.

There was no impairment loss recognized in the first quarter of 2011 or 2010.

A remaining gross unrealized loss of \$2,150 on AFS investments held as at March 31, 2011 (\$1,719 – December 31, 2010; \$3,167 – January 1, 2010), is recorded, net of tax, in the amount of \$1,483 (\$1,186 – December 31, 2010; \$2,123 – January 1, 2010) as Accumulated Other Comprehensive Loss.

Recoverable from Reinsurers

(\$ THOUSANDS)	As at March 31, 2011	As at Dec. 31, 2010	As at Jan 1, 2010
Reinsurers' share of unpaid claims	36,188	36,152	38,736
Reinsurers' share of unearned premiums	5,203	6,471	4,972
Total	41,391	42,623	43,708

As at March 31, 2011, the recoverable from reinsurers decreased to \$41.3 million compared to \$42.6 million as at December 31, 2010. The decrease reflects the decrease in gross and ceded unearned premiums due to the limiting of policy terms to six months in the Ontario auto line of business. All reinsurers, with balances due, have a rating of B++ or above as determined by A.M Best, except for certain Niche Products distributors who share a portion of the risk with EGI, for whom EGI holds deposits.

Accounts Receivable

(\$ THOUSANDS)	As at March 31, 2011	As at Dec. 31, 2010	As at Jan 1, 2010
Premium financing receivables	18,827	26,692	27,007
Facility Association	(90)	(154)	(133)
Agents and brokers	4,753	4,984	5,994
Other	–	190	82
Total	23,490	31,712	23m950

Premium financing receivables are the largest component of this asset as at March 31, 2011, and represent approximately 80% or \$18.8 million of total receivables. During the first quarter of 2011, premium financing receivables decreased to \$18.8 million from \$26.7 million at December 31, 2010. These premiums are primarily billed directly to policyholders who are provided with a monthly payment financing option. The decrease is directly attributable to the offering of maximum six-month policy terms in the Ontario auto line of business.

Provision for Unpaid Claims

EGI establishes loss reserves to provide for future amounts required to pay claims related to insured events, that have occurred and been reported but have not yet been settled, and related to events that have occurred but have not yet been reported to EGI. 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 that EGI's provision for unpaid claims (often called "reserves") is adequate, management has retained the services of an independent actuary.

The table below shows the development of the provision for claims reserves, including loss adjustment expenses as at December 31 in each year of the four years and for the three months ended March 31, 2011.

(\$ THOUSANDS)	Years ended December 31				
	2010	2009	2008	2007	2006
Reserve Carried (actuarial present value basis) ⁽¹⁾	239,036	207,220	185,255	169,091	146,101
Reserve at December 31, 2007					107,992
Cumulative paid to December 31, 2007					30,491
Cumulative Redundancy (Deficiency)					7,618
Reserve at December 31, 2008				118,675	81,249
Cumulative paid to December 31, 2008				44,790	53,520
Cumulative Redundancy (Deficiency)				5,626	11,332
Reserve at December 31, 2009			133,213	89,063	59,530
Cumulative paid to December 31, 2009			53,253	73,853	74,402
Cumulative Redundancy (Deficiency)			(1,211)	6,175	12,169
Reserve at December 31, 2010		146,455	96,526	58,723	36,349
Cumulative paid to December 31, 2010		57,465	92,567	105,567	97,824
Cumulative Redundancy (Deficiency)		3,300	(3,838)	4,801	11,928
Reserve at March 31, 2011	217,545	138,627	91,453	55,187	34,313
Cumulative paid to March 31, 2011	17,237	64,898	98,030	109,476	100,247
Cumulative Redundancy (Deficiency)	4,254	3,696	(4,228)	4,428	11,541

1) Amounts include Provision for Adverse Deviation (PfAD) of \$25,441 for 2010, \$22,688 for 2009; \$20,102 for 2008; \$17,401 for 2007; and \$14,756 for 2006.

The table above, which is reflected on a gross basis for all years, shows that the total prior year reserve redundancies included in the first quarter 2011 financial results, pursuant to the March 31, 2011, actuarial report, were \$4.2 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.

Share Capital

As of May 3, 2011, there were 12,059,582 common shares issued and outstanding. (See Note 13 to the unaudited interim consolidated first quarter 2011 financial statements.)

Liquidity and Capital Resources

The purpose of liquidity management is to ensure there is sufficient cash to meet all of EGI's financial commitments and obligations as they come due. The Company has suspended quarterly dividends to its common shareholders, to assist in building a stronger capital base to support future growth. 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. Additionally EGI was able to raise \$20.8 million in net proceeds from a rights offering in July 2008 to supplement current resources and

further strengthen its liquidity position. 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 incurred interest of 6.2% per annum which was payable monthly over the three-year term of the agreement. After three years, EGI was obligated to repay the amounts drawn as at the termination of the agreement. See "Risk Factors – Future Capital Requirements". Pursuant to the credit facility agreement, EGI was required to comply with various financial covenants and financial information reporting requirements.

The loan, which was due in October 2010, was repaid in full by EGI in June 2010. Internal resources were used to fund the \$19.55 million payment and EGI continues to be well capitalized.

EGI's contractual obligations relating to operating leases are \$1.1 million, due in less than a year, and \$8.2 million, due in the next nine years.

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

Capital Resources

For the three months ended March 31, 2011, shareholders' equity increased to \$148.9 million, an increase of \$2.0 million from December 31, 2010. The net increase was the result of net income of \$3.0 million in the quarter offset by an other comprehensive loss of \$0.5 million in the quarter.

As at March 31, 2011, Echelon General's Minimum Capital Test (MCT) ratio was 260%, compared to 250% as at December 31, 2010, significantly exceeding the minimum regulatory capital level required by the Office of the Superintendent of Financial Institutions.