Annual Report 2010

Outperforming

Charles Hamelin, three-time Olympic medalist

Who we are

Intact Financial Corporation is the largest provider of property and casualty (P&C) insurance in Canada, insuring approximately four million individuals and businesses through our subsidiaries. With an estimated 11% market share, we are the largest private provider of P&C insurance in Ontario, Quebec, Alberta and Nova Scotia. We distribute insurance under the Intact Insurance brand through a wide network of brokers and our wholly-owned subsidiary, BrokerLink. We also distribute insurance direct to consumers through our belairdirect and Grey Power brands. We manage our own investment portfolio of close to $9 billion in invested assets.

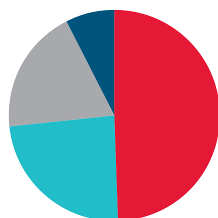
Financial highlights

(in millions of Canadian dollars, except as noted)

	2010	2009	2008	2007	2006
Consolidated performance					
Written insured risks (thousands)	**4,614.6**	4,603.6	4,601.5	4,679.9	4,565.1
Direct premiums written (excluding pools)	**4,498.1**	4,274.9	4,145.5	4,108.6	3,993.6
Net premiums earned	**4,231.3**	4,055.4	4,039.4	3,932.0	3,826.6
Net claims and general expenses	**4,073.9**	4,043.0	3,972.4	3,723.2	3,422.8
Combined ratio (excluding MYA)	**95.4%**	98.7%	97.1%	95.2%	89.4%
Interest and dividend income, net of expenses	**294.4**	292.7	328.8	344.8	321.3
Net gains on invested assets and other gains	**63.7**	(172.5)	(288.0)	73.6	193.5
Corporate and distribution income	**9.3**	7.2	15.6	44.3	33.4
Income before income taxes	**524.8**	139.8	123.6	671.6	952.0
Effective tax rate	**20.0%**	9.4%	(3.8%)	24.3%	30.9%
Net operating income	**399.0**	281.6	360.7	457.0	530.5
Net income	**419.8**	126.7	128.2	508.3	658.1
Earnings per share ($)	**3.65**	1.06	1.05	4.01	4.92
Average number of shares outstanding (millions)	**115.1**	119.9	122.0	126.7	133.7
Book value per share ($)	**27.37**	24.88	21.96	25.48	25.58
Return on equity	**13.9%**	4.5%	4.4%	15.4%	20.8%

2010 Direct premiums written by business line

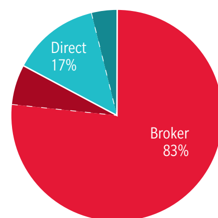
(excluding pools, %)



Personal auto	49.7%
Personal property	23.8%
Commercial P&C	19.0%
Commercial auto	7.5%

2010 Direct premiums written by distribution channel

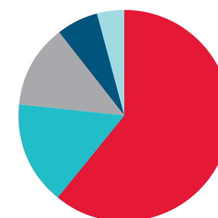
(excluding pools, %)



Intact Insurance	76.9%
BrokerLink	6.1%
belairdirect	13.3%
Grey Power	3.7%

2010 Investment asset mix

(net of hedging positions, % of fair value)



Fixed income securities	61.1%
Preferred shares	15.7%
Common shares	12.9%
Cash and short-term notes	6.3%
Other	4.0%

Dear fellow shareholders,

The "Outperforming" theme of this year's annual report is not a declaration of victory, but an indication that, while our outperformance is strong and in fact growing, it is something that our organization endeavours to solidify on an ongoing basis.

This performance is achieved by placing our customers at the centre of everything we do, and by focusing day in and day out on Living Our Values: integrity, respect, customer orientation, excellence and social responsibility. We are proud of our results and will constantly strive to outperform on the important metric of delivering value to our shareholders.

The year in review

2010 marked a successful year for the company, as our strategies and action plans continued to pay off. We grew our top line by more than 5% to reach $4.5 billion in direct premiums written, improved our combined ratio by more than three points to 95.4% and increased our net operating income per share by almost 50%. Our $8.7 billion investment portfolio also generated healthy returns with nearly $300 million of investment income.

From a capital perspective, we ended the year with a strong balance sheet despite having returned half a billion dollars to shareholders in the form of dividends and share repurchases. We have continued redeploying capital in early 2011, announcing an 8.8% dividend increase, repurchasing a further two million shares during the first two months of the year and renewing our share buyback program for an additional 5% of shares outstanding.

Employee engagement scores improved once again, increasing four points during the year, and are now up 12 points since 2008. We are well-positioned to achieve our objective to become recognized as one of Canada's top employers.

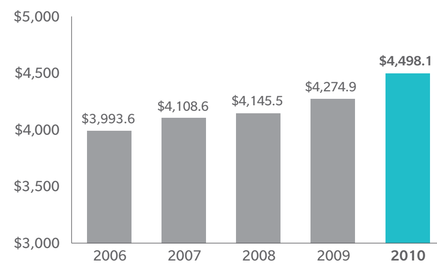
From a customer service perspective, we were pleased to be recognized as a top-ranked auto insurance company by J.D. Power and Associates. Grey Power received the overall number one ranking in Canada for customer satisfaction, while Intact Insurance was ranked the highest in customer satisfaction among private auto insurance companies in Quebec.

I am also proud to say that we remained committed to our communities across the country, as Intact donated approximately $2.7 million in 2010. Our employees continued to show their support for the United Way; together we raised more than $1 million. Also impressive was the immediate support shown to the victims of the tragic earthquake in Haiti, for which we contributed more than $100,000. Our employees understand the importance of helping communities and people in need when unforeseen events occur – it's what we stand for, it's what we do.

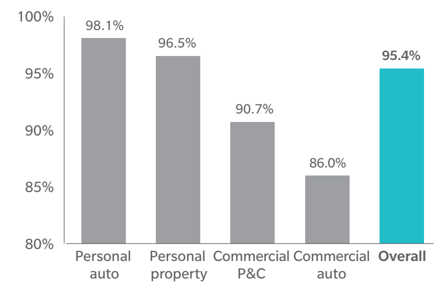
Our company also partnered with *Raising the Roof*, a national charity aimed at breaking the cycle of homelessness among young Canadians and supporting them to build a better future. Lastly, we have been a premier national partner of Speed Skating Canada since 2006, but we were never more proud than when we watched our team outperform on the world stage during the Vancouver 2010 Winter Olympics.

Charles Brindamour
President and Chief Executive Officer

Direct premiums written
(excluding pools, millions of dollars)



2010 Combined ratio by line of business
(excluding MYA, %)



Mitigating the impact of changing weather patterns

2010 was the year when the benefits of our intense focus on improving results in our home insurance segment truly shone through. Partially aided by the benign weather early in the year, our combined ratio in personal property improved 12.5 points from 2009 to 96.5%. Importantly, our outperformance versus the industry has been restored in this line of business.

We estimate the impact of our home insurance action plan to be roughly 13 points of combined ratio, compared to our initial target of a 10- to 15-point improvement through mid-2011. While we believe the improvements already in place should get us to the top end of this range, we are maintaining our focus, including rate increases, product changes, claims management, as well as prevention.

We are also working with municipal governments to develop tools to better assess vulnerabilities to climate change and to prioritize their investments in the modernization of municipal infrastructure. As an industry, we are working first and foremost on the prevention of water damage. Finally, along with the Faculty of Environment at the University of Waterloo, we have launched an important research program to help Canadians gain a better understanding of, and to adapt to, the new realities brought on by climate change.

Cause for optimism in Ontario auto

Meaningful reforms to Ontario's auto insurance regime were implemented in September of last year, and while it is early, initial signs are encouraging and consistent with prior expectations. It is important to point out, however, that the reforms were not intended to address the degree of fraud that became apparent in the last year. That's why, as a company, we are focused on managing and combatting the ongoing issue of fraud, well beyond what the reforms were meant to accomplish.

Despite the expected benefits of the reforms, we estimate that the combined ratio of the industry is still well above 110% in Ontario, and that premiums remain inadequate. Our disciplined approach to the Ontario auto market has led to a loss ratio outperformance versus the industry which accelerated from six points in 2009 to 18 points in 2010. We believe our pricing is adequate, given the expected benefits of the reforms, while our fraud prevention measures provide further profitability improvement opportunities.

Outlook for 2011

We expect top-line growth for the industry in 2011 to closely resemble that of 2010; mid-single digits in personal auto, upper-single digits in personal property and low-single digits in commercial lines. From an underwriting perspective, the industry ended 2010 with a combined ratio of 101%. For 2011, we anticipate some improvement in personal lines (resulting from auto reforms in Ontario and continued premium increases in personal property), but do not foresee the industry earning an underwriting profit. Finally, looking at the industry's return on equity (ROE), we do not expect improvement in the near term from the 7% level reported in 2010. Although underwriting might improve slightly, we anticipate this would be offset by the negative impact on investment income from the low yield environment.

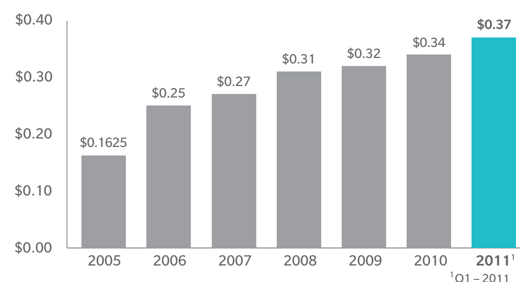
Looking specifically at Intact Financial Corporation, we believe we will meet our stated objective to outperform the industry's ROE by at least 500 basis points in 2011, given our combined ratio advantage, our yield advantage and our significant capital management flexibility.

Our company is impacted by regulators in two primary ways: our ability to price and design products in our auto businesses is regulated provincially, and our capital requirements are regulated by the Office of the Superintendent of Financial Institutions Canada (OSFI).

- Given the level of fraud prevalent in the Ontario auto market, a key aspect to monitor in 2011 is the regulator's ability to be responsive in adapting reforms to an evolving reality. We believe a balance must be struck between the affordability and the availability of the product, as the resulting stability would be a major victory for customers and the government.

Book value per share
($)

Quarterly dividend per share
($)



– Prior to the end of 2010, OSFI had indicated that potential changes to industry capital requirements would likely be neutral to industry capital levels. We were surprised in December by a discussion paper that, as currently drafted, would lower aggregate industry capital ratios by 14 percentage points. Along with others in the industry, we provided our feedback to OSFI, but it is too early to know how this process will unfold. That said, we see no change in our plan or strategy despite this uncertainty.

Leveraging the growth potential of our platforms

We are committed to continue enhancing our customer-driven efforts, an important part of which is the unique experience and choice we offer consumers on how they can shop for our products through our distinct brands.

For consumers who prefer to deal with a broker, we distribute insurance under the Intact Insurance brand through a wide network of brokers and our wholly-owned subsidiary, BrokerLink. In a continuous effort to improve our broker offering, Intact Insurance has been working hard over the last year with many brokers across the country to develop an innovative web solution designed specifically for the broker channel.

BrokerLink's mandate is to build a broker model that can successfully compete with alternative channels by leveraging its scale to invest in its brand and technology and offer customers choice. Growth at BrokerLink was accelerated in the fourth quarter with the acquisition of Insurance Central Limited. The acquisition increased BrokerLink's premium base by 25%, now totalling approximately $500 million.

Grey Power and belairdirect give consumers the option of buying our products directly by phone and on the Internet. Our direct platforms should benefit from two key trends in the Canadian marketplace – the speed at which consumers embrace technology, and the changing demographics of the Canadian population. As such, we are enthusiastic about the growth opportunities for these platforms in the coming period.

We believe our multi-channel distribution model puts us in a position to prosper from long-term trends that are affecting our industry, as the model is designed with specific success factors in mind. It keeps the customer at the centre of our business, allows us to fully leverage the benefits of our scale and highlights the unique strengths of brokers and their ability to offer consumers choice.

Lastly, we run our business without compromising on ethics, integrity or transparency. We understand that this is our licence to operate; it is the reason that we set high standards for all Intact employees, and it is why these principles are at the heart of our values and our commitment to our customers, to our brokers and to the communities in which we live and work.

Looking forward

Looking ahead, we are excited about our prospects for 2011 and beyond, and believe that our disciplined underwriting, robust capital levels and dedicated group of employees, place us in a strong position to benefit from the environment in which we compete.

In closing I would like to thank our Board of Directors, whose insight and guidance have, once again, helped us to make decisions critical to the success of our organization. And to our employees, whose dedication and discipline have enabled us to once again outperform our peers and deliver the excellence for which we all strive, I thank each of you.

Charles Brindamour
President and Chief Executive Officer

2010 was another successful year for your company, defined by strong organic growth with direct premiums written at $4.5 billion and improved profitability with net income at $420 million. Our much improved financial performance in 2010 was driven by corporate initiatives, improved industry fundamentals and enhanced financial market conditions.

2010 was also a great year for creating shareholder value. Thanks to our strong financial position, the company returned $500 million of capital to shareholders through dividends and share repurchases last year. Additionally, Intact shares appreciated 37% during the year, outperforming the overall S&P/TSX Composite Index as well as numerous financial indices.

Earlier this year, our continued strong financial position and the quality of our operating earnings allowed us to increase the dividend for the sixth consecutive year and renew the share buyback program for another 12-month period. The company's overall success is a testament to our comprehensive business strategy, scale advantage, ability to manage the fundamentals and quality of execution. As a result, Intact's financial performance continued to outpace the P&C insurance industry. The company made progress on its objectives: to be among the best companies within the financial services industry in terms of customer satisfaction and to become one of the top employers in the country.

In 2010, your Board continued to play a complementary role of representing your interests, as well as advising and supporting the management team on business and financial matters. We have increased our understanding and extended our oversight role as it relates to new accounting standards and changes to regulatory capital guidelines.

During the year, your Board continued to keep abreast of governance best practices and, as such, agreed to hold a shareholder advisory vote on executive compensation at our upcoming Annual Meeting. The company's compensation objectives, philosophy and principles, which focus on a pay-for-performance culture, are closely aligned with strong risk management principles and the long-term interests of shareholders.

In late 2009, your Board approved the adoption of a new Code of Conduct, known as Living Our Values, which centres around five core values that serve as the foundation for all behavior at Intact: integrity, respect, customer orientation, excellence and social responsibility. This year, we oversaw the implementation of two initiatives: the initial inclusion of our values into performance evaluations and the adoption of a new social responsibility statement, which encapsulates our social responsibility value. Under management's leadership, employees demonstrated a strong commitment to the environment, youth at risk and communities where we live and work.

On behalf of your Board of Directors, I would like to thank management and all of our employees for their exceptional contribution: the cornerstone of our strong performance. Looking back, I am honoured to serve as your Chair and would like to thank my fellow Board members for the valuable advice and counsel that they provide to an outstanding management team. Looking forward, I am confident about the prospects for 2011 and beyond. Your company is well-positioned to capitalize on its outperformance and has the right management team and people to continue our growth story with a focus on sustainable outperformance.

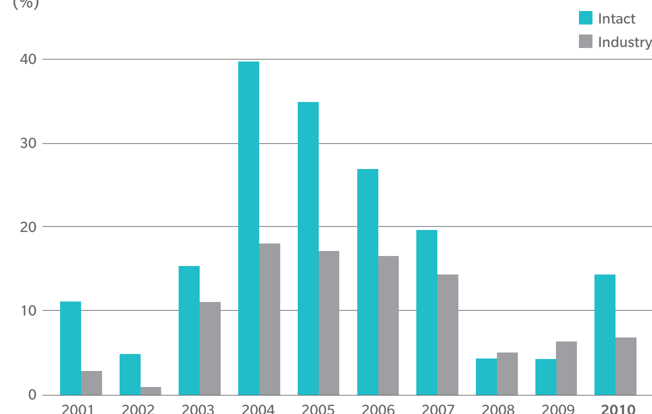
Claude Dussault
Chairman of the Board

We have **outperformed** the Canadian P&C insurance industry over time on several fronts

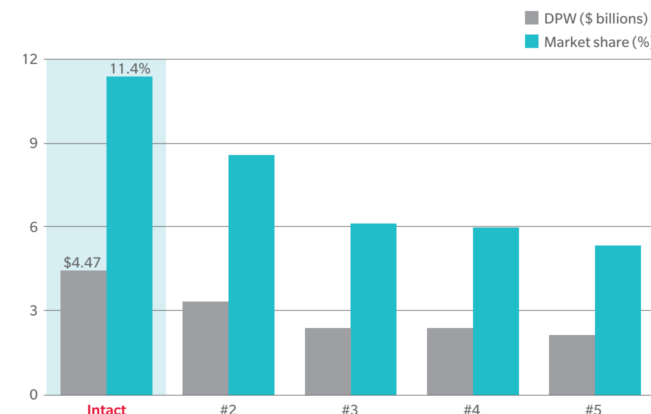
Direct premiums written growth
(%) (Base 100=2000)

Combined ratio[1]
(%)

Return on equity[2]
(%)



Market share by company



Industry data source: MSA Research excluding Lloyd's, ICBC, SGI, SAF, MPI and Genworth, as at Dec. 31, 2010.
Note: [1] Combined ratio includes the market yield adjustment (MYA).
[2] ROE is for Intact's P&C insurance subsidiaries.

Our industry outperformance in underwriting expanded in 2010

			Outperformance	
	Intact	Top 20 benchmark[1]	2010	5-year average[2]
DPW growth	5.0%	5.0%	0 bps	-27 bps
Combined ratio[3]	96.3%	104.3%	806 bps	455 bps
Return on equity[4]	14.2%	4.3%	989 bps	479 bps

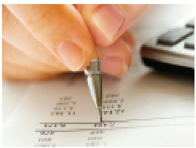
[1] Industry data source: MSA Research excluding Lloyd's and Intact
[2] Five-year period ending Dec. 31, 2010
[3] Combined ratio includes the market yield adjustment (MYA)
[4] ROE is for Intact's P&C insurance subsidiaries

Our disciplined approach to pricing enabled us to improve our underwriting results compared to our Canadian P&C industry benchmark in 2010. Our relative performance in personal lines was strong, as we expanded our combined ratio advantage in Ontario auto and returned to a positive gap versus the industry in personal property. Our commercial lines business remained very profitable while maintaining its healthy performance gap with the industry. The combination of superior underwriting results and our capital management activities led to a return on equity outperformance of close to 10 percentage points versus our industry benchmark in 2010.

Our competitive advantages help solidify our industry **outperformance**

Significant scale advantage

The key benefit of our scale is a large database of customer and claims information that enables us to identify trends and more accurately model risks. We also use our scale to negotiate preferred terms with suppliers, priority repair service, quality guarantees and lower material costs.



Sophisticated pricing and underwriting discipline

We use our superior underwriting expertise and proprietary segmentation models to price risks. Our objective is to establish pricing that will continue to both attract new customers and maintain existing customers with profitable profiles.

In-house claims expertise

Substantially all of our claims are handled in-house. In this way, claims are settled faster and more efficiently, while a more consistent service experience is created for the customer.

Broker relationships

The broker channel represents approximately 83% of our annual direct premiums written. We provide brokers with a variety of services including technology, sales training and financing to enable them to continue to grow and expand their businesses.

Solid investment returns

Our investment strategy is to generate solid after-tax returns while preserving capital and diversifying risk. Our $8.7 billion portfolio is comprised mainly of Canadian securities, including high-quality fixed income securities, common shares of large-capitalization companies and preferred shares.

Proven acquisition strategy

We are an active acquirer in the industry, with 11 successful acquisitions since 1988. Our strategy focuses on fit, technological integration and increasing the profitability of the acquired book of business through our pricing, underwriting expertise and claims.

Strong organic growth potential

Our multi-channel distribution strategy operates under four distinct brands:

Canada's largest home, auto and business insurance company distributes through a network of more than 1,800 brokers from coast-to-coast. These brokers offer customers choice, personalized service and trusted advice.

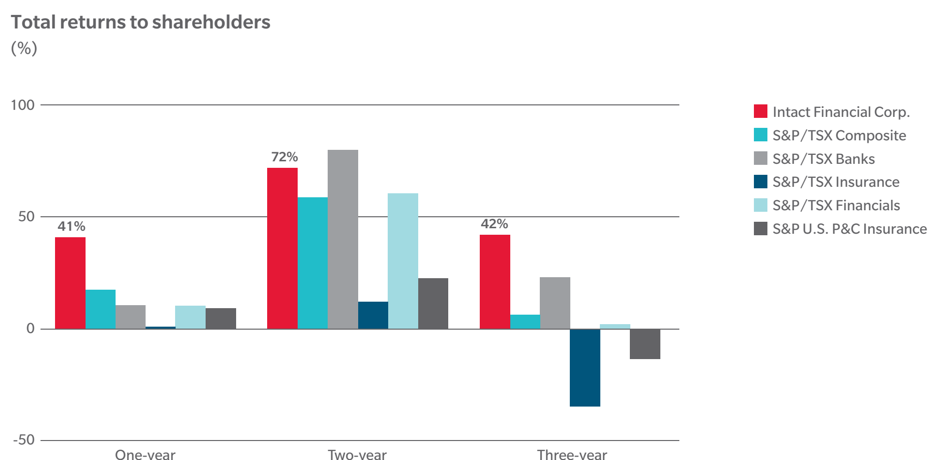
With over 50 offices and more than 700 employees across Ontario and Alberta, BrokerLink is one of the largest P&C insurance brokerages in Canada. BrokerLink writes approximately $500 million in premiums for its more than 200,000 customers.

Operating in Ontario and Quebec, belairdirect is ranked #1 for brand awareness in direct-to-consumer P&C insurance. By leveraging the Internet, belairdirect has grown at a rate of approximately 10% a year.

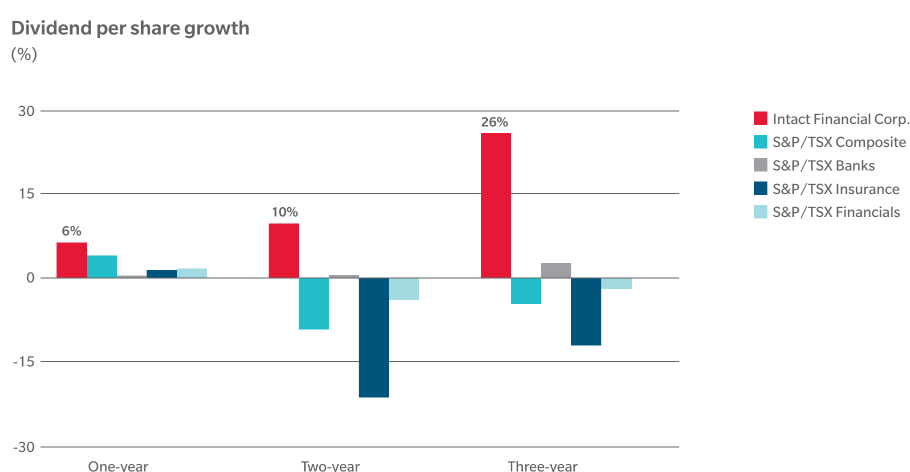
The industry leader in providing car and home insurance to people with 25+ years of good driving habits, Grey Power distributes directly to consumers in Alberta, Ontario and the Maritimes through a call centre and the Internet.

Our **outperformance** and financial strength have translated into value creation for our shareholders

Intact's 2010 total shareholder return (including dividends) of 41% was higher than the comparable indices, bolstered by our operating results and strong financial position. Our shareholder value creation also stands out on a three-year basis, a volatile period including the financial crisis of 2008 and subsequent equity market recovery.



We aim to maintain a sustainable dividend level that takes into account the cyclicality of the industry in which we operate. Our approach to annual dividend increases is conservative, but it is also intended to be competitive with our peers. The resulting dividend per share growth illustrates our outperformance versus several relevant indices. Since becoming a publicly traded company in 2004, we have grown our dividends per share by an average of 15% per year, translating into a level more than twice the original amount.



Source: Toronto Stock Exchange, Standard & Poor's

Credit ratings	A.M. Best financial strength rating: A+ Moody's issuer credit rating: A3 DBRS issuer credit rating: A (low)

Our capital management flexibility provides several levers to continue strong performance

Strong balance sheet

- Financial position remains very strong with $809 million in excess capital, based on MCT of 170%
- Our ratio of debt to total capital remains low at 13.9%, with additional debt capacity of about $271 million before reaching our target ratio of 20%
- Book value per share increased 10% in 2010

Share buyback history

- 2011 – Board authorized renewal of NCIB for an additional 5%
- 2010* – Repurchased 9.7 million shares for a total of $433 million
- 2008 – Repurchased 4.6 million shares for a total of $176 million
- 2007 – Completed a $500 million Substantial Issuer Bid

* Feb. 22, 2010 to Feb. 21, 2011

At Intact, we are here to insure and protect the things that customers care about: their home, their car and their business. Our raison d'être is to offer them an outstanding experience that goes beyond their expectations. Through our community investments, we reach beyond our commitment to helping customers and advance positive change in numerous Canadian communities where we do business. In 2010, we reconfirmed this commitment by adopting a new social responsibility statement.

At Intact we respect the environment and its finite resources and we believe in making the communities where we live and work safer, healthier, and happier. We demonstrate this by being environmentally responsible in our operations, supporting our employees in their citizenship endeavours, encouraging climate change adaptation and fostering vibrant and resilient communities for all of our stakeholders.

Moving forward, we will make progress on the development of safe and vibrant communities by continuing to make financial contributions and giving our time to community-based initiatives, with a particular focus on helping young people and at-risk youth. In line with helping Canadian youth develop their full potential, we teamed up with *Raising the Roof*, Canada's only national charity focused on long-term solutions to homelessness, to become a national toque partner and a lead partner of Youthworks. In addition, we contribute directly to an ever-expanding network of shelters in large urban areas including Vancouver, Calgary, Toronto, Montreal and Halifax.

We will also be focused on supporting communities in preparation for long-lasting changes in weather patterns through encouraging adaptation research and green space development. As part of our commitment, we are partnering with the University of Waterloo's Faculty of Environment on a first-of-its-kind research initiative which bridges our risk-management expertise with a diverse community of Canadian climate change thought leaders. This unique collaboration, which brings together government, industry and academia, is integral to delivering a concrete and solution-oriented action plan which can be used to advocate for a climate change adaptation policy in Canada. The outcome will be to foster sustainable and resilient communities for generations to come.

Intact Financial Corporation
Management's Discussion and Analysis
For the year ended December 31, 2010

TABLE OF CONTENTS

Section 1 – Intact Financial Corporation

11 1.1 Overview of the business
12 1.2 Critical capabilities
13 1.3 Key performance indicators

Section 2 – Overview of consolidated performance

14 2.1 Consolidated financial results

Section 3 – Industry outlook

16 3.1 Canadian property and casualty insurance industry 12-month outlook

Section 4 – Business developments and operating environment

Section 5 – Operating results

19 5.1 Net operating income
20 5.2 Underwriting results
21 5.3 Underwriting results by lines of business – personal lines
23 5.4 Underwriting results by lines of business – commercial lines
24 5.5 Investment income
24 5.6 Reconciliation to GAAP

Section 6 – Non operating results

25 6.1 Income before income taxes
25 6.2 Net investment gains (losses)
26 6.3 Market yield effect

Section 7 – Invested assets

Section 8 – Selected quarterly and annual information

30 8.1 Selected quarterly information
30 8.2 Selected annual information

Section 9 – Financial condition

31 9.1 Consolidated balance sheets highlights
32 9.2 Claims liabilities
33 9.3 Reinsurance
34 9.4 Shareholders' equity
35 9.5 Liquidity and capital resources
35 9.6 Capital management
37 9.7 Financing
37 9.8 Contractual obligations
38 9.9 Off-balance sheet arrangements

Section 10 – Accounting and disclosure matters

38 10.1 Disclosure controls and procedures
38 10.2 Internal controls over financial reporting
38 10.3 Related-party transactions
39 10.4 Critical accounting estimates and assumptions
43 10.5 Significant accounting changes
43 10.6 Future accounting changes

Section 11 – Risk management

45 11.1 Introduction
46 11.2 Risk management structure
47 11.3 Corporate governance ensuring compliance with laws and regulatory requirements
48 11.4 Ensuring risk management in the operations
48 11.5 Main risk factors and mitigating actions

Section 12 – Other matters

58 12.1 Cautionary note regarding forward-looking statements

Section 13 – Additional information

February 8, 2011

The following Management's Discussion and Analysis ("MD&A"), which was approved by the Board of Directors for the year ended December 31, 2010, is intended to enable the reader to assess the Company's results of operations and financial conditions for the three- and twelve-month periods ended December 31, 2010, compared to the corresponding periods in 2009. It should be read in conjunction with the Company's Consolidated financial statements and accompanying notes for its fiscal year ended December 31, 2010.

The Company uses both generally accepted accounting principles ("GAAP") and certain non-GAAP measures to assess performance. Non-GAAP measures do not have any standardized meaning prescribed by GAAP and are unlikely to be comparable to any similar measures presented by other companies. Management of Intact Financial Corporation analyzes performance based on underwriting ratios such as combined, general expenses and claims ratios as well as other performance measures such as return on equity ("ROE"). These measures and other insurance related terms are defined in the Company's glossary which is included in the Company's Annual Financial Report and posted on the Intact Financial Corporation web site at www.Intactfc.com. Click on "Investor Relations" and "Glossary" on the left navigation bar. Additional information about Intact Financial Corporation, including the Annual Information Form, may be found online on SEDAR at www.sedar.com.

Forward-looking statements

This document contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from these forward-looking statements as a result of various factors, including those discussed hereinafter or in the Company's 2010 Annual Information Form. Please read the cautionary note at the end of this document.

Certain totals, subtotals and percentages may not agree due to rounding. A change column has been provided for convenience showing the variation between the current period and the prior period. Not applicable (n/a) is used to indicate that the current and prior year figures are not comparable, not meaningful or if the percentage change exceeds 1,000%. "Intact", the "Company", "IFC" and "we" are terms used throughout the document to refer to Intact Financial Corporation and its subsidiaries. For captions used in this MD&A, words such as "Income", "Earnings" and "Gains" will always be placed before the words "Expense", "Loss" and "Losses".

Important notes:

- All references to direct premiums written in this MD&A exclude industry pools, unless otherwise noted.
- All references to "excess capital" in this MD&A include excess capital in the P&C insurance subsidiaries at 170% minimum capital test ("MCT") plus liquid assets in the holding company, unless otherwise noted.
- Catastrophe claims are any one claim, or group of claims, equal to or greater than $5.0 million, related to a single event.
- All underwriting results and related ratios exclude the market yield adjustment ("MYA"), except if noted otherwise.

SECTION 1 – Intact Financial Corporation

1.1 Overview of the business

Intact Financial Corporation ("IFC") is the largest provider of automobile, home and business insurance in Canada, insuring approximately four million individuals and businesses across Canada. Overall, the Company has an approximate 11% market share and is the leading private sector property and casualty ("P&C") insurer in Ontario, Quebec, Alberta and Nova Scotia. IFC distributes insurance under the Intact Insurance brand through a wide network of brokers and its wholly-owned subsidiary, BrokerLink. The Company also distributes insurance direct-to-consumers through belairdirect and Grey Power. At December 31, 2010, IFC and its insurance subsidiaries had an $8.7 billion portfolio of cash and invested assets, managed by the Company's investment management subsidiary.

Personal insurance

IFC is the largest personal auto and property insurer in Canada. The market as a whole is fragmented – the top five P&C insurers represent less than 40% of annual premiums in Canada. In automobile insurance, the Company is more than 35% larger than the second largest P&C insurer in Canada and about 52% larger than the third ranking P&C insurer, based on the most recently reported industry data for 2009 which includes both personal and commercial auto. In personal property, the gap is even larger – IFC is approximately 43% larger than the second largest insurer and about 90% larger than the number three insurer in the Canadian market. Though the Company holds the number one position in both segments of personal insurance, its estimated market share is only 14% in both automobile and property, demonstrating the growth potential of this segment of the business.

Commercial insurance

IFC is also one of the largest players in commercial insurance in Canada with a significant share of the small- to medium-sized commercial segment. These two segments make up approximately 90% of the Company's commercial premiums. Small and medium-sized commercial accounts have been more profitable over time, and market pricing is less volatile than for large commercial business.

Investment management

IFC actively manages its $8.7 billion portfolio of cash and invested assets to generate superior after-tax returns while balancing capital preservation and risk. The Company invests mainly in high-quality Canadian securities that are publicly traded. See section 7 for more information on the quality and mix of the Company's portfolio of invested assets.

1.2 Critical capabilities

IFC has several critical capabilities which have enabled the Company to sustain a performance advantage over other P&C insurers in Canada. These critical capabilities are described in the table below:

Significant scale advantage	The key benefit of scale is IFC's large database of customer and claims information that enables the Company to identify trends in claims and more accurately model the risk of each policy. IFC also uses its scale to negotiate preferred terms with suppliers, priority service on repairs, quality guarantees on workmanship and lower material costs.
Underwriting discipline/ pricing sophistication	The Company has superior underwriting expertise and proprietary segmentation models used to price risks. These models are continuously being refined to create a pricing advantage over competitors and identify certain segments of the market that are more profitable than others. The Company's objective is to establish pricing that will continue to both attract new clients and maintain existing clients with profitable profiles.
Expertise in claims management	Substantially all of IFC's claims are handled in-house. By managing claims in-house, claims are settled faster and less expensively, and a more consistent service experience is created for the customer.
Proven acquisition strategy	IFC is an active acquirer with 11 successful acquisitions since 1988. The Company's strategy is three-fold: – acquire businesses that fit existing business lines; – integrate those businesses into the Company's technology infrastructure; – increase the profitability of the acquired book of business through pricing, underwriting expertise and claims.
Solid investment returns	IFC's investment strategy is to generate solid after-tax returns while preserving capital and diversifying risk. The Company's $8.7 billion portfolio (including cash and cash equivalents) is mainly comprised of Canadian securities, including high-quality fixed income securities as well as common shares of large-cap companies and preferred shares that pay dividends.
Multi-channel growth model	The Company has a multi-channel distribution strategy including broker and direct-to-consumer brands. This strategy maximizes growth in the market and enables the Company to appeal to different customer preferences and to be more responsive to consumer trends.
Broker relationships	The broker channel represents approximately 83% of annual direct premiums written. IFC has more than 1,800 broker relationships across Canada for customers that prefer the highly-personalized, community-based service that insurance brokers provide. IFC provides a variety of services including technology, sales training and financing to brokers to enable them to continue to grow and expand their businesses.

1.3 Key performance indicators

IFC's key performance indicators are defined in the table below. Certain key performance indicators are considered non-GAAP measures. Non-GAAP measures do not have any standardized meaning prescribed by GAAP and may not be comparable to similar measures used by other companies in the Company's industry.

Category	Definition
Growth	**Direct premiums written** The total premiums written during a specified period (excluding pools).
	Written insured risks The number of vehicles in automobile insurance, the number of premises in personal property insurance and the number of policies in commercial insurance (excluding commercial auto insurance).
Profitability	**Net underwriting income** Net premiums earned less net claims incurred, commissions, premium taxes and general expenses (excluding MYA).
	Market-based yield Annualized total pre-tax dividend and interest income (before expenses) divided by the average fair values of equity and fixed income securities held during the reporting period.
	Net operating income After-tax net income from underwriting activities, corporate and distribution activities and interest and dividend income from invested assets.
	Operating return on equity Net operating income for the last 12-months divided by the average shareholders' equity (excluding accumulated other comprehensive income) over the same 12-month period. The average shareholders' equity is the mean of shareholders' equity at the beginning and the end of the period.
	Net income As reported in the Consolidated statements of income.
Performance and execution	**Claims ratio** Claims incurred, net of reinsurance, during a defined period and expressed as a percentage of net premiums earned for the same period.
	Expense ratio Underwriting expenses including commissions, premium taxes and all general and administrative expenses incurred in underwriting income during a defined period and expressed as a percentage of net premiums earned for the same period.
	Combined ratio The sum of the claims ratio and the expense ratio. A combined ratio below 100.0% indicates a profitable underwriting result. A combined ratio over 100.0% indicates an unprofitable underwriting result.
Capital management	**Return on equity ("ROE")** Net income for a 12-month period divided by the average shareholders' equity over the same 12-month period. Net income and shareholders' equity are determined in accordance with GAAP. The average shareholders' equity is the mean of shareholders' equity at the beginning and the end of the period.
	Book value per share Shareholders' equity divided by the number of outstanding common shares at the same date. Shareholders' equity is determined in accordance with GAAP.
	Minimum Capital Test ("MCT") Ratio of available capital to required capital. The regulatory minimum required capital is 150%. The Company has an internal operating target of 170%.
	Excess capital Excess capital in the P&C insurance subsidiaries at 170% minimum capital test ("MCT") plus excess liquid assets in the holding company and other subsidiaries.

SECTION 2 – Overview of consolidated performance

Fourth quarter and year-end highlights

– Continued healthy premium growth of close to 5%
– Net operating income per share of $0.70 in Q4
– ROE of 13.9% with a 10% increase in book value per share in 2010
– Quarterly dividend increased for the sixth consecutive year; up 8.8% to $0.37 per share

2.1 Consolidated financial results

TABLE 1 – COMPONENTS OF NET INCOME

(in millions of dollars, except as otherwise noted)	**Q4-2010**	Q4-2009	Change	**2010**	2009	Change
Direct premiums written (excluding pools)	**1,060.2**	1,011.4	4.8%	**4,498.1**	4,274.9	5.2%
Net underwriting income (excluding MYA) (table 6)	**21.8**	56.0	(61.1)%	**193.8**	54.0	258.9%
Combined ratio (excluding MYA)	**98.0%**	94.6%	3.4 pts	**95.4%**	98.7%	(3.3) pts
Interest and dividend income, net of expenses (table 11)	**72.9**	77.3	(5.7)%	**294.4**	292.7	0.6%
Interest expense on debt outstanding	**7.4**	4.4	68.2%	**28.3**	5.6	405.4%
Total gains (losses) excluding held for trading ("HFT") fixed income securities (table 14)	**34.8**	4.6	656.5%	**42.2**	(169.5)	n/a
Income before income taxes	**123.2**	125.4	(1.8)%	**524.8**	139.8	275.4%
Income tax expense	**25.7**	28.7	(10.5)%	**105.0**	13.1	701.5%
Effective income tax rate	**20.9%**	22.9%	(2.0) pts	**20.0%**	9.4%	10.6 pts
Net income	**97.5**	96.7	0.8%	**419.8**	126.7	231.3%
Net operating income (table 12)	**79.0**	98.1	(19.5)%	**399.0**	281.6	41.7%
Earnings per share ("EPS") – basic and diluted (dollars)	**0.87**	0.81	7.4%	**3.65**	1.06	244.3%
Net operating income per share (dollars)	**0.70**	0.82	(14.6)%	**3.47**	2.35	47.7%
Return on equity ("ROE") for the last 12 months	**13.9%**	4.5%	9.4 pts			
Operating return on equity for the last 12 months	**13.2%**	9.2%	4.0 pts			
Book value per share (dollars)	**27.37**	24.88	10.0%			

Fourth quarter 2010

Direct premiums written ("DPW") growth was 4.8% year-over-year, on meaningful contributions from all business lines. The 5.1% growth in personal lines' premiums was driven by rate increases, as units remained relatively unchanged. Commercial lines continued to gain momentum through the year with 4.2% premium growth in the fourth quarter reflecting unit growth and net increases in rates. As expected, the cancellation of unprofitable commercial group accounts in 2009 continued to impact premium growth in Q4-2010, reducing top-line commercial P&C growth by 2 points and overall company growth by 0.4 points.

The 98.0% combined ratio for the quarter primarily reflects the increased level of catastrophe losses; relating to both current and prior period events. Underwriting results were less robust than the particularly strong 94.6% combined ratio in Q4-2009, when our auto businesses benefited from the $22.4 million release of provisions associated with minor injury cap reforms. Ontario auto reforms are playing out as anticipated, but their full benefit will materialize over several quarters. The underlying current year loss ratio (excluding catastrophes and prior year development) improved 0.7 points versus Q4-2009.

Dividend and interest income (net of expenses) of $72.9 million, representing a market-based yield of 4.1%, was down 5.7% versus the same period of 2009 as a result of declining interest rates. Cash and invested assets were $8.7 billion at the end of December 2010, $0.6 billion higher than at year end 2009.

The Company's financial position remains very strong with book value per share reaching $27.37, 10% higher than a year ago, and $808.5 million of excess capital at the end of the fourth quarter, despite the Company's share buyback activity in 2010. Our ratio of debt to total capital remains low at 13.9% with additional debt capacity of about $271.4 million before reaching our target debt to total capital ratio of 20%.

Full year 2010

Direct premiums written increased 5.2% in 2010 versus 2009. The quality of IFC's insurance portfolio continues to be very healthy and industry pricing is improving with premiums increasing in personal lines and better dynamics in commercial lines. Growth in personal lines (DPW up 6.0%) was driven by firming prices, as units remained relatively flat versus 2009. As expected, both our auto and property businesses achieved accelerated premium growth versus 2009. Commercial lines also recorded premium growth in 2010 (DPW up 3.1%, and up 5.5% excluding the cancellation of unprofitable commercial group accounts in 2009), as the competitive environment has evolved to one where growth in units is achievable in spite of rate increases.

Underwriting results were very healthy with an overall combined ratio of 95.4% versus 98.7% last year. Compared to 2009, performance improvements in personal property and commercial P&C more than compensated for higher combined ratios in our auto businesses. In the Company's largest business, personal auto, the combined ratio was healthy at 98.1%, but up 3.2 points from 2009, driven by catastrophes. In personal property, water losses continue to pose a challenge; however, despite severe summer storms, the combined ratio improved 12.5 points to 96.5%. IFC made further progress on the home insurance action plan and the business benefited from better weather conditions to begin the year. On the commercial side, auto results were strong with a combined ratio of 86.0%, but were below the unusually strong 79.8% in 2009. The combined ratio in commercial P&C rebounded to 90.7% from the disappointing 104.1% in 2009. The improvement was due to a more normal level of large fire claims, as well as our initiatives in late 2009 to address a number of unprofitable commercial group accounts.

Interest and dividend income (net of expenses) was $294.4 million (up 0.6% from 2009) as the growth in our portfolio of invested assets more than offset the negative impact from declining interest rates. The Company recorded $42.2 million in investment gains excluding HFT bonds, as the continued recovery in markets and reduction in interest rates enabled our portfolio to return to an unrealized gain position. Overall, the investment portfolio grew $0.6 billion to $8.7 billion during 2010 due to higher market values and our $100.0 million medium term note offering (see section 4, *Business developments and operating environment*). The appreciation in market values also contributed to the 10% increase in book value per share to $27.37 at year end.

SECTION 3 – Industry outlook

3.1 Canadian property and casualty insurance industry 12-month outlook

IFC is well-positioned to continue outperforming the P&C insurance industry in the current environment due to its significant scale, pricing and underwriting discipline, prudent investment and capital management practices, and strong financial position.

	P&C insurance industry	IFC's strategy
Pricing and claims environment (12-month outlook)	• Industry premiums are likely to increase at a similar rate as in 2010, with mid single digit growth in personal auto (driven by Ontario), upper single digit growth in personal property (reflecting the impact of water-related losses and more frequent and/or severe storms) and low single digit growth in commercial lines (with no acceleration from the pace of 2010). • Loss ratio improvement is expected from personal auto (assuming Ontario reforms bring anticipated cost savings and are effective at slowing claims inflation) and personal property (as a result of the benefit from continued premium increases). • We do not anticipate loss ratio improvement in commercial lines, but expect pricing conditions to improve at a moderate pace over time, following several years of soft industry pricing. • Despite the potential combined ratio improvement, we do not expect the industry to earn an underwriting profit in the next 12 months.	• As a result of IFC's disciplined pricing strategy, the Company is well-positioned to grow organically as other companies reduce their appetite for new business and market pricing becomes more rational. • Our scale and pricing strategy have historically translated into a combined ratio advantage versus the industry. Through three quarters of 2010, IFC has outperformed the industry by approximately 500 basis points. – Our loss ratio advantage in Ontario auto has expanded to 14 percentage points. We believe our pricing is adequate, given the expected benefits of the reforms, while our fraud prevention measures provide further profitability improvement opportunities. – Due in large part to our action plans (rate adjustments, claims initiatives, product review) we now outperform the industry in personal property by 2.2 percentage points.
Capital markets	• Global capital markets remain volatile, with possible strength in the near term, but with vulnerability in the mid term as economic data raise questions about the sustainability of the global recovery. • Interest rates are likely to remain low in the near term. In Canada, material rate increases are unlikely as they would further strengthen the dollar, thereby negatively impacting the pace of recovery. In the U.S., the level of quantitative easing and slow recovery also do not suggest higher rates in the near term. We estimate that the industry's pre-tax investment yield will decline, given its asset mix and duration. • Debt and equity capital markets are currently open allowing companies to raise capital at reasonable rates. • Global capital requirements are becoming more stringent, while changes in requirements for Canadian P&C insurers could potentially reduce industry capital ratios by approximately 14 percentage points.	• IFC maintains a strong financial position with $808.5 million in excess capital and a debt to total capital ratio of 13.9%, which represents additional debt capacity of about $271.4 million before reaching our optimal debt to total capital ratio of 20%. • Our $8.7 billion cash and investment portfolio is largely Canadian dollar-denominated with minimal U.S. exposure. • IFC's investment portfolio has a differentiated asset strategy and slightly longer duration than the typical industry portfolio. As such, we expect our yield to decline to a lesser extent on a relative basis. • Capital requirements are not expected to negatively impact IFC to the same degree as the overall P&C insurance industry, given the composition and duration of our investment portfolio and the nature of our policyholder liabilities.
Overall	• The industry's return on equity was approximately 7% at the end of Q3-2010. We do not expect improvement in ROEs in the near term. Although low yields could lead to improved underwriting discipline, we believe this would be more than offset by a reduction in the level of investment income.	• We believe the Company is likely to outperform the industry's ROE by at least 500 basis points in the next 12 months, due to the following: – Our Q3 year-to-date outperformance is approximately 7%. – We anticipate a similar combined ratio advantage, due to continued robust action plans across all lines of business, in addition to an expanding yield advantage. – IFC maintains significant capital management flexibility.

SECTION 4 – Business developments and operating environment

Overall, the underwriting environment continues to evolve as expected with improved pricing dynamics in a number of business lines and jurisdictions due to three main factors affecting the industry as a whole: 1) continued pressure on underwriting margins, 2) low investment yields and consequently, 3) low returns on capital. These factors continue to support better pricing conditions, industry capacity reductions and further market consolidation, benefiting strong and disciplined players in the market such as IFC.

TABLE 2 – INDUSTRY GROWTH

Direct premiums written growth (%)	2008	2009	YTD Q3-2010
Auto	2.34	3.92	5.30
Personal property	7.02	8.12	9.53
Commercial P&C	1.72	0.26	3.34
Total	2.91	3.34	5.33

Source: MSA Research Inc.

Industry rates in personal lines are rising. In commercial lines, while conditions remain very competitive for new business, we have observed signs of firming up in segments where we operate. In Ontario, Canada's largest personal auto market, personal auto rate increases, including reform filings, averaged 6.2% for the industry in 2010.

Ontario auto reforms

On September 1, the Ontario government's auto reforms were implemented, offering greater choice for consumers while creating a more stable cost environment. The reforms include a new Statutory Accident Benefits Schedule ("SABS") effective September 1, 2010, a 50% reduction in coverage for medical, rehabilitation and attendant care upon renewal, and various other regulatory amendments that were filed by the Government of Ontario with the Registrar of Regulations.

Despite the 22% increase in industry rates since January 2008, we estimate that the combined ratio of the industry still exceeds 115% and that premiums remain inadequate. The recently implemented reforms should serve to mitigate the affordability issue (as Ontario drivers already pay between 5%–6% of disposable income for auto insurance, compared to 3% in other provinces) by reducing the rate of future claims inflation. The Financial Services Commission of Ontario ("FSCO") estimates that the reforms should reduce industry-wide claims costs by 6% over time, which should reduce premium deficiency and the risk of availability issues in the future.

Results to date

Although still in the early stage of the reforms, initial signs are encouraging, consistent with our previously-communicated expectations, and indicate that results for that line of business should improve in the coming 18 months; though the true effectiveness of the reforms will not be known for several months. Based on data to date, it appears that about 5% of consumers are requesting the optional coverage top-ups. At this stage, slightly more than 50% of Accident Benefits claims fall under the Minor Injury Guidelines, which is in line with expectations. Attendant Care Benefits are gradually reducing as policies are renewed with lesser coverage since the reforms. Home maintenance, housekeeping and caregiver benefits are also gradually reducing due to positive change to the incurred definition which now refers to actual economic loss. No material reduction in the number of medical benefit claims nor in the cost of examinations has been observed, as an increase in abuse and fraud with respect to accident benefits is offsetting some of the benefits expected from the reforms.

We continue to focus on carefully managing the ongoing and evolving risk for abuse and fraud in the system, and to refine our fraud containment measures that were instituted during 2010, in part due to observations we made during the past 12 months.

Capital markets

The Canadian equity market continued its ascent, as the S&P/TSX Composite Index increased 8.7% during the quarter, 19.0% in the second half of 2010 and 14.4% for the full year. The preferred share index rose to a lesser extent, up 0.4% in the quarter and 2.0% for the full year 2010. Movements in our equity investment values are generally in line with the equity markets' performance, although our exposures to individual sectors may be different. For example, we are less exposed to financial institutions by virtue of the hedge we implemented in Q1-2009. The negative impact on our unrealized gain position in Q4-2010 from the 5 year Government of Canada rate increasing approximately 40 basis points was partly mitigated by spreads on 5 year corporate bonds tightening by an estimated 10 basis points. Overall, the rally in equity markets resulted in an improvement in our unrealized gain position for the investment portfolio, but also in a loss on embedded derivatives.

Medium term note ("MTN") offering

During 2010, the Company completed an additional $100.0 million 30-year medium term note offering. This followed an offering in November 2009 of $150.0 million in 30-year MTNs at a coupon of 6.40%. The proceeds have been invested in the Company's investment portfolio.

Dividend increase

On February 8, 2011 the Board of Directors increased the Company's quarterly dividend by 8.8%, or 3 cents, to 37 cents per share on its outstanding common shares. The dividend will be payable on March 31, 2011 to shareholders of record on March 15, 2011. The decision reflects the Company's objective of returning value to shareholders, the strength of the Company's financial position and quality of operating earnings. This is the sixth consecutive year the Company has increased its dividend.

Normal course issuer bids

On August 5, 2010 the Company announced an increase in the number of shares that it may repurchase under its normal course issuer bid ("NCIB") over the 12-month period that commenced on February 22, 2010, from 5% of its public float to 10% of its public float.

On February 8, 2011 the Board of Directors authorized the renewal of the Company's NCIB to repurchase for cancellation an additional 5% of its outstanding shares, subject to the approval of the Toronto Stock Exchange ("TSX"). It is expected that this normal course issuer bid will begin on or about February 22, 2011 following the expiry of the current normal course issuer bid.

The Company's strong capital base and financial condition enables it to return capital to shareholders, while maintaining the financial resources and flexibility required to pursue its growth strategies.

Seasonality of the business

The property and casualty insurance business is seasonal in nature. While net premiums earned are generally stable from quarter to quarter, net underwriting income is typically highest in the second quarter of each year. This mainly is driven by weather conditions, reflected in the seasonal index below. The seasonal indicator is a non-GAAP measure which represents the ratio of the quarterly combined ratio to the annual combined ratio, excluding the MYA.

TABLE 3 – SEASONAL INDICATOR

	2010	2009	2008	2007	2006	2005	Six-year average
Q1	**0.98**	1.00	1.03	1.01	1.02	1.02	1.01
Q2	**0.98**	0.97	0.98	0.99	0.93	0.94	0.96
Q3	**1.01**	1.07	0.97	1.02	1.01	1.02	1.02
Q4	**1.03**	0.96	1.02	0.98	1.05	1.01	1.01

SECTION 5 – **Operating results**

5.1 Net operating income

Net operating income declined by $19.1 million in the fourth quarter as a result of lower underwriting and investment income. For the year, net operating income increased by $117.4 million due to a much stronger underwriting performance.

TABLE 4 – COMPONENTS OF NET OPERATING INCOME

(in millions of dollars, except as otherwise noted)	Q4-2010	Q4-2009	Change	2010	2009	Change
Net underwriting income (table 6)	**21.8**	56.0	(61.1)%	**193.8**	54.0	258.9%
Interest and dividend income, net of expenses (table 11)	**72.9**	77.3	(5.7)%	**294.4**	292.7	0.6%
Corporate and distribution income (loss)	**1.5**	(7.5)	n/a	**9.3**	7.2	29.2%
Pre-tax operating income	**96.2**	125.8	(23.5)%	**497.5**	353.9	40.6%
Tax impact	**(17.2)**	(27.7)	n/a	**(98.5)**	(72.3)	n/a
Net operating income	**79.0**	98.1	(19.5)%	**399.0**	281.6	41.7%

Changes in pre-tax operating income can be further analyzed as follows:

TABLE 5 – CHANGES IN PRE-TAX OPERATING INCOME (YEAR-OVER-YEAR)

(in millions of dollars)	Q4-2010	2010
Pre-tax operating income[1], as reported in 2009	**125.8**	**353.9**
Change in net underwriting income:		
Change in favourable prior year claims development	**(12.9)**	**69.1**
Other changes in net underwriting income	**5.1**	**46.1**
Change in catastrophe losses	**(26.9)**	**20.7**
Change in current accident year income from Facility Association	**0.5**	**3.9**
Total change in net underwriting income	**(34.2)**	**139.8**
Change in interest and dividend income, net of expenses	**(4.4)**	**1.7**
Change in corporate and distribution	**9.0**	**2.1**
Total change in pre-tax operating income	**(29.6)**	**143.6**
Pre-tax operating income, as reported in 2010	**96.2**	**497.5**

1 Pre-tax operating income is a non-GAAP measure.

Operating income (net and pre-tax) and net operating income per share are non-GAAP measures. Net operating income is defined as net income excluding the market yield effect and net gains (losses) on invested assets and other gains excluding HFT debt securities, after tax. Pre-tax operating income is defined as net operating income before income taxes. Net operating income per share is equal to net operating income for the period divided by the average outstanding number of shares for the same period. These measures are used by management and financial analysts to assess the Company's performance; however, they may not be comparable to similar metrics published by other companies.

5.2 Underwriting results

TABLE 6 – COMPONENTS OF UNDERWRITING RESULTS

(in millions of dollars, except as otherwise noted)	Q4-2010	Q4-2009	Change	2010	2009	Change
Net premiums earned	**1,091.5**	1,036.5	5.3%	**4,231.3**	4,055.4	4.3%
Net claims:						
Current year claims	**772.9**	740.8	4.3%	**2,863.8**	2,844.0	0.7%
Current year loss ratio	**70.8%**	71.5%	(0.7) pts	**67.7%**	70.1%	(2.4) pts
Current year catastrophes	**25.7**	(1.2)	n/a	**94.6**	115.3	(18.0)%
(Favourable) prior year claims development	**(53.1)**	(66.0)	n/a	**(192.8)**	(123.7)	n/a
Total net claims	**745.5**	673.6	10.7%	**2,765.6**	2,835.6	(2.5)%
Claims ratio	**68.3%**	65.0%	3.3 pts	**65.4%**	70.0%	(4.6) pts
Commissions, premium taxes, general expenses	**324.2**	306.9	5.6%	**1,271.9**	1,165.8	9.1%
Expense ratio	**29.7%**	29.6%	0.1 pts	**30.0%**	28.7%	1.3 pts
Net underwriting income	**21.8**	56.0	(61.1)%	**193.8**	54.0	258.9%
Combined ratio	**98.0%**	94.6%	3.4 pts	**95.4%**	98.7%	(3.3) pts

Fourth quarter 2010

Net premiums earned were up 5.3% in Q4-2010 due to the increase in written premiums over the past 12 months. The current year loss ratio improved in Q4-2010 versus Q4-2009, reflecting strong results in personal property. Although Q4-2010 experienced a relatively 'normal' level of catastrophe losses, the overall level of catastrophes was up $26.9 million from last year's benign Q4.

Favourable prior year development was lower than in Q4-2009, particularly in our auto businesses (as previously mentioned, Q4-2009 benefited from the $22.4 million release of provisions associated with minor injury cap reforms). Results in the quarter (5.3% of opening reserves, annualized) were above the historical range of 3–4%, but still less than Q4-2009's prior year development of 6.8%.

Full year 2010

Net premiums earned increased 4.3% during the year. The current year loss ratio is 2.4 points lower than in 2009 due to mild weather early in the year and the Company's action plans. Current year catastrophes were down $20.7 million versus 2009, despite the comparative results in the fourth quarter, primarily due to the absence of catastrophes in Q1-2010 and the elevated level in Q3-2009.

Full year favourable prior year development was significantly higher than in 2009 (4.8% of opening reserves, versus 3.2% in 2009), particularly in personal property and commercial P&C. The variance is largely attributable to the better than expected development in Q1-2010 of claims received in the latter part of 2009, as well as the low level of favourable prior year development in Q2-2009 and Q3-2009.

The expense ratio increased 1.3 points in 2010, largely due to higher variable commissions resulting from improved profitability.

5.3 Underwriting results by lines of business – personal lines

TABLE 7 – UNDERWRITING RESULTS FOR PERSONAL LINES

(in millions of dollars, except as otherwise noted)	Q4-2010	Q4-2009	Change	2010	2009	Change
Direct premiums written						
Automobile	**493.7**	474.6	4.0%	**2,235.9**	2,126.6	5.1%
Property	**257.1**	239.7	7.3%	**1,072.3**	994.2	7.9%
Total	**750.8**	714.3	5.1%	**3,308.2**	3,120.8	6.0%
Written insured risks (thousands)						
Automobile	**542.1**	535.1	1.3%	**2,475.1**	2,454.7	0.8%
Property	**379.5**	385.4	(1.5)%	**1,614.0**	1,643.2	(1.8)%
Total	**921.6**	920.5	0.1%	**4,089.1**	4,097.9	(0.2)%
Net premiums earned						
Automobile	**556.6**	531.0	4.8%	**2,158.0**	2,066.5	4.4%
Property	**254.6**	240.2	6.0%	**981.7**	926.4	6.0%
Total	**811.2**	771.2	5.2%	**3,139.7**	2,992.9	4.9%
Net underwriting income (loss)						
Automobile	**(16.5)**	10.4	n/a	**42.2**	105.0	(59.8)%
Property	**21.1**	29.3	(28.0)%	**34.7**	(83.7)	n/a
Total (excluding MYA)	**4.6**	39.7	(88.4)%	**76.9**	21.3	261.0%
Market yield adjustment	**18.5**	8.3	10.2	**(23.8)**	(26.8)	3.0
Net underwriting income (loss) (including MYA)	**23.1**	48.0	(24.9)	**53.1**	(5.5)	58.6

TABLE 8 – UNDERWRITING RATIOS FOR PERSONAL LINES

	Q4-2010	Q4-2009	Change	2010	2009	Change
Personal auto						
Claims ratio (excluding MYA)	**78.4%**	73.6%	4.8 pts	**73.0%**	71.3%	1.7 pts
Expense ratio	**24.6%**	24.4%	0.2 pts	**25.1%**	23.6%	1.5 pts
Combined ratio (excluding MYA)	**103.0%**	98.0%	5.0 pts	**98.1%**	94.9%	3.2 pts
Personal property						
Claims ratio (excluding MYA)	**57.4%**	53.5%	3.9 pts	**61.7%**	75.2%	(13.5) pts
Expense ratio	**34.3%**	34.3%	–	**34.8%**	33.8%	1.0 pts
Combined ratio (excluding MYA)	**91.7%**	87.8%	3.9 pts	**96.5%**	109.0%	(12.5) pts
Personal lines – total						
Claims ratio (excluding MYA)	**71.8%**	67.4%	4.4 pts	**69.4%**	72.5%	(3.1) pts
Expense ratio	**27.6%**	27.5%	0.1 pts	**28.1%**	26.8%	1.3 pts
Combined ratio (excluding MYA)	**99.4%**	94.9%	4.5 pts	**97.5%**	99.3%	(1.8) pts

Fourth quarter 2010

Direct premiums written growth in personal auto slowed from 6% in Q3-2010 to 4% in Q4-2010, in part due to the cautious approach to new business the Company has adopted as the Ontario auto reforms unfold. The Ontario reforms are playing out as anticipated, but their full benefit will materialize over several quarters (see section 4, *Business developments and operating environment*). We continue to expect industry pricing to firm up through 2011 in Ontario (the largest auto market in Canada) as the industry remains rate inadequate despite the reforms. Although results in Ontario improved versus Q3-2010, the overall 103.0% combined ratio in personal auto reflects an increased level of catastrophe losses and the early winter's impact on claims frequency (see table 3). The increase versus last year's 98.0% was due to an increase in catastrophe losses and less favourable prior year development (as described above). Excluding the impact of catastrophes and prior year development, the current year loss ratio improved 0.8 points.

Direct premiums written growth in personal property was 7.3% reflecting increases in rates and amounts insured. Units were down 1.5% in the quarter, suggesting that our premium increases remain ahead of our competitors'. The combined ratio of 91.7% is 3.9 points higher than last year's very robust 87.8%, as higher catastrophe losses more than offset improved current year results. Excluding the impact of catastrophes and prior year development, the current year loss ratio improved 2.5 points. We estimate that IFC's home insurance action plan has delivered 13 points of combined ratio improvement since early 2009.

Full year 2010

Personal auto underwriting results declined versus 2009 as the combined ratio increased from 94.9% to 98.1% mainly the result of losses related to July's Alberta hailstorm, acceleration of medical claims costs in Ontario auto and less favourable prior year development. Direct premiums written increased 5.1% reflecting higher premiums and a slight increase in written insured risks. Industry personal auto premiums have increased to take into consideration cost pressures associated with medical cost inflation in Ontario.

The significant improvement in underwriting results in personal property versus 2009 was due to stronger current year results (with contributions from the Company's action plan as well as mild weather early in the year) and more favourable prior year claims development. The overall combined ratio improved from 109.0% in 2009 to 96.5% in 2010. Direct premiums written increased 7.9% reflecting higher premiums, partly offset by a 1.8% decline in written insured risks.

Industry pools

Industry pools consist of the "residual market" (or Facility Association) as well as risk-sharing pools ("RSP") in Alberta, Ontario, Quebec, New Brunswick and Nova Scotia. In the fourth quarter, the net impact of industry pools positively impacted personal auto net underwriting income by $22.1 million year-over-year, excluding MYA. This variance reflects favourable prior year claims development in Q4-2010, while unfavourable claims development was reported in Q4-2009. Results for industry risk sharing pools tend to fluctuate between periods.

Progress on the home insurance action plan

The property and casualty insurance industry in Canada has experienced difficult results in home insurance over the last few years due to rising water-related claims, changing weather patterns and higher reconstruction costs. IFC has been addressing these issues in the personal property segment through a robust action plan to improve the combined ratio by 10–15 points.

Progress on our action plan continued in 2010:

- We increased rates and insured amounts by more than 13% compared to one year ago.
- We implemented perils-based pricing in several regions of the country.
- We continued our product redesign, including rolling out the higher deductible for water claims in certain areas.
- We continued to improve our claims processing and sourcing.

Disciplined approach in Ontario automobile insurance

Our 14 point loss ratio advantage versus the competition has come from a number of actions:

- Early recognition of claims trends translating into more than 30% in rate increases since 2007
- Prudent management of exposures where abuse is more present
- Pro-active claims management to mitigate abuse and fraud

5.4 Underwriting results by lines of business – commercial lines

TABLE 9 – UNDERWRITING RESULTS FOR COMMERCIAL LINES

(in millions of dollars, except as otherwise noted)	**Q4-2010**	Q4-2009	Change	**2010**	2009	Change
Direct premiums written						
Automobile	**85.1**	80.4	5.8%	**335.5**	321.9	4.2%
P&C	**224.3**	216.6	3.6%	**854.4**	832.2	2.7%
Total	**309.4**	297.0	4.2%	**1,189.9**	1,154.1	3.1%
Written insured risks (thousands)						
Automobile	**71.4**	66.5	7.4%	**282.4**	269.4	4.8%
P&C	**60.6**	59.1	2.5%	**243.1**	236.4	2.8%
Total	**132.0**	125.6	5.1%	**525.5**	505.8	3.9%
Net premiums earned						
Automobile	**83.9**	80.4	4.4%	**325.6**	315.2	3.3%
P&C	**196.4**	184.8	6.3%	**766.0**	747.3	2.5%
Total	**280.3**	265.2	5.7%	**1,091.6**	1,062.5	2.7%
Net underwriting income (loss)						
Automobile	**5.1**	23.8	(78.6)%	**45.6**	63.6	(28.3)%
P&C	**12.1**	(7.4)	n/a	**71.3**	(30.9)	n/a
Total (excluding MYA)	**17.2**	16.4	4.9%	**116.9**	32.7	257.5%
Market yield adjustment	**9.8**	4.5	5.3	**(12.6)**	(14.8)	2.2
Net underwriting income (including MYA)	**27.0**	20.9	6.1	**104.3**	17.8	86.5

TABLE 10 – UNDERWRITING RATIOS FOR COMMERCIAL LINES

	Q4-2010	Q4-2009	Change	**2010**	2009	Change
Commercial auto						
Claims ratio	**64.5%**	41.2%	23.3 pts	**56.1%**	51.5%	4.6 pts
Expense ratio	**29.4%**	29.2%	0.2 pts	**29.9%**	28.3%	1.6 pts
Combined ratio	**93.9%**	70.4%	23.5 pts	**86.0%**	79.8%	6.2 pts
Commercial P&C						
Claims ratio	**55.4%**	65.4%	(10.0) pts	**52.6%**	67.4%	(14.8) pts
Expense ratio	**38.4%**	38.6%	(0.2) pts	**38.1%**	36.7%	1.4 pts
Combined ratio	**93.8%**	104.0%	(10.2) pts	**90.7%**	104.1%	(13.4) pts
Commercial lines – total						
Claims ratio	**58.1%**	58.1%	–	**53.6%**	62.7%	(9.1) pts
Expense ratio	**35.7%**	35.8%	(0.1) pts	**35.7%**	34.2%	1.5 pts
Combined ratio	**93.8%**	93.8%	–	**89.3%**	96.9%	(7.6) pts

Fourth quarter 2010

Insured risks were up 7.4% in commercial auto as growth remained solid in select markets. The combined ratio of 93.9% is above last year's unusually strong 70.4% due to the combination of less robust current accident year results and lower favourable prior year development (Q4-2009 benefited from the release of provisions associated with minor injury cap reforms). Excluding the impact of catastrophes and prior year development, the current year loss ratio rose 4.7 points.

In commercial P&C, non-group premium growth was solid at approximately 5.5%. Including groups, premiums increased 3.6%, as the cancellation of unprofitable commercial group accounts in 2009 partly offset the 2.5% rise in units and 3.0% higher rates. We expect the impact of cancelled commercial groups to be immaterial going forward. The combined ratio improved 10.2 points on higher favourable prior year development. Excluding the impact of catastrophes and prior year development, the current year loss ratio was in line with 2009.

Full year 2010

Overall, direct premiums written in commercial lines increased 3.1% in 2010 with a 3.9% increase in written insured risks. The negative impact on growth from the cancellation of group accounts year to date was 3.0 percentage points of commercial P&C written premiums, while the benefit to earnings was approximately $15.9 million. The growth over 2009 reflects the changing competitive environment where growth in units is achievable in spite of rate increases, reflecting better market conditions in segments where we operate and the impact of our mid-market strategy.

The full year underwriting performance in commercial auto, with a combined ratio of 86.0%, is 6.2 points higher than last year as improved current year results were more than offset by lower favourable prior year development. In commercial P&C, underwriting results were much improved with a combined ratio of 90.7% due to the combination of a decrease in large losses and more favourable prior year claims development.

5.5 Investment income

TABLE 11

(in millions of dollars, except as otherwise noted)	Q4-2010	Q4-2009	Change	2010	2009	Change
Interest income	42.4	46.5	(8.8)%	178.9	178.7	0.1%
Dividend income	36.0	35.9	0.3%	136.1	130.8	4.1%
Interest and dividend income, before expenses	78.4	82.4	(4.9)%	315.0	309.5	1.8%
Expenses	(5.5)	(5.0)	(0.5)	(20.6)	(16.8)	(3.8)
Interest and dividend income, net of expenses	72.9	77.3	(5.7)%	294.4	292.7	0.6%
Market-based yield [1]	4.1%	4.4%	(0.3) pts	4.2%	4.5%	(0.3) pts

1 The market-based yield is a non-GAAP measure defined as the annualized total pre-tax dividend and interest income (before expenses) divided by the average fair values of equity and fixed income securities held during the reporting period. The market-based yield is a measure that may not be comparable to other companies since it is a non-GAAP measure.

Fourth quarter dividend and interest income (net of expenses) of $72.9 million was down 5.7% from the same quarter in 2009 as a result of declining interest rates. For the full year, income from investments was up slightly to $294.4 million as the growth of our investment portfolio offset the decline in interest rates during the year.

The market-based yield was 4.1%, down from 4.4% in the fourth quarter of 2009 as a result of the increase in market values of the underlying investments and a generally lower interest rate environment. Similarly, the full year market-based yield decreased 30 basis points to 4.2%.

5.6 Reconciliation to GAAP

Net operating income and net operating income per share are non-GAAP measures and as such must be reconciled to net income under GAAP as it appears in the Company's quarterly financial statements presented in section 13.

TABLE 12 – RECONCILIATION TO NET INCOME

(in millions of dollars, except as otherwise noted)	Q4-2010	Q4-2009	Change	2010	2009	Change
Net income (table 1)	97.5	96.7	0.8%	419.8	126.7	231.3%
Add investment losses (deduct gains) before HFT fixed income securities (table 14)	(34.8)	(4.6)	(30.2)	(42.2)	169.5	(211.7)
Add market yield effect (table 15)	7.8	5.1	2.7	14.9	44.6	(29.7)
Tax impact	8.5	0.9	7.6	6.5	(59.2)	65.7
Net operating income (excluding MYA) [1]	79.0	98.1	(19.5)%	399.0	281.6	41.7%
Average outstanding shares (millions)	112.6	119.9	(7.3)	115.1	119.9	(4.8)
Net operating income per share (dollars) [2]	0.70	0.82	(0.12)	3.47	2.35	1.12

1 Net operating income is defined as net income excluding the MYA and net gains (losses) on invested assets and other gains, after tax.
2 Net operating income per share is defined as net operating income for the period divided by the average outstanding number of shares for the same period.

SECTION 6 – Non operating results

6.1 Income before income taxes

Non operating results include net investment gains and losses and the market yield effect, all on a pre-tax basis. A summary of changes in income before income taxes is as follows:

TABLE 13 – CHANGES IN INCOME BEFORE INCOME TAXES (YEAR-OVER-YEAR)

(in millions of dollars)	Q4-2010	2010
Income before income taxes, as reported in 2009	125.4	139.8
Change in pre-tax operating income (table 5)	(29.6)	143.6
Change in net investment gains (losses) excluding HFT debt securities (table 14)	30.2	211.7
Change in market yield effect (table 15)	(2.8)	29.7
Income before income taxes, as reported in 2010	123.2	524.8
Income tax	(25.7)	(105.0)
Net income reported in 2010	97.5	419.8

6.2 Net investment gains (losses)

TABLE 14

(in millions of dollars)	Q4-2010	Q4-2009	Change	2010	2009	Change
Debt securities						
Gains on AFS securities	6.4	0.8	5.6	26.9	16.3	10.6
Gains on derivatives	5.2	0.4	4.8	4.4	4.4	–
Impairment reversal (losses)	0.5	2.8	(2.3)	0.5	(5.6)	6.1
Gains on fixed income securities and related derivatives	12.1	4.0	8.1	31.8	15.1	16.7
Equity securities						
Gains (losses), net of stand-alone derivatives	40.1	10.4	29.7	32.1	(75.5)	107.6
Impairment losses	(5.9)	(19.2)	13.3	(13.5)	(46.2)	32.7
Gains (losses) on embedded derivatives	(11.5)	9.4	(20.9)	(8.2)	(62.9)	54.7
Gains (losses) on equity securities and related derivatives	22.7	0.6	22.1	10.4	(184.6)	195.0
Total gains (losses) excluding HFT debt securities	34.8	4.6	30.2	42.2	(169.5)	211.7
Gains (losses) on HFT fixed income securities[1]	(36.1)	(17.9)	(18.2)	21.5	(3.0)	24.5
Total net gains (losses), before income taxes	(1.3)	(13.3)	12.0	63.7	(172.5)	236.2

1 The gains (losses) on HFT fixed income securities are offset by a MYA to claims liabilities, with an objective of a minimal impact to net income. The difference between the MYA and the gains and losses on HFT fixed income securities is referred to as the “market yield effect” in this MD&A. See table 15.

Fourth quarter 2010

With continued strong capital markets, the Company recorded significant net investment gains of $34.8 million excluding HFT bonds, compared to gains of $4.6 million in Q4-2009. Gains on the disposition of shares and bonds more than offset losses on embedded derivatives due to the increase in the value of our preferred shares portfolio.

Full year 2010

The Company recorded much improved net investment results in 2010 versus the prior year, as gains of $42.2 million excluding HFT bonds compared to losses of $169.5 million. The year-over-year variance was due to gains on the disposition of shares (versus significant losses in 2009), fewer losses on embedded derivatives and a lower level of impairments on equity securities.

6.3 Market yield effect

Claims liabilities are discounted at the estimated market yield of the assets backing these liabilities. The impact of changes in the discount rate used to discount claims liabilities based on the change in the market based yield of the underlying assets is called Market Yield Adjustment (MYA). The MYA to claims liabilities is offset by gains and losses on HFT fixed income securities with the objective that these items offset each other with a minimal overall impact to income. The difference between the MYA and the gains and losses on HFT fixed income securities is referred to as the "market yield effect" in this MD&A.

In 2010, the market yield effect had a $14.9 million negative impact ($44.6 million negative impact in 2009) mainly due to a mismatch caused by the de-risking of the bond portfolio where the proportion of corporate bonds was reduced. As a result, the market yield rate used to discount claims liabilities fell, and was not completely offset by gains on HFT bonds. The process of matching the weighted-dollar duration of the claims liabilities to assets classified as HFT works well under normal conditions. However, market fluctuations, change in yield curve, trading and change in asset mix can result in a positive or negative market yield effect.

TABLE 15 – MARKET YIELD EFFECT

(in millions of dollars, except as otherwise noted)	**Q4-2010**	Q4-2009	Change	**2010**	2009	Change
Positive (negative) impact of MYA on underwriting	**28.3**	12.8	15.5	**(36.4)**	(41.6)	5.2
Net gains (losses) on HFT debt securities	**(36.1)**	(17.9)	(18.2)	**21.5**	(3.0)	24.5
Market yield effect	**(7.8)**	(5.1)	(2.7)	**(14.9)**	(44.6)	29.7

SECTION 7 – Invested assets

The Company's portfolio of invested assets is managed by Intact Investment Management, Inc. ("IIM"), a wholly owned subsidiary of Intact Financial Corporation. The assets are managed by IIM in accordance with the Company's investment policy.

Investment policy

The Company has an investment policy that seeks to provide an attractive risk-return profile over the medium to long term. The investment policy takes into account the current and expected condition of capital markets, the historic return profiles of various asset classes and the variability of those returns over time, the availability of assets, diversification needs and benefits, regulatory capital required to support the various asset types, security ratings and other material variables likely to effect the overall performance of the Company's portfolio of invested assets. The overall risk profile of the portfolio is designed to balance the investment return required to satisfy the Company's liabilities while optimizing the investment opportunities available in the marketplace. Management monitors and enforces compliance with the Company's investment policy.

Asset mix

The investment portfolio includes high-quality government and corporate bonds, as well as Canadian equity securities of large, publicly-traded, dividend-paying companies. The Company does not invest in leveraged securities and exposure to the United States market is minimal. The Company manages its investments prudently to protect capital and generate superior after-tax returns.

TABLE 16 – INVESTED ASSET MIX (IN ACCORDANCE WITH GAAP)

(in millions of dollars, except as otherwise noted)	As at December 31, 2010		As at December 31, 2009	
	Fair value	% of fair value	Fair value	% of fair value
Short-term notes including cash and cash equivalents	500.6	5.8%	270.8	3.3%
Fixed income securities	4,458.0	51.5%	4,573.6	56.8%
Preferred shares	1,503.6	17.4%	1,581.6	19.6%
Common shares	1,876.7	21.7%	1,312.1	16.3%
Loans	314.2	3.6%	318.5	4.0%
Total invested assets including cash and cash equivalents	8,653.1	100.0%	8,056.6	100.0%

TABLE 17 – INVESTED ASSET MIX (NET OF HEDGING POSITIONS)

(in millions of dollars, except as otherwise noted)	As at December 31, 2010		As at December 31, 2009	
	Fair value	% of fair value	Fair value	% of fair value
Short-term notes including cash and cash equivalents	500.6	6.3%	270.8	3.5%
Fixed income securities	4,857.3	61.1%	4,958.7	64.6%
Preferred shares	1,252.0	15.7%	1,405.2	18.3%
Common shares	1,027.0	12.9%	726.4	9.5%
Loans	314.2	4.0%	318.5	4.1%
Total invested assets including cash and cash equivalents	7,951.1	100.0%	7,679.6	100.0%

The value of the investment portfolio increased significantly in 2010 due to the equity market rebound and proceeds of $100.0 million from the Company's medium term note offering.

The majority of the Company's portfolio is invested in high quality Canadian securities that are actively traded. The fair value for most invested assets is based on quoted bid prices. In cases where an active market does not exist, the estimated fair values are based on recent transactions or current market prices for similar securities.

- ***Fixed income securities*** The Company invests in highly-rated fixed income securities, including corporate bonds and government bonds. The fixed income portfolio is mostly Canadian with 11.5% foreign content. Approximately 98.6% of the fixed income portfolio is rated 'A' or better and all of the securities are investment grade. The Company has no exposure to leveraged capital notes in structured investment vehicles, directly or through the use of derivatives. The Company has $52.6 million ($103.1 million at December 31, 2009) in asset-backed securities mostly comprised of Canadian credit card loans ($40.1 million) and commercial mortgage-backed securities ($12.5 million).
- ***Common shares*** Common equity exposure is focused primarily on high dividend-paying Canadian equities. The Company seeks enhanced returns by identifying and investing in shares that are likely to pay increased dividends or pay special dividends. Management undertakes intensive analysis of investment opportunities to identify special dividend candidates. Similar evaluations are conducted to assess securities most likely to increase dividends. In addition, the equity portfolios are also actively managed to maximize dividend income throughout the year.
- ***Preferred shares*** The Company invests in preferred shares to achieve its objective of maximizing dividend income, as dividend income is not taxable, provided certain conditions are met. Generally, our preferred share portfolio is not traded and our shares are held until they are called. Consequently, the Company's results are generally impacted only when preferred shares are impaired, or when the shares are called or sold to avail of selected market opportunities. The preferred share portfolio is comprised entirely of Canadian issuers with a high proportion of the portfolio invested in securities that are at least P2 in their credit rating.
- ***Derivatives*** The Company uses derivative financial instruments for hedging purposes and to modify the risk profile of the portfolio of invested assets as long as the resulting exposures are within investment policy guidelines.

Sector mix by asset class

The following table shows sector exposures by asset class as a percentage of total cash and invested assets (excluding loans) as at December 31, 2010.

TABLE 18 – INVESTED ASSET MIX (IN ACCORDANCE WITH GAAP)

			Common shares		
	Fixed income	Preferred shares	IFC	S&P/TSX weighting	IFC total
Energy	2.2%	4.8%	26.3%	26.6%	8.2%
Materials	–	–	9.5%	24.1%	2.2%
Industrials	0.7%	0.1%	9.2%	5.5%	2.6%
Information technology	–	–	1.0%	2.4%	0.2%
Telecommunication	1.6%	8.8%	9.4%	4.0%	4.7%
Consumer discretionary	0.4%	2.3%	6.4%	4.5%	2.1%
Consumer staples	0.4%	0.4%	5.2%	2.5%	1.5%
Health care	–	–	0.6%	0.8%	0.1%
Financials	24.5%	78.6%	26.6%	27.9%	34.9%
Utilities	1.7%	4.4%	5.5%	1.7%	3.1%
Government	68.5%	0.6%	0.3%	–	40.4%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Total in millions	4,820.8	1,503.6	1,876.7	n/a	8,201.1

TABLE 19 – INVESTED ASSET MIX (NET OF HEDGING POSITIONS)

			Common shares		
	Fixed income	Preferred shares	IFC	S&P/TSX weighting	IFC total
Energy	2.1%	4.7%	35.4%	26.6%	7.0%
Materials	–	–	9.0%	24.1%	1.2%
Industrials	0.6%	0.1%	11.4%	5.5%	2.0%
Information technology	–	–	0.4%	2.4%	0.1%
Telecommunication	1.3%	8.9%	12.8%	4.0%	4.2%
Consumer discretionary	0.4%	2.3%	7.6%	4.5%	1.7%
Consumer staples	0.3%	0.3%	6.6%	2.5%	1.1%
Health care	–	–	0.6%	0.8%	0.1%
Financials	30.5%	79.0%	8.3%	27.9%	35.6%
Utilities	1.6%	4.4%	7.5%	1.7%	2.9%
Government	63.2%	0.3%	0.4%	–	44.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
Total in millions	5,220.1	1,252.0	1,027.0	n/a	7,499.1

Portfolio credit quality

As at December 31, 2010, the weighted average rating of the Company's fixed income portfolio was AA+ and the weighted average rating of its preferred share portfolio was P2, equivalent to a rating of BBB+. The Company had no fixed income securities or preferred shares with a rating below investment grade at December 31, 2010.

The following table includes the credit quality of the fixed income securities portfolio as at December 31, 2010 and 2009.

TABLE 20

(in millions of dollars, except as otherwise noted)	As at December 31, 2010		As at December 31, 2009	
	Fair value	**% of fair value**	Fair value	% of fair value
Fixed income securities[1]				
AAA	**1,701.4**	**38.2%**	2,463.5	53.9%
AA	**1,616.0**	**36.3%**	1,187.3	26.0%
A	**1,076.4**	**24.1%**	846.5	18.5%
BBB	**64.2**	**1.4%**	76.3	1.6%
Total	**4,458.0**	**100.0%**	4,573.6	100.0%

1 Source: Standard & Poor's ("S&P") or Dominion Bond Rating Services

The following table includes the credit quality of the preferred share portfolio as at December 31, 2010 and 2009.

TABLE 21

(in millions of dollars, except as otherwise noted)	As at December 31, 2010		As at December 31, 2009	
	Fair value	**% of fair value**	Fair value	% of fair value
Preferred shares[1]				
P1	**799.3**	**53.2%**	964.5	61.0%
P2	**402.7**	**26.8%**	296.3	18.7%
P3	**294.9**	**19.6%**	320.8	20.3%
Not rated	**6.7**	**0.4%**	–	–
Total	**1,503.6**	**100.0%**	1,581.6	100.0%

1 Source: Standard & Poor's ("S&P") or Dominion Bond Rating Services

Net pre-tax unrealized gains and losses on available-for-sale ("AFS") securities

TABLE 22

(in millions of dollars)	**December 31, 2010**	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009
Debt securities	**36.9**	72.9	52.9	17.4	21.4
Common shares	**117.6**	73.2	(11.2)	45.3	36.7
Preferred shares	**(46.1)**	(74.2)	(156.3)	(149.2)	(160.3)
Total net pre-tax unrealized gains (losses) position	**108.4**	71.9	(114.6)	(86.5)	(102.2)

The 14.4% increase in the S&P/TSX Composite Index, the 2.0% increase in the S&P/TSX Preferred Share Index and the declining interest rate environment in 2010 contributed to the $210.6 million improvement in the unrealized loss position.

Gains and losses in the common share portfolio are generally realized on an ongoing basis under normal capital market conditions reflecting the trading strategy in the high-dividend yield common share portfolio.

In determining the fair values of invested assets, management relies mainly on quoted market prices. There are no invested assets in the AFS or HFT categories which are not quoted on an active market, except for a very limited amount of fixed income securities that IFC holds (Refer to note 6 *Fair value measurement* to the Consolidated financial statements for details).

Impairment recognition

Common shares classified as AFS are assessed for impairment if the current market value drops significantly below the book value, or if there has been a prolonged decline in fair value below book value. Management then applies judgement based on each issuer's financial condition to determine whether objective evidence of impairment exists. This is determined by an assessment of information available at the time. Fixed income securities and preferred shares are considered to be impaired when there is objective evidence that suggests the issuer will fail to make the contractual interest or principal payments due under the terms of the instrument.

The net unrealized gain position on AFS common shares at the end of December 2010 was $117.6 million.

TABLE 23 – AGING OF UNREALIZED LOSSES ON AFS COMMON SHARES

(in millions of dollars)	**December 31, 2010**	September 30, 2010	June 30, 2010	March 31, 2010	December 31, 2009
< 25% below book value	**12.5**	18.0	37.8	16.4	19.4
> 25% below book value for < 6 consecutive months	**0.2**	2.4	9.4	0.4	0.4
> 25% below book value for > 6 consecutive months	**1.4**	4.5	0.4	0.2	–
Total net unrealized losses on AFS common shares	**14.1**	24.9	47.6	17.0	19.8

SECTION 8 – Selected quarterly and annual information

8.1 Selected quarterly information

TABLE 24

(in millions of dollars, except as otherwise noted)	**Q4-2010**	Q3-2010	Q2-2010	Q1-2010	Q4-2009	Q3-2009	Q2-2009	Q1-2009	Q4-2008
Written insured risks (thousands)	**1,053.6**	1,247.4	1,369.4	944.1	1,046.0	1,244.4	1,376.0	937.2	1,034.3
Direct premiums written (excluding pools)	**1,060.2**	1,205.8	1,317.8	914.3	1,011.4	1,144.1	1,250.6	868.8	968.2
Total revenues	**1,180.5**	1,185.7	1,189.5	1,113.2	1,124.7	1,116.4	1,064.6	936.5	956.0
Net premiums earned (table 6)	**1,091.5**	1,066.5	1,054.6	1,018.7	1,036.5	1,019.0	1,011.3	988.7	1,019.2
(Favourable) unfavourable prior year claims development[1]	**(53.1)**	(25.3)	(39.3)	(75.1)	(66.0)	(14.0)	(6.5)	(37.2)	(52.2)
Net underwriting (loss) income[1] (table 6)	**21.8**	36.7	66.3	69.0	56.0	(53.2)	43.2	7.9	11.0
Combined ratio (%)[1]	**98.0%**	96.6%	93.7%	93.2%	94.6%	105.2%	95.7%	99.2%	98.9%
Net operating income[1]	**79.0**	89.0	118.6	112.3	98.1	21.6	92.9	69.1	75.1
Net income (loss)	**97.5**	82.3	120.2	119.7	96.7	(8.0)	74.2	(36.3)	(64.1)
EPS – basic/diluted (dollars)	**0.87**	0.72	1.04	1.01	0.81	(0.07)	0.62	(0.30)	(0.53)
Net operating income per share (dollars)[1]	**0.70**	0.78	1.03	0.94	0.82	0.18	0.77	0.58	0.63

1 Excluding MYA

8.2 Selected annual information

TABLE 25

(in millions of dollars, except as otherwise noted)	**2010**	2009	2008
Total revenue	**4,668.9**	4,241.3	4,131.7
Net underwriting income (excluding MYA) (table 6)	**193.8**	54.0	117.0
Net income	**419.8**	126.7	128.2
EPS – basic and diluted (dollars)	**3.65**	1.06	1.05
Annual dividends per common share (dollars)	**1.36**	1.28	1.24
Invested assets	**8,515.3**	7,996.5	6,094.3
Total assets	**12,148.9**	11,351.3	9,785.2
Debt outstanding	**496.1**	397.7	–
Total shareholders' equity	**3,070.1**	2,982.6	2,632.6

SECTION 9 – Financial condition

9.1 Consolidated balance sheets highlights

The table below shows the significant Consolidated balance sheets items as reported on December 31, 2010 and December 31, 2009.

TABLE 26

(in millions of dollars, except as otherwise noted)	As at December 31, 2010	As at December 31, 2009	Change
Cash and cash equivalents	**137.8**	60.1	77.7
Invested assets			
Debt securities	**4,820.8**	4,784.3	36.5
Equity securities	**3,380.3**	2,893.7	486.6
Loans	**314.2**	318.5	(4.3)
Total invested assets	**8,515.3**	7,996.5	518.8
Premiums receivable	**1,762.0**	1,640.5	121.5
Deferred acquisition costs	**419.8**	396.2	23.6
Reinsurance assets	**235.2**	260.6	(25.4)
Intangible assets and goodwill	**380.6**	338.2	42.4
Other assets	**698.2**	659.2	39.0
Total assets	**12,148.9**	11,351.3	797.6
Claims liabilities	**4,378.5**	4,270.0	108.5
Unearned premiums	**2,585.6**	2,463.6	122.0
Debt outstanding	**496.1**	397.7	98.4
Financial liabilities	**490.3**	278.8	211.5
Other liabilities	**1,128.3**	958.6	169.7
Total liabilities	**9,078.8**	8,368.7	710.1
Share capital and contributed surplus	**1,089.4**	1,144.8	(55.4)
Retained earnings	**1,894.0**	1,902.2	(8.2)
Accumulated other comprehensive loss	**86.7**	(64.4)	151.1
Shareholders' equity	**3,070.1**	2,982.6	87.5
Book value per share (dollars)	**27.37**	24.88	2.49

Cash and invested assets

See section 7 – Invested assets.

Premiums receivable, deferred acquisition costs and unearned premiums

The increase in these balances is mostly due to accelerating growth in direct premiums written.

Reinsurance assets

Reinsurance assets, which comprise recoverable reserves and ceded unearned premiums, have decreased as reinsurers were billed for prior year events.

Intangible assets and goodwill

The increase is related to goodwill and intangible assets capitalized on acquisitions made during the year.

Other assets

Other assets increased $39.0 million as a result of increases in income taxes receivable and long-term investments.

Claims liabilities

Claims liabilities increase of $108.5 million is consistent with the business growth during 2010 partially offset by favourable prior year claims development.

Debt outstanding

The increase is due to the issuance of an additional $100.0 million of unsecured medium term notes during the first quarter of 2010.

Financial liabilities

The increase reflects larger short positions associated with the expansion of our market neutral investment strategy.

Other liabilities

The increase in Other liabilities includes increases in commission, taxes payable and other payables.

Shareholders' equity

See section 9.4 – Shareholders' equity.

9.2 Claims liabilities

Assessing claims reserve adequacy

Effectively assessing claims reserve adequacy is a critical skill required to effectively manage any property and casualty insurance business and is a strong determinant of the long-term viability of the organization. The total claims reserve is made up of two main elements: 1) reported claim case reserves, and 2) claims that are incurred but not reported ("IBNR"). IBNR reserves supplement the case reserves by taking into account:

– possible claims that have been incurred but not yet reported to the Company by policyholders;
– expected over/under estimation in case reserves based on historical patterns; and
– other claim adjustment expenses not included in the initial case reserve.

Case reserves and IBNR should be sufficient to cover all expected claims liabilities for events that have already occurred, whether reported or not, taking into account a provision for adverse deviation ("PfAD") and a discount for the time value of money (see 6.3 Market yield effect). The discount is applied to the total claims reserve and adjusted on a regular basis based on changes in market yields. If market yields rise, the discount would increase and reduce total claims liabilities and therefore, positively impact net underwriting income in that period, all else being equal. If market yields decline, it would have the opposite effect. IBNR and the PfAD are reviewed and adjusted at least quarterly.

Historically, the Company's claims liabilities have had a 3%–4% redundancy per year. This is commonly referred to as favourable prior year claims development. The rate of favourable prior year claims development was unusually high in 2003 to 2005 and does not represent a normal or expected level of reserve redundancy in a typical year. Prior year claims development fluctuates between quarters and from year to year.

TABLE 27 – ANNUALIZED RATE OF FAVOURABLE PRIOR YEAR CLAIMS DEVELOPMENT

(annualized rate)	Q4-2010	Q4-2009	2010	2009
(Favourable) unfavourable prior year claims development as a % of opening reserves	(5.3)%	(6.8)%	(4.8)%	(3.2)%

Favourable prior year claims development

Excluding MYA, favourable prior year claims development was $53.1 million in the fourth quarter and $192.8 million in 2010. For the entire year, favourable prior year claims development was 4.8% of opening reserves in 2010, a little above the historical long-term average.

The following table shows the development of claims liabilities for the 10 most recent accident years, with subsequent developments during the periods. The original reserve estimates are evaluated quarterly for redundancy or deficiency. The evaluation is based on actual payments in full or partial settlement of claims as well as on current estimates of claims liabilities for claims still open or claims incurred but not yet reported.

TABLE 28 – DEVELOPMENT OF CLAIMS LIABILITIES

(in millions of dollars, except as otherwise noted)	Total	Accident year									
		2009	2008	2007	2006	2005	2004	2003	2002	2001	2000 & earlier
Original reserve		1,429.5	1,376.4	1,282.2	1,178.0	1,118.8	1,117.7	973.2	838.6	729.0	1,688.7
(Favourable) unfavourable development during Q4 2010 excluding MYA	**(53.1)**	(26.1)	(9.0)	(3.4)	(1.6)	(6.5)	(6.2)	0.5	0.3	0.1	(1.2)
(Favourable) unfavourable development during YTD 2010 excluding MYA	**(192.8)**	(79.5)	(24.4)	(18.5)	(13.5)	(14.9)	(18.3)	(7.1)	(8.5)	(5.3)	(2.8)
Cumulative development											
As a % of original reserve		(3.2)%	(2.7)%	(2.2)%	(5.4)%	(13.1)%	(25.0)%	(22.1)%	(6.1)%	2.7%	3.0%

9.3 Reinsurance

The Company's objectives related to ceded reinsurance are:

– capital protection;

– reduction in the volatility of results;

– increase in underwriting capacity;

– access to the expertise of reinsurers.

The reinsurers chosen to participate in the program have a minimum rating of A- from A.M. Best or S&P at inception of the treaty. The financial analysis performed by the Company's specialized reinsurance brokers is also considered. The treaties have a security review clause allowing the Company to change a reinsurer during the term of the agreement if its rating falls below the minimum required. Diversification of reinsurers is analyzed and implemented to avoid excessive concentration in a specific reinsurance group.

At December 31, 2010, the Company's reinsurance treaties were with unaffiliated reinsurance companies substantially all of which met the Company's financial strength rating requirements.

Reinsurance coverage is spread across many reinsurers to minimize risk to the Company in the event of a very large loss. A single catastrophic event such as an earthquake could financially weaken a reinsurer, so distribution of risk is a key reinsurance strategy for the Company.

The placement of ceded reinsurance is done almost exclusively on an excess of loss basis (per event or per risk) as per practice, actuarial norms and regulatory guidelines. Under such programs, management considers that in order for a contract to reduce exposure to risk, it must be structured to ensure that the reinsurer assumes significant insurance risk related to the underlying reinsured policies and it is reasonably possible that the reinsurer may realize a significant loss from the reinsurance. Furthermore, the reinsurance treaties call for timely reimbursement of ceded losses.

TABLE 29

(in millions of dollars, except as otherwise noted)	2010	2009
Single risk events[1]		
Net retentions:		
On property policies	5.0	5.0
On liability policies		
From January 1st to June 30th	10.0	7.0
From July 1st to December 31st	10.0	10.0
Multi-risk events and catastrophes		
Net retention:	25.0	25.0
Coverage limit:	1,500.0	1,500.0
Risk retained based on the loss exposure:		
$0–$25 million	100.00%	100.00%
$25–$50 million	26.50%	16.75%
$50–$750 million	10.00%	10.00%
$750–$1,000 million	10.00%	0.0%
$1,000–$1,500 million	0.0%	0.0%

1 In a number of cases, like special classes of business or types of risks, the retention would be lower through specific treaties or the use of facultative reinsurance.

In line with industry practice, the Company's reinsurance recoverables with licensed Canadian reinsurers (December 31, 2010: $189.9 million; December 31, 2009: $208.8 million) are generally unsecured as Canadian regulations require these reinsurers to maintain minimum asset and capital balances in Canada to meet their Canadian obligations, and claims liabilities take priority over the reinsurer's subordinated creditors. Reinsurance recoverables with non-licensed reinsurers (December 31, 2010: $45.3 million; December 31, 2009: $51.8 million) are secured with cash, letters of credit and/or assets held in trust accounts of $65.6 million (2009 – $74.7 million).

9.4 Shareholders' equity

Share capital

As at February 8, 2011 there were 111,904,965 common shares issued and outstanding. Refer to the Company's Annual Information Form for more detailed information on the rights of common shareholders.

Long-term incentive plan

Under the Company's long-term incentive plan ("LTIP"), participants are awarded performance units and restricted stock units as part of their variable compensation. At the end of the 3-year performance cycle, the performance units will be converted to a certain number of common shares to be purchased on the market based on the Company's three-year average return on equity compared to the Canadian P&C insurance industry average. After the 3 year period, the restricted stock units vest and are converted to common shares to be purchased on the market. As at December 31, 2010, the number of performance units and restricted stock units accrued by participants was 436,104 and 193,533, respectively for a total outstanding of 629,637. The number of restricted common shares outstanding was 53,495.

Accumulated other comprehensive income (loss)

AOCI reflects the unrealized gains or losses related to AFS assets.

TABLE 30

(in millions of dollars)	Pre-tax	Taxes	After-tax
Opening AOCI balance on January 1, 2010	(102.2)	37.8	(64.4)
Changes in fair values during the period	257.2	(70.1)	187.1
Realized losses (gains) reclassified to income during the period	(46.6)	10.6	(36.0)
AOCI as at December 31, 2010	108.4	(21.7)	86.7

Unrealized losses on AFS assets were $102.2 million on January 1, 2010. The change in the fair value of AFS assets is mainly due to the improvement in equity markets representing a pre-tax increase of $257.2 million in AOCI. During the year, the Company sold AFS assets resulting in pre-tax realized net gains of $46.6 million. These were transferred in Net investment gains (losses) on the Consolidated statements of income with a corresponding decrease in AOCI.

9.5 Liquidity and capital resources

Cash flows

TABLE 31 – CASH FLOWS AND LIQUIDITIES

(in millions of dollars)	Q4-2010	Q4-2009	Change	2010	2009	Change
Selected inflows and (outflows)						
Operating activities:						
Cash provided by operating activities	**74.2**	77.3	(3.1)	**500.5**	538.0	(37.5)
Investing activities:						
Net cash inflow (outflow) from sales (purchases) of invested assets	**(84.1)**	(358.0)	273.9	**50.0**	(1,130.1)	1,180.1
Net purchases of brokerages and books of business and property and equipment	**(24.0)**	(27.8)	3.8	**(75.0)**	(102.5)	27.5
Financing activities:						
Dividends paid	**(38.3)**	(38.3)	–	**(155.8)**	(153.4)	(2.4)
Net proceeds from debt issuance	**–**	148.9	(148.9)	**98.6**	397.7	(299.1)
Common shares repurchased for cancellation	**(37.0)**	–	(37.0)	**(340.6)**	–	(340.6)
Change in cash and cash equivalents during the period	**(109.2)**	(197.9)	88.7	**77.7**	(450.3)	528.0

The Company's cash flows from operations remain robust. In the fourth quarter of 2010, operating activities generated cash flow consistent with the same quarter last year. On an annual basis, the decrease of operating cash flow is related to income taxes paid partially offset by higher net premiums received.

During 2010, cash provided by operating activities, as well as the proceeds from the debt issuance, was mainly used for the payment of dividends and the repurchase of common shares under the NCIB program.

9.6 Capital management

The Company's objectives when managing capital consist of maintaining sufficient capital to:

– support claims liabilities and ensure the confidence of policyholders,

– support competitive pricing strategies,

– meet regulatory capital requirements, and

– provide returns for its shareholders.

As at December 31, 2010, the Company had a total of $808.5 million in excess capital over an MCT of 170%, including $807.0 million in the insurance subsidiaries. This compares to total excess capital of $858.7 million at the end of 2009. The decline in excess capital mainly reflects the common shares repurchased under the NCIB for a total consideration of $340.6 million and dividends paid to shareholders of $155.8 million mostly offset by profitability for the year, the higher market value of the investment portfolio and an additional $100 million medium term note issue during the first quarter of 2010.

The capital of the Company is managed on a consolidated basis as well as individually for each regulated subsidiary. The P&C insurance subsidiaries of the Company are subject to the regulatory capital requirements defined by OSFI and the Insurance Companies Act ("ICA"). OSFI has established an MCT guideline which sets out 100% as the minimum and 150% as the supervisory target MCT standards for P&C insurance companies. To mitigate the risk of significant adverse market events that could deteriorate its capital position below the supervisory target, the Company has established an internal target MCT of 170%.

The following table presents the MCT ratio of the Company's insurance subsidiaries with a total for all these companies. The Company's MCT level at December 31, 2010 and 2009 was 233.4% and 231.9% respectively. The 1.5 points increase from December 31, 2009 mainly reflects profitability and increases in AOCI. These are partly offset by increased capital requirements on claims liabilities due to growth of the business and on investments due to increased market values and excess cash flows being invested.

TABLE 32

MCT – P&C insurance companies

(in millions of dollars, except as otherwise noted)	Intact Insurance	Belair Insurance	Nordic Insurance	Novex Insurance	Trafalgar Insurance	Total
At December 31, 2010						
Total capital available	**1,923.4**	**233.0**	**383.9**	**226.0**	**203.1**	**2,969.4**
Total capital required	**843.2**	**99.2**	**144.0**	**98.5**	**87.1**	**1,272.0**
Excess capital	**1,080.2**	**133.8**	**239.9**	**127.5**	**116.0**	**1,697.4**
MCT %	**228.1%**	**234.8%**	**266.7%**	**229.4%**	**233.1%**	**233.4%**
Excess at 150%	**658.6**	**84.1**	**168.0**	**78.2**	**72.5**	**1,061.4**
Excess at 170%	**490.0**	**64.3**	**139.2**	**58.5**	**55.0**	**807.0**
At December 31, 2009						
Total capital available	1,174.3	236.3	927.4	204.6	186.6	2,729.2
Total capital required	533.0	93.2	401.2	79.1	70.4	1,176.9
Excess capital	641.3	143.1	526.2	125.5	116.2	1,552.3
MCT %	220.3%	253.4%	231.1%	258.6%	265.0%	231.9%
Excess at 150%	374.8	96.4	325.6	86.0	81.0	963.8
Excess at 170%	268.2	77.8	245.3	70.1	66.9	728.4

Total capital available and total capital required represent amounts applicable to the Company's P&C insurance subsidiaries and are determined in accordance with prescribed OSFI rules. Total capital available mostly represents total equity less specific deductions for disallowed assets including goodwill and intangibles. Total capital required is calculated by classifying assets and liabilities into categories and applying prescribed risk factors to each category. As at December 31, 2010, the Company's P&C insurance subsidiaries were in compliance with both OSFI and ICA requirements as well as being above internal targets.

MCT monitoring

The MCT is impacted by many factors including changes in equity market performance, interest rates and underwriting profitability. Based on IFC's MCT of 233.4% on December 31, 2010, the following table sets out the estimated immediate impact or sensitivity of the Company's MCT ratio to certain sudden but independent changes in interest rates and equity market prices as at December 31, 2010. Actual results can differ materially from these estimates for a variety of reasons and therefore these sensitivities should be considered as directional estimates of the underlying factors.

TABLE 33 – MCT SENSITIVITY

	Interest rate[1] 1% increase	Equity markets[2] 10% decline
MCT impact[3]	(6)%	(4)%

1 The yield curve experiences an instantaneous parallel shift.
2 A shock of -10% is applied to all common share holdings net of any equity hedges that the Company may have. In addition, a shock of approximately -5% is applied to all preferred shares.
3 Capital sensitivities are calculated independently for each risk factor and assume that all other risk variables remain constant. No management action is considered.

Credit ratings

TABLE 34 – FINANCIAL STRENGTH RATINGS AND CREDIT RATINGS

	A.M. Best	Moody's	DBRS
Credit ratings of Intact Financial Corporation	a-	A3	A (low)
Financial strength ratings of the insurance subsidiaries of Intact Financial Corporation	A+	Aa3	n/a
	Affirmed on June 15, 2010	Affirmed on May 26, 2010	Affirmed on September 27, 2010

9.7 Financing

Medium term notes

On March 23, 2010, the Company completed an additional Series 2 offering of $100.0 million principal amount of unsecured medium term notes (the "Notes"). The Notes bear interest at a fixed annual rate of 6.40% until maturity on November 23, 2039, payable in equal semi-annual instalments commencing on May 23, 2010.

The following table details the two series of the Company's debt outstanding:

TABLE 35

	Medium term notes	
(in millions of dollars, except as otherwise noted)	Series 1	Series 2
Date issued	August 31, 2009	November 23, 2009 and March 23, 2010
Maturity date	September 3, 2019	November 23, 2039
Principal amount outstanding	$ 250.0	$ 250.0
Carrying value (amortized cost)	$ 248.7	$ 247.4
Fair value	$ 265.5	$ 268.6
Fixed annual coupon rate	5.41%	6.40%
Semi-annual coupon payment due on:	March 3, September 3	May 23, November 23

The Company has determined that its optimal Consolidated balance sheets should have debt representing up to 20% of total capital. The Company expects to reach this level over time but the timing of any future debt issuances will depend on prevailing market conditions and the need for funds. A debt to total capital ratio up to 20% is within the limits set out under the credit facility and by the rating agencies to maintain the Company's current ratings. As at December 31, 2010, the debt to total capital ratio was 13.9%. Based on current equity levels and a debt to total capital ratio of 20%, approximately $271.4 million of additional debt capacity remains.

The Company's primary purpose for raising debt capital is acquisitions. We may however raise capital independent of any specific acquisition, to take advantage of market opportunities and to optimize the cost of funds. If suitable acquisitions do not materialize in a reasonable time period, the Company may consider other uses of debt capital, including share repurchases. The proceeds from the issues are invested initially in the Company's investment portfolio.

Credit facility

Effective December 20, 2010, the Company obtained a 3 year unsecured, revolving term facility of $250.0 million which matures on December 20, 2013 in replacement of the previous revolving term facility of $150.0 million. This credit facility may be drawn as prime loans at the prime rate plus a margin or as bankers' acceptances at the bankers' acceptance rate plus a margin. Under the term of the facility, the Company must maintain a debt to total capital ratio of 25% or less and maintain an interest coverage ratio of 3 to 1. At December 31, 2010 the Company had not drawn down under the facility and is in full compliance with the covenants of the facility.

9.8 Contractual obligations

TABLE 36

		Payments due by period			
(in millions of dollars)	Total	Less than 1 year	1–3 years	4–5 years	After 5 years
Debt outstanding	500.0	–	–	–	500.0
Interest on debt outstanding	585.7	29.5	59.1	59.1	438.0
Claims liabilities	2,669.2	947.7	992.9	360.3	368.3
Operating leases on premises and equipment	333.9	68.5	118.6	76.1	70.7
Pension obligations[1]	71.3	14.2	26.6	11.1	19.4
Total contractual obligations	4,160.1	1,059.9	1,197.2	506.6	1,396.4

1 These amounts represent the annual mandatory funding required by OSFI, based on December 31, 2009 actuarial valuations.

9.9 Off-balance sheet arrangements

Securities lending

The Company participates in a securities lending program to generate fee income. This program is managed by the Company's custodian, a major Canadian financial institution, whereby the Company lends securities it owns to other financial institutions to allow them to meet their delivery commitments. As at December 31, 2010 the Company had loaned securities (which are reported in Invested assets on the Company's Consolidated balance sheets) with a fair value of $1,332.3 million (2009: $1,002.2 million).

Collateral is provided by the counterparty and is held in trust by the custodian for the benefit of the Company until the underlying security has been returned to the Company. The collateral cannot be sold or re-pledged externally by the Company, unless the counterparty defaults on its financial obligations. Additional collateral is obtained or refunded on a daily basis as the market value of the loaned securities fluctuates. The collateral consists of government securities with an estimated fair value of 105% of the fair value of the loaned securities and amounts to $1,399.0 million at December 31, 2010 (2009: $1,052.3 million).

SECTION 10 – Accounting and disclosure matters

10.1 Disclosure controls and procedures

The Company is committed to providing timely, accurate and balanced disclosure of all material information about the Company and to providing fair and equal access to such information. The Company's management is responsible for establishing and maintaining the Company's disclosure controls and procedures to ensure that information used internally and disclosed externally is complete and reliable. Due to the inherent limitations in all control systems, an evaluation of controls can provide only reasonable, not absolute, assurance that all control issues and instances of fraud or error, if any, within the Company have been detected. The Company continues to evolve and enhance its system of controls and procedures.

Management, at the direction and under the supervision of the Chief Executive Officer and the Chief Financial Officer of the Company, has evaluated the effectiveness of the Company's disclosure controls and procedures. The evaluation was conducted in accordance with the requirements of National Instrument 52-109 of the Canadian Securities Administrators. This evaluation confirmed, subject to the inherent limitations noted above, the effectiveness of the design and operation of disclosure controls and procedures as at December 31, 2010. The Company's management can therefore provide reasonable assurance that material information relating to the Company and its subsidiaries is reported to it on a timely basis so that it may provide investors with complete and reliable information.

10.2 Internal controls over financial reporting

Management, at the direction and under the supervision of the Chief Executive Officer and the Chief Financial Officer of the Company, has designed and is responsible for maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Consolidated financial statements for external purposes in accordance with Canadian GAAP and the requirements of National Instrument 52-109 of the Canadian Securities Administrators.

Management, at the direction and under the supervision of the Chief Executive Officer and the Chief Financial Officer of the Company, assessed the effectiveness of internal controls over financial reporting and, based on that assessment, concluded that internal controls over financial reporting were effective as at December 31, 2010. There were no changes in the Company's internal controls over financial reporting during the year ended December 31, 2010 that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

10.3 Related-party transactions

All related-party transactions are with entities associated with the Company's distribution segment. These transactions consist mainly of commissions for brokerage services and interest revenue from loans.

These transactions are carried out in the normal course of operations and are measured at the amount of consideration paid or received as established and agreed by the related parties. Management believes that such exchange amounts approximate fair value.

Note 19 of the accompanying audited Consolidated financial statements provides additional information on related party transactions.

10.4 Critical accounting estimates and assumptions

The Company's significant accounting policies are disclosed in Note 3 to the Company's audited Consolidated financial statements. The preparation of the Company's Consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in its Consolidated financial statements. These estimates and assumptions principally relate to the establishment of the value of policy liabilities, financial instruments, impairment losses, income taxes, employee future benefits, goodwill and intangibles. As more information becomes known, these estimates and assumptions could change and impact future results. The most significant estimates and assumptions management makes in preparing the Company's financial statements are described below. There were no significant changes made to the Company's assumptions over the past two years, except for the provision for adverse deviation, the market yield adjustments and the valuation of the embedded derivatives.

Policy liabilities

Policy liabilities consist of provisions for claims liabilities and premium liabilities, net of reinsurance. The provision for policy liabilities 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 the Company's P&C insurance subsidiaries, using appropriate actuarial techniques, evaluates the adequacy of its claims liabilities.

Claims liabilities are maintained to cover the Company's estimated ultimate amount to settle i) insured losses with respect to reported and unreported claims incurred as of the end of each accounting period and ii) claims expenses. The provision for claims liabilities is first determined on a case-by-case basis as claims are reported and then reassessed as additional information becomes known. The provision also considers future possible development of reported and unreported claims. Such reserves do not represent an exact calculation of liability, but instead represent estimates developed using projection techniques in accordance with Canadian accepted actuarial practice. The estimates used are related to 1) expectations of the ultimate cost of settlement and administration of claims based on management's assessment of facts and circumstances then known, 2) its review of historical settlement patterns, 3) estimates of trends in claims severity and frequency, 4) recent legal decisions and other factors such as changes in the legislation and taxation.

Net claims liabilities are discounted using a rate that reflects the estimated market yield of the underlying assets backing these claims liabilities. Several actuarial assumptions are used to calculate this discount rate. These may change from period to period in order to arrive at the most accurate and representative market yield based discount rate. Accordingly, the Company has continuously improved the market yield estimate over the recent years to better match the varied duration of liabilities.

Variables in the reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, 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 provisions may not be sufficient. Adjustments to reserves, both positive and negative, are reflected on the Consolidated statements of income of the period in which such estimates are updated. See table 8.1 and 8.4 in the audited Consolidated annual financial statements.

Premium deficiency

Unearned premiums are calculated on a pro rata basis, from the unexpired portion of the premiums written. The unearned premiums estimate is validated through standard actuarial techniques to ensure that these premiums are sufficient to cover the estimated future costs of servicing these policies and related claims. Premium liabilities are considered adequate when the unearned premiums reserve (after deducting any deferred acquisition cost asset) is at least equal to the present value, at the balance sheet date, of cash flows of the claims, expenses and taxes to be incurred after that date on account of the policies in force at that date or at an earlier date.

Deferred acquisition costs comprise commissions, premium taxes and expenses directly related to policy issuance. Such costs are deferred to the extent that they are recoverable from unearned premiums, after considering the anticipated claims, expenses and interest and dividend income in respect of these premiums. They are amortized on the same basis as the premiums and are reported in Commissions, premium taxes and general expenses on the Consolidated statements of income.

A premium deficiency would be recognized immediately by a charge to the Consolidated statements of income as a reduction of deferred acquisition costs to the extent that the unearned premiums reserve, plus anticipated invested assets 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.

Reinsurance

Reinsurance recoverables include amounts for expected recoveries related to claims liabilities as well as the portion of the reinsurance premium which has not yet been earned. 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 direct written policies. Amounts recoverable from reinsurers are estimated in a manner consistent with claims liabilities and are reported as reinsurance assets on the Company's Consolidated balance sheets. The ceding of insurance does not discharge the Company's primary liability to its insureds. An estimated allowance for doubtful accounts is recorded on the basis of periodic evaluations of balances due from reinsurers, reinsurer solvency, management's experience and current economic conditions.

Structured settlements

The Company enters into annuity agreements with various Canadian life insurance companies to provide for fixed and recurring payments to claimants. Under such arrangements, the Company removes the liability from its Consolidated balance sheets as the liability to its claimants is substantially discharged, although the Company remains exposed to the credit risk that life insurers fail to fulfill their obligations. Refer to Note 7 *Risk and capital management* of the Consolidated financial statements for further details.

Fair value of financial instruments

The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments are determined based on available information and the fair values hierarchy as follows:

Level 1

Level 1 comprises financial assets and liabilities that the Company measures by reference to published quotes in an active market. A financial instrument is regarded as quoted in an active market if quoted prices for that financial instrument are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. When a quoted active market exists, the fair values of financial assets are based on bid prices and the fair values of financial liabilities are based on ask prices.

Level 2

In the absence of an active market, fair values are determined by the Company based on prevailing market rates for instruments with similar characteristics and risk profiles or the fair values are determined by using valuation techniques commonly used by market participants, which refer to observable market data. Fair values determined using valuation models require the use of assumptions concerning the amount and timing of estimated future cash flows and discount rates. In determining those assumptions, the external readily observable market inputs are primarily looked at, including factors such as interest rate yield curves, currency rates, and price and rate volatilities, as applicable. Valuation techniques commonly used by the Company include comparisons with similar instruments where observable market prices exist, discounted cash flow analysis and option pricing models.

Level 3

In limited circumstances, the Company uses input parameters that are not based on observable market data with an adjustment to reflect uncertainty and to ensure that financial instruments are reported at fair values. Liquidity risks, relating to market prices that are not observable due to insufficient trading and volume or a lack of recent trades in a less active or inactive market, will be inherent in the cash flows of an asset or liability and are factored into the valuation techniques when measuring fair value.

The split of the Company's financial instruments between each of the above mentioned levels is presented in Note 6 *Fair value measurement* of the Consolidated financial statements.

Establishing fair value is a critical accounting estimate and has an impact on held-for-trading securities, AFS financial assets and financial liabilities accounted for at fair value and in the Consolidated financial statements. This estimate also has an impact in *Interest income* and *Net investment gains (losses)* on the Consolidated statements of income and *Other comprehensive income* on the Consolidated statements of comprehensive income.

Impairment of financial assets

The Company assesses impairment, as follows:

Financial assets other than held-for-trading are assessed for impairment at each balance sheet date. Impairment exists when there is objective evidence of an other-than-temporary ("OTT") decline in fair value below cost.

Common shares: A quantitative assessment is made to identify shares which have had a significant or prolonged decline in fair value. Management then applies judgment based on each issuer's financial condition to determine whether objective evidence of impairment exists.

Fixed income securities and preferred shares: These financial assets are impaired when there is evidence which suggests that the issuer will fail to make the contractual interest or principal payments due under the terms of the instrument. Possible impairment indicators include significant financial difficulty, a downgrade in credit rating or bankruptcy and financial reorganization. An impairment loss relating to available-for-sale fixed income securities is reversed when, in a subsequent period, the fair value of the instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized.

All impairment losses and reversals are recognized in *Net investment gains (losses)* on the Consolidated statements of income in the period in which they occur.

Management assesses quarterly which of these securities are OTT impaired. Any impairment loss is recognized when the assessment concludes that there is objective evidence of impairment. Each quarter, any security with an unrealized loss that is determined to have been OTT impaired is written down to its published fair value bid price for actively traded securities, with the amount of the write-down reflected on the Company's Consolidated statements of income for that quarter. Previously impaired securities continue to be monitored quarterly, with additional write-downs taken quarterly, if necessary. There are inherent risks and uncertainties involved in making these judgments.

Accounting for embedded derivatives

The Company owns perpetual preferred shares with call options which give the issuer the right to redeem the shares at a particular price. Canadian GAAP requires that these options be accounted for separately from the preferred shares which are classified as AFS. Canadian GAAP also requires that changes in the value of the preferred shares are recorded in *Other comprehensive income* ("OCI") while changes in the value of the option liability are recorded on the Consolidated statements of income, creating a mismatch. As the preferred share prices increased during the year, the value of the associated option liability did not increase as expected as a result of dispositions and change in inputs used in the valuation model.

During the second quarter of 2010, the Company refined the calculation of inputs used in the valuation model for embedded derivatives related to the perpetual preferred shares. The refinement resulted in a one-time gain of $21.4 million that is included in the Net investment gains (losses) from embedded derivatives for the twelve-month period ended in December 31, 2010.

Income taxes

Management exercises judgment in estimating the provision for income taxes. The Company is subject to income tax laws in various provincial jurisdictions where it operates. Various tax laws are potentially subject to different interpretations by the taxpayer and the relevant tax authority. To the extent that the Company's interpretations differ from those of tax authorities or the timing of realization is not as expected, the provision for income taxes may only increase or decrease in future periods to reflect actual experience.

The income tax expense is comprised of two components: current income taxes and future income taxes. Current income taxes are amounts expected to be payable or recoverable as a result of operations in the current year. Future income taxes arise from changes during the year in cumulative temporary differences between the accounting book values of assets and liabilities and their respective tax values. A future income tax asset is recognized to the extent that future realization of the tax benefit is more likely than not.

Employee future benefits

Pension plans

The Company sponsors a number of defined benefits plans providing pension to eligible employees after retirement. The pension plans provide benefits based on years of service, contributions and average earnings at retirement. Due to the long-term nature of these plans, the calculation of benefit expenses and obligations depends on various assumptions such as discount rates, expected rates of return on assets, projected salary increases, retirement age, mortality and termination rates. All assumptions are determined by management and are reviewed annually by the actuaries. The discount rate assumption used in determining pension and other post employment benefit obligations and net benefit expense reflects the market yields, as of the measurement date on high quality fixed income securities with cash flows that would provide the necessary cash flows to pay for benefit payments as they become due. The expected return on plan assets assumption is based on expected returns for the various asset classes by portfolio allocation. Anticipated future long term performance of individual asset categories is considered reflecting expected future inflation and expected real yields on fixed income securities and equities. Other assumptions are based on actual plan experience and the Company's best estimates.

Post-retirement benefit plans

The Company's obligation for post retirement benefits extends to the provision of medical, dental and life insurance to approximately five hundred currently retired employees. For other retirees and currently active employees, the Company has no post-retirement obligation for medical and dental costs, although the Company sponsors retiree-funded life, medical and dental plans.

The table below summarizes some key pension and other employee benefit plan data as at December 31, 2010:

TABLE 37

	Pension plans		Post retirement benefit plans	
(in millions of dollars)	**2010**	2009	**2010**	2009
Benefit obligation	**(704.6)**	(560.8)	**(13.6)**	(14.8)
Fair value of plan assets	**682.3**	570.7	**–**	–
Surplus (deficit)	**(22.3)**	9.9	**(13.6)**	(14.8)
Unrecognized amounts:				
Actuarial losses	**146.5**	105.7	**1.2**	2.8
Past service costs	**1.8**	2.2	**(3.8)**	(4.2)
Transition (asset) obligation	**(10.5)**	(21.1)	**0.5**	0.6
Valuation allowance	**(0.3)**	(0.6)	**–**	–
Total unrecognized amounts	**137.5**	86.2	**(2.1)**	(0.8)
Current expense	**15.7**	11.4	**0.9**	0.7

For accounting purposes, at the end of 2010, the Company's pension plans were in a deficit position of $22.3 million compared to a surplus of $9.9 million last year. The increase in the Benefit obligation during 2010 reflects an additional year of accrued service as well as a reduction of 80 basis points in the discount rate. Actuarial valuations based on plan assets and membership information as at December 31, 2010 will be performed during 2011 for some of the plans. Currently, the Company's best estimate of annual mandatory funding is in the range of 4% and 7% of total plan assets. This mandatory funding estimate includes an annual contribution requirement in the range of 1%–3% of total plan assets to fund past service deficits.

TABLE 38 – IMPACT OF CHANGES IN KEY ASSUMPTIONS ON PENSION PLANS AND OTHER POST-RETIREMENT BENEFITS OBLIGATION

	Obligation	
(in millions of dollars, except as otherwise noted)	**Pension plans**	**Post retirement benefit plans**
Impact of a change in 1% in key assumptions:		
Discount rate:		
Increase	**(113.9)**	**(1.2)**
Decrease	**136.4**	**1.3**
Rate of compensation increase:		
Increase	**32.1**	**n/a**
Decrease	**(30.6)**	**n/a**

Please refer to Note 12 to the Company's audited Consolidated financial statements for more details on the Company's pension plans and other post retirement benefits.

Goodwill and intangibles

Under GAAP, goodwill is not amortized but is tested annually for impairment of value on a reporting unit basis. Management's judgment is required to identify reporting units with similar economic characteristics and to select an appropriate valuation model. In the P&C insurance industry and the P&C insurance brokerage industry, it is common for companies to be acquired at a multiple of revenue or book value, adjusted for net assets other than intangibles. A range of values used to evaluate the multiple is developed using discounted cash flow valuation techniques. The models used reflect several management assumptions such as the growth rates and expected returns. Consideration is also given to economic conditions and the general outlook for the industry and markets in which the reporting unit operates. When establishing these assumptions, management adopts a conservative approach. When the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. When the carrying value of the reporting unit exceeds its fair value, the fair value of the goodwill is compared with its carrying value to determine the amount of impairment. When the carrying value of goodwill exceeds the fair value of the goodwill, an impairment loss is recognized on the Consolidated statements of income in an amount equal to the excess. The Company performed its impairment test of goodwill for years ended December 31, 2010 and 2009 and no impairment was identified. An intangible asset is recognized separately from goodwill when it results from contractual or other legal rights or when it is capable of being separated from the acquired enterprise and sold, transferred, licensed, rented, or exchanged. Finite life intangible assets are amortized to the Consolidated statements of income over their useful lives whereas infinite life intangible assets are not subject to amortization.

10.5 Significant accounting changes

There were no significant changes to the accounting policies during the period ended December 31, 2010.

10.6 Future accounting changes

International financial reporting standards

On January 1, 2011 IFRS replaced current Canadian accounting standards and for publicly accountable enterprises. In order to prepare and implement the conversion to IFRS, the Company has developed and implemented an IFRS changeover plan. The Company will continue to monitor new IFRS exposure drafts or standards expected to impact the Company.

We have completed substantially all the activities required to change to IFRS. Based on the Company's analysis of the accounting differences between Canadian GAAP and existing IFRS, the transition to IFRS will not have a significant impact on the financial position of the Company in 2011.

In general, an entity is required to apply IFRS principles on a retrospective basis; however, certain optional exemptions from retrospective application exist for areas where it would be operationally impractical. The Company has made its transition choices and policy elections. A summary of our significant first time adoption elections under IFRS 1 – "First Time Adoption of IFRS" together with post transition accounting policy differences between Canadian GAAP and IFRS are included in Table 39. The Company has elected not to restate prior business combinations due to the complexities in obtaining historical valuations and instead intends to apply the IFRS requirements prospectively to any acquisitions completed after January 1, 2011.

In addition to measurement differences as discussed in Table 39, there will be changes to ensure the Company's Consolidated financial statements comply with IFRS presentation and disclosures. Draft Q1 2011 interim IFRS financial statements and note disclosures have been prepared and are now being refined.

The initial adoption of IFRS will have no significant impact on disclosure controls and procedures, information technology systems or business activities. Appropriate staff training has been completed and will continue as new standards develop.

The Company has identified the following IFRS and accounting policy differences between Canadian GAAP and IFRS expected to have measurement impacts on the Company's Consolidated financial statements:

TABLE 39

Accounting areas	Differences	Accounting policies elected and preliminary impacts
a) Employee future benefits	**On transition to IFRS:** First-time adopters can elect to recognize all cumulative actuarial gains and losses at the date of transition as an adjustment to opening retained earnings. Alternatively, entities may elect an IFRS "corridor" approach to leave some actuarial gains and losses unrecognized, as if an IFRS "corridor approach" had always been applied.	The Company elected to recognize all cumulative actuarial gains and losses at the date of transition as an adjustment to retained earnings. The Company has established the January 1, 2010 transition impact on equity to be approximately $65.6 million, net of tax (see table 40).
	Post transition to IFRS: Entities have the choice of recognizing ongoing actuarial gains or losses in the income statement over time using the "corridor" approach, or alternatively, immediately to the statement of comprehensive income.	The Company elected to recognize ongoing actuarial gains or losses immediately to comprehensive income.
b) Financial instruments	**On transition to IFRS:** First-time adopters can also choose to (re-)classify their financial assets and financial liabilities at the transition date.	The Company elected not to change its investments classification.
	On and post transition to IFRS: Canadian GAAP accounting rules for financial instruments were for the most part harmonized with IFRS. However there are some differences between the two. The impairment assessment and the impairment model for certain AFS equity securities are different and require retrospective application on transition to IFRS. In addition, due to the absence in IFRS of the "other than temporary" impairment rule in Canadian GAAP, impairment losses on AFS equities may occur more quickly in the future.	The Company completed its assessment of the impact of IFRS transition on AFS equity securities. Retrospective application of IFRS impairment rules on transition requires a reclassification from Accumulated Other Comprehensive Income (AOCI) to retained earnings of approximately $309.7 million, net of tax (see table 40). This reclass will have no overall impact on the Company's shareholders' equity.

The Company has prepared a preliminary opening Consolidated balance sheet as of January 1, 2010 that reflects the adjustments discussed above.

TABLE 40 – RECONCILIATION OF THE COMPANY'S CONSOLIDATED BALANCE SHEETS AT JANUARY 1, 2010

(in millions of dollars)	Canadian GAAP	Measurement effect of transition to IFRS	IFRS	Reference
Cash and cash equivalents	60.1		60.1	
Invested assets	7,996.5		7,996.5	
Premiums receivable	1,640.5		1,640.5	
Deferred acquisition costs	396.2		396.2	
Reinsurance assets	260.6		260.6	
Intangible assets and goodwill	338.2		338.2	
Other assets	659.2	(59.4)	599.8	Table 39 a)
Total assets	**11,351.3**	**(59.4)**	**11,291.9**	
Claims liabilities	4,270.0		4,270.0	
Unearned premiums	2,463.6		2,463.6	
Debt outstanding	397.7		397.7	
Financial liabilities	278.8		278.8	
Other liabilities	958.6	6.2	964.8	Table 39 a)
Total liabilities	**8,368.7**	**6.2**	**8,374.9**	
Share capital and contributed surplus	1,144.8		1,144.8	
Retained earnings	1,902.2	(375.3)	1,526.9	Table 39 a) b)
Accumulated other comprehensive income (loss)	(64.4)	309.7	245.3	Table 39 b)
Shareholders' equity	2,982.6	(65.6)	2,917.0	
Total liabilities and shareholders' equity	**11,351.3**	**(59.4)**	**11,291.9**	

SECTION 11 – Risk management

11.1 Introduction

The Company has a comprehensive risk management framework and internal control procedures designed to manage and monitor various risks in order to protect our business, clients, shareholders and employees. Our risk management programs aim at avoiding risks that could materially impair our financial position, accepting risks that contribute to sustainable earnings and growth and disclosing these risks in a full and complete manner.

Effective risk management rests on identifying, understanding and communicating all risks the Company is exposed to in the course of its operations. In order to make sound business decisions, both strategically and operationally, management must have continual direct access to the most timely and accurate information possible. Either directly or through its committees, the Board of Directors ensures that the Company's management has put appropriate risk management programs in place. The Board of Directors, directly and in particular through its Audit and Risk Review Committee, oversees the Company's risk management programs, procedures and controls and, in this regard, receives periodic reports from, among others, the risk management department through the Chief Risk Officer, internal auditors and the independent auditors. A summary of the Company's key risks and the processes for managing and mitigating them is outlined below.

The risks described below and all other information contained in our public documents including our Consolidated financial statements and notes should be considered carefully. The risks and uncertainties described below are those we currently believe to be material, but they are not the only risks and uncertainties we face. If any of these risks, or any other risks and uncertainties that we have not yet identified, or that we currently consider to be not material, actually occur or become material risks, our business prospects, financial condition, results of operations and cash flows could be materially adversely affected.

While the Company employs a broad and diversified set of risk mitigation techniques those techniques and the judgments that accompany their application cannot anticipate every economic and financial outcome in all market environments or the specifics and timing of such outcomes.

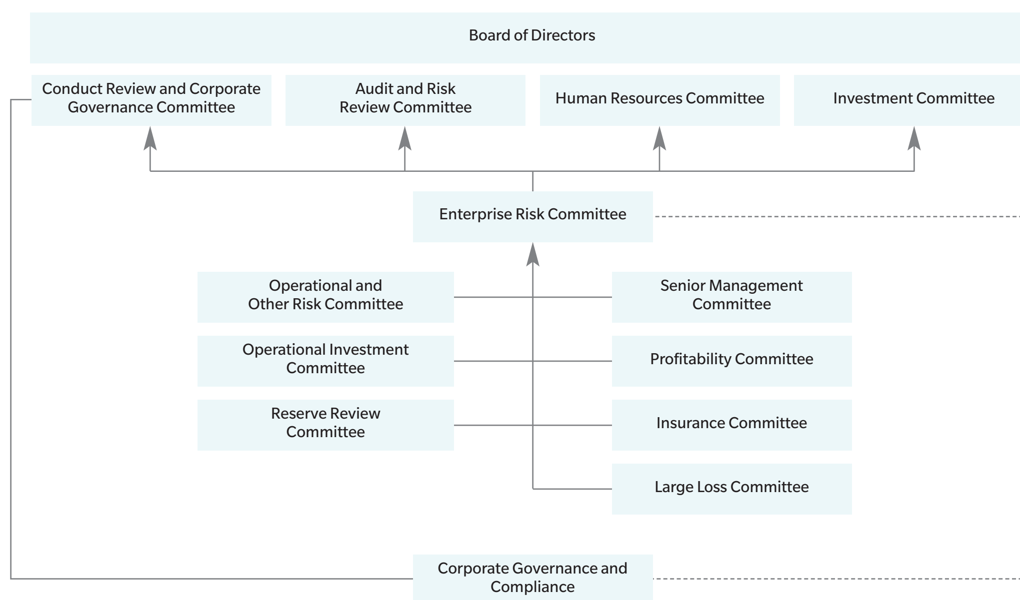
11.2 Risk management structure

The Board of Directors is ultimately responsible for overseeing the Company's risk-taking activities and risk management programs and is supported by the following committees to ensure that risks are being properly measured, monitored and reported:

- ***Audit and Risk Review Committee***: this committee is composed exclusively of independent members of our Board of Directors and is chaired by an independent director. In addition to its audit committee functions, which include the review of financial information and the monitoring of internal controls, this committee reviews trends and key risk positions and exposures, risk management programs, practices and internal controls and compliance with key operational risk policies and limits.
- ***Conduct Review and Corporate Governance Committee***: this committee is composed of a majority of independent members of our Board of Directors and is chaired by an independent director. This committee reviews, approves or makes recommendations to our Board of Directors with respect to related party transactions, compliance and market conduct programs and policies, including the resolution of conflicts of interests, and restrictions on the use of confidential information.
- ***Human Resources Committee***: this Committee is composed exclusively of independent members of our Board of Directors and is chaired by an independent director. The Committee oversees the management of the Company in relation to human resources matters, including compensation of employees, management and executives as well as assessment of the CEO and senior executives and succession plan. The Committee also addresses the compensation practices of the Company against the compensation practices itemized in the Financial Stability Board program, the best practices recommended by governance associations and regulatory requirements, and in this regard assesses the risks of the Company's practices after receiving the Chief Risk Officer's report and recommendations.
- ***Investment Committee***: this committee is composed of a majority of independent members of our Board of Directors with expertise in capital markets and related areas and is chaired by an independent director. The role of this committee is to advise the Company on the investment strategies that are appropriate in the context of the Company and its subsidiaries' activities as well as for the pension plans. The main functions of this committee are to recommend to the Board of Directors the adoption of investment policies aimed at supporting the Company and its subsidiaries in meeting their financial obligations while optimizing risk and return, and minimizing the potential for large losses.
- ***Enterprise Risk Committee*** (see figure 1): this committee is composed of senior officers and is chaired by the Chief Risk Officer designated by our Board of Directors. It meets on a quarterly basis and oversees and endorses our risk management priorities, assesses the effectiveness of risk management programs, policies and actions of each key function of our business and reports on an ongoing basis to the Chief Executive Officer, quarterly to the Audit and Risk Review committee, and at a minimum annually to our Board of Directors. The committee evaluates our overall risk profile, aiming for a balance between risk, return, and capital, and determines policies concerning security and information technology risk, crisis and business continuity risks and reputation risk. The committee is mandated to: (i) identify risks that could materially affect our business; (ii) measure risks from a financial or other impact standpoint, such as reputation; (iii) monitor risks; and (iv) avoid taking risks if they are not in line with the risk tolerance level determined by our Board of Directors.
- ***Corporate Governance and Compliance Department***: this department, under the direction of the Chief Legal Officer, acts independently from operations for various functions, including privacy matters, dealings with the Ombudsman office and public company matters, and reports directly to a committee of the Board of Directors for these functions. This department works closely with and reports any issues or risks it identifies in the course of its functions to the risk management function.

In addition, the Company has other committees responsible for managing, monitoring and reviewing specific aspects of risk related to our operations, investments, profitability, insurance operations, security and business continuity. Further details on how these committees operate, ensure compliance with laws and regulations and report to the Enterprise Risk Committee follow.

FIGURE 1 – RISK MANAGEMENT STRUCTURE



11.3 Corporate governance ensuring compliance with laws and regulatory requirements

The Company believes that sound corporate governance and compliance monitoring related to legal and regulatory requirements are paramount for maintaining the confidence of different stakeholders including its investors. Legal and regulatory compliance risk arises from non-compliance with the laws, regulations or guidelines applicable to the Company as well as the risk of loss resulting from non-fulfilment of a contract. The Company is subject to strict regulatory requirements and detailed monitoring of its operations in all provinces and territories where it conducts business, either directly or through its subsidiaries. The Company's corporate governance and compliance program is built on the following foundations:

- The Board of Directors and its committees are structured in accordance with sound corporate governance standards. Directors are presented with relevant information in all areas of the Company's operations to enable them to effectively oversee the Company's management, business objectives and risks.
- Disclosure controls and processes have been put into place so that relevant information is obtained and communicated to senior management and the Board of Directors to ensure that the Company meets its disclosure obligations while protecting the confidentiality of information. A decision-making process through the Disclosure Committee is also in place to facilitate timely and accurate public disclosure.
- Effective corporate governance depends on sound corporate compliance structures and processes. The Company has established an enterprise-wide Compliance Policy and framework including procedures and policies necessary to ensure adherence to laws, regulations and related obligations. Compliance activities include identification, mitigation and monitoring of compliance/reputation risks, as well as communication, education, and activities to promote a culture of compliance and ethical business conduct. In this regard, the Company recently launched an internal campaign promoting and reaffirming the Company's five core values, which are: integrity, respect, customer driven, excellence and social responsibility.
- The Board of Directors and the Audit and Risk Review Committee periodically receive reports on all important litigation, whether in the ordinary course of business where such litigation may have a material adverse effect, or outside the ordinary course of business.
- To manage the risks associated with compliance, regulatory, legal and litigation issues, the Company has specialized resources, reporting to the Chief Legal Officer that remain independent of operations. The Chief Legal Officer reports directly to the CEO and to the Board of Directors and its Committees on such matters, including with respect to privacy and Ombudsman complaints. The Company also uses third party legal experts and takes provisions when deemed necessary or appropriate.

While senior management has ultimate responsibility for compliance, it is a responsibility that each individual employee shares. This is clearly set out in Intact's core Business Values and Code of Conduct and employees sign a confirmation that they have reviewed and complied with them annually.

11.4 Ensuring risk management in the operations

Our internal structure is designed in order for the risk related teams, together with operations, to build a sustainable competitive advantage by fully integrating risk management in our daily business activities and strategic planning. Intact believes that each of the employees and management teams is responsible for taking the appropriate action to mitigate risks and ensure compliance with all legal and regulatory requirements:

- Heads of departments have primary responsibility and accountability for the effective control of risks/challenges affecting their respective departments. They are responsible for the execution of the risk management policies set by the Enterprise Risk Committee.
- Risk management members exercise their functions to partner with and support heads of department in the execution of risk management activities. Risk management oversight functions are carried out independently from the management team that originates the risk exposures. Examples of typical activities are:
  - Overseeing and objectively challenging the execution of risk management activities;
  - Monitoring the key risks of the business;
  - Having the authority to escalate risk management issues to a higher level and vetoing high risk business activity;
  - Allocating specific accountability for risk responses;
  - Enforcing compliance with the risk policies.
- The Internal Audit department provides an independent review of the design and effectiveness of internal controls over the Company's business operational risks. In carrying out this work, this department provides specific recommendations for improving the governance, risk and control framework.
- The Corporate governance and compliance department reviews, analyzes and reports current and developing legal and regulatory requirements in order to ensure continued compliance.

11.5 Main risk factors and mitigating actions

The Company's main risk factors together with the Company's risk management practices used to mitigate these risks are explained below.

Investment related risks

Market risk

Movements in short-term and long-term interest rates, credit spreads, foreign exchange rates and equity prices cause changes in realized and unrealized gains and losses. Generally, the Company's interest and dividend income will be reduced during sustained periods of lower interest rates and will likely result in unrealized gains in the value of fixed income securities the Company continues to hold, as well as realized gains to the extent the relevant securities are sold. During periods of rising interest rates, the fair value of the Company's existing fixed income securities will generally decrease and its realized gains on fixed income securities will likely be reduced or result in realized losses. Changes in credit spreads would have similar impacts as those described above for changes in interest rates.

General economic conditions, political conditions and many other factors can also adversely affect the equity markets and, consequently, the fair value of the equity securities the Company owns and ultimately affect the timing and level of realized gains or losses. The recent financial crisis provides an example of an event with a significant adverse impact on the Company's financial condition. During the crisis, several financial institutions failed or received government assistance and many others experienced significant distress. Most equity investments and some corporate fixed income securities declined significantly in value while sovereign government bond yields fell. Some of the Company's investments were negatively impacted by these events, resulting in losses.

While our strategy is long-term in nature, it is reviewed periodically to adapt to the investment environment when necessary, especially in times of turbulence and increased volatility. For example, the Company employed several risk mitigation measures during the financial crisis. Specifically, the Company implemented changes to its strategic asset mix, implemented a financial hedging program and increased holdings in cash. These actions reduced exposure to common shares and decreased the sensitivity of the MCT ratio to fluctuations in the equity markets.

Sensitivity analysis is one risk management technique that assists management in ensuring that risks assumed remain within the Company's risk tolerance level. Sensitivity analysis involves varying a single factor to assess the impact that this would have on the Company's results and financial condition.

For example, a 100 basis point increase in interest rates would increase income before taxes by approximately $22.1 million for the Company's AFS fixed income securities or preferred securities, as a result of marking to market the written call option liabilities embedded in the Company's redeemable preferred shares and the marking to market of derivatives positions. A 100 basis point increase would also decrease OCI by approximately $166.7 million. Conversely, a 100 basis point decrease in interest rates would decrease income before taxes and increase OCI by the same amounts, respectively.

The impacts described here are approximately linearly related to the change in interest rates.

Furthermore, a 10% increase in common shares and a 5% increase in preferred shares would decrease income before taxes by $14.3 million, as a result of marking to market the written call option liabilities embedded in the Company's redeemable preferred shares. However, it would result in a linear increase of OCI by $177.4 million. Conversely, a 10% decrease in equity prices and a 5% decrease in preferred shares would increase income before taxes and decrease OCI by the same amounts, respectively. The impacts described here are approximately linearly related to the change in the equity market.

The above sensitivity analyses were prepared using key assumptions as described below:

- the securities in the Company's portfolio are not impaired;
- interest rates and equity prices move independently;
- shifts in the yield curve are parallel;
- credit, liquidity and basis risks have not been considered;
- for our HFT debt securities, the estimated impact on income before taxes is assumed to be offset by the MYA. In addition, it is important to note that AFS securities in an unrealized loss position, as reflected in OCI, may at some point in the future be realized through either a sale or impairment.

The Company also uses stress tests to determine the impact of various market scenarios on its financial and capital position. (See MCT monitoring discussion in Section 9.5 *Liquidity and capital resources*).

To mitigate these risks, the Company's investment policies set forth limits for each type of investment, and compliance with the policies is closely monitored by the Investment Committee. The Company manages market risk through asset class and economic sector diversification and, in some cases, the use of derivatives. The Company also monitors and reviews the duration of its fixed income securities and its policy liabilities to ensure any duration mismatch is within acceptable tolerances.

The rate of currency exchange may also have an unintended effect on earnings and equity when measured in domestic currency. Although the Company is exposed to some foreign exchange risks arising from securities in some of its U.S. dollar-denominated assets, the general policy is to minimize foreign currency exposure. The Company mitigates foreign exchange rate risks by buying or selling successive monthly foreign exchange forward contracts or entering into foreign exchange swaps.

Credit risk

Credit risk is the possibility that counterparties may not be able to meet payment obligations when they become due. A counterparty is any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation to us. The Company's credit risk exposure is concentrated primarily in its fixed income, preferred share portfolios, over the counter derivatives and, to a lesser extent, in its reinsurance recoverables and annuity agreements entered into with various life insurance companies.

The Company's risk management strategy is to invest in fixed income instruments and preferred shares of high credit quality issuers and to limit the amount of credit exposure with respect to any one issuer by imposing limits based upon credit quality. See tables 20 and 21 for more details on the breakdown of credit quality of fixed income securities and preferred shares. In addition, the Company sets limits on the total credit exposure across all assets classes including both on and off balance sheet exposures.

Concentration of credit risk exists where a number of borrowers or counterparties are engaged in similar activities, are located in the same geographic area or have comparable economic characteristics. Their ability to meet contractual obligations may be similarly affected by changing economic, political or other conditions. The Company's invested assets could be sensitive to changing conditions in specific geographic regions or specific industries. The Company has a significant concentration of its invested assets in the financial sector. This risk concentration is closely monitored by the Company and it hedges some of the risk as it deems necessary. See tables 18 and 19 for more details on the breakdown of invested assets by economic sector.

Credit risk from derivative transactions reflects the potential for the counterparty to default on its contractual obligations when one or more transactions have a positive market value to the Company. Therefore, derivative-related credit risk is represented by the positive fair value of the instrument and is normally a small fraction of the contract's notional amount.

The Company subjects its derivative-related credit risk to the same credit approval, limit and monitoring standards that it uses for managing other transactions that create credit exposure. This includes evaluating the creditworthiness of counterparties and managing the size, diversification and maturity structure of the portfolio. Credit utilization for all products is compared with established limits on a continual basis and is subject to a quarterly review by the Investment Committee.

Netting is a technique that can reduce credit exposure from derivatives and is generally facilitated through the use of netting clauses in master derivative agreements. The netting clauses in a master derivative agreement provide for a single net settlement of all financial instruments covered by the agreement in the event of default. However, credit risk is reduced only to the extent that the Company's financial obligations toward the counterparty to such an agreement can be set off against obligations such counterparty has toward us. The Company uses netting clauses in master derivative agreements to reduce derivative-related credit exposure. The overall exposure to credit risk that is reduced through the netting clauses may change substantially following the reporting date as the exposure is affected by each transaction subject to the agreement as well as by changes in underlying market rates and values.

The use of collateral is another significant credit mitigation technique for managing derivative-related counterparty credit risk. Mark-to-market provisions in the Company's agreements with some counterparties provide the Company with the right to request that the counterparty pay down or collateralize the current market value of its derivatives positions when the value passes a specified threshold amount.

The Company enters into annuity agreements with various Canadian life insurance companies which have credit ratings of at least A- or higher, to provide for fixed and recurring payments to claimants. Under such arrangements, the Company derecognizes the liability from its Consolidated balance sheets as the liability to its claimants is substantially discharged, although the Company remains exposed to the credit risk that life insurers may fail to fulfill their obligations.

Use of derivatives

The Company uses derivatives principally to mitigate certain of the above mentioned risks. The Company's use of derivatives exposes it to a number of risks, including credit risk, interest rate and equity market fluctuations. The hedging of certain risks with derivatives results in basis risk. Basis risk is the risk that offsetting investments in a hedging strategy will not experience price changes in entirely opposite directions from each other. This imperfect correlation between the two investments creates the potential for excess gains or losses in a hedging strategy, thus adding risk to the position. The Company monitors the effectiveness of its hedges on a regular basis.

Insurance related risks

Reserve adequacy risk

Our success depends upon our ability to accurately assess the risks associated with the insurance policies that we write. We establish reserves to cover our estimated liability for the payment of all losses and loss adjustment expenses incurred with respect to premiums collected or due on the insurance policies that we write. Reserves do not represent an exact calculation of liability. Rather, reserves are our estimates of what we expect to be the ultimate cost of resolution and administration of claims. These estimates are based upon various factors, including:

- actuarial projections of the cost of settlement and administration of claims reflecting facts and circumstances then known;
- estimates of trends in claims severity and frequency;
- judicial theories of liability;
- variables in claims handling procedures;
- economic factors (such as inflation);
- judicial and legislative trends, and actions such as class action lawsuits and judicial interpretation of coverage or policy exclusions; and
- the level of insurance fraud.

Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact our ability to accurately assess the risks of the policies that we write. In addition, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the insurer and additional lags between the time of reporting and final settlement of claims.

We continually refine our reserve estimates in an ongoing process as claims are reported and settled. Establishing an appropriate level of reserves is an inherently uncertain process. The following factors may have a substantial impact on our future actual losses and loss adjustment expenses experience:

– the amounts of claims payments;
– the expenses that we incur in resolving claims;
– legislative and judicial developments; and
– changes in economic conditions, including inflation.

To the extent that actual losses and loss adjustment expenses exceed our expectations and the reserves reflected in our Consolidated financial statements, we will be required to reflect those changes by increasing our reserves. In addition, government regulators could require that we increase our reserves if they determine that our reserves were understated in the past. When we increase reserves, our pre-tax income for the period in which we do so will decrease by a corresponding amount. In addition, increasing or "strengthening" reserves causes a reduction in our insurance subsidiaries' capital and could cause a downgrading of the financial strength ratings of our insurance subsidiaries. Any such downgrade could, in turn, adversely affect our ability to sell insurance policies.

Business cycle risk

The P&C insurance industry is cyclical, and we may witness changes in the appetite and underwriting capacity of our competitors, depending on their own loss experience and results. This would have different impacts on pricing and our ability to write new business. The industry's profitability can be affected significantly by:

– competition;
– availability of capital to support the assumption of new business;
– rising levels of actual costs that are unforeseen by companies at the time they price their products;
– volatile and unpredictable developments, including unnatural, weather-related and other natural catastrophes or terrorists' attacks;
– changes in loss reserves resulting from the general claims and legal environments as different types of claims arise and judicial interpretations relating to the scope of insurers' liability develop;
– changes in insurance and tax laws and regulations as well as new legislative initiatives;
– general economic conditions, such as fluctuations in interest rates, inflation and other changes in the investment environment, which affect returns on invested capital and may impact the ultimate payout of loss amounts;
– general industry practices.

In addition, the profitability of automobile insurers can be affected significantly by many factors, including:

– regulatory regimes which limit their ability to detect and defend against fraudulent claims and fraud rings;
– developing trends in tort and class action litigation;
– changes in laws which could limit the use of used or like kind and quality after-market parts or compel compensation for alleged diminution in value notwithstanding repair of the vehicle;
– changes in other laws or regulations, including the adoption of consumer initiatives regarding rates charged for automobile or other insurance coverage or claims handling procedures; and
– privacy and consumer protection laws that prevent insurers from assessing risks or factors that have a high correlation with risks considered, such as credit scoring.

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

Catastrophic events risk

As we saw in different parts of the world in 2010, catastrophes can be caused by various natural and unnatural events. Natural catastrophic events may be affected by the impacts of climate change and include hurricanes, windstorms, earthquakes, hailstorms, rainstorms, ice storms, explosions, severe winter weather and fires. Unnatural catastrophic events include hostilities, terrorist acts, riots, crashes and derailments. Despite the use of "models", the incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes, windstorms and earthquakes may produce significant damage in large, heavily populated areas. Catastrophes can cause losses in a variety of P&C insurance lines. For example, the ice storm in Eastern Canada in 1998 caused P&C insurance losses in several lines of business, including business interruption, personal property, automobile and commercial property.

Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in our financial results and could materially reduce our profitability or harm our financial condition.

The Company's risk management strategy involves monitoring insured value accumulation and concentration risk, catastrophe scenario modeling, and reinsurance. See section 9.3 for more details on the Company's reinsurance program.

Climate change risk

Climate change is a challenge facing the entire property and casualty insurance industry. In particular, the Company's home insurance business has been affected due to changing climate patterns and an increase in the number and cost of claims associated with severe storms. Water damages now make up more than half of the Company's home insurance claims.

To address this issue, the Company has launched several initiatives including pricing and product changes to reflect new climate realities, a home insurance action plan, a review of claims processes and a greater focus on consumer loss prevention and education. The Company's progress on the home insurance action plan is described in detail in section 5.3.

Since 2010, the Company is associated with the University of Waterloo in order to learn from studies to be made on the impact of such changes.

Reinsurance risk

We use reinsurance to help manage our exposure to insurance risks. The availability and cost of reinsurance are subject to prevailing market conditions, both in terms of price and available capacity, which can affect our premium volume and profitability. Reinsurance companies exclude some coverages from the policies that we purchase from them or may alter the terms of such policies from time to time. For example, following the terrorist attacks of September 11, 2001, some reinsurers excluded coverage for terrorist acts or priced such coverage at prohibitively high rates. These gaps in reinsurance protection expose us to greater risks and greater potential losses and could adversely affect our ability to write future business. We may not be able to successfully mitigate risks through reinsurance arrangements, which could cause us to reduce our premiums written in certain lines or could result in losses.

We are supported by a number of reinsurers which may be affected by difficult situations and results. This increases the potential adverse effect on our results of operations if one or more of our reinsurers are unable to meet its financial obligations. Although all of our reinsurers have, amongst other criteria, a minimum financial strength rating of "A-" from A.M. Best and/or S&P at the time of entering into reinsurance arrangements with us, these ratings are subject to change and may be downgraded. Although reinsurance makes the assuming reinsurer liable to us to the extent of the risk ceded, we are not relieved of our primary liability to our policyholders as the direct insurer. As a result, we bear credit risk with respect to our reinsurers. Despite our efforts to monitor the overall situation with our reinsurers, including a regular review of the accounts payable due to our organization, there is no certainty that our reinsurers will pay all reinsurance claims on a timely basis or at all. We evaluate each reinsurance claim based on the facts of the case, historical experience with the reinsurer for similar claims under existing law, and provide for reinsurance amounts deemed uncollectible in our reserves. Other details regarding reinsurance are also included at sections 9.3 and 10.4.

Competition risk

The P&C insurance industry is highly competitive and intense competition for our insurance products could harm our ability to maintain or increase our profitability, premium pricing power and written insured risk volume. We believe that the industry will remain highly competitive in the foreseeable future. We also believe that competition in our business lines is based on price, service, commission structure, product features, financial strength and scale, ability to pay claims, ratings, reputation and name or brand

recognition. We compete with a large number of domestic and foreign insurers as well as with different Canadian banks that are selling insurance products. These firms may use business models different to ours and sell products through various distribution channels, including brokers and agents who sell products exclusively for one insurer and directly to the consumer. We compete not only for business and individual customers, employers and other group customers but also for brokers and other distributors of investment and insurance products.

In addition, we may not be aware of other companies that may be planning to enter the insurance market or existing insurers that may be planning to raise additional capital. Also, as it happened in 2010, competitors may add to their offer or try to increase their market shares by doing an acquisition, which could have an impact on our capacity to better compete. Any new, proposed or potential legislative or industry developments could further increase competition in our markets. We cannot be sure that we will be able to achieve or maintain any particular level of direct premiums written in this competitive environment.

Underwriting ability risk

Our performance depends on our ability to reduce financial loss resulting from the selection of risks to be insured and management of contract clauses. Unfavourable results in these areas can lead to deviations from the estimates based on actuarial assumptions. The Company has adopted policies which specify the Company's retention limits and risk tolerance, and its application depends on training and the discipline of our underwriting teams. Once the retention limits have been reached, the Company turns to reinsurance to cover the excess risk. Moreover, our profitability and ability to grow may also be adversely affected by our mandatory participation in the Facility Association in Canada's automobile insurance markets.

Product and pricing risk

Product design and pricing risk is the risk that the established price is or becomes insufficient to ensure an adequate return for shareholders as compared to the Company's profitability objectives. This risk may be due to an inadequate assessment of market needs, new business context, a poor estimate of the future experience of several factors, as well as the introduction of new products that could adversely impact the future behaviour of policyholders.

New products are reviewed by Senior Management and the risk is primarily managed by regularly analyzing the pricing adequacy of the Company's products as compared to recent experience. The pricing assumptions are revised as needed, and/or the various options offered by the reinsurance market are utilized.

Operational and other related risks

These risks are essentially resulting from inadequate or failed processes, people and systems or from external events. These include events such as unauthorized activity, internal and external criminal activity, information security failure, among others.

We believe that managing the risks related to the Company's business activities significantly reduces losses resulting from failed processes, procedures or controls, inadequate systems, human errors, fraud or external events such as natural disasters. To manage these risks, the Company follows a specific framework that is composed of different steps including identification, measurement, monitoring and mitigation.

For early detection of and clear insight into the Company's key operational risks or any other related type of risks, the risk management team uses many tools including periodic risk review interviews with management and risk and control self-assessments of the Company's critical functions. It also monitors and measures the Company's risks on an ongoing basis through key risk indicators which enable management to proactively initiate effective actions. The Company has also developed clear incident reporting channels within the organization to systematically report, manage and monitor operational incidents which could lead to potential financial losses or reputation damage. Ongoing training and exercises provided to all employees also contribute in increasing the operational risk awareness culture within the organization and minimizing the severity and occurrence of incidents.

The effective implementation of the overall operational and other related risk management program depends on management. Management is supported by the Risk Management department which assists in monitoring the risk processes and ensuring that appropriate actions are taken when necessary. The Operational and Other Related Risk Management department reports to the Enterprise Risk Committee, which is comprised of executive members appointed by the Board of Directors. The committee has the oversight responsibility for all enterprise risks and risk governance within the organization. Finally, to ensure transparency, the committee provides regular updates of its operations to the Senior Management Committee, the Audit and Risk Review Committee and the Board of Directors.

Strategy implementation risk

In order to seek profitable growth and maximize shareholders' returns, we intend to invest significant resources in expanding our core businesses and implementing our strategies. We cannot be sure that we will continue to succeed in implementing our strategies. We may experience difficulty in executing our strategies because of, among other things, increased competition, difficulty in developing and introducing new products, adverse economic conditions, changes in regulatory requirements and difficulty in our relationships with our distribution networks and insured clients. To help mitigate these risks, the Company relies extensively on technology to improve the Company's capacity to deliver our services.

In executing our growth strategy, we intend to continue to expand our operations and business in part by acquiring additional P&C insurance businesses. We cannot be sure that the market conditions will be favourable to undertaking or completing such acquisitions nor that we will be able to identify appropriate acquisition targets, profitably manage additional businesses or successfully integrate any acquired businesses into our operations. Furthermore, acquisitions may involve a number of special risks, including diversion of management's attention, failure to retain key personnel, unanticipated events or circumstances and legal liabilities, some or all of which could have a material adverse effect on our business, results of operations and financial condition. We cannot be sure that any acquired businesses will achieve the anticipated revenues, income and synergies. Acquisitions could also result in potentially dilutive issuances of equity securities. Failure on our part to manage our acquisition strategy successfully could have a material adverse effect on our business, results of operations and financial condition.

The Company mitigates these risks through formal processes and approvals which include:

– obtaining our Board of Directors' final approval of the medium term plan, which provides for strategic planning and capital allocation, and includes risk management analysis;
– having the financial and operational reports reviewed by the Audit Committee and our Board of Directors on a quarterly basis;
– having each of our business units develop detailed business plans, which are then executed by local management;
– having each significant acquisition reviewed and approved by our Board of Directors; and
– developing and maintaining high standards of conduct through distribution of our Code of Conduct to all new employees and through periodical reminders to all employees and training sessions. Fraud detection measures also play a role in reducing potential losses.

Business interruption risk

We may also experience an abrupt interruption of activities caused by unforeseeable and/or catastrophic events, an example of which being a global flu pandemic (e.g. H1N1). Our operations may be subject to losses resulting from such disruptions. Losses can relate to property, financial assets, trading positions and also to key personnel. If our business continuity plans cannot be put into action or do not take such events into account, losses may increase further.

In order to maintain the integrity and continuity of the Company's operations in the event of a crisis, we have developed personalized alert and mobilization procedures as well as communication protocols. For example, emergency action plans, business continuity plans, business recovery plans, major health crisis plans, building evacuation plans and crisis communication plans have all been defined and are tested on an ongoing basis. This process is supported by a crisis management structure adapted to our company's organization and to the type of events we may have to manage.

Distribution risk

Distribution risk is the risk related to the distribution of the Company's P&C insurance products. It includes the inherent risk of dealing with independent distributors, the risk related to new market entrants and the risk associated with the Company's multiple distribution channel strategy. We may also face the risk that one of our channels or business models would not be sustainable in a specific market or context.

We distribute our products primarily through a network of brokers and a great part of our success depends on the capacity of this network to be competitive against other distributors, including "direct" insurers, as well as our ability to maintain our business relationships with them while developing our distribution network strategy.

These brokers sell our competitors' insurance products and may stop selling our insurance products altogether. Strong competition exists among insurers for brokers with demonstrated ability to sell insurance products. Premium volume and profitability could be materially adversely affected if there is a material decrease in the number of brokers that choose to sell our insurance products. In addition, our strategy of distributing through the direct channel may adversely impact our relationship with brokers who distribute our products.

From time to time the Company issues loans or takes equity participation in certain brokers and by doing so, the Company exposes itself to financial risk and to potential relationship issues. In order to maintain strong relationships with brokers, each relationship is managed by officers in each of the main regions in which we operate. To mitigate the financial risk, the Company generally receives guarantees and uses standard agreements which contain general security and oversight clauses. The Board of Directors participates in this oversight process by reviewing these loan and equity arrangements annually. For different considerations, the broker's channel has been in a consolidation mode, not only in 2010 but for a few years, and we may think that this situation will remain for the next few years. The acquisition of brokers by others or even by insurers may impact our relationship with some of them and jeopardize our ability to grow our business.

The Company has established and maintains close relationships with its independent distributors by providing technology and training to help strengthen their market position. It closely monitors pricing gaps between its various channels and manages the different channels under different brand names including BrokerLink, its wholly owned broker network.

Regulation and legal risk

Our insurance subsidiaries are subject to regulation and supervision by insurance regulatory authorities of the jurisdictions in which they are incorporated and licensed to conduct business. These laws and regulations delegate regulatory, supervisory and administrative powers to federal, provincial and territorial insurance commissioners and agencies. Such laws and regulations are generally designed to protect policyholders and creditors rather than shareholders, and are related to matters including:

- personal auto insurance rate setting;
- risk-based capital and solvency standards;
- restrictions on types of invested assets;
- the maintenance of adequate reserves for unearned premiums and unpaid claims;
- the examination of insurance companies by regulatory authorities, including periodic financial and market conduct examinations;
- the licensing of insurers, agents and brokers;
- limitations on dividends and transactions with affiliates; and
- regulatory actions.

We believe that our insurance subsidiaries are in material compliance with all applicable regulatory requirements. It is not possible to predict the future impact of changing federal, provincial and territorial regulations on our operations, and we cannot be sure that laws and regulations enacted in the future will not be more restrictive than current laws. Overall, our business is heavily regulated and changes in regulation may reduce our profitability and limit our growth.

In addition, these laws and regulations typically require us to periodically file financial statements and annual reports, prepared on a statutory accounting basis, and other information with insurance regulatory authorities, including information concerning our capital structure, ownership and financial condition including, on an annual basis, the aggregate amount of contingent commissions paid and general business operations. We could be subject to regulatory actions, sanctions and fines if a regulatory authority believed we had failed to comply with any applicable law or regulation. Any such failure to comply with applicable laws could result in the imposition of significant restrictions on our ability to do business or significant penalties, which could adversely affect our reputation, results of operations and financial condition. In addition, any changes in laws and regulations, including the adoption of consumer or other initiatives regarding contingent and other commissions, rates charged for automobile or claims handling procedures, could materially adversely affect our business, results of operations and financial condition.

In addition to the occasional employment-related litigation, we are a defendant in a number of claims relating to our insurance and other related business operations. We may from time to time be subject to a variety of legal and regulatory actions relating to our current and past business operations, including, but not limited to:

- disputes over coverage or claims adjudication;
- disputes regarding sales practices, disclosures, premium refunds, licensing, regulatory compliance and compensation arrangements;
- disputes with our agents, brokers or network providers over compensation and termination of contracts and related claims;
- regulatory actions relating to consumer pressure in relation to benefits realized by insurers;
- disputes with taxing authorities regarding our tax liabilities and tax assets; and
- disputes relating to certain businesses acquired or disposed of by us.

Plaintiffs may also continue to bring new types of legal claims against the Company. Current and future court decisions and legislative activity may increase our exposure to these types of claims. Multiparty or class action claims may present additional exposure to substantial economic, non-economic or punitive damage awards. The loss of even one of these claims, if it resulted in a significant damage award or a judicial ruling that was otherwise detrimental, could have a material adverse effect on our results of operations and financial condition. Unfavourable claim rulings may render fair settlements more difficult to reach. We cannot determine with any certainty what new theories of recovery may evolve or what their impact may be on our businesses.

We may be subject to governmental or administrative investigations and proceedings in the context of our highly regulated sectors of activity. We cannot predict the outcome of these investigations, proceedings and reviews, and cannot be sure that such investigations, proceedings or reviews or related litigation or changes in operating policies and practices would not materially adversely affect our results of operations and financial condition. In addition, if we were to experience difficulties with our relationship with a regulatory body in a given jurisdiction, it could have a material adverse effect on our ability to do business in that jurisdiction and the price of the Company's common shares.

We are supported by an in-house team of lawyers and staff, and by outside counsel when deemed necessary or appropriate, in handling general regulation and litigation issues and are an active member of the major industry associations. Additionally, our government relations team ensures contact with the governments of the various provinces in which we operate, and can be proactive in situations that could affect our business.

General economic, financial market and political conditions

Our businesses and profitability may be materially adversely affected from time to time by general economic, financial market and political conditions. In periods of economic downturn characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment and lower consumer spending, individuals and businesses may choose not to purchase insurance products, may allow existing policies to lapse, or may choose to reduce the amount of coverage purchased. In addition to the demand for our insurance products being adversely affected, frequency or severity of claims could increase, resulting in lower earnings. General inflationary pressures may affect the costs of medical care, automobile parts and repair, construction and other items, and may increase the costs of paying claims.

In addition to the risk related to investments discussed previously, an economic downturn could have a significant impact on the financial condition of the Company's defined benefit employee pension plans. Consequently, this could impact the Company's financial condition.

Solvency risk

Regulatory authorities closely monitor the solvency of insurance companies by requiring them to comply with strict solvency standards based on the risk assumed by each company with respect to asset composition, liability composition, and the matching between these two components. The Company is required to submit regular reports to the regulatory authorities regarding its solvency, and publish its solvency ratio every quarter. The minimum solvency ratio targeted by the Company is 170.0%, which is higher than the regulatory MCT requirement of 150.0%. The appointed actuary must present an annual report to the Audit Committee and the Senior Management Committee on the Company's current and future solvency and mitigating measures.

Reputation risk

Our insurance products and services are ultimately distributed to individual consumers and businesses. From time to time, consumer advocacy groups or the media may focus attention on our products and services, thereby subjecting us or our subsidiaries to periodic negative publicity. We also may be negatively impacted in relation to our information systems, security and technology, or if one of our subsidiaries engages in practices resulting in increased public attention to our businesses. Negative publicity may also result in increased regulation and legislative scrutiny of practices in the P&C insurance industry as well as increased litigation. Such increase may further increase our costs of doing business and adversely affect our profitability by impeding our ability to market our products and services, requiring us to change our products or services or increasing the regulatory burdens under which we operate. The periodic negative insurance publicity and related businesses may negatively impact our financial results and financial condition. To mitigate these risks the Board of Directors has created the Disclosure Committee which is composed of senior officers and chaired by the Chief Legal Officer. This committee oversees the Company's disclosure practices and procedures; its role includes maintaining awareness and understanding of corporate disclosure rules and guidelines, educating and informing employees about the Company's disclosure practices, determining whether corporate developments constitute material information and reviewing and approving all material disclosure releases or statements of Intact Financial Corporation.

Credit downgrade risk

Independent third party rating agencies assess the Company's ability to honour its financial obligations (the "issuer credit rating"), and the insurance subsidiaries' ability to meet their ongoing policyholder obligations (the "financial strength rating").

The rating agencies periodically evaluate us to confirm that we continue to meet the criteria of the ratings previously assigned to us.

We may not be in a position to maintain either the issuer credit ratings or the financial strength ratings we have received from the rating agencies. An issuer credit rating downgrade could result in materially higher borrowing costs. A financial strength rating downgrade could result in a reduction in the number of insurance contracts we write and in a significant loss of business, as such business could move to other competitors with higher ratings, thus causing premiums and earnings to decrease.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet obligations associated with financial liabilities. To manage its cash flow requirements, the Company maintains a portion of its invested assets in liquid securities.

The Company's liquidity management is governed by establishing a prudent policy that identifies oversight responsibilities as well as by setting limits and implementing effective techniques to monitor, measure and control exposure to liquidity risk. A portion of invested assets is maintained in short-term (less than one year) highly liquid money market securities, which are used to manage the operational requirements of the Company. A large portion of the invested assets are held in highly liquid federal and provincial government debt to protect against any unanticipated large cash requirements. The Company also has an unsecured committed credit facility.

Limit on dividend and capital distribution risk

As a holding company, IFC is a legal entity and is separate and distinct from its operating subsidiaries, most of which are regulated insurance companies. Canadian insurance regulations limit the ability of our insurance subsidiaries to pay dividends and require our insurance subsidiaries to maintain specified levels of statutory capital and surplus. In addition, for competitive reasons, our insurance subsidiaries need to maintain financial strength ratings which require us to sustain minimum capital levels in our insurance subsidiaries. These restrictions affect the ability of our insurance subsidiaries to pay dividends and use their capital in other ways. The inability of our subsidiaries to pay dividends to us could have a material adverse effect on our business and financial condition.

Dependency on key employees risk

Our success has been, and will continue to be, dependent on our ability to retain the services of our existing key employees and to attract and retain additional qualified personnel in the future. The loss of the services of any of our key employees, or the inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of our business operations.

The Company has developed a focused recruiting strategy to aggressively market careers and opportunities at Intact. The strategy includes an updated web site, focused external recruiting, campaigns, rebranding and targeted advertising. It also includes partnering with four universities on graduate recruiting as well as commercial and personal lines trainee program recruiting. Talent identification and development programs have been implemented to retain and grow existing talent and ingrain succession planning.

SECTION 12 – Other matters

12.1 Cautionary note regarding forward-looking statements

Certain of the statements in this MD&A about the Company's current and future plans, expectations and intentions, results, levels of activity, performance, goals or achievements or any other future events or developments constitute forward-looking statements. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other similar or comparable words or phrases, are intended to identify forward-looking statements.

Forward-looking statements are based on estimates and assumptions made by management based on management's experience and perception of historical trends, current conditions and expected future developments, as well as other factors that management believes are appropriate in the circumstances. Many factors could cause the Company's actual results, performance or achievements or future events or developments to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the following factors: the Company's ability to implement its strategy or operate its business as management currently expects; its ability to accurately assess the risks associated with the insurance policies that the Company writes; unfavourable capital market developments or other factors which may affect the Company's investments and funding obligations under its pension plans; the cyclical nature of the P&C insurance industry; management's ability to accurately predict future claims frequency; government regulations; litigation and regulatory actions; periodic negative publicity regarding the insurance industry; intense competition; the Company's reliance on brokers and third parties to sell its products; the Company's ability to successfully pursue its acquisition strategy; its ability to execute its business strategy; the Company's participation in the Facility Association (a mandatory pooling arrangement among all industry participants); terrorist attacks and ensuing events; the occurrence of catastrophic events; the Company's ability to maintain its financial strength ratings; the Company's ability to alleviate risk through reinsurance; the Company's ability to successfully manage credit risk (including credit risk related to the financial health of reinsurers); the Company's reliance on information technology and telecommunications systems; the Company's dependence on key employees; general economic, financial and political conditions; the Company's dependence on the results of operations of its subsidiaries; the volatility of the stock market and other factors affecting the Company's share price; and future sales of a substantial number of its common shares.

All of the forward-looking statements included in this MD&A are qualified by these cautionary statements and those made in the "Risk Management" section of our MD&A for the year ended December 31, 2010. These factors are not intended to represent a complete list of the factors that could affect the Company; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein. The Company and management have no intention and undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

SECTION 13 – Additional information

The following tables present the consolidated net income and comprehensive income information, shareholders' equity and cash flows.

TABLE 41 – CONSOLIDATED STATEMENTS OF INCOME

(in millions of Canadian dollars, except as otherwise noted)	For the quarter ended December 31 2010	For the quarter ended December 31 2009	For the year ended December 31 2010	For the year ended December 31 2009
Revenues				
Premiums written				
Direct	**$ 1,051.4**	$ 1,006.5	**$ 4,474.7**	$ 4,261.7
Ceded	**(30.6)**	(24.1)	**(122.4)**	(110.4)
Net	**1,020.8**	982.4	**4,352.3**	4,151.3
Changes in net unearned premiums	**70.7**	54.1	**(121.0)**	(95.9)
Net premiums earned	**1,091.5**	1,036.5	**4,231.3**	4,055.4
Interest income	**42.4**	46.5	**178.9**	178.7
Dividend income	**36.0**	35.9	**136.1**	130.8
Net investment gains (losses)	**(1.3)**	(13.3)	**63.7**	(172.5)
Distribution income and other	**11.9**	19.1	**58.9**	48.9
	1,180.5	1,124.7	**4,668.9**	4,241.3
Expenses				
Underwriting				
Claims incurred	**717.2**	660.7	**2,802.0**	2,877.2
Commissions, premium taxes and general expenses	**324.2**	306.9	**1,271.9**	1,165.8
	1,041.4	967.6	**4,073.9**	4,043.0
Distribution expense and other	**3.0**	22.2	**21.3**	36.1
Investment expense	**5.5**	5.0	**20.6**	16.8
Interest on debt outstanding	**7.4**	4.5	**28.3**	5.6
	1,057.3	999.3	**4,144.1**	4,101.5
Income before income taxes	**123.2**	125.4	**524.8**	139.8
Income tax expense	**25.7**	28.7	**105.0**	13.1
Net income	**$ 97.5**	$ 96.7	**$ 419.8**	$ 126.7
Earnings per share, basic and diluted (dollars)	**$ 0.87**	$ 0.81	**$ 3.65**	$ 1.06
Dividends per share (dollars)	**$ 0.69**	$ 0.32	**$ 1.36**	$ 1.28
Basic and diluted average number of common shares (in millions)	**112.6**	119.9	**115.1**	119.9

TABLE 42 – CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions of Canadian dollars)	For the quarter ended December 31 2010	For the quarter ended December 31 2009	For the year ended December 31 2010	For the year ended December 31 2009
Net income	**$ 97.5**	$ 96.7	**$ 419.8**	$ 126.7
Net decrease in unrealized losses on available-for-sale securities	**69.8**	35.8	**257.2**	425.2
Income taxes	**(19.1)**	(27.6)	**(70.1)**	(140.6)
	50.7	8.2	**187.1**	284.6
Reclassification to income of net (gains) losses on available-for-sale securities	**(33.6)**	4.5	**(46.6)**	105.5
Income taxes	**10.3**	18.6	**10.6**	(8.4)
	(23.3)	23.1	**(36.0)**	97.1
Other comprehensive income	**27.4**	31.3	**151.1**	381.7
Comprehensive income	**$ 124.9**	$ 128.0	**$ 570.9**	$ 508.4

TABLE 43 – CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in millions of Canadian dollars)	Share capital	Contributed surplus	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance as at December 31, 2009	**$ 1,061.5**	**$ 83.3**	**$ 1,902.2**	**$ (64.4)**	**$ 2,982.6**
Net income	**–**	**–**	**419.8**	**–**	**419.8**
Other comprehensive income	**–**	**–**	**–**	**151.1**	**151.1**
Common shares repurchased for cancellation	**(68.4)**	**–**	**(272.2)**	**–**	**(340.6)**
Dividends paid	**–**	**–**	**(155.8)**	**–**	**(155.8)**
Long-term incentive plan	**–**	**13.0**	**–**	**–**	**13.0**
Balance as at December 31, 2010	**$ 993.1**	**$ 96.3**	**$ 1,894.0**	**$ 86.7**	**$ 3,070.1**
Balance as at December 31, 2008	$ 1,061.5	$ 88.3	$ 1,928.9	$ (446.1)	$ 2,632.6
Net income	–	–	126.7	–	126.7
Other comprehensive income	–	–	–	381.7	381.7
Common shares repurchased for cancellation	–	–	–	–	–
Dividends paid	–	–	(153.4)	–	(153.4)
Long-term incentive plan	–	(5.0)	–	–	(5.0)
Balance as at December 31, 2009	$ 1,061.5	$ 83.3	$ 1,902.2	$ (64.4)	$ 2,982.6

TABLE 44 – CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the quarter ended December 31		For the year ended December 31	
(in millions of Canadian dollars)	**2010**	2009	**2010**	2009
Cash flows from (used in) operating activities				
Net income	**$ 97.5**	$ 96.7	**$ 419.8**	$ 126.7
Adjustments for non-cash items	**2.3**	104.6	**114.8**	315.3
Changes in net claims liabilities	**(32.9)**	(84.2)	**134.9**	169.4
Changes in other operating assets and liabilities	**7.3**	(39.8)	**(169.0)**	(73.4)
Net cash flows from operating activities	**74.2**	77.3	**500.5**	538.0
Cash flows from (used in) investing activities				
Proceeds from sale of invested assets	**1,580.9**	1,888.7	**7,796.6**	6,151.6
Purchase of invested assets	**(1,665.0)**	(2,246.7)	**(7,746.6)**	(7,281.7)
Purchase of brokerages and books of business, net of sales	**(14.4)**	(11.1)	**(36.8)**	(51.9)
Purchase of property and equipment and other	**(9.6)**	(16.7)	**(38.2)**	(50.6)
Net cash flows used in investing activities	**(108.1)**	(385.8)	**(25.0)**	(1,232.6)
Cash flows from (used in) financing activities				
Common shares repurchased for cancellation	**(37.0)**	–	**(340.6)**	–
Net proceeds from debt issuance	**–**	148.9	**98.6**	397.7
Dividends paid	**(38.3)**	(38.3)	**(155.8)**	(153.4)
Net cash flows from (used in) financing activities	**(75.3)**	110.6	**(397.8)**	244.3
Net increase (decrease) in cash and cash equivalents	**(109.2)**	(197.9)	**77.7**	(450.3)
Cash and cash equivalents, beginning of period	**247.0**	258.0	**60.1**	510.4
Cash and cash equivalents, end of period	**$ 137.8**	$ 60.1	**$ 137.8**	$ 60.1

Management's responsibility for financial reporting

Management is responsible for the preparation and presentation of the consolidated financial statements of Intact Financial Corporation and its subsidiaries, collectively known as "the Company". This responsibility includes selecting appropriate accounting policies and making estimates and informed judgments based on the anticipated impact of current transactions, events and trends, consistent with Canadian generally accepted accounting principles.

In meeting its responsibility for the reliability of consolidated financial statements, the Company maintains and relies on a comprehensive system of internal control comprising organizational procedural controls and internal accounting controls. The Company's system of internal control includes the communication of policies and of the Company's Code of Conduct, comprehensive business planning, proper segregation of duties, delegation of authority for transactions and personal accountability, selection and training of personnel, safeguarding of assets and maintenance of records. The Company's internal auditors review and evaluate the system of internal control.

The Company's Board of Directors, acting through the Audit and Risk Review Committee, which is composed entirely of Directors, who are neither officers nor employees of the Company, oversees management's responsibility for the design and operation of effective financial reporting and internal control systems, the preparation and presentation of financial information and the management of risk areas.

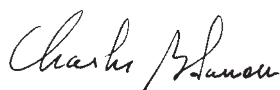
The Audit and Risk Review Committee conducts such review and inquiry of management and the internal and external auditors as it deems necessary to establish that the Company employs an appropriate system of internal control, adheres to legislative and regulatory requirements and applies the Company's Code of Conduct. The internal and external auditors, as well as the Actuary, have full and unrestricted access to the Audit and Risk Review Committee, with and without the presence of management.

Pursuant to the *Insurance Companies Act* (Canada) or to *An Act Respecting Insurance* (Quebec) ("the Acts"), the Actuary, who is a member of management, is appointed by the Board of Directors. The Actuary is responsible for discharging the various actuarial responsibilities required by the Acts and conducts a valuation of policy liabilities, in accordance with Canadian generally accepted actuarial standards, reporting his results to management and the Audit and Risk Review Committee.

The Office of the Superintendent of Financial Institutions Canada for the federally regulated property and casualty ("P&C") subsidiaries and l'Autorité des marchés financiers for the Quebec regulated P&C subsidiary make such examinations and inquiries into the affairs of the P&C subsidiaries as deemed necessary.

The Company's external auditors, Ernst & Young LLP, Chartered Accountants, are appointed by the shareholders to conduct an independent audit of the consolidated financial statements of the Company and meet separately with both management and the Audit and Risk Review Committee to discuss the results of their audit, financial reporting and related matters. The auditors' report to shareholders appears on the following page.

February 8, 2011



Charles Brindamour
President and Chief Executive Officer

Mark A. Tullis
Chief Financial Officer

To the Shareholders of Intact Financial Corporation

We have audited the accompanying Consolidated financial statements of **Intact Financial Corporation** which comprise the Consolidated balance sheets as at December 31, 2010 and 2009 and the Consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the Consolidated financial statements

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

Auditors' responsibility

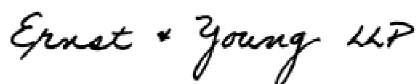
Our responsibility is to express an opinion on these Consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain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

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

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

Opinion

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



Chartered Accountants
Licensed Public Accountants

Toronto, Canada
February 8, 2011

Intact Financial Corporation

Audited Consolidated financial statements

For the year ended December 31, 2010

TABLE OF CONTENTS

Audited Consolidated financial statements

64 Consolidated balance sheets

65 Consolidated statements of income

65 Consolidated statements of comprehensive income

66 Consolidated statements of changes in shareholders' equity

66 Consolidated statements of cash flows

Notes to Consolidated financial statements

67 Note 1 – Status of the Company

67 Note 2 – Basis of presentation

67 Note 3 – Summary of significant accounting policies

74 Note 4 – Invested assets and financial liabilities

78 Note 5 – Derivative financial instruments

80 Note 6 – Fair value measurement

84 Note 7 – Risk and capital management

90 Note 8 – Policy liabilities

94 Note 9 – Income taxes

96 Note 10 – Other assets

97 Note 11 – Goodwill and intangible assets

98 Note 12 – Employee future benefits

101 Note 13 – Debt outstanding

101 Note 14 – Share capital

102 Note 15 – Stock-based compensation

103 Note 16 – Additional information on the Consolidated statements of cash flows

104 Note 17 – Acquisitions and divestitures

104 Note 18 – Contingencies, commitments and guarantees

105 Note 19 – Related-party transactions

106 Note 20 – Segmented information

107 Note 21 – Disclosures on rate regulation

Consolidated balance sheets

(in millions of Canadian dollars)

As at December 31,	**2010**	2009
Assets		
Cash and cash equivalents	**$ 137.8**	$ 60.1
Invested assets (note 4)		
Debt securities	**4,820.8**	4,784.3
Equity securities	**3,380.3**	2,893.7
Loans	**314.2**	318.5
	8,515.3	7,996.5
Accrued interest and dividend income	**43.0**	43.0
Premium receivables	**1,762.0**	1,640.5
Income taxes receivable	**52.1**	40.4
Other receivables	**248.4**	244.9
Reinsurance assets (note 8)	**235.2**	260.6
Deferred acquisition costs	**419.8**	396.2
Future income tax asset (note 9)	**20.0**	38.0
Other assets (note 10)	**334.7**	292.9
Intangibles (note 11)	**169.5**	159.6
Goodwill (note 11)	**211.1**	178.6
Total assets	**$12,148.9**	$ 11,351.3
Liabilities		
Claims liabilities (note 8)	**$ 4,378.5**	$ 4,270.0
Unearned premiums (note 8)	**2,585.6**	2,463.6
Income taxes payable	**77.7**	102.5
Future income tax liability (note 9)	**54.1**	25.8
Financial liabilities (note 4)	**490.3**	278.8
Other liabilities	**996.5**	830.3
Debt outstanding (note 13)	**496.1**	397.7
	9,078.8	8,368.7
Contingencies, commitments and guarantees (note 18)		
Shareholders' equity		
Share capital (note 14)	**993.1**	1,061.5
Contributed surplus	**96.3**	83.3
Retained earnings	**1,894.0**	1,902.2
Accumulated other comprehensive income (loss)	**86.7**	(64.4)
	3,070.1	2,982.6
Total liabilities and shareholders' equity	**$12,148.9**	$ 11,351.3

See accompanying notes to audited Consolidated financial statements.

On behalf of the Board:

Charles Brindamour
Director

Eileen Mercier
Director

Consolidated statements of income

(in millions of Canadian dollars, except as noted)

For the years ended December 31,	2010	2009
Revenues		
Premiums written		
Direct	$ 4,474.7	$ 4,261.7
Ceded	(122.4)	(110.4)
Net	4,352.3	4,151.3
Changes in net unearned premiums	(121.0)	(95.9)
Net premiums earned	4,231.3	4,055.4
Interest income (note 4)	178.9	178.7
Dividend income (note 4)	136.1	130.8
Net investment gains (losses) (note 4)	63.7	(172.5)
Distribution income and other	58.9	48.9
	4,668.9	4,241.3
Expenses		
Underwriting		
Claims incurred (note 8)	2,802.0	2,877.2
Commissions, premium taxes and general expenses	1,271.9	1,165.8
	4,073.9	4,043.0
Distribution expenses and other	21.3	36.1
Investment expenses (note 4)	20.6	16.8
Interest on debt outstanding	28.3	5.6
	4,144.1	4,101.5
Income before income taxes	524.8	139.8
Income tax expense (note 9)	105.0	13.1
Net income	$ 419.8	$ 126.7
Earnings per share, basic and diluted (in dollars)	$ 3.65	$ 1.06
Dividends per share (in dollars)	$ 1.36	$ 1.28
Basic and diluted average number of common shares (in millions)	115.1	119.9

See accompanying notes to audited Consolidated financial statements.

Consolidated statements of comprehensive income

(in millions of Canadian dollars)

For the years ended December 31,	2010	2009
Net income	$ 419.8	$ 126.7
Net decrease in unrealized losses on available-for-sale securities	257.2	425.2
Income taxes (note 9)	(70.1)	(140.6)
	187.1	284.6
Reclassification to income of net (gains) losses on available-for-sale securities	(46.6)	105.5
Income taxes (note 9)	10.6	(8.4)
	(36.0)	97.1
Other comprehensive income	151.1	381.7
Comprehensive income	$ 570.9	$ 508.4

See accompanying notes to audited Consolidated financial statements.

Consolidated statements of changes in shareholders' equity

(in millions of Canadian dollars)

	Share capital	Contributed surplus	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance as at December 31, 2009	**$ 1,061.5**	**$ 83.3**	**$ 1,902.2**	**$ (64.4)**	**$ 2,982.6**
Net income	**–**	**–**	**419.8**	**–**	**419.8**
Other comprehensive income	**–**	**–**	**–**	**151.1**	**151.1**
Common shares repurchased for cancellation (note 14)	**(68.4)**	**–**	**(272.2)**	**–**	**(340.6)**
Dividends paid	**–**	**–**	**(155.8)**	**-**	**(155.8)**
Long-term incentive plan	**–**	**13.0**	**–**	**–**	**13.0**
Balance as at December 31, 2010	**$ 993.1**	**$ 96.3**	**$ 1,894.0**	**$ 86.7**	**$ 3,070.1**
Balance as at December 31, 2008	$ 1,061.5	$ 88.3	$ 1,928.9	$ (446.1)	$ 2,632.6
Net income	–	–	126.7	–	126.7
Other comprehensive income	–	–	–	381.7	381.7
Common shares repurchased for cancellation (note 14)	–	–	–	–	–
Dividends paid	–	–	(153.4)	–	(153.4)
Long-term incentive plan	–	(5.0)	–	–	(5.0)
Balance as at December 31, 2009	$ 1,061.5	$ 83.3	$ 1,902.2	$ (64.4)	$ 2,982.6

See accompanying notes to audited Consolidated financial statements.

Consolidated statements of cash flows

(in millions of Canadian dollars)

For the years ended December 31,	**2010**	2009
Cash flows from (used in) operating activities		
Net income	**$ 419.8**	$ 126.7
Adjustments for non-cash items (note 16)	**114.8**	315.3
Changes in net claims liabilities	**134.9**	169.4
Changes in other operating assets and liabilities (note 16)	**(169.0)**	(73.4)
Net cash flows from operating activities	**500.5**	538.0
Cash flows from (used in) investing activities		
Proceeds from sale of invested assets	**7,796.6**	6,151.6
Purchase of invested assets	**(7,746.6)**	(7,281.7)
Purchase of brokerages and books of business, net of sales	**(36.8)**	(51.9)
Purchase of property and equipment and other	**(38.2)**	(50.6)
Net cash flows used in investing activities	**(25.0)**	(1,232.6)
Cash flows from (used in) financing activities		
Common shares repurchased for cancellation	**(340.6)**	–
Net proceeds from debt issuance	**98.6**	397.7
Dividends paid	**(155.8)**	(153.4)
Net cash flows from (used in) financing activities	**(397.8)**	244.3
Net increase (decrease) in cash and cash equivalents	**77.7**	(450.3)
Cash and cash equivalents, beginning of year	**60.1**	510.4
Cash and cash equivalents, end of year (note 16)	**$ 137.8**	$ 60.1

See accompanying notes to audited Consolidated financial statements.

NOTE 1 – Status of the Company

Intact Financial Corporation ("Intact" or the "Company") (TSX: IFC) incorporated under the *Canada Business Corporations Act*, is domiciled in Canada and its shares are publicly traded on the Toronto Stock Exchange. The Company has investments in wholly-owned subsidiaries which operate principally in the Canadian property and casualty ("P&C") insurance market. The Company's significant subsidiaries are Intact Insurance Company, Belair Insurance Company Inc., The Nordic Insurance Company of Canada, Novex Insurance Company, Trafalgar Insurance Company of Canada, Equisure Financial Network Inc., Canada Brokerlink Inc. and Grey Power Insurance Brokers Inc.

During 2009, ING Groep completed the disposal of its entire 70% shareholding in the Company via the sale of the Company's common shares to a number of institutional investors on a private placement basis and the sale of common shares pursuant to a secondary public offering.

NOTE 2 – Basis of presentation

These Consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The accounting policies used to prepare the financial statements of the Company's regulated insurance subsidiaries also comply with the accounting requirements of their respective regulators. Generally, in preparing their financial statements, the subsidiaries apply the same accounting policies as the Company.

The Company consolidates the financial statements of all subsidiary companies and eliminates on consolidation all intercompany balances and transactions.

The equity accounting method is applied to account for investments in entities over which the Company exerts significant influence. Gains and losses on sales of these investments are reported in *Net investment gains (losses)* on the Consolidated statements of income only when realized, while expected losses due to other than temporary impairments are recognized immediately. All related-party transactions are with entities subject to significant influence. These transactions are made in the normal course of business and are recorded at the exchange amount.

Earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if the holders of securities or contracts entitling them to obtain common shares in exchange for their securities or contracts exercised their right to obtain common shares.

In preparing these Consolidated financial statements, the Company has adopted certain presentation standards. All amounts in these statements are in millions of Canadian dollars except as otherwise noted. Certain comparative figures have been reclassified to conform to the presentation adopted in the current period. In these Consolidated financial statements and notes, captions such as "Income", "Earnings" and "Gains" are placed before the words "Expense", "Loss" and "Losses".

NOTE 3 – Summary of significant accounting policies

The preparation of Consolidated financial statements in accordance with Canadian GAAP requires management to make assumptions and estimates that affect the reported amounts of assets and liabilities at the dates of the Consolidated financial statements, the reported amounts of revenue and expenses for the years presented, as well as the disclosure of contingent assets and liabilities (note 18). These estimates are subject to uncertainty. Significant estimates include *policy liabilities* (note 8), *fair value measurement* (note 6), *impairment of financial assets* (note 4), *income taxes* (note 9), *employee future benefits* (note 12), and *goodwill and intangibles* (note 11). Changes in estimates are recorded in the accounting period in which they occur.

The significant accounting policies used in preparing these Consolidated financial statements, including those specified by the insurance regulators, are, in all material respects, in accordance with Canadian GAAP and are summarized below. These policies have been consistently applied during the year.

a) Accounting changes

The Company made no significant accounting policy changes this year.

b) Significant accounting policies

Insurance policy contracts

Revenue recognition

Premiums written are deferred as unearned premiums and recognized as revenue, net of reinsurance, on a pro rata basis over the terms of the underlying policies, usually twelve months and generally no longer than twenty-four months. Distribution income, mainly consisting of commissions, is recorded on an accrual basis.

Policy liabilities

Policy liabilities consist of unearned premiums and claims liabilities, gross of the reinsurers' share. The appointed actuary, using appropriate actuarial techniques, evaluates the adequacy of policy liabilities.

Claims liabilities are first determined on a case-by-case basis as claims are reported and then reassessed as additional information becomes known. Included in claims liabilities is a provision to account for the future development of these claims, including claims incurred but not reported by policyholders ("IBNR"), as well as a provision for adverse deviations, as required by accepted actuarial practice in Canada. Claims liabilities are discounted to take into account the time value of money.

In estimating claims liabilities, standard actuarial techniques are used. These techniques are based on historical loss development factors and payment patterns. They require the use of assumptions such as loss and payment development factors, future rates of claims frequency and severity, inflation, reinsurance recoveries, expenses, changes in the legal environment, changes in tax legislation, changes in the regulatory environment and other matters, taking into consideration the circumstances of the Company and the nature of the insurance policies.

Unearned premiums are calculated on a pro rata basis, from the unexpired portion of the premiums written. The unearned premiums estimate is validated through standard actuarial techniques to ensure that these premiums are sufficient to cover the estimated future costs of servicing these policies and related claims.

Net claims liabilities are discounted using a rate that reflects the estimated market yield of the underlying assets backing these claims liabilities. Several actuarial assumptions are used to calculate this discount rate. These may change from period to period in order to arrive at the most accurate and representative market yield based discount rate.

Structured settlements

The Company enters into annuity agreements with various Canadian life insurance companies that have credit ratings of at least A- or higher to provide for fixed and recurring payments to claimants. Under such arrangements, the Company removes the liability from its Consolidated balance sheets as the liability to its claimants is substantially discharged, although the Company remains exposed to the credit risk that life insurers fail to fulfill their obligations. Refer to note 7 *Risk and capital management* for further details.

Industry pools

When certain automobile owners are unable to obtain insurance via the voluntary insurance market, they are insured via the Facility Association ("FA"). In addition, entities can choose to cede certain risks to FA administered risk sharing pools ("RSP"). The related risks associated with FA insurance policies and policies ceded by companies to the RSP are aggregated and shared by the entities in the P&C insurance industry, generally in proportion to market share and volume of business ceded to the RSP. The Company applies the same accounting policies to FA and RSP insurance it assumes as it does to insurance polices issued by the Company directly to policyholders.

In accordance with the Office of the Superintendent of Financial Institutions Canada ("OSFI") guidelines, ceded and assumed RSP premiums are reported in *Direct premiums written* on the Consolidated statements of income.

In addition, IFC acts as a "facility carrier" responsible for the administration of a portion of the FA policies. In exchange for providing these services the Company receives fees. Policy issuance fees are earned immediately while claims handling fees are deferred and earned as claims are opened and settled.

Reinsurance

Reinsurance assets include reinsurers' share of claims liabilities and unearned premiums. The Company presents third party reinsurance balances in the Consolidated balance sheets on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a net basis in the Consolidated statements of income. The estimates for the reinsurers' share of claims liabilities are determined on a basis consistent with the related claims liabilities. Refer to note 7 *Risk and capital management* for further details.

Reinsurance liabilities are reported in Other liabilities and relate to ceded premiums payable.

Deferred acquisition costs

Deferred acquisition costs comprise commissions, premium taxes and expenses directly related to policy issuance. Such costs are deferred to the extent that they are recoverable from unearned premiums, after considering the anticipated claims, expenses and interest and dividend income in respect of these premiums. They are amortized on the same basis as the premiums and are reported in *Commissions, premium taxes and general expenses* on the Consolidated statements of income.

Financial instruments contracts

The Company has classified or designated all of its financial assets and liabilities in the following categories:

– available for sale ("AFS")
– held-for-trading ("HFT")
– loans and receivables
– other financial liabilities

The table below summarizes the Company's initial and subsequent measures of financial instruments, as well as the reporting of related changes in fair value based on classification category.

TABLE 3.1 – FINANCIAL INSTRUMENTS MEASUREMENT BASIS AND CLASSIFICATION OF RELATED CHANGES IN FAIR VALUE

Classification category	Initial measurement	Subsequent measurement	Changes in fair value
Financial assets			
AFS instruments	Fair value using bid prices at the trade date	Fair value using bid prices at balance sheet date	Reported on the Consolidated statements of other comprehensive income ("OCI") when unrealized or on the Consolidated statements of income (Net investment gains (losses)) when realized or impaired
HFT instruments	Fair value using bid prices at the trade date	Fair value using bid prices at balance sheet date	Reported on the Consolidated statements of income (Net investment gains (losses))
Loans and receivables	Fair value at the issuance date	Amortized cost using the effective interest method	Reported on the Consolidated statements of income (Net investment gains (losses)) when realized or impaired
Financial liabilities			
HFT instruments	Fair value using ask prices at the trade date	Fair value using ask prices at balance sheet date	Reported on the Consolidated statements of income (Net investment gains (losses))
Other financial liabilities	Fair value at the issuance date	Amortized cost using the effective interest method	Reported on the Consolidated statements of income (Net investment gains (losses)) when the liability is extinguished

Invested assets

AFS financial assets

As described in table 3.1, AFS financial assets are recorded at fair value on the Consolidated balance sheets on the trade date and changes in fair values are recorded, net of income taxes, in other comprehensive income ("OCI") until the financial asset is disposed of, or has become other than temporarily impaired (see table 4.2 *Carrying value of invested assets*). When the asset is disposed of, or has become other than temporarily impaired, the gain or loss is reported in Net investment gains (losses) on the Consolidated statements of income and the amount is deducted from OCI. Gains and losses on the sale of AFS fixed income and equity securities are calculated on a first in, first out basis and on an average cost basis, respectively.

HFT financial assets

HFT financial assets and liabilities are purchased or incurred with the intention of generating profits in the near term ("classified as HFT") or are voluntarily so designated by the Company ("designated as HFT").

The Company designated a portion of its fixed income securities that are backing its net claims liabilities as HFT. This designation aims to reduce the volatility of the Consolidated statements of income related to the fluctuations in fair values of underlying net claims liabilities due to changes in discount rates. To comply with regulatory guidelines, the Company ensures that the weighted dollar duration of the fixed income securities designated as HFT is approximately equal to the weighted dollar duration of the net claims liabilities. The rate used to discount claims liabilities is calculated based on an exact dollar match of invested assets backing these claims liabilities.

Loans and receivables

Loans issued to third parties and affiliates are designated as loans and receivables. These financial assets are accounted for at amortized cost using the effective interest rate method. As long as a loan or receivable is held and not impaired, changes in fair value are not recognized on the Consolidated statements of income.

Financial liabilities

Other financial liabilities

The Company's medium term notes together with associated issuance costs are classified as *Debt outstanding* and accounted for at amortized cost using the effective interest method.

Derivative financial instruments

Derivative financial instruments are used for risk management purposes. Currency swaps, options, forwards, futures and total return swaps are held for non-trading purposes to mitigate foreign exchange and market risks.

Derivative financial instruments are recognized at their fair value, with changes in the fair value reflected on the Consolidated statements of income and reported in *Net investment gains (losses)* during the period in which they arise. Refer to note 5 for further details.

Embedded derivatives

A derivative instrument may be embedded in another financial instrument (the "host instrument"). Embedded derivatives are treated as separate derivative financial instruments when their economic characteristics and risks are not clearly and closely related to those of the host instrument. The terms of the embedded derivatives are the same as those of a stand-alone derivative financial instrument, and the combined contract is not designated or classified as HFT. Embedded derivatives are classified as HFT financial assets and liabilities.

Fair value measurement

The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received.

Subsequent to initial recognition, the fair values of financial instruments are determined based on available information and a three-level fair values hierarchy. The split of the Company's financial instruments between each of the fair value hierarchy levels is described in note 6.

If the fair value of a financial asset measured at fair value becomes negative, it is recorded as a financial liability until its fair value becomes positive, at which time it is recorded as a financial asset, or it is extinguished. These changes in classification occur mainly to derivative financial instruments. Derivative financial instruments with positive fair values are reported in *Other receivables* and those with negative fair values are reported in *Financial liabilities*. See table 5.1 for more details.

Impairment of financial assets

The Company assesses impairment, as follows:

Financial assets other than held-for-trading are assessed for impairment at each balance sheet date. Impairment exists when there is objective evidence of an other-than-temporary ("OTT") decline in fair value below cost.

Common shares: A quantitative assessment is made to identify shares which have had a significant or prolonged decline in fair value. Management then applies judgment based on each issuer's financial condition to determine whether objective evidence of impairment exists.

Fixed income securities and preferred shares: These financial assets are impaired when there is evidence which suggests that the issuer will fail to make the contractual interest or principal payments due under the terms of the instrument. Possible impairment indicators include significant financial difficulty, a downgrade in credit rating or bankruptcy and financial reorganization. An impairment loss relating to available-for-sale fixed income securities is reversed when, in a subsequent period, the fair value of the instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized.

All impairment losses and reversals are recognized in *Net investment gains (losses)* on the Consolidated statements of income in the period in which they occur.

Revenue and expense recognition

Dividends are recognized when the shareholder's right to receive payment is established, which is the ex-dividend date, and are reported in *Dividend income* on the Consolidated statements of income. Interest income from fixed income securities and loans is recognized on an accrual basis and reported in *Interest income* on the Consolidated statements of income.

Transaction costs associated with financial instruments classified or designated as HFT are recognized in the Consolidated statements of income as incurred. For other financial instruments, transaction costs, together with premiums or discounts, are capitalized on initial recognition and amortized using the effective interest method.

Other significant accounting policies

Cash and cash equivalents

Cash and cash equivalents consist of cash as well as highly liquid invested assets that are readily convertible into a known amount of cash are subject to insignificant risk of changes in value and have an original maturity of three months or less from the date of purchase.

Income taxes

The Company provides for income taxes using the liability method of tax allocation. Under this method, income tax expense is calculated based on income tax laws and rates substantively enacted as at the Consolidated balance sheet dates. The income tax expense is comprised of two components: current income taxes and future income taxes. Current income taxes are amounts expected to be payable or recoverable as a result of operations in the current year. Future income taxes arise from changes during the year in cumulative temporary differences between the accounting carrying values of assets and liabilities and their respective tax bases. A future income tax asset is recognized to the extent that future realization of the tax benefit is more likely than not.

Employee future benefits

Pension and post retirement benefit plans

For defined benefit pension and other retirement plans, the accrued benefit obligations, net of the fair value of plan assets and unamortized items are recognized on the Consolidated balance sheets. The unamortized items are the past service costs, the transitional asset, the transitional valuation allowance and the net actuarial gains or losses. To match costs and services, these items are amortized on a straight-line basis over the expected average remaining service lifetime ("EARSL") of active members expected to receive benefits under the pension plans and over the expected average lifetime of the retirees receiving benefits under the other retirement plans. Changes in the valuation allowance are not deferred.

For each plan, the Company has adopted the following policies:

- The actuarial determination of the accrued obligations for pensions and other retirement benefits uses the projected unit credit cost method based on benefits accrued for services provided by employees to date and management's best estimate assumptions. See note 12 *Employee future benefits*.
- For the purpose of calculating the expected return on plan assets, plan assets are valued at fair value.
- Only actuarial gains or losses in excess of 10% of the greater of the accrued benefit obligations or the fair value of plan assets are amortized over the EARSL for pension plans and over the expected average lifetime of the retirees receiving benefits under the other retirement plans.
- Past service costs arising from plan amendments are amortized on a straight-line basis over the EARSL for pension plans and over the expected average lifetime of the retirees receiving benefits under the other retirement plans.
- The Company amortizes the transitional asset (obligation) arising from the adoption on January 1, 2000 of the CICA Handbook Section 3461, using the prospective application method on a straight-line basis over the EARSL as of January 1, 2000 for pension plans and over the expected average lifetime of the retirees receiving benefits as of January 1, 2000 under the other retirement plans.
- When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

Post employment benefits

Health and dental benefits continue to be provided to eligible employees who are absent from work due to disability (or other approved leave) for the duration of their leave. The estimated present value of these benefits is charged to income in the year the absence commences.

Stock-based compensation

The Company has three types of stock-based compensation plans:

Long-term incentive plan

Certain key employees are entitled to a long-term incentive plan ("LTIP"). Under the plan, these employees are granted awards to receive the Company's common shares as a part of their compensation. Each award vests and is paid out at the end of a three-year performance cycle. The value of a portion of the actual award varies based on a performance measure which compares the Company's three-year average return on equity relative to that of the Canadian P&C insurance industry. Certain common shares received are restricted for two years. The Company re-estimates the number of awards that are expected to vest at each reporting period. At the time of the payout, the Company purchases on the market the equivalent amount of common shares. This type of compensation is measured at the fair value of the award at the grant date and is recognized as an expense over the vesting period with a corresponding increase reported in contributed surplus.

Employee share purchase plan

Employees who are not eligible for the LTIP are entitled to make contributions in accordance with a voluntary employee share purchase plan ("ESPP"). Under the ESPP, eligible employees can contribute up to 10% of their annual base salary through a payroll deduction. As an incentive to participate in the plan, the Company contributes to the plan an amount equal to 50% of the employee contribution. The common shares are purchased on the market by an independent broker at the end of each month and are held by a custodian on behalf of the employees. The common shares purchased with the Company's contributions vest upon continued employment for a period of twelve months. The Company's contributions under the ESPP are accrued and expensed over the vesting period.

Deferred share unit plan

Non-employee directors of the Company are eligible to participate in the Company's deferred share unit ("DSU") plan. The directors are given the choice of cash, the Company's shares, DSUs, or a combination of the three for their compensation. Both the shares and the DSUs vest at the time of the grant. The DSUs are redeemed upon director termination and are settled for cash at that time. When directors elect to receive shares, the Company makes instalments to the share agent for the purchase of the Company's shares on behalf of the directors. The Company records the expense for cash payments when paid, and for share payments when instalments are made to the share agent. The DSUs are cash-settled awards which are accounted for as an expense at the time of granting with a corresponding financial liability reported in *Other liabilities*. This liability is re-measured at each reporting date with any fluctuations in the liability also recorded as an expense until it is settled in cash.

Acquisitions and divestitures

Acquisitions of businesses where the Company obtains control are accounted for using the purchase method. This involves allocating the purchase price paid for a business to the assets acquired, including identifiable intangibles and the liabilities assumed, based on their fair values at the date of acquisition. Any excess is recorded as goodwill.

Goodwill and intangibles

Goodwill is initially measured as the excess of the fair value of the consideration transferred over the acquisition-date fair value of identifiable assets acquired and liabilities assumed. After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested annually for impairment or whenever there is an indication that the goodwill may be impaired. Impairment, if any, identified through this assessment is reported on the Consolidated statements of income.

Intangibles acquired are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. The useful lives of intangibles are assessed to be either finite or indefinite. Substantially all of the Company's intangibles were assessed to have a finite life.

The Company's intangibles consist of customer relationships, rights to offer renewals, and internally generated software. Amortization methods and rates are shown below.

	Method	Rate or term
Customer relationships including rights to offer renewals	Straight-line	10 years
Internally generated software	Straight-line	3 to 5 years

Long-term investments

The Company reports its long-term investments in *Other assets* on the Consolidated balance sheets.

The Company uses the equity accounting method to report investments where it has significant influence. These comprise companies operating in the corporate and distribution segment. Under this method, the Company's share of the investee's net income is reported in *Distribution income and other* on the Consolidated statements of income.

The Company reports at cost long-term investments for which it does not exercise significant influence. Income from these investments is reported only to the extent received or receivable in *Dividend income* on the Consolidated statements of income.

Property and equipment

Property and equipment are carried at cost less accumulated amortization. Amortization rates are established to depreciate the cost of the assets over their estimated useful lives. Amortization methods and rates are shown below.

	Method	Rate or term
Computer equipment	Straight-line	30–36 months
Furniture and equipment	Declining balance and straight-line	20% and 60 months, respectively
Leasehold improvements	Straight-line	Over the terms of related leases

c) Future accounting changes

International financial reporting standards

The CICA has announced that Canadian GAAP for publicly accountable enterprises was replaced with IFRS. The Company will begin preparing its financial statements in accordance with IFRS for periods beginning on and after January 1, 2011.

NOTE 4 – Invested assets and financial liabilities

The following tables summarize the Company's invested assets.

TABLE 4.1 – INVESTED ASSETS BY CLASSIFICATION

As at December 31, 2010	AFS	Classified as HFT	Designated as HFT	Loans and receivables	Total
Debt securities					
Short-term notes	**362.8**	–	–	–	**362.8**
Fixed income					
Investment grade					
Government, government-guaranteed and supranational	**1,345.2**	–	**1,591.1**	–	**2,936.3**
Corporate	**637.7**	–	**831.4**	–	**1,469.1**
Asset-backed	**52.6**	–	–	–	**52.6**
Total fixed income	**2,035.5**	–	**2,422.5**	–	**4,458.0**
Equity securities					
Preferred shares					
Investment grade					
Retractable	**266.1**	–	–	–	**266.1**
Fixed rate perpetual	**639.9**	–	–	–	**639.9**
Other perpetual	**590.9**	–	–	–	**590.9**
Non rated					
Fixed rate perpetual	**6.7**	–	–	–	**6.7**
Total preferred shares	**1,503.6**	–	–	–	**1,503.6**
Common shares	**1,061.2**	**397.5**	**418.0**	–	**1,876.7**
Loans	–	–	–	**314.2**	**314.2**
Total	**4,963.1**	**397.5**	**2,840.5**	**314.2**	**8,515.3**

As at December 31, 2009	AFS	Classified as HFT	Designated as HFT	Loans and receivables	Total
Debt securities					
Short-term notes	210.7	–	–	–	210.7
Fixed income					
Investment grade					
Government, government-guaranteed and supranational	1,627.6	–	1,630.8	–	3,258.4
Corporate	522.4	–	689.7	–	1,212.1
Asset-backed	103.1	–	–	–	103.1
Total fixed income	2,253.1	–	2,320.5	–	4,573.6
Equity securities					
Preferred shares					
Investment grade					
Retractable	320.7	–	–	–	320.7
Fixed rate perpetual	822.1	–	–	–	822.1
Other perpetual	438.8	–	–	–	438.8
Non rated					
Fixed rate perpetual	–	–	–	–	–
Total preferred shares	1,581.6	–	–	–	1,581.6
Common shares	743.8	183.7	384.6	–	1,312.1
Loans	–	–	–	318.5	318.5
Total	4,789.2	183.7	2,705.1	318.5	7,996.5

TABLE 4.2 – CARRYING VALUE OF INVESTED ASSETS

	HFT invested assets	Other invested assets				Total invested assets
As at December 31, 2010	At fair value	Unamortized cost	Unrealized gains	Unrealized losses	Net unrealized gains (losses)	At carrying value
Debt securities						
Short-term notes	–	362.8	–	–	–	362.8
Fixed income						
Investment grade						
Government, government-guaranteed and supranational	1,591.1	1,320.4	25.8	(1.0)	24.8	2,936.3
Corporate	831.4	626.5	11.7	(0.5)	11.2	1,469.1
Asset-backed	–	51.7	0.9	–	0.9	52.6
Total fixed income	2,422.5	1,998.6	38.4	(1.5)	36.9	4,458.0
Equity securities						
Preferred shares						
Investment grade						
Retractable	–	262.3	7.6	(3.8)	3.8	266.1
Fixed rate perpetual	–	672.1	11.3	(43.5)	(32.2)	639.9
Other perpetual	–	609.4	7.7	(26.2)	(18.5)	590.9
Non rated						
Fixed rate perpetual	–	5.9	0.8	–	0.8	6.7
Total preferred shares	–	1,549.7	27.4	(73.5)	(46.1)	1,503.6
Common shares	815.5	943.6	131.7	(14.1)	117.6	1,876.7
Loans	–	314.2	–	–	–	314.2
Total	3,238.0	5,168.9	197.5	(89.1)	108.4	8,515.3
As at December 31, 2009						
Debt securities						
Short-term notes	–	210.7	–	–	–	210.7
Fixed income						
Investment grade						
Government, government-guaranteed and supranational	1,630.8	1,624.8	12.5	(9.7)	2.8	3,258.4
Corporate	689.7	506.3	16.5	(0.4)	16.1	1,212.1
Asset-backed	–	100.6	2.8	(0.3)	2.5	103.1
Total fixed income	2,320.5	2,231.7	31.8	(10.4)	21.4	4,573.6
Equity securities						
Preferred shares						
Investment grade						
Retractable	–	323.3	10.5	(13.1)	(2.6)	320.7
Fixed rate perpetual	–	924.2	13.4	(115.5)	(102.1)	822.1
Other perpetual	–	494.4	24.2	(79.8)	(55.6)	438.8
Non rated						
Fixed rate perpetual	–	–	–	–	–	–
Total preferred shares	–	1,741.9	48.1	(208.4)	(160.3)	1,581.6
Common shares	568.3	707.1	56.5	(19.8)	36.7	1,312.1
Loans	–	318.5	–	–	–	318.5
Total	2,888.8	5,209.9	136.4	(238.6)	(102.2)	7,996.5

As of December 31, 2010 and 2009, asset-backed securities consisted of auto loan receivables, credit card receivables and commercial mortgage-backed securities. All of these asset-backed securities are AAA rated as at December 31, 2010 and 2009.

As at December 31, 2010, the fair value of loans was $330.3 ($334.1 as at December 31, 2009). The fair value was established with valuation techniques that used both input parameters based on observable market data and input parameters not based on observable market data.

The Company uses Dominion Bond Rating Services ("DBRS") and Standard & Poor's ("S&P") to rate fixed income securities and preferred shares. Fixed income securities with a rating equal to or above BBB- are classified as investment grade and those rated lower than BBB- are classified as either below investment grade or non rated. Preferred shares with a rating equal to or above P3 low are classified as investment grade and those rated below P3 low are classified as below investment grade or non rated.

Securities lending

The Company participates in a securities lending program to generate fee income. This program is managed by the Company's custodian, a major Canadian financial institution, whereby the Company lends securities it owns to other financial institutions to allow them to meet their delivery commitments. As at December 31, 2010, the Company had loaned securities (which are reported in *Invested assets*) with a fair value of $1,332.3 ($1,002.2 as at December 31, 2009).

Collateral is provided by the counterparty and is held in trust by the custodian for the benefit of the Company until the underlying security has been returned to the Company. The collateral cannot be sold or re-pledged externally by the Company, unless the counterparty defaults on its financial obligations. Additional collateral is obtained or refunded on a daily basis as the market value of the underlying loaned securities fluctuates. The collateral consists of government securities with an estimated fair value of 105% of the fair value of the securities loaned and amounted to $1,399.0 at December 31, 2010 ($1,052.3 as at December 31, 2009).

Equities sold short

The Company's market neutral equity investment strategy consists of having both long and short equity positions. The objective is to maximize the value added from active equity portfolio management while at the same time using short positions to mitigate overall equity market volatility. Long positions are reported in *equity securities,* and short positions are reported in *Financial liabilities* on the Consolidated balance sheets.

The Company has secured its short positions by pledging government fixed income securities as collateral.

TABLE 4.3 – LONG AND SHORT POSITIONS

	2010		2009	
	Fair value	Fixed income securities pledged as collateral	Fair value	Fixed income securities pledged as collateral
Long positions	397.5	–	183.7	–
Short positions	(397.3)	407.2	(183.4)	183.2

The following table shows the terms to maturity of the Company's invested assets portfolio.

TABLE 4.4 – MATURITY OF INVESTED ASSETS

As at December 31, 2010	One year or less	Over one year to five years	Over five years	No specific maturity	Total
Short-term notes	362.8	–	–	–	362.8
Fixed income securities	346.3	2,639.2	1,472.5	–	4,458.0
Preferred shares	43.2	146.9	74.7	1,238.8	1,503.6
Common shares	–	–	–	1,876.7	1,876.7
Loans	35.5	156.8	114.1	7.8	314.2
Total	787.8	2,942.9	1,661.3	3,123.3	8,515.3
As at December 31, 2009					
Short-term notes	210.7	–	–	–	210.7
Fixed income securities	141.6	3,045.3	1,386.7	–	4,573.6
Preferred shares	18.9	191.3	114.5	1,256.9	1,581.6
Common shares	–	–	–	1,312.1	1,312.1
Loans	33.0	154.1	121.2	10.2	318.5
Total	404.2	3,390.7	1,622.4	2,579.2	7,996.5

The following table details the Company's financial liabilities.

TABLE 4.5 – FINANCIAL LIABILITIES

	2010	2009
Short investment positions (table 4.3)	**397.3**	183.4
Unsettled investment trades and other payables	**10.4**	13.0
Embedded derivatives (note 5b)	**66.8**	66.8
Derivative liabilities (table 5.1)	**15.8**	15.6
Total	**490.3**	278.8

The following table provides additional details about the items reported in *Interest income*, *Dividend income* and *Net investment gains (losses)*.

TABLE 4.6 – INTEREST INCOME, DIVIDEND INCOME AND NET INVESTMENT GAINS (LOSSES)

	2010	2009
Amounts reported in interest and dividend income		
Interest income from:		
HFT financial instruments	**96.0**	85.4
AFS financial instruments	**66.0**	75.3
Loans and receivables	**16.9**	18.0
Total interest income	**178.9**	178.7
Dividend income from:		
HFT financial instruments, net	**26.2**	18.4
AFS financial instruments	**109.9**	112.4
Total dividend income	**136.1**	130.8
Expenses	**(20.6)**	(16.8)
Interest and dividend income, net of expenses	**294.4**	292.7
Amounts reported in net investment gains (losses):		
Net realized gains (losses) from:		
Financial instruments classified as HFT	**4.2**	8.3
Financial instruments designated as HFT	**43.8**	140.5
Derivative financial instruments	**(34.9)**	(151.6)
AFS financial instruments	**72.0**	(54.6)
Embedded derivatives	**(8.2)**	(62.9)
Impairment reversals (losses) of:		
Fixed income securities	**0.5**	(5.6)
Common share equity securities	**(13.5)**	(46.2)
Other net gains (losses)	**(0.2)**	(0.4)
Net investment gains (losses)	**63.7**	(172.5)

NOTE 5 – Derivative financial instruments

a) Types of derivatives

Derivative financial instruments are financial contracts whose value is derived from an underlying interest rate, foreign exchange rate, equity or commodity instrument or index.

The Company uses derivatives principally to mitigate certain risks described in note 7.

Forwards and futures

Forward contracts are tailor-made agreements that are transacted between counterparties in the over-the-counter market. Futures are standardized contracts with respect to amounts and settlement dates, and are traded on regulated futures exchanges.

Interest rate forwards and futures are contractual obligations to buy or sell an interest-rate sensitive financial instrument on a predetermined future date at a specified price.

Currency forwards and futures are contractual obligations to exchange one currency for another on a predetermined future date.

The Company uses forwards and futures for risk management purposes. Forwards are used to mitigate the risk arising from foreign currency fluctuations and futures are used to alter exposure to interest rate fluctuations.

Swaps

Total return swaps are over-the-counter contracts in which two counterparties exchange a series of cash flows based on agreed upon rates or value of an index, a basket of stocks or a single stock, applied to a notional amount.

Currency swaps include single currency, cross currency and cross currency interest rate swaps. Single currency swaps are agreements where two counterparties exchange a series of payments based on different interest rates (such as fixed rates for floating rates) applied to a notional amount in a single currency. Cross currency swaps involve the exchange of fixed payments in one currency for the receipt of fixed payments in another currency. Cross currency interest rate swaps involve the exchange of both interest and principal amounts in two different currencies.

The Company uses swaps for risk management purposes, mainly in conjunction with other financial instruments to synthetically alter the cash flows of certain of its financial assets and financial liabilities.

Credit derivatives

Credit derivatives are over-the-counter contracts that transfer credit risk related to an underlying financial instrument from one counterparty to another.

The Company uses credit derivatives for risk management purposes, mainly to alter credit exposure to specific bond issuers.

The following table shows the fair values and the notional amounts of derivatives by terms of maturity. Positive fair values are reported in *Other receivables* and negative fair values are reported in *Financial liabilities*.

TABLE 5.1 – FAIR VALUES AND NOTIONAL AMOUNTS OF DERIVATIVES BY TERM TO MATURITY AND NATURE OF RISK

	Fair value		Notional amount		
As at December 31, 2010	Positive	Negative	One year or less	Over one year to five years	Over five years
Held for non-trading purposes					
Where hedge accounting is applied					
Foreign currency exposure					
Swaps	**2.6**	**–**	**–**	**22.9**	**–**
Where hedge accounting is not applied					
Foreign currency exposure					
Forwards	**–**	**–**	**32.2**	**–**	**–**
Swaps	**0.8**	**–**	**4.3**	**–**	**–**
Equity exposure					
Total return swaps	**–**	**15.0**	**412.0**	**–**	**–**
Options	**0.4**	**–**	**2.3**	**10.5**	**0.4**
Credit default swaps	**0.1**	**0.8**	**–**	**49.7**	**–**
Interest rate exposure					
Futures			**75.0**	**–**	**–**
Total	**3.9**	**15.8**			
As at December 31, 2009					
Held for non-trading purposes					
Where hedge accounting is applied					
Foreign currency exposure					
Swaps	1.6	–	–	22.9	–
Where hedge accounting is not applied					
Foreign currency exposure					
Forwards	–	–	29.3	–	–
Swaps	0.7	–	–	5.0	–
Equity exposure					
Total return swaps	–	14.5	385.1	–	–
Options	0.7	–	1.1	11.9	2.9
Credit default swaps	0.3	1.1	–	52.4	–
Interest rate exposure					
Futures			–	–	–
Total	3.3	15.6			

b) Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract. Some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified financial variable. The fair value of embedded derivatives as at December 31, 2010 amounted to $66.8 ($66.8 as at December 31, 2009) and is linked entirely to the Company's investment in perpetual preferred shares. The Company did not attempt to establish a notional amount for these embedded derivatives but a proxy for that amount could be the original cost of these perpetual preferred shares which amounted to $963.7 at December 31, 2010 ($1,160.3 as at December 31, 2009). Embedded derivatives are reported in *Financial liabilities* on the Consolidated balance sheets.

NOTE 6 – Fair value measurement

Determination of fair value and fair value hierarchy

In accordance with Section 3862 *Financial instruments – Disclosures*, for financial instruments measured at fair value on the balance sheet, the Company categorizes fair value measurement according to a three level hierarchy as described below.

Level 1

Level 1 comprises financial assets and liabilities that the Company measures by reference to published quotes in an active market. A financial instrument is regarded as quoted in an active market if quoted prices for that financial instrument are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. When a quoted active market exists, the fair values of financial assets are based on bid prices and the fair values of financial liabilities are based on ask prices.

Level 2

In the absence of an active market, fair values are based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability directly or indirectly such as prevailing market rates for instruments with similar characteristics and risk profiles, or the fair values are determined by using valuation techniques commonly used by market participants, which refer to observable market data. Fair values determined using valuation models require the use of assumptions concerning the amount and timing of estimated future cash flows and discount rates. In determining those assumptions, the external readily observable market inputs are primarily looked at, including factors such as interest rate yield curves, currency rates, and price and rate volatilities, as applicable. Valuation techniques commonly used by the Company include comparisons with similar instruments where observable market prices exist, discounted cash flow analysis and option pricing models.

Level 3

In limited circumstances, the Company uses input parameters that are not based on observable market data, with an adjustment to reflect uncertainty and to ensure that financial instruments are reported at fair values. Liquidity risks, relating to market prices that are not observable due to insufficient trading volume or a lack of recent trades in a less active or inactive market, will be inherent in the cash flows of an asset or liability and are factored into the valuation techniques when measuring fair value.

The split of the Company's financial instruments between each of the above mentioned levels is presented below.

TABLE 6.1 – FAIR VALUE HIERARCHY OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

As at December 31, 2010	Level 1	Level 2	Level 3	Total
Invested assets				
Debt securities				
Short-term notes	362.8	–	–	362.8
Fixed income				
Investment grade				
Government, government-guaranteed and supranational	2,227.9	708.4	–	2,936.3
Corporate	943.7	525.4	–	1,469.1
Asset-backed	–	52.6	–	52.6
Total fixed income	3,171.6	1,286.4	–	4,458.0
Equity securities				
Preferred shares				
Investment grade				
Retractable	266.1	–	–	266.1
Fixed rate perpetual	608.9	–	31.0	639.9
Other perpetual	555.7	–	35.2	590.9
Non rated				
Fixed rate perpetual	6.1	–	0.6	6.7
Total preferred shares	1,436.8	–	66.8	1,503.6
Common shares	1,876.7	–	–	1,876.7
Total invested assets measured at fair value	6,847.9	1,286.4	66.8	8,201.1
Derivatives				
Derivative assets	–	3.9	–	3.9
Derivative liabilities	–	(15.8)	–	(15.8)
Embedded derivatives	–	–	(66.8)	(66.8)
Total derivatives	–	(11.9)	(66.8)	(78.7)
Short investment positions	397.3	–	–	397.3
Total other financial liabilities measured at fair value	397.3	–	–	397.3

As at December 31, 2009	Level 1	Level 2	Level 3	Total
Invested assets				
Debt securities				
Short-term notes	210.7	–	–	210.7
Fixed income				
Investment grade				
Government, government-guaranteed and supranational	2,691.9	566.5	–	3,258.4
Corporate	262.1	950.0	–	1,212.1
Asset-backed	–	103.1	–	103.1
Total fixed income	2,954.0	1,619.6	–	4,573.6
Equity securities				
Preferred shares				
Investment grade				
Retractable	320.7	–	–	320.7
Fixed rate perpetual	787.3	–	34.8	822.1
Other perpetual	406.8	–	32.0	438.8
Non rated				
Fixed rate perpetual	–	–	–	–
Total preferred shares	1,514.8	–	66.8	1,581.6
Common shares	1,312.1	–	–	1,312.1
Total invested assets measured at fair value	5,991.6	1,619.6	66.8	7,678.0
Derivatives				
Derivative assets	–	3.3	–	3.3
Derivative liabilities	–	(15.6)	–	(15.6)
Embedded derivatives	–	–	(66.8)	(66.8)
Total derivatives	–	(12.3)	(66.8)	(79.1)
Short investment positions	183.4	–	–	183.4
Total other financial liabilities measured at fair value	183.4	–	–	183.4

Level 3 financial instruments represent embedded derivatives related to the Company's perpetual preferred shares which are reported as a derivative liability in *Financial liabilities* and also reported as *Equity securities* in invested assets (asset component) on the Consolidated balance sheets.

To determine the fair value of embedded derivatives, the Company uses several input parameters. The majority of these parameters are based on observable market data. One significant parameter, the implied volatility, is unobservable and is calculated using an internally developed model.

Changes in the derivative liability are reported in *Net investment gains (losses)* on the Consolidated statements of income. An equal change in the asset component is reported in OCI.

During the second quarter of the year, the Company refined the calculation of inputs used in the valuation model for embedded derivatives. These modifications resulted in a decrease of $21.4 million in the value of embedded derivative liabilities in the second quarter of 2010 with the corresponding gain recognized in *Net investment gains (losses)* on the Consolidated statements of income.

The following table shows a reconciliation of the opening and closing carrying value of the Company's embedded derivatives.

TABLE 6.2 – RECONCILIATION OF LEVEL 3 FINANCIAL INSTRUMENTS

	Carrying value at January 1, 2010	Gains (losses) reported in Net investment gains (losses)	Gains (losses) reported in OCI	Purchases	Sales	Carrying value at December 31, 2010
Asset component (Equity securities)	66.8	(3.4)	11.6	5.9	(14.1)	66.8
Embedded derivatives (Financial liabilities)	(66.8)	(8.2)	–	(5.9)	14.1	(66.8)

	Carrying value at January 1, 2009	Gains (losses) reported in Net investment gains (losses)	Gains (losses) reported in OCI	Purchases	Sales	Carrying value at December 31, 2009
Asset component (Equity securities)	4.9	0.4	62.5	–	(1.0)	66.8
Embedded derivatives (Financial liabilities)	(4.9)	(62.9)	–	–	1.0	(66.8)

Losses reported in *Net investment gains (losses)* for embedded derivatives still held at December 31, 2010 amounted to $11.6 ($62.5 as at December 31, 2009).

The following table shows the impact on the carrying value of the Company's embedded derivatives of changing the implied volatility by 10% and the resulting gains (losses). The Company believes that this percentage change provides a fair indication of how the Company's consolidated results would be impacted in the event of a significant change in volatility.

TABLE 6.3 – SENSITIVITY ANALYSIS FOR LEVEL 3 FINANCIAL INSTRUMENTS

	10% increase in volatility	10% decrease in volatility
Asset component		
Change in Equity securities	11.8	(11.5)
Change in OCI	11.8	(11.5)
Embedded derivatives		
Change in Financial liabilities	11.8	(11.5)
Additional Net investment gains (losses)	(11.8)	11.5

NOTE 7 – Risk and capital management

We have a comprehensive risk management framework and internal control procedures designed to manage and monitor various risks in order to protect our business, clients, shareholders and employees. Our risk management programs aim at avoiding risks that could materially impair our financial position, accepting risks that contribute to sustainable earnings and growth and disclosing these risks in a full and complete manner.

Effective risk management rests on identifying, understanding and communicating all risks the Company is exposed to in the course of its operations. In order to make sound business decisions, both strategically and operationally, management must have continual direct access to the most timely and accurate information possible. Either directly or through its committees, the Board of Directors ensures that the Company's management has put appropriate risk management programs in place. The Board of Directors, directly and in particular through its Audit and Risk Review Committee ("Audit Committee"), oversees the Company's risk management programs, procedures and controls and, in this regard, receives periodic reports from, among others, the risk management department through the Chief Risk Officer, internal auditors and the independent auditors. A summary of the Company's key risks arising from its financial instruments and the processes for managing and mitigating them is outlined below. For more information on the risks arising from the Company's financial instruments and its operations all together, refer to the *Risk management* section of the 2010 Management Discussion and Analysis related to these Consolidated financial statements.

The majority of the invested assets portfolio is invested in well-established, active and liquid markets. See note 6 *Fair value measurement* to see how the Company categorizes its fair value measurements according to a three level hierarchy.

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: market price risk (i.e. equity price risk), interest rate risk and currency risk. The Company's exposures to market risk together with the Company's risk management practices used to mitigate these risks are explained below. The Company's investment policies establish principles and limits pertaining to these risks. The Investment Committee regularly monitors compliance with these investment policies.

a) Equity price risk

Equity price risk is the risk of losses arising from movements in equity market prices. The Company is significantly exposed to changes in equity market prices.

Sensitivity analysis is one risk management technique that assists management in ensuring that risks assumed remain within the Company's risk tolerance level. Sensitivity involves varying a single factor to assess the impact that this would have on the Company's results and financial condition.

A 10% increase in common shares and a 5% increase in preferred share market values would decrease income before taxes by $14.3 million, as a result of marking to market the written call option liabilities embedded in the Company's redeemable preferred shares. However, it would result in a linear increase in OCI of $177.4 million. Conversely, a 10% decrease in common shares and a 5% decrease in preferred share market values would increase income before taxes and decrease OCI by the same amounts, respectively.

To mitigate these risks, the Company's investment policies set forth limits for each type of investment, and compliance with the policies is closely monitored by the Investment Committee. The Company manages market risk through asset class and economic sector diversification and, in some cases, the use of derivatives.

b) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company is significantly exposed to changes in interest rates. Movements in short-term and long-term interest rates, including change in credit spreads, cause changes in the realized and unrealized gains/losses.

For example, a 100 basis point increase in interest rates would increase income before taxes by approximately $22.1 million for the Company's AFS fixed income securities and preferred securities, as a result of marking to market the written call option liabilities embedded in the Company's redeemable preferred shares and the marking to market of derivatives positions. A 100 basis point increase would also decrease OCI by approximately $166.7 million. Conversely, a 100 basis point decrease in interest rates would decrease income before taxes and increase OCI by the same amounts, respectively.

The above sensitivity analyses were prepared using key assumptions as described below:

– the securities in the Company's portfolio are not impaired;
– interest rates and equity prices move independently;
– shifts in the yield curve are parallel;
– credit, liquidity and basis risks have not been considered;
– for our HFT debt securities, the estimated impact on income before taxes is assumed to be offset by the impact of changes in the discount rate used to discount claims liabilities. AFS securities in an unrealized loss position, as reflected in OCI, may at some point in the future be realized through either a sale or impairment.

The Company's exposure to the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates is detailed in table 7.1.

Interest rate risk exposures are reported based on the earlier of financial instruments contractual repricing date or maturity date. Effective interest rates have been disclosed where applicable. The effective rates shown in the table below represent historical rates for fixed-rate instruments carried at amortized cost and current market rates for floating-rate instruments or instruments carried at fair value. The following table does not incorporate management's expectation of future events where expected repricing or maturity dates differ significantly from the contractual dates.

TABLE 7.1 – EXPOSURE TO INTEREST RATE RISK

		Fixed rate				
As at December 31, 2010	**Floating rates**	**Under 12 months**	**Over 1 to 5 years**	**Over 5 years**	**Non-rate sensitive**	**Total**
Assets						
Cash net of overdrafts	(32.5)	–	–	–	–	(32.5)
Cash equivalents	–	170.3	–	–	–	170.3
Effective interest rate		0.94%				
Short-term notes	–	362.8	–	–	–	362.8
Effective interest rate		1.17%				
Fixed income securities	14.9	346.3	2,624.3	1,472.5	–	4,458.0
Effective interest rate		2.00%	2.49%	3.51%		
Preferred shares	119.8	34.1	628.4	721.3	–	1,503.6
Effective interest rate		5.06%	4.80%	5.15%		
Common shares	–	–	–	–	1,876.7	1,876.7
Loans	–	35.5	156.8	121.9	–	314.2
Effective interest rate		5.85%	5.92%	5.84%		
Reinsurance assets	–	76.8	109.6	29.8	19.0	235.2
Effective interest rate		3.39%	3.39%	3.39%		
Other assets	–	0.9	3.0	–	3,256.7	3,260.6
Total assets	102.2	1,026.7	3,522.1	2,345.5	5,152.4	12,148.9
Liabilities and shareholders' equity						
Claims liabilities	–	1,554.4	2,219.9	604.2	–	4,378.5
Effective interest rate		3.39%	3.39%	3.39%		
Debt outstanding	–	–	–	496.1	–	496.1
Effective interest rate				5.91%		
Financial liabilities	13.5	24.3	23.5	31.7	397.3	490.3
Effective interest rate		–	4.26%	5.08%	2.25%	
Other liabilities	–	–	–	–	3,713.9	3,713.9
Shareholders' equity	–	–	–	–	3,070.1	3,070.1
Total liabilities and shareholders' equity	13.5	1,578.7	2,243.4	1,132.0	7,181.3	12,148.9
Net long (short) exposure	88.7	(552.0)	1,278.7	1,213.5	(2,028.9)	–

		Fixed rate				
As at December 31, 2009	Floating rates	Under 12 months	Over 1 to 5 years	Over 5 years	Non-rate sensitive	Total
Assets						
Cash net of overdrafts	(32.4)	–	–	–	–	(32.4)
Cash and cash equivalents	–	92.5	–	–	–	92.5
Effective interest rate		0.19%				
Short–term notes	–	210.7	–	–	–	210.7
Effective interest rate		0.21%				
Fixed income securities	14.4	141.6	3,030.9	1,386.7	–	4,573.6
Effective interest rate		1.38%	2.62%	4.04%		
Preferred shares	118.8	12.3	513.9	936.6	–	1,581.6
Effective interest rate		5.08%	5.00%	5.50%		
Common shares	–	–	–	–	1,312.1	1,312.1
Loans	–	33.0	154.1	131.4	–	318.5
Effective interest rate		5.94%	5.90%	5.76%		
Reinsurance assets	–	100.4	107.4	34.7	18.1	260.6
Effective interest rate		3.71%	3.71%	3.71%		
Other assets	–	–	3.3	0.1	3,030.7	3,034.1
Total assets	100.8	590.5	3,809.6	2,489.5	4,360.9	11,351.3
Liabilities and shareholders' equity						
Claims liabilities	–	1,767.8	1,891.6	610.6	–	4,270.0
Effective interest rate		3.71%	3.71%	3.71%		
Debt outstanding	–	–	–	397.7	–	397.7
Effective interest rate				5.78%		
Financial liabilities	16.9	27.5	16.2	34.8	183.4	278.8
Effective interest rate		–	4.53%	5.51%	2.25%	
Other liabilities	–	–	–	–	3,422.2	3,422.2
Shareholders' equity	–	–	–	–	2,982.6	2,982.6
Total liabilities and shareholders' equity	16.9	1,795.3	1,907.8	1,043.1	6,588.2	11,351.3
Net long (short) exposure	83.9	(1,204.8)	1,901.8	1,446.4	(2,227.3)	–

c) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company is not significantly exposed to changes in exchange rates. Although the Company is exposed to some foreign exchange risks arising from securities in some of its U.S. dollar-denominated assets, the general policy is to minimize foreign currency exposure. The Company mitigates foreign exchange rate risks by buying or selling successive monthly foreign exchange forward contracts or entering into foreign exchange swaps.

d) Basis risk

The Company's use of derivatives exposes it to a number of risks, including credit risk, interest rate and equity market fluctuations. The hedging of certain risks with derivatives results in basis risk. Basis risk is the risk that offsetting investments in a hedging strategy will not experience price changes in entirely opposite directions from each other. This imperfect correlation between the two investments creates the potential for excess gains or losses in a hedging strategy, thus adding risk to the position. The Company monitors the effectiveness of its hedges on a regular basis.

e) Credit risk

Credit risk is the possibility that counterparties may not be able to meet payment obligations when they become due. A counterparty is any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation to the Company. The Company's credit risk exposure is concentrated primarily in its fixed income, preferred share portfolios, over the counter derivatives and, to a lesser extent, in its reinsurance recoverable and annuity agreements entered into with various life insurance companies.

Maximum exposure to credit risk

The table below details the Company's maximum exposure to credit risk without taking into account any collateral held or other credit enhancements available to the Company to mitigate this risk. For on-balance sheet exposures, maximum credit exposure is defined as the carrying value of the asset net of any impairment losses. Detail on these credit risk exposures including information on how the Company mitigates these, is given below.

TABLE 7.2 – MAXIMUM EXPOSURE TO CREDIT RISK

	2010	2009
On-balance sheet credit risk exposure		
Cash and cash equivalents	**137.8**	60.1
Debt securities	**4,820.8**	4,784.3
Equity securities	**3,380.3**	2,893.7
Loans	**314.2**	318.5
Derivatives assets (table 5.1)	**3.9**	3.3
Premium receivables	**1,762.0**	1,640.5
Reinsurance assets	**235.2**	260.6
Other financial assets[1]	**339.6**	325.0
Total on-balance sheet credit risk exposure	**10,993.8**	10,286.0
Off-balance sheet credit risk exposure		
Original price of annuities purchased[2]	**456.3**	425.9
Total off-balance sheet credit risk exposure	**456.3**	425.9

1 Other financial assets include the following amounts as reported on the Consolidated balance sheets: Accrued interest and dividend income, Other receivables less derivative assets and Income taxes receivable.
2 See paragraph titled *Structured settlements* below for details.

Structured settlements

The Company enters into annuity agreements with various Canadian life insurance companies to provide for fixed and recurring payments to claimants. At December 31, 2010, none of the life insurers from which the Company had purchased annuities was in default. The original purchase price of the annuities totalled $456.3 ($425.9 as at December 31, 2009). The risk-adjusted balance is determined by applying the standard OSFI defined measures of counterparty risk to the credit equivalent amount and is $1.1 as at December 31, 2010 ($1.1 as at December 31, 2009).

Invested assets

The Company's risk management strategy is to invest in fixed income instruments and preferred shares of high credit quality issuers and to limit the amount of credit exposure with respect to any one issuer by imposing limits based upon credit quality. The Company's investment policy requires that, at the time of the investment, substantially all fixed income securities have a minimum credit rating of BBB and preferred shares have a minimum credit rating of P3. Management monitors subsequent credit rating changes on a regular basis.

For subsidiaries of the Company who are regulated by OSFI, the assets invested in any entity or group of related entities are limited to 5% of the subsidiaries' assets by OSFI. The Company also monitors aggregate concentrations of credit risk by country of issuance and by industry. See table 7.4.

The Company receives guarantees for loans.

Derivatives-related

Credit risk from derivative transactions reflects the potential for the counterparty to default on its contractual obligations when one or more transactions have a positive market value to the Company. Therefore, derivative-related credit risk is represented by the positive fair value of the instrument and is normally a small fraction of the contract's notional amount.

The Company subjects its derivative-related credit risk to the same credit approval, limit and monitoring standards that it uses for managing other transactions that create credit exposure. This includes evaluating the creditworthiness of counterparties, and managing the size, diversification and maturity structure of the portfolio. Credit utilization for all products is compared with established limits on a continual basis and is subject to quarterly review by the Investment Committee.

Netting is a technique that can reduce credit exposure from derivatives and is generally facilitated through the use of netting clauses in master derivative agreements. The netting clauses in a master derivative agreement provide for a single net settlement of all financial instruments covered by the agreement in the event of default. However, credit risk is reduced only to the extent that the Company's financial obligations toward the counterparty to such an agreement can be offset against obligations such counterparty has toward us. The Company uses netting clauses in master derivative agreements to reduce derivative-related credit exposure. The overall exposure to credit risk that is reduced through the netting clauses may change substantially following the reporting date as the exposure is affected by each transaction subject to the agreement as well as by changes in underlying market rates and values.

The use of collateral is another significant credit mitigation technique for managing derivative-related counterparty credit risk. Mark-to-market provisions in the Company's agreements with some counterparties provide the Company with the right to request that the counterparty pay down or collateralize the current market value of its derivatives positions when the value passes a specified threshold amount.

Replacement cost represents the total fair value of all outstanding contracts in a gain position, before factoring in the master netting agreements. The amounts in the table below exclude fair value relating to exchange-traded instruments as they are subject to daily margining and are deemed to have no credit risk.

The credit equivalent amount is the sum of the replacement cost plus an add-on amount for potential future credit exposure as defined by OSFI. The risk-adjusted balance is determined by applying the standard OSFI-defined measures of counterparty risk to the credit equivalent amount.

TABLE 7.3 – DERIVATIVE-RELATED CREDIT RISK

As at December 31, 2010	Replacement cost	Credit equivalent amount	Risk adjusted balance
Total derivative assets	**3.9**	**37.1**	**0.2**
Less: Impact of master netting agreements	(0.1)	–	–
Total after netting agreements	**3.8**	**37.1**	**0.2**
As at December 31, 2009			
Total derivative assets	3.3	34.9	0.1
Less: Impact of master netting agreements	(0.3)	–	–
Total after netting agreements	3.0	34.9	0.1

Reinsurance

The Company uses reinsurance to manage underwriting risks. Although reinsurance makes the assuming reinsurer liable to us to the extent of the risk ceded, we are not relieved of our primary liability to our policyholders as the direct insurer. As a result, we bear credit risk with respect to our reinsurers. There is no certainty that our reinsurers will pay all reinsurance claims on a timely basis or at all.

The Company assesses the financial soundness of the reinsurers before signing any reinsurance treaties and monitors their situation on a regular basis. In addition, the Company has minimum rating requirements for its reinsurers. Substantially, all reinsurers are required to have a minimum credit rating of A- at inception of the treaty. Rating agencies used are A.M. Best and Standard & Poors. The Company also requires that most of its treaties have a security review clause allowing the Company to replace a reinsurer during the treaty period should the reinsurer's credit rating fall below the level acceptable to the Company. Management concluded that the Company was not exposed to significant loss from reinsurers for potentially uncollectible reinsurance as at the Consolidated balance sheet dates.

The Company is the assigned beneficiary of collateral consisting of cash, trust accounts and letters of credit totalling $65.6 at December 31, 2010 ($67.7 as at December 31, 2009) as guarantee from unlicensed reinsurers. This collateral is held in support of policy liabilities of $45.3 at December 31, 2010 ($51.9 as at December 31, 2009) and could be used should these reinsurers be unable to meet their obligations.

Concentration of credit risk

Concentration of credit risk exists where a number of borrowers or counterparties are engaged in similar activities, are located in the same geographic area or have comparable economic characteristics. Their ability to meet contractual obligations may be similarly affected by changing economic, political or other conditions. The Company's invested assets could be sensitive to changing conditions in specific geographic regions or specific industries. The Company has a significant concentration of its invested assets in the financial sector. This risk concentration is closely monitored by the Company and it hedges some of the risk as it deems necessary.

TABLE 7.4 – CONCENTRATIONS OF CREDIT RISK FOR INVESTED ASSETS

As at December 31,	2010	2009
By country of issuer		
Canada	93.0%	92.8%
US	0.8%	0.7%
Other	6.2%	6.5%
Total	100.0%	100.0%
By industry		
Government	38.9%	43.4%
Banks, insurance and diversified financial services	37.3%	37.3%
Energy	7.9%	5.0%
Other	15.9%	14.3%
Total	100.0%	100.0%

f) Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet obligations associated with financial liabilities. To manage its cash flow requirements, the Company maintains a portion of its invested assets in liquid securities. A maturity analysis for non-derivative financial invested assets is presented in table 4.4 and a maturity analysis of derivative assets (corresponding to the fair value positive amounts) is presented in table 5.1. See note 13 for the maturity profile of the Company's medium term notes.

The Company's liquidity management is governed by establishing a prudent policy that identifies oversight responsibilities as well as by setting limits and implementing effective techniques to monitor, measure and control exposure to liquidity risk. A portion of invested assets is maintained in short-term (less than one year) highly liquid money market securities, which are used to manage the operational requirements of the Company. A large portion of the invested assets are held in highly liquid federal and provincial government debt to protect against any unanticipated large cash requirements. The Company also has an unsecured committed credit facility. See note 13b.

g) Fair value disclosure

The fair values of financial instruments and policy liabilities are disclosed in notes 4, 5, 6, 7 and 8 respectively. The fair value of other financial assets and liabilities approximates their carrying amount due to their short-term nature.

h) Capital management

The Company's objectives when managing capital consist of maintaining sufficient capital to support claims liabilities and ensure the confidence of policyholders, support competitive pricing strategies, meet regulatory capital requirements, provide returns for its shareholders and maintain a leadership position in the Canadian P&C insurance industry.

The P&C insurance subsidiaries of the Company are subject to the regulatory capital requirements defined by OSFI and the Insurance Companies Act ("ICA"). OSFI has established a Minimum Capital Test guideline ("MCT") which sets out 100% as the minimum and 150% as the supervisory target MCT standards for P&C insurance companies.

The following table presents the aggregate minimum capital test for the Company's P&C insurance subsidiaries.

TABLE 7.5 – MCT

As at December 31,	**2010**	2009
Total capital available	**2,969.4**	2,729.2
Total capital required	**1,272.0**	1,176.9
Excess capital	**1,697.4**	1,552.3
MCT %	**233.4%**	231.9%
Excess capital at 150%	**1,061.4**	963.8

Total capital available and total capital required represent amounts applicable to the Company's P&C insurance subsidiaries and are determined in accordance with prescribed OSFI rules. Total capital available mostly represents total equity less specific deductions for disallowed assets including goodwill and intangibles. Total capital required is calculated by allocating assets and liabilities into categories and applying prescribed risk factors to each category. As at December 31, 2010, the Company's P&C insurance subsidiaries were in compliance with both OSFI and ICA requirements as well as internal targets.

Annually the Company performs Dynamic Capital Adequacy Testing on the MCT to ensure that the Company has sufficient capital to withstand significant adverse event scenarios. These scenarios are reviewed each year to ensure appropriate risks are included in the testing process. The 2010 results indicated that the Company's capital position is exceeding regulation requirements. In addition, the target, actual and forecasted capital position of the Company is subject to ongoing monitoring by management using stress and scenario analysis to ensure its adequacy.

NOTE 8 – Policy liabilities

Policy liabilities are established to reflect the estimate of the total amount of all liabilities associated with the insurance policies at the Consolidated balance sheet dates, including claims IBNR. The ultimate cost of these liabilities will vary from the best estimate for a variety of reasons, including additional information with respect to the facts and circumstances of the claims incurred.

a) Movements of net claims liabilities

The following table shows the movements of the Company's net claims liabilities during the year.

TABLE 8.1 – MOVEMENTS OF NET CLAIMS LIABILITIES

As at December 31, 2010	Direct claims liabilities	Reinsurers' share	Net claims liabilities
Balance, beginning of year	**4,270.0**	**242.6**	**4,027.4**
Current year claims incurred	**3,013.7**	**55.3**	**2,958.4**
Prior year (favourable) unfavourable claims development	**(194.6)**	**(1.8)**	**(192.8)**
Increase due to changes in discount rate	**38.4**	**2.0**	**36.4**
Total claims incurred	**2,857.5**	**55.5**	**2,802.0**
Claims paid	**(2,749.0)**	**(81.9)**	**(2,667.1)**
Balance, end of year	**4,378.5**	**216.2**	**4,162.3**

As at December 31, 2009			
Balance, beginning of year	4,064.9	207.0	3,857.9
Current year claims incurred	3,018.6	59.3	2,959.3
Prior year (favourable) unfavourable claims development	(121.5)	2.2	(123.7)
Increase due to changes in discount rate	44.3	2.7	41.6
Total claims incurred	2,941.4	64.2	2,877.2
Claims paid	(2,736.3)	(28.6)	(2,707.7)
Balance, end of year	4,270.0	242.6	4,027.4

b) Amounts by line of business

The following table details net claims liabilities by line of business.

TABLE 8.2 – NET CLAIMS LIABILITIES

As at December 31, 2010	Direct claims liabilities	Reinsurers' share	Net claims liabilities
Personal lines			
Auto: liability	**1,485.8**	**5.3**	**1,480.5**
Auto: personal accident	**990.3**	**8.3**	**982.0**
Auto: other	**85.9**	**10.7**	**75.2**
Property	**456.9**	**79.7**	**377.2**
Other	**5.2**	**1.1**	**4.1**
Total	**3,024.1**	**105.1**	**2,919.0**
Commercial lines			
Auto: liability	**287.8**	**2.5**	**285.3**
Auto: personal accident	**57.8**	**1.0**	**56.8**
Auto: other	**12.4**	**0.4**	**12.0**
Property	**192.8**	**20.4**	**172.4**
Liability	**794.8**	**84.1**	**710.7**
Other	**8.8**	**2.7**	**6.1**
Total	**1,354.4**	**111.1**	**1,243.3**
Balance, end of year	**4,378.5**	**216.2**	**4,162.3**

As at December 31, 2009	Direct claims liabilities	Reinsurers' share	Net claims liabilities
Personal lines			
Auto: liability	1,477.7	6.1	1,471.6
Auto: personal accident	856.6	11.5	845.1
Auto: other	78.6	5.9	72.7
Property	489.8	90.8	399.0
Other	5.1	1.0	4.1
Total	2,907.8	115.3	2,792.5
Commercial lines			
Auto: liability	283.8	2.0	281.8
Auto: personal accident	47.3	0.5	46.8
Auto: other	12.0	0.9	11.1
Property	207.2	23.3	183.9
Liability	803.9	98.0	705.9
Other	8.0	2.6	5.4
Total	1,362.2	127.3	1,234.9
Balance, end of year	4,270.0	242.6	4,027.4

The following table details unearned premiums by line of business.

TABLE 8.3 – UNEARNED PREMIUMS

As at December 31, 2010	Unearned premiums	Reinsurers' share	Net unearned premiums
Personal lines			
Auto: liability	**596.7**	**–**	**596.7**
Auto: personal accident	**234.9**	**–**	**234.9**
Auto: other	**469.5**	**–**	**469.5**
Property	**659.9**	**–**	**659.9**
Other	**3.6**	**–**	**3.6**
Total	**1,964.6**	**–**	**1,964.6**
Commercial lines			
Auto: liability	**92.3**	**0.5**	**91.8**
Auto: personal accident	**13.8**	**–**	**13.8**
Auto: other	**65.2**	**–**	**65.2**
Property	**267.6**	**3.5**	**264.1**
Liability	**154.2**	**0.9**	**153.3**
Other	**27.9**	**14.1**	**13.8**
Total	**621.0**	**19.0**	**602.0**
Balance, end of year	**2,585.6**	**19.0**	**2,566.6**

As at December 31, 2009	Unearned premiums	Reinsurers' share	Net unearned premiums
Personal lines			
Auto: liability	563.5	–	563.5
Auto: personal accident	214.3	–	214.3
Auto: other	475.7	–	475.7
Property	612.2	–	612.2
Other	3.3	–	3.3
Total	1,869.0	–	1,869.0
Commercial lines			
Auto: liability	87.9	0.3	87.6
Auto: personal accident	12.9	–	12.9
Auto: other	62.7	–	62.7
Property	252.7	3.5	249.2
Liability	147.0	1.3	145.7
Other	31.4	12.9	18.5
Total	594.6	18.0	576.6
Balance, end of year	2,463.6	18.0	2,445.6

c) Fair value of net claims liabilities

The Company estimates that the fair value of net claims liabilities approximate their carrying amounts. There was no premium deficiency at the Consolidated balance sheet dates.

The following table shows the impact of both the time value of money and the provision for adverse deviation on the carrying amount of claims liabilities.

TABLE 8.4 – DISCOUNTING OF CLAIMS LIABILITIES

	2010			2009		
	Claims liabilities	Reinsurers' share	Net	Claims liabilities	Reinsurers' share	Net
Undiscounted value	4,288.6	212.4	4,076.2	4,218.0	239.0	3,979.0
Effect of time value of money using a rate of 3.39% (2009 – 3.71%)	(323.7)	(15.4)	(308.3)	(345.3)	(17.0)	(328.3)
Provision for adverse deviation	413.6	19.2	394.4	397.3	20.6	376.7
Carrying amount	4,378.5	216.2	4,162.3	4,270.0	242.6	4,027.4

Since the time value of money is considered when determining the claims liabilities estimate, an increase or decrease in the discount rate would result in a decrease or increase in claims liabilities, respectively. A 1% change in the discount rate would have an impact of $95.1 on the fair value of claims liabilities at December 31, 2010 ($91.8 as at December 31, 2009).

d) Reinsurance

In the ordinary course of business, the Company reinsures certain risks with other reinsurers to limit its maximum loss in the event of catastrophes or other major losses. The following table shows the Company's net retention and coverage limits by nature of risk.

TABLE 8.5 – REINSURANCE NET RETENTION AND COVERAGE LIMITS BY NATURE OF RISK

	2010	2009
Single risk events[1]		
Net retentions:		
On property policies	5.0	5.0
On liability policies		
From January 1st to June 30th	10.0	7.0
From July 1st to December 31st	10.0	10.0
Multi-risk events and catastrophes		
Net retention:	25.0	25.0
Coverage limit:	1,500.0	1,500.0
Risk retained based on the loss exposure:		
$0–$25 million	100.00%	100.00%
$25–$50 million	26.50%	16.75%
$50–$750 million	10.00%	10.00%
$750–$1,000 million	10.00%	0.00%
$1,000–$1,500 million	0.00%	0.00%

1 For certain special classes of business or types of risks, the retention would be lower through specific treaties or the use of facultative reinsurance.

TABLE 8.6 – NET IMPACT OF REINSURANCE ON THE CONSOLIDATED STATEMENTS OF INCOME

	2010	2009
Reduction in:		
Premiums earned	(121.4)	(109.5)
Claims incurred	55.4	64.2
Commissions expense	19.7	15.7
Net impact before income taxes	(46.3)	(29.6)

NOTE 9 – Income taxes

a) Income tax expense

The following table shows the current and future portion of the Company's income tax expense reported on the Consolidated statements of income.

TABLE 9.1 – CONSOLIDATED STATEMENTS OF INCOME

	2010	2009
Current	**85.8**	(10.4)
Future	**19.2**	23.5
Income tax expense	**105.0**	13.1

The following table shows the current and future portion of the Company's income tax expense reported on the Consolidated statements of comprehensive income.

TABLE 9.2 – CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	2010	2009
Current	**34.7**	131.4
Future	**24.8**	17.6
Income tax expense	**59.5**	149.0

b) Effective income tax rate

The effective rates of income tax on the Consolidated statements of income are different from the combined Canadian federal and provincial income tax rate of 30.4% (31.8% as at December 31, 2009) as set out in the following table:

TABLE 9.3 – EFFECTIVE TAX RATE RECONCILIATION

	2010 %	2009 %
Income tax expense calculated at statutory tax rates	**30.4**	31.8
Increase (decrease) in income tax rates resulting from:		
Non-taxable dividend income	**(7.6)**	(26.4)
Losses for which a benefit is not recognized or written off	**–**	1.2
Non-deductible (non-taxable) other loss (income)	**(0.9)**	(1.2)
(Non-taxable) non-deductible portion of capital (gains) losses	**–**	5.1
Recovery of tax asset not previously recognized	**(0.8)**	(2.5)
Impact of tax rates changes	**(0.2)**	–
Other	**(0.9)**	1.4
Effective income tax rate	**20.0**	9.4

c) Components of future income tax asset and liability

The following table shows the components of future tax assets and liabilities by source of temporary difference as reported on the Company's Consolidated balance sheets.

TABLE 9.4 – COMPONENTS OF FUTURE INCOME TAX ASSET AND LIABILITY

	2010	2009
Future income tax asset		
Net claims liabilities	56.3	57.7
Invested assets	–	2.6
Expenses deferred for tax purposes	35.4	36.0
Property and equipment	3.2	3.6
Losses available for carry-forward	15.5	15.5
Other	1.1	1.4
Total future income tax asset	111.5	116.8
Future income tax liability		
Invested assets	1.6	–
Deferred income for tax purposes	76.5	41.9
Deferred gains and losses on specified debt obligations	23.4	27.7
Pension and post retirement benefit plans	25.6	19.7
Property and equipment	8.1	6.4
Other	10.4	8.9
Total future income tax liability	145.6	104.6
Net future income tax asset (liability)	(34.1)	12.2
Reported in:		
Future income tax asset	20.0	38.0
Future income tax liability	54.1	25.8

The Company recognized a future tax asset for all of its unused non-capital losses as at December 31, 2010 and 2009.

At December 31, 2010 the Company had allowable capital losses of $55.8 ($56.7 as at December 31, 2009), which had not been recognized when computing the future tax asset because it is more likely than not that the Company would not able to recover the tax asset in the foreseeable future. These losses, which have no expiry date, can be used to reduce future taxable capital gains.

NOTE 10 – Other assets

The following table shows the components of other assets.

TABLE 10.1 – COMPONENTS OF OTHER ASSETS

	2010	2009
Property and equipment (table 10.2)	45.9	46.3
Prepaid pension asset (note 12)	138.5	118.4
Long-term investments		
In affiliates (table 10.3)	118.9	98.3
Carried at cost	19.2	20.3
Prepaids	9.4	8.3
Other	2.8	1.3
Total other assets	**334.7**	292.9

The following table details the property and equipment as well as the related accumulated amortization.

TABLE 10.2 – PROPERTY AND EQUIPMENT DETAILS

	2010			2009		
	Cost	Accumulated amortization	Carrying amount	Cost	Accumulated amortization	Carrying amount
Computer equipment	25.1	18.3	6.8	78.8	72.3	6.5
Furniture and equipment	64.5	44.4	20.1	64.5	42.3	22.2
Leasehold improvements	38.6	19.7	18.9	34.7	17.2	17.5
Land and buildings	0.1	–	0.1	0.1	–	0.1
Total	**128.3**	**82.4**	**45.9**	178.1	131.8	46.3

Long-term investments in affiliates

The following table presents the movements in the long-term investments in affiliates during the year.

TABLE 10.3 – MOVEMENT OF LONG-TERM INVESTMENTS IN AFFILIATES

	2010	2009
Balance, beginning of year	98.3	64.1
Net acquisitions	12.3	30.5
Income	15.0	10.8
Dividends	(6.7)	(7.1)
Balance, end of year	**118.9**	98.3

During the year, there were no events or changes in circumstances that indicated that the carrying amounts of these investments may not be recoverable. Total dividends received from investments carried at cost amounted to $2.4 for the year ended December 31, 2010 ($1.1 as at December 31, 2009). These dividends are reported in *Dividend income* on the Consolidated statements of income.

NOTE 11 – Goodwill and intangible assets

The following table shows the changes in goodwill and intangible assets that occurred during the year.

TABLE 11.1 – GOODWILL AND INTANGIBLE ASSETS CONTINUITY SCHEDULE

		Intangibles		
As at December 31, 2010	Goodwill	Customer relationships and rights to offer renewals	Internally developed software	Total intangibles
Cost, beginning of year	178.6	94.4	143.2	237.6
Accumulated amortization, beginning of year	–	(35.3)	(42.7)	(78.0)
Carrying value, beginning of year	178.6	59.1	100.5	159.6
Acquisitions and costs capitalized (note 17)	46.8	17.6	27.7	45.3
Dispositions	(14.3)	(2.3)	–	(2.3)
Amortization expense	–	(9.8)	(23.3)	(33.1)
Cost, end of year	211.1	109.7	170.9	280.6
Accumulated amortization, end of year	–	(45.1)	(66.0)	(111.1)
Carrying value, end of year	211.1	64.6	104.9	169.5
As at December 31, 2009				
Cost, beginning of year	160.8	83.4	106.2	189.6
Accumulated amortization, beginning of year	–	(26.4)	(26.8)	(53.2)
Carrying value, beginning of year	160.8	57.0	79.4	136.4
Acquisitions and costs capitalized (note 17)	17.8	11.0	37.0	48.0
Dispositions	–	–	–	–
Amortization expense	–	(8.9)	(15.9)	(24.8)
Cost, end of year	178.6	94.4	143.2	237.6
Accumulated amortization, end of year	–	(35.3)	(42.7)	(78.0)
Carrying value, end of year	178.6	59.1	100.5	159.6

No impairment of goodwill and intangibles was identified in either 2010 or 2009.

NOTE 12 – Employee future benefits

The Company has several defined benefit pension plans. For these plans, the measurement date is December 31 and, for all plans, the latest actuarial valuations were performed as of December 31, 2009.

The Company offers employer paid post retirement benefit ("PRB") plans offering life insurance and health benefits to certain retirees, which are closed to active employees. The post retirement benefits plans are unfunded. The measurement date for post retirement benefits plans is December 31 and the latest actuarial valuations were performed as of December 31, 2009.

The following table shows the details of the movements in the Company's pension plans.

TABLE 12.1 – PENSION PLAN MOVEMENTS

	Benefit obligation	Plan assets	Unrecognized liabilities (assets) amounts	Total net assets (liabilities)	Expenses (revenues)
Balance as at December 31, 2009	**(560.8)**	**570.7**	**86.2**	**96.1**	**–**
Employer current service cost	**(25.4)**	**–**	**–**	**(25.4)**	**25.4**
Interest costs on benefit obligation	**(35.2)**	**–**	**–**	**(35.2)**	**35.2**
Actuarial assumptions movements					
Net actuarial gains (losses)	**(97.9)**	**–**	**97.9**	**–**	**–**
Actual return on assets	**–**	**91.5**	**(91.5)**	**–**	**–**
Expected return on assets	**–**	**–**	**39.1**	**39.1**	**(39.1)**
Change in valuation allowance	**–**	**–**	**–**	**–**	**–**
Amortization	**–**	**–**	**5.8**	**5.8**	**(5.8)**
Cash movements					
Employees contributions	**(6.9)**	**6.9**	**–**	**–**	**–**
Employer contributions	**–**	**34.8**	**–**	**34.8**	**–**
Benefits paid	**21.6**	**(21.6)**	**–**	**–**	**–**
Settlements	**–**	**–**	**–**	**–**	**–**
Balance as at December 31, 2010	**(704.6)**	**682.3**	**137.5**	**115.2**	**15.7**
Balance as at December 31, 2008	(448.7)	459.7	68.0	79.0	–
Employer current service cost	(17.9)	–	–	(17.9)	17.9
Interest costs on benefit obligation	(30.6)	–	–	(30.6)	30.6
Actuarial assumptions movements					
Net actuarial gains (losses)	(80.3)	–	80.3	–	–
Actual return on assets	–	99.2	(99.2)	–	–
Expected return on assets	–	–	32.6	32.6	(32.6)
Change in valuation allowance	–	–	–	–	–
Amortization	–	–	4.5	4.5	(4.5)
Cash movements					
Employees contributions	(6.4)	6.4	–	–	–
Employer contributions	–	28.5	–	28.5	–
Benefits paid	23.1	(23.1)	–	–	–
Settlements	–	–	–	–	–
Balance as at December 31, 2009	(560.8)	570.7	86.2	96.1	11.4

The following table shows the Company's pension plans and post retirement benefits plans funding status as well as the split of the net prepaid assets as reported in *Other assets* and *Other liabilities*.

TABLE 12.2 – FUNDING STATUS

	Pension plans		Post retirement benefit plan	
	2010	2009	**2010**	2009
Benefit obligation	**(704.6)**	(560.8)	**(13.6)**	(14.8)
Fair value of plan assets	**682.3**	570.7	**–**	–
Surplus (deficit)	**(22.3)**	9.9	**(13.6)**	(14.8)
Unrecognized amounts:				
Actuarial losses	**146.5**	105.7	**1.2**	2.8
Past service costs	**1.8**	2.2	**(3.8)**	(4.2)
Transition (asset) obligation	**(10.5)**	(21.1)	**0.5**	0.6
Valuation allowance	**(0.3)**	(0.6)	**–**	–
	137.5	86.2	**(2.1)**	(0.8)
Net prepaid asset (accrued liability) at the end of the year	**115.2**	96.1	**(15.7)**	(15.6)
Reported in:				
Other assets (note 10)	**138.5**	118.4	**–**	–
Other liabilities	**23.3**	22.3	**15.7**	15.6

Some of the Company's pension plans are not fully funded. For these plans, the aggregate amount of benefit obligation is $447.7 at December 31, 2010 ($347.0 as at December 31, 2009), and the fair value of plan assets is $370.0 as at December 31, 2010 ($296.2 as at December 31, 2009), which results in a net deficit of $77.7 at December 31, 2010 ($50.8 as at December 31, 2009).

The following table shows the details of the movements in the Company's post retirement benefit plans.

TABLE 12.3 – POST RETIREMENT BENEFITS PLAN MOVEMENTS

	Benefit obligation	Plan assets	Unrecognized liabilities (assets) amounts	Total net assets (liabilities)	Expense (revenue)
Balance as at December 31, 2009	**(14.8)**	**–**	**(0.8)**	**(15.6)**	**–**
Interest costs on benefit obligation	**(1.1)**	**–**	**–**	**(1.1)**	**1.1**
Actuarial gains (losses)	**1.5**	**–**	**(1.5)**	**–**	**–**
Amortization	**–**	**–**	**0.2**	**0.2**	**(0.2)**
Cash movements					
Employer contributions	**–**	**0.8**	**–**	**0.8**	**–**
Benefits paid	**0.8**	**(0.8)**	**–**	**–**	**–**
Balance as at December 31, 2010	**(13.6)**	**–**	**(2.1)**	**(15.7)**	**0.9**
Balance as at December 31, 2008	(15.3)	–	(0.5)	(15.8)	–
Interest costs on benefit obligation	(0.9)	–	–	(0.9)	0.9
Actuarial gains (losses)	0.5	–	(0.5)	–	–
Amortization	–	–	0.2	0.2	(0.2)
Cash movements					
Employer contributions	–	0.9	–	0.9	–
Benefits paid	0.9	(0.9)	–	–	–
Balance as at December 31, 2009	(14.8)	–	(0.8)	(15.6)	0.7

The following table shows the composition of the Company's pension plan assets.

TABLE 12.4 – COMPOSITION OF PENSION PLAN ASSETS

	2010	2009
Equity securities	**40.3%**	50.3%
Debt securities	**58.5%**	45.1%
Cash and cash equivalents	**1.2%**	4.6%

The pension plan assets composition does not take into account the impact of derivatives and short securities held in the pension plans invested assets portfolio.

The following table shows the details of the expense for both the Company's pension plans and post retirement benefit plans.

TABLE 12.5 – COMPOSITION OF THE EXPENSE

	Pension plans		Post retirement benefits	
	2010	2009	**2010**	2009
Current service cost	**25.4**	17.9	**–**	–
Interest cost on benefit obligation	**35.2**	30.6	**1.1**	0.9
Actual return on plan assets	**(91.5)**	(99.2)	**–**	–
Net actuarial (gains) losses	**97.9**	80.3	**(1.5)**	(0.5)
Accrued benefit expense before adjustments to recognize the long-term nature of employee future benefit costs	**67.0**	29.6	**(0.4)**	0.4
Excess of actual return over expected return on plan assets for the year	**52.4**	66.6	**–**	–
Net actuarial gains (losses) arising during the year (table 12.6)	**(97.9)**	(80.3)	**1.5**	0.5
Change in valuation allowance	**–**	–	**–**	–
Amortization of past service cost	**0.4**	0.4	**(0.4)**	(0.5)
Amortization of transitional (asset) obligation	**(10.6)**	(10.5)	**0.1**	0.1
Amortization of net actuarial losses	**4.7**	5.8	**0.1**	0.2
Amortization of valuation allowance	**(0.3)**	(0.2)	**–**	–
Total	**15.7**	11.4	**0.9**	0.7

The following table shows the net actuarial gains (losses) that arose during the year.

TABLE 12.6 – COMPONENTS OF NET ACTUARIAL GAINS (LOSSES) ARISING DURING THE YEAR

	Pension plans		Post retirement benefits	
	2010	2009	**2010**	2009
Actuarial gains (losses) arising from the:				
Change in the discount rate used to measure the benefit obligation	**(91.9)**	(52.5)	**(1.0)**	(0.5)
Experience	**(6.0)**	(27.8)	**2.5**	1.0
Total net actuarial gains (losses)	**(97.9)**	(80.3)	**1.5**	0.5

The following table summarizes the key weighted average assumptions used for the measurement of the benefit obligations and benefit expense.

TABLE 12.7 – ASSUMPTIONS

	Pension plans		Post retirement benefits	
	2010	2009	**2010**	2009
To determine benefit obligation at end of year				
Discount rate	**5.3%**	6.1%	**4.9%**	5.6%
Rate of increase in future compensation	**3.5%**	3.5%	**n/a**	n/a
Health care cost trend rate	**n/a**	n/a	**9.0%**	8.5%
Dental care cost trend rate	**n/a**	n/a	**4.5%**	4.5%
To determine benefit expense for the year				
Discount rate	**6.1%**	6.7%	**5.6%**	6.0%
Rate of increase in future compensation	**3.5%**	3.5%	**n/a**	n/a
Expected long-term rate of return on plan assets	**6.8%**	7.0%	**n/a**	n/a
Health care cost trend rate	**n/a**	n/a	**8.5%**	9.0%
Dental care cost trend rate	**n/a**	n/a	**4.5%**	4.5%

The impact of a 1% increase or decrease in the health care and dental care cost trend rate would not be significant on the Company's results or financial position.

NOTE 13 – Debt outstanding

a) Medium term notes

On March 23, 2010, the Company completed an additional Series 2 offering of $100.0 principal amount of unsecured medium term notes (the "Notes"). The Notes bear interest at a fixed annual rate of 6.40% until maturity on November 23, 2039, payable in equal semi-annual instalments commencing on May 23, 2010.

The following table details the Company's debt outstanding.

TABLE 13.1 – MEDIUM TERM NOTES OUTSTANDING

	Medium term notes	
	Series 1	**Series 2**
Date issued	**August 31, 2009**	**November 23, 2009**
		March 23, 2010
Maturity date	**September 3, 2019**	**November 23, 2039**
Principal amount outstanding	**$ 250.0**	**$ 250.0**
Fixed annual rate	**5.41%**	**6.40%**
Semi-annual coupon payment due on:	**March 3, September 3**	**May 23, November 23**

TABLE 13.2 – FAIR VALUE AND CARRYING VALUE OF MEDIUM TERM NOTES

	December 31, 2010		December 31, 2009	
	Carrying value	**Fair value**	Carrying value	Fair value
Series 1	**248.7**	**265.5**	248.7	252.8
Series 2	**247.4**	**268.6**	149.0	146.5
Total debt outstanding	**496.1**	**534.1**	397.7	399.3

The Notes may be redeemed at the option of the issuer, in whole or in part at any time, at a redemption price equal to the greater of (i) the Government of Canada Yield at the date of redemption plus a margin and (ii) par.

b) Credit facility

Effective December 20, 2010, the Company obtained a 3-year unsecured revolving term facility of $250.0 which matures on December 20, 2013 in replacement of a previous revolving term facility of $150.0. This credit facility may be drawn as prime loans at the prime rate plus a margin or as bankers' acceptances at the bankers' acceptance rate plus a margin. As at December 31, 2010, the Company had not drawn down the facility.

NOTE 14 – Share capital

a) Share capital authorized, issued and outstanding

The following table shows the Company's share capital, authorized, issued and outstanding.

TABLE 14.1 – AUTHORIZED, ISSUED AND OUTSTANDING

	As at December 31, 2010			As at December 31, 2009		
	Authorized (number of shares)	**Issued and outstanding (number of shares)**	**Share capital**	Authorized (number of shares)	Issued and outstanding (number of shares)	Share capital
Common shares	**Unlimited**	**112,179,565**	**$ 993.1**	Unlimited	119,906,567	$ 1,061.5
Class A shares	**Unlimited**	**–**	**–**	Unlimited	–	–

Issued and outstanding Class A Shares would rank both with regards to dividends and return on capital in priority to Common shares.

Common shares have no nominal or par value.

b) Normal course issuer bid

On February 22, 2010, the Company commenced a normal course issuer bid (“NCIB”) to purchase during the next 12 months up to 5,977,913 shares. On August 4, 2010, the Company increased the number of shares to be purchased under the NCIB to 11,955,827 representing 10% of its public float.

As at December 31, 2010, 7,727,002 common shares had been repurchased for cancellation under the NCIB at an average price of $44.06 per share for a total consideration of $340.6. Total cost paid, including fees, was first charged to share capital to the extent of the average carrying value of the common shares purchased for cancellation, and the excess of $272.2 was charged to retained earnings.

NOTE 15 – Stock-based compensation

a) Long-term incentive plan

The following table shows the outstanding units fair value for each of the Company’s performance cycles.

TABLE 15.1 – OUTSTANDING UNITS AND FAIR VALUE BY PERFORMANCE CYCLE

As at December 31, 2010	Number of units	Per unit fair value at grant date (in $)	Amount
2008–2010 performance cycle	**47,563**	**32.76**	**1.6**
2009–2011 performance cycle	**224,201**	**23.06**	**5.2**
2010–2012 performance cycle	**357,873**	**35.06**	**12.5**
Total	**629,637**	**30.61**	**19.3**
As at December 31, 2009			
2007–2009 performance cycle	–	44.27	–
2008–2010 performance cycle	5,600	32.76	0.2
2009–2011 performance cycle	157,460	23.06	3.6
Total	163,060	23.39	3.8

The following table shows the movement in LTIP share units during the year.

TABLE 15.2 – UNITS ESTIMATE

	2010 units	2009 units
LTIP (share equivalents)		
Outstanding, beginning of year	**163,060**	306,864
Net change in estimate during the year	**466,577**	(143,804)
Outstanding, end of year	**629,637**	163,060
LTIP (restricted common shares)		
Outstanding, end of year	**53,495**	342,731

The amount charged to compensation expense was $11.8 for the year ended December 31, 2010 (2009 – reversal of $2.7).

b) Employee share purchase plan

The following table shows the movement in ESPP restricted common shares during the year.

TABLE 15.3 – UNITS ESTIMATE

	2010 units	2009 units
ESPP (restricted common shares)		
Outstanding, beginning of year	**108,546**	89,906
Awarded during the year	**100,490**	102,974
Vested or forfeited during the year	**(101,474)**	(84,334)
Outstanding, end of year	**107,562**	108,546

The amount charged to compensation expense for the ESPP was $4.0 for the year ended December 31, 2010 ($3.4 for 2009).

NOTE 16 – Additional information on the Consolidated statements of cash flows

The following table provides additional details on the items included in the cash from operating activities.

TABLE 16.1 – ADDITIONAL INFORMATION ON THE STATEMENTS OF CASH FLOWS

	2010	2009
Adjustment for non-cash items:		
Change in unearned premiums, net	**121.0**	96.0
Net investment (gains) losses	**(63.7)**	172.5
Change in deferred acquisition costs, net	**(23.1)**	(13.5)
Future income taxes expense	**19.2**	23.5
Amortization of:		
Property and equipment	**15.2**	17.0
Intangible assets	**33.1**	24.8
Premiums net of discounts on fixed income securities	**10.5**	5.5
Other	**2.6**	(10.5)
Total as reported on the Consolidated statements of cash flows	**114.8**	315.3
Changes in other operating assets and liabilities:		
Premium and other receivables	**(122.9)**	(172.6)
Income taxes payable, net	**(36.3)**	275.7
Other assets	**(26.2)**	(43.7)
Payables and other liabilities	**16.4**	(132.8)
Total as reported on the Consolidated statements of cash flows	**(169.0)**	(73.4)
Income taxes paid (recovered)	**150.0**	(152.8)
Interest paid	**29.6**	5.6
Composition of cash and cash equivalents as at December 31:		
Cash, net of bank overdrafts	**(32.5)**	(32.4)
Cash equivalents	**170.3**	92.5
Total	**137.8**	60.1

NOTE 17 – Acquisitions and divestitures

The following table shows the details of the business combinations that occurred during the year. The results of the acquired companies since their respective acquisition date are included in the Company's Consolidated statements of income.

The allocation of the net purchase price was established as follows:

TABLE 17.1 – ACQUISITIONS

	2010	2009
Purchase price	32.5	22.5
Fair value of net liabilities assumed	31.9	6.3
Excess of purchase price over fair value	64.4	28.8
Allocated to:		
Intangibles	17.6	11.0
Goodwill	46.8	17.8

The following divestitures occurred during the year:

TABLE 17.2 – DIVESTITURES

	2010	2009
Sales price	12.3	–
Book value:		
Tangible net (assets) liabilities disposed	3.5	(0.2)
Intangibles disposed	(2.3)	–
Goodwill disposed	(14.3)	–
Loss on disposal	0.8	0.2

NOTE 18 – Contingencies, commitments and guarantees

In the normal course of operations, various claims and legal proceedings are instituted against the Company. Legal proceedings are often subject to numerous uncertainties and it is not possible to predict the outcome of individual cases. In management's opinion, the Company has made adequate provision for, or has adequate insurance to cover all claims and legal proceedings. Consequently, any settlements reached should not have a material adverse effect on the Company's consolidated future operating results and financial position.

The Company provides indemnification agreements to directors and officers, to the extent permitted by law, against certain claims made against them as a result of their services to the Company. The Company has insurance coverage for these agreements.

The following table presents future minimum payments under long-term leases for premises and equipment.

TABLE 18.1 – FUTURE MINIMUM PAYMENTS UNDER LONG-TERM LEASES FOR PREMISES AND EQUIPMENT

Year	Premises	Equipment
2011	48.1	20.4
2012	47.5	19.1
2013	42.1	9.9
2014	36.6	4.5
2015	33.1	1.9
Thereafter	70.5	0.2
Total	277.9	56.0

NOTE 19 – Related-party transactions

All related-party transactions are with entities associated with the Company's distribution segment. These transactions consist mainly of commissions for brokerage services and interest revenue from loans.

a) Revenues and expenses with related parties

The following table shows the revenues and expenses that were incurred with related parties.

TABLE 19.1 – REVENUE AND EXPENSES WITH RELATED PARTIES

For the year ended December 31,	2010	2009
Reported in:		
Income		
Interest income	14.4	12.4
Expenses		
Commissions, premium taxes and general expenses	101.8	92.8

b) Balance sheet amounts with related parties

The following table shows the amounts of loans and accrued interest and dividend income from related parties.

TABLE 19.2 – BALANCE SHEET AMOUNTS WITH RELATED PARTIES

As at December 31,	2010	2009
Reported in:		
Loans	243.6	241.9
Accrued interest and dividend income	0.6	0.6

NOTE 20 – Segmented information

The Company has two reportable segments, the underwriting segment and the corporate and distribution segment.

The Company's core business activity is P&C insurance underwriting. The underwriting segment includes two lines of business: personal lines and commercial lines. Personal lines include automobile and property while commercial lines include automobile and property and liability. Underwriting income include changes in claims liabilities due to movements in discount rates.

The corporate and distribution segment includes the results of the Company's participation in brokers and other operations.

a) Results of the Company's reportable segments

The following table shows the results of the Company's reportable segments.

TABLE 20.1 – RESULTS OF THE COMPANY'S REPORTABLE SEGMENTS

As at December 31, 2010	Underwriting	Corporate and distribution	Inter-segment eliminations	Total
Revenues	4,231.3	157.6	(98.7)	4,290.2
Expenses	4,073.9	119.3	(98.0)	4,095.2
Subtotal	157.4	38.3	(0.7)	195.0
Interest and dividend income				315.0
Net investment gains (losses)				63.7
Investment expenses				(20.6)
Interest on debt outstanding				(28.3)
Total income before income taxes				524.8
As at December 31, 2009				
Revenues	4,055.4	129.1	(80.1)	4,104.4
Expenses	4,043.0	112.1	(75.9)	4,079.2
Subtotal	12.4	17.0	(4.2)	25.2
Interest and dividend income				309.5
Net investment gains (losses)				(172.5)
Investment expenses				(16.8)
Interest on debt outstanding				(5.6)
Total income before income taxes				139.8

b) Assets of the Company's reportable segments

The following table shows the assets of the Company's reportable segments.

TABLE 20.2 – ASSETS OF THE COMPANY'S REPORTABLE SEGMENTS

As at December 31, 2010	Underwriting	Corporate and distribution	Inter-segment eliminations	Total
Invested assets	8,456.4	58.9	–	8,515.3
Other assets	3,066.7	201.9	(15.6)	3,253.0
Intangibles	109.5	60.0	–	169.5
Goodwill	74.4	136.7	–	211.1
Total assets	11,707.0	457.5	(15.6)	12,148.9
As at December 31, 2009				
Invested assets	7,815.6	184.8	(3.9)	7,996.5
Other assets	2,823.7	202.5	(9.6)	3,016.6
Intangibles	107.4	52.2	–	159.6
Goodwill	74.4	104.2	–	178.6
Total assets	10,821.1	543.7	(13.5)	11,351.3

c) Results by line of business

TABLE 20.3 – RESULTS BY LINE OF BUSINESS

For the year ended December 31,	2010	2009
Direct premiums written		
Personal	**3,284.7**	3,107.4
Commercial	**1,190.0**	1,154.3
Total	**4,474.7**	4,261.7
Underwriting income (loss)		
Personal	**53.1**	(5.5)
Commercial	**104.3**	17.9
Total	**157.4**	12.4

NOTE 21 – Disclosures on rate regulation

The Company's insurance subsidiaries are licensed under insurance legislation in each of the provinces and territories in which they conduct business. Automobile insurance is a compulsory product and is subject to different regulations across the provinces and territories in Canada, including those with respect to rate setting. Rate setting mechanisms generally fall under three categories:

Category	Description
File and use	Insurers file their rates with the relevant authorities and wait for a prescribed period of time and then implement the proposed rates.
File and approve	Insurers must wait for specific approval of filed rates before they may be used.
Use and file	Rates are filed following use.

Table 21.1 lists the provincial authorities which regulate automobile insurance rates. Automobile direct premiums written in these provinces totalled $2,528.3 in 2010 ($2,413.1 as at December 31, 2009) and represented approximately 99.2% (99.1% as at December 31, 2009) of direct automobile premiums written.

TABLE 21.1 – PROVINCIAL AUTHORITIES AND RATE FILINGS

Province	Rate filing	Regulatory authority
Alberta	File and approve or file and use	Alberta Automobile Insurance Rate Board
Ontario	File and approve	Financial Services Commission of Ontario
Quebec	Use and file	L'Autorité des marchés financiers
Nova Scotia	File and approve	Nova Scotia Utility and Review Board
New Brunswick	File and approve	New Brunswick Insurance Board
Prince Edward Island	File and approve	Island Regulatory Appeals Commission
Newfoundland and Labrador	File and approve	Board of Commissioners of Public Utilities

Relevant regulatory authorities may, in some circumstances, require retroactive rate adjustments, which could result in a regulatory asset or liability. At December 31, 2010 and 2009, the Company had no significant regulatory asset or liability.

Five-year financial history

(in millions of Canadian dollars, except as noted)

	2010	2009	2008	2007	2006
Consolidated performance					
Written insured risks (thousands)	**4,614.6**	4,603.6	4,601.5	4,679.9	4,565.1
Direct premiums written (excluding pools)	**4,498.1**	4,274.9	4,145.5	4,108.6	3,993.6
Net premiums earned	**4,231.3**	4,055.4	4,039.4	3,932.0	3,826.6
Prior year claims reserve development (favourable)	**(167.5)**	(94.4)	(113.9)	(115.9)	(169.9)
Net underwriting income (excluding MYA)	**193.8**	54.0	117.0	189.1	403.8
Combined ratio (excluding MYA)	**95.4%**	98.7%	97.1%	95.2%	89.4%
Interest and dividend income, net of expenses	**294.4**	292.7	328.8	344.8	321.3
Net gains (losses) on invested assets and other gains	**63.7**	(172.5)	(288.0)	73.6	193.5
Corporate and distribution income	**9.3**	7.2	15.6	44.3	33.4
Income before income taxes	**524.8**	139.8	123.6	671.6	952.0
Effective tax rate %	**20.0%**	9.4%	(3.8%)	24.3%	30.9%
Net operating income (excluding MYA)	**399.0**	281.6	360.7	457.0	530.5
Net income	**419.8**	126.7	128.2	508.3	658.1
Earnings per share (dollars)	**3.65**	1.06	1.05	4.01	4.92
Average number of shares outstanding	**115.1**	119.9	122.0	126.7	133.7
Return on equity %	**13.9%**	4.5%	4.4%	15.4%	20.8%
Personal lines – total					
Written insured risks (thousands)	**4,089.1**	4,097.9	4,103.7	4,190.5	4,077.6
Direct premiums written (excluding pools)	**3,308.2**	3,120.8	3,009.9	2,962.1	2,810.7
Net premiums earned	**3,139.7**	2,992.9	2,958.8	2,845.0	2,696.7
Combined ratio (excluding MYA)	**97.5%**	99.3%	101.2%	96.7%	91.0%
Net underwriting income (excluding MYA)	**76.9**	21.3	(36.0)	92.7	242.2
Personal auto					
Written insured risks (thousands)	**2,475.1**	2,454.7	2,449.3	2,514.4	2,440.1
Direct premiums written (excluding pools)	**2,235.9**	2,126.6	2,057.0	2,057.7	1,969.2
Net premiums earned	**2,158.0**	2,066.5	2,067.5	2,008.0	1,911.2
Combined ratio (excluding MYA)	**98.1%**	94.9%	95.9%	94.5%	87.3%
Net underwriting income (excluding MYA)	**42.2**	105.0	84.7	111.4	242.5
Personal property					
Written insured risks (thousands)	**1,614.0**	1,643.2	1,654.4	1,676.1	1,637.4
Direct premiums written (excluding pools)	**1,072.3**	994.2	952.9	904.4	841.5
Net premiums earned	**981.7**	926.4	891.3	837.0	785.5
Combined ratio (excluding MYA)	**96.5%**	109.0%	113.6%	102.2%	100.0%
Net underwriting income (excluding MYA)	**34.7**	(83.7)	(120.7)	(18.7)	(0.3)
Commercial lines – total					
Written insured risks (thousands)	**525.5**	505.8	497.8	489.3	487.5
Direct premiums written (excluding pools)	**1,189.9**	1,154.1	1,135.6	1,146.5	1,182.9
Net premiums earned	**1,091.6**	1,062.5	1,080.7	1,087.1	1,129.9
Combined ratio (excluding MYA)	**89.3%**	96.9%	85.9%	91.1%	85.7%
Net underwriting income (excluding MYA)	**116.9**	32.7	153.0	96.2	161.7
Commercial auto					
Written insured risks (thousands)	**282.4**	269.4	263.8	255.8	253.6
Direct premiums written (excluding pools)	**335.5**	321.9	317.8	321.2	327.5
Net premiums earned	**325.6**	315.2	318.9	320.2	326.8
Combined ratio (excluding MYA)	**86.0%**	79.8%	87.2%	93.7%	86.9%
Net underwriting income (excluding MYA)	**45.6**	63.6	40.8	20.1	43.0
Commercial P&C					
Written insured risks (thousands)	**243.1**	236.4	234.0	233.5	233.9
Direct premiums written (excluding pools)	**854.4**	832.2	817.8	825.3	855.4
Net premiums earned	**766.0**	747.3	761.8	766.9	803.1
Combined ratio (excluding MYA)	**90.7%**	104.1%	85.3%	90.1%	85.2%
Net underwriting income (excluding MYA)	**71.3**	(30.9)	112.2	76.2	118.7
Financial condition					
Excess capital in P&C companies (over 170% MCT)	**807.0**	728.4	357.5	214.1	463.7
MCT %	**233.4%**	231.9%	205.0%	187.9%	210.0%
Cash generated from operations	**500.5**	538.0	619.7	620.3	431.0
Debt to total capital	**13.9%**	11.8%	0%	0%	0%
Book value per share (dollars)	**27.37**	24.88	21.96	25.48	25.58
Invested assets					
Performance					
Market-based investment yield	**4.2%**	4.5%	5.0%	5.1%	4.8%
Portfolio mix					
Total invested assets and cash	**8,653.1**	8,056.6	6,604.7	7,245.9	7,367.8
Cash and short-term investments	**5.8%**	3.3%	12.1%	0.4%	11.4%
Fixed income securities	**51.5%**	56.8%	53.6%	53.4%	44.2%
Common shares	**21.7%**	16.3%	12.1%	23.6%	21.5%
Preferred shares	**17.4%**	19.6%	18.5%	19.7%	19.8%
Other	**3.6%**	4.0%	3.7%	2.9%	3.1%

Two-year quarterly review

(in millions of Canadian dollars, except as noted)

	2010				2009			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Consolidated performance								
Written insured risks (thousands)	1,053.6	1,247.4	1,369.4	944.1	1,046.0	1,244.4	1,376.0	937.2
Direct premiums written (excluding pools)	1,060.2	1,205.8	1,317.8	914.3	1,011.4	1,144.1	1,250.6	868.8
Net premiums earned	1,091.5	1,066.5	1,054.6	1,018.7	1,036.5	1,019.0	1,011.3	988.7
Prior year claims reserve development (favourable)	(77.6)	1.9	(13.7)	(78.0)	(78.8)	25.1	(17.0)	(23.7)
Net underwriting income (excluding MYA)	21.8	36.7	66.3	69.0	56.0	(53.2)	43.2	7.9
Combined ratio (excluding MYA)	98.0%	96.6%	93.7%	93.2%	94.6%	105.2%	95.7%	99.2%
Interest and dividend income, net of expenses	72.9	73.0	75.4	73.1	77.3	72.9	72.6	72.5
Net gains (losses) on invested assets and other gains	(1.3)	26.4	32.7	5.9	(13.3)	11.7	(35.1)	(135.8)
Corporate and distribution income	1.5	–	8.0	(0.2)	(7.5)	3.6	6.7	1.8
Income before income taxes	123.2	98.5	152.0	151.0	125.4	(16.0)	97.2	(66.9)
Effective tax rate %	20.9%	16.4%	20.9%	20.7%	22.9%	(50.0%)	23.7%	(45.8%)
Net operating income (excluding MYA)	79.0	89.0	118.6	112.3	98.1	21.6	92.9	69.1
Net income	97.5	82.3	120.2	119.7	96.7	(8.0)	74.2	(36.3)
Earnings per share (dollars)	0.87	0.72	1.04	1.01	0.81	(0.07)	0.62	(0.30)
Average number of shares outstanding	112.6	113.7	115.2	119.1	119.9	119.9	119.9	119.9
Return on equity %	13.9%	14.2%	11.5%	10.3%	4.5%	(1.2%)	1.1%	2.4%
Personal lines – total								
Written insured risks (thousands)	921.6	1,123.3	1,215.4	828.8	920.5	1,125.3	1,225.8	826.2
Direct premiums written (excluding pools)	750.8	928.1	975.7	653.6	714.3	871.3	921.8	613.4
Net premiums earned	811.2	791.4	783.1	754.0	771.2	748.4	745.8	727.4
Combined ratio (excluding MYA)	99.4%	99.3%	97.2%	94.0%	94.9%	106.2%	95.3%	101.0%
Net underwriting income (excluding MYA)	4.6	5.2	22.3	44.9	39.7	(46.3)	35.4	(7.3)
Personal auto								
Written insured risks (thousands)	542.1	671.3	751.3	510.4	535.1	663.5	751.2	504.9
Direct premiums written (excluding pools)	493.7	625.5	664.7	452.0	474.6	589.8	635.2	426.9
Net premiums earned	556.6	545.3	538.8	517.3	531.0	517.3	516.2	502.0
Combined ratio (excluding MYA)	103.0%	96.3%	95.7%	97.0%	98.0%	95.9%	89.6%	96.1%
Net underwriting income (excluding MYA)	(16.5)	19.8	23.0	15.9	10.4	21.4	53.6	19.6
Personal property								
Written insured risks (thousands)	379.5	452.0	464.1	318.4	385.4	461.8	474.6	321.3
Direct premiums written (excluding pools)	257.1	302.6	311.0	201.6	239.7	281.5	286.6	186.5
Net premiums earned	254.6	246.1	244.3	236.7	240.2	231.1	229.6	225.4
Combined ratio (excluding MYA)	91.7%	106.0%	100.3%	87.8%	87.8%	129.3%	107.9%	112.0%
Net underwriting income (excluding MYA)	21.1	(14.6)	(0.7)	29.0	29.3	(67.7)	(18.2)	(26.9)
Commercial lines – total								
Written insured risks (thousands)	132.0	124.1	154.1	115.3	125.6	119.1	150.2	110.9
Direct premiums written (excluding pools)	309.4	277.7	342.1	260.7	297.0	272.8	328.8	255.4
Net premiums earned	280.3	275.1	271.6	264.7	265.2	270.6	265.4	261.1
Combined ratio (excluding MYA)	93.8%	88.6%	83.8%	90.9%	93.8%	102.6%	97.0%	94.1%
Net underwriting income (excluding MYA)	17.2	31.5	44.1	24.1	16.4	(7.0)	8.0	15.4
Commercial auto								
Written insured risks (thousands)	71.4	65.1	85.5	60.4	66.5	61.2	83.8	57.9
Direct premiums written (excluding pools)	85.1	79.0	100.6	70.8	80.4	73.6	97.2	70.7
Net premiums earned	83.9	82.7	80.8	78.3	80.4	79.5	78.0	77.2
Combined ratio (excluding MYA)	93.9%	80.5%	74.6%	95.0%	70.4%	87.1%	73.9%	88.1%
Net underwriting income (excluding MYA)	5.1	16.2	20.5	3.9	23.8	10.2	20.4	9.2
Commercial P&C								
Written insured risks (thousands)	60.6	59.0	68.6	54.9	59.1	57.9	66.4	53.0
Direct premiums written (excluding pools)	224.3	198.7	241.5	189.9	216.6	199.2	231.6	184.7
Net premiums earned	196.4	192.4	190.8	186.4	184.8	191.1	187.4	183.9
Combined ratio (excluding MYA)	93.8%	92.0%	87.6%	89.2%	104.0%	109.0%	106.7%	96.6%
Net underwriting income (excluding MYA)	12.1	15.3	23.6	20.2	(7.4)	(17.2)	(12.4)	6.2
Financial condition								
Excess capital in P&C companies (over 170% MCT)	807.0	669.5	585.6	786.9	728.4	580.9	444.1	385.4
MCT %	233.4%	222.7%	217.6%	236.7%	231.9%	219.2%	211.1%	208.2%
Cash generated from operations	74.2	258.4	194.4	(26.6)	77.3	215.7	228.0	17.0
Debt to total capital	13.9%	14.1%	14.6%	14.6%	11.8%	8.0%	0.0%	0.0%
Book value per share (dollars)	27.37	26.70	25.32	25.04	24.88	24.13	23.36	21.56
Invested assets								
Performance								
Market-based investment yield	4.1%	4.1%	4.4%	4.1%	4.4%	4.4%	4.4%	4.7%
Portfolio mix								
Total invested assets and cash	8,653.1	8,596.5	8,216.7	7,980.5	8,056.6	7,839.9	6,992.4	6,495.9
Cash and short-term investments	5.8%	4.8%	3.7%	2.2%	3.3%	5.5%	12.8%	11.8%
Fixed income securities	51.5%	53.4%	54.6%	55.8%	56.8%	53.9%	49.5%	53.5%
Common shares	21.7%	20.8%	19.7%	18.9%	16.3%	16.0%	12.6%	11.2%
Preferred shares	17.4%	17.3%	18.1%	19.1%	19.6%	20.6%	20.9%	19.1%
Other	3.6%	3.7%	3.9%	4.0%	4.0%	4.0%	4.2%	4.4%

Asset-backed security A financial security whose value and income payments are derived from and collateralized (or backed) by a specified pool of underlying assets such as auto loans and credit card receivables.

Actuarial gains (losses) Effect of changes in actuarial assumptions and experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred).

Basis risk Basis risk is the risk that offsetting investments in a hedging strategy will not experience price changes in entirely opposite directions from each other.

Book value per share Represents shareholders' equity at the end of the period divided by the number of outstanding common shares on the same date. Shareholders' equity is determined in accordance with GAAP.

Case reserves The liability established to reflect the estimated cost of unpaid claims that have been reported and claims expenses that the insurer will ultimately be required to pay.

Catastrophe A catastrophe is defined as a single event resulting in $5.0 million or more in aggregate claims.

Claims expenses The direct and indirect expenses of settling claims.

Claims ratio Claims incurred, net of reinsurance, during a defined period and expressed as a percentage of net premiums earned for the same period.

Claims liabilities Claims liabilities are technical accounting provisions comprised of three main elements: 1) case reserves 2) claims that are incurred but not reported (IBNR) and 3) provision for adverse development as required by accepted actuarial practice in Canada. Claims liabilities are discounted to take into account the time value of money.

Combined ratio The sum of the claims ratio and the expenses ratio. A combined ratio below 100% indicates profitable underwriting results. A combined ratio over 100% indicates unprofitable results.

Corporate sustainability Corporate sustainability represents the way a company achieves enhanced ethical standards and a balance of economic, environmental and social imperatives addressing the concerns and expectations of its stakeholders.

Corridor method or approach Systematic method for recognizing in the statement of income the net cumulative unrecognized actuarial gains and losses. Under this method, the portion of actuarial gains and losses to be recognized for a specific pension plan is the excess of the greater of: (a) 10% of the present value of the defined benefit obligation and (b) 10% of the fair value of the plan assets, both established at the same date, divided by the expected average remaining working lives of the employees participating in the plan.

Collateral Assets pledged as security for a loan or other obligation. Collateral can take many forms, such as cash, highly rated securities, receivables, etc.

Counterparty A counterparty is any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation of the company.

Credit derivatives Credit derivatives, such as credit default swaps, are over-the-counter contracts that transfer credit risk related to an underlying financial instrument (referenced asset) from one counterparty to another.

Credit risk Credit risk is the possibility that one counterparty may not be able to meet payment obligations when they become due.

Currency risk Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Derivative A contract between two parties, which requires little or no initial investment and where payments between the parties are dependent upon the movements in price of an underlying instrument, index or financial rate. The notional amount of the derivative is the contract amount used as a reference point to calculate the payments to be exchanged between the two parties, and the notional amount itself is generally not exchanged by the parties.

Derivative-related credit risk Credit risk from derivative transactions is generated by the potential for the counterparty to default on its contractual obligations when one or more transactions have a positive market value to the company. Therefore, derivative-related credit risk is represented by the positive fair value of the instrument and is normally a small fraction of the contract's notional amount.

Direct premiums written The total amount of premiums for new and renewal policies billed (written) during a specific reporting period from the primary insured.

Earnings per share (EPS), basic Calculated as net income less preferred share dividends divided by the average number of shares outstanding.

Earnings per share (EPS), diluted Calculated as net income less preferred share dividends divided by the average number of shares outstanding adjusted for the dilutive effects of stock options and other convertible securities.

Equity price risk Equity price risk is the risk of losses arising from movements in equity market prices.

Excess capital Excess capital in the P&C insurance subsidiaries at 170% minimum capital test (MCT) plus excess liquid assets in the holding company and other subsidiaries.

Expense ratio Underwriting expenses including commissions, premium taxes and all general and administrative expenses, incurred in underwriting income during a defined period and expressed as a percentage of net premiums earned for the same period.

Facility Association The Facility Association is an entity established by the automobile insurance industry to ensure that automobile insurance is available to all owners and licensed drivers of motor vehicles where such owners or drivers are unable to obtain automobile insurance through the private insurance market. The Facility Association serves the following provinces and territories: Alberta, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nova Scotia, Nunavut, Ontario, Prince Edward Island and Yukon.

Fair value The amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

Forwards derivatives Forward contracts are effectively tailor-made agreements that are transacted between counterparties in the over-the-counter market.

Futures derivatives Futures contracts are standardized contracts with respect to amounts and settlement dates, and are traded on regular future exchanges.

Interest rate forwards and futures contracts Contractual obligations to buy or sell an interest-rate sensitive financial instrument at a predetermined future date at a specified price.

Currency forwards and futures contracts Contractual obligations to exchange one currency for another at a specified price for settlement at a predetermined future date.

Frequency (of claims) Total number of claims reported in a specific period.

Hedge A risk management technique used to insulate financial results from market, interest rate or foreign currency exchange risk (exposure) arising from normal investing operations. The elimination or reduction of such exposure is accomplished by establishing offsetting or "hedging" positions.

Incurred but not reported (IBNR) claims reserve Reserves (accounting provisions) for estimated claims that have been incurred but not yet reported by policyholders including a reserve for future developments on claims which have been reported.

IFRS International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB). The term "IFRS" includes IFRS standards and Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or its predecessor, the former Standing Interpretations Committee (SIC).

Industry pools Industry pools consist of the "residual market" as well as risk-sharing pools (RSP) in Alberta, Ontario, Quebec, New Brunswick and Nova Scotia. These pools are managed by the Facility Association except for the Quebec RSP.

Invested assets or investment portfolio Financial instrument assets owned by the company including debt and equity securities and loans.

Interest rate risk Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet obligations associated with financial liabilities.

Market-based yield The market-based yield is a non-GAAP measure defined as the annualized total pre-tax dividend and interest income (before expenses) divided by the average fair values of equity and fixed income securities held during the reporting period.

Market yield adjustment (MYA) The impact of changes in the discount rate used to discount claims liabilities based on the change in the market based yield of the underlying assets.

Market yield effect The difference between the MYA and the gains and losses on "held-for-trading" debt securities (the objective is that these two items offset each other with a minimal overall impact to net income).

Master netting agreement An agreement between the company and a counterparty designed to reduce the credit risk of derivative transactions through the creation of a legal right to offset the exposure in the event of a default.

Minimum capital test (MCT) Ratio of available capital to required capital. Federally regulated property and casualty insurers, including our Canadian insurance subsidiaries, must meet a minimum capital test (MCT) that assesses the insurer's available capital in relation to its required capital and requires that available capital equal at least the minimum capital requirement. OSFI expects insurers to establish a target capital level above the minimum requirement, and maintain ongoing capital, at no less than the supervisory target of 150% of required capital under MCT. The company has an internal operating target of 170%.

Net operating income After-tax net income from underwriting activities (excluding MYA), corporate and distribution activities and interest and dividend income from invested assets.

Net premiums earned Premiums written that are recognized for accounting purposes as revenue earned during a period.

Net premiums written Direct premiums written for a given period less premiums ceded to reinsurers and retrocessionaires during such period.

Net underwriting income Net premiums earned less net claims incurred, commissions, premium taxes and general expenses (excluding MYA).

Normal course issuer bid A program for the repurchase of the company's own common shares, for cancellation through a stock exchange, that is subject to the various rules of the relevant stock exchange and securities commission.

Notional amount The contract amount used as a reference point to calculate cash payments for derivatives.

Office of the Superintendent of Financial Institutions Canada (OSFI) The primary regulator of federally chartered financial institutions and federally administered pension plans in Canada. OSFI's mission is to safeguard policyholders, depositors and pension plan members from undue loss.

Operating return on equity Net operating income for the last 12-months divided by the average shareholders' equity (excluding accumulated other comprehensive income) over the same 12-month period. The average shareholders' equity is the mean of shareholders' equity at the beginning and the end of the period.

Options Contractual agreements under which the seller (writer) grants the purchaser the right, but not the obligation, either to buy (call option) or sell (put option) an asset (underlying asset) at a predetermined price, at or by a specified future date.

Prior year claims development Prior year claims development is the change in total prior year claims liabilities in a given period. A reduction to claims liabilities is called favourable prior year claims development. An increase in claims liabilities is called unfavourable prior year claims development.

Provision for adverse deviation An amount added to undiscounted case reserves and IBNR to account for adverse deviation from claims reserve estimates.

Reinsurer An insurance company that agreed to indemnify another insurance or reinsurance company, the ceding company, against all or a portion of the insurance or reinsurance risks underwritten by the ceding company, under one or more policies.

Return on equity (ROE) Net income for a 12-month period divided by the average shareholders' equity over the same 12-month period. Net income and shareholders' equity are determined in accordance with GAAP. The average shareholders' equity is the mean of shareholders' equity at the beginning and end of the period.

Risk Financial institutions, including insurance companies, face a number of different risks that expose them to possible losses including market risk, interest rate risk, currency risk, basis risk, credit risk, liquidity risk, insurance related risk, operational risk, strategy implementation risk, regulation and legal risk, solvency risk, reputation risk and other risks.

Securities lending Transactions in which the owner of a security agrees to lend it under the terms of a prearranged contract to a borrower for a fee. The borrower must collateralize the security loan at all times.

Securities sold short A transaction in which the seller sells securities and then borrows the securities in order to deliver them to the purchaser upon settlement. At a later date, the seller buys identical securities in the market to replace the borrowed securities.

Severity (of claims) Average cost of a claim calculated by dividing the total cost of claims by the total number of claims.

Shareholders' equity Capital invested by the shareholders via share capital and contributed surplus, plus retained earnings and accumulated other comprehensive income (loss).

Structured settlements Periodic payments to an injured person or survivor for a determined number of years for life, typically in settlement for a claim under a liability policy, usually funded through the purchase of an annuity.

Swaps, including currency and total return swaps Over-the-counter contracts in which two counterparties exchange a series of cash flows based on agreed upon rates such as exchange rates or value of an equity index applied to a contract notional amount.

Written insured risks The number of vehicles in automobile insurance, the number of premises in personal property insurance and the number of policies in commercial insurance (excluding commercial auto insurance).

Board of Directors

Charles Brindamour [4]
President and Chief Executive Officer

Yves Brouillette [1,2]
Corporate Director and President, Placements Beluca Inc.

Paul Cantor [3,4]
Chair of the Public Sector Pension Investment Board and of York University's Board of Governors and Senior Advisor, Bennett Jones LLP

Marcel Côté [2,3]
Senior Partner, Secor Consulting Inc.

Robert W. Crispin [1,4]
Corporate Director

Claude Dussault
Chairman of the Board

Eileen Mercier [1,4]
Chair and Board Member, Ontario Teachers' Pension Plan

Timothy H. Penner [2,3]
President of Procter & Gamble Inc.

Louise Roy [2,3]
Chancellor and Chair of the Board of Université de Montréal and Invited Fellow, Center for Interuniversity Research and Analysis on Organizations

Stephen Snyder [1,2]
President and CEO of TransAlta Corporation

Carol Stephenson [2,3]
Dean, Richard Ivey School of Business, University of Western Ontario

Notes:
(1) Denotes member of the Audit & Risk Review Committee
(2) Denotes member of the Conduct Review & Corporate Governance Committee
(3) Denotes member of the Human Resources Committee
(4) Denotes member of the Investment Committee

For complete biographies of the members of the Board of Directors, please see the Management Proxy Circular which may be found online at www.sedar.com.

Executive management

Charles Brindamour
President and Chief Executive Officer

Martin Beaulieu
Senior Vice-President, Personal Lines

Susan Black
Chief Human Resources Officer

Alan Blair
Senior Vice-President, Atlantic Canada

Debbie Coull-Cicchini
Senior Vice-President, Ontario

Claude Désilets
Chief Risk Officer

Louis Gagnon
President, Intact Insurance

Denis Garneau
Senior Vice-President, Quebec

Françoise Guénette
Senior Vice-President, Corporate and Legal Services and Secretary

Denis Guertin
President, Direct to Consumers Distribution

Byron Hindle
Senior Vice-President, Commercial Lines

Derek Iles
Senior Vice-President, Western Canada

David Lincoln
Senior Vice-President, Corporate Audit Services

Jack Ott
Senior Vice-President and Chief Information Officer

Marc Pontbriand
Executive Vice-President, Claims and IT

Marc Provost
Senior Vice-President, Managing Director and Chief Investment Officer, Intact Investment Management Inc.

Mark Tullis
Chief Financial Officer

Pete Weightman
President, BrokerLink

For complete biographies of the executive management, please see the corporate governance section of the www.intactfc.com web site.

DESIGN: BRYAN MILLS IRADESSO WWW.BMIR.COM

Credit rating

IFC's long-term issuer rating and senior unsecured debt are rated A3 by Moody's Investors Service and the Company's five principal operating insurance subsidiaries are rated Aa3 for insurance financial strength (IFS). IFC's long-term issuer rating and senior unsecured debt are rated a- by A.M. Best and its primary insurance subsidiaries are rated A+ for financial strength rating (FSR). The Company's long-term issuer rating and senior unsecured debt is rated A (low) by DBRS.

Toronto Stock Exchange (TSX) listing

Ticker symbol: IFC

Annual Meeting of Shareholders

Date: Wednesday May 4, 2011
Time: 2:00 pm ET
Art Gallery of Ontario
Baillie Court
317 Dundas Street West
Toronto, Ontario M5T 1G4

Version française

Il existe une version française du présent rapport annuel à la section Relations investisseurs de notre site Web intactcf.com. Les intéressés peuvent obtenir une version imprimée en appelant au 1 866 778 0774 ou en envoyant un courriel à ir@intact.net.

Transfer agent and registrar

Computershare Investor Services Inc.
100 University Avenue, 9th Floor
Toronto, Ontario M5J 2Y1
1 800 564 6253

Auditors

Ernst & Young LLP

Earnings release dates

Q1 – Wednesday May 4, 2011
Q2 – Thursday August 4, 2011
Q3 – Wednesday November 2, 2011
Q4 – Wednesday February 8, 2012

Investor relations

Dennis Westfall
Director, Investor Relations
416 341 1464, ext: 45122
dennis.westfall@intact.net
Toll-free: 1 866 778 0774

Media inquiries

Sandra Nunes
Manager, External Communications
416 341 1464, ext: 43127
sandra.nunes@intact.net

Dividend reinvestment

Shareholders can reinvest their cash dividends in common shares of Intact Financial Corporation on a commission-free basis either through a broker, subject to eligibility as determined by the broker, or through Canadian ShareOwner Investments Inc. Full details can be obtained by visiting the Investor Relations section of the www.intactfc.com web site.

Eligible dividend designation

For purposes of the enhanced dividend tax credit rules contained in the Income Tax Act (Canada) and any corresponding provincial and territorial tax legislation, all dividends (and deemed dividends) paid by Intact Financial Corporation to Canadian residents on our common shares after December 31, 2005, are designated as eligible dividends. Unless stated otherwise, all dividends (and deemed dividends) paid by the Company hereafter are designated as eligible dividends for the purposes of such rules.

Information for shareholders outside of Canada

Dividends paid to residents in countries with which Canada has bilateral tax treaties are generally subject to the 15% Canadian non-resident withholding tax. There is no Canadian tax on gains from the sale of shares (assuming ownership of less than 25%) or debt instruments of the Company owned by non-residents not carrying on business in Canada. No government in Canada levies estate taxes or succession duties.

Common share prices and volume

	High	Low	Close	Volume
Q1	$ 44.90	$ 36.37	$ 44.81	24,228,119
Q2	$ 47.19	$ 42.98	$ 44.90	16,616,122
Q3	$ 48.05	$ 40.51	$ 45.61	13,796,808
Q4	$ 51.73	$ 44.54	$ 50.86	13,181,308
Year 2010	**$ 51.73**	**$ 36.37**	**$ 50.86**	**67,822,357**
Q1	$ 37.50	$ 26.17	$ 36.00	54,684,783
Q2	$ 37.63	$ 32.67	$ 34.05	24,407,951
Q3	$ 36.37	$ 31.28	$ 33.98	19,054,203
Q4	$ 37.82	$ 32.37	$ 37.15	16,313,412
Year 2009	$ 37.82	$ 26.17	$ 37.15	114,460,349
Q1	$ 41.51	$ 33.03	$ 36.49	13,873,578
Q2	$ 41.50	$ 34.24	$ 35.55	8,786,544
Q3	$ 43.04	$ 35.05	$ 35.96	9,970,713
Q4	$ 40.00	$ 26.03	$ 31.61	10,433,907
Year 2008	$ 43.04	$ 26.03	$ 31.61	43,064,742

Source: Toronto Stock Exchange

Intact Financial Corporation
700 University Ave.
Toronto, Ontario
M5G 0A1
www.intactfc.com

On the cover

Canadian speed skater Charles Hamelin embodies outperformance. Charles has been a member of the National Short Track Team for seven years, as both an individual skater and a relay team member. During this time Charles has won countless World Cup medals and three Olympic medals; two gold medals in Vancouver in 2010 and a silver medal in Turin in 2006. Excellence, discipline and outperformance – these are strengths that Intact and Charles share.

PHOTO CREDIT: EWAN NICHOLSON PHOTOGRAPHY, COURTESY AGENDA SPORT MARKETING
STYLE CREDIT: NIKE