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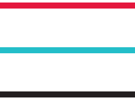


ANNUAL REPORT 2012

CONTINUING OUR JOURNEY

A disciplined, experienced team delivering consistent industry outperformance

A local presence from coast to coast

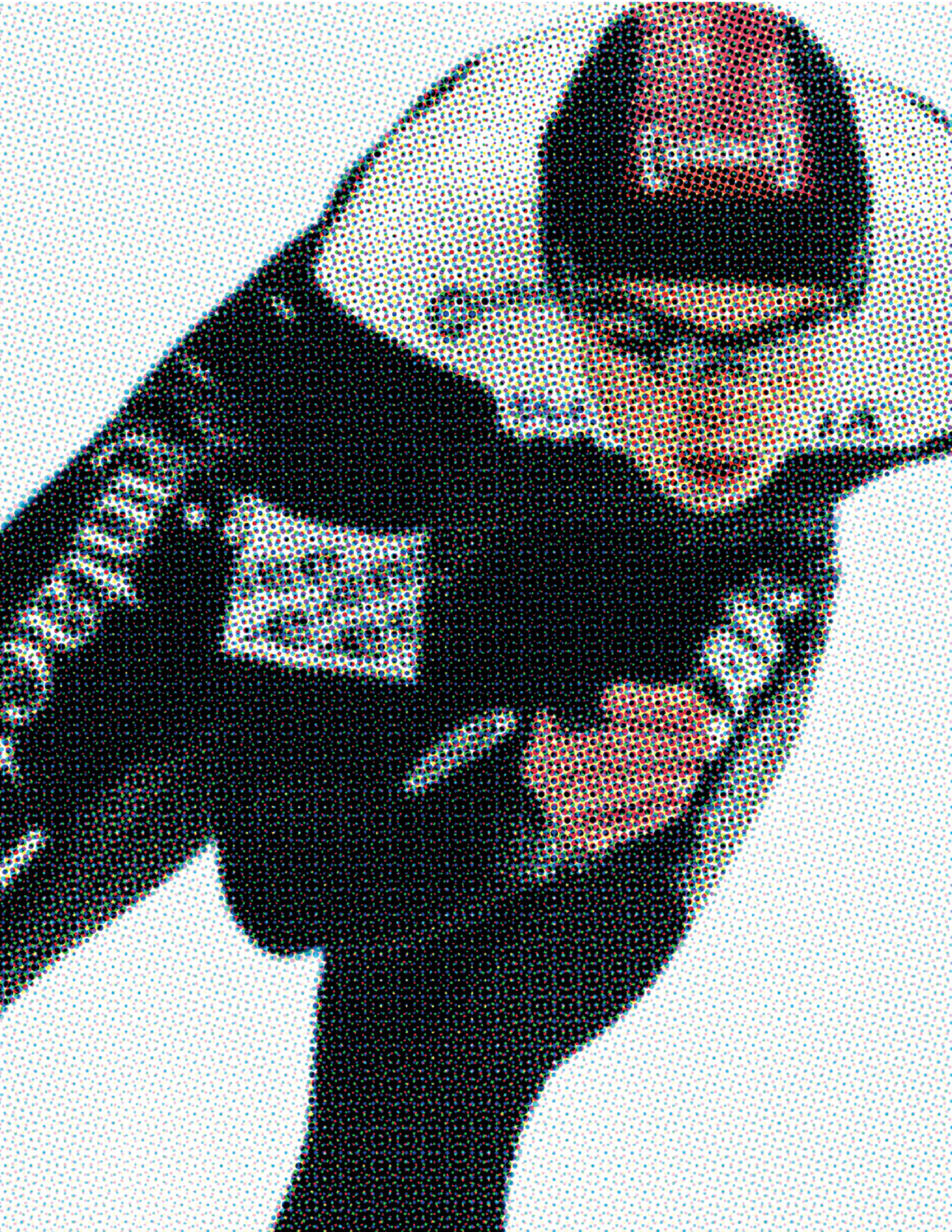
Proven consolidator in a fragmented industry

TO BUILD A WORLD-CLASS P&C INSURER

Delivering an outstanding customer experience

Solid financial position to capitalize on growth opportunities

Fostering vibrant and resilient communities for all our stakeholders



who we are

Intact Financial Corporation is the largest provider of property and casualty ("P&C") insurance in Canada with $7 billion in direct premiums written and an estimated market share of 17%. | We insure more than five million individuals and businesses through our insurance subsidiaries and are the largest private sector provider of P&C insurance in British Columbia, Alberta, Ontario, Québec 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 directly to consumers through belairdirect and Grey Power. We internally manage our investments totalling approximately $13 billion.

CONTINUING OUR JOURNEY TO BUILD A WORLD-CLASS P&C INSURER

We are continuing on a journey that began many years ago. A journey guided by our values, the success of which is made possible through leveraging our scale, sophistication, service and discipline. Recent acquisitions have accelerated our journey, but through it all, we remain true to our strategy to build a world-class company which our employees can be proud to work for, our brokers and customers proud to affiliate with, and our shareholders proud to own.

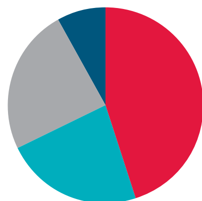
Financial highlights

(in millions of Canadian dollars, except as noted)

	IFRS			Canadian GAAP	
	2012	2011	2010	2009	2008
Consolidated performance					
Written insured risks (thousands)	**6,729**	5,084	4,614	4,604	4,601
Direct premiums written	**6,868**	5,099	4,498	4,275	4,146
Net premiums earned	**6,571**	4,880	4,231	4,055	4,040
Combined ratio	**93.1%**	94.4%	95.4%	98.7%	97.1%
Underwriting income	**451**	273	193	54	117
Net investment income	**389**	326	294	293	329
Net operating income	**675**	460	402	282	361
Net investment gains (losses)	**37**	204	182	(173)	(288)
Net income	**587**	465	498	127	128
Net operating income per share ($)	**5.00**	3.91	3.49	2.35	2.96
Earnings per share ($)	**4.33**	3.96	4.32	1.06	1.05
Book value per share ($)	**33.03**	29.73	26.47	24.88	21.96
Operating return on equity	**16.8%**	15.3%	15.1%	9.2%	11.3%
Adjusted return on equity	**16.5%**	17.4%	17.1%	4.8%	4.6%

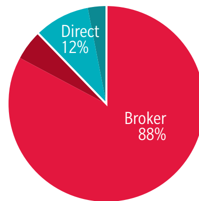
Superior performance and financial strength have translated into a total shareholder return of 91% over the past five years.

2012 Direct premiums written by business line
(excluding pools, %)



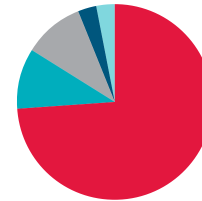
Personal auto	45%
Personal property	23%
Commercial P&C	24%
Commercial auto	8%

2012 Direct premiums written by distribution channel
(excluding pools, %)



Intact Insurance	83%
BrokerLink	5%
belairdirect	9%
Grey Power	3%

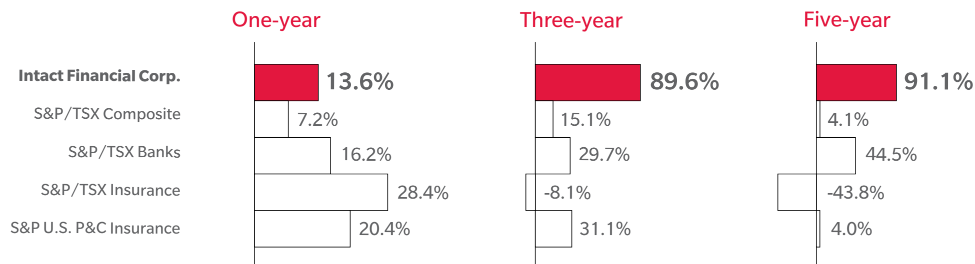
2012 Investment mix
(net of hedging positions, % of fair value)



Fixed income	74%
Common shares	10%
Preferred shares	10%
Cash and short-term notes	3%
Loans	3%

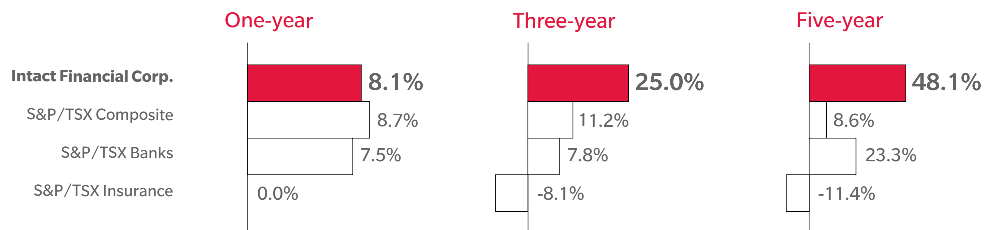
Total return to shareholders (%)

Our five-year total shareholder return (including dividends) of 91.1% was higher than the comparable indices, bolstered by our operating results.



Dividends per share growth (%)

Since becoming a publicly traded company in 2004, we have grown our dividends per share every year, on average by 13.3% annually.



Source: Toronto Stock Exchange, Standard & Poor's

Our people can be proud of their accomplishments this year. By continuing to live our values and hold ourselves to the highest standard, I am confident our journey will be successful.

Charles Brindamour
Chief Executive Officer

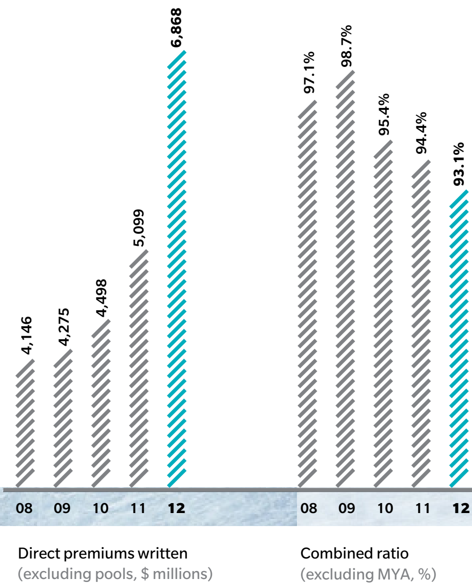
Year in review | 2012 was a remarkable year for the Company in a number of ways. We began the year with the integration of AXA Canada's people, products and processes – the largest acquisition in the history of the Canadian P&C industry. In virtually every aspect of the integration, the outcome was better than planned. Thanks to the tireless efforts of our dedicated employees, we maintained world-class service to our brokers and customers. This resulted in a retention rate similar to what we would expect in a normal year. | The integration progressed swiftly, which enabled us to take advantage of another strategic opportunity: Jevco. The Jevco acquisition broadened our product offering to brokers and customers. The integration has gotten off to a strong start, as we began to renew policies on our platform in November, within weeks of closing. | By broadening our product offering and bringing on board people from both of these organizations, we are embarking on the next phase of our journey in a much stronger strategic and operational position. This bodes well for our development in the months and years to come. | Thanks to these initiatives, in addition to organic growth, we substantially grew our top line by 35% to reach almost $7 billion. Our strategies and action plans also helped improve our combined ratio to 93.1% and increased our net operating income per share by 28%. Our $13 billion investment portfolio generated healthy returns, with $389 million of net investment income. | From a capital perspective, we ended the year with a solid balance sheet despite making significant acquisitions in the past 18 months. We entered 2013 with a solid capital cushion of nearly $600 million and a debt-to-capital ratio slightly below our long-term target. Consistent with our capital management philosophy, we announced a 10% dividend increase earlier this year, marking the eighth consecutive year of dividend increases. | While our strategic and financial progress was significant, we also remained committed to making a meaningful and lasting difference in communities where we operate. In 2012, we contributed $3.5 million to charitable organizations with a focus on addressing the needs of youth at risk and helping communities prepare for climate change. At Intact, we promote employee citizenship by offering financial support and time off to those who aspire to help make a difference.

Well positioned for profitable growth in auto | We reported a 95.7% combined ratio in personal auto in 2012, as elevated losses from catastrophes and less favourable prior year claims development negatively impacted results. However, our underlying loss ratio was unchanged year over year. Effective auto reforms in Ontario, combined with the adoption of fraud prevention measures and prudent reserving actions taken in late 2012, position our personal auto business for profitable growth in the years ahead. Our confidence in

personal auto is bolstered by a 5-point loss ratio advantage versus the industry in Canada last year. | We will strive to further grow our earnings in this segment by leveraging our broad distribution platform. Building on strong relationships with brokers across the country and leveraging our new web solution will be key ingredients of growth at Intact Insurance. Both belairdirect and Grey Power are also poised for growth as they will benefit from two key trends in the Canadian marketplace – the speed at which consumers embrace technology and the changing demographics of the Canadian population.

Achieving sustainability in home insurance | Home insurance results improved 10 points in 2012, in part from an unusually high level of favourable prior year claims development. Despite the improvement, we continue to experience elevated losses from severe weather across the country, with Alberta facing the most severe situation. As such, we remain diligent in our efforts to sustainably improve results. With the industry facing similar challenges, we expect hard market conditions to continue for the foreseeable future. | We are committed to operating our home insurance business at a combined ratio of 95% or better, even if catastrophe losses remain at elevated levels, as observed in recent years. To attain this objective, we are taking actions that will generate gradual benefits over the next 24 to 36 months. These actions include continued tailoring of our offering by type of peril with differentiation in pricing, coverage, claims management initiatives and intensified prevention and loss mitigation incentives. | While these actions will help in the mid-term, we want to make a meaningful long-term contribution as well. Since 2010, we have supported the University of Waterloo's Climate Change Adaptation Project. A comprehensive report was published in the summer of 2012 which outlined 20 practical recommendations that will go a long way to help communities better prepare for the new climate reality.

A transformational year in commercial lines | The acquisition of AXA Canada greatly enhanced our commercial lines offer, which now exhibits a much broader suite of products and industry expertise. The addition of AXA Canada also increased our market presence in commercial insurance by adding



Direct premiums written (excluding pools, $ millions)

Combined ratio (excluding MYA, %)

approximately $1 billion of premiums, resulting in premium growth of 50% in 2012. Importantly, this rapid growth did not come at the expense of profitability, as we reported a full year combined ratio of 88.9%. | Conditions in commercial lines have been quite soft in recent years, though we have been successful in achieving low single-digit rate increases while maintaining retention levels. We now see broader signs of hardening in approximately 25% of the commercial P&C market. With more than a thousand underwriters at Intact across Canada, we believe we are well positioned in the market.

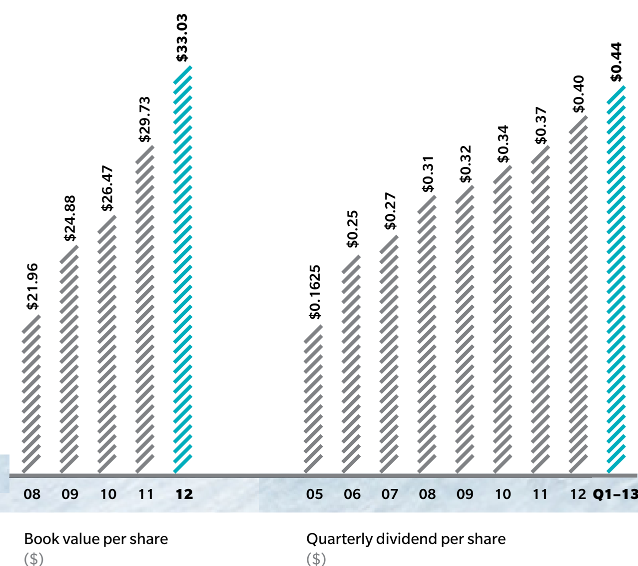
Outlook for 2013 | We do not expect the industry's return on equity ("ROE") to improve materially in the near term from the 10% level reported in 2012, as underwriting improvements will likely be offset by the negative impact of the low-yield environment

on investment income. | Looking specifically at Intact Financial, we believe we will continue to outperform the industry's ROE by at least 500 basis points (our stated objective) in 2013, given our combined ratio advantage, our yield advantage and our capital management flexibility.

Leveraging our organic growth potential | We believe our multi-channel distribution model puts us in a position to prosper from long-term trends that affect our industry, as the model is designed with specific success factors in mind. It keeps the customer at the centre of our business, highlights the strengths of brokers and their ability to offer consumers choice, and allows us to fully leverage the benefits of our scale. We are committed to continually enhancing our customer-driven efforts, an important part of which is the unique experience and choice we offer consumers in how they can shop for our products.

Supporting our broker partners | As entrepreneurs committed to growing their businesses, our broker partners now have an even stronger ally to champion their cause and help their businesses prosper. Our scale and financial stability enable us to support brokers by investing in technology and advertising to help them improve their growth and their productivity. A highlight of 2012 was our success at rolling out our innovative customer web solution, which combines the convenience of buying car insurance online with the support of a broker. Surveys conducted in 2012 illustrate that broker support of Intact is at an all-time high. We are extremely proud of this accomplishment. I want to thank our brokers for their continuous support throughout the integrations, and assure them that we will work to maintain that support in the years ahead.

One team with common values | Our success this past year was due to the combined efforts of our 11,000 employees, a group that I believe represents the best team in the country. It goes without saying that 2012 was another demanding year as they continued to demonstrate our strong customer-driven mindset and provided industry-leading service to our brokers, despite two fast-paced integrations. Our employees truly exemplify our quest for excellence, and I want to thank each and every one of them.



Book value per share ($)

Quarterly dividend per share ($)

The journey forward | Looking ahead, we are excited about our prospects for 2013 and beyond, and believe the importance we place on underwriting results continues to serve us well in the current low interest rate environment. Given the quality of our operations, the flexibility provided by our financial position, and the additions of AXA Canada and Jevco, we firmly believe that we will continue to outperform the industry and strengthen our leadership position. | In closing, I believe 2012 was another extraordinary year for our Company, made possible by the efforts of many parties. I would like to thank our Board of Directors, whose insight and guidance have, once again, helped steer us in the right direction as we continue on our journey. Finally, to our shareholders, thank you for your continued support. We will strive to maintain your confidence and reward it in the years ahead.

Charles Brindamour
Chief Executive Officer

2012 marked another milestone in the implementation of the well honed strategy that your Board of Directors has shaped, as your Company continued on its journey to build a world-class P&C insurer.

Claude Dussault
Chairman of the Board

Despite the tepid growth of the Canadian economy and the industry's profitability challenges, Intact continued to deliver strong financial results as its growth accelerated and its profitability improved. These results affirm the merits of the sound strategic direction pursued by your Company and the significant efforts devoted to ensuring the successful integration of people, products and processes following the AXA Canada and Jevco acquisitions. Your Board has and will continue to spend a lot of time with your executive team reviewing and adapting their strategy as new opportunities and challenges emerge. | Intact has built a reputation for prudent management and for its integrated corporate risk management structure. In 2012, your Board built upon these foundations and adopted a risk appetite statement that clearly identifies the nature and extent of risks that your Company is prepared to assume in its operations and strategies. This statement will provide executives and Directors with a rigorous analytical framework to guide them in their decisions. During the year, your Board also paid special attention to Intact's reinsurance, natural disasters and earthquake insurance plans and programs. | Once again in 2012, your Board identified best practices in terms of governance, and as a result, we became a signatory of the Catalyst Accord and, in early 2013, we decided to create a dedicated risk committee. Moving forward, we will also evaluate the advantages of adopting policies regarding the length of your Directors' tenure and the interrelated or interlocking relationships of your Directors. We also continued to review both executive and Board compensation, expanded on the disclosure of our practices and recommended a shareholder advisory vote on our approach to executive compensation for the third consecutive year. | In the coming weeks, we will bid farewell to two valued Board members, Marcel Côté and Paul Cantor, who will be retiring from your Board in May. Mr. Côté has brought unconventional thinking and a fresh perspective to our discussions, while we all benefited from Mr. Cantor's wise counsel and sound judgement, notably in the governance area. I would like to thank them for their immense contribution; they served you with distinction. | Our track record, since we became a widely held Canadian public company four years ago, is an impressive one. Our numerous accomplishments are a testament to the hard work and dedication of our remarkable team of 11,000 employees, the strength of your executive team and the guidance provided by your Board. Looking ahead, I am confident that our future is full of promise, and your Board will ensure that Intact continues on its journey to build a world-class organization.

Claude Dussault
Chairman of the Board

The Board of Directors assumes responsibility for the *stewardship* of the Company. It is responsible for the supervision of the management of the business and affairs of the Company with the objective of enhancing value for shareholders and with a view to ensuring the long-term viability of the Company.

Yves Brouillette

Audit and Risk Review Committee
CRCG Committee

Mr. Brouillette has deep international and industry experience, having been the CEO of ING Latin America from 2002 to 2005, CEO of Intact Financial from 1993 to 2001 and Chairman from 2003 to 2007. He is a Fellow of the Canadian Institute of Actuaries and a graduate of the Advanced Management Program of Harvard Business School.

Timothy H. Penner

CRCG Committee
Human Resources Committee

Mr. Penner brings extensive marketing and operations management expertise, having spent 33 years with Procter & Gamble, including as President of P&G Canada from 1999 to 2011. He also serves on the Board of the Hospital for Sick Children and the YMCA of Greater Toronto.

Robert W. Crispin

Audit and Risk Review Committee
Investment Committee (Chair)

Before retirement, Mr. Crispin was Chairman and CEO of ING Investment Management Americas, and was responsible for ING Mutual Funds, ING Institutional Markets, and ING Group's insurance operations in Brazil, Chile, and Peru. He was previously Vice Chairman of Travelers Companies and Chief Investment Officer of Lincoln National Corp.

Carol Stephenson

CRCG Committee
Human Resources Committee (Chair)

Ms. Stephenson is currently the Dean of the Richard Ivey School of Business at Western University. She has over 30 years of experience in telecommunications and technology, formerly as CEO of Lucent Technologies Canada. She was appointed an Officer of the Order of Canada in 2009. She is the former Chair of the Government of Canada's Advisory Committee on Senior Level Retention and Compensation.

Claude Dussault

Chairman of the Board

Mr. Dussault was formerly President and CEO of Intact Financial from 2001 through 2007 and has been Chairman since 2008. He is currently President of ACVA Investing Corp., a Fellow of the Canadian Institute of Actuaries, and has completed the Advanced Executive Education Program at the Wharton School of Business.

A Skills Matrix has been developed to ensure that all skills and strengths needed by the Company, its mission, and future development are met by the Board as a whole as they continue to steer us on our journey to build a world-class P&C insurer.

Eileen Mercier
Audit and Risk Review Committee (Chair)
Investment Committee

Ms. Mercier is currently the Chair of the Board of the Ontario Teachers' Pension Plan. She is a professional director with strong strategic and risk management skills built over a career that spans more than 40 years in general management. From 1995 to 2003, she headed her own management consulting firm specializing in financial strategy, restructuring, and corporate governance issues.

Marcel Côté
CRCG Committee (Chair)
Human Resources Committee

Mr. Côté, the founder of Secor Consulting, a consulting firm specializing in business strategy, is now a strategic advisor to KPMG-Secor. In 1989 and 1990, he was Director of Strategic Planning and Communication for the Office of the Prime Minister of Canada. He is also a Fellow of the Center for International Affairs of Harvard University.

Charles Brindamour
Chief Executive Officer
Investment Committee

Mr. Brindamour joined Intact in 1992 as an actuary and held progressive management positions before becoming CEO in 2008. Under his leadership, the Company became an independent and widely held Canadian company in 2009, and in 2011, engineered the acquisition of AXA Canada. He is on the board of the C.D. Howe Institute and is Chair of the Board of the Insurance Bureau of Canada.

Paul Cantor
Human Resources Committee
Investment Committee

Mr. Cantor is Senior Advisor at Bennett Jones LLP, and Board Chair of the Global Risk Institute in Financial Services and of Revera Inc. He held previous positions as the Chair of the Public Sector Pension Investment Board and other senior executive positions in the financial services sector.

Louise Roy
CRCG Committee
Human Resources Committee

Ms. Roy is the first woman to be both Chancellor and Chair of the Université de Montréal. She has strong labour and government relations skills developed over a career that includes roles as President and CEO of the Montreal Urban Community Transport Commission and SVP of International Air Transport Association ("IATA"). She was named an Officer of the National Order of Québec in 2009 and the Order of Canada in 2012.

Stephen Snyder
Audit and Risk Review Committee
CRCG Committee

Mr. Snyder was previously President and CEO of TransAlta Corp., Noma Industries Ltd., GE Canada Inc., and Camco Inc. He is currently a director of the Canadian Stem Cell Foundation, and past Chair of organizations such as the Alberta Secretariat for Action on Homelessness, and the Calgary Committee to End Homelessness. He was awarded the Conference Board of Canada Honorary Associate Award in 2008.

Note: CRCG denotes Conduct Review and Corporate Governance 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.

BECOMING ONE OF CANADA'S BEST EMPLOYERS

Throughout the year, we continued our efforts towards becoming one of the best employers in the country by providing a workplace where our people feel welcome, respected, and appreciated; and where they can contribute their best every day. | And we had many accomplishments in 2012. Despite the incredible challenges of integrating the people, products and processes of AXA Canada and Jevco within the Intact team, our employees also worked hard to ensure that we delivered on our promise to offer an outstanding experience to our customers and the best service to our brokers.

Intact has a long and proud Canadian history; our journey began more than 200 years ago

1809 | After a major fire, a group of Halifax businessmen formed the Halifax Fire Insurance Association, later renamed the Halifax Insurance Company.

1950s | In the late 1950s, Halifax Insurance Company was purchased by Nationale-Nederlanden, one of the largest Dutch insurance companies at the time.

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Our values

We behave with **integrity**.

We **respect** each other.

We are **customer driven**.

We strive for **excellence**.

We are **socially responsible**.

1980s | In the 1980s, we continued to grow as Nationale-Nederlanden acquired three well-known regional insurers – Commerce Group, Belair and Western Union.

2002 | Now operating as ING Canada, we surpassed $3 billion of premiums after acquiring Zurich Canada's home, auto and small and medium-sized business lines, becoming the largest P&C insurance provider in the country.

Their efforts and achievement were recognized by a number of industry affiliates, including World Finance, the Insurance Brokers Association of Ontario and J.D. Power and Associates. Our employees' dedication to our customers and brokers is a reflection of their commitment to the success of our organization. | Throughout 2012, we focused on better managing the performance of our employees and providing them with greater recognition for their achievements. These efforts resulted in a significant

11,000 employees

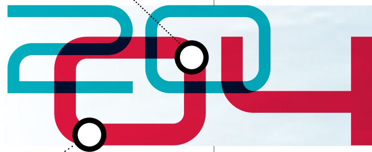
190 actuaries

115 offices

increase in the engagement of our employees as we continue our journey toward becoming one of Canada's best employers. Accomplishing this in a transformative year is something of which we are all very proud. Such results, along with our highest-ever survey response rate, clearly demonstrate that our people are eager to tell us what makes our organization a great place to work, what we can do to make it even better, and that we're headed in the right direction. | Our employees recognize the benefits that can come from working for the largest P&C insurance provider in Canada. There are ample opportunities for employees to grow and to work with innovative tools, systems and strategies. | Although we trust that ours is the best team in the industry, it's not simply about working hard to get to the next level, it's about excellence. "Insurance is about people, not about things," is not just something we say; it's something in which we truly believe. We know that our purpose is to help people and businesses, and that's what we do, day in and day out. We know that how we do it can really make a difference in the lives of our customers. | The values we introduced when we became Intact in 2009 – integrity, respect, excellence, social responsibility and being customer driven – reinforce this understanding and permeate the everyday actions of all of us. These values guide us, allow us to remain disciplined, drive us to contribute our best and ensure that we deliver on our promises. | As we progress through another year, our collective efforts will contribute to our success as a whole, and our team will become even stronger.

WHAT SUSTAINABLE ADVANTAGES HAS INTACT BUILT THUS FAR ON ITS JOURNEY TO BUILD A WORLD-CLASS P&C INSURER?

2004 | We announce the acquisition of Allianz Insurance Company of Canada, including Trafalgar Insurance Company of Canada and Canada Brokerlink. The Allianz acquisition, with its portfolio of personal and small to medium-sized commercial lines business, helps to reinforce our core business position and further expand our national presence. At this point, we insure 1.4 million properties and 2.2 million vehicles in our personal lines segment.



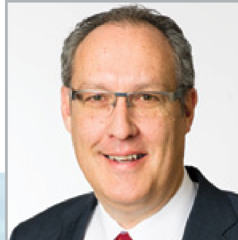
2004 | To help finance the acquisition of Allianz, our former parent, ING Group, decides to sell an initial 30% stake to the public. On December 10, 2004, we begin trading as a publicly listed company on the Toronto Stock Exchange.

Louis Gagnon

President and Chief Operating Officer

Proven consolidator

Intact has a track record of successfully carrying out 12 accretive acquisitions since 1988. Our most recent acquisition, Jevco, has gotten off to a strong start. Through the dedicated efforts of our people, the AXA Canada integration has had better-than-expected customer retention and broker satisfaction. We believe we are well positioned to benefit from continued industry consolidation. Our business development team focuses on finding the right opportunities at the right price, in order to grow strategically important segments through leveraging our core strengths.

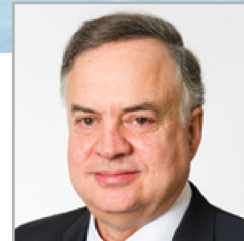


Jean-François Blais

President, Intact Insurance

Broker relationships

We remain committed to ensuring brokers are successful. Our scale and financial stability enable us to support brokers and to invest in technology and advertising to help them improve their growth and their productivity. I am very proud that in 2012 we received our highest score ever in a nationwide survey of 6,000 brokers, as we maintained our world-class service despite the challenge of a large integration. We are honoured to have our suite of products offered at over 2,000 brokerages across Canada, where customers can receive highly personalized, community-based service.



Marc Pontbriand

President, Direct to Consumers Distribution

Strong organic growth potential

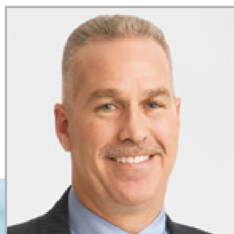
As the largest P&C insurance provider in Canada, we are well positioned to respond to changes in customers' needs. This year, we made dealing with us easier than ever by adding web functionalities across our platforms, and added recreational vehicles to our product offering. For example, at belairdirect, a customer is now able to quote, buy, and track claims online, all from the convenience of a computer or tablet. We see strong organic growth potential in continuing to offer customers the products they want, when and how they want them.

Marc Provost

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

Solid investment returns

The team at Intact Investment Management has consistently delivered solid returns by managing investments conservatively and having the discipline to not reach for returns at the expense of undue risk. Through an unparalleled relationship with senior executives, every aspect of the investment strategy and asset class mandates is custom-made to meet Intact Financial's objectives. We manage the investments on an after-tax basis and hold a predominantly Canadian portfolio where 99% of fixed income is rated 'A' or better.



Lucie Martel

Senior Vice-President and Chief Human Resources Officer

In-house expertise

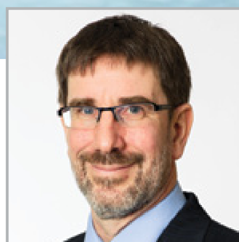
As we move into the second year of the AXA Canada integration, I am particularly pleased with the talent retention and cultural fit between the two organizations. An employee survey conducted in autumn 2012 shows that employee engagement has increased since last surveyed, even after such a large integration. I feel strongly that our people are our greatest strength, and our in-house expertise plays a substantial role in setting us apart from the competition in terms of turnaround time, cost control and customer satisfaction.

Françoise Guénette

Senior Vice-President, Corporate and Legal Services and Secretary

Sound corporate governance

We believe that sound corporate governance and compliance monitoring related to legal and regulatory requirements and best practices are paramount for maintaining the confidence of our various stakeholders, including investors. We have specialized legal resources in-house as well as access to third party legal experts. Reporting directly to the CEO and the Board of Directors and its Committees on matters of compliance, regulatory, legal and litigation issues provides an important element of independent oversight.

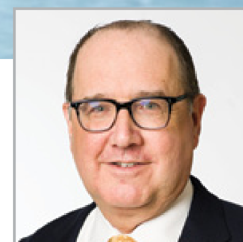


Claude Désilets

Senior Vice-President and Chief Risk Officer

Sophisticated pricing and underwriting discipline

Proactive risk management and strict underwriting discipline are essential for consistent long-term underwriting outperformance, as shown by Intact's three-point outperformance on combined ratio over the past 10 years. Our scale provides us the data to build a world-class pricing model, while prudent reserving practices ensure that we are reflecting changes in the claims environment in a timely manner and mitigating potential losses through a rapid response in education, coverage and pricing.



Mark A. Tullis

Senior Vice-President and Chief Financial Officer

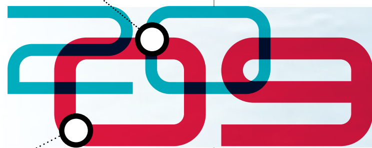
Strong capital base

Our solid balance sheet and conservative capital approach have allowed us to increase dividends each year since our IPO, while also investing in growth opportunities. In fact, our capital position remains solid despite completing two acquisitions in the past 18 months. Our investment mix and the short-tail nature of our business help shield us from capital markets volatility. We are proud that our shareholders have the highest confidence in our financial reporting.

FOUR DISTINCT AVENUES FOR GROWTH

Our journey has various potential avenues, all of which lead to profitable growth.

2009 | ING Group sells its remaining 70% majority ownership to the public. We complete our transformation from a Canadian subsidiary of a Dutch banking and insurance giant into an independent Canadian-listed and widely held company. ING Insurance Company of Canada becomes Intact Insurance Company, and we rebrand the financial holding company Intact Financial Corporation, with over 7,500 employees.



2009 | Our employees continue to show their commitment to making the communities where we live and work safer, healthier and happier places. Together with the Company, we donate more than $1 million to the United Way in the year.

1 FIRMING MARKET CONDITIONS (0–2 YEARS)

PERSONAL LINES

- Build on outperformance in automobile to accelerate growth
- Industry premiums likely to be bolstered by hard market conditions in personal property

COMMERCIAL LINES

- Leverage acquired expertise and products, and our industry outperformance to gain share in a firming environment

2 DEVELOP EXISTING PLATFORMS (0–3 YEARS)

Continue to expand support to our broker partners

Leverage addition of AXA Canada and Jevco products

belairdirect.

GREY POWER

Expand and grow belairdirect and Grey Power

Build a broker offer better able to compete with direct writers

3 CONSOLIDATE CANADIAN MARKET (0–5 YEARS)

CAPITAL

- Solid financial position

STRATEGY

- Grow areas where IFC has a competitive advantage

OPPORTUNITIES

- Canadian P&C industry remains fragmented
- Global capital requirements becoming more stringent
- Continued difficulties in global capital markets

4 EXPAND BEYOND EXISTING MARKETS (0–5+ YEARS)

PRINCIPLE

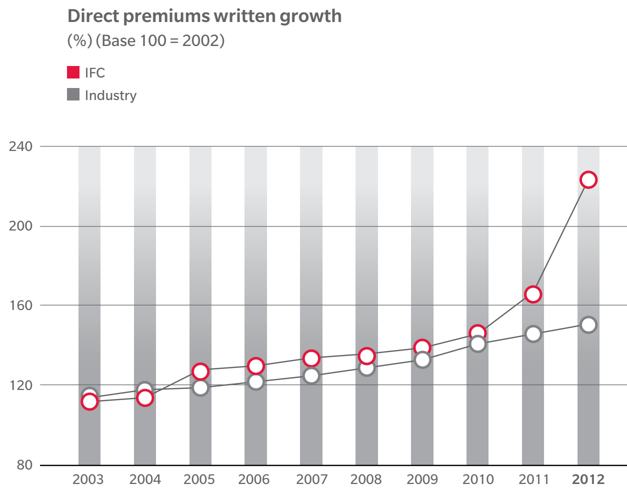
- Build organic growth pipeline with meaningful impact within 5+ years

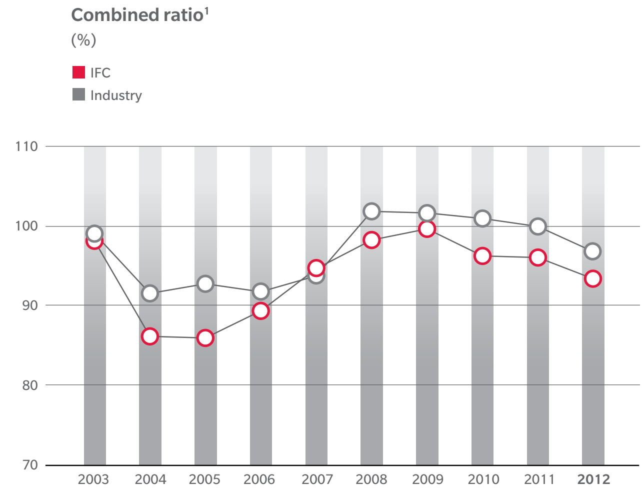
STRATEGY

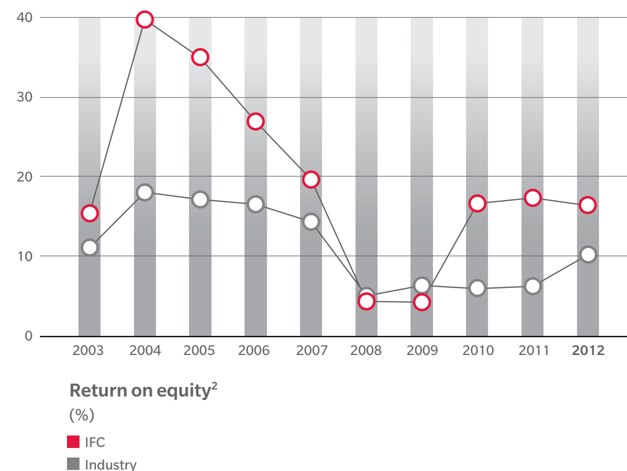
- Enter new market by leveraging our world-class strengths:

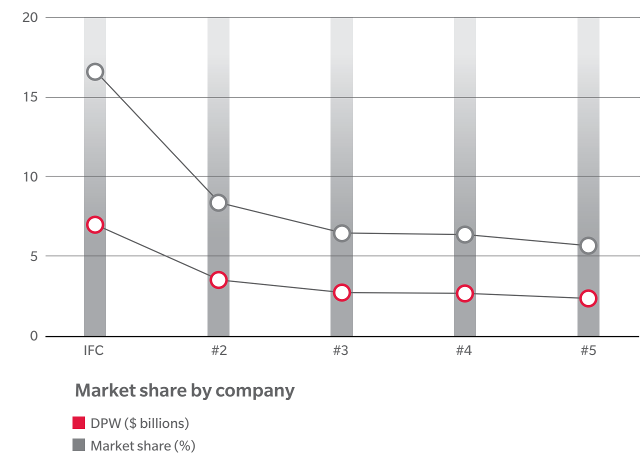
1) pricing and segmentation,
2) claims management, and
3) online expertise

Consistent, industry-leading performance is a hallmark of our journey.









	IFC	Industry benchmark[3]	Outperformance 2012	Outperformance 5-year average[4]
DPW growth	34.3%	2.7%	3,158 bps	881 bps
Combined ratio[1]	93.4%	98.1%	464 bps	537 bps
Return on equity[2]	16.5%	10.3%	618 bps	508 bps

The combination of superior underwriting results and the productive deployment of our capital led to an ROE outperformance of more than 6 percentage points in 2012.

Industry data source: MSA Research excluding Lloyd's, ICBC, SGI, SAF, MPI, Genworth and IFC, as at Dec. 31, 2012.

[1] Combined ratio includes the market yield adjustment ("MYA").

[2] ROEs reflect IFRS beginning in 2010. Since 2011, IFC's ROE is adjusted return on common shareholders' equity ("AROE"), as defined on page 26.

[3] Generally consists of the 20 largest companies, excluding Lloyd's, Genworth, FM Global and IFC.

[4] 5-year period ending Dec. 31, 2012.

Committed to our customers

At BrokerLink, we deliver an excellent customer experience on the phone, online or in person. We make it easy for our customers to connect with us by offering extended calling hours, online chat and our friendly, in-branch local service. | BrokerLink insurance advisors are ready to serve. We use feedback from our customer surveys to build an even better service experience. We're dedicated to providing the right advice, recommending the most appropriate coverage and finding the best value for each customer. |

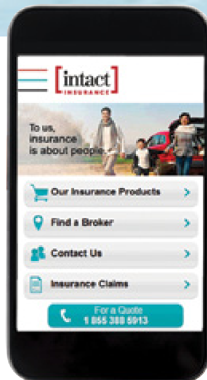
2011 | More than 7,000 people are evacuated from the Northern Alberta region due to the Slave Lake wildfires. We are one of the first insurance companies on the scene to help get our customers back on track. In less than 24 hours, we establish three mobile claims centres and, in less than two weeks, help over 1,000 families, in some cases providing emergency funding.

2011 | We acquire AXA Canada for $2.6 billion, increasing our direct premiums written by $2.0 billion to more than $6.5 billion. This acquisition strengthens our offerings, notably in business insurance. It also improves our capacity to support brokers, expands our distribution platform and deepens the quality of our management team. We employ over 10,000 people in Canada for the first time, and grow our Rely network of auto repair shops to over 600 from 450 in 2004.

BrokerLink is one of the largest P&C insurance brokerages in Canada with over 60 offices and more than 750 employees across Ontario and Alberta – writing more than $550 million in premiums for our 225,000 customers.

Products provided with the advice of a broker conveniently accessible via web, mobile, telephone and in person

Intact Insurance is Canada's largest provider of home, auto and business insurance, chosen by more than four million customers. We focus on what matters most to customers – getting them back on track as quickly as possible after an unexpected event.



Our coast to coast presence and strong relationships with more than 2,000 insurance brokerages mean the company can provide the outstanding service, comfort and continuity customers deserve.

We continue to invest in easy and convenient access to our products by adapting to customers' and consumers' needs. In 2012, our Buy Online platform enabled consumers in Ontario, Québec and Alberta to use the convenience of the web to access car insurance with brokers completely integrated into the process. In addition, we made our website content accessible on mobile devices.

GREY POWER®

Savings for good drivers 50 or over

2012 | Less than a year after announcing the AXA Canada acquisition, we announced the purchase of Jevco Insurance Company, expanding our product suite to include recreational vehicles and commercial specialty lines. We now have over 5 million customers, and insure 2.2 million properties and 3.6 million vehicles in the personal lines segment alone. Over 3,000 claims professionals work to resolve more than 500,000 claims this year. We replace 5,650,000 sq. ft. of flooring in 2012, an area equal to 333 NHL hockey rinks.

[intact] 2012

2012 | At year end, our five-year total shareholder return of 91.1% is significantly ahead of the broader S&P/TSX Composite Index return of 4.1% and the U.S. P&C Insurance Index return of 4.0%.

Grey Power rewards experienced drivers with great value for money and service tailored for Canadians 50 or over. In the last 20 years, we have built a strong brand and emerged as a leader and top choice for this demographic.

WE RECOGNIZE GOOD DRIVERS AND GOOD DRIVERS RECOGNIZE US

"Highest in Customer Satisfaction among Auto Insurers in the Ontario/Atlantic Region"* 2012 J.D. Power and Associates

| Grey Power is highly customer driven and believes in providing friendly, expert advice both online and by phone. In 2012, Grey Power was awarded "Highest in Customer Satisfaction among Auto Insurers in the Ontario/Atlantic Region" by J.D. Power and Associates. | Convenience is key to our customers and their busy lifestyles. We continue to build a stronger online presence. With simple navigation and rich content, customers have ready access to the information required to make sound insurance decisions. This, coupled with extended hours in the call centre, puts customers in the driver's seat when it comes to deciding when and how they buy insurance.

belairdirect.

Keeping it simple to better serve our customers

For nearly 60 years now, belairdirect has been devising comprehensive and innovative home and auto insurance solutions to meet the specific needs of Canadians. Today, belairdirect has even more to offer: personalized services provided any time, with auto insurance quotes available online, by mobile phone, electronic tablet or telephone, and even in person at our local branches. To give customers greater control and make their insurance experience more convenient, they can purchase a car insurance policy online, manage their own file and follow up on their claims, all the while chatting with a representative, should they so desire. | Recently, belairdirect added an easy-to-use online home insurance quote to its wide range of services. And with a new website in the works, as well as a new approach to online auto insurance transactions, the Company is positioning itself as a world-class direct insurer. | 2012 was a winning year for belairdirect, ranking "Highest in Customer Satisfaction among Home Insurers in the Ontario/Atlantic region," according to J.D. Power and Associates.

WE ARE ON THE JOURNEY WITH OUR CUSTOMERS EVERY STEP OF THE WAY

2013–15 | Outperforming from an ROE perspective is important to outgrow the industry over time – our objective is to beat the industry's ROE by at least 5 points every year. We outperformed by an average of 9 points over the past three years and 6 points in 2012. | Over the next three years, we expect our outperformance to come from pricing and segmentation, claims management, and investments and capital management. We also intend to reinvest in improving our customers' experience.

2013–15 | We also have an objective to grow our net operating income per share ("NOIPS") by 10% per year over time. We believe this is the best way to express our growth ambition. NOIPS growth averaged 29% over the past three years and was 28% in 2012. | Over the next three years, we expect annual growth in NOIPS to come from organic growth, margin improvement and capital management/deployment.

"I have talked to many of the thousands of flooded people and many with other companies are upset/not happy with their companies – all with Intact had very positive comments."

– Bernard K., Thunder Bay, ON

"So very pleased with the workers – always easy to deal with. Thank you."

– Marlene B., Thunder Bay, ON

From offering the insurance products customers want, when and how they want them, to answering over two million claims calls within seconds, any time of day, 365 days a year, we aim to keep things quick and easy for the customer every step of the way. | At Intact, we recognize that customers are diverse individuals, and we strive to deliver a tailored product, in a manner that is most convenient to them. For those who prefer the guidance of a broker, we are available through a network of over 2,000 brokerages, coast to coast, including our own BrokerLink with more than 700 employees. New in 2012, customers are now able to quickly obtain an auto quote and purchase insurance online, with the option to connect with a broker at any point. Furthermore, in listening to our customers' needs, we broadened our product offering this past year to include recreational vehicles such as motorcycles and ATVs, while continuing to grow and fine tune our direct channel products. We continue to recognize experienced drivers with good driving records through Grey Power, while belairdirect now provides customers with nearly the full experience,

"I have nothing but good things to say about Intact Insurance and the members of the Rely Network. I did not have to wait long; that afternoon, a contractor came to the house to temporarily stop the leak and prevent any further damage."

– Pierre S., Dollard-des-Ormeaux, QC

"In my opinion she has gone far above and beyond what I expected from an insurance claim agent."

– Melanie C., Calgary, AB

from quote to claim, from the convenience of a laptop or tablet. | Last year, over five million Canadians chose to renew their policies with us. We now insure one in six cars and over 1.7 million homes in Canada. With that comes the responsibility to continue our commitment to put customers first and get them

~500,000 claims resolved

3,000 claims professionals

2 million+ calls answered

back on track after an adverse event. We believe what makes us unique is our speed of response, unparalleled customer service and local presence coast to coast. | By picking up the phone in seconds and handling almost all claims in-house, we can provide a seamless experience while mitigating damages and helping customers recover promptly. Working jointly with providers selected individually based on their own merits, we are able to maintain a service that goes beyond expectations, even when Mother Nature unleashes tremendous stress on the operation. | In mid-August, the city of Calgary suffered a hailstorm that impacted thousands of customers. An after-hours call centre went to work the same day, and within a week, we had set up a 50,000 sq. ft. auto facility to assess damages, remove dents and provide rentals on site. | In late May, the city of Thunder Bay declared a state of emergency after a rainstorm unleashed 91 millimetres of rain, flooding the city's sewage facility and impacting over 1,000 customers. Within 24 hours, additional staff was mobilized, bringing over 20 additional field adjusters and 100 contracting crews to the local community. We were the only insurance company to set up a drive-in centre right in town. | These are some of the many ways we commit to getting customers back on track and back to their normal lives. It is a commitment on which we can deliver through our coast to coast presence, the quality control possible through in-house expertise and our interconnectivity in terms of telephony and technology. When we asked our customers how satisfied they were and whether they would recommend us to their friends and family after a claim, we were pleased to hear that we are rated among the best in North America. We strive to do even better each year and, to this end, are investing in modernizing our claims technology to increase efficiencies, and reduce fraud and abuse in the system, which costs customers and insurers alike.

Our commitment to helping people goes beyond our promise to provide an outstanding experience to consumers who choose to place their trust and confidence in us.

Our commitment extends to helping build strong and resilient communities where we live and work. | Throughout the year, we continued to strengthen, intensify and deepen our philanthropic giving and social responsibility endeavours as we supported more than 200 charitable organizations across the country and helped deliver two significant initiatives aimed at helping Canadians adapt to climate change and source solutions to youth homelessness.

Fostering safe and vibrant communities |

The impact of youth homelessness is widespread and it extends well beyond the 65,000 Canadian youth who do not have a place to call home; it affects us all – socially and economically. As a result, it is imperative to find sustainable solutions to help enable homeless youth to become active, independent and contributing members of society. | That's why we're focused on helping alleviate youth homelessness and encouraging independence and strength-of-mind among at-risk youth in Canada. We believe that every youth deserves a safe, adequate and affordable place that they can call home and the hope, encouragement and opportunity to develop to their full potential. |

We actively participate in Raising the Roof's Youthworks initiative by providing employment opportunities to at-risk youth and by sharing the successes and lessons from our experience. Released in November 2012, Raising the Roof's comprehensive report records the experiences of business, agencies and youth in a series of interviews and a national roundtable discussion. It focuses on understanding how to motivate and support Canadian business to provide innovative employment, mentorship and skills training opportunities to disadvantaged youth. Along with the report, Raising the Roof launched resources to help prospective employers and community agencies give disadvantaged youth opportunities in today's workforce. In 2012, approximately 500 of our employees also participated in Raising the Roof's Toque Campaign to help raise awareness about youth homelessness and funding for local shelters. |

In 2012, we continued to support and expand the network of shelters and community agencies in large urban centres across Canada that provide homeless youth with a place to stay, counselling and vocational support. For example, we helped the YMCA of Greater Toronto extend their services, increase the number of staff and offer youth transition programs at one of their shelters and drop-in centres.

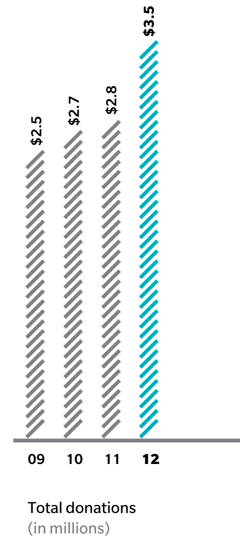
Adapting to changing weather patterns

Climate change is one of the most significant issues facing Canadian society today. As the largest provider of property and casualty insurance in Canada, we know that climate change is a reality as we witness the impact of rising temperatures, heavier precipitation and more frequent and severe storms firsthand. Extreme weather leaves behind an emotional and economic burden on communities and society at large. In 2012 alone, we witnessed Mother Nature's fury with rainstorms in Montreal and Thunder Bay and hailstorms in Calgary and Ottawa. The frequency and severity of these events remind us that our environment is vulnerable and Canadian society must adapt to climate change. That's why we have been collaborating with the University of Waterloo on the Climate Change Adaptation Project, an initiative designed to identify and operationalize practical, meaningful and cost-effective adaptation solutions to the most challenging impacts of climate change facing Canada. Working with a diverse and distinguished community of Canadian climate change experts, the project's team identified the most vulnerable areas where adaptive solutions to climate change are most urgently required. These include: city infrastructure, biodiversity, freshwater resources, Aboriginal communities and agriculture.

In June 2012, Intact and the University of Waterloo released Canada's most comprehensive roadmap for climate change adaptation in Canada, which outlined 20 practical and cost-effective recommendations that can be implemented on a priority basis in the short term. We believe that this roadmap is an opportunity for Canada to implement effective climate change adaptation solutions that will build strong and resilient communities for generations to come. The acquisitions of AXA Canada and Jevco and the integration of more than 2,000 people are providing us with the opportunity to move to modern buildings and improve our existing facilities. During the year, our employees in Mississauga moved to a Leadership in Energy and Environmental Design-designated office and, later this year, our people in Halifax and Québec City will be moving to new, modern offices and we will be renovating and improving the energy efficiency of our 2020 University St., Montreal office. A number of our facilities are also making improvements by

installing more efficient heating and cooling systems and water saving mechanisms. We also encourage our environmentally minded people to come together in green teams to help promote sustainability in their workplace and inspire colleagues to make sound environmental choices.

Encouraging the involvement and citizenship of our people | We encourage and support the charitable initiatives and involvement of our employees in their communities by providing financial support and time off through our community and volunteer matching gift programs, our Team Volunteer Day and our annual United Way campaign. | During 2012, more than 800 of our employees participated in our donation and volunteer matching gift programs that can provide up to $1,000 per employee to charitable organizations. Furthermore, more than 1,300 of our people participated in our Team Volunteer Day program and spent close to 11,000 hours helping the non-profit organization of their choice deliver their services. | We also recognize the important role that social agencies play in their respective communities. That's why we support the United Way as they identify and tackle the root causes of social issues for the betterment of our communities. In 2012, our people generously increased their United Way contributions to approximately $920,000, and we enthusiastically matched their donations, bringing our collective giving to the campaign to more than $1.8 million.



Total donations
(in millions)

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 people in their citizenship endeavours, encouraging climate change adaptation and fostering vibrant and resilient communities for all of our stakeholders.

Intact Financial Corporation
Management's Discussion and Analysis

For the year ended December 31, 2012 (in millions of dollars, except as otherwise noted)

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February 5, 2013

The following MD&A is the responsibility of management and has been reviewed and approved by the Board of Directors for the year ended December 31, 2012. This MD&A is intended to enable the reader to assess our results of operations and financial condition for the three- and twelve-month periods ended December 31, 2012, compared to the corresponding periods in 2011. It should be read in conjunction with our audited Consolidated financial statements for our fiscal year ended December 31, 2012. All amounts herein are expressed in Canadian dollars.

We use both IFRS and non-IFRS measures to assess performance. Non-IFRS measures do not have any standardized meaning prescribed by IFRS and are unlikely to be comparable to any similar measures presented by other companies. See Section 16 – *Non-IFRS financial measures* for the definition and reconciliation to the most comparable IFRS measures. Management analyzes performance based on underwriting ratios such as combined, expense, loss and claims ratios, as well as other performance measures such as AEPS, NOIPS, ROE, AROE, OROE, MCT and debt-to-capital ratio. These measures and other insurance-related terms used in this MD&A are defined in the glossary available in the "Investor Relations" section of our web site at www.intactfc.com. Further 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. Our actual results could differ materially from these forward looking statements as a result of various factors, including those discussed hereafter or in our 2012 Annual Information Form. Please read the cautionary note in Section 17 – *Cautionary note regarding forward-looking statements*.

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 or not meaningful, or if the percentage change exceeds 1,000%. "Intact", the "Company", "IFC", "we" and "our" are terms used throughout the document to refer to Intact Financial Corporation and its subsidiaries.

Important notes:

- All references to DPW in this MD&A exclude industry pools, unless otherwise noted.
- All underwriting results and related ratios exclude the MYA, but include our share of the results of jointly held insurance operations, unless otherwise noted.
- Net investment income includes our share of the results of jointly held insurance operations, unless otherwise noted.
- Catastrophe claims are any one claim, or group of claims, equal to or greater than $7.5 million ($5 million in 2011), related to a single event.
- All references to "excess capital" in this MD&A include excess capital in the P&C subsidiaries at 170% MCT plus net liquid assets of the non-regulated entities, unless otherwise noted.

Glossary of abbreviations

This MD&A contains abbreviations which are defined as follows:

Abbreviation	Definition
AEPS	Adjusted EPS
AFS	Available-for-sale
AMF	Autorité des marchés financiers
AOCI	Accumulated OCI
AROE	Adjusted ROE
DBRS	Dominion Bond Rating Services
DPW	Direct premiums written
EPS	Earnings per share to common shareholders
FSCO	Financial Services Commission of Ontario
FVTPL	Fair value through profit and loss
IASB	International Accounting Standards Board
IBNR	Incurred but not reported
IFRS	International Financial Reporting Standards
IRR	Internal rate of return
KPI	Key performance indicators
MCT	Minimum capital test
MD&A	Management's Discussion and Analysis
MYA	Market yield adjustment
NCIB	Normal course issuer bid
NOI	Net operating income
NOIPS	NOI per share
OCI	Other comprehensive income
OROE	Operating ROE
OSFI	Office of the Superintendent of Financial Institutions
P&C	Property and casualty
PfAD	Provision for adverse deviation
ROE	Return on equity
S&P	Standard & Poor's
U.S.	United States

SECTION 1 – Profile

1.1 Overview

We are the largest provider of P&C insurance in Canada with $6.9 billion in DPW and an estimated market share of 17%. We insure more than five million individuals and businesses through our insurance subsidiaries and are the largest private sector provider of P&C insurance in British Columbia, Alberta, Ontario, Québec and Nova Scotia. We distribute insurance under the Intact Insurance brand through a wide network of brokers and our wholly owned subsidiary, BrokerLink, while non-standard auto insurance in Ontario is distributed under the Jevco brand. We also distribute insurance directly to consumers through belairdirect and Grey Power. We internally manage our investments totalling approximately $13.0 billion.

SECTION 2 – Key performance indicators

Our most relevant KPI are defined in the tables below. NOI, NOIPS, AROE, OROE and AEPS are considered non-IFRS financial measures. See Section 16 – *Non-IFRS financial measures* for the reconciliation to the most comparable IFRS measures.

Growth indicators

DPW growth	Total amount of premiums written during a specified period compared to the same period last year (in percentage).
Written insured risks growth	Number of vehicles in automobile insurance, number of premises in personal property insurance and number of policies in commercial insurance (excluding commercial auto insurance) compared to the same period last year (in percentage).

Profitability indicators

NOI	As detailed in Table 2 – *Components of NOI*.
NOIPS	NOI for a specific period less preferred share dividends, divided by the weighted-average number of common shares outstanding during the same period.
ROE	Net income for a 12-month period less preferred share dividends, divided by the average shareholders' equity (excluding preferred shares) over the same 12-month period. Net income and shareholders' equity are determined in accordance with IFRS. The average shareholders' equity is the mean of shareholders' equity at the beginning and the end of the period, adjusted for significant capital transactions, if appropriate.
AROE	Net income from continuing operations for a 12-month period less preferred share dividends, plus the after-tax impact of amortization of intangible assets recognized in business combinations, integration and restructuring costs and change in fair value of contingent consideration, divided by the average shareholders' equity (excluding preferred shares) over the same 12-month period. Net income from continuing operations and shareholders' equity are determined in accordance with IFRS. The average shareholders' equity is the mean of shareholders' equity at the beginning and end of the period, adjusted for significant capital transactions, if appropriate.
OROE	NOI for the last 12 months divided by the average shareholders' equity (excluding preferred shares and AOCI) 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, adjusted for significant capital transactions, if appropriate.
EPS	As reported in the audited Consolidated statements of comprehensive income.
AEPS	Net income from continuing operations for a specific period less preferred share dividends plus the after-tax impact of amortization of intangible assets recognized in business combinations, integration and restructuring costs and change in fair value of contingent consideration, divided by the weighted-average number of common shares outstanding during the same period.
IRR	The rate of return expected to be produced on the shareholders' capital deployed over the life of a project or acquisition.

Performance and execution indicators

Claims ratio	Claims incurred, net of reinsurance, during a specific period and expressed as a percentage of net premiums earned for the same period.
Expense ratio	Underwriting expenses including commissions, premium taxes and general expenses incurred in connection with underwriting activities during a specific 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% indicates a profitable underwriting result. A combined ratio over 100% indicates an unprofitable underwriting result.

Financial strength indicators

Book value per share	Shareholders' equity (excluding preferred shares) divided by the number of common shares outstanding at the same date. Shareholders' equity is determined in accordance with IFRS.
MCT	Minimum capital test, as defined by OSFI and AMF.
Debt-to-capital ratio	Total debt outstanding divided by the sum of total shareholders' equity and total debt outstanding, at the same date.

Incentive compensation is based on the comparison of results for DPW growth, combined ratio, NOIPS and AROE as defined above, against those of our Canadian P&C insurance industry benchmark. See Section 6 – *Business developments and operating environment* for more details on our performance versus the industry.

SECTION 3 – Overview of our consolidated performance

3.1 Fourth quarter highlights

- Net operating income per share up 25% to $1.42, reflecting a combined ratio of 92.1%
- Premium growth of 7%, bolstered by the addition of Jevco
- Operating ROE of 16.8%, with an 11% increase in book value per share in 2012
- Quarterly dividend raised 10% to $0.44 per share
- AXA Canada and Jevco integrations on track

3.2 Consolidated financial results

TABLE 1 – FINANCIAL HIGHLIGHTS

	Q4-2012	Q4-2011	Change	2012	2011	Change
Selected highlights						
DPW	1,690	1,576	7%	6,868	5,099	35%
Underwriting income (Table 4)	138	118	17%	451	273	65%
Combined ratio	92.1%	92.7%	(0.6) pts	93.1%	94.4%	(1.3) pts
Net investment income (Table 9)	102	103	(1)%	389	326	19%
Integration and restructuring costs	29	42	(31)%	108	71	52%
Change in fair value of contingent consideration	–	41	(100)%	11	41	(73)%
Finance costs	16	15	7%	60	41	46%
Income before income taxes (Table 10)	228	116	97%	734	594	24%
Income taxes	47	40	18%	147	137	7%
Effective income tax rate	20.6%	34.5%	(13.9) pts	20.0%	23.1%	(3.1) pts
Net income from continuing operations	181	76	138%	587	457	28%
Net income from discontinued operations	–	8	(100)%	–	8	(100)%
Net income attributable to shareholders	181	84	115%	587	465	26%
Preferred share dividends	(5)	(5)	–	(21)	(8)	163%
Net income attributable to common shareholders	176	79	123%	566	457	24%
EPS, basic and diluted (in dollars)	1.32	0.62	113%	4.33	3.96	9%
AEPS, basic and diluted (in dollars)[1]	1.51	1.14	32%	5.15	4.82	7%
NOI (Table 2)[1]	194	152	28%	675	460	47%
NOIPS, basic and diluted (in dollars)[1]	1.42	1.14	25%	5.00	3.91	28%
ROE for the last 12 months[2]	13.8%	14.3%	(0.5) pts			
AROE for the last 12 months[1,2]	16.5%	17.4%	(0.9) pts			
OROE for the last 12 months[1,2]	16.8%	15.3%	1.5 pts			
Book value per share (in dollars)	33.03	29.73	11%			

[1] Refer to Section 16 – *Non-IFRS financial measures*.

[2] In 2012, the average shareholders' equity calculation was adjusted on a pro rata basis to account for the $229 million of common shares issued as at September 4, 2012 (2011 calculation was adjusted for the $921 million issued as at September 23, 2011).

Fourth quarter 2012

We reported a 92.1% combined ratio in Q4-2012, representing a 0.6 point improvement versus Q4-2011. A number of positive elements bolstered the results, including a high level of favourable prior year claims development, a low amount of catastrophe losses and benign weather. Offsetting these positives were an elevated level of large losses in commercial P&C and the impact of our actions taken to protect against early signs of deterioration in bodily injury claims in Alberta and uncertainty in Ontario. Although there were large year-over-year movements in the reported results of our personal lines businesses, overall we believe the 92.1% combined ratio is indicative of our underlying performance in the quarter.

Net investment income of $102 million in the fourth quarter was relatively flat from a year ago, as additional investments obtained from the Jevco Insurance Company ("Jevco") acquisition were offset by declining yields. The market-based yield of 3.6% was down from 3.9% in Q4-2011. Investments amounted to $13.0 billion, up $1.1 billion from one year ago.

DPW growth of 7% reflects the addition of Jevco and low single-digit organic growth, driven by our direct businesses. As we remain in the early stages of the integration, growth in the quarter was not impacted by any loss of premiums from re-underwriting the Jevco business.

We ended Q4-2012 in a solid financial position, with an estimated MCT of 205%, $599 million in excess capital, and book value per share of $33.03, 11% higher than a year ago. Our debt-to-capital ratio at the end of the year was 18.9%, below our internal target level of 20%. We reported an operating ROE of 16.8% for 2012, slightly above our adjusted ROE of 16.5%.

Full year 2012

DPW growth of 35% in 2012 reflects the additions of AXA Canada Inc. ("AXA Canada") and four months of Jevco. Underwriting income increased $178 million in 2012, with a combined ratio of 93.1%, compared to 94.4% in 2011. The increase in underwriting income reflects the addition of AXA Canada and was the result of improved current year results and higher favourable prior year claims development, which more than offset higher catastrophe losses. The underlying current year loss ratio (excluding the impact of catastrophes and prior year claims development) improved 0.6 points versus 2011. Overall, three of our four lines of business reported improved underwriting results – the exception was personal auto, which recorded a combined ratio of 95.7%, less strong than the 90.9% in 2011.

Net investment income of $389 million in 2012 was up 19% from a year ago as a result of the additional investments obtained as part of the AXA Canada and Jevco acquisitions, partially offset by declining yields.

The increase in underwriting income combined with higher investment income more than offset the $68 million decline in net investment gains excluding FVTPL fixed-income securities, resulting in adjusted EPS of $5.15 in 2012, 7% higher than last year.

SECTION 4 – Operating results

4.1 Net operating income

The details of NOI and related indicators are as follows:

TABLE 2 – COMPONENTS OF NOI

	Q4-2012	Q4-2011	Change	2012	2011	Change
Underwriting income (Table 4)	**138**	118	17%	**451**	273	65%
Net investment income (Table 9)	**102**	103	(1)%	**389**	326	19%
Other income (expense), net[1]	**6**	(11)	(155)%	**14**	(3)	(567)%
Pre-tax operating income (Table 3)	**246**	210	17%	**854**	596	43%
Tax impact	**(52)**	(58)	(10)%	**(179)**	(136)	32%
NOI[2]	**194**	152	28%	**675**	460	47%
Preferred share dividends	**(5)**	(5)	–	**(21)**	(8)	163%
NOI to common shareholders	**189**	147	29%	**654**	452	45%
Weighted-average number of common shares (in millions)	**133.3**	129.6	3.7	**130.8**	115.3	15.5
NOIPS, basic and diluted (in dollars)[2]	**1.42**	1.14	25%	**5.00**	3.91	28%

[1] Includes corporate expenses and distribution results.
[2] Refer to Section 16 – *Non-IFRS financial measures*.

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

TABLE 3 – CHANGES IN PRE-TAX OPERATING INCOME (YEAR-OVER-YEAR)

	Q4-2012	2012
Pre-tax operating income, as reported in 2011[1]	210	596
Changes in underwriting income:		
Change in favourable prior year claims development	47	149
Other changes in underwriting income	(43)	66
Change in catastrophe losses	16	(37)
Total change in underwriting income	20	178
Change in net investment income	(1)	63
Change in other income, net	17	17
Total change in pre-tax operating income	36	258
Pre-tax operating income, as reported in 2012[1]	246	854

[1] Refer to Section 16 – *Non-IFRS financial measures*.

4.2 Underwriting results

TABLE 4 – COMPONENTS OF UNDERWRITING RESULTS

	Q4-2012	Q4-2011	Change	2012	2011	Change
Net premiums earned	1,742	1,616	8%	6,571	4,880	35%
Net claims:						
Current year claims (excluding catastrophes)	1,121	1,009	11%	4,179	3,133	33%
Current year loss ratio	*64.4%*	*62.5%*	*1.9 pts*	*63.6%*	*64.2%*	*(0.6) pts*
Current year catastrophes	16	32	(50)%	245	208	18%
Favourable prior year claims development	(85)	(38)	124%	(372)	(223)	67%
Total net claims	1,052	1,003	5%	4,052	3,118	30%
Claims ratio	*60.4%*	*62.0%*	*(1.6) pts*	*61.6%*	*63.9%*	*(2.3) pts*
Commissions, premium taxes, general expenses	552	495	12%	2,068	1,489	39%
Expense ratio	*31.7%*	*30.7%*	*1.0 pts*	*31.5%*	*30.5%*	*1.0 pts*
Net underwriting income	138	118	17%	451	273	65%
Combined ratio	*92.1%*	*92.7%*	*(0.6) pts*	*93.1%*	*94.4%*	*(1.3) pts*

Fourth quarter 2012

Underwriting income of $138 million in Q4-2012 was up 17% from Q4-2011. A $47 million increase in favourable prior year claims development and a $16 million reduction in catastrophe losses more than offset the 1.9 point increase in the current year loss ratio due to an elevated level of large losses in commercial P&C.

Favourable prior year claims development, at 5.2% of opening reserves on an annualized basis, was above the 2.8% recorded in Q4-2011 and our historical level of 3%–4%. The favourable development, amounting to $85 million, was composed of $60 million in commercial P&C, $43 million in personal property and $11 million in commercial auto, partially offset by unfavourable development of $29 million in our personal auto line of business.

The expense ratio increased by one point in the fourth quarter versus Q4-2011, driven by increased variable commissions resulting from improved profitability.

Full year 2012

Underwriting income of $451 million in 2012 was up $178 million from 2011, largely reflecting the addition of AXA Canada. The improvement was due to a 0.6 point reduction in the current year loss ratio and a $149 million increase in favourable prior year claims development, partially offset by a $37 million increase in catastrophe losses.

Favourable prior year claims development, at 5.7% of opening reserves on an annualized basis, was above the 4.9% recorded in 2011 and our historical level.

The expense ratio was one point higher in 2012 versus 2011, as higher commissions related to the shift in our business mix following the acquisition of AXA Canada and increased variable commissions resulting from improved profitability more than offset improvements in the general expense ratio, driven by synergies.

4.3 Underwriting results by lines of business – personal lines

TABLE 5 – UNDERWRITING RESULTS FOR PERSONAL LINES

	Q4-2012	Q4-2011	Change	2012	2011	Change
DPW						
Automobile	722	664	9%	3,093	2,419	28%
Property	375	363	3%	1,562	1,208	29%
Total	1,097	1,027	7%	4,655	3,627	28%
Written insured risks (in thousands)[1]						
Automobile	783	778	1%	3,584	2,723	32%
Property	527	522	1%	2,225	1,742	28%
Total	1,310	1,300	1%	5,809	4,465	30%
Net premiums earned						
Automobile	825	754	9%	3,077	2,406	28%
Property	377	364	4%	1,462	1,129	29%
Total	1,202	1,118	8%	4,539	3,535	28%
Underwriting income (loss)						
Automobile	(25)	52	(148)%	132	219	(40)%
Property	124	41	202%	94	(40)	(335)%
Total	99	93	6%	226	179	26%

[1] Written insured risks do not include Jevco.

TABLE 6 – UNDERWRITING RATIOS FOR PERSONAL LINES

	Q4-2012	Q4-2011	Change	2012	2011	Change
Personal auto						
Claims ratio	77.4%	68.2%	9.2 pts	70.0%	65.8%	4.2 pts
Expense ratio	25.7%	25.1%	0.6 pts	25.7%	25.1%	0.6 pts
Combined ratio	103.1%	93.3%	9.8 pts	95.7%	90.9%	4.8 pts
Personal property						
Claims ratio	31.7%	53.6%	(21.9) pts	57.8%	68.4%	(10.6) pts
Expense ratio	35.4%	35.0%	0.4 pts	35.7%	35.1%	0.6 pts
Combined ratio	67.1%	88.6%	(21.5) pts	93.5%	103.5%	(10.0) pts
Personal lines – total						
Claims ratio	63.0%	63.4%	(0.4) pts	66.1%	66.6%	(0.5) pts
Expense ratio	28.8%	28.3%	0.5 pts	28.9%	28.4%	0.5 pts
Combined ratio	91.8%	91.7%	0.1 pts	95.0%	95.0%	0.0 pts

Fourth quarter 2012

DPW growth in personal auto was 9% year-over-year in Q4-2012, reflecting the addition of Jevco and low single-digit organic growth, primarily from our direct businesses. The combined ratio of 103.1% was 9.8 points weaker than last year's solid 93.3%, largely due to $29 million of unfavourable prior year claims development, versus $27 million of favourable development in Q4-2011. This quarter's unfavourable development resulted from our actions taken to protect against early signs of deterioration in bodily injury claims in Alberta and uncertainty in Ontario (see Section 6.5 – *Personal auto environment* for further details). Some of the actions impacted the 2012 accident year, resulting in a 2.9 point year-over-year increase in the underlying current year loss ratio (excluding catastrophes and prior year claims development).

DPW growth in personal property was 3% year-over-year in Q4-2012, driven by higher rates. The Q4-2012 combined ratio of 67.1% was 21.5 points better than last year's very strong 88.6%. This exceptionally strong performance was the result of an unusually high level of favourable prior year claims development, our continued actions to improve profitability and benign weather. A portion of the favourable development relates to the resolution of certain files that we consider "one-time" in nature, which improved the combined ratio by approximately 6 points. Excluding catastrophes and prior year development, the underlying current year loss ratio improved 5.8 points from last year.

Full year 2012

Personal auto underwriting results deteriorated 4.8 points versus last year's 90.9%, driven by higher catastrophe losses from a severe August hail storm in Calgary, and a lower level of favourable prior year claims development, particularly in the fourth quarter. Excluding catastrophes and prior year claims development, the underlying current year loss ratio was unchanged from 2011. DPW increased 28% from 2011, reflecting the additions of AXA Canada and four months of Jevco.

Underwriting results in personal property improved a substantial 10 points to 93.5% in 2012, aided by higher favourable prior year claims development, benign weather in the first and fourth quarters of the year and continued actions to improve profitability. Catastrophe losses for the year, while higher than historical levels, were not substantially different from 2011. We are committed to achieving a combined ratio of 95% or better in this line of business, even if losses from catastrophes remain elevated. Excluding catastrophes and prior year claims development, the underlying loss ratio improved 4.4 points versus 2011. DPW increased 29% from 2011, reflecting the addition of AXA Canada.

4.4 Underwriting results by lines of business – commercial lines

TABLE 7 – UNDERWRITING RESULTS FOR COMMERCIAL LINES

	Q4-2012	Q4-2011	Change	2012	2011	Change
DPW						
Automobile	**146**	130	12%	**552**	396	39%
P&C	**447**	419	7%	**1,661**	1,076	54%
Total	**593**	549	8%	**2,213**	1,472	50%
Written insured risks (in thousands)[1]						
Automobile	**120**	101	19%	**477**	325	47%
P&C	**113**	107	6%	**443**	294	51%
Total	**233**	208	12%	**920**	619	49%
Net premiums earned						
Automobile	**146**	130	12%	**536**	384	40%
P&C	**394**	368	7%	**1,496**	961	56%
Total	**540**	498	8%	**2,032**	1,345	51%
Underwriting income						
Automobile	**23**	10	130%	**99**	52	90%
P&C	**16**	15	7%	**126**	42	200%
Total	**39**	25	56%	**225**	94	139%

[1] Written insured risks do not include Jevco.

TABLE 8 – UNDERWRITING RATIOS FOR COMMERCIAL LINES

	Q4-2012	Q4-2011	Change	2012	2011	Change
Commercial auto						
Claims ratio	**54.7%**	63.2%	(8.5) pts	**51.6%**	56.7%	(5.1) pts
Expense ratio	**29.5%**	29.8%	(0.3) pts	**29.9%**	29.8%	0.1 pts
Combined ratio	**84.2%**	93.0%	(8.8) pts	**81.5%**	86.5%	(5.0) pts
Commercial P&C						
Claims ratio	**54.4%**	57.5%	(3.1) pts	**51.9%**	56.7%	(4.8) pts
Expense ratio	**41.5%**	38.2%	3.3 pts	**39.7%**	38.9%	0.8 pts
Combined ratio	**95.9%**	95.7%	0.2 pts	**91.6%**	95.6%	(4.0) pts
Commercial lines – total						
Claims ratio	**54.5%**	59.0%	(4.5) pts	**51.8%**	56.7%	(4.9) pts
Expense ratio	**38.2%**	36.0%	2.2 pts	**37.1%**	36.3%	0.8 pts
Combined ratio	**92.7%**	95.0%	(2.3) pts	**88.9%**	93.0%	(4.1) pts

Fourth quarter 2012

DPW growth in commercial auto was 12% versus Q4-2011, reflecting the addition of Jevco and low single-digit organic growth. The combined ratio of 84.2% was 8.8 points improved from last year's 93.0%, reflecting higher favourable prior year claims development. The underlying current year loss ratio (excluding catastrophes and prior year claims development) improved 1.8 points year-over-year.

Commercial P&C DPW increased by 7% in Q4-2012 versus the same quarter last year, reflecting the addition of Jevco and low single-digit organic growth. The combined ratio of 95.9% was largely unchanged from 95.7% last year. The claims ratio improved 3.1 points, as higher favourable prior year claims development was partially offset by an elevated level of large losses, while the expense ratio was 3.3 points higher due to an increase in variable commissions related to improved profitability and timing. The underlying current year loss ratio, excluding catastrophes and prior year claims development, deteriorated 7.6 points versus Q4-2011.

Full year 2012

DPW in commercial auto grew by 39% in 2012, reflecting the additions of AXA Canada and four months of Jevco. The combined ratio was 81.5% in 2012 compared to 86.5% in 2011, with the improvement driven by higher favourable prior year claims development and improved current year results. The underlying current year loss ratio (excluding catastrophes and prior year claims development) improved 1.8 points year-over-year.

DPW growth in commercial P&C was 54% in 2012, reflecting the additions of AXA Canada and four months of Jevco. The combined ratio improved 4.0 points from 95.6% to 91.6% as higher favourable prior year claims development more than offset weaker current year results (including a high level of large losses in Q1 and Q4 of 2012). The underlying current year loss ratio (excluding catastrophes and prior year claims development) deteriorated 3.6 points year-over-year.

4.5 Investment income

As at December 31, 2012, all investments of the Company, including the additional investments from the Jevco acquisition, are managed internally by IFC's subsidiary, Intact Investment Management Inc. ("IIM"). The asset mix is designed to generate interest and dividend income while ensuring an optimal mix of risk and total return. Assets are managed according to an investment policy and a significant portion of our portfolio is invested in fixed-income securities. In order to generate dividend income, we also actively invest in common shares of large-cap companies that pay dividends and in preferred shares.

TABLE 9 – NET INVESTMENT INCOME

	Q4-2012	Q4-2011	Change	2012	2011	Change
Interest income	72	75	(4)%	276	221	25%
Dividend income	40	36	11%	144	131	10%
Investment income, before expenses	112	111	1%	420	352	19%
Expenses	(10)	(8)	25%	(31)	(26)	19%
Net investment income	102	103	(1)%	389	326	19%
Average investments[1]	12,179	11,090	10%	11,487	8,903	29%
Market-based yield[2]	3.6%	3.9%	(0.3) pts	3.6%	4.0%	(0.4) pts

[1] Defined as the mid-month average fair value of equity and fixed-income securities held during the reporting period.
[2] Refer to Section 16 – *Non-IFRS financial measures*.

Fourth quarter 2012

Net investment income of $102 million in the fourth quarter was relatively flat from a year ago, as additional investments obtained from the Jevco acquisition were offset by declining yields. The market-based yield of 3.6% was down from 3.9% in Q4-2011.

Full year 2012

Net investment income was $389 million in 2012, 19% higher than 2011 primarily from the additional investments related to our acquisitions of AXA Canada and Jevco. The market-based yield declined 40 basis points versus 2011 to 3.6% as a result of declining interest rates and a higher proportion of fixed-income securities after including the AXA Canada and Jevco portfolios.

SECTION 5 – Non-operating results

Non-operating results include net investment gains and losses excluding FVTPL fixed-income securities, market yield effect, amortization of intangible assets recognized in business combinations and non-recurring charges (i.e., integration and restructuring costs and change in fair value of contingent consideration). These elements are not representative of our operating performance because they relate to special items or bear significant volatility from one period to the other, or because they are not part of our normal activities. As a result, these elements are excluded from the measurement of NOI and related measures.

5.1 Income before income taxes

A summary of changes in income before income taxes is as follows:

TABLE 10 – CHANGES IN INCOME BEFORE INCOME TAXES (YEAR-OVER-YEAR)

	Q4-2012	2012
Income before income taxes, as reported in 2011	116	594
Operating results		
Change in pre-tax operating income (Table 3)	36	258
Non-operating results		
Change in net investment gains or losses excluding FVTPL fixed-income securities (Table 11)	37	(68)
Change in market yield effect (Table 12)	(13)	(35)
Change in amortization of intangible assets recognized in business combinations	(2)	(8)
Change in integration and restructuring costs	13	(37)
Change in fair value of contingent consideration	41	30
Income before income taxes, as reported in 2012	228	734

Fourth quarter 2012

Increases in underwriting income and other income led to a $36 million improvement in pre-tax operating income in Q4-2012. Income before income taxes also improved versus Q4-2011 by $41 million as Q4-2012 did not include a change in fair value of contingent consideration. A $37 million increase in net investment gains and a $13 million decline in integration and restructuring costs further added to income before income taxes. These were partially offset by a $13 million change in market yield effect.

Full year 2012

Income before income taxes increased by $140 million in 2012 versus 2011, as substantially higher pre-tax operating income and a $30 million change in fair value of contingent consideration were offset by a $68 million decline in net investment gains, $37 million higher integration and restructuring costs and a $35 million change in market yield effect.

5.2 Net investment gains (losses)

TABLE 11– NET INVESTMENT GAINS (LOSSES)

	Q4-2012	Q4-2011	Change	2012	2011	Change
Fixed-income securities						
Gains on AFS securities	13	12	1	25	26	(1)
Losses on derivatives	(2)	(11)	9	(2)	(26)	24
Gains on fixed-income securities and related derivatives	11	1	10	23	–	23
Equity securities						
Gains, net of derivatives	33	28	5	102	207	(105)
Impairment losses	(12)	(30)	18	(42)	(65)	23
Losses on embedded derivatives	(2)	(6)	4	(11)	(2)	(9)
Gains (losses) on equity securities and related derivatives	19	(8)	27	49	140	(91)
Net investment gains (losses) excluding FVTPL fixed-income securities	30	(7)	37	72	140	(68)
Net investment gains (losses) on FVTPL fixed-income securities	(24)	–	(24)	(35)	64	(99)
Net investment gains (losses)	6	(7)	13	37	204	(167)

Fourth quarter 2012

Our $30 million net investment gains excluding FVTPL fixed-income securities in Q4-2012 compare to losses of $7 million in Q4-2011. The improvement is principally due to lower impairment losses on equity securities.

Full year 2012

The $68 million decrease year-over-year on net investment gains excluding FVTPL fixed-income securities is the result of fewer gains on our equity portfolio ($105 million decrease), mostly preferred shares which we repositioned in 2011, triggering gains. This decline was partially offset by higher gains on fixed-income securities and related derivatives ($23 million), and by a $23 million decrease in impairment losses compared to 2011.

5.3 Market yield effect

Claims liabilities are discounted using 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 referred to as MYA. The MYA to claims liabilities is offset by gains and losses on FVTPL 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 FVTPL fixed-income securities is referred to as the "market yield effect" in this MD&A.

The process of matching the weighted-dollar duration of the claims liabilities to assets classified as FVTPL works well under normal conditions. However, market fluctuations, changes in yield curve, trading and changes in asset mix can result in a positive or negative market yield effect.

TABLE 12 – MARKET YIELD EFFECT

	Q4-2012	Q4-2011	Change	2012	2011	Change
Positive (negative) impact of MYA on underwriting	11	–	11	(17)	(81)	64
Net investment gains (losses) on FVTPL fixed-income securities (Table 11)	(24)	–	(24)	(35)	64	(99)
Market yield effect	(13)	–	(13)	(52)	(17)	(35)

5.4 Integration and restructuring costs

In connection with the acquisitions of AXA Canada and Jevco, we established integration plans directed at integrating the acquired businesses with our own business and capturing cost synergies across the combined entities, including shared services and corporate functions.

Integration and restructuring costs are comprised of amounts related to system conversions, occupancy, severance and other employee-related charges as well as other integration amounts, such as consulting fees and marketing costs related to customer communications and rebranding activities. We recorded $29 million of such expenses in the fourth quarter of 2012 – $21 million related to AXA Canada and $8 million related to Jevco. For the full year 2012, the total recorded was $108 million – $79 million related to AXA Canada and $29 million related to Jevco.

SECTION 6 – Business developments and operating environment

6.1 Acquisition of AXA Canada Inc.

We have completed the renewal cycle processing for all one-year term policies in personal lines and non-specialty commercial lines, while conversion of commercial specialty lines and two-year policies are being carried out on IFC systems. As customer retention on the AXA Canada portfolio remains quite robust, we are now able to shift more of our focus to growth as we enter year two of the integration. From a growth perspective, our results reflect our improved value proposition, which includes a broader product suite, maintaining the outer boundary of Intact and AXA Canada risk appetite, managing rate dislocation at renewal and a continued focus on small and medium-sized businesses in commercial lines.

We are focused on decommissioning AXA systems with the objective of completing the system shutdown in the first part of 2014, once all policies have been converted. As such, we maintain our $100 million after-tax synergies target and expect to largely reach this run-rate by the end of 2013. As at December 31, 2012, we estimate our run-rate at $52 million. In addition, we continue to believe further opportunities for benefits exist in the mid-term related to segmentation and additional supply chain benefits. Separately, we generated claims indemnity synergies (short-term supply chain benefits) in 2012, which offset the negative impact of higher reinsurance costs related to AXA Canada.

Integration and restructuring costs typically occur earlier in the integration process than synergies, as they are often required to generate synergies. We recorded $71 million of pre-tax expenses in 2011 and a further $79 million in 2012.

6.2 Acquisition of Jevco Insurance Company

On September 4, 2012, we completed the $530 million acquisition of Jevco. The completion of this transaction represents another important step on our journey to build a world-class P&C insurer. The addition of Jevco enables us to strengthen our offer to brokers and customers by broadening our product offering into areas where we were under-represented – primarily recreational vehicles, commercial specialty lines and non-standard auto insurance.

We estimate an IRR from the acquisition – our primary metric when measuring potential targets – of 20% or higher. We also expect the acquisition to be accretive to net operating income per share in 2013. Annual expense synergies amounting to $15 million after-tax are expected from a combination of external loss adjustment expense reductions, shared services savings, reinsurance and systems-related cost savings. We expect our run-rate to be close to this level by the end of 2014.

Integration and restructuring costs are included in net income and include amounts related to system conversions, severance and other employee-related charges as well as other integration amounts, such as consulting fees and marketing costs related to customer communications and rebranding activities. We recorded $29 million of pre-tax expenses during the year.

Formal integration has begun, and the process of converting Jevco policies into IFC systems is underway in all lines of business. We continue our employee integration activities, are reviewing the rates and segmentation for non-standard auto and motorcycles, and will work to re-underwrite portions of the Jevco portfolio, where required.

6.3 Sale of AXA Life Insurance Inc.

On January 1, 2012, we completed the sale of AXA Canada's life insurance business to SSQ, Life Insurance Company Inc. for proceeds of $300 million. There was no gain or loss on the transaction as the sale proceeds correspond to the net value recorded on the Company's Consolidated balance sheet as at December 31, 2011 for this business. Most of the proceeds from the sale were applied to reduce debt outstanding.

6.4 Canadian P&C insurance industry results – YTD Q3-2012 comparison

The Canadian P&C insurance results for YTD Q3-2012 are available. Highlights are as follows:

TABLE 13 – CANADIAN P&C INSURANCE RESULTS

	P&C industry[1]	Industry Benchmark[2]	IFC
DPW growth	3.2%	3.1%	47.0%
Combined ratio[3]	96.8%	97.8%	94.1%
Return on equity (YTD annualized)[4]	9.0%	9.9%	15.9%

Industry data source: MSA Research Inc.

[1] Excludes Lloyd's, ICBC, SGI, SAF, MPI, Genworth and IFC.

[2] Generally consists of the 20 largest companies, excluding Lloyd's, Genworth and IFC.

[3] Combined ratio includes MYA.

[4] IFC's ROE corresponds to the adjusted return on equity (AROE).

We continued to outperform our P&C insurance industry benchmark in the first three quarters of 2012. Our acquisition of AXA Canada provided substantial DPW growth, while we delivered a combined ratio 3.7 percentage points better than our industry benchmark YTD Q3-2012. The combination of superior underwriting results, investment results and capital management led to an ROE outperformance of 6.0 percentage points versus our industry benchmark.

6.5 Personal auto environment

Ontario

In September of 2010, the Ontario government's auto reforms were implemented, offering greater choice for consumers while creating a more stable cost environment. The reforms also directly targeted abuse and fraud in the auto insurance system, which increase costs and lead to higher premiums.

Our view of the effectiveness of the Ontario auto reforms has not changed. We continue to see the benefits of the reforms and our actions; however, we remain prudent and disciplined in our approach to the business, particularly given the level of uncertainty remaining in the system.

- Although we are not seeing material signs of deterioration in bodily injury claims, we believe there is sufficient uncertainty to warrant a more conservative reserving position. This reduced the level of favourable prior year claims development in Q4-2012.
- The industry still has over 30,000 mediation cases in backlog. Some improvement was seen during 2012 as the industry backlog declined 16% from January 2012. FSCO finalized an outsourcing agreement that provides access to additional mediators and arbitrators. Beginning in the fourth quarter of 2012, an additional 2,000 mediations and 500 arbitrations were assigned monthly in order to address the backlog. The size of the industry backlog and the delay for cases to be heard maintain a fair level of uncertainty with respect to the interpretation of the new regulations implemented through the reforms. Specifically, for IFC, we continue to actively manage our files in dispute and, as a result, our mediation backlog has been reduced by over 30% since the peak in 2011. Thus far, no mediation outcomes point to deterioration in the environment.
- On September 27, 2012, a court decision further expanded the current definition of catastrophic impairment to include persons with a single functional impairment due to a mental or behavioural disorder. Current year results, and a portion of the unfavourable prior year claims development recorded in the quarter, reflect this expanded definition.
- In recent weeks, the Ontario government has continued to demonstrate its intention to target fraud and abuse by announcing the following measures, which originated from the Anti-Fraud Task Force's recommendations:
  - requiring insurers to provide claimants with all reasons for denying a claim;
  - giving claimants the right to receive a bi-monthly, detailed statement of benefits paid out on their behalf;
  - increasing the role of claimants in fraud prevention (e.g., require them to confirm attendance at a health clinic); and
  - making providers subject to sanctions for overcharging insurers for goods and services and banning them from asking consumers to sign blank claim forms.

According to industry results, the loss ratio in Ontario auto for year-to-date Q3-2012, excluding IFC, was 75.9%, improved from 102.5% in 2010 and 83.6% in 2011, aided by favourable prior year claims development, continued rate increases and the benefits from auto reforms. Industry results have improved significantly since 2010, but still reflect a combined ratio slightly above 100%, indicating that a number of industry players continue to be in a loss position in that jurisdiction. We continue to outperform the industry in Ontario auto, with a 9 point loss ratio advantage in the first nine months of 2012.

In the fourth quarter of 2012, FSCO approved rate increases of 0.02%. For the full year 2012, rate decreases of 0.26% were approved, which compares to rate increases of 4.92% in 2011, 6.20% in 2010 and 9.05% in 2009.

Alberta

A number of recent developments risk changing the dynamics of a system that has been quite stable since the 2004 reforms.

- The level of activity on bodily injury files that are in litigation has begun to increase in recent months.
- A court decision from January 2012 to exclude certain injuries involving the jaw or teeth from the minor injury cap is beginning to impact results. The decision also led many to consider chronic pain to be outside of the minor injury cap.
- Due to the age of older minor injury claims and the changing environment, plaintiff lawyers are aggressively working files in order to build the case for their clients.
- Given these observations, we prudently moved to stay ahead of this potential trend by increasing reserves for all accident years since the reforms, further contributing to the unfavourable development in our personal auto underwriting results in Q4-2012.

6.6 Home insurance

In 2008, we began working on a home insurance action plan aimed at combating the rising costs of water-related claims, changing weather patterns and higher reconstruction costs. Our objective was to bring 10 to 15 points of improvement to the personal property line of business with a plan that included:

- increasing rates and insured amounts;
- implementing perils-based pricing in several regions of the country;
- redesigning our products, including rolling out a higher deductible for water claims in certain areas; and
- improving our claims processing and sourcing.

Table 14 illustrates that the initiative was successful at improving the combined ratio in this line of business by the stated objective. More recently, however, the impact from catastrophes has been higher than in the past, resulting in reported combined ratios that are higher than acceptable. Results in 2012 benefited from an unusual level of favourable prior year claims development, without which reported results would appear less strong. Although we have experienced elevated losses from severe weather across the country, the situation continues to be most severe in Alberta.

TABLE 14 – COMPOSITION OF COMBINED RATIOS – PERSONAL PROPERTY

	2012	2011	2010	2009	2008
Combined ratio excluding catastrophe losses and PYD	**89.2%**	93.6%	94.6%	101.2%	104.3%
Impact of catastrophe losses	**10.3%**	13.3%	5.9%	8.6%	8.7%
Impact of prior year claims development (PYD)	**(6.0)%**	(3.4)%	(4.0)%	(0.8)%	0.6%
Reported combined ratio	**93.5%**	103.5%	96.5%	109.0%	113.6%

We are committed to operating our personal property business at a combined ratio of 95% or better, even if catastrophe losses remain at elevated levels. To attain this objective we are considering the following actions, to be implemented starting in the first half of 2013, with ultimate benefits generated over the next 24 to 36 months:

- continued rate increases;
- increased base deductibles on policies;
- options to buy sub-limits on hail, wind and sewer back-up coverage to reduce costs for customers;
- claims management initiatives; and
- intensified education and loss-mitigation incentives.

6.7 Capital markets

The Canadian equity market improved marginally in the fourth quarter of 2012, as the S&P/TSX Index increased 0.9% and the preferred share index was relatively flat, up 0.1%. For the full year, the S&P/TSX Index rose 4.0%, while the preferred share index ticked up 0.4%. Movements in our equity investment values are generally in line with the equity markets' performance, although our exposures to individual sectors may be different. Lower interest rates compared to fourth quarter 2011 resulted in lower interest income, which was offset by higher dividends and investment income from Jevco assets. Our pre-tax unrealized gain position decreased by $13 million from the third quarter of 2012, from the realization of gains and from higher yields, offset in part by the improved equity market performance. Tables 11, 24 and 25 provide detailed information on the net investment gains (losses) and unrealized gains (losses) of our investment portfolio.

6.8 Industry pools

Industry pools consist of the "residual market" (or Facility Association) as well as risk-sharing pools ("RSP") in Alberta, Ontario, Québec, New Brunswick and Nova Scotia. In the fourth quarter of 2012, the net impact of industry pools positively impacted personal auto underwriting income by $29.3 million year-over-year, excluding MYA. The variance was the result of an increase in favourable prior year claims development which resulted from a more positive view of Ontario auto reforms. Results for industry risk sharing pools tend to fluctuate between periods.

6.9 Weather conditions

Q4-2012 experienced precipitation that was largely in line with historical averages, with lower levels in Central Canada offset by higher levels of precipitation in the West. Temperatures were cooler than last year and the ten-year average, driven mainly by lower temperatures in Alberta. The relatively benign weather conditions led to reduced claims frequency and bolstered underwriting results in our personal property line of business. The only weather-related catastrophe event resulted from the remnants of Hurricane Sandy that impacted parts of Ontario and Québec in late October.

6.10 Seasonality of the business

The P&C insurance business is seasonal in nature. While net premiums earned are generally stable from quarter to quarter, net underwriting income is affected by weather conditions, which may vary significantly between quarters.

TABLE 15 – SEASONAL INDICATOR

	2012	2011	2010	2009	2008	2007	Six-year average
Q1	**0.99**	1.00	0.98	1.00	1.03	1.01	1.00
Q2	**0.99**	1.03	0.98	0.97	0.98	0.99	0.99
Q3	**1.03**	0.99	1.01	1.07	0.97	1.02	1.02
Q4	**0.99**	0.98	1.03	0.96	1.02	0.98	0.99

6.11 Ice storm 1998

On October 23, 2012, we announced an agreement in principle for the out-of-court settlement of the class action lawsuit in relation to the 1998 Québec ice storm. The amount of the settlement agreement is $12.5 million. This settlement agreement was approved by the Québec Superior Court in December of 2012. The cost of this settlement will be covered by reinsurance and existing accruals.

SECTION 7 – Strategy and outlook

7.1 Canadian P&C insurance industry 12-month outlook

Our two primary objectives are to outperform the industry ROE by at least 500 basis points every year and to grow our NOIPS by 10% per year over time. We are well-positioned to continue outperforming the P&C insurance industry in the current environment due to our pricing and underwriting discipline, claims management capabilities, as well as our prudent investment and capital management practices.

	Canadian P&C insurance industry	Our strategy
Market environment (12-month outlook)	• Industry premium growth is likely to evolve at a similar pace to that of the last 12 months. • We do not foresee significant loss ratio improvement in personal auto, as Ontario reforms have largely brought the anticipated cost savings. • Personal property results are expected to benefit from continued hard market conditions and potential actions companies take to mitigate losses from future catastrophes. • We do not anticipate loss ratio improvement in commercial lines, but expect conditions to improve at a moderate pace over time, following several years of a soft market environment.	• We maintain our disciplined strategy while capitalizing on our strong position to grow organically in the prevailing market conditions. • Our growth efforts in the Ontario auto market have begun to take effect, particularly in our direct business. • Given the trend of increases in severe weather, we intend to build on the actions previously taken to ensure adequate profitability and create a sustainable competitive advantage in home insurance. • In commercial lines, we intend to build on our historical loss ratio advantage and to accelerate our penetration in small to mid-sized businesses. The additions of AXA Canada and Jevco have bolstered our product offering and enable us to grow meaningfully in the mid-sized segment and in specialty lines.
Capital markets	• Recent economic data lead us to believe that interest rates, which are currently very low, might remain low for the foreseeable future. As a result, we estimate that the industry's pre-tax investment yield will decline approximately 25 basis points, given its asset mix and duration, which could support firmer market conditions. • Capital markets remain volatile, as economic data raise questions about the strength of the global recovery. Industry capital levels could be negatively impacted if volatility results in downward pressure on market values. • Global capital requirements are continuing to influence asset decisions of many companies. • In Canada, OSFI's 2013 MCT proposals could reduce industry excess capital levels.	• We maintain a solid financial position, with $599 million in excess capital and a debt-to-capital ratio of 18.9% as at the end of 2012. • Our $13.0 billion investment portfolio is largely Canadian dollar-denominated. European government debt and U.S. debt markets represent 2% of the total portfolio. • We expect our market-based yield to continue to decline, partially offsetting the growth in our investment portfolio. Investment income will be affected accordingly. • New MCT guidelines were capital neutral in 2012, while we expect them to slightly reduce excess capital levels in 2013, based on the current composition of our investment portfolio.
Overall	• The industry's ROE was approximately 6% in 2011. We expect combined ratio improvement in 2012, but expect it to be partially offset by a reduction in the level of investment income. The resulting ROE is likely to improve to the upper single-digit range, as it was through the first nine months of the year. We expect the industry's ROE in 2013 to remain slightly below its long-term average of 10%.	• We believe we will outperform the industry's ROE by at least 500 basis points in the next 12 months.

7.2 Critical capabilities

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

Scale	The key benefit of scale is our large database of customer and claims information that enables us to identify trends in claims and more accurately model the risk of each policy. We also use our scale to negotiate preferred terms with suppliers, priority service on repairs, quality guarantees on workmanship and lower material costs.
Sophisticated pricing and underwriting	We have superior underwriting expertise and proprietary segmentation models used to price risks. These models are continuously being refined to create an advantage over competitors and identify certain segments of the market that are more profitable than others. Our objective is to establish a model that will both attract new clients and maintain existing clients with profitable profiles.
In-house claim expertise	Substantially all of our 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.
Broker relationships	The broker channel represents approximately 88% of annual DPW. We have more than 2,000 broker relationships across Canada for customers that prefer the highly personalized, community-based service that insurance brokers provide. We provide a variety of services including technology, sales training and financing to brokers to enable them to continue to grow and expand their businesses.
Multi-channel distribution	We have a multi-channel distribution strategy including broker and direct-to-consumer brands. This strategy maximizes growth in the market and enables us to appeal to different customer preferences and to be more responsive to consumer trends.
Proven industry consolidator	We are a proven industry consolidator, with 13 successful acquisitions since 1988, the most recent being Jevco. Our primary strategy is to target large-scale acquisitions of $500 million or more in DPW and to pursue acquisitions in lines of business where we have expertise. Our acquisition targets are to achieve an internal rate of return of at least 15%, to bring the loss ratio of the acquired book of business to our average loss ratio and to bring the expense ratio to two points below our ratio, within 18 to 24 months.
Strong expertise in investment portfolio management	Over the years, we have built strong expertise in investment management. In-house management provides greater flexibility in support of our insurance operations at competitive costs. In establishing our asset allocation, we consider a variety of factors including the prospective risk and return of various asset classes, the duration of claim obligations, the risk of underwriting activities and the capital supporting our business. Our primary investment objective is to generate consistent after-tax income while minimizing the potential for extremely large losses. We focus mostly on Canadian income products while preserving capital, diversifying risk and considering capital requirements in evaluating the attractiveness of different investment alternatives.

SECTION 8 – Financial condition

8.1 Condensed balance sheets

The table below shows the significant audited Consolidated balance sheets captions as well as the amounts recognized for the assets acquired and liabilities assumed at the acquisition date of Jevco.

TABLE 16 – CONDENSED BALANCE SHEETS

As at	Reference	December 31, 2012	December 31, 2011	Jevco
Assets				
Investments				
Cash and cash equivalents		172	206	23
Debt securities		8,757	7,887	890
Preferred shares		1,263	1,281	16
Common shares		2,376	2,051	110
Loans		391	403	2
	Section 8.2	12,959	11,828	1,041
Assets classified as held for sale[1]		–	1,631	–
Premium receivables		2,670	2,487	100
Reinsurance assets		320	409	31
Deferred acquisition costs		705	652	33
Other assets		1,083	884	134
Intangible assets and goodwill		2,076	1,862	183
Total assets		19,813	19,753	1,522
Liabilities directly associated with assets classified as held for sale[1]		–	1,330	–
Claims liabilities	Section 8.3	7,656	6,886	731
Unearned premiums		4,046	3,790	204
Financial liabilities related to investments		486	532	–
Other liabilities		1,589	1,581	57
Debt outstanding	Section 9.1	1,143	1,293	–
Total liabilities		14,920	15,412	992
Common shares	Section 9.1	2,118	1,889	
Preferred shares		489	489	
Contributed surplus		121	115	
Retained earnings		1,982	1,642	
AOCI		183	206	
Shareholders' equity	Section 14	4,893	4,341	
Book value per common share (in dollars)		33.03	29.73	

[1] On January 1, 2012, we completed the sale of AXA Life Insurance Inc., AXA Canada's life insurance business, to SSQ, Life Insurance Company Inc. for proceeds of $300 million.

8.2 Investments

As at December 31, 2012, our total investments reached $13.0 billion, an increase of $1.1 billion from 2011 driven by the acquisition of Jevco. Our investment portfolio is mainly comprised of Canadian securities and includes a mix of cash and short-term notes, fixed-income securities and preferred and common shares. Nearly all investments are denominated in Canadian dollars and currency exposure is economically hedged.

Our portfolio is managed in accordance with our investment policy. The overall risk profile of the portfolio is designed to balance the investment return required to satisfy our liabilities while optimizing the investment opportunities available in the marketplace. Management monitors and enforces compliance with our investment policy.

Fixed-income securities We invest in corporate and government bonds and approximately 99% of our fixed-income portfolio is rated 'A' or better. We have no exposure to leveraged capital notes in structured investment vehicles, directly or through the use of derivatives. As at December 31, 2012, we have $276 million ($236 million at December 31, 2011) in asset-backed securities, mostly comprised of Canadian credit card and auto loan receivables ($217 million as at December 31, 2012, $158 million as at December 31, 2011) and mortgage-backed securities ($59 million as at December 31, 2012, $78 million as at December 31, 2011). All of these are rated 'AAA' as at December 31, 2012 and 2011.

Common shares Common equity exposure is focused primarily on dividend-paying Canadian equities. In addition, our equity portfolios are also actively managed to enhance dividend income throughout the year.

Preferred shares We invest in preferred shares to achieve our objective of generating dividend income, as such income is not taxable under Canadian laws, provided certain conditions are met. Generally, our preferred share portfolio is not traded and our shares are held until they are called. Consequently, our non-operating results are generally impacted only when preferred shares are impaired, when the shares are called, or when the shares are sold to take advantage of 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 We use derivative financial instruments for hedging purposes and for the purpose of modifying the risk profile of our investment portfolio, as long as the resulting exposures are within investment policy guidelines.

Investment mix

The following table provides an overview of the investment mix.

TABLE 17 – INVESTMENT MIX

As at	December 31, 2012	As a % of total	December 31, 2011	As a % of total
Short-term notes, including cash and cash equivalents	386	3%	450	4%
Fixed-income securities	8,543	66%	7,643	65%
Preferred shares	1,263	10%	1,281	11%
Common shares	2,376	18%	2,051	17%
	12,568	97%	11,425	97%
Loans	391	3%	403	3%
Total investments	**12,959**	**100%**	11,828	100%

As part of our investment strategies, we have both long and short equity positions in order 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 Common shares and short positions are reported in Financial liabilities related to investments on the audited Consolidated balance sheets. We also use strategies where a long equity position is economically hedged using swap agreements or other hedging instruments.

The following table illustrates our total investments and asset mix after reflecting the impact of hedging strategies and financial liabilities related to investments. This table represents our economic exposure by class of assets.

TABLE 18 – INVESTMENT MIX NET OF HEDGING POSITIONS AND FINANCIAL LIABILITIES RELATED TO INVESTMENTS

As at	December 31, 2012	As a % of total	December 31, 2011	As a % of total
Short-term notes, including cash and cash equivalents	386	3%	450	4%
Fixed-income securities	9,212	74%	8,185	73%
Preferred shares	1,195	10%	1,214	11%
Common shares	1,299	10%	1,013	9%
	12,092	97%	10,862	97%
Loans	391	3%	403	3%
Total investments net of hedging positions and financial liabilities related to investments	**12,483**	**100%**	11,265	100%

The investment mix as at December 31, 2012 is essentially unchanged compared to December 31, 2011.

The following table reconciles the total investments before and after reflecting hedging strategies and financial liabilities related to investments.

TABLE 19 – RECONCILIATION BETWEEN TOTAL INVESTMENTS AND TOTAL INVESTMENTS NET OF HEDGING POSITIONS AND FINANCIAL LIABILITIES RELATED TO INVESTMENTS

As at	December 31, 2012	December 31, 2011
Total investments (Table 17)	12,959	11,828
Deduct equities sold short positions	(301)	(368)
Deduct equity exposure reduction	–	(49)
Deduct swap agreements and other derivatives	(70)	(76)
Deduct net asset value attributable to third party unit holders	(105)	(70)
Total investments net of hedging positions and financial liabilities related to investments (Table 18)	12,483	11,265

Sector mix by asset class

The following table shows sector exposures by asset class, after reflecting the impact of hedging strategies and financial liabilities related to investments, as a percentage of total investments (excluding cash and cash equivalents and loans). This table represents our economic exposure by class sector as at December 31, 2012.

TABLE 20 – SECTOR MIX BY ASSET CLASS (NET OF HEDGING POSITIONS AND FINANCIAL LIABILITIES RELATED TO INVESTMENTS)

	Short-term notes and fixed-income securities	Preferred shares	Common shares		IFC total
			IFC	S&P/TSX weighting	
Government	63%	–	–	–	50%
Financials	34%	78%	14%	32%	36%
Energy	1%	13%	31%	25%	5%
Telecommunication	–	3%	16%	5%	2%
Industrials	1%	–	8%	6%	2%
Utilities	1%	5%	6%	2%	2%
Consumer discretionary	–	1%	11%	5%	1%
Materials	–	–	8%	19%	1%
Consumer staples	–	–	4%	3%	1%
Information technology	–	–	2%	1%	–
Health care	–	–	–	2%	–
Total	100%	100%	100%	100%	100%
Total	9,426	1,195	1,299	n/a	11,920

Our investment portfolio is concentrated mainly in the government and financial sectors in order to provide liquidity and stability to our balance sheet and to focus on dividend-paying Canadian equities.

Portfolio credit quality

The following table highlights the credit quality of our fixed-income securities portfolio.

TABLE 21 – CREDIT QUALITY OF THE FIXED-INCOME SECURITIES

	December 31, 2012		December 31, 2011	
	Fair value	As a % of total	Fair value	As a % of total
Fixed-income securities[1]				
AAA	3,701	43%	2,534	33%
AA	3,467	41%	2,955	39%
A	1,268	15%	2,008	26%
BBB	93	1%	128	2%
Non-rated	14	–	18	–
Total	8,543	100%	7,643	100%

[1] Source: S&P or DBRS.

As at December 31, 2012, the weighted-average rating of our fixed-income portfolio was 'AA+', unchanged since December 31, 2011. The average duration of our bond portfolio was 4.07 (3.92 net of the impact of derivatives used to reduce overall interest rate exposure).

The following table shows the credit quality of our preferred share portfolio.

TABLE 22 – CREDIT QUALITY OF THE PREFERRED SHARE PORTFOLIO

	December 31, 2012		December 31, 2011	
	Fair value	**As a % of total**	Fair value	As a % of total
Preferred shares[1]				
P1	**369**	**29%**	691	54%
P2	**797**	**63%**	393	31%
P3	**89**	**7%**	196	15%
Non-rated	**8**	**1%**	1	–
Total	**1,263**	**100%**	1,281	100%

[1] Source: S&P or DBRS.

The weighted-average rating of our preferred share portfolio was 'P2' as at December 31, 2012, unchanged since December 31, 2011.

The following table provides our investment portfolio breakdown by region of issuer.

TABLE 23 – PORTFOLIO BREAKDOWN BY REGION OF ISSUER

As at	**December 31, 2012**	December 31, 2011
Canada	**97%**	92%
U.S.	**–**	2%
Europe[1]	**2%**	4%
Other	**1%**	2%
Total	**100%**	100%

[1] European government debt represented 1.95% of our total portfolio as at December 31, 2012 (2.24% as at December 31, 2011). We have no exposure to the nations of Greece, Ireland, Italy, Portugal or Spain.

Our investment portfolio is mainly comprised of Canadian securities. We do not invest in leveraged securities and our exposure to the U.S. market is minimal. Despite the difficulties in Europe, our portfolio remains strong as we have only minimal exposure.

Net pre-tax unrealized gains (losses) on AFS securities

In determining the fair value of investments, we rely mainly on quoted market 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.

The following table presents the net pre-tax unrealized gains (losses) on AFS securities.

TABLE 24 – NET PRE-TAX UNREALIZED GAINS (LOSSES) ON AFS SECURITIES

As at	**December 31, 2012**	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011
Fixed-income securities	**81**	105	98	64	101
Preferred shares	**121**	136	134	154	156
Common shares	**63**	37	(7)	36	44
Net pre-tax unrealized gain position	**265**	278	225	254	301

During Q4-2012, our pre-tax unrealized gain position decreased by $13 million. This decrease is mostly due to fixed-income securities ($24 million) and preferred shares ($15 million) as bond prices inched lower and gains were realized. However, common shares partially offset this decrease with a $26 million positive contribution.

The $36 million decrease year-over-year in our pre-tax unrealized gain position stems from fixed-income securities ($20 million) and preferred shares ($35 million) as gains were realized, partially offset by a $19 million increase in the unrealized gain position on our common shares, due to stronger markets.

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

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 the fair value below book value. Management also assesses whether there are reasons to believe that the decline in the market value is permanent. Based on our assessment, we recorded impairment losses on AFS common shares amounting to $10 million and $40 million in Q4-2012 and full year 2012, respectively.

TABLE 25 – AGING OF UNREALIZED LOSSES ON AFS COMMON SHARES

As at	**December 31, 2012**	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011
Less than 25% below book value	**17**	26	40	25	36
More than 25% below book value for less than 6 consecutive months	**1**	4	10	1	4
More than 25% below book value for 6 consecutive months or more	**9**	3	4	12	5
Unrealized losses on AFS common shares	**27**	33	54	38	45

8.3 Claims liabilities

Claims liabilities amounted to $7.7 billion as at December 31, 2012, up $0.8 billion from the December 31, 2011 level, reflecting the acquisition of Jevco.

Assessing claims reserve adequacy

Effectively assessing claims reserve adequacy is a critical skill required to effectively manage any P&C 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 IBNR. IBNR reserves supplement the case reserves by taking into account:

- possible claims that have been incurred but not yet reported to us 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 PfAD and a discount for the time value of money (see Section 5.3 – *Market yield effect*). The discount is applied to the total claims reserve and adjusted on a regular basis for changes in market yields. If market yields rise, the discount would increase and reduce total claims liabilities and, therefore, positively impact underwriting income in that period, all else being equal. If market yields decline, it would have the opposite effect. IBNR and PfAD are reviewed and adjusted at least quarterly.

Prior year claims development (excluding MYA)

The following table shows the development of claims liabilities for the nine most recent accident years and earlier. The reserve estimates are evaluated quarterly for redundancy or deficiency. The evaluation is based on actual payments in full or partial settlement of insurance contracts and current estimates of claims liabilities for claims still open or claims still unreported. Prior year claims development can fluctuate from quarter to quarter and year to year and, therefore, should be evaluated over longer periods of time. The historical rate of favourable prior year claims development as a percentage of opening claims has been approximately 3% to 4% per year over the long term.

TABLE 26 – PRIOR YEAR CLAIMS DEVELOPMENT (EXCLUDING MYA)

		Accident year									
	Total	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002 & earlier
Original reserve[1]		2,411	2,120	1,835	1,652	1,458	1,300	1,190	1,161	1,014	2,268
Favourable development during Q4-2012[2]	**(85)**	(1)	(6)	(13)	(18)	(10)	(7)	(3)	(1)	(2)	(24)
Favourable development during 2012[2]	**(372)**	(149)	(35)	(34)	(34)	(18)	(20)	(14)	(7)	(6)	(55)
Cumulative development as a % of original reserve[3]		(6.6)%	(8.5)%	(6.3)%	(5.9)%	(5.9)%	(8.2)%	(15.6)%	(26.4)%	(22.8)%	(8.9)%

[1] Comprises Intact original reserve, as well as AXA Canada reserve as of September 23, 2011 and Jevco reserve as of September 4, 2012.

[2] Including Jevco starting October 1, 2012.

[3] Calculated on a pro rata basis to account for Jevco reserve as of September 4, 2012.

TABLE 27 – ANNUALIZED RATE OF FAVOURABLE PRIOR YEAR CLAIMS DEVELOPMENT

(annualized rate)	**Q4-2012**	Q4-2011	**2012**	2011
Favourable prior year claims development (as a % of opening reserves)	**5.2%**	2.8%	**5.7%**	4.9%

Favourable prior year claims development, at 5.2% of opening reserves on an annualized basis, was above the 2.8% recorded in Q4-2011 and above our historical level. The favourable development, amounting to $85 million, was composed of $60 million in commercial P&C, $43 million in personal property and $11 million in commercial auto, partially offset by unfavourable development of $29 million in our personal auto line of business.

Favourable prior year claims development in 2012, at 5.7%, was also above 2011 and our historical level of 3% to 4%.

8.4 Employee future benefit programs

We have a number of defined benefit pension plans. We also offer employer-paid post-retirement benefit plans providing life insurance and health and dental benefits to certain active employees and retirees that are now closed to new entrants, as well as post-employment benefit plans that provide health and dental coverage. The post-retirement and post-employment benefit plans are unfunded.

The following table presents the movement of the net benefit liability for the year ended December 31, 2012.

TABLE 28 – CHANGE IN NET BENEFIT LIABILITY

	2012
Balance, beginning of year	**299**
Employer contributions	**(210)**
Negative impact of variations in discount rate assumptions[1]	**113**
Actual return on plan assets[2]	**(91)**
Positive impact of variation in salary increase and inflation[1]	**(68)**
Interest costs on defined benefit obligation	**64**
Current service cost	**60**
Other actuarial losses[1]	**(18)**
Balance, end of year	**149**

[1] Recognized in OCI.

[2] Comprised of expected return on plan assets ($68 million) recognized in income and of actuarial gains on pension plan assets ($23 million) recognized in OCI.

Net benefit liability decreased during 2012, mainly due to higher employer contributions partially offset by a negative variation in discount rate.

Benefit obligations are dependent on assumptions, such as the discount rate and the rate of compensation increase. The discount rate, which is used to determine the present value of estimated future benefit payments at the measurement date, is one of the key assumptions of the calculation. We have little discretion in selecting the discount rate, as it must represent the market rate for high-quality corporate fixed-income investments available for the period to maturity of the benefits. As a result, discount rate changes are based on market conditions.

The fair value of our pension plan assets amounted to $1.4 billion as at December 31, 2012, of which 58.5% is invested in fixed-income securities. The remaining portion is essentially invested in equity securities. Plan assets are highly dependent on the level of contributions and on the pension fund's asset performance. During 2012, we made pension contributions totalling $210 million (including discretionary pension contributions of $114 million) and we achieved a good return on plan assets of 8.9%. Based on the latest projections of all our plans, our total cash contributions to the pension plans are expected to be within $60 million to $105 million in 2013. The contributions will vary depending on funding relief measures, if any, and decisions taken to use or not letters of credit as permitted by legislation.

TABLE 29 – IMPACT OF CHANGES IN KEY ASSUMPTIONS

As at December 31, 2012	Impact on net benefit liability
Impact of a change of 1% in key assumptions:	
Discount rate	
Increase	(256)
Decrease	312
Rate of compensation increase	
Increase	74
Decrease	(70)

Refer to Note 19 – *Employee future benefits* to the accompanying audited Consolidated financial statements for more details on our pension plans, post-retirement and post-employment benefit plans.

SECTION 9 – Liquidity and capital resources

9.1 Financing and capital structure

We do not generally require financing to support our ongoing operations. We use financing instruments, with a preference for long tenures, to optimize our balance sheet or to support growth initiatives. We believe our optimal capital structure is one where the debt-to-capital ratio is up to 20%, and we intend to operate at this level on an ongoing basis. We may exceed this level from time to time to capture market opportunities, but we will strive to return to our target within a reasonable time frame.

In connection with the acquisition of Jevco, we secured long-term financing at attractive rates, despite a volatile capital market environment. The $530 million acquisition was financed with the proceeds from the issuance of common shares, as well as from a portion of the issuance of medium-term notes ("MTN") and from our excess capital.

Subscription receipts offering

On May 11, 2012, to partially fund the acquisition of Jevco, we completed an offering of 3,780,000 subscription receipts ("receipts") at $62.75 per receipt for gross proceeds of $237 million. On the date of the closing of the acquisition of Jevco, our 3,780,000 receipts were converted into 3,780,000 common shares. For this offering, we incurred $8 million in share issuance costs, net of $2 million of taxes, which were accounted for as a reduction in Common shares on the audited Consolidated balance sheets.

Medium-term notes

On June 15, 2012, to reduce term-loan indebtedness and to fund a portion of the Jevco acquisition, we completed an offering of $200 million principal amount of Series 5 unsecured MTN. On September 10, 2012, we issued an additional $50 million principal amount, bringing the total offering to $250 million. These notes bear interest at a fixed annual rate of 5.16% until maturity on June 16, 2042, payable in semi-annual instalments commencing on December 16, 2012. The net proceeds of the additional issuance are being used for general corporate purposes.

Credit facilities

During the first quarter of 2012, following the sale of AXA Life Insurance Inc., we repaid the two-year term-loan facility (the "Tranche A Facility") in full, as well as $150 million on the three-year term-loan facility (the "Tranche B Facility"), for total cash consideration of $250 million. On June 18, 2012, we repaid the remaining $150 million on the Tranche B Facility by using a portion of the proceeds from the MTN issuance. This completed the full repayment of the short-term financing related to the AXA Canada acquisition.

On October 26, 2012, we increased our committed amount by $50 million to $300 million on our four-year unsecured revolving term credit facility. We also extended the term from September 23, 2015 to October 26, 2016. This credit facility is available for temporary funding purposes that may occur from time to time. It may be drawn as a prime loan at the prime rate plus a margin or as bankers' acceptance at the bankers' acceptance rate plus a margin. This facility was undrawn as at December 31, 2012.

As part of the covenants of the loans under the credit facilities, we are required to maintain certain financial ratios, which were fully met as at December 31, 2012 and 2011.

As a net result of the notes issuance and the term-loan repayment, as well as the conversion of the subscription receipts into common shares, we ended the year 2012 with a debt-to-capital ratio of 18.9%, a decrease of 4.0 points compared to December 31, 2011.

9.2 Credit ratings

Following the announcement of the acquisition of AXA Canada in 2011, A.M. Best had placed IFC and its principal operating subsidiaries under review. In April 2012, A.M. Best removed IFC and its principal operating subsidiaries from under review and affirmed the ratings for IFC and its principal operating subsidiaries. Concurrently, A.M. Best upgraded the insurance financial strength ratings from 'A' to 'A+' for AXA Insurance Inc., AXA Insurance (Canada), AXA Pacific Insurance Company and Intact Farm Insurance Inc.

Following the announcement of the acquisition of Jevco and its underlying financing, A.M. Best, Moody's and DBRS affirmed their respective ratings for financial strength and long-term issuer credit for IFC and its subsidiaries. In November 2012, A.M. Best upgraded the insurance financial strength rating of Jevco from 'B++' to 'A', with a positive outlook.

TABLE 30 – CREDIT RATINGS

	A.M. Best	Moody's[1]	DBRS
Long-term issuer credit ratings of IFC	a-	Baa1	A (low)
Financial strength ratings of IFC's principal insurance subsidiaries[2]	A+	A1	n/a

[1] Jevco and companies previously held by AXA Canada are not rated by Moody's.
[2] Jevco has been assigned a rating of A with a positive outlook.

9.3 Base shelf prospectus and medium-term note supplement

On July 5, 2011, we filed a final short form base shelf prospectus with the securities regulatory authorities in each of the provinces and territories of Canada that will allow us to offer up to $2.5 billion in any combination of debt, preferred or common share securities, subscription receipts, warrants, share purchase contracts and units over the following 25 months. We also filed a supplement to our base shelf prospectus to establish an MTN program that would allow us to issue up to $750 million in unsecured MTN. As at December 31, 2011, the amounts available under the respective prospectuses were $1.95 billion and $450 million. In 2012, the subscription receipts that were converted into common shares as well as the Series 5 MTN offerings were completed under the base shelf prospectus and the MTN supplement. As a result, the amounts available were $1.46 billion under the base shelf prospectus, which includes $200 million under the MTN supplement, as at December 31, 2012.

9.4 Cash flows

TABLE 31 – SELECTED INFLOWS (OUTFLOWS)

	Q4-2012	Q4-2011	Change	2012	2011	Change
Operating activities						
Net cash flows provided by operating activities	204	94	110	723	532	191
Investing activities						
Business combination, net of cash acquired	–	–	–	(507)	(2,546)	2,039
Net proceeds from sale (purchases) of investments	(241)	4	(245)	(235)	266	(501)
Proceeds from sale of AXA Canada's life insurance business	–	–	–	300	–	300
Purchases of brokerages, books of business, intangibles, property and equipment, net of sales	(17)	(12)	(5)	(134)	(66)	(68)
Financing activities						
Net proceeds from issuance of debt	–	–	–	249	797	(548)
Repayment of debt	–	–	–	(400)	–	(400)
Proceeds from issuance of common shares	–	–	–	227	910	(683)
Proceeds from issuance of preferred shares	–	–	–	–	485	(485)
Common shares repurchased for share-based payments	2	–	2	(26)	(3)	(23)
Common shares repurchased for cancellation	–	–	–	–	(129)	129
Dividends paid on common shares and preferred shares	(58)	(53)	(5)	(231)	(178)	(53)
Net increase (decrease) in cash and cash equivalents	(110)	33	(143)	(34)	68	(102)

During 2012, cash provided by operating activities, as well as the proceeds from the sale of AXA Canada's life insurance business and from the issuance of MTN Series 5 and common shares were mainly used to acquire Jevco, to repay term loans and to pay dividends.

9.5 Contractual obligations

TABLE 32 – CONTRACTUAL OBLIGATIONS

		Payments due by period			
	Total	Less than 1 year	1–3 years	4–5 years	After 5 years
Debt outstanding[1]	1,143	–	–	–	1,143
Claims liabilities[2]	4,459	1,806	1,097	722	834
Operating leases on premises and equipment	842	106	181	154	401
Pension obligations[3]	222	59	96	41	26
Total contractual obligations	6,666	1,971	1,374	917	2,404

[1] Capital only.
[2] Reported claims case reserves.
[3] These amounts represent the annual mandatory funding required by OSFI, based on the latest actuarial valuations.

We consider that we have sufficient capital resources, cash flows from operating activities and borrowing capacity to support our current and anticipated activities, scheduled principal and interest payments on our outstanding debt, the payment of dividends and other expected financial requirements in the near term.

SECTION 10 – Capital management

10.1 Capital management objectives

Our objectives when managing capital consist of balancing the need to:

- support claims liabilities and ensure the confidence of policyholders;
- support competitive pricing strategies;
- meet regulatory capital requirements;
- provide adequate returns for our shareholders; and
- maintain our strong position in the Canadian P&C insurance industry.

Our capital is managed on a consolidated basis, as well as individually for each regulated subsidiary. Our federally chartered P&C insurance subsidiaries are subject to the regulatory capital requirements defined by OSFI and the *Insurance Companies Act*. Québec provincially chartered subsidiaries are subject to the requirements set by the AMF and the *Act respecting insurance*. OSFI and AMF have established MCT guidelines, which set out 100% as the minimum and 150% as the supervisory target MCT standard for Canadian P&C insurance companies. To ensure that we attain our objectives, we have established a minimum internal threshold of 170%, in excess of which, under normal circumstances, we will maintain our capital.

MCT guidelines change from time to time and may impact our capital levels. We therefore monitor all changes, actual or planned, very carefully. At this point in time, we do not foresee any significant impact to our capital levels from the implementation of new MCT guidelines recently published.

The following table presents the estimated aggregate MCT ratio of our P&C insurance subsidiaries.

TABLE 33 – AGGREGATE MCT

As at	**December 31, 2012**	December 31, 2011
Total capital available	**3,764**	3,285
Total capital required	**1,840**	1,668
MCT %	**205%**	197%
Excess capital at 100%	**1,924**	1,617
Excess capital at 150%	**1,004**	783
Excess capital at 170%[1]	**636**	449

[1] Includes Jevco excess capital over 170%. Jevco minimum internal threshold is currently under review.

Total capital available and total capital required represent amounts applicable to our P&C insurance subsidiaries and are determined in accordance with prescribed OSFI and AMF rules. Total capital available mostly represents total shareholders' equity less specific deductions for disallowed assets including goodwill and intangible assets. Total capital required is calculated by classifying assets and liabilities into categories and applying prescribed risk factors to each category. As at December 31, 2012, our P&C insurance subsidiaries remained well capitalized on an individual basis and were in compliance with regulatory requirements, as well as above internal thresholds.

Our MCT level as at December 31, 2012 remained solid at an estimated 205%. The increase from December 31, 2011 mainly reflects the operating profit and also a slight temporary positive impact from the 2012 MCT guidelines changes, which will reverse in 2013. These were partially offset by usage of a portion of excess capital as a source of funding for the acquisition of Jevco.

Including net liquid assets of the non-regulated entities, we had an estimated total of $599 million in excess capital at an MCT of 170% as at December 31, 2012, compared to total excess capital of $435 million as at December 31, 2011. The increase in excess capital position mainly reflects the operational profit of the insurance subsidiaries.

We maintain adequate excess capital levels to ensure that the probability of breaching the regulatory minimum requirements is very low. Such levels may vary over time depending on our evaluation of risks and the potential impact on capital. For example, during periods of high volatility in capital markets, we will maintain higher capital levels to absorb fluctuations in equity markets or interest rates. We will also keep higher levels of excess capital if we foresee growth or acquisition opportunities in the mid-term. Finally, we will return excess capital to shareholders firstly through annual dividend increases and then through buy-backs. We intend to increase our dividends annually, albeit at a conservative pace to respect the volatility of the insurance business. We prefer to use buy-backs to return larger amounts of capital since they allow us to control the pace of execution.

10.2 MCT sensitivity

The MCT is impacted by many factors including changes in equity market performance, interest rates and underwriting profitability. Based on our estimated MCT of 205% as at December 31, 2012, the following table sets out the estimated immediate impact or sensitivity of our MCT ratio to certain sudden but independent changes in interest rates and equity markets. Actual results can differ materially from these estimates for a variety of reasons and, therefore, these sensitivities should be considered as directional estimates.

TABLE 34 – SENSITIVITY TO INTEREST RATES AND EQUITY MARKETS

	Interest rates 1% increase[1]	Equity markets decline[2]
MCT[3]	**(4) pts**	**(3) pts**

[1] The yield curve experiences an instantaneous parallel shift.
[2] A shock of 10% is applied to all common shareholdings, net of any equity hedges that we 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.

Annually, we perform Dynamic Capital Adequacy Testing on the MCT to ensure that we have sufficient capital to withstand significant adverse event scenarios. We review these scenarios each year to ensure appropriate risks are included in the testing process. The 2012 results indicated that our capital position is strong. In addition, our target, actual and forecasted capital position is subject to ongoing monitoring by management using stress tests and scenario analysis to ensure its adequacy.

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 audited Consolidated financial statements, 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 risk policies and limits.

– ***Conduct Review and Corporate Governance Committee***: this committee is composed exclusively 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.

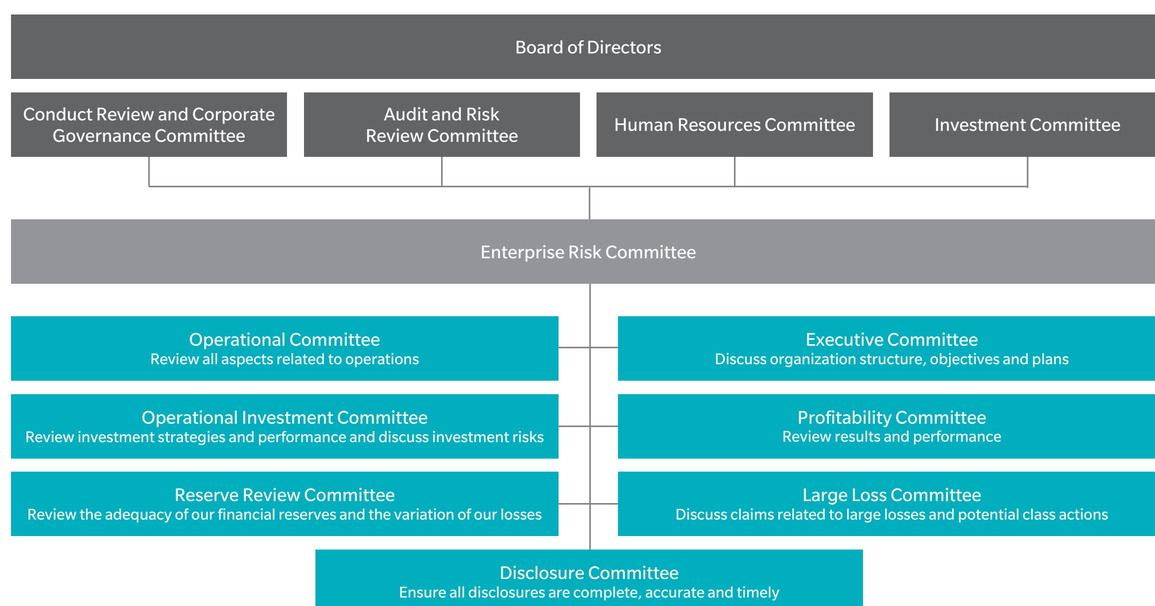
– ***Human Resources Committee***: this committee is composed exclusively of independent members of our Board of Directors and is chaired by an independent director. This committee oversees the management of the Company in relation to human resources matters, including compensation of employees, management and executives as well as assessment of the Chief Executive Officer and senior executives and succession plan. This committee also assesses the compensation practices of the Company against the compensation practices itemized in the Financial Stability Board program and 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*** *(refer to 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 at least 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 a quarterly basis to the Audit and Risk Review committee, and semi-annually to our Board of Directors. The committee evaluates our overall risk profile, aiming for a balance between risk, return, and capital, and approves risk policies. 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) manage risk in accordance with the risk tolerance level determined by our Board of Directors. Periodically, this committee may establish sub-committees to review specific subjects in greater detail and report back on its findings and recommendations. This allows the committee to access the expertise throughout the Company and to operate more efficiently in addressing key risks.

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 follow on how these committees operate, ensure compliance with laws and regulations and report to the Enterprise Risk Committee.

FIGURE 1 – COMMITTEES INVOLVED IN RISK MANAGEMENT



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.
- 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 Chief Executive Officer 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.

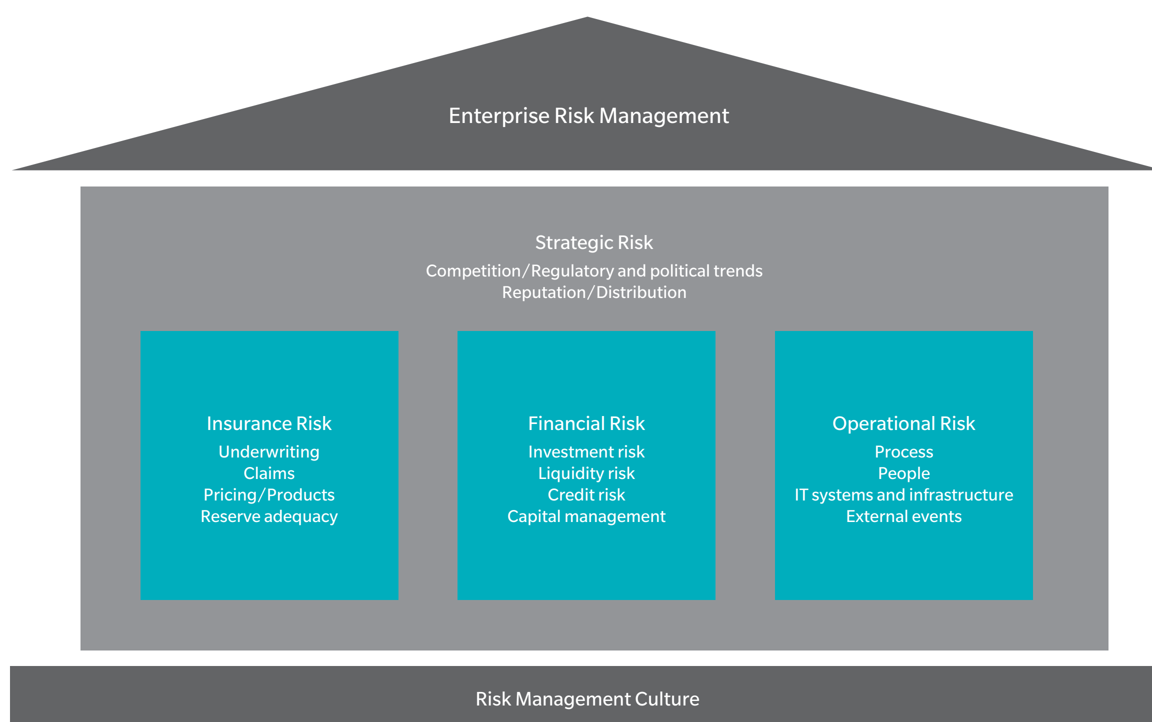
While senior management has ultimate responsibility for compliance, it is a responsibility that each individual employee shares. This is clearly set out in the Company's core Business Values and Code of Conduct and employees sign a confirmation that they have reviewed and complied with them annually.

11.4 Mandate of Enterprise Risk Management

Our business strategies and capital management decisions are tied to the risks the Company is prepared to accept, manage, mitigate or avoid. The Enterprise Risk Management function reports to the Board on capital level sufficiency to support planned business operations in line with our risk appetite. Based on the alignment and governance provided by the development of our own expertise in risk management, and by the best practices and governance models, we develop risk management policies and processes to manage and minimize systemic risks in the organization and receive early warnings of high-risk incidents.

The Enterprise Risk Management strategy is designed to provide an overview of our risks and ensure that appropriate actions are taken to protect our clients, employees, shareholders and other stakeholders. Our risk model is based on four main categories: Strategic Risk, Insurance Risk, Financial Risk and Operational Risk (see Figure 2).

FIGURE 2 – RISK MANAGEMENT MODEL



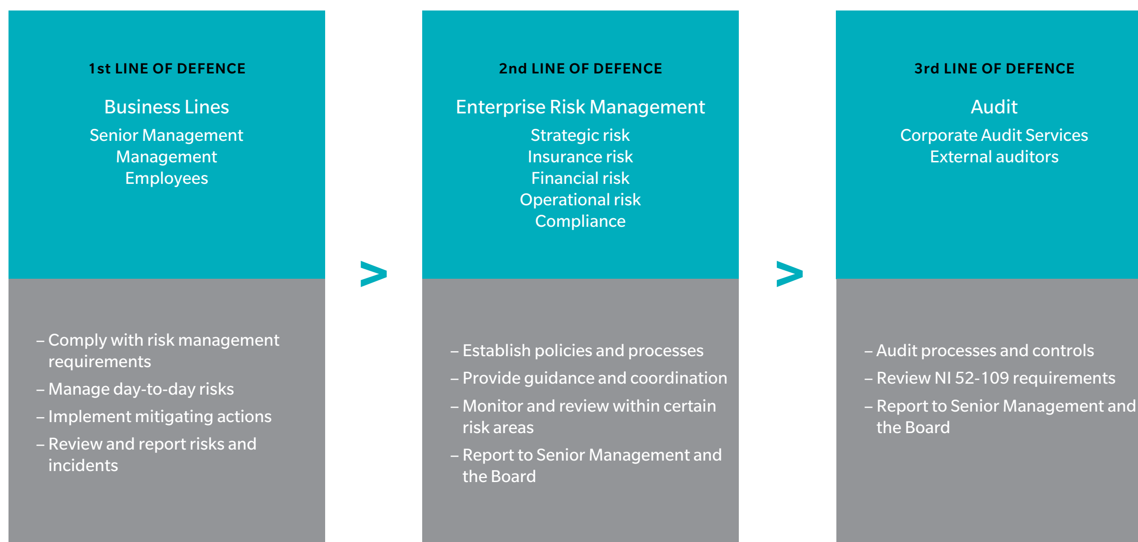
Our Enterprise Risk Management objectives consist of:

- overseeing and objectively challenging the execution of risk management activities;
- identifying, as completely as possible, the most important risks and issues that may affect us;
- monitoring of identified risks, major incidents and controls for weaknesses and reviewing adopted strategies;
- allocating risk ownership and responsibilities;
- gathering early warning information;
- escalating risk management issues and vetoing high-risk business activities;
- enforcing compliance to the risk policies;
- disclosing key risks completely and transparently; and
- supporting management in raising risk awareness and insight.

A shared responsibility:

- Heads of departments have primary responsibility and accountability for effective control of risks/challenges affecting their business. They are responsible for the execution of risk management policies set by Enterprise Risk Management-related functions (see Figure 3).
- Enterprise Risk Management functions partner with and support heads of departments in the execution of risk management activities. Risk management functions are "independent" of the management that can be affected by the risk exposures.
- Corporate Audit Services as well as external auditors play an independent role in ensuring objective assurance on the effectiveness of the risk management program and of the internal control framework.

FIGURE 3 – RISK MANAGEMENT FUNCTIONS – THE THREE LINES OF DEFENCE



We have an integrated risk-based approach to significantly increase the effectiveness of the program, ensuring that delegated authorities' actions are consistent with the overall strategy and risk appetite. Overall the risk profile and communication must be transparent with the objective of minimizing "surprises" to internal and external stakeholders on risk management and value creation.

11.5 Risk appetite

How do we manage corporate risk?

From a risk management perspective, our objective is to protect the sustainability of our activities while delivering on our promises to our stakeholders. To do so, we strive to maintain our financial strength, even in unpredictable environments or under extreme stress. We take a prudent approach to managing risk, and the following principles help us establish the nature and scope of risks we are willing to assume:

- we focus on our core competencies;
- we keep our overall risk profile in check;
- we protect ourselves against extreme events;
- we promote a strong risk culture; and
- we maintain our ability to access capital markets at reasonable costs.

11.6 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.

Insurance risk

Catastrophic events risk

The occurrence and severity of natural disasters may be affected by climate change and may take different forms, including but not limited to hurricanes, windstorms, earthquakes, hailstorms, rainstorms, ice storms, floods, explosions, severe winter weather and fires. Unnatural catastrophic events include hostilities, terrorist acts, riots, explosions, 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 or more recently the wildfires in Slave Lake in May 2011 caused P&C insurance losses in several lines of business, including business interruption, personal property, automobile and commercial property. Based on our property insurance exposures, the occurrence of a major earthquake in British Columbia could have a significant impact on our profitability and financial condition. Depending on the magnitude of the earthquake, its epicentre, and the extent of the damages, the losses could be substantial even after significant reinsurance recoveries. There could also be significant additional costs to find the required reinsurance capacity upon further renewals.

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 of risks, catastrophe scenario modeling, and the use of reinsurance. Consequently, the diversification of risk among an appropriate number of reinsurers is vital for the Company. See Section 11.7 – *Reinsurance* for more details on the Company's reinsurance program.

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:

- amounts of claims payments;
- 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 audited 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 income before income taxes 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. See Section 8.3 – *Claims liabilities* for more details on the claims reserve and prior year claims development.

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; and
- general industry practices.

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.

Climate change risk

Climate change is a challenge faced by the entire P&C 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.

Since 2010, the Company has supported the University of Waterloo's Climate Change Adaptation Project in order to learn from climate change studies and promote strategies for loss prevention. A comprehensive report was published in the summer of 2012 that outlined 20 practical and cost-effective recommendations to mitigate the impact of climate change in Canada.

Reinsurance risk

We use reinsurance to help manage our exposure to insurance risk. 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. The year of 2011 was particularly difficult for reinsurers, who faced many catastrophes around the world. It began with two earthquakes in New Zealand and another one in Japan followed by a tsunami, but they were also heavily impacted by other events such as wind storms in the U.S. and floods in Thailand. Consequently, there was an upward shift in reinsurance market conditions for earthquake exposure in Canada in 2012. This clearly shows the impact worldwide catastrophe events can have on the reinsurers' situation and therefore on the conditions and support provided to the Company.

Reinsurance companies may exclude some coverage 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 align the insurance and reinsurance terms and conditions as closely as possible to minimize these gaps. Other details regarding reinsurance are also included at Section 11.7 – *Reinsurance*.

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 levels 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 several Canadian banks that are selling insurance products. These firms may use business models different than 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.

Our multi-channel distribution strategy, including the broker channel, direct to consumer brands and web platforms, enhances our ability to adapt to evolving conditions in the insurance market. To secure strong relationships with our brokers, we provide them with advanced technology and support their growth with innovative financing. The Company invests significantly in promoting its brands with an increasing focus on using web and mobile technology to reach consumers.

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 and 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.

Financial risk

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 to those described above for changes in interest rates. Currently, interest rates are at the low end of the range over the last half century. In this context, purchases of fixed-income securities will likely be at lower yields than several years ago, putting downward pressure on investment income.

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 financial crisis of 2008 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. The potential contagion of the European Sovereign Debt crisis is another example of an event that could materially affect the value of the Company's investments.

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. Periodically, the Company employs several risk mitigation measures such as changes to its strategic asset mix, hedging of interest rate or equity risk and increased holdings in cash. These actions serve to reduce exposures in the investment portfolio and decrease the sensitivity of the MCT ratio to financial market volatility.

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 have no impact on net income 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 decrease OCI by approximately $138 million. Conversely, a 100-basis-point decrease in interest rates would increase OCI by the same amount and would have no impact on net income. 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 net income by $16 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 $143 million. Conversely, a 10% decrease in equity prices and a 5% decrease in preferred shares would increase net income 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:

- securities in our 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;
- impact on our pension plans is not included;
- for our FVTPL fixed-income securities, the estimated impact on net income 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 AOCI, may at some point in the future be realized through either a sale or an impairment; and
- risk reduction measures perform as expected, with no material basis risk and no counterparty defaults.

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 10 – *Capital management*.

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 debt portfolios, preferred share portfolios, over-the-counter derivatives and, to a lesser extent, reinsurance recoverables and structured settlements agreements entered into with various life insurance companies.

The Company's risk management strategy is to invest in debt 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 21 and 22 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 asset 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 investments could be sensitive to changing conditions in specific geographic regions or specific industries. The Company has a significant concentration of its investments 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 Table 20 for more details on the breakdown of investments 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. In addition, the Company may be subject to wrong-way risk arising from certain derivative transactions. Wrong-way risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty.

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 that have credit ratings of at least 'A-' or higher to provide for fixed and recurring payments to claimants. Under such arrangements, the Company no longer records the liability in its audited Consolidated balance sheet 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, as well as interest rate, equity market and currency 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.

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.

Credit downgrades may affect the Company's ability to raise capital or may result in an increase in the cost of raising capital with negative implications for shareholders and other stakeholders.

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 investments 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 investments 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 investments 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.

The Company has issued MTN to finance acquisitions and for general corporate purposes. To manage liquidity risk, the Company has issued longer-term maturities and has staggered the maturities accordingly.

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, our ability to pay dividends and the price of securities issued by the Company.

Strategic risk

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. The evolution of customer preferences for different distribution channels could lead to a material decline in the Company's market share.

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 that 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 reasons, the broker channel has been in a consolidation mode for the last few years and we believe that this situation will continue 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 investments;
- maintenance of adequate reserves for unearned premiums and unpaid claims;
- examination of insurance companies by regulatory authorities, including periodic financial and market conduct examinations;
- 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 tax 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. Multi-party 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 jurisdictions in which we operate, and can be proactive in situations that could affect our business.

In addition, the profitability of automobile insurers can be significantly affected 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 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.

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 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%, which is higher than the regulatory MCT requirement of 150%. The appointed actuary must present an annual report to the Audit and Risk Review Committee and the Enterprise Risk Committee on the Company's current and future solvency and mitigating measures. In 2011, the Company adopted a capital management policy. The policy contains guidelines to help ensure that the Company maintains adequate capital to withstand adverse event scenarios and has documented procedures to take corrective action should any unanticipated conditions arise.

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 publicity of insurance 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. In addition, the Enterprise Risk Committee monitors the Company's operations to identify situations that can negatively affect the Company's reputation. If necessary, the committee approves policies and implements procedures to mitigate reputation risk.

Operational risk

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, and 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 to increasing the operational risk awareness culture within the organization and minimizing the severity and occurrence of incidents.

The effective implementation of the overall operational 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 risk management department reports to the Enterprise Risk Committee. 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 Audit and Risk Review Committee and the Board of Directors.

Information technology risk

The use of information technology enables us to increase our productivity, to offer attractive products and interfaces to existing and potential customers, and to distinguish ourselves from the competition by benefiting from a competitive advantage. However, our dependency on technology, network, telephony and critical applications makes our ability to operate and our profitability vulnerable to service interruption, third party agreement failure and security breaches. Massive denial of service attacks and system intrusion attempts could compromise our ability to operate and Intact could be unable to safeguard confidential information from public disclosure. To maintain our performance levels, we are required to periodically modernize our systems and to constantly seek to renew. Time required for accomplishing projects, unplanned delay or cost, or not being successful in executing such projects could lead to a significant decline in service levels, impact retention negatively and jeopardize our competitive advantage.

To ensure the security and the resilience of our systems, the safeguarding of our confidential information and the integrity of our information and databases, various dedicated teams plan, test and execute our continuity and security plans. Their efforts are supported by teams constantly monitoring our systems and ready to intervene if an incident occurs. To ensure the expected levels of service are delivered by our critical third party service providers, service level agreements are signed and added to relevant contracts.

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 and 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.

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.

11.7 Reinsurance

In the ordinary course of business, we reinsure certain risks with other reinsurers to limit our maximum loss in the event of catastrophic events or other significant losses.

Our objectives related to ceded reinsurance are:

- capital protection;
- reduction in the volatility of results;
- increase in underwriting capacity; and
- access to the expertise of reinsurers.

The placement of ceded reinsurance is done almost exclusively on an excess of loss basis (per event or per risk) as is typically the practice. The Company's ceded reinsurance programs comply with 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.

Amongst other criteria, all reinsurers chosen to participate in the reinsurance program have a minimum rating of 'A-' from A.M. Best and/or S&P at the time of entering into reinsurance arrangements with us. The financial analysis performed by the Company's specialized reinsurance brokers and other qualitative information are also considered in the selection of the Company's reinsurers. The treaties have special termination clauses and a security review clause allowing the Company to change a reinsurer during the term of the treaties if its rating falls below the minimum required or for other reasons that might jeopardize the Company's ability to continue doing business with a reinsurer as intended at the time of entering into the reinsurance arrangement. Because of the importance of the Catastrophe program in place, a certain level of concentration exists with high-quality reinsurers, but diversification of reinsurers remains a key element and is analyzed and implemented to avoid excessive concentration in a specific reinsurance group. A single catastrophic event such as an earthquake could financially weaken a reinsurer, so distribution of risk is an important reinsurance strategy for the Company.

At December 31, 2012, all of our reinsurance treaties are with unaffiliated reinsurance companies, substantially all of which meet our financial strength rating requirements.

In line with industry practice, our reinsurance recoverable with licensed Canadian reinsurers ($240 million as at December 31, 2012, $276 million as at December 31, 2011) 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 recoverable with non-licensed reinsurers ($80 million as at December 31, 2012, $130 million as at December 31, 2011) are secured with cash, letters of credit and/or assets held in trust accounts or under security agreements of $173 million as at December 31, 2012 ($183 million as at December 31, 2011).

Annually, we review and adjust accordingly our reinsurance coverage as well as our net retention of risks in order to reflect our current exposures and our capital base.

SECTION 12 – Off-balance sheet arrangements

12.1 Securities lending

We participate in a securities lending program to generate fee income. This program is managed by our custodian, a major Canadian financial institution, whereby we lend securities we own to other financial institutions to allow them to meet their delivery commitments. We loaned securities, which are reported as Investments in the accompanying audited Consolidated financial statements, with a fair value of $2.2 billion as at December 31, 2012 ($1.6 billion as at December 31, 2011). Collateral is provided by the counterparty and is held in trust by the custodian for our benefit until the underlying security has been returned to us. The collateral cannot be sold or re-pledged externally by us, 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 loaned securities and amounts to $2.3 billion as at December 31, 2012 ($1.6 billion as at December 31, 2011).

SECTION 13 – Accounting and disclosure matters

13.1 Significant accounting judgments, estimates and assumptions

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from these estimates.

The key estimates and assumptions that have a risk of causing a material adjustment to the carrying value of certain assets and liabilities within the next financial year are as follows:

Valuation of claims liabilities

The ultimate cost of claims liabilities is estimated by using a range of standard actuarial claims projection techniques in accordance with Canadian accepted actuarial practice.

The main assumption underlying these techniques is that a company's past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analyzed by accident years, but can also be further analyzed by geographical area, as well as by significant business line and claim type. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based. Additional qualitative judgment is used to assess the extent to which past trends may not apply in future, in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking into account all of the uncertainties involved.

Valuation of pension benefit obligation

The cost of defined benefit pension plans and other post-employment medical benefits and the present value of the pension obligation are determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, the employees' age upon retirement, mortality rates and future pension increases. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, a defined benefit obligation is highly sensitive to changes in the assumptions. All assumptions are reviewed at each reporting date. Details of the key assumptions used in the estimates are contained in Note 19.5 – *Assumptions used* to the accompanying audited Consolidated financial statements.

Impairment

Goodwill and intangible assets

We determine whether goodwill and intangible assets with indefinite useful lives are impaired at least on an annual basis. Also, intangible assets under development are not subject to amortization but are tested for impairment on an annual basis. Impairment testing of these assets requires an estimation of the recoverable amount of the cash generating units to which the assets are allocated. The assumptions used in this estimation of the recoverable amount are discussed in Note 18 – *Goodwill and intangible assets* to the accompanying audited Consolidated financial statements.

Financial assets

We determine whether financial assets, other than those classified or designated as at FVTPL, are impaired at each audited Consolidated balance sheet date. These financial assets are impaired when there is objective evidence of a decline in fair value below cost. Considerations that form the basis of these objective evidence judgments include a significant or prolonged decline in fair value of an AFS equity instrument and a loss event that has occurred impairing the expected cash flows of an AFS debt instrument. For asset-backed securities, considerations include liquidity risk, credit risk, volatility, discount rates, prepayment rates and default rate assumptions.

Measurement of embedded derivatives

We own perpetual preferred shares with call options which give the issuer the right to redeem the shares at a particular price. Accounting standards require the value of the option liability to be measured separately from the preferred shares. The value of the option liability for embedded derivatives is determined using a valuation which relies predominantly on the price volatility of the underlying preferred shares, which can be significantly affected by market conditions. Judgment is also required to determine the time period over which the volatility is measured.

Measurement of income taxes

Management exercises judgment in estimating the provision for income taxes. We are subject to federal income tax law and provincial income tax laws in the various jurisdictions where we operate. Various tax laws are potentially subject to different interpretations by the taxpayer and the relevant tax authority. To the extent that our interpretations of tax laws differ from those of tax authorities or that the timing of realization of deferred tax assets is not as expected, the provision for income taxes may increase or decrease in future periods to reflect actual experience.

Business combinations

Upon initial recognition, the acquiree's assets and liabilities have been included in the audited Consolidated balance sheets at fair value. Management estimated the fair values using estimates on future cash flows and discount rates. However, actual results can be different from those estimates. The changes in the estimates that relate to new information obtained about facts and circumstances that existed as of the acquisition date, made at initial recognition with regard to items for which the valuation was incomplete, would have an impact on the amount of goodwill recognized. Any other changes in the estimates made at initial recognition would be reported in the audited Consolidated statements of comprehensive income. The detail on assets acquired and liabilities assumed is presented in Note 4 – *Business combinations* to the accompanying audited Consolidated financial statements.

13.2 Financial instruments

An important portion of our audited Consolidated balance sheets is composed of financial instruments. Our financial assets include investments (cash and cash equivalents, debt securities, preferred shares, common shares and loans) and receivables. Our financial liabilities include claims liabilities, financial liabilities related to investments and debt outstanding. Derivative financial instruments are used for risk management purposes and are generally held for non-trading purposes to mitigate foreign exchange and market risks (see Section 11.6 – *Main risk factors and mitigating actions*). They consist mostly of forwards, futures, swaps and options.

- Forwards are used to mitigate the risk arising from foreign currency fluctuations and futures are used to modify exposure to interest rate fluctuations.
- Swaps are used mainly in conjunction with other financial instruments to synthetically alter the cash flows of certain investments and credit exposure to specific bond issuers.
- Options are used to modify our exposure to interest rate risk.
- Inflation caps, which are a type of option, are used to manage inflation risk.

Financial instruments are required to be recognized at their fair value on initial recognition. Subsequent measurement is at amortized cost or fair value depending on the classification of the financial instruments. Financial instruments classified as at FVTPL or AFS are carried at fair value, while all others are carried at amortized cost.

The fair value of financial instruments on initial recognition is normally the transaction price, being the fair value of the consideration given or received. Subsequent to initial recognition, the fair value of financial instruments is determined based on available information and categorized according to a three-level fair value hierarchy. The distribution of our financial instruments between each of the fair value hierarchy levels is described in Note 8 – *Fair value measurement* to the accompanying audited Consolidated financial statements.

Where the fair values of financial assets and financial liabilities reported on the audited Consolidated balance sheets cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of discounted cash flow models and/or mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment is required to establish fair values.

For discounted cash flow analyses, estimated future cash flows and discount rates are based on current market information and rates applicable to financial instruments with similar yields, credit quality and maturity characteristics. Estimated future cash flows are influenced by factors such as economic conditions (including country-specific risks), concentrations in specific industries, types of instruments, currencies, market liquidity and financial conditions of counterparties. Discount rates are influenced by risk-free interest rates and credit risk. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Refer to Note 3 – *Summary of significant accounting policies*, Note 7 – *Derivative financial instruments* and Note 8 – *Fair value measurement* to the accompanying audited Consolidated financial statements for details on the classification and measurement of financial instruments.

13.3 Standards issued but not yet effective

Consolidated financial statements

IFRS 10 – *Consolidated financial statements* replaces IAS 27 – *Consolidated and separate financial statements* and SIC-12 – *Consolidation – special purpose entities* and establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. The main features are as follows:

- the principle of control sets out the three elements of control: (1) power over the investee; (2) exposure, or rights, to variable returns from involvement with the investee; and (3) the ability to use power over the investee to affect the amount of the investor's returns; and
- when preparing consolidated financial statements, an entity must use uniform accounting policies for reporting like transactions and other events in similar circumstances. Intragroup balances and transactions must be eliminated.

The standard is effective for years beginning on or after January 1, 2013 and, other than additional disclosure requirements, is not expected to have a significant impact on our financial statements.

Joint arrangements

IFRS 11 – *Joint arrangements* replaces IAS 31 – *Interest in joint ventures* and SIC-13 – *Jointly controlled entities – non-monetary contributions by venturers* and is to be applied by all entities that are a party to a joint arrangement, whereby two or more parties have joint control. The main features of this new standard are as follows:

- joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control;
- joint arrangements are classified into two types – joint operations and joint ventures;
- an entity determines the type of arrangement in which it is involved by considering its rights and obligations;
- a joint operator will recognize and measure the assets, liabilities, revenues and expenses in relation to its interest in the arrangement; and
- a joint venturer will recognize an investment and measure it using the equity method.

The standard is effective for years beginning on or after January 1, 2013 and, other than additional disclosure requirements, is not expected to have a significant impact on our financial statements.

Disclosure of interests in other entities

IFRS 12 – *Disclosure of interests in other entities* replaces the disclosure requirements of IAS 27 – *Consolidated and separate financial statements*, IAS 28 – *Investments in associates*, and IAS 31 – *Interests in joint ventures*. IFRS 12 establishes disclosure objectives according to which an entity discloses information regarding consolidated entities, associates, joint arrangements, unconsolidated structured entities and non-controlling interests.

The standard is effective for years beginning on or after January 1, 2013 and is not expected to have a significant impact on our financial statements.

Fair value measurement

In May 2011, the IASB issued IFRS 13 – *Fair value measurement* with a view to setting out a single IFRS framework for defining, measuring and disclosing fair value. The main features are as follows:

- defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date;
- the fair value measurement requires an entity to determine the following:
  - the particular asset or liability being measured;
  - for a non-financial asset, the highest and best use of the asset and whether the asset is used in combination with other assets or on a stand-alone basis;
  - the market in which an orderly transaction would take place for the asset or liability; and
  - the appropriate valuation technique(s) to use when measuring fair value. The technique(s) should maximize the use of relevant observable inputs and minimize unobservable inputs. Those inputs should be consistent with the inputs a market participant would use when pricing the asset or liability; and
- the entity is to disclose those valuation techniques and inputs used to develop the fair value measurements.

The standard is effective for years beginning on or after January 1, 2013 and, other than additional disclosure requirements, is not expected to have a significant impact on our financial statements.

Employee benefits

In June 2011, the IASB completed its project to improve the accounting for pension and other post-employment benefits by issuing an amended version of IAS 19 – *Employee benefits*. The main features are as follows:

- eliminate an option to defer the recognition of gains and losses, known as the "corridor method";
- require entities to compute the asset return component using the discount rate used to measure the defined benefit obligations rather than the expected return on assets; and
- enhance the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.

The standard is effective for years beginning on or after January 1, 2013 and is generally to be applied retrospectively. The use of the discount rate in calculating the asset returns will generally result in an increase in employee future benefit expense and a corresponding offset in OCI with no overall change in Total comprehensive income attributable to shareholders.

Financial statement presentation

In June 2011, the IASB amended IAS 1 – *Presentation of Financial Statements.* The principal change resulting from the amendments to IAS 1 is a requirement within the Statement of Other comprehensive income to distinguish between items within OCI that may be reclassified to the statement of income and items that will not.

The standard is effective for years beginning on or after July 1, 2012 and will not have an impact on our financial statements as the items within OCI that may be reclassified to the Consolidated statements of income are already disclosed together.

Financial instruments: classification and measurement

In November 2009, the IASB issued IFRS 9 – *Financial Instruments.* This standard represents the completion of the first part of a three-part project to replace IAS 39 – *Financial Instruments: Recognition and Measurement*. The new standard reduces complexity by replacing the many different rules in IAS 39. The key features of the new standard are as follows:

- a business model test is applied first in determining whether a financial asset is eligible for measurement at amortized cost. The business model objective is based on holding financial assets in order to collect contractual cash flows rather than realizing cash flows from the sale of the financial assets;
- in order to be eligible for amortized cost measurement, an asset must have contractual cash flow characteristics representing the principal and interest;
- all other financial assets are measured at fair value on the balance sheet;
- an entity can elect on initial recognition to present the fair value changes on an equity investment that is not held for trading directly in OCI. The dividends on investments for which this election is made must be recognized in profit or loss, but gains or losses are not removed from OCI when the equity investment is disposed of; and
- if a financial asset is eligible for amortized cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch.

The standard is effective for years beginning on or after January 1, 2015. We will analyze the impact that this standard will have on our audited Consolidated financial statements in conjunction with the other phases of the standard when issued.

13.4 Related-party transactions

We enter into transactions with associates and joint ventures in the normal course of business. All related-party transactions are with entities associated with our distribution channel. These transactions mostly comprise commissions for insurance policies and interest and principal payments on loans. These transactions are measured at the amount of consideration paid or received as established and agreed to by the related parties. Management believes that such exchange amounts approximate fair value.

We also enter into transactions with key management personnel and post-employment plans. Our key management personnel include all members of the Board of Directors and certain members of the Executive Committee. Key management personnel can purchase insurance products offered by the Company in the normal course of business. The terms and conditions of such transactions are essentially the same as those available for our clients and employees. Transactions with post-employment plans comprise the contributions paid to these plans.

Note 26 – *Related-party transactions* to the accompanying audited Consolidated financial statements provides additional information on related-party transactions.

13.5 Disclosure controls and procedures

We are 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. Management is responsible for establishing and maintaining our 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. We continue to evolve and enhance our 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 our 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, 2012. 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.

13.6 Internal controls over financial reporting

Management has designed and is responsible for maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Following the acquisition of Jevco on September 4, 2012, management has limited the scope of design of the Company's disclosure controls and procedures and internal control over financial reporting to exclude the controls, policies and procedures of Jevco. Jevco's contribution to our audited Consolidated financial statements for the year ended December 31, 2012 was 2% of consolidated revenue. Additionally, at December 31, 2012, Jevco's total assets and total liabilities were approximately 7% and 6% of consolidated total assets and total liabilities, respectively. Management is committed to removing this limitation within the timeframe permitted by regulation.

No significant changes were made to our ongoing internal controls over financial reporting during 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

SECTION 14 – Investor information

14.1 Authorized share capital

Our authorized share capital consists of an unlimited number of common shares and Class A shares.

14.2 Outstanding share data

The following table presents the outstanding share data as at February 5, 2013.

TABLE 35 – OUTSTANDING SHARE DATA

(number of shares)	
Common shares	**133,333,665**
Class A	
Series 1 Preferred Shares	**10,000,000**
Series 3 Preferred Shares	**10,000,000**

Refer to our Annual Information Form for more detailed information on the rights of shareholders and to Note 21 – *Common shares and preferred shares* to the accompanying audited Consolidated financial statements for additional information.

14.3 Dividends declared on common shares and on preferred shares

The following table presents the total dividends declared on each class of shares for the year ended December 31, 2012.

TABLE 36 – DIVIDENDS DECLARED PER SHARE

(in dollars)	
Common shares	**1.60**
Class A	
Series 1 Preferred Shares	**1.05**
Series 3 Preferred Shares	**1.05**

On February 5, 2013, the Board of Directors increased the quarterly dividend by 10%, or four cents, to 44 cents per share on our outstanding common shares. The decision reflected our objective to create value for shareholders, the strength of our financial position and the quality of our operating earnings. This is the eighth consecutive year we have increased our dividend.

14.4 NCIB program

The NCIB program expired on February 22, 2012 and was not renewed. No common shares were repurchased for cancellation under the NCIB program in 2012. As at December 31, 2011, 2,750,900 common shares at an average price of $47.03 were repurchased for cancellation for a total cash consideration of $129 million.

14.5 Long-term incentive plans

The following table shows the outstanding units and fair value for each of the Company's performance cycles as at December 31, 2012.

TABLE 37 – OUTSTANDING UNITS AND FAIR VALUE BY PERFORMANCE CYCLE

	Number of units	Weighted-average grant date fair value (in $)	Amount (in millions of $)
2010–2012 performance cycle	**447,829**	**35.06**	**16**
2011–2013 performance cycle	**396,820**	**50.84**	**20**
2012–2014 performance cycle	**244,124**	**57.96**	**14**
Total	**1,088,773**	**45.90**	

Refer to Note 23 – *Share-based payments* to the audited Consolidated financial statements for additional details.

14.6 Expected issuance dates of our financial results

The expected issuance dates of our financial results for the next 12 months are as follows:

First quarter results, for the period ending March 31, 2013	May 8, 2013
Second quarter results, for the period ending June 30, 2013	July 31, 2013
Third quarter results, for the period ending September 30, 2013	November 6, 2013
Year-end results, for the period ending December 31, 2013	February 5, 2014

SECTION 15 – Selected annual and quarterly information

15.1 Selected annual information

The following table presents selected annual information for the years shown.

TABLE 38 – SELECTED ANNUAL INFORMATION

	2012	2011	2010
Total revenues	**7,127**	5,532	4,788
Underwriting income	**451**	273	193
Net income from continuing operations	**587**	457	498
Net income attributable to shareholders	**587**	465	498
EPS from continuing operations, basic and diluted (in dollars)	**4.33**	3.89	4.32
EPS, basic and diluted (in dollars)	**4.33**	3.96	4.32
Cash dividends declared per share (in dollars)			
Common shares	**1.60**	1.48	1.36
Class A			
Series 1 Preferred Shares	**1.05**	0.49	–
Series 3 Preferred Shares	**1.05**	0.39	–

The following table presents selected annual information as at the dates shown.

TABLE 39 – SELECTED ANNUAL INFORMATION

As at	**December 31, 2012**	December 31, 2011	December 31, 2010
Investments	**12,959**	11,828	8,653
Total assets	**19,813**	19,753	12,075
Debt outstanding	**1,143**	1,293	496
Shareholders' equity	**4,893**	4,341	2,969

15.2 Selected quarterly information

TABLE 40 – SELECTED QUARTERLY INFORMATION

	Q4-2012	Q3-2012	Q2-2012	Q1-2012	Q4-2011	Q3-2011	Q2-2011	Q1-2011
Written insured risks (in thousands)	**1,543**	1,794	2,018	1,374	1,508	1,251	1,379	946
DPW	**1,690**	1,798	1,977	1,403	1,576	1,226	1,354	943
Total revenues	**1,877**	1,791	1,723	1,736	1,730	1,329	1,248	1,225
Net premiums earned	**1,742**	1,640	1,599	1,590	1,616	1,121	1,075	1,068
Current year catastrophes	**16**	150	62	17	32	58	104	14
Favourable prior year claims development	**(85)**	(70)	(83)	(134)	(38)	(31)	(73)	(81)
Underwriting income	**138**	67	123	123	118	65	33	58
Combined ratio	**92.1%**	95.9%	92.3%	92.3%	92.7%	94.2%	97.0%	94.6%
NOI	**194**	122	180	179	152	111	95	102
Net income from continuing operations	**181**	96	133	177	76	101	123	157
Net income attributable to shareholders	**181**	96	133	177	84	101	123	157
NOIPS, basic and diluted (in dollars)	**1.42**	0.89	1.35	1.34	1.14	0.97	0.87	0.91
EPS from continuing operations, basic and diluted (in dollars)	**1.32**	0.70	0.98	1.33	0.55	0.87	1.12	1.42
EPS, basic and diluted (in dollars)	**1.32**	0.70	0.98	1.33	0.62	0.87	1.12	1.42

Our results reflect the acquisition of Jevco since September 4, 2012 and the acquisition of AXA Canada since September 23, 2011. See also discussion on seasonality of the business in Section 6 – *Business developments and operating environment*.

SECTION 16 – Non-IFRS financial measures

Non-IFRS financial measures do not have standardized meanings prescribed by IFRS and may not be comparable to similar measures used by other companies in our industry. These non-IFRS financial measures are used by management and financial analysts to assess our performance.

- AEPS and AROE exclude the impact of amortization of intangible assets recognized in business combinations, integration and restructuring costs, all on an after-tax basis, as well as the change in fair value of contingent consideration (not deductible for tax purposes).
- NOI, NOIPS and OROE exclude net income from discontinued operations, net investment gains and losses excluding FVTPL fixed-income securities, market yield effect, amortization of intangible assets recognized in business combinations, integration and restructuring costs and change in fair value of contingent consideration, as well as the related tax impact.
- The market-based yield represents the annualized total pre-tax investment income (before expenses), divided by the average fair values of net equity and fixed-income securities held during the reporting period.

We believe that these metrics reflect more accurately our underlying business performance.

TABLE 41 – RECONCILIATION BETWEEN NET INCOME ATTRIBUTABLE TO SHAREHOLDERS AND AEPS

	Q4-2012	Q4-2011	2012	2011
Net income attributable to shareholders	**181**	84	**587**	465
Less net income from discontinued operations	**–**	(8)	**–**	(8)
Add amortization of intangible assets recognized in business combinations, net of tax	**4**	4	**16**	10
Add integration and restructuring costs, net of tax	**22**	32	**80**	56
Add change in fair value of contingent consideration	**–**	41	**11**	41
Adjusted net income attributable to shareholders	**207**	153	**694**	564
Less preferred share dividends	**(5)**	(5)	**(21)**	(8)
Adjusted net income attributable to common shareholders	**202**	148	**673**	556
Divided by weighted-average number of common shares (in millions)	**133.3**	129.6	**130.8**	115.3
AEPS, basic and diluted (in dollars)	**1.51**	1.14	**5.15**	4.82

TABLE 42 – RECONCILIATION BETWEEN NET INCOME ATTRIBUTABLE TO SHAREHOLDERS AND NOIPS

	Q4-2012	Q4-2011	2012	2011
Net income attributable to shareholders	**181**	84	**587**	465
Less net income from discontinued operations	**–**	(8)	**–**	(8)
Add income taxes	**47**	40	**147**	137
Add net investment losses (deduct net investment gains) excluding FVTPL fixed-income securities (Table 11)	**(30)**	7	**(72)**	(140)
Add market yield effect (Table 12)	**13**	–	**52**	17
Add amortization of intangible assets recognized in business combinations	**6**	4	**21**	13
Add integration and restructuring costs	**29**	42	**108**	71
Add change in fair value of contingent consideration	**–**	41	**11**	41
Pre-tax operating income	**246**	210	**854**	596
Tax impact on operating income	**(52)**	(58)	**(179)**	(136)
NOI	**194**	152	**675**	460
Less preferred share dividends	**(5)**	(5)	**(21)**	(8)
NOI to common shareholders	**189**	147	**654**	452
Divided by weighted-average number of common shares (in millions)	**133.3**	129.6	**130.8**	115.3
NOIPS, basic and diluted (in dollars)	**1.42**	1.14	**5.00**	3.91

SECTION 17 – Cautionary note regarding forward-looking statements

Certain of the statements included 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", "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 designed to protect policyholders and creditors rather than investors; 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 to clients; the Company's ability to successfully pursue its acquisition strategy; the Company's ability to execute its business strategy; the terms and conditions of, and regulatory approvals relating to, the integration of Jevco; various other actions to be taken or requirements to be met in connection with the Jevco acquisition and integrating the Company and Jevco; synergies arising from, and the Company's integration plans relating to, the AXA Canada acquisition; management's estimates and expectations in relation to resulting accretion, IRR and debt-to-capital ratio after closing of the AXA Canada and Jevco acquisitions; various other actions to be taken or requirements to be met in connection with the AXA Canada acquisition and integrating the Company and AXA Canada; the Company's participation in the Facility Association (a mandatory pooling arrangement among all industry participants) and similar mandated risk-sharing pools; terrorist attacks and ensuing events; the occurrence of catastrophic events; the Company's ability to maintain its financial strength and issuer credit ratings; access to debt financing and the Company's ability to compete for large commercial business; 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; changes in laws or regulations; 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 Section 11 – *Risk management* herein. These factors are not intended to represent a complete list of the factors that could affect the Company. These factors should, however, be considered carefully. Although the forward-looking statements are based upon what management believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. When relying on forward-looking statements to make decisions, investors should ensure the preceding information is carefully considered. Undue reliance should not be placed 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.

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 International Financial Reporting Standards.

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* of Canada or to the *Insurance Act* ("Québec") ("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 these 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 the Autorité des marchés financiers for the Québec 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, 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 5, 2013

Charles Brindamour
Chief Executive Officer

Mark A. Tullis
Senior Vice President and 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, 2012 and 2011, and the consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the years ended December 31, 2012 and 2011, and a summary of significant accounting policies and other explanatory information.

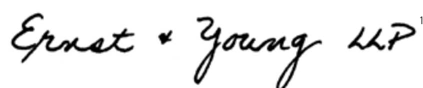
Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is 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 auditors consider 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, 2012 and 2011 and its financial performance and its cash flows for the years ended December 31, 2012 and 2011 in accordance with International Financial Reporting Standards.



Montréal, Canada
February 5, 2013

[1] CPA auditor, CA, public accountancy permit no. A114960

ERNST & YOUNG — A member firm of Ernst & Young Global Limited

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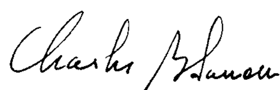
Audited Consolidated balance sheets

(in millions of Canadian dollars, except as otherwise noted)

As at	Note	December 31, 2012	December 31, 2011
Assets			
Investments	6		
Cash and cash equivalents		$ 172	$ 206
Debt securities		8,757	7,887
Preferred shares		1,263	1,281
Common shares		2,376	2,051
Loans		391	403
		12,959	11,828
Assets classified as held for sale	5	–	1,631
Accrued investment income		66	66
Premium receivables		2,670	2,487
Reinsurance assets		320	409
Income taxes receivable		105	58
Deferred tax assets	14	129	158
Deferred acquisition costs		705	652
Other assets	17	412	294
Investments in associates and joint ventures	15	266	241
Property and equipment	16	105	67
Intangible assets	18	1,153	1,068
Goodwill	18	923	794
Total assets		$ 19,813	$ 19,753
Liabilities			
Liabilities directly associated with assets classified as held for sale	5	$ –	$ 1,330
Claims liabilities	11	7,656	6,886
Unearned premiums	11	4,046	3,790
Financial liabilities related to investments	6	486	532
Income taxes payable		35	17
Deferred tax liabilities	14	140	123
Other liabilities	17	1,414	1,441
Debt outstanding	20	1,143	1,293
		14,920	15,412
Shareholders' equity			
Common shares	21	2,118	1,889
Preferred shares	21	489	489
Contributed surplus		121	115
Retained earnings		1,982	1,642
Accumulated other comprehensive income		183	206
		4,893	4,341
Total liabilities and shareholders' equity		$ 19,813	$ 19,753

See accompanying notes to the audited Consolidated financial statements.

On behalf of the Board:



Charles Brindamour
Director

Eileen Mercier
Director

Audited Consolidated statements of comprehensive income

(in millions of Canadian dollars, except as otherwise noted)

For the years ended December 31,	Note	2012	2011
Direct premiums written	12	$ 6,854	$ 5,126
Net premiums earned	12	6,561	4,907
Net claims incurred	11	(4,053)	(3,133)
Underwriting expenses		(2,063)	(1,501)
		445	273
Impact of change in net claims discount rate	11	(17)	(81)
Underwriting income		428	192
Net investment income	6	388	326
Net investment gains	6	37	204
Share of profit from investments in associates and joint ventures	15	22	16
Other revenues		88	50
Other expenses		(50)	(41)
Finance costs		(60)	(41)
Integration and restructuring costs	13	(108)	(71)
Change in fair value of contingent consideration	17	(11)	(41)
Income before income taxes		734	594
Income tax expense	14	147	137
Net income from continuing operations attributable to shareholders		587	457
Net income from discontinued operations attributable to shareholders		–	8
Net income attributable to shareholders		$ 587	$ 465
Weighted-average number of common shares, basic and diluted (in millions)	22	130.8	115.3
Earnings per common share, basic and diluted (in dollars)	22	$ 4.33	$ 3.96
From continuing operations		4.33	3.89
From discontinued operations		–	0.07
Dividends paid per common share (in dollars)		$ 1.60	$ 1.48
Net income attributable to shareholders		$ 587	$ 465
Other comprehensive income (loss)			
Items that may be reclassified subsequently to net income attributable to shareholders			
Derivatives designated as cash flow hedges:			
Net changes in unrealized gains (losses)		1	(15)
Reclassification to income of net losses		–	7
Available-for-sale securities:			
Net changes in unrealized gains		52	42
Reclassification to income of net gains		(87)	(179)
Income tax benefit	14	11	36
		(23)	(109)
Items that will not be reclassified subsequently to net income attributable to shareholders			
Net actuarial losses on employee future benefits	19	(5)	(139)
Income tax benefit	14	2	34
		(3)	(105)
Other comprehensive loss		(26)	(214)
Total comprehensive income attributable to shareholders		$ 561	$ 251

See accompanying notes to the audited Consolidated financial statements.

Audited Consolidated statements of changes in shareholders' equity

(in millions of Canadian dollars, except as otherwise noted)

	Note	Common shares	Preferred shares	Contributed surplus	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance as at January 1, 2012		**$ 1,889**	**$ 489**	**$ 115**	**$ 1,642**	**$ 206**	**$ 4,341**
Net income attributable to shareholders		**–**	**–**	**–**	**587**	**–**	**587**
Other comprehensive loss		**–**	**–**	**–**	**(3)**	**(23)**	**(26)**
Total comprehensive income (loss)		**–**	**–**	**–**	**584**	**(23)**	**561**
Common shares issued	21	**229**	**–**	**–**	**–**	**–**	**229**
Dividends declared on common shares	21	**–**	**–**	**–**	**(210)**	**–**	**(210)**
Dividends declared on preferred shares	21	**–**	**–**	**–**	**(21)**	**–**	**(21)**
Share-based payments	23	**–**	**–**	**6**	**(13)**	**–**	**(7)**
Balance as at December 31, 2012		**$ 2,118**	**$ 489**	**$ 121**	**$ 1,982**	**$ 183**	**$ 4,893**
Balance as at January 1, 2011		$ 993	$ –	$ 96	$ 1,565	$ 315	$ 2,969
Net income attributable to shareholders		–	–	–	465	–	465
Other comprehensive income		–	–	–	(105)	(109)	(214)
Total comprehensive income (loss)		–	–	–	360	(109)	251
Common shares repurchased for cancellation	21	(24)	–	–	(105)	–	(129)
Common shares issued	21	920	–	–	–	–	920
Preferred shares issued	21	–	489	–	–	–	489
Dividends declared on common shares	21	–	–	–	(170)	–	(170)
Dividends declared on preferred shares	21	–	–	–	(8)	–	(8)
Share-based payments	23	–	–	19	–	–	19
Balance as at December 31, 2011		$ 1,889	$ 489	$ 115	$ 1,642	$ 206	$ 4,341

See accompanying notes to the audited Consolidated financial statements.

Audited Consolidated statements of cash flows

(in millions of Canadian dollars, except as otherwise noted)

For the years ended December 31,	Note	2012	2011
Operating activities			
Net income attributable to shareholders		$ 587	$ 465
Adjustments for non-cash items	24	144	(109)
Changes in other operating assets and liabilities	24	(147)	(94)
Changes in net claims liabilities	11	139	270
Net cash flows provided by operating activities		723	532
Investing activities			
Business combinations, net of cash acquired	4	(507)	(2,546)
Proceeds from sale of investments		12,303	9,070
Purchases of investments		(12,538)	(8,804)
Proceeds from sale of discontinued operations	5	300	–
Purchases of brokerages and books of business, net of sales		(61)	(10)
Purchases of intangibles and property and equipment		(73)	(56)
Net cash flows used in investing activities		(576)	(2,346)
Financing activities			
Net proceeds from issuance of debt	20	249	797
Repayment of debt		(400)	–
Proceeds from issuance of common shares	21	227	910
Proceeds from issuance of preferred shares	21	–	485
Common shares repurchased for share-based payments	23	(26)	(3)
Common shares repurchased for cancellation	21	–	(129)
Dividends paid on common shares	21	(210)	(170)
Dividends paid on preferred shares	21	(21)	(8)
Net cash flows provided by (used in) financing activities		(181)	1,882
Net increase (decrease) in cash and cash equivalents		(34)	68
Cash and cash equivalents, beginning of year		206	138
Cash and cash equivalents, end of year	24	$ 172	$ 206

See accompanying notes to the audited Consolidated financial statements.

NOTE 1 – Status of the Company

Intact Financial Corporation (the "Company"), incorporated under the *Canada Business Corporations Act*, is domiciled in Canada and its shares are publicly traded on the Toronto Stock Exchange (TSX: IFC). The Company has investments in wholly owned subsidiaries which operate principally in the Canadian property and casualty ("P&C") insurance market. The Company acquired all of the issued and outstanding shares of Jevco Insurance Company ("Jevco") on September 4, 2012 and of AXA Canada Inc. ("AXA Canada") on September 23, 2011. Further details of the acquisitions are provided in Note 4 – *Business combinations*. The Company's significant operating 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., Grey Power Insurance Brokers Inc., Intact Farm Insurance Inc. and Jevco Insurance Company.

The registered office of the Company is 700 University Avenue, Toronto, Canada.

NOTE 2 – Basis of presentation

2.1 Statement of compliance

These audited Consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). These audited Consolidated financial statements and the accompanying notes were authorized for issue in accordance with a resolution of the Board of Directors on February 5, 2013.

2.2 Preparation and presentation of financial statements

The Company presents its audited Consolidated balance sheets broadly in order of liquidity.

Subsidiaries are entities over which the Company has the power to govern the financial and operating policies so as to obtain benefits from their activities, generally involving a shareholding of more than one-half of the voting shares. The financial statements of all subsidiary companies are fully consolidated from the date control is transferred to the Company. They are deconsolidated from the date control ceases. All balances, transactions, income and expenses, and profits and losses resulting from intercompany transactions and dividends are eliminated in full on consolidation.

Associates and joint ventures are accounted for using the equity method. As defined under IFRS, associates are entities over which the Company exerts significant influence and joint ventures are entities over which the Company exerts joint control. See Note 3.1c) – *Investments in associates and joint ventures* for accounting policy details.

Certain comparative figures have been reclassified to conform with the presentation adopted in the current year.

NOTE 3 – Summary of significant accounting policies

3.1 Significant accounting policies

a) Insurance contracts

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the Company agrees to compensate a policyholder on the occurrence of an adverse specified uncertain future event. As a general guideline, the Company determines whether it has significant insurance risks by comparing the benefits that could become payable under various possible scenarios relative to the premium received from the policyholder for insuring the risk.

Premium and commission revenue recognition

Premiums written are net of cancellations, promotional returns and sale taxes. Premiums written are recognized on the date coverage begins and are deferred as Unearned premiums and recognized as premiums earned, net of reinsurance, on a pro rata basis over the terms of the underlying policies, usually 12 months and generally no longer than 24 months.

Commission revenues from reinsurance contracts are recorded on the date on which the insurance contracts are ceded. They are deferred as unearned commissions and recognized on a pro rata basis over the length of the ceded contracts and included as a deduction from Underwriting expenses on the audited Consolidated statements of comprehensive income. The unearned reinsurance commissions are recorded in Other liabilities on the audited Consolidated balance sheets.

Other commission revenue is recorded on an accrual basis and included in Other revenues on the audited Consolidated statements of comprehensive income.

Claims liabilities

Claims liabilities represent the amounts required to provide for the estimated ultimate expected cost of settling claims related to insured events, both reported and unreported, that have occurred on or before the balance sheet date. They also include a provision for adjustment expenses representing the estimated ultimate expected costs of investigating, resolving and processing these claims.

Claims liabilities are first determined on a case-by-case basis as insurance claims are reported and are then reassessed as additional information becomes known. Also included in claims liabilities is a provision to account for the future development of these insurance claims, including insurance claims incurred but not reported ("IBNR") by policyholders, as required by the Canadian Institute of Actuaries ("CIA").

Claims liabilities are estimated by the appointed actuary using generally accepted Canadian actuarial standard techniques and based on assumptions that represent best estimates of possible outcomes, such as historical loss development factors and payment patterns, future rates of insurance, claims frequency and severity, inflation, reinsurance recoveries, expenses, changes in the legal environment, changes in the regulatory environment and other matters, taking into consideration the circumstances of the Company and the nature of the insurance policies.

Claims liabilities are discounted to take into account the time value of money, 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.

To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience and to provide greater comfort that the actuarial liabilities are sufficient to pay future benefits, actuaries are required to include margins in some assumptions. A range of allowable margins is prescribed by the CIA relating to claims development, reinsurance recoveries and investment income variables. The impact of the margins is referred to as the provision for adverse deviation ("PfAD").

Claims liabilities are reported gross of the reinsurers' share on the audited Consolidated balance sheets and the reinsurers' share is reported as an asset in Reinsurance assets on the audited Consolidated balance sheets. Changes in claims liabilities are recognized in Net claims incurred on the audited Consolidated statements of comprehensive income. The claims liabilities are no longer recorded when the contract expires, is discharged or is cancelled.

Deferred acquisition costs

Policy acquisition costs incurred in acquiring insurance premiums comprise commissions, premium taxes and expenses directly related to the writing or renewal of insurance policies. These acquisition costs are deferred and amortized on the same basis as the unearned premiums and are reported in Underwriting expenses on the audited Consolidated statements of comprehensive income.

Deferred acquisition costs are no longer recorded when the corresponding contracts are settled or cancelled.

Liability adequacy test

At the end of each reporting period, a liability adequacy test is performed, in accordance with IFRS, to validate the adequacy of unearned premiums and deferred acquisition costs. A premium deficiency would exist if unearned premiums were deemed insufficient to cover the estimated future costs associated with the unexpired portion of written insurance policies. A premium deficiency would be recognized immediately as a reduction of deferred acquisition costs to the extent that unearned premiums plus anticipated investment income are not considered adequate to cover all deferred acquisition costs and related insurance claims and expenses. If the premium deficiency is greater than the unamortized deferred acquisition costs, a liability is accrued for the excess deficiency.

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 the FA-administered risk-sharing pools ("RSP"). The related risks associated with FA insurance policies and policies ceded to the RSP are aggregated and shared by the entities in the Canadian 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 any FA and RSP insurance it assumes as it does to insurance polices issued by the Company directly to policyholders. In accordance with Office of Superintendent of Financial Institutions Canada ("OSFI") guidelines, assumed and ceded RSP premiums are reported in Direct premiums written.

The Company 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 over the servicing life of the claims.

Reinsurance

Reinsurance assets include reinsurers' share of claims liabilities and unearned premiums. The Company reports third party reinsurance balances on the audited Consolidated balance sheets on a gross basis to indicate the extent of credit risk related to third party reinsurance. The estimates for the reinsurers' share of claims liabilities are presented as an asset and are determined on a basis consistent with the related claims liabilities. Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting period.

Structured settlements

The Company enters into annuity agreements with various Canadian life insurance companies that have credit ratings of at least 'A-' or higher at the inception date of the contract to provide for fixed and recurring payments to claimants. As a result, the liability to its claimants is substantially discharged and the Company removes that liability from its audited Consolidated balance sheets. However, the Company remains exposed to the credit risk that life insurers may fail to fulfill their obligations. Refer to Note 9 – *Financial risk* for further details about credit risk for structured settlements.

b) Financial instruments contracts

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

- Available-for-sale ("AFS");
- Financial assets and liabilities at fair value through profit and loss ("FVTPL");
- Cash and cash equivalents, loans and receivables; or
- Other financial liabilities.

The table below summarizes the Company's initial and subsequent measurement basis of financial instruments, as well as the reporting of related changes in fair value on the audited Consolidated statements of comprehensive income 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	Fair value using bid prices at the trade date	Fair value using bid prices at end of period	Reported in Other comprehensive income (loss) when unrealized or in Net investment gains (losses) when realized or impaired
FVTPL	Fair value using bid prices at the trade date	Fair value using bid prices at end of period	Reported in Net investment gains (losses)
Cash and cash equivalents, loans and receivables	Fair value at the issuance date	Amortized cost using the effective interest method	Reported in Net investment gains (losses) when realized or impaired (except for cash and cash equivalent where no impairment exists)
Financial liabilities			
FVTPL	Fair value using ask prices at the trade date	Fair value using ask prices at end of period	Reported in Net investment gains (losses)
Other financial liabilities	Fair value at the issuance date	Amortized cost using the effective interest method	Reported in Net investment gains (losses) when the liability is extinguished

Financial assets are no longer recorded when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership. Financial assets lent by the Company in the course of the securities lending operations remain on the balance sheets because the Company has not substantially transferred the risks and rewards related to the assets lent.

Financial liabilities are no longer recorded when they have expired or have been cancelled.

Financial assets and liabilities are offset and the net amount is reported on the audited Consolidated balance sheets only when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

Financial instruments

AFS

Instruments classified as AFS include debt and equity securities. Debt securities in this category are those that are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions. Equity investments classified as AFS are those which are neither classified nor designated as at FVTPL. Gains and losses on the sale of AFS debt and equity securities are calculated on a first in, first out basis and on an average cost basis, respectively.

FVTPL

Non-derivative financial assets and liabilities at FVTPL are purchased or incurred with the intention of generating profits in the near term ("classified as at FVTPL") or are voluntarily designated as such by the Company ("designated as at FVTPL").

A portion of the Company's debt securities backing its claims liabilities has been designated as at FVTPL. This designation aims to reduce the volatility caused by the fluctuations in fair values of the underlying claims liabilities due to changes in discount rates. To comply with regulatory guidelines, the Company ensures that the weighted dollar duration of the debt securities designated as at FVTPL is approximately equal to the weighted dollar duration of the claims liabilities.

Cash and cash equivalents

Cash and cash equivalents consist of cash as well as highly liquid investments 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.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Debt outstanding

The Company's medium-term notes net of associated issuance costs, as well as the drawn amount under credit facilities, are classified as Debt outstanding and accounted for at amortized cost using the effective interest method.

Mutual fund investments

The Company invests in mutual funds offered by a third party. These funds invest mainly in equities and distribute most of their income. The Company's participation in these investment vehicles can fluctuate from day to day based on the amount invested by the Company and third parties. When the Company is deemed to control such vehicles, they are consolidated and the third party liability is recorded as a liability at fair value and disclosed as Net asset value attributable to third party unit holders.

Derivative financial instruments

Derivative financial instruments are used for hedging purposes and for the purpose of modifying the risk profile of the Company's investment portfolio, as long as the resulting exposures are within the investment policy guidelines. The Company uses various types of derivative financial instruments, including forwards, futures, swaps and options.

Derivative financial instruments are recognized on the audited Consolidated balance sheets at their fair value as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value are reported on the audited Consolidated statements of comprehensive income in Net investment gains (losses) during the period in which they arise. See Note 7 – *Derivative financial instruments* 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, therefore, embedded derivatives are designated or classified separately from the host contract. Embedded derivatives are financial assets and liabilities classified as at FVTPL.

Hedge accounting

The Company uses derivatives in its hedging strategies to manage its exposure to risk arising from financial instruments. Where hedge accounting can be applied, a hedge relationship is designated and documented at inception to detail the particular risk management objective and the strategy for undertaking the hedge transaction. The documentation identifies the specific asset, liability or anticipated cash flows being hedged, the risk that is being hedged, the type of hedging instrument used and how

effectiveness will be assessed. The hedging instrument must be highly effective in accomplishing the objective of offsetting changes in either the fair value or the anticipated cash flows attributable to the risk being hedged both at inception and throughout the life of the hedge. Hedge accounting is discontinued prospectively when it is determined that the hedging instrument is no longer effective as a hedge, the hedging instrument is terminated or sold, or upon the sale or early termination of the hedged item.

Cash flow hedges

In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative, net of taxes, is recognized in Other comprehensive income ("OCI") while the ineffective portion is recognized in Net investment gains (losses). When hedge accounting is discontinued, the amounts accumulated in Accumulated other comprehensive income ("AOCI") are reclassified to Net income attributable to shareholders on the same basis as these costs are incurred. Gains and losses on derivatives are reclassified immediately to Net income (loss) attributable to shareholders when the hedged item is sold or terminated early.

Long-term investments

Long-term investments are unquoted investments for which the Company has no significant influence. These investments are not traded and as such are carried at cost less any accumulated impairment losses, which approximates fair value. The investments are included in Other assets on the audited Consolidated balance sheets.

Fair value measurement

The fair value of financial instruments on initial recognition is normally the transaction price, being the fair value of the consideration given or received.

Subsequent to initial recognition, the fair value of financial instruments is determined based on available information and categorized according to a three-level fair value hierarchy. The distribution of the Company's financial instruments between each of the fair value hierarchy levels is described in Note 8 – *Fair value measurement*.

Where the fair values of financial assets and financial liabilities reported on the audited Consolidated balance sheets cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of discounted cash flow models and/or mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data is not available, judgment is required to establish fair values.

For discounted cash flow analyses, estimated future cash flows and discount rates are based on current market information and rates applicable to financial instruments with similar yields, credit quality and maturity characteristics. Estimated future cash flows are influenced by factors such as economic conditions (including country-specific risks), concentrations in specific industries, types of instruments, currencies, market liquidity and financial conditions of counterparties. Discount rates are influenced by risk-free interest rates and credit risk.

Changes in assumptions about these factors could affect the reported fair value of financial instruments.

Impairment of financial assets

The Company determines, at each balance sheet date, whether there is objective evidence that financial assets, other than those classified or designated as at FVTPL, are impaired. A financial asset or a group of financial assets is impaired when there is objective evidence of impairment as a result of one or more events that has an impact on the estimated future cash flows of the financial asset or group of financial assets. An AFS debt instrument is impaired if there is objective evidence that a loss event has occurred which has impaired the expected cash flows. Objective evidence for an AFS equity instrument would include a significant or prolonged decline in fair value of the instrument below its cost. The table hereafter demonstrates the measurement and recognition of impairment losses for each type of financial asset.

For debt securities classified as AFS, impairment is recorded for the difference between amortized cost and fair value when it is probable that the future cash flows will not be fully recovered following a credit event that affected the issuer of those debt securities. However, a credit event is not sufficient to constitute, in itself, evidence of impairment. Other factors are considered to conclude that the debt security is impaired, such as payment default. If the risk diminishes or disappears, the impairment provision can be reversed. Impairment reversals are recognized as gains in the audited Consolidated statements of comprehensive income.

For equity instruments classified as AFS, a significant and/or prolonged decline of the fair value below the cost is evidence of impairment. The Company determined that common shares with an unrealized loss of at least 25% for a nine-month period and perpetual preferred shares with an unrealized loss of at least 25% for a 12-month period are generally impaired. Common shares in an unrealized loss position for 15 or more consecutive months and perpetual preferred shares in an unrealized loss position

for 18 or more consecutive months are generally impaired. For all equity instruments, a decline below cost of more than 50% at the end of any reporting period are generally impaired. When there is objective evidence that impairment exists, the equity instrument is written down, regardless of the unrealized loss, in the audited Consolidated statements of comprehensive income, for an amount equal to the unrealized loss. Impairments on equity instruments are not reversible.

For assets classified as loans and receivables, the instruments that are individually significant are tested for impairment when there is a payment default or when there are objective indications that the counterparty will not honour its obligations. When an instrument in that category is determined to be impaired, its carrying amount is reduced either to its estimated realizable value, which is obtained by discounting estimated future cash flows from the investment concerned using the effective interest rate, or the fair value of collateral. The provision can be reversed when the event that gave rise to its recognition subsequently disappears. The loans and receivables which have not been individually impaired are grouped by similar characteristics to be tested for impairment.

TABLE 3.2 – MEASUREMENT AND RECOGNITION OF FINANCIAL ASSET IMPAIRMENT

Instrument category	Loss measurement	Reported loss	Subsequent fair value increases
AFS debt instrument	Difference between amortized cost and current fair value less any unrealized loss on that instrument previously recognized	Impairment loss removed from OCI and recognized in Net investment gains (losses) on the audited Consolidated statements of comprehensive income	Recognized in Net investment gains (losses) when there is observable positive development on the original impairment loss event. Otherwise, recognized in OCI
AFS equity instrument	Difference between acquisition cost and current fair value less any impairment loss on that instrument previously recognized	Unrealized loss removed from OCI and recognized in Net investment gains (losses) on the audited Consolidated statements of comprehensive income	Recognized directly in OCI
Financial assets carried at amortized cost	Difference between the asset's carrying value and the present value of the estimated future cash flows	Impairment loss is recognized in Net investment gains (losses) on the audited Consolidated statements of comprehensive income	Recognized in Net investment gains (losses) when there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized
Financial assets carried at cost	Difference between the asset's carrying value and the present value of the estimated future cash flows	Impairment loss is recognized in Net investment gains (losses) on the audited Consolidated statements of comprehensive income	Impairment losses are not reversed

Revenue and expense recognition

Dividends are recognized when the shareholders' right to receive payment is established, which is the ex-dividend date. Dividends paid on instruments sold short are recorded as a reduction of dividend income. Interest income from debt securities and loans is recognized on an accrual basis. Premiums and discounts on fixed income instruments classified as AFS are amortized using the effective interest rate method. Dividends received, dividends paid and interest income are reported in Net investment income on the audited Consolidated statements of comprehensive income.

Transaction costs associated with financial instruments classified or designated as at FVTPL are recognized on the audited Consolidated statements of comprehensive income as incurred. For other financial instruments, transaction costs are capitalized on initial recognition and amortized using the effective interest method. Premiums earned or discounts incurred for loans and AFS securities are also amortized using the effective interest method.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect at the balance sheet date, and non-monetary assets and liabilities are translated at the exchange rates in effect on the transaction dates. Revenue and expenses are translated at the exchange rates in effect on the transaction dates. Exchange differences on translation are included in Net investment gains (losses) on the audited Consolidated statements of comprehensive income.

However, exchange differences on translation of non-monetary financial assets classified as AFS are recognized in OCI until settlement of the corresponding asset, at which time they are transferred in Net investment gains (losses) on the audited Consolidated statements of comprehensive income.

c) Investments in associates and joint ventures

The Company's investments in associates and joint ventures are accounted for using the equity method. They are reported on the audited Consolidated balance sheets at cost plus post-acquisition changes in the Company's share of net assets of the associates. The Company's profit from such investments is shown on the audited Consolidated statements of comprehensive income and reflects the after-tax share of the results of operations of the associates. Profits or losses resulting from transactions between the Company and its associates and joint ventures are eliminated to the extent of the interest in the associate. The Company determines at each reporting date whether there is any objective evidence that the investments in associates and joint ventures are impaired. The financial statements of associates and joint ventures are prepared for the same reporting period as the Company. Where necessary, adjustments are made to bring the accounting policies of associates and joint ventures into line with those of the Company.

d) Business combinations

Business combinations are accounted for using the acquisition method. At the acquisition date, the identifiable assets acquired and liabilities assumed of the acquiree are estimated at their fair value. Goodwill is initially measured at cost, being the excess of the fair value of the consideration transferred over the Company's share in the net identifiable assets acquired and liabilities assumed.

The cost of the acquisition (purchase price) is measured at the fair value of the consideration at acquisition date. Acquisition-related costs are recognized directly in Net income attributable to shareholders on the audited Consolidated statements of comprehensive income in the period they are incurred.

When the Company acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual term, economic circumstances and pertinent conditions at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

Any contingent consideration to be assumed by the acquirer is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration resulting from additional information obtained after the acquisition date about facts and circumstances that existed at the acquisition date are considered measurement period adjustments and reflected in the provisional fair value of assets acquired and liabilities assumed. Subsequent changes in the fair value of the contingent consideration relating to events that occurred after the acquisition date are not considered measurement period adjustments and are recorded in the audited Consolidated statements of comprehensive income.

e) Goodwill and intangible assets

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is tested at least annually for impairment. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to the cash generating unit ("CGU") that is expected to benefit from the combination (see Note 18 – *Goodwill and intangible assets*). Gains and losses calculated on the disposal of a business include the carrying value of goodwill relating to the business sold. The Company performs its annual test for goodwill impairment at June 30. The Company currently has one CGU (see Note 3.1n) – *Operating segments* for details). The recoverable amount of the CGU was determined based on the present value of expected future cash flows.

Intangible assets acquired separately are measured initially at cost. Intangible assets acquired in a business combination are recorded at fair value as at the date of acquisition. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortized over their useful lives and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Intangible assets with indefinite lives, as well as those intangibles that are under development, are not subject to amortization, but are tested for impairment on an annual basis. Gains and losses arising from the disposition or impairment of an intangible asset are measured as the difference between the net disposal proceeds and the carrying value of the asset and are reported in Other revenues or Other expenses on the audited Consolidated statements of comprehensive income.

The Company's intangible assets consist of distribution networks, customer relationships and internally developed software. The useful life of the distribution network acquired as part of the acquisition of AXA Canada has been assessed to be indefinite and, therefore, it is not subject to amortization, but is tested for impairment on an annual basis. The life of this asset is assessed to

be indefinite as the related cash flows are expected to continue indefinitely. The distribution network acquired as part of the acquisition of Jevco, customer relationships and internally developed software have all been assessed as having finite useful lives and amortization methods and terms are shown below.

TABLE 3.3 – DEPRECIATION METHODS OF INTANGIBLE ASSETS

	Method	Term
Distribution network (Jevco)	Straight-line	25 years
Customer relationships	Straight-line	10 years
Internally developed software	Straight-line	3 to 7 years

f) Property and equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation rates are established to depreciate the cost of the assets over their estimated useful lives. Depreciation methods as well as rates or terms are shown below.

TABLE 3.4 – DEPRECIATION METHODS OF PROPERTY, PLANT AND EQUIPMENT

	Method	Rate or term
Buildings	Straight-line	19 to 43 years
Computer equipment	Straight-line	2 to 3 years
Furniture and equipment	Declining balance and straight-line	20% and 5 years, respectively
Leasehold improvements	Straight-line	Over the terms of related leases

g) Leases

Finance leases that transfer to the Company substantially all the risks and benefits incidental to ownership of the leased items are capitalized at the commencement of the lease at the fair value of the leased item or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between interest charges and reduction of the lease liability. Interest charges are charged to Underwriting expenses on the audited Consolidated statements of comprehensive income.

There is no certainty that the Company will obtain ownership of the leased assets by the end of the lease term. Therefore, the assets are depreciated over the shorter of the estimated useful life of the assets and the lease terms.

Leases which do not transfer to the Company substantially all the risks and benefits incidental to ownership of the leased items are operating leases. Payments made under operating leases are charged to Underwriting expenses on the audited Consolidated statements of comprehensive income on a straight-line basis over the period of the lease.

h) Assets classified as held for sale and discontinued operations

Assets are classified as held for sale when the carrying amount is to be recovered principally through a sale transaction rather than through continued use and such sale is considered highly probable. Assets held for sale are measured at the lower of their carrying amount or fair value less costs to sell.

Assets classified as held for sale by the Company are considered as discontinued operations if the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the Company and they: represent a separate major line of business or geographical area of operations; are part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or are a subsidiary acquired exclusively with a view to resell.

Liabilities directly associated with assets classified as held for sale are measured at the lower of their carrying value or fair value. Interest and other expenses related to these liabilities continue to be recorded and the liabilities are presented net of intragroup transactions.

Revenues and expenses from discontinued operations comprise the revenues and expenses of the subsidiary held for sale, adjusted with the revaluations at fair value of the related assets classified as held for sale and corresponding liabilities. Revenues and expenses from discontinued operations are presented on a net basis, as Net income from discontinued operations in the audited Consolidated statements of comprehensive income.

i) Integration and restructuring costs

A provision for restructuring costs is recognized when: the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

The provision for restructuring costs is measured at the present value of the expenditures expected to be required to settle the obligation.

Integration costs mainly include technology-related expenses, occupancy, employee-related costs, branding and consulting expenses incurred as a direct result of the acquisition process. Integration costs are recognized on the audited Consolidated statements of comprehensive income when incurred.

j) Income taxes

Income tax expense (benefit) comprises current and deferred tax. Income tax is recognized in Net income from continuing operations attributable to shareholders on the audited Consolidated statements of comprehensive income, except to the extent that it relates to discontinued operations, where it is recognized directly in Net income from discontinued operations, or to the extent that it relates to items recognized in OCI or directly to equity, where it is recognized directly in OCI or equity.

Current income tax is based on the results of operations in the current year, adjusted for items that are not taxable or not deductible. Current income tax is calculated based on income tax laws and rates enacted or substantively enacted as at the balance sheet date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation and provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided using the liability method on temporary differences between the carrying value of assets and liabilities and their respective tax values. Deferred tax is calculated using income tax laws and rates enacted or substantively enacted as at the balance sheet date, which are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax assets are recognized for all deductible temporary differences as well as unused tax losses and tax credits to the extent that it is probable that taxable profit will be available against which the losses can be utilized.

For each legal entity consolidated, current tax assets and liabilities are offset when they relate to the same taxation authority, which allows the legal entity to receive or make one single net payment, and when it intends to settle the outstanding balances on a net basis. Upon consolidation, a current tax asset of one entity is offset against a current tax liability of another entity, if and only if the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such net payment or to recover the asset or settle the liability simultaneously.

k) Employee future benefits

Pension and post-retirement plans

For the defined benefit pension and other retirement plans, the present value of the accrued benefit obligations, net of the fair value of plan assets, adjusted for deferred past service cost, is recognized on the audited Consolidated balance sheets as an asset, if positive or as a liability if negative. The actuarial determination of the accrued benefit obligations for pensions and other retirement benefits uses the projected unit credit method and management's best estimate assumptions. See Note 19 – *Employee future benefits.* Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognized directly in OCI in the period in which they occur. Such actuarial gains and losses are also immediately recognized in Retained earnings on the audited Consolidated balance sheets as they will not be reclassified to Net income attributable to shareholders in subsequent periods.

Cost, recognized on the audited Consolidated statements of comprehensive income, for employee future benefit plans includes:

- the cost of pension benefits provided in exchange for employees' services rendered during the year;
- the interest cost of pension obligations, determined by reference to market yields on high-quality corporate bonds; and
- the asset return calculated using the expected long-term return on the fair value of the plan assets.

Post-employment benefits

Health and dental benefits continue to be provided to eligible employees who are absent from work due to long-term disability (or other approved leave) for the duration of their leave. The estimated present value of these benefits is charged to Net income attributable to shareholders on the audited Consolidated statements of comprehensive income in the period the absence commences.

l) Share-based payments

The Company has three types of shared-based payment plans:

Long-term incentive plan

Certain key employees are entitled to a long-term incentive plan ("LTIP"). Under this program, participants are awarded notional share units referred to as performance stock units ("PSUs") and restricted stock units ("RSUs"). The payout for the PSUs is based on a specific target composed of the difference between the three-year average return on equity of the Company and that of the Canadian P&C industry. Most RSUs automatically vest three years from the year of the grant. Vesting for RSUs is not linked to the Company's performance.

The awards are valued at fair value at grant date, which corresponds to the average share price of the Company over the last quarter of the preceding year. The value of each award is not revalued subsequently, but the Company re-estimates the number of awards that are expected to vest at each reporting period. The cost of the awards is recognized as an expense on the audited Consolidated statements of comprehensive income over the vesting period, with a corresponding entry in Contributed surplus on the audited Consolidated balance sheets. At the time of the payout, the Company purchases in the market the amount of common shares based upon the performance targets achieved, with respect to the vesting of the PSUs, and an amount of common shares equal to the amount of RSUs, with respect to the vesting of RSUs.

Employee share purchase plan

Employees who are not eligible for the LTIP are entitled to make contributions to 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 in 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 12 months. The Company's contributions under the ESPP are cash-settled awards which 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. A portion of the remuneration of non-employee directors of the Company must be received in DSUs or shares of the Company. For the remainder of their compensation, the directors are given the choice of cash, shares of the Company, DSUs or a combination of the three. 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 plan administration for the purchase of shares of the Company on behalf of the directors. 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 based on the current share price, with any fluctuations in the liability also recorded as an expense until it is settled in cash.

m) Current versus non-current

In line with industry practice for insurance companies, the Company's balance sheets are not presented using current and non-current classifications, but are rather presented broadly in order of liquidity. Most of the Company's assets and liabilities are considered current given they are expected to be realized or settled within the Company's normal operating cycle respectively. All other assets and liabilities are considered as non-current and generally include: Investments in associates and joint ventures, Deferred tax assets, Property and equipment, Intangible assets, Goodwill, Deferred tax liabilities and Debt outstanding.

n) Operating segments

The Company's business activities comprise P&C insurance operations. These activities are captured within a sole operating segment, P&C insurance operations. Internal reports on the performance of the segment are regularly reviewed by senior management, the Company's Chief Executive Officer and the Board of Directors.

3.2 Standards issued but not yet effective

a) Consolidated financial statements

IFRS 10 – *Consolidated financial statements* replaces IAS 27 – *Consolidated and separate financial statements* and SIC-12 – *Consolidation – special purpose entities* and establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. The main features are as follows:

- The principle of control sets out the three elements of control: (1) power over the investee; (2) exposure, or rights, to variable returns from involvement with the investee; and (3) the ability to use power over the investee to affect the amount of the investor's returns; and
- When preparing consolidated financial statements, an entity must use uniform accounting policies for reporting like transactions and other events in similar circumstances. Intragroup balances and transactions must be eliminated.

The standard is effective for years beginning on or after January 1, 2013 and, other than additional disclosure requirements, is not expected to have a significant impact on the Company's financial statements.

b) Joint arrangements

IFRS 11 – *Joint arrangements* replaces IAS 31 – *Interest in joint ventures* and SIC-13 – *Jointly controlled entities – non-monetary contributions by venturers* and is to be applied by all entities that are a party to a joint arrangement, whereby two or more parties have joint control. The main features are as follows:

- Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control;
- Joint arrangements are classified into two types – joint operations and joint ventures;
- An entity determines the type of arrangement in which it is involved by considering its rights and obligations;
- A joint operator will recognize and measure the assets, liabilities, revenues and expenses in relation to its interest in the arrangement; and
- A joint venturer will recognize an investment and measure it using the equity method.

The standard is effective for years beginning on or after January 1, 2013 and, other than additional disclosure requirements, is not expected to have a significant impact on the Company's financial statements.

c) Disclosure of interests in other entities

IFRS 12 – *Disclosure of interests in other entities*, replaces the disclosure requirements of IAS 27 – *Consolidated and separate financial statements*, IAS 28 – *Investments in associates*, and IAS 31 – *Interests in joint ventures*. IFRS 12 establishes disclosure objectives according to which an entity discloses information regarding consolidated entities, associates, joint arrangements, unconsolidated structured entities and non-controlling interests.

The standard is effective for years beginning on or after January 1, 2013 and is not expected to have a significant impact on the Company's financial statements.

d) Fair value measurement

In May 2011, the IASB issued IFRS 13 – *Fair value measurement* with a view to setting out a single IFRS framework for defining, measuring and disclosing fair value. The main features are as follows:

- Defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date;
- The fair value measurement requires an entity to determine the following:
  - The particular asset or liability being measured;
  - For a non-financial asset, the highest and best use of the asset and whether the asset is used in combination with other assets or on a stand-alone basis;
  - The market in which an orderly transaction would take place for the asset or liability;
  - The appropriate valuation technique(s) to use when measuring fair value. The technique(s) should maximize the use of relevant observable inputs and minimize unobservable inputs. Those inputs should be consistent with the inputs a market participant would use when pricing the asset or liability; and
- The entity is to disclose those valuation techniques and inputs used to develop the fair value measurements.

The standard is effective for years beginning on or after January 1, 2013 and, other than additional disclosure requirements, is not expected to have a significant impact on the Company's financial statements.

e) Employee benefits

In June 2011, the IASB completed its project to improve the accounting for pension and other post-employment benefits by issuing an amended version of IAS 19 – *Employee benefits*. The main features are as follows:

- Eliminates an option to defer the recognition of gains and losses, known as the "corridor method";
- Requires entities to compute the asset return component using the discount rate used to measure the defined benefit obligations rather than the expected return on assets; and
- Enhances the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.

The standard is effective for years beginning on or after January 1, 2013 and is generally to be applied retrospectively. The use of the discount rate in calculating the asset returns will generally result in an increase in employee future benefit expense and a corresponding offset in OCI with no overall change in Total comprehensive income attributable to shareholders.

f) Financial statement presentation

In June 2011, the IASB amended IAS 1 – *Presentation of Financial Statements*. The principal change resulting from the amendments to IAS 1 is a requirement within the Statement of Other comprehensive income to distinguish between items within OCI that may be reclassified to the statement of income and items that will not.

The standard is effective for years beginning on or after July 1, 2012 and will not have an impact on the Company's financial statements as the items within OCI that may be reclassified subsequently to net income are already disclosed together.

g) Financial instruments: classification and measurement

In November 2009, the IASB issued IFRS 9 – *Financial Instruments*. This standard represents the completion of the first part of a three-part project to replace IAS 39 – *Financial Instruments: Recognition and Measurement*. The new standard reduces complexity by replacing the many different rules in IAS 39. The main features are as follows:

- A business model test is applied first in determining whether a financial asset is eligible for measurement at amortized cost. The business model objective is based on holding financial assets in order to collect contractual cash flows rather than realizing cash flows from the sale of the financial assets;
- In order to be eligible for amortized cost measurement, an asset must have contractual cash flow characteristics representing the principal and interest;
- All other financial assets are measured at fair value on the balance sheet;
- An entity can elect on initial recognition to present the fair value changes on an equity investment that is not held for trading directly in OCI. The dividends on investments for which this election is made must be recognized in profit or loss, but gains or losses are not removed from OCI when the equity investment is disposed of; and
- If a financial asset is eligible for amortized cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch.

The standard is effective for years beginning on or after January 1, 2015. The Company will analyze the impact that this standard will have on its audited Consolidated financial statements in conjunction with the other phases of the standard when issued.

3.3 Significant accounting judgments, estimates and assumptions

The carrying values of certain assets and liabilities are often determined based on estimates and assumptions of future events. The key estimates, changes to which could cause a material adjustment to the carrying value of certain assets and liabilities within the next financial year, are as follows:

a) Valuation of claims liabilities

The ultimate cost of claims liabilities is estimated by using a range of standard actuarial claims projection techniques in accordance with Canadian accepted actuarial practice.

The main assumption underlying these techniques is that a company's past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analyzed by accident years, but can also be further analyzed by geographical area, as well as by significant business line and claim type. Large claims are usually separately addressed, either by being reserved at the

face value of loss adjuster estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based. Additional qualitative judgment is used to assess the extent to which past trends may not apply in future, in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

b) Valuation of pension benefit obligation

The cost of defined benefit pension plans and other post-employment medical benefits and the present value of the pension obligation are determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, the employees' age upon retirement, mortality rates and future pension increases. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, a defined benefit obligation is highly sensitive to changes in the assumptions. All assumptions are reviewed at each reporting date. Details of the key assumptions used in the estimates are contained in Note 19.5 – *Assumptions used*.

c) Impairment

Goodwill and intangible assets

The Company determines whether goodwill and intangible assets with indefinite useful lives are impaired at least on an annual basis. Also, intangible assets under development are not subject to amortization but are tested for impairment on an annual basis. Impairment testing of these assets requires an estimation of the recoverable amount of the cash generating units to which the assets are allocated. The assumptions used in this estimation of the recoverable amount are discussed in Note 18 – *Goodwill and intangible assets*.

Financial assets

The Company determines whether financial assets, other than those classified or designated as at FVTPL, are impaired at each audited Consolidated balance sheet date. These financial assets are impaired when there is objective evidence of a decline in fair value below cost. Considerations which form the basis of these objective evidence judgments include a significant or prolonged decline in fair value of an AFS equity instrument and a loss event that has occurred impairing the expected cash flows of an AFS debt instrument. For asset-backed securities, considerations include liquidity risk, credit risk, volatility, discount rates, prepayment rates and default rate assumptions.

d) Measurement of 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. Accounting standards require the value of the option liability to be measured separately from the preferred shares. The value of the option liability for embedded derivatives is determined using a valuation which relies predominantly on the price volatility of the underlying preferred shares, which can be significantly affected by market conditions. Judgment is also required to determine the time period over which the volatility is measured.

e) Measurement of income taxes

Management exercises judgment in estimating the provision for income taxes. The Company is subject to federal income tax law and provincial income tax laws in the various 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 of tax laws differ from those of tax authorities or that the timing of realization of deferred tax assets is not as expected, the provision for income taxes may increase or decrease in future periods to reflect actual experience.

f) Business combinations

Upon initial recognition, the acquiree's assets and liabilities have been included in the audited Consolidated balance sheets at fair value. Management estimated the fair values using estimates on future cash flows and discount rates. However, actual results can be different from those estimates. The changes in the estimates that relate to new information obtained about facts and circumstances that existed as of the acquisition date, made at initial recognition with regard to items for which the valuation was incomplete, would have an impact on the amount of goodwill recognized. Any other changes in the estimates made at initial recognition would be reported in the audited Consolidated statements of comprehensive income. The detail on assets acquired and liabilities assumed is presented in Note 4 – *Business combinations*.

NOTE 4 – Business combinations

4.1 Jevco Insurance Company

On May 2, 2012, the Company announced that it had signed a definitive agreement with The Westaim Corporation for the acquisition of all of the issued and outstanding shares of its subsidiary Jevco for cash consideration of $530 million. Following receipt of all required approvals, the acquisition closed and Jevco became a wholly owned subsidiary on September 4, 2012. The acquisition enhances the Company's product offering to include additional specialty and niche insurance products in Canada.

The results of operations of Jevco are included in the audited Consolidated financial statements beginning on the date of acquisition. On the audited Consolidated statement of comprehensive income for the year ended December 31, 2012, Jevco contributed $125 million to net premiums earned and $15 million to net income before restructuring costs. Had Jevco been consolidated from January 1, 2012, the additional net premiums earned would have been $374 million and the additional net income attributable to shareholders would have been $41 million.

The following table summarizes the consideration paid for Jevco, and the amounts recognized for the assets acquired and liabilities assumed at September 4, 2012 (the acquisition date).

TABLE 4.1 – BUSINESS COMBINATION – JEVCO

As at	December 31, 2012	September 4, 2012
Purchase price – cash consideration paid	530	530
Provisional fair value of assets acquired and liabilities assumed		
Investments (including cash and cash equivalents of $23 million)	1,041	1,041
Premium receivables	100	100
Reinsurance assets	31	31
Deferred tax assets	26	23
Deferred acquisition costs	33	29
Property and equipment	24	24
Intangible asset – distribution network (net of deferred tax liabilities of $23 million)	62	62
Other assets	84	84
Claims liabilities	(731)	(716)
Unearned premiums	(204)	(204)
Deferred tax liabilities (excluding deferred tax liabilities related to intangible assets of $23 million)	(3)	(3)
Other liabilities	(31)	(31)
Total identifiable net assets	432	440
Goodwill	98	90

The fair value of the acquired identifiable distribution network is based on a preliminary discounted cash flow analysis. The useful life of the distribution network has been assessed as 25 years and will be amortized on a straight-line basis over that period.

Goodwill reflects the quality of the acquired business and the synergies expected following the integration of Jevco. The goodwill is not expected to be deductible for tax purposes.

The determination of the fair value of identifiable assets and liabilities acquired will be completed within the prescribed period of one year following the acquisition.

4.2 AXA Canada Inc.

On May 31, 2011, the Company announced that it had signed a definitive agreement with AXA SA for the acquisition of all of the issued and outstanding shares of its subsidiary AXA Canada for a cash consideration of $2,621 million and contingent consideration of up to $100 million. Following receipt of all required regulatory approvals, the acquisition closed and AXA Canada became a wholly owned subsidiary on September 23, 2011.

AXA Canada provided P&C insurance in Canada, principally through a network of independent brokers. It carried out its activities primarily through its wholly owned insurance subsidiaries. On January 1, 2012, the Company completed the sale of AXA Life Insurance Inc. ("AXA Life Insurance") (see Note 5 – *Assets classified as held for sale and directly associated liabilities*).

The following table summarizes the consideration paid for AXA Canada, and the amounts recognized for the assets acquired and liabilities assumed at September 23, 2011 (the acquisition date).

TABLE 4.2 – BUSINESS COMBINATION – AXA CANADA

As at	**December 31, 2012**	December 31, 2011
Cash consideration paid	**2,621**	2,621
Fair value of contingent consideration	**48**	48
Purchase price	**2,669**	2,669
Fair value of assets acquired and liabilities assumed		
Investments (including cash and cash equivalents of $75 million)	**3,565**	3,565
Assets classified as held for sale	**1,459**	1,459
Investments in associates and joint ventures	**100**	100
Premium receivables	**679**	679
Reinsurance assets	**131**	131
Deferred tax assets	**88**	89
Deferred acquisition costs	**211**	211
Property and equipment	**13**	13
Intangible assets	**897**	897
Other assets	**64**	64
Claims liabilities	**(2,193)**	(2,193)
Unearned premiums	**(1,148)**	(1,148)
Liabilities directly associated with assets classified as held for sale	**(1,178)**	(1,170)
Deferred tax liabilities	**(128)**	(128)
Other liabilities	**(471)**	(473)
Total identifiable net assets	**2,089**	2,096
Goodwill	**580**	573

The fair value of the acquired identifiable intangible assets is based on a discounted cash flow analysis of the distribution network and the customer relationships acquired. The useful life of the distribution network, reflecting the strength of the relationships, has been assessed as indefinite and is therefore not subject to amortization, and it is tested for impairment on an annual basis. The customer relationships, accessed through consolidated distribution entities, are amortized over a period of 10 years.

Goodwill reflects the quality of the acquired business and the synergies expected following the integration of AXA Canada. The goodwill is not expected to be deductible for tax purposes.

A contingent consideration contract clause requires the Company to pay up to an additional $100 million to AXA SA based on the development of the consolidated reserves of AXA Canada, excluding the life and health business, as at December 31, 2010. As of March 31, 2012, the $100 million of contingent consideration had been recognized, of which $11 million was recognized in the first quarter of 2012.

The determination of the fair value of the identifiable assets and liabilities acquired is complete.

NOTE 5 – Assets classified as held for sale and directly associated liabilities

As part of the acquisition of AXA Canada, the Company acquired AXA Life Insurance. On September 26, 2011, the Company announced that it had entered into a definitive share purchase agreement to sell this subsidiary to a third party. The transaction closed on January 1, 2012, following receipt of all regulatory approvals, for an amount of $300 million. There was no gain or loss from this transaction.

Prior to its disposal, AXA Life Insurance was measured at fair value less costs to sell and classified as a disposal group held for sale. All its assets are grouped together in Assets classified as held for sale and all its liabilities are grouped together in Liabilities directly associated with assets classified as held for sale on the audited Consolidated balance sheets.

AXA Life Insurance qualified as a discontinued operation, given its classification as a disposal group acquired for resale purposes.

NOTE 6 – Financial instruments

6.1 Investments summary

The following tables summarize the Company's investments.

TABLE 6.1 – INVESTMENTS BY CLASSIFICATION

	AFS	Classified as at FVTPL	Designated as at FVTPL	Cash and cash equivalents, loans and receivables	Total
As at December 31, 2012					
Cash and cash equivalents	**–**	**–**	**–**	**172**	**172**
Debt securities					
Short-term notes	**214**	**–**	**–**	**–**	**214**
Fixed income					
Investment grade					
Government	**2,716**	**–**	**2,917**	**–**	**5,633**
Corporate	**1,173**	**–**	**1,447**	**–**	**2,620**
Asset-backed	**198**	**–**	**78**	**–**	**276**
Non-rated	**8**	**–**	**6**	**–**	**14**
Total debt securities	**4,309**	**–**	**4,448**	**–**	**8,757**
Preferred shares					
Investment grade					
Retractable	**117**	**–**	**–**	**–**	**117**
Fixed-rate perpetual	**296**	**–**	**–**	**–**	**296**
Other perpetual	**842**	**–**	**–**	**–**	**842**
Non-rated	**8**	**–**	**–**	**–**	**8**
Total preferred shares	**1,263**	**–**	**–**	**–**	**1,263**
Common shares	**1,301**	**405**	**670**	**–**	**2,376**
Loans	**–**	**–**	**–**	**391**	**391**
Total investments	**6,873**	**405**	**5,118**	**563**	**12,959**
As at December 31, 2011					
Cash and cash equivalents	–	–	–	206	206
Debt securities					
Short-term notes	244	–	–	–	244
Fixed income					
Investment grade					
Government	2,318	–	2,315	–	4,633
Corporate	1,170	3	1,583	–	2,756
Asset-backed	119	–	117	–	236
Non-rated	9	–	9	–	18
Total debt securities	3,860	3	4,024	–	7,887
Preferred shares					
Investment grade					
Retractable	165	–	–	–	165
Fixed-rate perpetual	323	–	–	–	323
Other perpetual	792	–	–	–	792
Non-rated	1	–	–	–	1
Total preferred shares	1,281	–	–	–	1,281
Common shares	1,063	435	553	–	2,051
Loans	–	–	–	403	403
Total investments	6,204	438	4,577	609	11,828

TABLE 6.2 – CARRYING VALUE OF INVESTMENTS

	FVTPL instruments	Other investments				Total investments
	At fair value	Unamortized cost	Unrealized gains	Unrealized losses	Net unrealized gains	At carrying value
As at December 31, 2012						
Cash and cash equivalents	**–**	**172**	**–**	**–**	**–**	**172**
Debt securities						
Short-term notes	**–**	**214**	**–**	**–**	**–**	**214**
Fixed income						
Investment grade						
Government	**2,917**	**2,653**	**64**	**(1)**	**63**	**5,633**
Corporate	**1,447**	**1,158**	**15**	**–**	**15**	**2,620**
Asset-backed	**78**	**195**	**3**	**–**	**3**	**276**
Non-rated	**6**	**8**	**–**	**–**	**–**	**14**
Total debt securities	**4,448**	**4,228**	**82**	**(1)**	**81**	**8,757**
Preferred shares						
Investment grade						
Retractable	**–**	**114**	**3**	**–**	**3**	**117**
Fixed-rate perpetual	**–**	**219**	**77**	**–**	**77**	**296**
Other perpetual	**–**	**802**	**52**	**(12)**	**40**	**842**
Non-rated	**–**	**7**	**1**	**–**	**1**	**8**
Total preferred shares	**–**	**1,142**	**133**	**(12)**	**121**	**1,263**
Common shares	**1,075**	**1,238**	**90**	**(27)**	**63**	**2,376**
Loans	**–**	**391**	**–**	**–**	**–**	**391**
Total investments	**5,523**	**7,171**	**305**	**(40)**	**265**	**12,959**
As at December 31, 2011						
Cash and cash equivalents	–	206	–	–	–	206
Debt securities						
Short-term notes	–	244	–	–	–	244
Fixed income						
Investment grade						
Government	2,315	2,237	81	–	81	4,633
Corporate	1,586	1,153	18	(1)	17	2,756
Asset-backed	117	116	3	–	3	236
Non-rated	9	9	–	–	–	18
Total debt securities	4,027	3,759	102	(1)	101	7,887
Preferred shares						
Investment grade						
Retractable	–	164	3	(2)	1	165
Fixed-rate perpetual	–	245	78	–	78	323
Other perpetual	–	715	83	(6)	77	792
Non-rated	–	1	–	–	–	1
Total preferred shares	–	1,125	164	(8)	156	1,281
Common shares	988	1,019	89	(45)	44	2,051
Loans	–	403	–	–	–	403
Total investments	5,015	6,512	355	(54)	301	11,828

As of December 31, 2012, asset-backed securities consist of mortgage-backed securities, auto loan receivables, credit card receivables and asset-backed commercial paper. These asset-backed securities are AAA rated as at December 31, 2012 and 2011.

The Company uses data from various rating agencies to rate debt securities and preferred shares. When there are two ratings for the same instrument, the Company uses the lower of the two. When there are three ratings for the same instrument, the Company uses

the median. Debt securities with a rating equal to or above BBB- are classified as investment grade. Preferred shares with a rating equal to or above P3 low are classified as investment grade.

As at December 31, 2012, the fair value of the loans was $396 million (December 31, 2011 – $436 million). The fair value was established using valuation techniques that used both input parameters based on observable market data and input parameters not based on observable market data.

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

TABLE 6.3 – MATURITY OF INVESTMENTS

	Less than 1 year	From 1 to 5 years	Over 5 years	No specific maturity	Total
As at December 31, 2012					
Cash and cash equivalents	**172**	**–**	**–**	**–**	**172**
Short-term notes	**214**	**–**	**–**	**–**	**214**
Fixed income	**776**	**4,529**	**3,238**	**–**	**8,543**
Preferred shares	**20**	**89**	**16**	**1,138**	**1,263**
Common shares	**–**	**–**	**–**	**2,376**	**2,376**
Loans	**4**	**108**	**273**	**6**	**391**
Total investments	**1,186**	**4,726**	**3,527**	**3,520**	**12,959**
As at December 31, 2011					
Cash and cash equivalents	206	–	–	–	206
Short-term notes	244	–	–	–	244
Fixed income	741	4,136	2,766	–	7,643
Preferred shares	22	115	29	1,115	1,281
Common shares	1	–	–	2,050	2,051
Loans	42	171	183	7	403
Total investments	1,256	4,422	2,978	3,172	11,828

6.2 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. The Company lends securities it owns to other financial institutions to allow them to meet their delivery commitments. As at December 31, 2012, the Company has loaned securities with a fair value of $2,176 million (December 31, 2011 – $1,550 million), which are reported in Investments.

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 $2,285 million as at December 31, 2012 (December 31, 2011 – $1,628 million).

6.3 Equities sold short

Among the Company's various investment strategies is a market-neutral equity investment strategy. The objective of this strategy, which consists of having both long and short equity positions, 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 Common shares and short positions are reported in Financial liabilities related to investments on the audited Consolidated balance sheets. The Company has secured its short positions by pledging government debt securities as collateral.

TABLE 6.4 – LONG AND SHORT POSITIONS

	As at December 31, 2012		As at December 31, 2011	
	Fair value	Debt securities pledged as collateral	Fair value	Debt securities pledged as collateral
Long positions	**300**	**–**	369	–
Short positions	**(301)**	**308**	(368)	377

6.4 Financial liabilities related to investments

TABLE 6.5 – DETAILS OF THE COMPANY'S FINANCIAL LIABILITIES RELATED TO INVESTMENTS

As at	December 31, 2012	December 31, 2011
Equities sold short positions (Table 6.4)	**301**	368
Net asset value attributable to third party unit holders	**105**	70
Embedded derivatives (Note 7.3)	**68**	67
Payable to investment brokers on unsettled trades	**5**	4
Derivative financial liabilities (Table 7.1)	**7**	23
Total financial liabilities related to investments	**486**	532

6.5 Investment results

The following table provides additional details about the items reported in Net investment income and Net investment gains.

TABLE 6.6 – DETAILS OF THE COMPANY'S NET INVESTMENT INCOME AND NET INVESTMENT GAINS

For the years ended December 31,	2012	2011
Amounts reported in Net investment income		
Interest income from:		
Financial instruments at FVTPL	**147**	116
AFS financial instruments	**106**	84
Loans and receivables	**22**	21
Total interest income	**275**	221
Dividend income (expense) from:		
AFS financial instruments	**111**	109
Financial instruments at FVTPL, net	**41**	33
Dividends paid on equities sold short	**(10)**	(11)
Dividends from long-term investments, at cost	**2**	–
Total dividend income	**144**	131
Expenses	**(31)**	(26)
Net investment income	**388**	326
Amounts reported in Net investment gains		
Net realized gains (losses) from:		
AFS financial instruments	**127**	265
Financial instruments designated as at FVTPL	**(48)**	46
Financial instruments classified as at FVTPL	**21**	(16)
Derivative financial instruments	**(20)**	(34)
Embedded derivatives	**(11)**	(2)
Impairment losses from:		
Common shares	**(40)**	(52)
Preferred shares	**(2)**	(13)
Other net gains	**10**	10
Net investment gains	**37**	204

NOTE 7 – Derivative financial instruments

7.1 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.

Derivative financial instruments are used for hedging purposes and for the purpose of modifying the risk profile of the Company's investment portfolio, as long as the resulting exposures are within the investment policy guidelines.

a) 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 regular future 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 to mitigate the risk arising from foreign currency fluctuations and futures to alter exposure to interest rate fluctuations.

b) 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.

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

The Company uses swaps primarily for risk management purposes, mainly in conjunction with other financial instruments to synthetically alter the cash flows of certain investments and credit exposure to specific bond issuers.

c) Options

Options are contractual agreements under which the seller grants to the buyer the right, but not the obligation, to either buy (call option) or sell (put option) a security, index, interest rate, exchange rate or other financial instrument at a predetermined price, at or by a specified future date. The seller (writer) of the option receives a premium from the purchase for this right and can also settle the contract by paying the cash settlement value of the purchaser's right.

The Company uses options to modify its exposure to interest rate risk.

The Company also uses inflation caps, which are a type of option, to manage inflation risk.

7.2 Fair value and notional amounts of derivatives

The following table shows the fair values and the notional amounts of derivatives by terms of maturity. Positive fair values are reported in Other assets and negative fair values are reported in Financial liabilities related to investments on the audited Consolidated balance sheets.

TABLE 7.1 – FAIR VALUES AND NOTIONAL AMOUNTS OF DERIVATIVES BY TERM TO MATURITY AND NATURE OF RISK

	Fair value		Notional amount			
	Positive	Negative	Less than 1 year	From 1 to 5 years	Over 5 years	Total
As at December 31, 2012						
Held for non-trading purposes						
Foreign currency contracts						
Forwards	–	–	31	–	–	31
Interest rate contracts						
Futures	–	–	117	–	–	117
Swaps	2	–	–	130	–	130
Options	–	–	2	7	–	9
Equity contracts						
Total return swaps	–	6	671	–	–	671
Credit contracts						
Credit default swaps	–	1	–	249	–	249
Inflation contracts						
Options	–	–	36	164	53	253
Total	2	7				
As at December 31, 2011						
Held for non-trading purposes						
Foreign currency contracts						
Forwards	–	4	285	–	–	285
Swaps	3	–	23	–	–	23
Interest rate contracts						
Futures	–	–	291	–	–	291
Swaps	3	–	–	130	–	130
Options	–	–	223	–	–	223
Equity contracts						
Total return swaps	–	15	554	–	–	554
Options	8	4	780	7	–	787
Credit contracts						
Credit default swaps	–	–	10	–	–	10
Inflation contracts						
Options	–	–	–	180	77	257
Total	14	23				

7.3 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 the embedded derivatives amounted to $68 million as at December 31, 2012 (December 31, 2011 – $67 million) 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 $979 million as at December 31, 2012 (December 31, 2011 – $921 million). Embedded derivatives are reported in Financial liabilities related to investments on the audited Consolidated balance sheets.

NOTE 8 – Fair value measurement

8.1 Determination of fair value and fair value hierarchy

In accordance with IFRS 7 for financial instruments measured at fair value on the audited Consolidated balance sheets, the Company categorizes its fair value measurements according to a three-level hierarchy as described below:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: valuation techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- Level 3: valuation techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

A financial instrument is regarded as quoted in an active market (Level 1) 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.

In the absence of an active market, fair values are based on inputs other than quoted prices that are observable for the asset or liability directly or indirectly (Level 2). Such inputs include prevailing market rates for instruments with similar characteristics and risk profiles, the closing price of the most recent trade date subject to liquidity adjustments or average brokers' quotes when trades are too sparse to constitute an active market. The Company determines the fair values of some instruments by using valuation techniques commonly used by the market participants, which refer to observable market data, like discounted cash flow analyses and option pricing models. For some other financial instruments, the Company relies on the valuation services of third parties that developed the structure of these instruments. The third parties measure the fair values of the financial instruments using the following valuation techniques:

- When the financial instrument is a derivative, the fair value is calculated on the basis of observable market data and reflects the estimated amount that the Company would receive or might have to pay to terminate the contracts as at December 31;
- When the financial instrument is made up of underlying securities quoted on an active market, the third party uses bid prices for financial assets and ask prices for financial liabilities at the valuation date; and
- When the financial instrument is made up of underlying funds, investments in the underlying mutual funds are valued at the net asset value of the shares held, as determined by the manager of the underlying funds at the valuation date.

In limited circumstances, the Company uses input parameters that are not based on observable market data (Level 3). Non-market observable inputs use fair values determined in whole or in part using a valuation technique or model based on assumptions that are neither supported by prices from observable current market transactions in the same instrument nor based on available market data.

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 related to investments and also reported in Preferred shares on the audited Consolidated balance sheets.

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

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

TABLE 8.1 – FAIR VALUE HIERARCHY OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

	Level 1	Level 2	Level 3	Total
As at December 31, 2012				
Investments				
Debt securities				
Short-term notes	214	–	–	214
Fixed income				
Investment grade				
Government	4,659	974	–	5,633
Corporate	2,109	511	–	2,620
Asset-backed	164	112	–	276
Non-rated	–	14	–	14
Total debt securities	7,146	1,611	–	8,757
Preferred shares				
Investment grade				
Retractable	117	–	–	117
Fixed rate perpetual	272	–	24	296
Other perpetual	798	–	44	842
Non-rated	8	–	–	8
Total preferred shares	1,195	–	68	1,263
Common shares	2,376	–	–	2,376
Total investments	10,717	1,611	68	12,396
Derivative financial assets	–	2	–	2
Total financial assets measured at fair value	10,717	1,613	68	12,398
Derivative financial liabilities				
Derivative financial liabilities	–	7	–	7
Embedded derivatives	–	–	68	68
Total derivative financial liabilities	–	7	68	75
Net asset value attributable to third party unit holders	105	–	–	105
Equities sold short positions	301	–	–	301
Total financial liabilities measured at fair value	406	7	68	481

TABLE 8.1 – FAIR VALUE HIERARCHY OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES (continued)

	Level 1	Level 2	Level 3	Total
As at December 31, 2011				
Investments				
Debt securities				
Short-term notes	244	–	–	244
Fixed income				
Investment grade				
Government	3,770	863	–	4,633
Corporate	1,551	1,205	–	2,756
Asset-backed	125	111	–	236
Non-rated	–	18	–	18
Total debt securities	5,690	2,197	–	7,887
Preferred shares				
Investment grade				
Retractable	165	–	–	165
Fixed rate perpetual	300	–	23	323
Other perpetual	748	–	44	792
Non-rated	1	–	–	1
Total preferred shares	1,214	–	67	1,281
Common shares	2,043	–	8	2,051
Total investments	8,947	2,197	75	11,219
Derivative financial assets	8	6	–	14
Total financial assets measured at fair value	8,955	2,203	75	11,233
Derivative financial liabilities				
Derivative financial liabilities	4	19	–	23
Embedded derivatives	–	–	67	67
Total derivative financial liabilities	4	19	67	90
Net asset value attributable to third party unit holders	70	–	–	70
Equities sold short positions	368	–	–	368
Total financial liabilities measured at fair value	442	19	67	528

8.2 Level 3 financial instruments

Changes in the embedded derivatives are reported in Net investment gains on the audited Consolidated statements of comprehensive income. An equal change in the asset component is reported in OCI.

The following table shows a reconciliation of the opening and closing carrying values of the Company's embedded derivatives and their asset components.

TABLE 8.2 – RECONCILIATION OF LEVEL 3 FINANCIAL INSTRUMENTS

	Asset component (preferred shares)	Embedded derivatives (financial liabilities)
Carrying value as at January 1, 2012	**67**	**(67)**
Gains (losses) reported in Net investment gains	**14**	**(11)**
Losses reported in OCI	**(3)**	**–**
Purchases	**7**	**(7)**
Sales	**(17)**	**17**
Carrying value as at December 31, 2012	**68**	**(68)**
Carrying value as at January 1, 2011	67	(67)
Gains (losses) reported in Net investment gains	24	(2)
Losses reported in OCI	(22)	–
Purchases	24	(24)
Sales	(37)	37
Business combination (Note 4)	11	(11)
Carrying value as at December 31, 2011	67	(67)

Net gains reported in Net investment gains for the embedded derivatives and their asset components still held as at December 31, 2012 amounted to $3 million for 2012 (December 31, 2011 – $22 million).

The following table shows the impact of changing the implied volatility by 10% on the carrying value of the Company's embedded derivatives and the resulting gains (losses). The Company believes that this percentage change provides a fair indication of how the Company's Net income attributable to shareholders would be impacted in the event of a significant change in this non-observable valuation parameter.

TABLE 8.3 – SENSITIVITY ANALYSIS FOR LEVEL 3 FINANCIAL INSTRUMENTS

	10% increase in volatility	10% decrease in volatility
As at December 31, 2012		
Asset component		
Increase (decrease) in preferred shares	**11**	**(10)**
Increase (decrease) in OCI	**11**	**(10)**
Embedded derivatives		
Increase (decrease) in financial liabilities	**11**	**(10)**
Increase (decrease) in net investment gains (losses)	**(11)**	**10**
As at December 31, 2011		
Asset component		
Increase (decrease) in preferred shares	10	(10)
Increase (decrease) in OCI	10	(10)
Embedded derivatives		
Increase (decrease) in financial liabilities	10	(10)
Increase (decrease) in net investment gains (losses)	(10)	10

NOTE 9 – Financial risk

The Company has a comprehensive risk management framework and internal control procedures designed to manage and monitor various risks in order to protect the Company's business, clients, shareholders and employees. The risk management programs aim to manage risks that could materially impair the Company's financial position, accept risks that contribute to sustainable earnings and growth and disclose these risks in a full and complete manner.

Effective risk management consists in identifying, understanding and communicating all risks that 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.

The majority of the investment portfolio is invested in well-established, active and liquid markets. See Note 8 – *Fair value measurement* for information about how the Company categorizes its fair value measurements according to a three-level hierarchy.

9.1 Market risk

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: currency risk, interest rate risk and other market price risk, such as equity price 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% variation in equity markets and a 5% variation in the price of preferred shares, excluding the impact of any impairment, would impact Net income and OCI as follows:

TABLE 9.1 – SENSITIVITY ANALYSIS FOR EQUITY PRICE RISK

	Equity markets[1] increase	Equity markets[1] decrease
As at December 31, 2012		
Net income	**(16)**	**16**
OCI	**143**	**(143)**
As at December 31, 2011		
Net income	(14)	14
OCI	134	(134)

[1] A shock of 10% is applied to all common shares, net of any equity hedges, and a shock of 5% is applied to all preferred shares.

The impact resulting from changes in equity markets, described above, is generally a linear relationship to the change in the equity markets. Therefore, the impact will increase or decrease in linear proportion to the changes in equity markets.

The above sensitivity analysis was prepared using the following key assumptions:

- 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 and liquidity risks have not been considered;
- Impact on the Company's pension plans is not included;
- Risk reduction measures perform as expected, with no material basis risk and no counterparty defaults; and
- AFS equities in an unrealized loss position, as reflected in AOCI, may, at some point in the future, be realized either through a sale or an impairment.

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 changes in credit spreads, cause changes in realized and unrealized gains and losses. To mitigate interest rate risk, the Company uses interest rate futures and bond forwards to hedge the variability in cash flows related to the issuance of its debt.

A 100-basis-point variation in interest rates would normally impact Net income as a result of marking to market the written call option liabilities embedded in the Company's redeemable preferred shares. A 100-basis-point variation would also impact OCI. The impacts would be as follows:

TABLE 9.2 – SENSITIVITY ANALYSIS FOR INTEREST RATE RISK

	Interest rates 100-basis-point increase	Interest rates 100-basis-point decrease
As at December 31, 2012		
Net income	**–**	**–**
OCI	**(138)**	**138**
As at December 31, 2011		
Net income	5	(5)
OCI	(135)	135

The above sensitivity analysis was prepared using the following key assumptions:

- 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;
- Impact on the Company's pension plans is not included;
- Risk reduction measures perform as expected, with no material basis risk and no counterparty defaults;
- For the Company's FVTPL fixed-income securities, the estimated impact on net income is assumed to be offset by the market-yield adjustment; and
- AFS fixed-income securities in an unrealized loss position, as reflected in AOCI, may, at some point in the future, be realized either through a sale or an 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 9.3.

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 9.3 – EXPOSURE TO INTEREST RATE RISK

	Floating rates	Fixed rates			Non-rate sensitive	Total
		Less than 1 year	From 1 to 5 years	Over 5 years		
As at December 31, 2012						
Assets						
Cash and cash equivalents	162	10	–	–	–	172
Effective interest rate		*0.96%*				
Short-term notes	–	214	–	–	–	214
Effective interest rate		*0.95%*				
Fixed income	11	773	4,521	3,238	–	8,543
Effective interest rate		*1.38%*	*1.78%*	*2.20%*		
Preferred shares	54	21	876	312	–	1,263
Effective interest rate		*5.62%*	*5.08%*	*4.90%*		
Common shares	–	–	–	–	2,376	2,376
Loans	49	4	85	253	–	391
Effective interest rate		*5.33%*	*5.82%*	*5.46%*		
Reinsurance assets	–	130	130	60	–	320
Effective interest rate		*2.10%*	*2.10%*	*2.10%*		
Other assets	2	–	–	–	6,532	6,534
Total assets	278	1,152	5,612	3,863	8,908	19,813
Liabilities and shareholders' equity						
Claims liabilities	–	3,101	3,123	1,432	–	7,656
Effective interest rate		*2.10%*	*2.10%*	*2.10%*		
Debt outstanding	–	–	–	1,143	–	1,143
Effective interest rate				*5.45%*		
Financial liabilities related to investments	8	6	37	24	411	486
Effective interest rate			*5.11%*	*4.92%*		
Other liabilities	–	–	–	–	5,635	5,635
Shareholders' equity	–	–	–	–	4,893	4,893
Total liabilities and shareholders' equity	8	3,107	3,160	2,599	10,939	19,813
Net long (short) exposure	270	(1,955)	2,452	1,264	(2,031)	–

	Floating rates	Fixed rates: Less than 1 year	Fixed rates: From 1 to 5 years	Fixed rates: Over 5 years	Non-rate sensitive	Total
As at December 31, 2011						
Assets						
Cash and cash equivalents	76	42	–	–	88	206
Effective interest rate		*0.86%*				
Short-term notes	–	244	–	–	–	244
Effective interest rate		*0.87%*				
Fixed income	88	724	4,070	2,761	–	7,643
Effective interest rate		*1.60%*	*1.80%*	*2.55%*		
Preferred shares	70	21	838	352	–	1,281
Effective interest rate		*5.48%*	*5.01%*	*4.78%*		
Common shares	–	–	–	–	2,051	2,051
Loans	–	42	164	117	80	403
Effective interest rate		*5.85%*	*5.90%*	*5.86%*		
Reinsurance assets	–	111	116	52	130	409
Effective interest rate		*2.30%*	*2.30%*	*2.30%*		
Other assets	3	3	–	–	7,510	7,516
Total assets	237	1,187	5,188	3,282	9,859	19,753
Liabilities and shareholders' equity						
Claims liabilities	–	2,741	2,858	1,287	–	6,886
Effective interest rate		*2.30%*	*2.30%*	*2.30%*		
Debt outstanding	400	–	–	893	–	1,293
Effective interest rate				*5.53%*		
Financial liabilities related to investments	23	3	31	20	455	532
Effective interest rate			*4.95%*	*4.76%*		
Other liabilities	–	–	–	–	6,701	6,701
Shareholders' equity	–	–	–	–	4,341	4,341
Total liabilities and shareholders' equity	423	2,744	2,889	2,200	11,497	19,753
Net long (short) exposure	(186)	(1,557)	2,299	1,082	(1,638)	–

c) Currency risk

Currency risk is the risk that the fair value of 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 foreign exchange rates. The Company is exposed to some foreign exchange risks arising from securities in some of its U.S. dollar denominated assets; however, 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.

The following table illustrates the foreign-denominated financial assets and derivative financial instruments used to reduce the currency risk:

TABLE 9.4 – EXPOSURE TO CURRENCY RISK

As at	December 31, 2012	December 31, 2011
Currency exposure – U.S. dollar		
Net investments	13	276
Less: U.S. dollar forward exchange contracts and currency swaps, notional amount	(13)	(276)
Net currency risk – U.S. dollar	–	–
Currency exposure – other currencies	–	–
Total net currency exposure on financial assets	–	–

9.2 Basis risk

The Company's use of derivatives exposes it to a number of risks, including credit risk as well as interest rate, equity market and currency 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.

9.3 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 debt portfolios, preferred share portfolios and, over-the-counter derivatives and, to a lesser extent, in its reinsurance recoverable and structured settlements agreements entered into with various life insurance companies.

a) 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. Detail on these credit risk exposures, including information on how the Company mitigates these, is given in the remaining part of the note.

TABLE 9.5 – MAXIMUM EXPOSURE TO CREDIT RISK

As at	December 31, 2012	December 31, 2011
On-balance sheet credit risk exposure		
Cash and cash equivalents	172	206
Debt securities	8,757	7,887
Preferred shares	1,263	1,281
Common shares	2,376	2,051
Loans	391	403
Derivative financial assets (Table 7.1)	2	14
Premium receivables	2,670	2,487
Reinsurance assets	320	409
Other financial assets[1]	530	356
Total on-balance sheet credit risk exposure	16,481	15,094
Off-balance sheet credit risk exposure		
Original price of structured settlements purchased	676	598
Total off-balance sheet credit risk exposure	676	598

[1] Other financial assets comprise the following amounts as reported on the audited Consolidated balance sheets: Other receivables and recoverables, Accrued investment income, Income taxes receivable and Long-term investments at cost.

b) Structured settlements

The Company has obligations to pay certain fixed amounts to claimants on a recurring basis and has purchased annuities from life insurers to provide for those payments. In the event that the life insurers are in default, the Company may have to assume a financial guarantee obligation. Therefore, the net risk to the Company is any credit risk related to the life insurers. Since the Company deals with registered life insurers, this credit risk is minimal.

As at December 31, 2012, none of the life insurers from which the Company had purchased annuities were in default. The original purchase price of the annuities totalled $676 million (December 31, 2011 – $598 million). The risk-adjusted balance is determined by applying the standard OSFI-defined measures of counterparty risk to the credit equivalent amount and was $2 million as at December 31, 2012 (December 31, 2011 – $1 million).

c) Investments

The Company's risk management strategy is to invest in debt 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 debt 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 the Company's OSFI-regulated subsidiaries, the assets invested in any entity or group of related entities are limited by OSFI to 5% of the subsidiaries' assets. The Company also monitors aggregate concentrations of credit risk by country of issuance and by industry (see Table 9.6 hereafter).

The Company receives guarantees for loans.

d) Derivative-related risk

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. The Company has adopted a policy whereby, upon signing the derivative contract, the counterparty is required to have a minimum credit rating of "A-" and an issuer credit spread below established thresholds.

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 the Company. 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 replacement cost of $2 million as at December 31, 2012 (December 31, 2011 – $6 million) represents the total fair value of all outstanding contracts in a gain position before factoring in the master netting agreements of nil (December 31, 2011 – $1 million) and excludes fair values relating to exchange-traded instruments as they are subject to daily margining and are deemed to have no credit risk.

The credit equivalent amount of $103 million as at December 31, 2012 (December 31, 2011 – $45 million) 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.

e) Reinsurance

The Company relies on reinsurance to manage underwriting risk. Although reinsurance makes the assuming reinsurer liable to the Company to the extent of the risk ceded, the Company is not relieved of its primary liability to its policyholders as the direct insurer. As a result, the Company bears credit risk with respect to its reinsurers. There is no certainty that its 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 & Poor's. 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 year-end date.

The Company is the assigned beneficiary of collateral consisting of cash, trust accounts and letters of credit totalling $173 million as at December 31, 2012 (December 31, 2011 – $183 million) as guarantees from unlicensed reinsurers. This collateral is held in support of policy liabilities of $80 million as at December 31, 2012 (December 31, 2011 – $130 million) and could be used should these reinsurers be unable to meet their obligations.

f) 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 investments could be sensitive to changing conditions in specific geographic regions or specific industries. The Company has a significant concentration of its investments 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 9.6 – CONCENTRATIONS OF CREDIT RISK FOR INVESTMENTS

As at	**December 31, 2012**	December 31, 2011
By country of issuer		
Canada	**97%**	92%
U.S.	**–**	2%
Other	**3%**	6%
Total	**100%**	100%
By industry		
Government	**48%**	42%
Banks, insurance and diversified financial services	**34%**	35%
Energy	**8%**	9%
Other	**10%**	14%
Total	**100%**	100%

9.4 Liquidity risk

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

As a result of the nature of its property and casualty insurance activities, cash flows may be highly volatile and unpredictable. The Company's liquidity needs are rigorously managed by matching asset and liability cash flows and by establishing forecasts respecting returns obtained and required. The Company invests in various types of assets in order to match them to its liabilities. This method maps the obligations toward insured clients to asset life and performance. The Company reviews the status of the matching on a quarterly basis.

To manage its cash flow requirements, a portion of the Company's investments is maintained in short-term (less than one year), highly liquid money-market securities. A large portion of the investments are held in highly liquid federal and provincial government debt to protect against any unanticipated large cash requirements. In addition, the Company also has an unsecured committed credit facility, see Note 20.3 – *Credit facilities*.

The following table presents the undiscounted value of financial liabilities by expected maturity. The expected maturities of claims liabilities are determined by estimating the moment at which the claims liabilities will effectively be settled. Unearned premiums have been excluded because they do not constitute actual obligations.

TABLE 9.7 – EXPECTED MATURITY OF FINANCIAL LIABILITIES

	Less than 1 year	From 1 to 5 years	Over 5 years	No specific maturity	Total
As at December 31, 2012					
Claims liabilities	**3,101**	**3,123**	**1,432**	**–**	**7,656**
Financial liabilities related to investments	**12**	**–**	**–**	**474**	**486**
Income taxes payable	**27**	**8**	**–**	**–**	**35**
Debt outstanding	**–**	**–**	**1,143**	**–**	**1,143**
Other financial liabilities	**933**	**286**	**4**	**25**	**1,248**
Total financial liabilities	**4,073**	**3,417**	**2,579**	**499**	**10,568**
As at December 31, 2011					
Claims liabilities	2,741	2,858	1,287	–	6,886
Financial liabilities related to investments	27	–	–	505	532
Income taxes payable	5	12	–	–	17
Debt outstanding	–	400	893	–	1,293
Other financial liabilities	788	280	–	43	1,111
Total financial liabilities	3,561	3,550	2,180	548	9,839

NOTE 10 – Insurance risk

10.1 Insurance risk and management

The Company principally underwrites automobile, home and commercial property and liability contracts to individuals and small to medium-size businesses. The majority of the insurance risk to which the Company is exposed is of a short-tail nature. Policies generally cover a 12-month period, with the exception of a portion of the personal line insurance contracts where coverage is for a two-year period. The average duration of claims liabilities is 2.4 years as at December 31, 2012 and 2011.

Insurance contract risk is the risk that a loss arises from the following reasons:

- Underwriting and pricing;
- Fluctuation in the timing, frequency and severity of claims relative to expectations;
- Inadequate reinsurance protection; and
- Large unexpected losses arising from a single event such as a catastrophe event.

Insured events can occur at any time during the coverage period and can generate losses of variable amounts. An objective of the Company is to ensure that sufficient claims liabilities are established to cover future insurance claim payments. The Company's success depends upon its ability to accurately assess the risk associated with the insurance contracts underwritten by the Company. The Company establishes claims liabilities to cover the estimated liability for the payment of all losses, including loss adjustment expenses incurred with respect to insurance contracts underwritten by the Company. Claims liabilities do not represent an exact calculation of the liability. Rather, claims liabilities are the Company's best estimates of its expected ultimate cost of resolution and administration of claims. Expected inflation is taken into account when estimating claims liabilities, thereby mitigating inflation risk.

The composition of the Company's insurance risk, as well as the methods employed to mitigate the risks, are described below.

a) Underwriting and pricing risks

The insurance business is cyclical in nature whereby the industry generally reduces insurance rates following periods of increased profitability, while it generally increases rates following periods of sustained loss. The Company's profitability tends to follow this cyclical market pattern and can also be affected by demand and competition. In addition, the Company is at risk from changes in automobile insurance legislation, the economic environment and climate patterns.

In order to properly monitor the Company's risk appetite, pricing targets are set by the Insurance Risk Department and distributed to each region. Pricing targets are established using an internal return on equity model and a risk-based capital model.

Risks associated with commercial and personal property may vary in relation to the geographical area of the risk insured by the Company. The Company's exposure to concentrations of insurance risk, in terms of type of risk and level of insured benefits, is mitigated by careful selection and implementation of underwriting strategies, which is in turn largely achieved through diversification across industry sectors and geographical areas. For automobile insurance, legislation is in place at a provincial level and this creates differences in the benefits provided among the provinces.

The following table illustrates the concentration of insurance contracts on the basis of direct premiums written:

TABLE 10.1 – CONCENTRATIONS OF INSURANCE CONTRACTS ON THE BASIS OF DIRECT PREMIUMS WRITTEN

For the years ended December 31,	2012	2011
Direct premiums written by line of business		
Personal Automobile	45%	47%
Personal Property	23%	24%
Commercial Automobile	8%	8%
Commercial P&C	24%	21%
Total	100%	100%
Direct premiums written by province		
Ontario	40%	45%
Québec	30%	26%
Alberta	17%	18%
British Columbia	7%	5%
Other	6%	6%
Total	100%	100%

The Enterprise Risk Committee monitors the Company's overall risk profile, aiming for a balance between risk, return and capital and determines policies concerning the Company's risk management framework. The committee's mandate is to identify, measure and monitor risks and avoid risks that are outside of the Company's risk tolerance level. Further, in order to minimize unforeseen risks, new products are subject to an internal product and approval review process. The Company also uses reinsurance under its strategy for managing the underwriting risk. The availability and cost of reinsurance are subject to prevailing market conditions, both in terms of price and available capacity, which can affect the Company's ceded premium volume and profitability. Reinsurance companies exclude some types of coverage from the contracts that the Company purchases from them or may alter the terms of such contracts from time to time. These gaps in reinsurance protection expose the Company to greater risk and greater potential loss and could adversely affect its ability to underwrite future business. Where the Company cannot successfully mitigate risk through reinsurance arrangements, consideration is given to reducing premiums written in order to lower its risk.

b) Risk related to frequency and severity of claims

The occurrence of claims being unforeseeable, the Company is exposed to the risk that the number and the severity of claims would exceed the estimates.

Strict claim review policies are in place to assess all new and ongoing claims. Regular detailed reviews of claims handling procedures and frequent investigations of possible fraudulent claims reduce the Company's risk exposure. Further, the Company enforces a policy of actively managing and promptly pursuing claims, in order to reduce its exposure to unpredictable future developments that could negatively impact the business. The Company has established a Large Loss Committee responsible for analyzing large losses and contentious matters to ensure that appropriate claims liabilities are established and approved.

c) Reinsurance risk

Under reinsurance programs, management considers that in order for a contract to reduce exposure to risk, it must be structured to ensure that the reinsurer assumes the significant insurance risk related to the underlying reinsured contracts and it is reasonably possible that the reinsurer may realize a significant loss from the reinsurance. Although the Company has reinsurance arrangements, it is not relieved of its direct obligations to its contract holders and thus a credit exposure exists with respect to ceded insurance, to the extent that any reinsurer is unable to meet the obligations that are assumed under such reinsurance agreements. The Company evaluates reinsurance recoverables and receivables at each balance sheet date and provides for reinsurance amounts deemed uncollectible. The Company's placement of reinsurance is diversified such that it is not dependent on a single reinsurer and the Company's operations are not substantially dependent upon any single reinsurance contract. The Company has collateral in place to support amounts receivable and recoverable from non-registered reinsurers.

d) Catastrophe risk

Catastrophe risk is the risk of occurrence of a catastrophic event (e.g., hurricanes, earthquakes and hail or windstorms) that affects a large number of policyholders simultaneously. Catastrophes can have a significant impact on the underwriting income of an insurer.

The Company has limited its exposure to catastrophe risk by imposing maximum claim amounts on certain contracts as well as by using reinsurance arrangements in order to limit exposure to catastrophic events. The placement of ceded reinsurance is almost exclusively on an excess-of-loss basis (per event or per risk) as per practice, actuarial norms and regulatory guidelines. Retention limits for the excess-of-loss reinsurance vary by product line and territory. The following table shows the Company's net retention and reinsurance coverage limits by nature of risk.

TABLE 10.2 – REINSURANCE NET RETENTION AND COVERAGE LIMITS BY NATURE OF RISK

	2012	2011[1]
Single risk events[2]		
Net retentions:		
On property policies	**5**	2–5
On liability policies	**2–10**	5–10
Multi-risk events and catastrophes[3]		
Net retentions	**50**	15–25
Coverage limit	**3,300**	1,430–1,500

[1] As at December 31, 2011, when most of the reinsurance programs were renewed, the Company and AXA Canada maintained separate reinsurance programs and the numbers above reflect the retentions and limits of each program.
[2] For certain special classes of business or types of risks as well as for Jevco, the retention may be lower through specific treaties or the use of facultative reinsurance.
[3] Includes a reinsurance treaty in place for a specific portfolio in British Columbia.

e) Sensitivity to insurance risk

The principal assumption underlying the claims liability estimates is that the Company's future claims development will follow a similar pattern to past claims development experience.

Claims liabilities estimates are also based on various quantitative and qualitative factors, including:
- average claim costs, including claim handling costs;
- average number of claims by accident year;
- trends in claims severity and frequency;
- other factors such as inflation, expected or in-force government pricing and coverage reforms, and the level of insurance fraud;
- discounted rate; and
- provision for adverse developments ("PfAD").

Most or all of the qualitative factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact the Company's ability to accurately assess the risk of the insurance contracts that the Company underwrites. In addition, there may be significant lags between the occurrence of the insured event and the time it is actually reported to the Company and additional lags between the time of reporting and final settlement of claims.

The Company refines its claims liabilities estimates on an ongoing basis as claims are reported and settled. Establishing an appropriate level of claims liabilities is an inherently uncertain process and the policies surrounding this are overseen by the Company's Reserve Review Committee.

The claim liabilities' sensitivity to certain key assumptions are outlined below. It has not been possible to quantify the sensitivity to certain assumptions such as legislative changes or uncertainty in the estimation process. The analysis below is performed for possible movements in the assumptions with all other assumptions held constant, showing the impact on Net income and on Shareholders' equity. Movements in these assumptions may be non-linear and may be correlated with one another.

TABLE 10.3 – SENSITIVITY ANALYSIS

Sensitivity factors	Change in assumptions	Impact on Net income	Impact on Shareholders' equity
As at December 31, 2012			
Average number of claims (frequency)	**+5%**	**(68)**	**(50)**
Average claim cost (severity)	**+5%**	**(343)**	**(253)**
Discount rate	**+1%**	**175**	**129**
As at December 31, 2011			
Average number of claims (frequency)	+5%	(52)	(38)
Average claim cost (severity)	+5%	(305)	(225)
Discount rate	+1%	164	118

NOTE 11 – Claims liabilities and unearned premiums

11.1 Summary of claims liabilities and unearned premiums

Claims liabilities are established to reflect the estimate of the full amount of all liabilities associated with the insurance contracts earned at the balance sheet date, including insurance claims incurred but not reported. The ultimate amount of these liabilities will vary from the best estimate made for a variety of reasons, including additional information with respect to the facts and circumstances of the insurance claims incurred.

The following table presents movements in the Company's claims liabilities during the year.

TABLE 11.1 – MOVEMENT OF THE CLAIMS LIABILITIES

	Direct	Ceded	Net
As at December 31, 2012			
Balance, beginning of year	**6,886**	**368**	**6,518**
Current year claims	**4,511**	**79**	**4,432**
Prior year favourable claims development	**(472)**	**(93)**	**(379)**
Total claims incurred	**4,039**	**(14)**	**4,053**
Increase due to changes in discount rate	**18**	**1**	**17**
Claims paid	**(4,018)**	**(87)**	**(3,931)**
Business combinations (Note 4)	**731**	**29**	**702**
Balance, end of year	**7,656**	**297**	**7,359**
As at December 31, 2011			
Balance, beginning of year	4,379	216	4,163
Current year claims	3,464	108	3,356
Prior year unfavourable (favourable) claims development	(212)	11	(223)
Total claims incurred	3,252	119	3,133
Increase due to changes in discount rate	84	3	81
Claims paid	(3,022)	(76)	(2,946)
Business combinations (Note 4)	2,193	106	2,087
Balance, end of year	6,886	368	6,518

The following table presents movements in the Company's unearned premiums during the year.

TABLE 11.2 – MOVEMENT OF UNEARNED PREMIUMS

	Direct	Ceded	Net
As at December 31, 2012			
Balance, beginning of year	**3,790**	**41**	**3,749**
Premiums written	**6,854**	**221**	**6,633**
Premiums earned	**(6,802)**	**(241)**	**(6,561)**
Business combinations (Note 4)	**204**	**2**	**202**
Balance, end of year	**4,046**	**23**	**4,023**
As at December 31, 2011			
Balance, beginning of year	2,586	19	2,567
Premiums written	5,126	160	4,966
Premiums earned	(5,070)	(163)	(4,907)
Business combinations (Note 4)	1,148	25	1,123
Balance, end of year	3,790	41	3,749

The following tables present claims liabilities and unearned premiums by line of business.

TABLE 11.3 – CLAIMS LIABILITIES

	Direct	Ceded	Net
As at December 31, 2012			
Personal lines			
Automobile	**4,301**	**44**	**4,257**
Property	**594**	**42**	**552**
Total personal lines	**4,895**	**86**	**4,809**
Commercial lines			
Automobile	**649**	**18**	**631**
P&C	**2,112**	**193**	**1,919**
Total commercial lines	**2,761**	**211**	**2,550**
Total	**7,656**	**297**	**7,359**
As at December 31, 2011			
Personal lines			
Automobile	3,546	24	3,522
Property	761	154	607
Total personal lines	4,307	178	4,129
Commercial lines			
Automobile	543	6	537
P&C	2,036	184	1,852
Total commercial lines	2,579	190	2,389
Total	6,886	368	6,518

TABLE 11.4 – UNEARNED PREMIUMS

	Direct	Ceded	Net
As at December 31, 2012			
Personal lines			
Automobile	**1,928**	**1**	**1,927**
Property	**961**	**–**	**961**
Total personal lines	**2,889**	**1**	**2,888**
Commercial lines			
Automobile	**294**	**1**	**293**
P&C	**863**	**21**	**842**
Total commercial lines	**1,157**	**22**	**1,135**
Total	**4,046**	**23**	**4,023**
As at December 31, 2011			
Personal lines			
Automobile	1,782	1	1,781
Property	935	1	934
Total personal lines	2,717	2	2,715
Commercial lines			
Automobile	259	2	257
P&C	814	37	777
Total commercial lines	1,073	39	1,034
Total	3,790	41	3,749

11.2 Fair value of claims liabilities

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

TABLE 11.5 – CARRYING VALUE OF CLAIMS LIABILITIES

	Direct	Ceded	Net
As at December 31, 2012			
Undiscounted value	**7,308**	**284**	**7,024**
Effect of time value of money using a discount rate of 2.10%	**(373)**	**(18)**	**(355)**
Provision for adverse deviation	**721**	**31**	**690**
Carrying value	**7,656**	**297**	**7,359**
As at December 31, 2011			
Undiscounted value	6,587	356	6,231
Effect of time value of money using a discount rate of 2.30%	(370)	(17)	(353)
Provision for adverse deviation	669	29	640
Carrying value	6,886	368	6,518

11.3 Net loss from reinsurance

The net loss arising from reinsurance ceded included in Underwriting income on the audited Consolidated statements of comprehensive income is detailed as follows:

TABLE 11.6 – NET LOSS FROM REINSURANCE

For the years ended December 31,	**2012**	2011
Reduction in:		
Net premiums earned	**(241)**	(163)
Net claims incurred	**(13)**	122
Underwriting expenses	**27**	21
Net loss from reinsurance	**(227)**	(20)

11.4 Prior year claims development

The following tables show the estimates of cumulative incurred claims, including IBNR, for the six most recent accident years, with subsequent developments during the periods and together with cumulative payments to date. 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 and current estimates of claims liabilities for claims still open or claims still unreported.

The Company applied the transitional rules of IFRS 4 that permit only five years of information to be disclosed upon adoption of IFRS. The claims development information disclosed is being increased from five years to ten years over the period 2012 to 2016.

TABLE 11.7 – PRIOR YEAR CLAIMS DEVELOPMENT – DIRECT

		Accident year					
	Total	2012	2011	2010	2009	2008	2007 & earlier
Undiscounted claims liabilities outstanding at end of accident year		2,419	2,399	2,067	1,864	1,639	4,619
Revised estimates							
One year later		–	2,290	1,961	1,800	1,643	4,443
Two years later		–	–	1,939	1,801	1,614	4,370
Three years later		–	–	–	1,774	1,604	4,291
Four years later		–	–	–	–	1,584	4,214
Five years later		–	–	–	–	–	4,044
Current estimate		2,419	2,290	1,939	1,774	1,584	4,044
Paid claims in subsequent periods							
One year later		–	(876)	(584)	(599)	(619)	(1,175)
Two years later		–	–	(297)	(184)	(157)	(570)
Three years later		–	–	–	(214)	(145)	(481)
Four years later		–	–	–	–	(170)	(343)
Five years later		–	–	–	–	–	(328)
Cumulative payment to date		–	(876)	(881)	(997)	(1,091)	(2,897)
Direct undiscounted claims liabilities	**7,308**	**2,419**	**1,414**	**1,058**	**777**	**493**	**1,147**
Discounting and provision for adverse deviation	**348**						
Direct claims liabilities	**7,656**						

TABLE 11.8 – PRIOR YEAR CLAIMS DEVELOPMENT – NET

		Accident year					
	Total	2012	2011	2010	2009	2008	2007 & earlier
Undiscounted claims liabilities outstanding at end of accident year		2,357	2,299	2,031	1,796	1,624	4,291
Revised estimates							
One year later		–	2,201	1,916	1,737	1,623	4,134
Two years later		–	–	1,888	1,736	1,594	4,066
Three years later		–	–	–	1,712	1,584	3,983
Four years later		–	–	–	–	1,560	3,908
Five years later		–	–	–	–	–	3,819
Current estimate		2,357	2,201	1,888	1,712	1,560	3,819
Paid claims in subsequent periods							
One year later		–	(827)	(554)	(568)	(607)	(1,137)
Two years later		–	–	(292)	(177)	(155)	(559)
Three years later		–	–	–	(211)	(144)	(462)
Four years later		–	–	–	–	(169)	(334)
Five years later		–	–	–	–	–	(317)
Cumulative payment to date		–	(827)	(846)	(956)	(1,075)	(2,809)
Net undiscounted claims liabilities	**7,024**	**2,357**	**1,374**	**1,042**	**756**	**485**	**1,010**
Discounting and provision for adverse deviation	**335**						
Net claims liabilities	**7,359**						

NOTE 12 – Revenue

TABLE 12.1 – TOTAL REVENUE

For the years ended December 31,	2012	2011
Net premiums earned	**6,561**	4,907
Interest income (Table 6.6)	**275**	221
Dividend income (Table 6.6)	**144**	131
Net investment gains (Table 6.6)	**37**	204
Share of profit from investments in associates and joint ventures (Table 15.2)	**22**	16
Other revenues	**88**	50
Total revenue	**7,127**	5,529

TABLE 12.2 – PREMIUMS WRITTEN AND EARNED

For the years ended December 31,	2012	2011
Premiums written		
Direct	**6,854**	5,126
Ceded	**(221)**	(160)
Net	**6,633**	4,966
Changes in unearned premiums	**(72)**	(59)
Net premiums earned	**6,561**	4,907

NOTE 13 – Integration and restructuring costs

Following the announcements of the acquisitions of Jevco and AXA Canada, the Company established integration plans directed at integrating the acquired business with its own business and capturing cost synergies across the combined entities, including shared services and corporate functions. Integration and restructuring costs primarily include technology-related expenses, occupancy, employee-related costs, branding and consulting expenses. These costs are included in Integration and restructuring costs on the audited Consolidated statements of comprehensive income.

TABLE 13.1 – INTEGRATION AND RESTRUCTURING COSTS

For the years ended December 31,	**2012**	2011
AXA Canada	**79**	71
Jevco	**29**	–
Total integration and restructuring costs	**108**	71

The restructuring provision has been established in relation to the acquisitions of Jevco and AXA Canada, based on the decisions communicated as at December 31, 2012 and 2011. The restructuring provision is recorded in Other liabilities on the audited Consolidated balance sheets.

TABLE 13.2 – MOVEMENT OF THE RESTRUCTURING PROVISION

As at	**December 31, 2012**	December 31, 2011
Balance, beginning of the year	**27**	–
Additional provision	**26**	29
Payments	**(19)**	(2)
Reversals for unused amounts	**(4)**	–
Balance, end of year	**30**	27

NOTE 14 – Income taxes

14.1 Income tax expense (benefit)

The following table shows the major components of income tax expense (benefit) on the audited Consolidated statements of comprehensive income for the years ended December 31, 2012 and 2011.

TABLE 14.1 – COMPOSITION OF INCOME TAX EXPENSE (BENEFIT)

For the years ended December 31,	**2012**	2011
Current tax expense (recovery)		
Current year	**118**	129
Prior year adjustment	**(5)**	(5)
Benefit arising from a previously unrecognized tax loss or temporary difference	**(5)**	(4)
	108	120
Deferred tax expense		
Origination and reversal of temporary differences	**39**	17
	39	17
Income tax expense recorded in Net income from continuing operations	**147**	137
Income tax recorded in OCI		
Net actuarial losses on employee future benefits	**(2)**	(34)
Net changes in unrealized losses on derivatives designated as cash flow hedges	**–**	(2)
Net changes in unrealized gains on AFS instruments	**13**	15
Reclassification to income of net gains on AFS instruments	**(24)**	(49)
Total income tax benefit recorded in OCI	**(13)**	(70)

14.2 Effective income tax rate

The effective income tax rates are different from the combined Canadian federal and provincial income tax rates. The audited Consolidated statements of comprehensive income contain items that are non-taxable or non-deductible for income tax purposes, which cause the income tax expense to differ from what it would have been if based on statutory tax rates. The difference is broken down as follows:

TABLE 14.2 – EFFECTIVE TAX RATE RECONCILIATION

For the years ended December 31,	2012	2011
Income tax expense calculated at statutory tax rates	26.4%	28.0%
Increase (decrease) in income tax rates resulting from:		
Non-taxable dividend income	(5.5)%	(6.7)%
Non-deductible expenses	1.6%	3.9%
Non-taxable income	(1.5)%	(0.7)%
Recovery of tax asset not previously recognized	(0.5)%	(2.0)%
Non-taxable portion of capital gains	(0.1)%	(0.4)%
Other	(0.4)%	1.0%
Effective income tax rate	20.0%	23.1%

14.3 Components of deferred tax assets and liabilities

TABLE 14.3 – COMPONENTS OF DEFERRED INCOME TAX ASSETS AND LIABILITIES

	Audited Consolidated balance sheets		Audited Consolidated statements of comprehensive income	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Deferred tax assets				
Net claims liabilities	91	80	11	(1)
Deferred expenses for tax purposes	74	79	(12)	15
Losses available for carry forward	29	15	14	–
Post-employment benefit plans	40	79	(39)	37
Other	3	3	–	1
Total deferred tax assets	237	256	(26)	52
Deferred tax liabilities				
Deferred income for tax purposes	59	55	4	(21)
Deferred gains and losses on specified debt obligations	20	22	(2)	(3)
Investments	–	–	–	6
Property and equipment	15	9	6	6
Intangible assets	154	135	16	2
Total deferred tax liabilities	248	221	24	(10)
Reported in:				
Deferred tax assets	129	158		
Deferred tax liabilities	140	123		
Income tax expense reported in Net income attributable to shareholders			39	17
Income tax expense (benefit) reported in OCI			11	(79)
Income tax benefit reported in equity	(7)	(11)		
Increase in deferred tax assets (net) resulting from business combinations (Note 4)	3	39		

As at December 31, 2012, the Company had allowable capital losses of $37 million (December 31, 2011 – $38 million), which had not been recognized when computing the deferred tax asset. These losses, which have no expiry date, can be used to reduce future taxable capital gains.

As at December 31, 2012, the Company had not recognized a deferred tax asset of $1 million (December 31, 2011 – $4 million) of unused non-capital losses. The Company has recognized a deferred tax asset for all other unused non-capital losses as at December 31, 2012 and 2011.

NOTE 15 – Investments in associates and joint ventures

The investments in associates and joint ventures are investments in private entities. They are initially recorded at the amount of consideration paid, which includes the fair value of tangible assets, intangible assets and goodwill identified on acquisition.

TABLE 15.1 – SUMMARIZED AGGREGATE BALANCE SHEET FINANCIAL INFORMATION OF ASSOCIATES AND JOINT VENTURES

As at	**December 31, 2012**	December 31, 2011
Assets		
Current	**328**	309
Non-current	**468**	428
Total assets	**796**	737
Liabilities		
Current	**219**	211
Non-current	**316**	290
Total liabilities	**535**	501
Net assets	**261**	236
Investments in associates and joint ventures	**266**	241

TABLE 15.2 – SHARE OF PROFIT FROM INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

For the years ended December 31,	**2012**	2011
Revenue	**385**	259
Net income	**46**	37
Share profit from investments in associates and joint ventures	**22**	16

During the reporting period, there were no events or changes in circumstances that indicated that the carrying values of these investments may not be recoverable.

NOTE 16 – Property and equipment

TABLE 16.1 – RECONCILIATION OF CARRYING VALUE OF PROPERTY AND EQUIPMENT

	Cost	**Accumulated depreciation**	**Carrying value**
As at December 31, 2012			
Land and buildings	**20**	**2**	**18**
Computer equipment	**53**	**37**	**16**
Furniture and equipment	**106**	**67**	**39**
Leasehold improvements	**57**	**25**	**32**
Total property and equipment	**236**	**131**	**105**
As at December 31, 2011			
Computer equipment	41	26	15
Furniture and equipment	76	49	27
Leasehold improvements	42	17	25
Total property and equipment	159	92	67

TABLE 16.2 – RECONCILIATION OF MOVEMENT IN PROPERTY AND EQUIPMENT

	Land and buildings	Computer equipment	Furniture and equipment	Leasehold improvements	Total
As at December 31, 2012					
Carrying value, beginning of year	–	15	27	25	67
Acquisitions	–	9	18	15	42
Disposals	–	–	–	(3)	(3)
Depreciation expense	–	(9)	(8)	(8)	(25)
Business combinations (Note 4)	18	1	2	3	24
Carrying value, end of year	**18**	**16**	**39**	**32**	**105**
As at December 31, 2011					
Carrying value, beginning of year	–	7	20	19	46
Acquisitions	–	12	8	2	22
Disposals	–	–	(1)	–	(1)
Depreciation expense	–	(5)	(5)	(4)	(14)
Business combinations (Note 4)	–	1	5	8	14
Carrying value, end of year	–	15	27	25	67

NOTE 17 – Other assets and other liabilities

17.1 Components of other assets

TABLE 17.1 – COMPONENTS OF OTHER ASSETS

As at	December 31, 2012	December 31, 2011
Other receivables and recoverables	340	216
Prepaids	21	14
Long-term investments, at cost	19	16
Employee future benefit assets (Note 19)	11	21
Financial assets related to investments	3	15
Other	18	12
Total other assets	**412**	294

During the reporting period, there were no events or changes in circumstances that indicated that the carrying values of the long-term investments may not be recoverable.

17.2 Components of other liabilities

TABLE 17.2 – COMPONENTS OF OTHER LIABILITIES

As at	December 31, 2012	December 31, 2011
Commissions payable	307	277
Industry pools payable	222	202
Premium and sale taxes payable	190	132
Employee future benefit liabilities (Note 19)	160	320
Restructuring provision (Note 13)	30	27
Contingent consideration (Note 4)	11	90
Other payables	494	393
Total other liabilities	**1,414**	1,441

As at December 31, 2012, the fair value of the contingent consideration on the purchase of AXA Canada was reassessed from $89 million to $100 million. The $11 million increase in value is recorded in Change in fair value of contingent consideration on the audited Consolidated statements of comprehensive income. The contingent consideration liability will be paid in the first quarter of 2013.

NOTE 18 – Goodwill and intangible assets

18.1 Summary of goodwill and intangible assets

TABLE 18.1 – RECONCILIATION OF CARRYING VALUE OF GOODWILL AND INTANGIBLE ASSETS

	Cost	Accumulated amortization	Carrying value
As at December 31, 2012			
Goodwill	**923**	**–**	**923**
Intangible assets			
Distribution network – indefinite useful life	**820**	**–**	**820**
Distribution network – finite useful life	**85**	**1**	**84**
Total distribution network	**905**	**1**	**904**
Internally developed software	**270**	**152**	**118**
Customer relationships	**209**	**78**	**131**
Total intangible assets	**1,384**	**231**	**1,153**
As at December 31, 2011			
Goodwill	794	–	794
Intangible assets			
Distribution network – indefinite useful life	820	–	820
Internally developed software	206	92	114
Customer relationships	192	58	134
Total intangible assets	1,218	150	1,068

TABLE 18.2 – RECONCILIATION OF MOVEMENTS OF GOODWILL AND INTANGIBLE ASSETS

	Intangible assets				
	Total distribution network	Customer relationships	Internally developed software	Total intangible assets	Goodwill
As at December 31, 2012					
Carrying value, beginning of year	**820**	**134**	**114**	**1,068**	**794**
Acquisitions and costs capitalized	**–**	**20**	**34**	**54**	**26**
Dispositions	**–**	**(3)**	**–**	**(3)**	**(2)**
Business combinations (Note 4)	**85**	**–**	**–**	**85**	**105**
Amortization expense	**(1)**	**(20)**	**(30)**	**(51)**	**–**
Carrying value, end of year	**904**	**131**	**118**	**1,153**	**923**
As at December 31, 2011					
Carrying value, beginning of year	–	65	105	170	211
Acquisitions and costs capitalized	–	5	35	40	10
Dispositions	–	–	–	–	–
Business combinations (Note 4)	820	77	–	897	573
Amortization expense	–	(13)	(26)	(39)	–
Carrying value, end of year	820	134	114	1,068	794

a) Goodwill

The carrying value of goodwill is allocated to a single CGU, which is the Company's sole operating segment, P&C insurance operations. It is the lowest level at which there are separately identifiable cash flows.

b) Intangible assets

Management has determined that intangible assets with finite useful lives are not impaired. Intangible assets with indefinite useful lives and intangible assets which are under development are subject to annual impairment testing. The carrying values of these intangible assets have been allocated to the P&C insurance operations CGU, being the lowest level at which there are separately identifiable cash flows.

18.2 Impairment test and assumptions

The Company performs an annual goodwill impairment test, as well as an impairment test for intangible assets with indefinite useful lives and for intangible assets under development. The most recent test was performed as at June 30, 2012. As at this date, the P&C insurance operations CGU was tested for impairment, calculating both the fair value less costs to sell and the value in use. The value-in-use calculation was based on the following key estimates and assumptions:

- Cash flow projections for the next three years are based on financial budgets approved by management and are determined by budgeted margins based on past performance and management expectations for the Company and the industry;
- Cash flows beyond the three-year period were extrapolated using estimated growth rates of 3.2% (June 30, 2011 – 3.0%), which do not exceed the long-term average past growth rate for the insurance business in which the Company operates; and
- A company-specific risk-adjusted discount rate of 13.4% was used (June 30, 2011 – 11.5%).

The test results indicate that the recoverable amount of the P&C insurance operations CGU exceeds its carrying value and no impairment loss for goodwill or intangible assets has been recognized for the year ended December 31, 2012 or in prior periods.

The Company is not aware of any reasonably possible change in any of the above key assumptions that would cause the carrying value of the CGU to exceed its recoverable amount.

NOTE 19 – Employee future benefits

The Company has a number of defined benefit pension plans. The Company also offers employer-paid post-retirement benefit plans, providing life insurance and health and dental benefits to certain active employees and retirees that are now closed to new entrants, as well as post-employment benefit plans that provide health and dental coverage. The post-retirement and post-employment benefit plans are unfunded.

The measurement date for the defined benefit pension plans, as well as for the post-retirement and post-employment benefit plans, is December 31. The latest actuarial valuations for defined benefit pension plans were performed as at December 31, 2011 or 2010 depending on the plan.

19.1 Funded status

The following table shows the aggregate funded status of the Company's defined benefit pension, post-retirement and post-employment benefit plans as well as the net deficit amounts reported in Other assets and Other liabilities.

TABLE 19.1 – FUNDED STATUS

	Employee future benefits	
As at	**December 31, 2012**	December 31, 2011
Present value of defined benefit obligation	**(1,506)**	(1,406)
Fair value of plan assets	**1,357**	1,093
Deficit	**(149)**	(313)
Unamortized past service costs	**–**	14
Net benefit liability	**(149)**	(299)
Reported on the audited Consolidated balance sheets in:		
Other assets	**11**	21
Other liabilities[1]	**(160)**	(320)

[1] The amount reported in Other liabilities is composed of $126 million relating to pension plans (December 31, 2011 – $285 million) and $34 million relating to post-retirement and post-employment benefit plans (December 31, 2011 – $35 million).

TABLE 19.2 – EMPLOYEE FUTURE BENEFITS STATUS AND EXPERIENCE ADJUSTMENTS ON PLAN LIABILITIES AND PLAN ASSETS FOR THE CURRENT AND PREVIOUS FOUR PERIODS

As at December 31,	**2012**	2011	2010	2009	2008
Present value of defined benefit obligation	**(1,506)**	(1,406)	(722)	(581)	(464)
Fair value of plan assets	**1,357**	1,093	682	570	460
Deficit	**(149)**	(313)	(40)	(11)	(4)
Experience adjustments on plan liabilities	**3**	(15)	(7)	(27)	–
Experience adjustments on plan assets	**23**	30	52	67	(154)

19.2 Present value of defined benefit obligation

The movement of the present value of the defined benefit obligation for the years ended December 31, 2012 and 2011 is as follows:

TABLE 19.3 – MOVEMENT OF THE PRESENT VALUE OF DEFINED BENEFIT OBLIGATION

	Employee future benefits	
As at	**December 31, 2012**	December 31, 2011
Balance, beginning of year	**1,406**	722
Current service cost	**60**	38
Interest costs on defined benefit obligation	**64**	45
Past service cost	**(14)**	21
Settlement/curtailment/termination benefits	**–**	(12)
Net actuarial losses recognized in OCI	**27**	169
Employee contributions	**12**	8
Benefit payments	**(49)**	(43)
Business combinations (Note 4)	**–**	458
Balance, end of year	**1,506**	1,406
Of which:		
Obligations of funded plans		
Plans partially funded	**1,002**	1,068
Plans fully funded	**409**	245
Obligations of unfunded plans	**95**	93
	1,506	1,406

19.3 Fair value of plan assets

The movement of the fair value of plan assets for the years ended December 31, 2012 and 2011 is as follows:

TABLE 19.4 – MOVEMENT OF THE FAIR VALUE OF PLAN ASSETS

	Employee future benefits	
As at	**December 31, 2012**	December 31, 2011
Balance, beginning of year	**1,093**	682
Expected return on assets	**68**	48
Net actuarial gains recognized in OCI	**23**	30
Employee contributions	**12**	8
Employer contributions	**210**	64
Benefit payments	**(49)**	(43)
Business combinations (Note 4)	**–**	304
Balance, end of year	**1,357**	1,093

Actuarial gains and losses on fair value of plan assets represent the difference between the actual return and the expected return on plan assets. The actual return on pension plan assets for the year ended December 31, 2012 was $91 million (December 31, 2011 – $78 million).

Employer contributions for the year ended December 31, 2012 include discretionary pension contributions of $114 million. Based on the latest projections of all its plans, total cash contributions by the Company are expected to be within $60 million to $105 million in 2013. The contributions will vary depending on funding relief measures, if any, and decisions taken by the Company to use or not letters of credit as permitted by legislation.

The following table shows the composition of the Company's pension plan assets, at fair value.

TABLE 19.5 – COMPOSITION OF PENSION PLAN ASSETS

As at	**December 31, 2012**	December 31, 2011
Equity securities	**39.9%**	44.3%
Debt securities	**58.5%**	55.4%
Cash and cash equivalents	**1.6%**	0.3%

19.4 Employee future benefit expense and OCI

The following table details the components of the employee benefits expense for defined benefit plans, recognized on the audited Consolidated statements of comprehensive income.

TABLE 19.6 – EMPLOYEE FUTURE BENEFITS EXPENSE

	Employee future benefits	
For the years ended December 31,	**2012**	2011
Current service cost – defined benefit plans	**60**	38
Interest costs on defined benefit obligation	**64**	45
Expected return on assets	**(68)**	(48)
Amortization of past service cost	**–**	7
Settlement/curtailment/termination benefits	**–**	(12)
Net actuarial losses recognized in OCI	**4**	139
Total employee benefits expense	**60**	169

TABLE 19.7 – ACTUARIAL GAINS AND LOSSES IN OCI

	Employee future benefits	
For the years ended December 31,	**2012**	2011
Balance, beginning of year	**(180)**	(41)
Gains (losses) in OCI related to:		
Changes in assumptions on present value of defined benefit obligation and experience	**(27)**	(169)
Difference between actual return and expected return on plan assets	**23**	30
Total losses recognized in OCI	**(4)**[1]	(139)
Balance, end of year	**(184)**	(180)

[1] Net actuarial losses on employee future benefits in the audited Consolidated statements of comprehensive income also include $1 million from the share of associates and joint ventures.

19.5 Assumptions used

The following table summarizes the key weighted-average assumptions used in measuring the Company's pension and post-retirement and post-employment benefit plans.

TABLE 19.8 – ASSUMPTIONS

	Pension plans		Post-retirement and post-employment benefit plans	
	December 31, 2012	December 31, 2011	**December 31, 2012**	December 31, 2011
To determine benefit obligation at end of period				
Discount rate	**4.0%**	4.4%	**3.7%**	4.2%
Rate of increase in future compensation	**3.0%**	3.5%	**3.0%**	3.5%
Health care cost trend rate	**n/a**	n/a	**8.0%**	8.5%
Dental care cost trend rate	**n/a**	n/a	**4.5%**	4.5%
To determine benefit expense for the period				
Discount rate	**4.4%**	5.3%	**4.2%**	4.9%
Rate of increase in future compensation	**3.5%**	3.5%	**3.5%**	3.5%
Expected long-term rate of return on plan assets	**6.0%**	6.3%	**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 overall expected rate of return on assets is determined based on market expectations prevailing on that date, applicable to the period over which the obligation is to be settled. The expected long-term rate of return is determined based on the expected future performance for each asset class and is weighted based on the current and expected asset portfolio mix. Consideration is given to historical performance, the premium return generated from an actively managed portfolio, economic developments, inflation rates and administrative expenses.

The following table presents the sensitivity of the net employee benefits liability to key assumptions:

TABLE 19.9 – IMPACT OF CHANGES IN KEY ASSUMPTIONS

As at	**December 31, 2012**	December 31, 2011
Discount rate:		
1% increase	**(256)**	(216)
1% decrease	**312**	268
Rate of compensation increase:		
1% increase	**74**	65
1% decrease	**(70)**	(60)

A 1% increase or decrease in the health care and dental care cost trend rate would not significantly affect the Company's results or financial position as at the balance sheet date.

NOTE 20 – Debt outstanding

20.1 Summary of debt outstanding

The following table presents the summary of debt outstanding:

TABLE 20.1 – FAIR VALUE AND CARRYING VALUE OF DEBT OUTSTANDING

	December 31, 2012		December 31, 2011	
As at	Carrying value	Fair value	Carrying value	Fair value
Term notes, series 1	**249**	**289**	249	275
Term notes, series 2	**248**	**310**	247	282
Term notes, series 3	**99**	**125**	99	110
Term notes, series 4	**298**	**335**	298	307
Term notes, series 5	**249**	**265**	–	–
Tranche A Facility	**–**	**–**	100	100
Tranche B Facility	**–**	**–**	300	300
Total debt outstanding	**1,143**	**1,324**	1,293	1,374

The term notes and loans under the credit facilities are accounted for at amortized cost which equals their carrying value. The term 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 Government of Canada Yield at the date of redemption plus a margin or their par value. The loans under the credit facilities may be repaid and cancelled by the Company at any time.

Interest expenses on term notes and credit facilities are presented as Finance costs on the audited Consolidated statements of comprehensive income.

20.2 Term notes

On June 15, 2012, to reduce term-loan indebtedness and to fund a portion of the Jevco acquisition, the Company completed an offering of $200 million principal amount of Series 5 unsecured medium-term notes. On September 10, 2012, the Company issued an additional $50 million principal amount, bringing the total offering to $250 million.

TABLE 20.2 – TERM NOTES OUTSTANDING TERMS

	Series 1	Series 2	Series 3	Series 4	Series 5
Date issued	August 31, 2009	November 23, 2009	July 8, 2011	August 18, 2011	June 15, 2012
Date of supplemental issue		March 23, 2010			September 10, 2012
Maturity date	September 3, 2019	November 23, 2039	July 8, 2061	August 18, 2021	June 16, 2042
Principal amount outstanding (in millions of dollars)	250	250	100	300	250
Fixed annual rate	5.41%	6.40%	6.20%	4.70%	5.16%
Semi-annual coupon payment due each year on:	March 3 September 3	May 23 November 23	January 8 July 8	February 18 August 18	June 16 December 16

20.3 Credit facilities

On September 23, 2011, to fund a portion of the purchase price for the acquisition of AXA Canada, the Company obtained a loan of $100 million from a two-year term-loan facility (the “Tranche A Facility”) and obtained a loan of $300 million from a three-year term-loan facility (the “Tranche B Facility”). Both loans bear interest at the prime rate plus a margin or at the bankers’ acceptance rate plus a margin. In 2012, the Company repaid in full the $400 million loan.

Effective September 23, 2011, the Company obtained a four-year unsecured revolving term credit facility of $250 million, which was to mature on September 23, 2015 in replacement of a previous revolving term credit facility. On October 26, 2012, the committed amount was increased by $50 million to $300 million and the term was extended to October 26, 2016. This credit facility may be drawn as a prime loan at the prime rate plus a margin or as bankers' acceptance at the bankers' acceptance rate plus a margin. As at December 31, 2012, this facility was undrawn.

As part of the covenants of the loans under the credit facilities, the Company is required to maintain certain financial ratios which were fully met as at December 31, 2012 and 2011.

NOTE 21 – Common shares and preferred shares

21.1 Authorized

Authorized share capital consists of an unlimited number of common shares and Class A shares.

21.2 Issued and outstanding

TABLE 21.1 – ISSUED AND OUTSTANDING SHARES

	Number of shares	Amount (in millions of $)	Dividends declared per share (amount in $)
Classes of shares			
As at December 31, 2012			
Common	**133,333,665**	**2,118**	**1.60**
Class A			
Series 1 Preferred	**10,000,000**	**244**	**1.05**
Series 3 Preferred	**10,000,000**	**245**	**1.05**
Total Class A	**20,000,000**	**489**	
As at December 31, 2011			
Common	129,553,665	1,889	1.48
Class A			
Series 1 Preferred	10,000,000	244	0.49
Series 3 Preferred	10,000,000	245	0.39
Total Class A	20,000,000	489	

Common

TABLE 21.2 – RECONCILIATION OF NUMBER OF COMMON SHARES OUTSTANDING

As at	December 31, 2012 (in shares)	December 31, 2011 (in shares)
Balance, beginning of the year	**129,553,665**	112,179,565
Common shares issued	**3,780,000**	20,125,000
Common shares repurchased for cancellation	**–**	(2,750,900)
Balance, end of the year	**133,333,665**	129,553,665

On September 4, 2012, on the date of the closing of the acquisition of Jevco, 3,780,000 subscription receipts ("receipts") were converted into 3,780,000 common shares. The Company had completed its offering of the 3,780,000 subscription receipts on May 11, 2012 at $62.75 per receipt for gross proceeds of $237 million. Shares issuance costs of $8 million, net of $2 million of taxes, were accounted for as a reduction in Common shares on the audited Consolidated balance sheets.

On September 23, 2011, subsequent to the acquisition of AXA Canada, the Company converted its 20,125,000 subscription receipts into 20,125,000 common shares. The Company had completed its offering of the 20,125,000 receipts on June 9, 2011 at $47.80 per receipt for gross proceeds of $962 million. For this offering, the Company incurred $41 million in share issuance costs, net of $10 million of taxes, which were accounted for as a reduction in Common shares on the audited Consolidated balance sheets.

Class A

Issued and outstanding Class A shares would rank, both with regards to dividends and return of capital, in priority to the common shares.

TABLE 21.3 – RECONCILIATION OF NUMBER OF CLASS A SHARES OUTSTANDING

As at	**December 31, 2012 (in shares)**	December 31, 2011 (in shares)
Balance, beginning of the year	**20,000,000**	–
Series 1 Preferred Shares issued	–	10,000,000
Series 3 Preferred Shares issued	–	10,000,000
Balance, end of the year	**20,000,000**	20,000,000

Series 1 Preferred

On July 12, 2011, the Company issued and sold 10,000,000 non-cumulative rate reset Class A shares Series 1 (the "Series 1 Preferred Shares"), at a price of $25.00 per share, for aggregate gross proceeds of $250 million. For this offering, the Company incurred $6 million in share issuance costs, net of $2 million in taxes, which were accounted for as a reduction in preferred shares on the audited Consolidated balance sheets.

The holders of these shares are entitled to receive fixed non-cumulative preferential cash dividends, as and when declared by the Board of Directors of the Company, on a quarterly basis for the initial fixed-rate period ending on December 31, 2017, based on an annual rate of 4.20%. The dividend rate will be reset on December 31, 2017 and every five years thereafter at a rate equal to the five-year Government of Canada bond yield plus 1.72%. Subject to certain conditions, on December 31, 2017 and on December 31 every five years thereafter, the holders of Series 1 Preferred Shares will have the right to convert their shares into Non-cumulative Floating Rate Class A Shares Series 2 (the "Series 2 Preferred Shares"). In addition, the Company has the option to redeem the Series 1 and Series 2 Preferred Shares on the same dates.

Series 3 Preferred

On August 18, 2011, the Company completed a Series 3 offering of preferred shares by issuing and selling 10,000,000 non-cumulative rate reset Class A shares Series 3 (the "Series 3 Preferred Shares"), at a price of $25.00 per share, for aggregate gross proceeds of $250 million. For this offering, the Company incurred $5 million in share issuance costs, net of $2 million of taxes, which were accounted for as a reduction in preferred shares on the audited Consolidated balance sheets.

The holders of these shares are entitled to receive fixed non-cumulative preferential cash dividends, as and when declared by the Board of Directors of the Company, on a quarterly basis, for the initial fixed-rate period ending on September 30, 2016, based on an annual rate of 4.20%. The dividend rate will be reset on September 30, 2016 and every five years thereafter at a rate equal to the five-year Government of Canada bond yield plus 2.66%. Subject to certain conditions, on September 30, 2016 and on September 30 every five years thereafter, holders of Series 3 Preferred Shares will have the right to convert their shares into Non-cumulative Floating Rate Class A Shares Series 4 (the "Series 4 Preferred Shares"). In addition, the Company has the option to redeem the Series 3 Preferred Shares and Series 4 Preferred Shares on the same dates.

21.3 Normal course issuer bid

The NCIB program expired on February 22, 2012 and was not renewed. No common shares were repurchased for cancellation under the NCIB program in 2012. As at December 31, 2011, 2,750,900 common shares at an average price of $47.03 were repurchased for cancellation for a total consideration of $129 million. 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 $105 million was charged to retained earnings on the audited Consolidated balance sheets.

NOTE 22 – Earnings per share

Earnings per common share were calculated by dividing the net income attributable to the common shares of the Company by the weighted-average number of common shares outstanding during the year. Dilution is not applicable and, therefore, diluted earnings per common share are the same as earnings per common share. The net income attributable to the common shares and the weighted-average number of common shares outstanding during the year are calculated as follows:

TABLE 22.1 – EARNINGS PER SHARE

For the years ended December 31,	**2012**	2011
Net income attributable to common shares		
Net income from continuing operations	**587**	457
Less: Dividends declared on preferred shares, net of tax	**21**	8
Adjusted net income from continuing operations attributable to common shares	**566**	449
Net income from discontinued operations	**–**	8
Total net income attributable to common shares	**566**	457
Weighted-average number of common shares outstanding		
Number of common shares outstanding at beginning of the year	**129,553,665**	112,179,565
Adjustment for weighted-average common shares:		
Issued at the date of acquisition of AXA Canada	**–**	5,513,699
Issued at the date of acquisition of Jevco	**1,218,689**	–
Repurchased under the NCIB program	**–**	(2,384,771)
Weighted-average number of common shares outstanding during the year	**130,772,354**	115,308,493
EPS – basic and diluted (in dollars)	**4.33**	3.96

NOTE 23 – Share-based payments

23.1 Long-term incentive plans

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

TABLE 23.1 – OUTSTANDING UNITS AND FAIR VALUE BY PERFORMANCE CYCLE

	Number of units	Weighted-average grant date fair value (in $)	Amount (in millions of $)
As at December 31, 2012			
2010–2012 performance cycle	**447,829**	**35.06**	**16**
2011–2013 performance cycle	**396,820**	**50.84**	**20**
2012–2014 performance cycle	**244,124**	**57.76**	**14**
Total	**1,088,773**	**45.90**	
As at December 31, 2011			
2009–2011 performance cycle	368,242	23.06	8
2010–2012 performance cycle	419,617	35.06	15
2011–2013 performance cycle	227,832	48.06	11
Total	1,015,691	33.63	

The following table shows the movements in the long-term incentive plans ("LTIP") share units during the years.

TABLE 23.2 – MOVEMENTS IN LTIP

As at	**December 31, 2012 (in units)**	December 31, 2011 (in units)
LTIP (share equivalents)		
Outstanding, beginning of year	**1,015,691**	629,637
Awarded	**323,490**	283,402
Net change in estimate of units outstanding	**162,693**	150,215
Units settled	**(413,101)**	(47,563)
LTIP share units outstanding, end of year	**1,088,773**	1,015,691

The amount charged to Underwriting expenses in the audited Consolidated statements of comprehensive income for LTIP was $16 million for the year ended December 31, 2012 (December 31, 2011 – $19 million).

During 2012, the Company settled LTIP units granted in 2009 that vested through the plan administrator by purchasing shares in the market and remitting them to the participants. The cumulative cost of the vested units, amounting to $10 million, was removed from Contributed surplus. The difference between the market price of the shares and the cumulative cost for the Company of the vested units, amounting to $13 million, net of $4 million of income taxes, was recorded in Retained earnings.

23.2 Employee share purchase plan

The following table shows the movements in employee share purchase plan ("ESPP") restricted common shares during the years.

TABLE 23.3 – MOVEMENTS IN ESPP

As at	**December 31, 2012 (in units)**	December 31, 2011 (in units)
ESPP (restricted common shares)		
Outstanding, beginning of year	**120,317**	107,562
Awarded	**126,242**	112,250
Vested or forfeited	**(104,745)**	(99,495)
ESPP units outstanding, end of year	**141,814**	120,317

The amount charged to Other expenses in the audited Consolidated statements of comprehensive income for the ESPP was $7 million for the year ended December 31, 2012 (December 31, 2011 – $5 million).

23.3 Deferred share unit plan

The deferred share units are cash-settled awards for which the provision recorded as at December 31, 2012 is $4 million (December 31, 2011 – $3 million). The amount charged to Other expenses on the audited Consolidated statements of comprehensive income was $1 million for the years ended December 31, 2012 and 2011.

NOTE 24 – Additional information on the audited Consolidated statements of cash flows

The following table provides additional details on the items included in net cash flows provided by operating activities.

TABLE 24.1 – ADDITIONAL INFORMATION ON THE AUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,	2012	2011
Adjustments for non-cash items		
Net investment gains	**(37)**	(204)
Deferred income tax expense	**39**	17
Depreciation of property and equipment	**25**	14
Amortization of intangible assets	**51**	39
Net premiums on debt securities classified as AFS	**35**	18
Share-based payments	**16**	19
Other	**15**	(12)
Total	**144**	(109)
Changes in other operating assets and liabilities		
Assets classified as held for sale	**–**	(172)
Liabilities directly associated with assets classified as held for sale	**–**	160
Unearned premiums, net	**72**	56
Deferred acquisition costs, net	**(20)**	(21)
Premium and other receivables	**(83)**	(29)
Income taxes receivable, net	**(34)**	(84)
Other operating assets	**(32)**	63
Other operating liabilities	**(50)**	(67)
Total	**(147)**	(94)
Composition of cash and cash equivalents		
Cash	**161**	164
Cash equivalents	**11**	42
Total cash and cash equivalents, end of year	**172**	206
Other relevant cash flow disclosures		
Interest paid	**59**	33
Interest received	**277**	233
Dividends received	**142**	131
Income taxes paid, net	**117**	208

NOTE 25 – Contingencies and commitments

25.1 Contingencies

In the normal course of operations, various insurance 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 insurance 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.

25.2 Commitments

The Company has entered into commercial operating leases on certain property and equipment. These leases have a life ranging from one to fourteen years with renewal options included in the contracts. Future minimum rental payments under non-cancellable operating leases as at the end of the reporting period are as follows:

TABLE 25.1 – OPERATING LEASE COMMITMENTS

As at	December 31, 2012
Within one year	106
After one year but not more than five years	335
More than five years	401
Total operating lease rental payments	**842**

NOTE 26 – Related-party transactions

The Company enters into transactions with associates and joint ventures in the normal course of business, as well as key management personnel and post-employment plans. Transactions with related parties are at normal market prices and mostly comprise commissions for insurance policies and interest and principal payments on loans.

26.1 Transactions with associates and joint ventures

TABLE 26.1 – INCOME AND EXPENSES WITH ASSOCIATES AND JOINT VENTURES

For the years ended December 31,	2012	2011
Reported in:		
Income		
Net investment income	7	7
Expenses		
Underwriting expenses	159	131

TABLE 26.2 – ASSETS AND LIABILITIES AMOUNTS WITH ASSOCIATES AND JOINT VENTURES

As at	December 31, 2012	December 31, 2011
Reported in:		
Assets		
Loans	**115**	138
Liabilities		
Other liabilities	**68**	44

26.2 Compensation of key management personnel

Key management personnel are comprised of all members of the Board of Directors and certain members of the Executive Committee. The summary of compensation of key management personnel is as follows:

TABLE 26.3 – COMPENSATION OF KEY MANAGEMENT PERSONNEL

For the years ended December 31,	2012	2011
Salaries	**3**	2
Share-based awards	**3**	6
Annual incentive plans[1]	**3**	3
Pension value	**1**	1
Total compensation of key management personnel	**10**	12

[1] Annual incentive plans are based on the Company's performance versus the industry. Figures are preliminary as industry data will only be available in March 2013. The Company's Management Proxy Circular will reflect the final figures.

Key management personnel can purchase insurance products offered by the Company in the normal course of business. The terms and conditions of such transactions are essentially the same as those available to clients and employees of the Company.

26.3 Post-employment plans

The Company made contributions to post-employment plans of $210 million for the year ended December 31, 2012 (December 31, 2011 – $64 million).

NOTE 27 – Capital management

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

The capital is managed on a consolidated basis, as well as individually for each regulated subsidiary. The federally chartered P&C insurance subsidiaries of the Company are subject to regulatory capital requirements defined by OSFI and the *Insurance Companies Act* ("ICA"). Québec provincially chartered subsidiaries are subject to the requirements set by the Autorité des marchés financiers ("AMF") and the *Act respecting insurance*. OSFI and AMF have established a Minimum Capital Test ("MCT") guideline, which sets out 100% as the minimum and 150% as the supervisory target MCT standard for Canadian P&C insurance companies. To ensure that it attains its objectives, the Company has established a minimum internal threshold of 170%, in excess of which, under normal circumstances, the Company will maintain its capital.

The following table presents the estimated aggregate MCT ratio for the Company's P&C insurance subsidiaries.

TABLE 27.1 – AGGREGATE MCT

As at	**December 31, 2012**	December 31, 2011
Total capital available	**3,764**	3,285
Total capital required	**1,840**	1,668
MCT %	**205%**	197%
Excess capital at 100%	**1,924**	1,617
Excess capital at 150%	**1,004**	783
Excess capital at 170%[1]	**636**	449

[1] Includes Jevco excess capital over 170%. Jevco minimum internal threshold is currently under review.

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 and AMF rules. Total capital available mostly represents total shareholders' equity less specific deductions for disallowed assets including goodwill and intangible assets. Total capital required is calculated by classifying assets and liabilities into categories and applying prescribed risk factors to each category. As at December 31, 2012, the Company's P&C insurance subsidiaries remained well capitalized on an individual basis and were in compliance with regulatory requirements, as well as above internal threshold.

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 2012 results indicated that the Company's capital position is strong. 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 28 – 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.

The following table lists the provincial authorities which regulate automobile insurance rates. Automobile direct premiums written in these provinces totalled $3,539 million as at December 31, 2012 (December 31, 2011 – $2,707 million) and represented approximately 97.1% as at December 31, 2012 (December 31, 2011 – 96.5%) of direct automobile premiums written.

TABLE 28.1 – 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
Québec	Use and file	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. As at December 31, 2012 and 2011, the Company had no significant regulatory asset or liability.

Five-year financial history

(Excluding MYA. In millions of Canadian dollars, except as noted)

	IFRS			Canadian GAAP	
	2012	2011	2010	2009	2008
Consolidated performance					
Written insured risks (thousands)	**6,729**	5,084	4,614	4,604	4,601
Direct premiums written[1]	**6,868**	5,099	4,498	4,275	4,146
Net premiums earned	**6,571**	4,880	4,231	4,055	4,040
Favourable prior year claims development	**(372)**	(223)	(193)	(94)	(114)
Underwriting income	**451**	273	193	54	117
Combined ratio	**93.1%**	94.4%	95.4%	98.7%	97.1%
Net investment income	**389**	326	294	293	329
Net investment gains (losses)	**37**	204	182	(173)	(288)
Income before income taxes	**734**	594	637	140	124
Effective tax rate	**20.0%**	23.1%	22.0%	9.4%	(3.8)%
Net operating income	**675**	460	402	282	361
Net income	**587**	465	498	127	128
Net operating income per share ($)	**5.00**	3.91	3.49	2.35	2.96
Earnings per share ($)	**4.33**	3.96	4.32	1.06	1.05
Average number of shares outstanding (millions)	**130.8**	115.3	115.1	119.9	122.0
Operating return on equity	**16.8%**	15.3%	15.1%	9.2%	11.3%
Return on equity	**13.8%**	14.3%	16.9%	4.5%	4.4%
Personal lines – total					
Written insured risks (thousands)	**5,809**	4,465	4,089	4,098	4,103
Direct premiums written[1]	**4,655**	3,627	3,308	3,121	3,010
Net premiums earned	**4,539**	3,535	3,139	2,993	2,959
Combined ratio	**95.0%**	95.0%	97.5%	99.3%	101.2%
Underwriting income (loss)	**226**	179	76	21	(36)
Personal auto					
Written insured risks (thousands)	**3,584**	2,723	2,475	2,455	2,449
Direct premiums written[1]	**3,093**	2,419	2,236	2,127	2,057
Net premiums earned	**3,077**	2,406	2,157	2,067	2,068
Combined ratio	**95.7%**	90.9%	98.1%	94.9%	95.9%
Underwriting income	**132**	219	41	105	85
Personal property					
Written insured risks (thousands)	**2,225**	1,742	1,614	1,643	1,654
Direct premiums written[1]	**1,562**	1,208	1,072	994	953
Net premiums earned	**1,462**	1,129	982	926	891
Combined ratio	**93.5%**	103.5%	96.5%	109.0%	113.6%
Underwriting income (loss)	**94**	(40)	35	(84)	(121)
Commercial lines – total					
Written insured risks (thousands)	**920**	619	525	506	498
Direct premiums written[1]	**2,213**	1,472	1,190	1,154	1,136
Net premiums earned	**2,032**	1,345	1,092	1,062	1,081
Combined ratio	**88.9%**	93.0%	89.3%	96.9%	85.9%
Underwriting income	**225**	94	117	33	153
Commercial auto					
Written insured risks (thousands)	**477**	325	282	269	264
Direct premiums written[1]	**552**	396	336	322	318
Net premiums earned	**536**	384	326	315	319
Combined ratio	**81.5%**	86.5%	86.0%	79.8%	87.2%
Underwriting income	**99**	52	46	64	41
Commercial P&C					
Written insured risks (thousands)	**443**	294	243	237	234
Direct premiums written[1]	**1,661**	1,076	854	832	818
Net premiums earned	**1,496**	961	766	747	762
Combined ratio	**91.6%**	95.6%	90.7%	104.1%	85.3%
Underwriting income (loss)	**126**	42	71	(31)	112
Financial condition					
Excess capital (over 170% MCT)	**599**	435	809	859	428
Aggregate MCT	**205%**	197%	233%	232%	205%
Cash provided by operating activities	**723**	532	360	538	620
Debt-to-capital ratio	**18.9%**	22.9%	14.3%	11.8%	0.0%
Book value per share ($)	**33.03**	29.73	26.47	24.88	21.96
Investments					
Performance					
Market-based investment yield	**3.6%**	4.0%	4.2%	4.5%	5.0%
Total investments	**12,959**	11,828	8,653	8,057	6,605
Portfolio mix (net of hedging positions)					
Short-term notes, including cash and cash equivalents	**3%**	4%	6%	3%	12%
Fixed income securities	**74%**	73%	61%	64%	55%
Preferred shares	**10%**	11%	16%	19%	18%
Common shares	**10%**	9%	13%	10%	11%
Loans	**3%**	3%	4%	4%	4%

[1] Excluding pools

Two-year quarterly review

(Excluding MYA. In millions of Canadian dollars, except as noted)

	IFRS 2012				IFRS 2011			
	Q4	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Consolidated performance								
Written insured risks (thousands)	**1,543**	**1,794**	**2,018**	**1,374**	1,508	1,251	1,379	946
Direct premiums written[1]	**1,690**	**1,798**	**1,977**	**1,403**	1,576	1,226	1,354	943
Net premiums earned	**1,742**	**1,640**	**1,599**	**1,590**	1,616	1,121	1,075	1,068
Favourable prior year claims development	**(85)**	**(70)**	**(83)**	**(134)**	(38)	(31)	(72)	(82)
Underwriting income	**138**	**67**	**123**	**123**	118	64	33	58
Combined ratio	**92.1%**	**95.9%**	**92.3%**	**92.3%**	92.7%	94.2%	97.0%	94.6%
Net investment income	**102**	**92**	**95**	**100**	103	74	76	73
Net investment gains (losses)	**6**	**16**	**3**	**12**	(7)	78	71	62
Income before income taxes	**228**	**117**	**166**	**223**	116	118	153	207
Effective tax rate	**20.6%**	**17.9%**	**19.9%**	**20.5%**	34.5%	14.4%	19.6%	24.3%
Net operating income	**194**	**122**	**180**	**179**	152	111	95	102
Net income	**181**	**96**	**133**	**177**	84	101	123	157
Net operating income per share ($)	**1.42**	**0.89**	**1.35**	**1.34**	1.14	0.97	0.87	0.91
Earnings per share ($)	**1.32**	**0.70**	**0.98**	**1.33**	0.62	0.87	1.12	1.42
Average number of shares outstanding (millions)	**133.3**	**130.6**	**129.6**	**129.6**	129.6	111.2	109.5	110.9
Operating return on equity	**16.8%**	**16.4%**	**17.3%**	**16.2%**	15.3%	14.0%	13.6%	14.8%
Return on equity	**13.8%**	**12.1%**	**12.9%**	**13.6%**	14.3%	16.8%	17.3%	17.8%
Personal lines – total								
Written insured risks (thousands)	**1,310**	**1,573**	**1,747**	**1,179**	1,300	1,122	1,216	827
Direct premiums written[1]	**1,097**	**1,277**	**1,362**	**919**	1,027	934	995	671
Net premiums earned	**1,202**	**1,132**	**1,104**	**1,101**	1,118	826	799	792
Combined ratio	**91.8%**	**103.0%**	**94.1%**	**91.4%**	91.7%	94.0%	99.4%	96.0%
Underwriting income (loss)	**99**	**(34)**	**66**	**95**	93	49	5	32
Personal auto								
Written insured risks (thousands)	**783**	**954**	**1,102**	**745**	778	676	756	513
Direct premiums written[1]	**722**	**843**	**907**	**621**	664	622	674	459
Net premiums earned	**825**	**765**	**744**	**743**	754	563	549	540
Combined ratio	**103.1%**	**94.9%**	**89.0%**	**95.2%**	93.3%	86.4%	85.7%	97.7%
Underwriting income (loss)	**(25)**	**39**	**82**	**36**	52	76	79	12
Personal property								
Written insured risks (thousands)	**527**	**619**	**645**	**434**	522	446	460	314
Direct premiums written[1]	**375**	**434**	**455**	**298**	363	312	321	212
Net premiums earned	**377**	**367**	**360**	**358**	364	263	250	252
Combined ratio	**67.1%**	**119.8%**	**104.5%**	**83.5%**	88.6%	110.3%	129.5%	92.3%
Underwriting income (loss)	**124**	**(73)**	**(16)**	**59**	41	(27)	(74)	20
Commercial lines – total								
Written insured risks (thousands)	**233**	**221**	**271**	**195**	208	129	163	119
Direct premiums written[1]	**593**	**521**	**615**	**484**	549	292	359	272
Net premiums earned	**540**	**508**	**495**	**489**	498	295	276	276
Combined ratio	**92.7%**	**80.3%**	**88.2%**	**94.4%**	95.0%	94.9%	90.0%	90.4%
Underwriting income	**39**	**101**	**57**	**28**	25	15	28	26
Commercial auto								
Written insured risks (thousands)	**120**	**114**	**146**	**97**	101	68	92	64
Direct premiums written[1]	**146**	**132**	**159**	**115**	130	83	108	75
Net premiums earned	**146**	**133**	**129**	**128**	130	88	84	82
Combined ratio	**84.2%**	**77.0%**	**79.6%**	**85.2%**	93.0%	82.8%	75.4%	91.7%
Underwriting income	**23**	**31**	**26**	**19**	10	15	21	6
Commercial P&C								
Written insured risks (thousands)	**113**	**107**	**125**	**98**	107	61	71	55
Direct premiums written[1]	**447**	**389**	**456**	**369**	419	209	251	197
Net premiums earned	**394**	**375**	**366**	**361**	368	207	192	194
Combined ratio	**95.9%**	**81.4%**	**91.3%**	**97.6%**	95.7%	100.0%	96.2%	89.9%
Underwriting income	**16**	**70**	**31**	**9**	15	0	7	20
Financial condition								
Excess capital (over 170% MCT)	**599**	**598**	**649**	**595**	435	534	758	784
Aggregate MCT	**205%**	**201%**	**205%**	**205%**	197%	202%	228%	236%
Cash provided by (used by)operating activities	**204**	**367**	**279**	**(127)**	94	359	95	(16)
Debt-to-capital ratio	**18.9%**	**19.5%**	**19.8%**	**19.1%**	22.9%	23.4%	14.4%	14.4%
Book value per share ($)	**33.03**	**31.81**	**30.30**	**30.40**	29.73	28.97	26.89	26.91
Investments								
Performance								
Market-based investment yield	**3.6%**	**3.6%**	**3.7%**	**3.7%**	3.9%	3.8%	4.2%	4.0%
Total investments	**12,959**	**12,844**	**11,668**	**11,513**	11,828	11,827	8,625	8,593
Portfolio mix (net of hedging positions)								
Short-term notes, including cash and cash equivalents	**3%**	**5%**	**5%**	**3%**	4%	2%	1%	4%
Fixed income securities	**74%**	**72%**	**72%**	**73%**	73%	73%	66%	62%
Preferred shares	**10%**	**10%**	**10%**	**11%**	11%	12%	16%	16%
Common shares	**10%**	**10%**	**9%**	**10%**	9%	9%	13%	14%
Loans	**3%**	**3%**	**4%**	**3%**	3%	4%	4%	4%

[1] Excluding pools

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).

Adjusted earnings per share ("AEPS") Net income from continuing operations for a specific period less preferred share dividends plus the after-tax impact of amortization of intangible assets recognized in business combinations, integration and restructuring costs and change in fair value of contingent consideration, divided by the weighted-average number of common shares outstanding during the same period.

Adjusted return on equity ("AROE") Net income from continuing operations for a 12-month period less preferred share dividends plus the after-tax impact of amortization of intangible assets recognized in business combinations, integration and restructuring costs and change in fair value of contingent consideration, divided by the average shareholders' equity (excluding preferred shares) over the same 12-month period. Net income from continuing operations and shareholders' equity are determined in accordance with IFRS. The average shareholders' equity is the mean of shareholders' equity at the beginning and end of the period, adjusted for significant capital transactions, if appropriate.

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 mortgage-backed securities, auto loan receivables, credit card receivables and asset-backed commercial paper.

Basis risk Basic 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 Shareholders' equity (excluding preferred shares) divided by the number of common shares outstanding at the same date. Shareholders' equity is determined in accordance with IFRS.

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 Any one claim, or group of claims, equal to or greater than $7.5 million ($5 million in 2011) related to a single event.

Claims expenses The direct and indirect expenses of settling claims.

Claims liabilities Technical accounting provisions comprised of the following: (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.

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

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

Combined ratio The sum of the claims ratio and the expense ratio. A combined ratio below 100% indicates a profitable underwriting result. A combined ratio over 100% indicates an unprofitable underwriting result.

Corridor method 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.

Counterparty Any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation to 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 Possibility that counterparties may not be able to meet payment obligations when they become due.

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

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

Debt-to-capital ratio Total debt outstanding divided by the sum of total shareholders' equity and total debt outstanding, at the same date.

Derivative A contract between two parties that 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 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.

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

Earnings per share to common shareholders ("EPS"), basic Calculated as net income attributable to common shareholders divided by the weighted-average number of common shares outstanding during the period.

Earnings per share to common shareholders ("EPS"), diluted Calculated as net income attributable to common shareholders divided by the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of stock options and other convertible securities.

Equities sold short A transaction in which the seller sells equities and then borrows the equities in order to deliver them to the purchaser upon settlement. At a later date, the seller buys identical equities in the market to replace the borrowed 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 net liquid assets of the non-regulated entities.

Expense ratio Underwriting expenses including commissions, premium taxes and general expenses incurred in connection with underwriting activities during a specific 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 Forward contracts are effectively tailor-made agreements that are transacted between counterparties in the over-the-counter market.

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

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

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.

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.

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.

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.

Internal rate of return ("IRR") The rate of return expected to be produced on the shareholders' capital deployed over the life of a project or acquisition.

International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The term "IFRS" includes IFRS and interpretations developed by the International Financial Reporting Interpretations Committee ("IFRIC").

Investments or investment portfolio Financial assets owned by the Company including debt and equity securities and loans.

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 Non-IFRS financial measure defined as the annualized total pre-tax investment income (before expenses) divided by the average fair values of net 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 ("MYE") The difference between the MYA and the gains and losses on fair value through profit and loss ("FVTPL") fixed-income securities (the objective is that these two items offset each other with a minimal overall impact to 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 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 ("NOI") Net income from continuing operations for a specific period less preferred share dividends, plus the after-tax impact of amortization of intangible assets recognized in business combinations, integration and restructuring costs, change in fair value of contingent consideration, net investment gains (losses) excluding FVTPL fixed-income securities and MYE.

Net operating income per share ("NOIPS") Net operating income for a specific period less preferred share dividends, divided by the weighted-average number of common shares outstanding during the same period.

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.

Normal course issuer bid ("NCIB") 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.

Operating return on equity ("OROE") Net operating income for the last 12-months divided by the average shareholders' equity (excluding preferred shares and 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, adjusted for significant capital transactions, if appropriate.

Options Contractual agreements under which the seller grants to the buyer 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 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 ("PfAD") 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 less preferred share dividends, divided by the average shareholders' equity (excluding preferred shares) over the same 12-month period. Net income and shareholders' equity are determined in accordance with IFRS. The average shareholders' equity is the mean of shareholders' equity at the beginning and the end of the period, adjusted for significant capital transactions, if appropriate.

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.

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 claimants 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.

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

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]
Chief Executive Officer

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

Paul Cantor [3],[4]
Senior Advisor, Bennett Jones LLP

Marcel Côté [2],[3]
Strategic Advisor, KPMG-Secor

Robert W. Crispin [1],[4]
Corporate Director

Claude Dussault
Chairman of the Board, Intact Financial Corp.
and President, ACVA Investing Corp.

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

Timothy H. Penner [2],[3]
Corporate Director

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]
Corporate Director

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

Notes:
(1) Denotes member of the Audit and Risk Review Committee
(2) Denotes member of the Conduct Review and 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 Committee members

Charles Brindamour
Chief Executive Officer

Martin Beaulieu
Senior Vice-President, Personal Lines

Alan Blair
Senior Vice-President, Atlantic Canada

Jean-François Blais
President, Intact Insurance

Debbie Coull-Cicchini
Senior Vice-President, Ontario

Claude Désilets
Senior Vice-President and Chief Risk Officer

Monika Federau
Senior Vice-President, Marketing

Louis Gagnon
President and Chief Operating Officer

Denis Garneau
Senior Vice-President, Québec

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

Byron Hindle
Senior Vice-President, International Business Development

Mathieu Lamy
Senior Vice-President, Claims

Alain Lessard
Senior Vice-President, Commercial Lines

Louis Marcotte
Senior Vice-President, Strategic Distribution

Lucie Martel
Senior Vice-President and Chief Human Resources Officer

Jennie Moushos
Senior Vice-President, Western Canada

Jack Ott
Senior Vice-President and Chief Information Technology Officer

Marc Pontbriand
President, Direct to Consumers Distribution

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

Mark Tullis
Senior Vice-President and Chief Financial Officer

Pete Weightman
President, BrokerLink

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Credit rating

IFC's long-term issuer rating with Moody's Investors Services is 'Baa1' and the Company's principal operating insurance subsidiaries are rated 'A1' for insurance financial strength ("IFS"). IFC's long-term issuer rating with A.M. Best is 'a-' and its principal operating subsidiaries have an IFS rating of 'A+' with a stable outlook. IFC's long-term issuer rating with DBRS is 'A (low)'.

DBRS has assigned a rating of 'Pfd-2(low)' with a stable trend for the Non-cumulative Rate Reset Class A Shares Series 1 (the "Series 1 Preferred Shares") issued on July 12, 2011 and for the Non-cumulative Rate Reset Class A Shares Series 3 (the "Series 3 Preferred Shares") issued on August 18, 2011.

Toronto Stock Exchange (TSX) listings

Common Shares Ticker Symbol: IFC
Series 1 Preferred Shares Ticker Symbol: IFC.PR.A
Series 3 Preferred Shares Ticker Symbol: IFC.PR.C

Annual Meeting of Shareholders

Date: Wednesday, May 8, 2013
Time: 2:00 pm ET
Art Gallery of Ontario
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 8, 2013
Q2 – Wednesday, July 31, 2013
Q3 – Wednesday, November 6, 2013
Q4 – Wednesday, February 5, 2014

Investor inquiries

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Media inquiries

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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 Company's website at www.intactfc.com.

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 and preferred 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 of 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	$ 61.69	$ 55.65	$ 60.03	13,056,282
Q2	$ 65.00	$ 59.58	$ 63.39	17,767,530
Q3	$ 64.69	$ 57.61	$ 59.80	13,760,058
Q4	$ 65.13	$ 58.25	$ 64.77	12,876,735
Year 2012	**$ 65.13**	**$ 55.65**	**$ 64.77**	**57,460,605**
Q1	$ 51.58	$ 46.49	$ 55.40	12,935,794
Q2	$ 55.57	$ 47.79	$ 50.25	19,966,321
Q3	$ 57.77	$ 51.41	$ 57.53	19,783,681
Q4	$ 59.82	$ 53.37	$ 58.53	18,098,968
Year 2011	$ 59.82	$ 46.49	$ 58.53	70,784,764
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

Source: Toronto Stock Exchange.

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

WE ARE CUSTOMER DRIVEN

We listen to customers, understand their needs, offer the best solutions and deliver on our promises. We make it easy for customers to deal with us. We go beyond expectations and always deliver an outstanding experience.

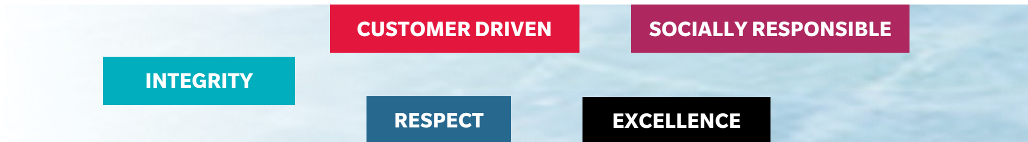
WE BEHAVE WITH INTEGRITY

We demonstrate the highest ethical standards of personal conduct. We behave with honesty, integrity, openness and fairness when dealing with each other, customers, partners and governments.

WE ARE SOCIALLY RESPONSIBLE

We respect the environment and its finite resources. We believe in making the communities where we live and work safer, healthier and happier. We encourage the involvement and citizenship of all our employees.

LIVING OUR VALUES



WE RESPECT EACH OTHER

We value the diversity of our people and their dreams. We foster an environment conducive to personal growth, development and new opportunities. We recognize and value the contribution that each of us and our teams are making to our success.

WE STRIVE FOR EXCELLENCE

We are disciplined in our approaches and our actions, which is why we excel in all aspects of our business. We embrace change and the opportunities it creates, encourage innovative thinking and always seek to improve. We value and reward high performance and success. We provide high value to our shareholders.