

Consolidated Financial Statements of

**EGI FINANCIAL HOLDINGS INC.**

For the quarters ended March 31, 2011 and 2010

**(IFRS Basis)**

**EGI FINANCIAL HOLDINGS INC.**  
**Consolidated Statements of Financial Position**  
**as at March 31, 2011, December 31, 2010, and January 1, 2010**  
(unaudited, in thousands of Canadian dollars)

	Note	March 31 2011	December 31 2010	January 1 2010
<b>Assets</b>				
Cash and short-term deposits		17,775	17,033	46,885
Investments	6	359,994	353,643	294,365
Accounts receivable		23,490	31,712	32,950
Due from insurance companies		3,930	7,352	5,545
Deferred policy acquisition costs	8	13,821	15,979	14,807
Reinsurers' share – unearned premium	7	5,203	6,471	4,972
– provision for unpaid claims	9	36,188	36,152	38,736
Prepaid expenses and other assets		1,423	1,361	2,947
Property and equipment		305	414	838
Intangible assets		603	531	468
Deferred income taxes		4,180	4,135	3,952
		466,912	474,783	446,465
<b>Liabilities</b>				
Bank indebtedness		–	–	19,550
Payable to insurance companies		1,506	2,093	1,829
Accounts payable and accrued liabilities		5,284	4,824	6,312
Income taxes payable		1,052	2,394	4,151
Unearned premiums	7	64,642	78,335	72,643
Unearned commission		671	728	513
Other liabilities		440	1,007	816
Provision for unpaid claims	9	244,381	239,036	207,220
		317,976	328,417	313,034
<b>Shareholders' Equity</b>				
Share capital	13	69,087	69,087	68,618
Contributed surplus		608	545	416
Retained earnings		66,702	63,674	59,525
Accumulated other comprehensive income		12,539	13,060	4,872
Total shareholders' equity		148,936	146,366	133,431
		466,912	474,783	446,465

**EGI FINANCIAL HOLDINGS INC.**

**Consolidated Statements of Income and Comprehensive Income  
for the three months ended March 31, 2011 and 2010**

(unaudited, in thousands of Canadian dollars, except per share amounts)

	Note	2011	2010
<b>Revenue</b>			
Gross written and assumed premiums		30,850	43,990
Less: Premiums ceded to reinsurers		(2,931)	(5,774)
Net written and assumed premiums		27,919	38,216
(Increase) decrease in gross unearned premiums		13,693	(2,113)
Increase (decrease) in unearned premiums, reinsurers' share		(1,268)	2,121
Change in provision for unearned premiums		12,425	8
Net earned premiums		40,344	38,224
Investment income	6	4,402	3,574
<b>Total revenue</b>		<b>44,746</b>	<b>41,798</b>
<b>Expenses</b>			
Gross claims incurred		27,910	33,348
Less: claims recoveries from reinsurers		(1,406)	(1,488)
Net incurred claims		26,504	31,860
Acquisition costs		8,828	8,537
Operating costs	14	5,125	3,637
Interest		-	299
<b>Total expenses</b>		<b>40,457</b>	<b>44,333</b>
Income before income taxes		4,289	(2,535)
Income tax expense (recovery)		1,261	(689)
<b>Net income (loss)</b>		<b>3,028</b>	<b>(1,846)</b>
<b>Other comprehensive income (loss), net of taxes</b>			
Available-for-sale securities:			
Change in net unrealized gains		519	2,589
Reclassification of net realized (gains) losses to net income		(754)	(607)
Cumulative translation (loss) gain		(286)	46
<b>Other comprehensive income (loss) attributable to shareholders of the Company</b>		<b>(521)</b>	<b>2,028</b>
<b>Total comprehensive income (loss) attributable to shareholders of the Company</b>		<b>2,507</b>	<b>182</b>
<b>Earnings per share attributable to shareholders of the Company</b>			
	15		
Net income per share – basic		0.25	(0.15)
Net income per share – diluted		0.24	(0.14)

**EGI FINANCIAL HOLDINGS INC.**

**Consolidated Statements of Changes in Equity  
for the three months ended March 31, 2011 and 2010**

(unaudited, in thousands of Canadian dollars)

	<b>Share Capital</b>	<b>Contributed Surplus</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Retained Earnings</b>	<b>Total</b>
Balance at January 1, 2011	69,087	545	13,060	63,674	146,366
Net income	–	–	–	3,028	3,028
Other comprehensive income (loss)	–	–	(521)	–	(521)
Common shares issued	–	–	–	–	–
Stock options					
– granted (net of forfeitures)	–	63	–	–	63
– exercised	–	–	–	–	–
<b>Balance at March 31, 2011</b>	<b>69,087</b>	<b>608</b>	<b>12,539</b>	<b>66,702</b>	<b>148,936</b>

	<b>Share Capital</b>	<b>Contributed Surplus</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Retained Earnings</b>	<b>Total</b>
Balance at January 1, 2010	68,618	416	4,872	59,525	133,431
Net income (loss)	–	–	–	(1,846)	(1,846)
Other comprehensive income	–	–	2,028	–	2,028
Common shares issued	18	–	–	–	18
Stock options					
– granted (net of forfeitures)	–	73	–	–	73
– exercised	–	(5)	–	–	(5)
<b>Balance at March 31, 2010</b>	<b>68,636</b>	<b>484</b>	<b>6,900</b>	<b>57,679</b>	<b>133,699</b>

**EGI FINANCIAL HOLDINGS INC.**

**Consolidated Statement of Cash Flow  
for the three months ended March 31, 2011 and 2010**

(unaudited, in thousands of Canadian dollars)

	<b>2011</b>	<b>2010</b>
Cash provided by (used in):		
Operating activities		
Net income (loss)	3,028	(1,846)
Items not involving cash:		
Amortization	117	447
Amortization of premiums on bonds	269	173
Realized and unrealized (gains) losses on investments	(1,155)	(826)
(Increase) decrease in accrued investment income	(1,056)	(891)
Other	63	73
	1,266	(2,870)
Net change in other non-cash balances	4,392	4,939
	5,658	2,069
Financing activities		
Issue of common shares	-	15
Investing activities		
Acquisition of subsidiary, net of cash acquired	-	221
Purchases of property and equipment and intangible assets	(80)	(280)
Purchase of investments	(76,477)	(83,178)
Sale/maturity of investments	71,641	71,992
	(4,916)	(11,245)
Increase (decrease) in cash and short-term deposits	742	(9,161)
Cash and short-term deposits, beginning of period	17,033	46,885
Cash and short-term deposits, end of period	17,775	37,724
Supplementary information		
Income taxes paid	2,657	6,102
Interest paid	-	302

## **EGI FINANCIAL HOLDINGS INC.**

### **Notes to Consolidated Interim Financial Statements for the three months ended March 31, 2011 and 2010**

(unaudited, in thousands of Canadian dollars)

#### **1 Organization**

EGI Financial Holdings Inc. (the Company) was incorporated on August 18, 1997, under the Business Corporations Act (Ontario) and is incorporated and domiciled in Canada. The Company is principally engaged, through its subsidiaries, in property and casualty insurance in Canada and the U.S. The Company's head office is located at 2680 Matheson Blvd. East, Suite 300, Mississauga, Ontario.

The Company purchased American Colonial Insurance Company (ACIC) during the first quarter of 2010 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 fair value 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 is 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; and 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 Basis of preparation and adoption of 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 (IFRS), and requires 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.

These 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.

## **EGI FINANCIAL HOLDINGS INC.**

### **Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010**

(unaudited, in thousands of Canadian dollars)

The policies applied in these 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 these interim consolidated financial statements, including the transition adjustments recognized on change-over to IFRS.

The interim consolidated financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010.

### **3 Summary of significant accounting policies**

These interim consolidated financial statements have been prepared in accordance with IFRS. The preparation of the interim consolidated financial statements in accordance with IFRS 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 interim financial statements. Estimates also affect the reported amounts of revenue and expenses for the reporting period for the consolidated statements of income. Actual results could differ from those estimates.

#### **Basis of measurement**

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value, including available-for-sale investments.

#### **Consolidation**

The financial statements of the Company consolidate the accounts of EGI Financial Holdings Inc. and its subsidiaries. All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Subsidiaries are those entities, including special purpose entities, which EGI Financial Holdings Inc. controls by having the power to govern the financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether EGI Financial Holdings Inc. controls another entity. Subsidiaries are fully consolidated from the date on which control is obtained by EGI Financial Holdings Inc. and are de-consolidated from the date that control ceases.

#### **Business Combinations**

Consideration transferred in a business combination is measured at fair value at the date of acquisition and includes any cash paid plus the fair value of assets given, liabilities incurred and equity instruments issued by the company. The consideration transferred also includes contingent consideration arrangements, if any, recorded at fair value. Directly attributable acquisition-related costs are expensed in the current period and reported within operating expenses. At the date of acquisition, the Company recognizes the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired business. The identifiable assets acquired and the liabilities assumed are initially recognized at fair value. The excess of the consideration paid over the fair value of net assets acquired is recorded as goodwill. Where the fair value of

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

(unaudited, in thousands of Canadian dollars)

consideration paid is less than the fair value of net assets acquired, the excess is recognized in the income statement. Any pre-existing equity interests in an acquiree are re-measured to fair value at the date of the business combination and any resulting gain or loss is recognized in the income statement.

#### Foreign currency translation

(i) Functional and presentation currency

Items included in the financial statements of each consolidated entity of the Company are measured using the currency of the primary economic environment in which the entity operates (the “functional currency”). The consolidated financial statements are presented in Canadian dollars, which is the Company’s functional and presentation currency.

The financial statements of entities that have a functional currency different from the presentation currency of the Company (“foreign operations”) are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – at the average rate of the period (as this is considered a reasonable approximation to actual rates). All resulting changes are recognized in other comprehensive income (OCI) as cumulative translation adjustments.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in other comprehensive income related to the foreign operation are recognized in the income statement. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in other comprehensive income related to the subsidiary are reallocated between controlling and non-controlling interests.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates in effect at the date the transactions occurred. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at period-end exchange rates of monetary assets and liabilities are recognized in investment income in the statement of income. Exchange gains and losses related to non-monetary investments classified or designated as AFS are recorded in OCI.

#### 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 loans and receivables and are recorded at an amortized cost which approximates fair value.

#### Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

(unaudited, in thousands of Canadian dollars)

assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

- (i) **Financial assets and liabilities at fair value through profit or loss:** A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term, or if it is designated at fair value through profit or loss by management. The Company has designated as fair value through profit and loss under the fair value option financial assets which contain embedded derivatives that significantly alter the cash flows of the underlying asset.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statement of income. Gains and losses arising from changes in fair value are presented in the statement of income within investment income in the period in which they arise.

- (ii) **Available-for-sale investments:** Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company's available-for-sale assets comprise marketable securities and investments in debt and common equity securities.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in OCI.

Interest on available-for-sale investments, calculated using the effective interest method, is recognized in the statement of income within investment income. Dividends on available-for-sale equity instruments are recognized in the statement of income as part of other gains and losses when the Company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of income and included within investment income.

- (iii) **Loans and receivables:** Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of accounts receivables and cash and cash equivalents. Loans and receivables are initially recognized at fair value plus transaction costs. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less any provision for impairment.
- (iv) **Financial liabilities at amortized cost:** Financial liabilities at amortized cost include accounts payable and bank indebtedness. Accounts payable are initially recognized at fair value plus transaction costs. Subsequently, accounts payable are measured at amortized cost using the effective interest method. Bank indebtedness is recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

(unaudited, in thousands of Canadian dollars)

#### 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.

#### 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 period. 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 gross basis in the consolidated statements of income to indicate the results of direct and ceded premiums written and the portion of gross claims expense that is recoverable from reinsurers.

#### Revenue recognition

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

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

(unaudited, in thousands of Canadian dollars)

#### 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.

#### 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 and impairment. 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 deferred 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. Deferred 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 or other comprehensive income in the year which includes the date of enactment or substantive enactment. Deferred income tax assets are recognized to the extent the realization of such assets is more likely than not. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is intention to settle the balances on a net basis.

#### Stock-based compensation

The Company has a stock option plan. The 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 diluted basis) and shares

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

(unaudited, in thousands of Canadian dollars)

reserved for issuance under the employee stock option plans, options for services and employee stock purchase plans.

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.

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. At the time the 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.

#### Provisions

Provisions for restructuring costs, warranties and legal claims, where applicable, are recognized in other liabilities when the Company has a present legal or constructive obligation as a result of past events. It is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material. The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

#### Accounting standards issued but not yet applied

International Financial Reporting Standard 9, *Financial Instruments* ("IFRS 9"), was issued in November 2009. It addresses classification and measurement of financial assets and liabilities and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: Amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments are never recycled to profit and loss, but accumulated gains or losses can be transferred within shareholder's equity.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, *Financial Instruments – Recognition and Measurement*, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

(unaudited, in thousands of Canadian dollars)

#### 4 Critical accounting estimates and assumptions

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

##### *Policy Liabilities*

Policy liabilities consist of provisions for unpaid claims and unearned premium liabilities.

Claim liability reserves are maintained to cover EGI's estimated ultimate liability for unpaid losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. The provision for unpaid claims and adjustment expenses is first determined on a case-by-case basis as claims are reported and then reassessed as additional information becomes known. The provision also accounts for the future development of these claims, including claims incurred but not reported (IBNR). Reserves do not represent an exact calculation of liability, but instead represent estimates developed using projection techniques in accordance with Canadian accepted actuarial practice. These reserve estimates are expectations of the ultimate cost of settlement and administration of claims based on EGI's assessment of facts and circumstances then known, its review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors.

Variables in the reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, economic inflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. Additionally, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the insurer. Reserve estimates are refined in a systematic ongoing process as historical loss experience develops and additional claims are reported and settled. Because the establishment of reserves is an inherently uncertain process involving estimates, current reserves may not be sufficient. Adjustments to reserves, both positive and negative, are reflected in the statement of income for the period in which such estimates are updated.

The provision for unpaid claims and adjustment expenses is discounted to take into account the time value of money. It also includes a provision for adverse deviation, as required by Canadian accepted actuarial practice. The appointed actuary of EGI's subsidiaries, using appropriate actuarial techniques, evaluates the adequacy of the policy liabilities. Refer to note 9 for further information.

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

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

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

#### *Impairment of Financial Assets*

The Company considers an impairment if there is objective evidence that an available-for-sale financial assets 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.

Factors considered by the Company include but are not limited to:

- a) significant financial difficulty of the issuer or obligor;
- b) a breach of contract, such as a default or delinquency in interest or principal payments;
- c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- d) it becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- e) the disappearance of an active market for that financial asset because of financial difficulties; or
- f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - (i) adverse changes in the payment status of borrowers in the group (e.g., an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or
  - (ii) national or local economic conditions that correlate with defaults on the assets in the group (e.g., an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

#### *Reinsurance*

Reinsurance recoverables include amounts for expected recoveries related to provision for unpaid claims as well as the portion of the reinsured premiums which has not yet been earned by the reinsurer. The cost of reinsurance is accounted for over the terms of the underlying reinsured policies, using assumptions consistent with those used to account for the policies. Amounts recoverable from reinsurers are estimated in a manner consistent with claim and claim adjustment expense reserves and are reported in the consolidated balance sheet. The ceding of an insurance liability to a reinsurer does not discharge EGI's primary liability to the policyholders. The Company's policy is to record an estimated allowance for doubtful accounts on the basis of periodic evaluations of balances due from reinsurers, reinsurer solvency, management's experience and current economic conditions.

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

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#### *Income Taxes*

Judgement is used in determining provision for income taxes and the recording of current and deferred income taxes. Amounts are determined based on income tax laws and rates in effect or substantively enacted at the reporting date. Unforeseen future changes to income tax laws and rates may impact the reported value of future income taxes and adjustments may need to be made which will affect future reporting periods

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

Deferred income taxes, accumulated as a result of temporary differences, which are more likely than not to reverse, are included in the consolidated balance sheet. In addition, the consolidated statement of income contains items that are non-taxable or non-deductible for income tax purposes, which cause the income tax provision to differ from what it would be if based on statutory rates.

#### **5 Transition to IFRS**

The effect of the Company's transition to IFRS, described in note 2, is summarized in this note as follows:

- (i) Transition elections
- (ii) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS
- (iii) Adjustments to the statement of cash flows

##### **(i) Transition elections**

The Company has applied the mandatory transition exceptions and the following optional exemptions to full retrospective application of IFRS.

	<u>As described in note 5(ii)</u>
Cumulative translation adjustment	(b)
Business combinations	(d)
Insurance contracts	(f)
Classification and measurement of previously recognized financial statements	(g)

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**(ii) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS**

	Note	December 31, 2010	March 31, 2010	January 1, 2010
<b>Equity</b>				
Equity as reported under Canadian GAAP		\$146,366	\$133,699	\$133,431
IFRS adjustments increase (decrease):				
Adjustment to AOCI - unrealized foreign exchange gains and losses related to investments designated as available-for-sale.	(a)	166	161	85
Adjustment to AOCI- election re cumulative translation adjustment account	(b)	678	678	678
Adjustment to contributed surplus- stock options- graded vesting adjustment	(c)	13	13	13
Adjustments to retained earnings	(a)(b)(c)	(857)	(852)	(776)
Equity as reported under IFRS		\$146,366	\$133,699	\$133,431

	Note	Year ended December 31, 2010	Three months ended March 31, 2010
<b>Comprehensive income</b>			
As reported under Canadian GAAP		\$12,337	\$182
Increase(decrease) in net income for:			
Unrealized foreign exchange gain (loss) re AFS investments	(a)	(81)	(76)
Increase (decrease) in other comprehensive income for:			
Unrealized foreign exchange gain (loss) re AFS investments	(a)	81	76
As reported under IFRS		\$12,337	\$182

**Explanatory notes**

- (a) 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

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

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- and increase OCI for the three month period ended March 31, 2010, and year ended December 31, 2010, respectively.
- (b) In accordance with IFRS transitional provisions, the Company has elected to reset the cumulative translation adjustment account, which includes unrealized gains and losses arising from the translation of foreign operations, to zero at the date of transition to IFRS. An adjustment of \$678 to reduce retained earnings and increase accumulated other comprehensive income has been recorded as at January 1, 2010, and December 31, 2010.
  - (c) Under IFRS the Company accrues the cost of employee stock options over the vesting period using the graded method of amortization rather than the straight-line method, which was the Company's policy under Canadian GAAP. An adjustment of \$13 to increase contributed surplus and decrease retained earnings was made to reflect stock options granted and outstanding as at January 1, 2010. There were no additional adjustments for the three months ended March 31, 2011 and the year ended December 31, 2010.
  - (d) Under IFRS, available-for-sale 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 are recorded at fair value of \$2,000 as at March 31, 2010 and December 31, 2010.
  - (e) In accordance with IFRS transitional provisions, the Company elected to apply IFRS relating to business combinations prospectively from January 1, 2010. As such, Canadian GAAP balances relating to business combinations entered into before that date, including goodwill, have not been retrospectively restated and have been carried forward without adjustment.
  - (f) The Company has elected to apply the transitional provisions in IFRS 4, Insurance Contracts, and disclose only five years of data in its claim development tables, as permitted by IFRS 4 in the year of adoption of IFRS. The disclosure will be increased in each succeeding additional year, until the full ten years of information is included.
  - (g) In accordance with IFRS transitional provisions, the Company has elected to reclassify cash and cash equivalents as loans and receivables. Previously, under Canadian GAAP, cash and cash equivalents were classified as held-to-maturity investments. There was no financial statement impact related to the reclassification.

#### **(iii) Adjustments to the statement of cash flows**

The transition from Canadian GAAP to IFRS had no significant impact on cash flows generated by the Company. Under Canadian GAAP, cash flows relating to interest payments were classified as operating. IFRS provides an accounting policy choice of classifying interest as operating, investing or financing depending on the nature of the underlying cash flows. Classification must remain consistent from period to period. The Company has chosen to classify cash flows relating to interest payments as operating.

**EGI FINANCIAL HOLDINGS INC.**

**Notes to Consolidated Interim Financial Statements (continued)  
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**6 Investments**

The Company' policy is to utilize 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 March 31, 2011, December 31, 2010, and January 1, 2010:

<b>Available-for-sale</b>	<b>Carrying and fair values</b>		
	<b>March 31, 2011</b>	<b>December 31, 2010</b>	<b>January 1, 2010</b>
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
<b>Total bonds</b>	<b>270,524</b>	<b>269,400</b>	<b>231,570</b>
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
<b>Total available-for-sale</b>	<b>346,656</b>	<b>342,189</b>	<b>292,419</b>
<b>Held for trading</b>			
Preferred shares	10,201	9,373	–
Investment income due and accrued	3,137	2,081	1,946
<b>Total investments</b>	<b>359,994</b>	<b>353,643</b>	<b>294,365</b>

**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 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:

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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 within the fair value hierarchy, as outlined above, as at March 31, 2011, December 31, 2010, and January 1, 2010:

<b>Investments at fair value as at March 31, 2011</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Bonds	–	270,167	357	270,524
Equities	84,333	–	2,000	86,333
	84,333	270,167	2,357	356,857
<b>Investments at fair value as at December 31, 2010</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Bonds	–	269,090	310	269,400
Equities	80,162	–	2,000	82,162
	80,162	269,090	2,310	351,562
<b>Investments at fair value as at January 1, 2010</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
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 0.6% (December 31, 2010 – 0.6%; January 1, 2010 – 0.1%) of the total investment portfolio required to be measured at fair value) consists of corporate bonds and preferred shares with a fair

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value of \$357 (December 31, 2010 – \$310; January 1, 2010 – \$450) and \$2,000 (December 31, 2010 – \$2,000; January 1, 2010 – \$0) respectively.

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

	2011	2010
Balance at beginning of Quarter	2,310	450
Add: Additions during period – preferred shares	–	2,000
Less: Disposals during period – bonds	–	(308)
Net unrealized gains (losses) included in other comprehensive income	47	39
Balance at end of Quarter	2,357	2,181

**Impaired assets and provisions for losses**

The Board of Directors has established a policy to write down or make a provision for any investments that are impaired.

Management has reviewed currently available information regarding those investments whose estimated fair values are less than carrying values. For those investments that are considered impaired, the Company has recorded the difference between the cost, or amortized cost, of the investment and its fair value as an impairment, which reduces investment income recorded in the period.

An impairment loss of nil (2010 – \$0) was recognized.

A remaining gross unrealized loss of \$2,150 on 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 AOCI.

**Investment income**

Investment income was derived from the following:

	First Quarter 2011	First Quarter 2010
Interest income	3,010	2,861
Dividend income	493	456
Net realized gains	1,041	902
Fair value increase on HFT investments	165	–
Foreign exchange loss <sup>(1)</sup>	(42)	(334)
Investment expenses	(265)	(311)
	4,402	3,574

(1) The foreign exchange loss of \$42 (2010 – \$300) arose primarily from cash balances and available-for-sale securities held during the period, denominated in U.S. dollars, used to fund claims liabilities, denominated in U.S. dollars.

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**7 Unearned Premium**

	March 31, 2011		December 31, 2010		January 1, 2010	
	Gross	Ceded	Gross	Ceded	Gross	Ceded
Personal Lines:						
Automobile						
– accident benefits	12,408	886	16,802	1,220	17,471	1,100
– liability	22,890	1,637	28,130	1,900	24,901	1,499
– other	9,976	149	12,219	185	11,776	167
<b>Total Personal Lines</b>	<b>45,274</b>	<b>2,672</b>	<b>57,151</b>	<b>3,305</b>	<b>54,148</b>	<b>2,766</b>
Niche Products:						
Property						
– commercial	4,204	1,230	4,683	1,316	4,376	1,105
– personal	10,423	874	9,883	841	6,627	551
Liability	4,162	382	5,073	491	5,180	539
Accident and sickness	94	2	236	2	502	11
Commercial auto	123	43	958	516	452	–
Other	362	–	351	–	1,358	–
<b>Total Niche Products</b>	<b>19,368</b>	<b>2,531</b>	<b>21,184</b>	<b>3,166</b>	<b>18,495</b>	<b>2,206</b>
	<b>64,642</b>	<b>5,203</b>	<b>78,335</b>	<b>6,471</b>	<b>72,643</b>	<b>4,972</b>

Reconciliation of Unearned Premium at the end of the period:

	2011		2010	
	Gross	Ceded	Gross	Ceded
Unearned premium at the beginning of the period	78,335	6,471	72,643	4,972
Premium written and ceded during the period	30,849	2,931	43,990	5,774
Premium earned in income	44,542	4,199	41,878	3,654
<b>Unearned premium at the end of the period</b>	<b>64,642</b>	<b>5,203</b>	<b>74,755</b>	<b>7,092</b>

In the first quarter of 2011, the Company issued policies with a maximum six month policy term in the Ontario automobile line of business. This resulted in a decrease in premiums written for the period compared to the first quarter of 2010.

**8 Deferred policy acquisition costs**

Reconciliation of deferred acquisition costs at the end of the period:

	2011	2010
Balance at beginning of the period	15,979	14,807
Acquisition costs incurred during the period	6,751	9,122
Amortization of acquisition costs during the period	8,909	9,235
<b>Acquisition costs deferred at end of the period</b>	<b>13,821</b>	<b>14,694</b>

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

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#### 9 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 for 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 period.

The fair value of the provision for unpaid claims approximates carrying value determined in accordance with generally accepted actuarial methods in Canada, 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% for 2011 (2010 – 2.56%) for all lines of business. The Company determines the discount rate based on the 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 \$3,979 reduction to the net provision for unpaid claims relating to redundancies in prior periods' estimates (2010 – \$1,965 deficiency).

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 aggregate impact of the provision for adverse deviation is to increase the provision for unpaid claims on a gross basis by \$26,234 as at March 31, 2011 (December 31, 2010 – \$25,560; January 1, 2010 – \$22,688).

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

APV basis	March 31, 2011		December 31, 2010		January 1, 2010	
	Gross	Ceded	Gross	Ceded	Gross	Ceded
Personal Lines:						
Accident benefits	103,784	21,805	101,194	21,274	86,805	19,290
Liability	100,001	5,894	97,692	6,378	92,311	15,169
Other	3,356	429	4,052	422	3,914	667
<b>Total Personal Lines</b>	<b>207,141</b>	<b>28,128</b>	<b>202,938</b>	<b>28,074</b>	<b>183,030</b>	<b>35,126</b>
Niche Products:						
Property						
Commercial	4,734	600	4,098	640	3,278	266
Personal	597	106	367	78	307	109
Liability	22,986	2,692	22,338	2,670	16,291	2,903
Accident and sickness	2,828	683	2,647	696	3,222	332
Commercial auto	5,616	3,979	5,774	3,994	–	–
Other	479	–	874	–	1,092	–
<b>Total Niche</b>	<b>37,240</b>	<b>8,060</b>	<b>36,098</b>	<b>8,078</b>	<b>24,190</b>	<b>3,610</b>
	<b>244,381</b>	<b>36,188</b>	<b>239,036</b>	<b>36,152</b>	<b>207,220</b>	<b>38,736</b>

**Claims development**

Provision for unpaid claims analysis	2011	2010
Unpaid claims, beginning of quarter, net	202,884	168,484
Change in undiscounted estimates for losses of prior years	(3,571)	1,996
Change in discount rate	–	–
Change in PFADs	(1,984)	(1,146)
Interest cost	1,577	1,133
Provision for claims occurring in current year	30,482	29,877
Paid on claims occurring during		
Current year	(4,995)	(4,662)
Prior year	(16,200)	(13,903)
Unpaid claims, end of quarter, net	208,193	181,779
Reinsurers' share	36,188	39,050
	<b>244,381</b>	<b>220,829</b>

**10 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

## EGI FINANCIAL HOLDINGS INC.

### Notes to Consolidated Interim Financial Statements (continued) for the three months ended March 31, 2011 and 2010

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insurance risks originally accepted by the Company in writing premiums. This reinsurance does not relieve the Company of its primary obligation to policyholders.

During the first quarter of 2011, 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 (2010 – \$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 (2010 – \$2,000) to a maximum coverage of \$23,000 (2010 – \$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 judgement, 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.

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

##### ***Insurance risk***

The risk under any one insurance contract is the possibility that the event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, the risk is random and therefore unpredictable. The principal risk that the Company faces under its insurance contract is that the actual claims payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or the severity of the claims is greater than estimated. Insurance events are random and the actual number and amount of claims will vary from year to year from the estimate.

The concentration of insurance risk by product line, country, province or state, and underlying currency, will also impact financial results depending on the nature and location of events.

##### ***Impact of change in key ratios***

###### *Loss ratio*

An increase of 1% in the loss ratio would result in an increase of gross unpaid claims and IBNR to \$403. This increase in expense would be recognized in the income statement.

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#### *Expense ratio*

An increase of 1% in the operating expense ratio would result in an increase to operating expenses of \$403 and would reduce income before taxes by \$403.

#### ***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, 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 its 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 reports 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 consulting 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 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 its 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.

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 also to key personnel. The Company has developed business continuity plans designed to allow it 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 securities 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 a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows;
- the risk that future inflation of policyholder cash flows exceed returns on long-term investment securities; 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 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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**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 flows of the Company's fixed income securities portfolio. Generally, the Company's investment income will be reduced during sustained periods of lower interest rates as higher yielding fixed income securities 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 securities 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 securities portfolio as at March 31, 2011, December 31, 2010, and January 1, 2010, based on parallel 200 basis point shifts in interest rates up and down in 100 basis point increments.

<b>As at March 31, 2011</b>			
<b>Change in interest rates</b>	<b>Fair value of fixed income portfolio</b>	<b>Hypothetical change on fair value</b>	<b>Effect on OCI</b>
200 basis point rise	242,011	(11%)	(19,674)
100 basis point rise	255,526	(6%)	(10,439)
No change	270,524	–	–
100 basis point decline	287,230	6%	11,527
200 basis point decline	305,897	13%	24,407
<b>As at December 31, 2010</b>			
<b>Change in interest rates</b>	<b>Fair value of fixed income portfolio</b>	<b>Hypothetical change on fair value</b>	<b>Effect on OCI</b>
200 basis point rise	240,205	(11%)	(20,194)
100 basis point rise	254,069	(6%)	(10,604)
No change	269,400	–	–
100 basis point decline	286,394	6%	11,755
200 basis point decline	305,208	13%	24,768
<b>As at January 1, 20110</b>			
<b>Change in interest rates</b>	<b>Fair value of fixed income portfolio</b>	<b>Hypothetical change on fair value</b>	<b>Effect on OCI</b>
200 basis point rise	209,222	(10%)	(14,302)
100 basis point rise	219,883	(5%)	(7,830)
No change	231,570	–	–
100 basis point decline	244,428	6%	8,615
200 basis point decline	258,510	12%	18,050

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As discussed in note 9, 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 on net income:

<b>Change in discount rate</b>	<b>Net provision for unpaid claims</b>	<b>Hypothetical change in value</b>	<b>Effect on net income</b>
<b>As at March 31, 2011</b>			
100 basis point rise	203,406	(2%)	3,303
No change	208,193	–	–
100 basis point decline	213,230	2%	(3,475)
<b>As at December 31, 2010</b>			
100 basis point rise	198,267	(2%)	3,193
No change	202,884	–	–
100 basis point decline	207,752	2%	(3,367)
<b>As at January 1, 2010</b>			
100 basis point rise	164,529	(2%)	2,650
No change	168,484	–	–
100 basis point decline	172,691	2%	(2,819)

**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 securities.

The maturity profile of bonds as at March 31, 2011, December 31, 2010, and January 1, 2010, are as follows:

<b>March 31, 2011</b>	<b>Less than 1 year</b>	<b>1 – 3 years</b>	<b>3 – 5 years</b>	<b>Greater than 5 years</b>	<b>Total</b>
Bonds	23,863	38,319	54,486	153,856	270,524
Percentage of total	9%	14%	20%	57%	100%
<b>December 31, 2010</b>	<b>Less than 1 year</b>	<b>1 – 3 years</b>	<b>3 – 5 years</b>	<b>Greater than 5 years</b>	<b>Total</b>
Bonds	15,613	45,563	53,853	154,371	269,400
Percentage of total	6%	17%	20%	57%	100%
<b>January 1, 2010</b>	<b>Less than 1 year</b>	<b>1 – 3 years</b>	<b>3 – 5 years</b>	<b>Greater than 5 years</b>	<b>Total</b>
Bonds	16,796	36,058	61,473	117,243	231,570
Percentage of total	7%	16%	26%	51%	100%

**Future cash flows**

The following table summarizes the expected timing of cash flows arising from insurance obligations, on an undiscounted basis (note 9), as at March 31, 2011, December 31, 2010, and January 1, 2010:

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<b>March 31, 2011</b>	<b>Less than 1 year</b>	<b>1 – 3 years</b>	<b>3 – 5 years</b>	<b>Greater than 5 years</b>	<b>Total</b>
Actuarial liabilities (undiscounted)	72,674	87,262	47,388	30,294	237,618
Less: Reinsurance recoverable	12,550	3,123	5,681	2,814	34,168
Net actuarial liabilities	60,124	84,139	41,707	27,480	203,450
<b>December 31, 2010</b>	<b>Less than 1 year</b>	<b>1 – 3 years</b>	<b>3 – 5 years</b>	<b>Greater than 5 years</b>	<b>Total</b>
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
<b>January 1, 2010</b>	<b>Less than 1 year</b>	<b>1 – 3 years</b>	<b>3 – 5 years</b>	<b>Greater than 5 years</b>	<b>Total</b>
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

***Equity price risk***

Fluctuations in the value of equity securities 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 securities held.

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

The table below summarizes the potential impact of a 20% change in the value of the equity securities (common and preferred shares) on net income and OCI as at March 31, 2011, December 31, 2010, and January 1, 2010. 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.

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Change in equity holdings	Effect on Net Income			Effect on OCI		
	March 31 2011	December 31, 2010	January 1 2010	March 31 2011	December 31, 2010	January 1 2010
20% rise	1,408	–	–	10,230	9,803	8,153
20% decline	(1,408)	–	–	(10,230)	9,803	(8,153)

**Credit risk**

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

The following table sets forth the Company's fixed income securities portfolio by credit quality according to DBRS as at March 31, 2011, December 31, 2010, and January 1, 2010.

**Fixed income portfolio**

	As at March 31, 2011		As at December 31, 2010		As at January 1, 2010	
	Fair value	Fair value	Fair value	Fair value	Fair value	Fair value
AAA	115,511	43%	113,197	42%	111,702	48%
AA	63,673	24%	68,438	25%	64,446	28%
A	73,655	27%	72,602	27%	48,090	21%
BBB	14,534	5%	12,708	5%	6,882	3%
BB	2,356	1%	962	–	–	–
B	438	–	1,183	1%	–	–
CCC	357	–	310	–	–	–
Total	270,524	100%	269,400	100%	231,570	100%

**Reinsurance recoverables**

The following table summarizes the balances outstanding from reinsurers as at March 31, 2011, December 31, 2010, and January 1, 2010, by risk rating:

March 31, 2011			
Credit rating	Gross reinsurance recoverable	Less: Provisions and securities held	Net reinsurance recoverable
A	38,449	–	38,449
Not rated	3,554	6,098	–
	42,003	6,098	38,449

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<b>December 31, 2010</b>			
<b>Credit rating</b>	<b>Gross reinsurance recoverable</b>	<b>Less: Provisions and securities held</b>	<b>Net reinsurance recoverable</b>
A	41,936	–	41,936
Not rated	4,487	5,845	–
	46,423	5,845	41,936
<b>January 1, 2010</b>			
<b>Credit rating</b>	<b>Gross reinsurance recoverable</b>	<b>Less: Provisions and securities held</b>	<b>Net reinsurance recoverable</b>
A	44,590	–	44,590
Not rated	1,201	4,637	–
	45,791	4,637	44,590

Included in gross reinsurance recoverable is reinsurers' share of unearned premiums of \$5,203 (December 31, 2010 – \$6,471; January 1, 2010 – \$4,972), reinsurers' share of provision for unpaid claims of \$36,188 (December 31, 2010 – \$36,152; January 1, 2010 – \$38,736) and receivables from reinsurers presented as due from insurance companies of \$612 (December 31, 2010 – \$3,800; January 1, 2010 – \$2,083).

No balances due from reinsurers are considered past due as at March 31, 2011.

***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 but a significant portion of the claims incurred for this line of business are in U.S. dollars. A portion of the Company's cash and investments are 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 March 31, 2011, December 31, 2010, and January 1, 2010. 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 assets and financial liabilities, and should not be relied on as indicative of actual or future results.

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<b>March 31, 2011</b>			
<b>Change in CAD/ USD rate</b>		<b>Effect on Net Income</b>	<b>Effect on OCI</b>
10% rise		(290)	(1,127)
10% decline		290	1,127
<b>December 31, 2010</b>			
<b>Change in CAD/ USD rate</b>		<b>Effect on Net Income</b>	<b>Effect on OCI</b>
10% rise		(399)	(1,283)
10% decline		399	1,283
<b>January 1, 2010</b>			
<b>Change in CAD/ USD rate</b>		<b>Effect on Net Income</b>	<b>Effect on OCI</b>
10% rise		(360)	(1,360)
10% decline		360	1,360

## 12 Capital management

Capital is comprised of the Company's shareholders' equity which at March 31, 2011, was \$148,436 (December 31, 2010 – \$146,366; January 1, 2010 – \$133,431). 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.

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 March 31, 2011, was 1.0:1. 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. At March 31, 2011, December 31, 2010, and January 1, 2010, the Company exceeded the minimum regulatory capital requirement. Legislation applicable to insurance companies imposes certain restrictions on the Company's ability to pay dividends.

## 13 Share capital

	<b>March 31 2011</b>	<b>December 31 2010</b>	<b>January 1 2010</b>
Authorized			
Unlimited common shares			
Unlimited special shares issuable in Series			
Issued			
12,059,582 common shares (December 31, 2010 – 12,059,582 common shares; January 1, 2010 – 12,000,582 common shares)	69,087	69,087	68,618

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**14 Operating costs by nature**

	<b>First Quarter 2011</b>	<b>First Quarter 2010</b>
Salaries and benefits	3,567	1,626
Systems costs	907	648
Professional fees	251	197
Printing and postage	230	267
Other expenses	170	899
	<b>5,125</b>	<b>3,637</b>

**15 Income (loss) per share**

	<b>First Quarter 2011</b>	<b>First Quarter 2010</b>
Basic income per share:		
Net income (loss) available to common shareholders	3,028	(1,846)
Average number of common shares (in thousands)	12,060	12,002
Basic income (loss) per share	\$0.25	\$(0.15)
Diluted income per share:		
Average number of common shares (in thousands)	12,060	12,002
Average number of common shares obligation under employee stock option plan (in thousands)	784	785
Average number of diluted common shares (in thousands)	12,844	12,787
Diluted income (loss) per share	\$0.24	(0.14)

**16 Segmented information**

The Company operates through three divisions. 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.

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	<b>First Quarter 2011</b>	<b>First Quarter 2010</b>
Revenue		
Earned premiums and other revenue		
Property and casualty insurance		
Canada – Personal Lines	31,483	28,391
– Niche Products	8,699	9,827
	40,182	38,218
International (United States)	162	6
	40,344	38,224
Interest and dividends, net of investment expenses	3,238	3,006
Realized investment gains	1,041	902
Fair value increase on HFT investments	165	–
Foreign exchange losses	(42)	(334)
<b>Total revenue</b>	<b>44,746</b>	<b>41,798</b>
Income (loss) before income taxes		
Property and casualty insurance		
Canada – Personal Lines	1,029	(3,982)
– Niche Products	6	(1,257)
	1,035	(5,239)
International (United States)	(767)	(291)
Corporate and other	(381)	(280)
Underwriting loss	(113)	(5,810)
Interest and dividends, net of investment expenses	3,238	3,006
Realized investment gains	1,041	902
Fair value increase on HFT investments	165	–
Foreign exchange losses	(42)	(334)
Interest expense	–	(299)
<b>Total income before income taxes</b>	<b>4,289</b>	<b>(2,535)</b>

<b>Balance Sheet</b>	<b>March 31 2011</b>	<b>December 31 2010</b>	<b>January 1 2010</b>
Canada – Investments	351,237	344,146	290,558
– Provision for unpaid claims	243,581	238,076	203,526
International – Investments	8,757	9,497	3,807
– Provision for unpaid claims	800	960	3,694