

Stronger together

Intact Financial Corporation is the largest provider of property and casualty (“P&C”) insurance in Canada with \$7.3 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 \$12.3 billion.

FINANCIAL HIGHLIGHTS

(Excluding MYA. In millions of Canadian dollars, except as noted)

	IFRS				Canadian GAAP
	2013	2012	2011	2010	2009
Consolidated Performance					
Written insured risks (thousands)	7,115	6,729	5,084	4,614	4,604
Direct premiums written	7,319	6,868	5,099	4,498	4,275
Net premiums earned	7,014	6,571	4,880	4,231	4,055
Combined ratio	98.0%	93.1%	94.4%	95.4%	98.7%
Underwriting income	142	451	273	193	54
Net investment income	406	389	326	294	293
Net operating income	500	675	460	402	282
Net investment gains (losses)	(83)	37	204	182	(173)
Net income	431	571	465	498	127
Net operating income per share (\$)	3.62	5.00	3.91	3.49	2.35
Earnings per share (\$)	3.10	4.20	3.96	4.32	1.06
Book value per share (\$)	33.94	33.03	29.73	26.47	24.88
Operating return on equity	11.2%	16.8%	15.3%	15.1%	9.2%
Adjusted return on equity	10.3%	16.1%	17.4%	17.1%	4.8%



ONLINE ANNUAL REPORT

To access our inaugural online annual report, including interactive graphs, CEO’s message and other customer and broker testimonials, please scan the QR code below or visit reports.intactfc.com.



On the cover and page 1: In July 2012, a fire completely destroyed Amy and Marc Jessome’s home in Dartmouth, Nova Scotia. After being contacted by the Jessomes’ broker, Intact claims representative Mark Wornell was on the scene. Mark worked with the Jessomes to help restore their property, rebuild their home and get their lives back on track.

At Intact, insurance is about people – our customers, employees, brokers and the communities in which we live. It’s about shared values, shared commitments and knowing that when challenges come, you’re not alone. It’s about being there when you’re needed, where you’re needed, and it’s about understanding that people are always **stronger together**.



Table of contents

Performance at-a-glance	2	Together with brokers...	18
CEO’s message	4	Together with communities...	22
Chairman’s message	7	Financial review	26
Board of Directors	8	Glossary	162
Together with customers...	10	Board and Executive Committee members	164
Together with employees...	14		



Our superior operating performance and financial strength have translated into a total shareholder return of 155% in the past five years, while allowing us to increase our dividends per share each year since our IPO, on average by 13% per year.

2013 Direct premiums written by business line

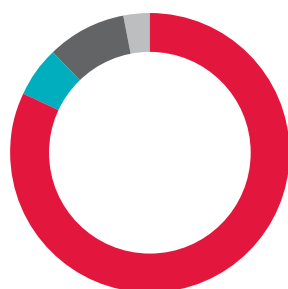
(excluding pools, %)



Personal auto	46%
Personal property	22%
Commercial P&C	24%
Commercial auto	8%

2013 Direct premiums written by distribution channel

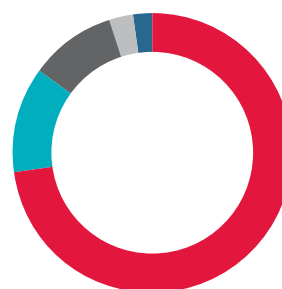
(excluding pools, %)



Intact Insurance	82%
BrokerLink	6%
belairdirect	9%
Grey Power	3%

2013 Investment mix

(net of hedging positions and financial liabilities related to investments)

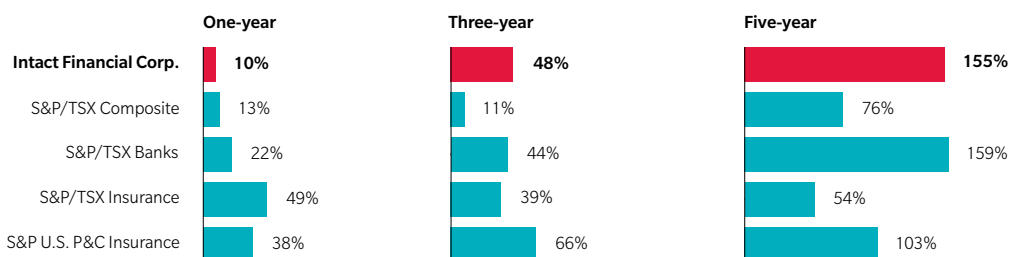


Fixed income	73%
Common shares	12%
Preferred shares	10%
Loans	3%
Cash and short-term notes	2%

Total shareholder return

20.6%

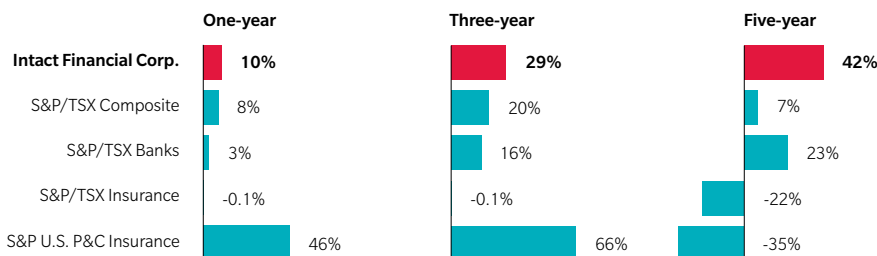
On a total shareholder return basis (including dividends), our 20.6% CAGR over the past five years was higher than most comparable indices, bolstered by our operating results.



Dividends per share growth

7.3%

We are proud of our dividend growth track record, including a five-year CAGR of 7.3%, which compares favourably versus our peers.

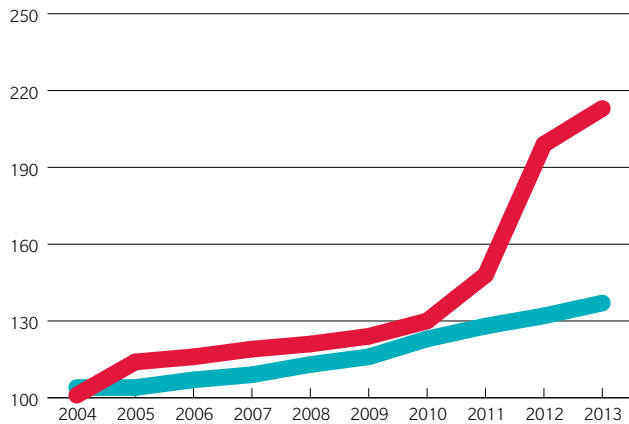


Source: Toronto Stock Exchange, Standard & Poor's

Direct premiums written growth

(%) (Base 100 = 2003)

● IFC
● Industry

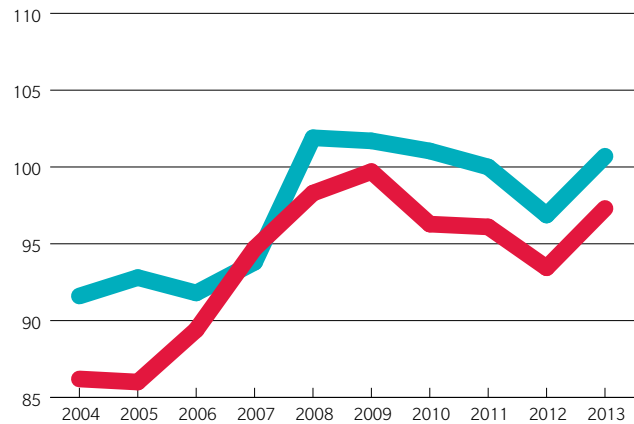


The combination of our organic growth and accretive acquisitions has led to a significant growth outperformance versus the industry.

Combined ratio¹

(%)

● IFC
● Industry

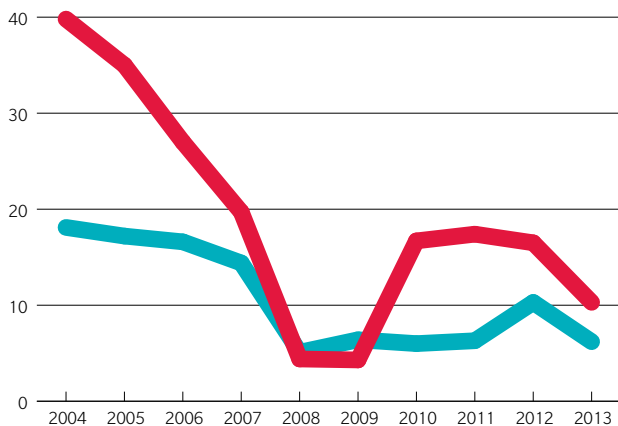


Our sophisticated pricing, underwriting discipline and in-house claims expertise have enabled us to consistently outperform the industry's combined ratio.

Return on equity (ROE)²

(%)

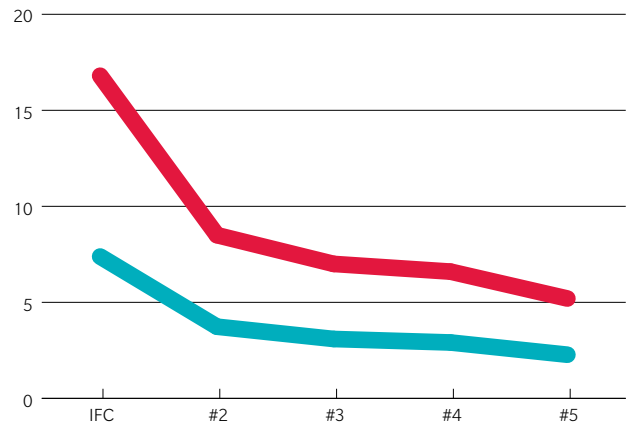
● IFC
● Industry



Our superior underwriting results, investment performance and capital management have led to a consistent ROE outperformance versus the industry.

Market share by company

● Market share (%)
● Direct premiums written (\$ billions)



With an estimated market share of 17%, we are nearly twice the size of our next largest competitor and approximately 15 times the size of the average company in the industry.

Industry data source: MSA Research excluding Lloyd's, ICBC, SGI, SAF, MPI, Genworth and IFC, as at Dec. 31, 2013

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 162.

The passion of our people



United by shared commitment, employees at Intact lived our value of always striving for excellence and delivered on our promise to go beyond our customers' expectations. They showed what it means to be "stronger together".

Insurance is not about things. Insurance is about people. Last year, this belief was brought home by the storms and flooding in Toronto and Alberta and the tragic train derailment in Lac-Mégantic. The impact of these events was profound; at the same time, the response to these events was inspiring. Across Canada, and throughout our Company, we saw people coming together in times of need.

At Intact, employees from every region quickly assembled and worked tirelessly to support their colleagues, to reach out to communities and to help our customers remain resilient.

I was proud of the speed of our response and, more importantly, the compassion of our people during difficult times for thousands of our customers.

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Year in review

2013 was a year with more than its share of "bad times". It was challenging for Canadian P&C insurers as the industry saw more than \$3 billion of losses from catastrophes. Here at Intact, we incurred \$530 million in pre-tax catastrophe losses after reinsurance. Despite this, we still generated an operating return on equity (OROE) of more than 11%, grew our business by 7% and launched a number of strategic initiatives which better position us for the years to come.

While we continued to outperform the industry in 2013, we know that we can do better. Our goal is to return to our historical levels of profitability by continuously improving the quality of our operations and by mitigating the impact of natural disasters on our business.

From an operational perspective, we made significant progress towards improving our performance in personal property. We remain confident that our initiatives will bring 10 points of improvement in the upcoming 18 to 24 months, with the objective of sustainably operating at a combined ratio of 95% or better in this line of business. We ended 2013 with a combined ratio of 104.4% in personal property, as catastrophe losses of \$272 million added almost 18 points. However, I am pleased to see that personal

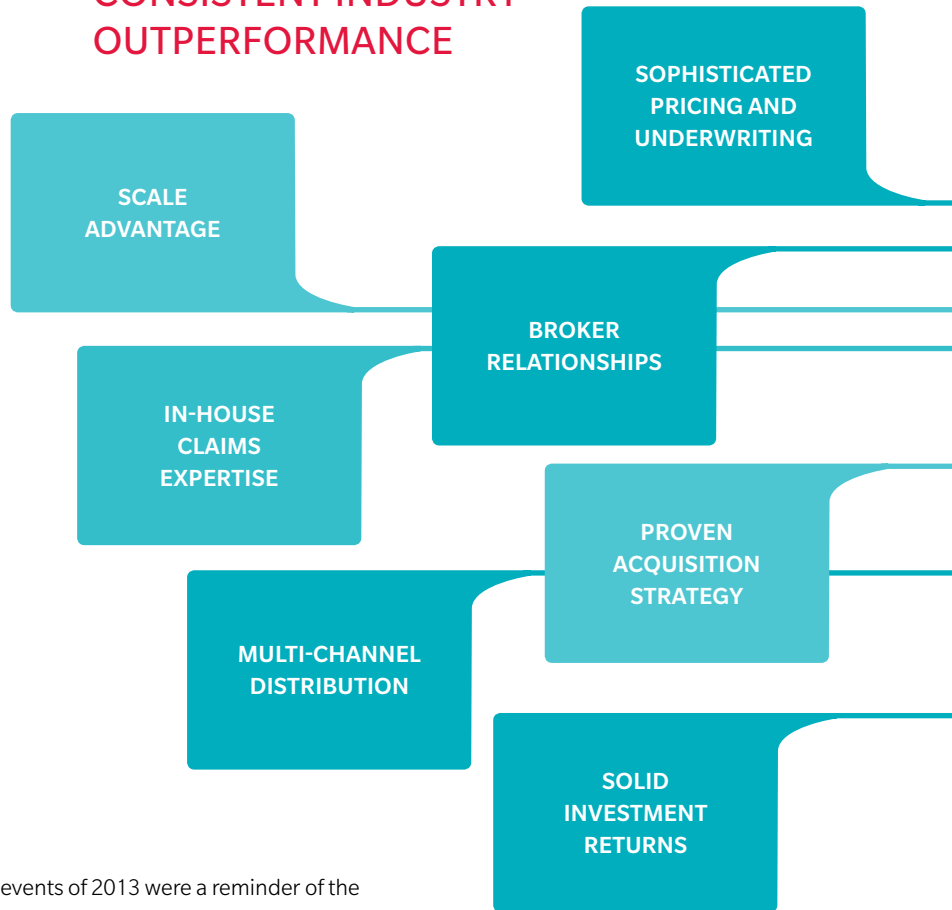
property, which in recent years has lagged our relative performance in other lines, is now starting to show signs of outperformance, with a 2 point loss ratio advantage versus the industry in 2013.

In automobile insurance, we generated a solid combined ratio of 93.2% in 2013, despite the challenges presented by severe weather conditions. Our appetite for growth remains, as we expect to maintain our margins in this market segment. In Ontario, Canada's largest automobile insurance market, the government understands that further rate reductions can only come in conjunction with meaningful additional cost reduction measures. Since announcing its strategy last year, the government has shown its commitment to reducing the cost of insurance to Ontario consumers by introducing a number of legislative and regulatory measures that have and will contribute to reducing the cost of claims in the months to come. These are steps in the right direction and we continue to support the government's efforts to make auto insurance both more affordable and more sustainable.

Our commercial lines businesses experienced 8 points of catastrophe losses, resulting in a full year 2013 combined ratio of 100.9%. We continue to take the required product and pricing actions to ensure we generate a more acceptable combined ratio in the near term. Furthermore, we intend to build on our historical loss ratio advantage to accelerate our penetration in small to mid-sized businesses and in specialty lines.

Despite the magnitude of catastrophe losses, the Company ended the year with a solid balance sheet. We enter 2014 with excess capital of \$550 million and a debt-to-capital ratio below our target level of 20%. We remain optimistic about our prospects, and earlier this year we announced a 9% dividend increase, which marked the ninth consecutive year that the dividend has been raised.

CONSISTENT INDUSTRY OUTPERFORMANCE

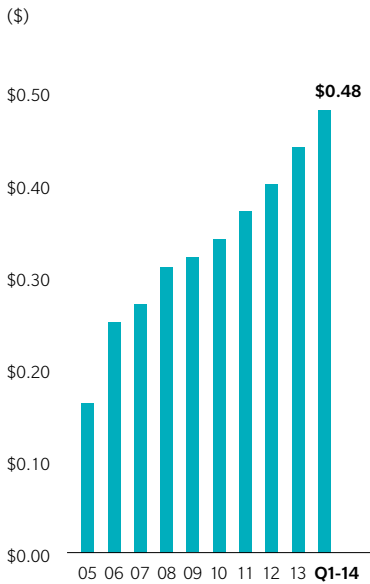


The events of 2013 were a reminder of the importance of building strong and resilient communities. During the year, we contributed nearly \$4 million to charitable organizations with a focus on addressing the needs of youth at risk and helping communities prepare for climate change. We also continued to support employee citizenship, helping our people make a difference by providing financial support and time off to help their communities.

Industry outlook

In the near term, we foresee low single-digit premium growth for the industry. We anticipate that the current hard market conditions in personal property will accelerate in the foreseeable future. We also expect that the commercial P&C market will continue to firm up, with intensity accelerating for approximately one-quarter of the market in the near term.

Quarterly dividends per share



Given the unprecedented level of catastrophe losses seen in 2013 we expect the industry's combined ratio to improve in 2014. Overall, we expect the industry's ROE to trend back towards its long-term average of 10%. Looking specifically at Intact, we expect to outperform the industry's ROE by at least 500 basis points in 2014.

A successful initial five years

We have made tremendous progress since becoming a fully independent Canadian company five years ago. As the largest provider of P&C insurance in the country, we now insure more than five million individuals and businesses. But it is not just about being the largest – we continuously outperform the industry by utilizing our scale, by managing our customers' claims in-house, and by the sophistication and discipline embedded in our pricing and risk selection. Shareholders have benefited from our progress as our shares have generated a total return of 155% in the past five years.

Looking ahead, together

I am proud of what we have accomplished in such a short period of time and look forward to the future. Our primary objectives in the near term are ensuring the sustainability of our operations, as discussed above, improving the experience of our customers and better serving our broker partners.

Delivering a customer experience that is second to none

We will work to further enhance the customer experience, while continuing to offer best-in-class claims service and a broad product offering. This year we launched Usage Based Insurance (UBI), an auto insurance product customized to individual driving behaviours. We also recognized consumers' increasing preference to access insurance through the web, by increasing our presence online, making our websites tablet and mobile friendly, and broadening our direct to consumer distribution through a partnership with Sun Life Financial. Moving forward, we will expand and leverage existing web capabilities, and pursue a cultural transformation to better integrate customer feedback throughout the decision-making process.

Supporting our broker partners

With the acquisitions of AXA Canada and Jevco, we now have one of the broadest product offerings in the market. Our increased scale and financial strength make us an even stronger ally for our broker partners. As before, we stand ready to invest in brokers' businesses to help them grow and prosper. In addition, we have invested in technologies to make brokers' workflows more efficient and in advertising to increase brand awareness. As always, we maintain our commitment to providing a customer and broker experience second to none.

Our people

Our success is due to the combined efforts of our 11,000 people, a group that I believe is the best team in the country. I have already noted that 2013 was an exceptionally demanding year in which they helped hundreds of thousands of our customers, continued to demonstrate their strong customer-driven mindset and provided industry-leading service to our brokers. Many companies promise excellence; our employees deliver it and I want to thank each and every one of them.

While 2013 was a challenging year it was also a rewarding one for our Company and our people as it showed how, in so many ways, we are making a positive difference in the lives of our customers.

In closing, I would like to thank our Board of Directors, whose insight and guidance have helped us to make decisions critical to the success of our organization. Finally, to our shareholders, thank you for your continued support – together we are stronger for it. We will strive to maintain your confidence and reward it in the years ahead.

Charles Brindamour
Chief Executive Officer

Responsible governance

Throughout 2013 your Company and its people have shown a remarkable resilience in the wake of unprecedented natural disasters which disrupted the lives of thousands of our clients and caused hundreds of millions of dollars in damage. Wherever disasters struck, our people were there to help our customers resume their normal life in the most compassionate way.

What is even more remarkable is the financial performance the Company achieved during these challenging times. Despite the scope of the devastation caused by these disasters and the challenges of a low interest rate environment, we continued to create value for shareholders and continued our outperformance compared to the industry.

Throughout the year, your Board of Directors devoted much of its time and energy with the executive team to establishing the strategic direction to further advance the development of your Company. In this regard, we welcomed two new members of the Board of Directors, Dr. Janet De Silva and Mr. Frederick Singer. Their combined international experience and insight into the vast potential of new and emerging technologies were a valuable complement to our collective expertise.

Your Board of Directors also continued its review of governance best practices among financial institutions, which resulted in the establishment of a new committee of the Board of Directors devoted exclusively to the supervision and assessment of the various risks to which your Company may be exposed. In addition, we approved the appointment of a Chief Governance Officer, a newly created executive position that will integrate the various corporate governance functions within the Company and reinforce their influence. Thanks to the commitment of your Board of Directors to ensure the quality of our governance framework, the Company was recognized among the 10 best governed companies in Canada.¹



Claude Dussault
Chairman of the Board

Throughout the year, your Board of Directors devoted much of its time and energy with the executive team to establishing the strategic direction to further advance the development of your Company.

2013 was a year of unprecedented adversity in the wake of multiple natural disasters and uncertain financial markets. It was also a year when our 11,000 employees across the country came together to honour our promise to our customers and delivered a superb performance; and I would like to thank them for their efforts.

A few weeks ago marked our fifth anniversary as a widely held and independent company. Our performance and the dedication of our people during that period has not only confirmed the merits of the strategic direction established by your Board of Directors over the years, but also the benefits of the Company's prudent financial practices, its discipline and its quest for operational excellence. On behalf of my colleagues, I want to assure you that we remain more dedicated than ever to ensuring the future successes of your Company.

A handwritten signature in black ink, appearing to read 'Claude Dussault'. The signature is fluid and cursive.

Claude Dussault
Chairman of the Board

¹ Globe and Mail Board Games 2013



1. Claude Dussault

Chairman of the Board

Mr. Dussault was President and CEO of Intact Financial (formerly ING Canada Inc.) 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.

2. Charles Brindamour

Chief Executive Officer

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.

3. Yves Brouillette

Audit Committee

Risk Management Committee

Mr. Brouillette has deep international and industry experience, having been CEO of ING Canada Inc. from 1993 to 2001 and CEO of ING Latin America from 2002 to 2005. Currently, he holds the position of President of Placements Beluca Inc. and is a director of White Mountains Insurance Group, Ltd. He is a Fellow of the Canadian Institute of Actuaries and a graduate of the Advanced Management Program of Harvard Business School.

4. Robert W. Crispin

Audit Committee

Risk Management 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. Mr. Crispin received an MBA from the University of Connecticut and holds the Chartered Financial Analyst designation.

5. Janet De Silva

Compliance Review and Corporate Governance Committee

Risk Management Committee

Dr. De Silva is currently the Dean of Ivey Asia, leading the Hong Kong Campus and mainland China operations of Ivey Business School at Western University. She has more than 10 years of leadership experience as CEO of Sun Life Financial's business in Hong Kong and its Mainland China joint venture and as Co-Founder and CEO of Retail China Limited. She was also the past Chair and President of the Canadian Chamber of Commerce in Hong Kong and Chair of the Canada China Business Council in Beijing.

6. Eileen Mercier

Audit Committee (Chair)

Risk Management 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. In 2013, Ms. Mercier was named to Canada's Top 100 Most Powerful Women in the Accenture Corporate Directors category.



The Board of Directors assumes responsibility for the stewardship of the Company. It oversees the management of the Company with the objective of enhancing shareholder value and ensuring the Company's long-term viability, profitability and development.

7. Timothy H. Penner

Compliance Review and Corporate Governance Committee (Chair)

Risk Management Committee

Mr. Penner brings extensive marketing and operations management expertise, having spent 33 years with Procter & Gamble, including President of P&G Canada from 1999 to 2011. He also serves on the Board of SickKids Hospital and the YMCA of Greater Toronto, and is on the Ontario Task Force on Competitiveness, Productivity and Economic Progress.

8. Louise Roy

Compliance Review and Corporate Governance Committee

Human Resources and Compensation Committee

Ms. Roy is the first woman to occupy both the positions of 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 the International Air Transport Association (IATA). She was named an Officer of the National Order of Québec in 2009 and of the Order of Canada in 2012. In 2013, Ms. Roy was named as one of Canada's Top 100 Most Powerful Women.

9. Frederick Singer

Audit Committee

Human Resources and Compensation Committee

Mr. Singer is an Internet pioneer and currently the CEO of Echo360, a leading education company. Previously, he was Senior Advisor to the CEO of Softbank Corporation in Japan and Venture Partner with Softbank Capital in the U.S. Mr. Singer was formerly an SVP at AOL, a founder of the Washington Post online service and a Board member at DoubleClick media.

10. Stephen Snyder

Audit Committee

Human Resources and Compensation 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.

11. Carol Stephenson

Compliance Review and Corporate Governance Committee

Human Resources and Compensation Committee (Chair)

Ms. Stephenson served as the Dean of the Ivey Business School at Western University from 2003 until her retirement in 2013. 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, and was ranked one of Canada's Top 25 Women of Influence in 2011. She is the former Chair of the Government of Canada's Advisory Committee on Senior Level Retention and Compensation.

Together with customers...

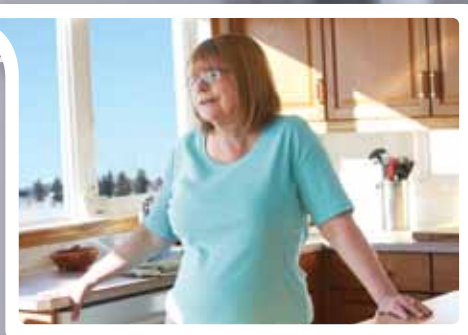


Kathleen Boutland (left), customer, and
Tia Esber (right), Field Claims Representative

Our customers depend on us to create products that meet their needs, to provide the service they deserve and to make them aware of steps they can take to protect their homes, cars and businesses. We keep our commitments not just by working *for* our customers, but by working *with* them. Together we are stronger.



We are proud of our people's efforts in responding to the catastrophic events in 2013, but we know that we have to do more. Intact is taking the lead in acknowledging today's changing weather patterns and building awareness of available prevention measures, which can be as simple as installing a backflow valve, shown here by Field Claims Representative Mailinda Thomson. Together with our customers, we will help ensure that our communities remain safe and strong.



In the summer of 2013, a period of sustained heavy rainfall set off the most devastating floods in Alberta's history. In High River, Kathleen Boutland's basement was flooded by almost nine feet of water and sewage that "took out everything," including her hot water tank and furnace. Bringing in extra staff from across Canada, Intact mobilized community response teams to accelerate the process of helping customers. Kathleen spoke with several claims representatives, including Tia Esber, and was incredibly happy with their compassion and knowledge, saying, "They walked me through what to do, they listened to me and made me feel comfortable."





Joseph Peretto, an Associate in belairdirect's fast-paced call centre, is known for providing excellent customer service. One of Joseph's talents is the ability to turn a negative customer experience into a positive one. By listening to the customer's needs, Joseph consistently tries to help customers understand their coverage and get the right product for their needs.



"As a firm, there's a sense of urgency in everything we do. And when disaster strikes, especially on many fronts like that, people got organized quickly. Others had newspaper ads, but we had boots on the ground."
— Charles Brindamour, Chief Executive Officer, in Alberta, June 2013

Together with our customers we helped rebuild, and we continue to work to protect them through loss prevention education and discounts.

2013 was a record year for catastrophic events, with unprecedented devastation caused by the train derailment in Lac-Mégantic, floods in Southern Alberta and storms in the Greater Toronto Area. Aside from the emotional toll, these events also cost the industry \$3.2 billion of insured damages, making 2013 the fifth year in a row in which industry losses exceeded \$1 billion. With record damages came a record number of claims, and it is with tireless dedication and compassion that our employees mobilized coast-to-coast to help our customers. Throughout this time, we maintained our industry-leading service levels despite the high volume of calls. Together with our customers we helped rebuild, leveraging our Rely network of repair shops and contractors, and we continue to work to protect our customers through loss prevention education and discounts.

Unparalleled claims experience

With over 3,000 claims professionals, we have the scale and expertise to handle virtually all our claims in-house, providing a seamless, high-quality experience. Our customer care telephony platform connects 35 sites and 12,000 phones coast-to-coast, delivering the ability to answer customer questions 99.9% of the time. The network sends every call to the best location, selecting the agent with the right skills to help deliver industry-leading service 24/7.

The robustness and dependability of our claims promise is most evident during a catastrophic event. During the Calgary floods last summer, when even our own Calgary office was inaccessible, we were able to handle 17,000 calls in the immediate aftermath with a low 1% abandon rate. Within 12 hours of the event, we had set up a Catastrophe Response Centre, with full connectivity for employees coming from different regions to help in a coordinated effort. Within one week, we mobilized over 600 adjusters from across the country, putting boots on the ground to get families and businesses back on track as soon as possible. In fact, over 95% of property assessments were completed within three weeks and all auto claims were settled within two months, despite our receiving over 5,500 claims from this event alone.

This was only possible through the dedication and empathy of our employees, who took time away from their personal lives to help people in need. When the Toronto floods followed barely a month later, our people again mobilized coast-to-coast to step up for our customers. We believe that it is because of their commitment to help people that our businesses are highly ranked by J.D. Power. When we survey our customers on how satisfied they are and whether they would recommend us to their friends and family after a claim, we are pleased to find that we are rated among the best in North America.

Tailoring products to customers' needs

It has become increasingly obvious that severe weather is here to stay. Accordingly, we are working hard to make the protection we offer our customers more sustainable, as well as to help them prevent future damages. This year, we launched our *insuranceisevolving.com* website, which educates consumers on how to protect their homes against climate change; and we continue to roll out additional features on this website. We are also offering discounts to customers who adopt loss prevention measures such as installing sewer back-up valves or sump pumps. Together with our customers, we are working to keep home insurance both affordable and sustainable.



In automobile insurance, we are lowering our rates for good drivers and offering consumers more options than before. For example, we are deploying our Usage Based Insurance (UBI) initiative, which will allow customers to save up to 25% on their premium based on driving behaviours. Customers who participate in the program can log into a website to track their estimated discount, see detailed statistics on their driving history, and receive customized tips based on this driving profile, giving them control over their premiums.

Making ourselves more accessible

In 2013, we continued to broaden the options available to consumers for researching insurance coverage and interacting with us. For those who prefer to do research on their own but still want the advice of a broker, we continued to improve in our Buy-Online program, where a consumer can research and obtain a quote online before being connected to a broker.

In our direct-to-consumer channel, the belairdirect and Grey Power brands are engaging with consumers in real time, offering

personalized service through an average of 3,000 chat sessions a month. All our brands' websites were redesigned last year to provide optimized viewing across desktops, tablets and mobile devices, bringing different information to the forefront by predicting the user's needs. We've also launched newsletters and blogs containing tips to keep life simple.

As we continue to evolve this year, what doesn't change is our unwavering focus on the customer. While there will be greater focus on prevention this year, our industry-leading claims service remains solid – supported by scale, in-house expertise and the passion of our employees. The Intact promise is that, outside of a catastrophic event, if a customer does not talk to a representative within 30 minutes of their first call, we will write a cheque for the full amount of the customer's yearly premium up to a maximum of \$1,000. As a testament to how good the service is, with over five million customers in Canada, we had to pay out on this promise fewer than 20 times in 2013.

Claims Representatives Chris Patterson and Chevone Griffith were on the frontlines of the catastrophic events of 2013. When the calls started coming in, it was first and foremost about, as Chris puts it, "making sure people stayed safe," and then helping customers going through the claims process. Chevone volunteered for overtime during the December ice storm to help with the large volume of calls over the holidays. As she says, "Reassuring customers and giving useful suggestions was our first priority."

Together with employees...

We believe in a culture of collaboration in which everyone has the opportunity to achieve their personal best. We support each other in serving our customers, while respecting our colleagues' diversity and individual needs. Insurance is about people, and at Intact that's a lesson we never get tired of learning.

A Learning Consultant in our Calgary office, Marie Corey has trained Intact employees and brokers about innovations in our personal lines products and systems since 2008. Working in classrooms and through webinars, Marie enjoys "engaging with people and educating our staff, as well as brokers, about what Intact can offer them. In every session, I try to keep it fun, but still get the message across."



A former underwriter, she draws on her experience to "show people how they can sell a new product and to help them get even better at serving their customers' needs." The strong engagement scores for Marie's team show that both students and peers appreciate her approach.





Marie Corey, Learning Consultant,
Personal Insurance



Every year, Intact employees and their families are invited to participate in our “on ice” sponsorships with their local NHL teams and Speed Skating Canada. This provides an opportunity to support sports from the grassroots level and creates a tangible link between our sponsorships and our employees.

Our employees are making a difference every day. Last year’s events confirm that the work that our people do really matters. When severe weather events occur, or tragedies such as the one in Lac-Mégantic, our employees are there to help our customers make it through difficult times. When these situations arise, our employees are quickly able to provide customers with the necessary resources to start them down the road to getting back to normal, and offer the reassurance they need to begin that journey.

We want to make a difference in the lives of our people. Becoming a best employer, where our employees can do their best and flourish, is an ever-important goal that we continue to strive for.

But their role in society goes beyond helping people become more resilient in challenging times. They are also making it possible for people, businesses and society to prosper in good times. They are making a difference by giving people confidence and freedom from worry, so they can live their lives looking forward. The dedication, respect and compassion that our employees show towards our customers, when getting them back on track, proves that we have the most capable professionals in the business. In good times, or bad, they are making a difference.

Becoming an employer of choice

As an organization, we also want to make a difference in the lives of our people. Becoming a best employer, where our employees can do their best and flourish, is an ever-important goal toward which we continue to strive.

In many ways, we’re already there. Our employees have told us how much they trust and appreciate their colleagues. By respecting each other’s differences and valuing each other’s similarities they are constantly demonstrating their positive attitude towards diversity. And the excitement that surrounds our “Diversity Day” celebrations reflects this common opinion. The way in which our people support one another every day tells us that they enjoy working with their colleagues.

We truly believe that the efforts of each and every employee are important to the overall success of our organization. We celebrate their commitment to bettering themselves, furthering their careers, and capitalizing on opportunities to take on new roles throughout the organization.

Encouraging continuous improvement

To reinforce this belief, we provide our people with the chance to continuously build their skills. We encourage our employees to continuously progress and improve by offering learning and development opportunities, and they were the first to tell us that we are moving in the right direction. All employees have access to our learning centre as one of the tools available to help them gain knowledge, meet their goals and expand their career options.

The centre provides access to numerous training modules and courses on a variety of career-related topics.

Last year we introduced our new career management program. The workshop and webinars that make up the program provide employees with the understanding of what they themselves, their manager and the organization can do to foster their career. Program participants learn how to identify their strengths, interests, values, motivators, development needs and work environment preferences. Ultimately, the goal is to create a career action plan that helps them identify their preferred career path. This plan, and participating in other career development activities such as job shadowing, speed mentoring and career fairs, are invaluable resources for employees.

Enabling our people

As we move forward, our goals are to enable our people and build on our past achievements. We’ve improved our performance management practices and continue to re-evaluate them to make sure we’re creating the best possible program for our employees. We’re also focusing on making significant improvements with our technology. We are investing heavily in the development and implementation of new systems that will be great resources to our employees. These investments will make processes simpler so our people can continue to provide an outstanding experience for our customers.

As we continue to learn and grow, we will earn the right to consider ourselves one of Canada’s most respected and successful companies. True to our values, we will be a company where our people are engaged because they know their work matters – and a company where our customers are our advocates because they know that what matters to them matters to us.



Lindsay Mackenzie, a Regional Manager and underwriter, is dedicated to both personal and professional growth and takes every opportunity to further herself, including participating in internal development courses offered by Intact. In 2013, Lindsay was presented with the Emerging Leader Award by the CIP Society after being nominated by a broker.



We’re a company that values diversity. It’s part of our strategy to invest in people and create a workplace where people feel engaged and employees can contribute their best every day. In September, we celebrated “Diversity Day” in several offices across the country. It was a way to share our unique experiences and backgrounds, which enrich us and form the core of who we are as a company.

OUR VALUES



Together with brokers...



Patricia Sagl, Manager, Business Development (left), shown with brokers Emilio McIntyre and Natalie Haller of LMS ProLink.

We know that much of our success depends upon the success of our broker partners. That is why we invest resources and expertise in helping brokers grow and prosper. We are committed to working with them and to providing products, technology, marketing and support that they can use to build their businesses and better serve their customers.



Natalie Haller and Emilio McIntyre are two of the many brokers we had in mind when designing our Compass Training program. At these sessions, we don't just teach, we also listen, and the market insight we receive from brokers helps us design better products. Of course, that also benefits brokers; as Emilio observed, "Knowing you have a good product helps build confidence in what you have to offer."



Patricia Sagl played an integral role in the coordination and delivery of Compass Training seminars in Ontario, which helped our brokers to understand how to better tailor commercial insurance to customer needs. This program had initially targeted 1,000 brokers in Ontario, but demand was so great that over 2,500 brokers participated. Patricia said that the feedback from the training was very positive and that "even experienced brokers thought it was really valuable."





At the last RCCAQ Annual Convention in Québec, we had a booth featuring “My Driving Discount”, a UBI solution that will allow eligible drivers to save up to 25% on their auto insurance premiums based on driving behaviours. Shown here is Lisa Desgagné (left), Business Centre Director, with two of our broker partners.



John Baizana of Baizana Insurance Brokers joined BrokerLink in 2013 and now serves as the Regional Branch Manager for the Ottawa region.

Our strategy consists of offering a complete suite of products, providing brokers with the technology to make their lives easier, creating a brand that is well known and trusted, expanding the reach of brokers in new communication channels and providing financial support to help them succeed.

One of the main challenges that both insurers and brokers will face in the coming years is to better adapt to the ever evolving shopping and buying behaviours of consumers and their increased expectations in terms of access and ease of doing business. When shopping for insurance, price and brand recognition are top of mind for consumers. However, customer service and the level of trust towards an insurer are the key factors for brokers to retain their customer base. We are pursuing a strategy that encompasses all of these factors.

Offering the right products

On the product side, we are confident that we offer one of the broadest portfolios of products, unmatched in the industry. Last year, we successfully completed the integration of AXA Canada and Jevco, while maintaining the same high level of service that brokers are accustomed to from us. Now that these integrations are complete, we can devote more energy to fostering the growth of both Intact and our brokers.

We are taking steps to ensure the sustainability of the personal property product in the face of severe weather events, and are doing so by offering product options that allow customers to tailor protection to their specific needs. In addition, customers will be able to mitigate

rate increases by taking loss prevention actions. It is imperative that insurers and brokers collaborate in promoting climate change adaptation initiatives to increase the resiliency of our homes, businesses and communities.

More recently, we began rolling out our Usage Based Insurance (UBI) solution in auto insurance. This is a key strategic initiative for Intact Insurance and our intention is to make it available across the country during 2014 both to consumers and to small businesses, allowing brokers' customers to save up to 25% on their premium based on their driving behaviours. UBI is a key component of our growth strategy, both for us and for brokers, as it should attract new customers and increase retention.

Technology investments

We are focused on making it easy for both brokers and customers to deal with us. Brokers tell us that our technology solutions integrate with their management systems better than those of our peers, and allow them to have smoother, more efficient workflows.

Our broker portal is a market-leading solution for quoting new business, and more importantly, allows policy changes in real time, resulting in quick turnaround times for customers. We are moving to address brokers' desire to go paperless by launching an electronic policy documentation solution that speaks to all broker management systems. Today, more than two-thirds of our personal lines policies are issued through this software and most of the new business written by brokers is done through our broker portal.

We will be making significant technology investments in the years to come. These investments continue to be aimed at enabling our people and brokers to become more efficient, and will result in eventually phasing out our legacy underwriting systems and revamping other customer-facing applications such as billing.



A customer experience second to none

As consumers increasingly look online for insurance, we launched Buy-Online in 2012 to provide a new customer acquisition tool for brokers and an online presence for their businesses. This year, it resulted in 280,000 additional leads to participating brokers. In 2014, our objective is to significantly increase the amount of insurance sold by brokers through the web. We will also enhance our own website and deliver a mobile platform.

Intact Insurance brand awareness is growing as we continue our marketing presence through TV ads and sponsorship of Canadian hockey and speed skating teams. We are proud to say that despite the Intact brand being only five years old, when consumers are asked about home and auto insurance companies, they mention Intact Insurance first, unprompted, almost twice as often as other more established brands in Canada.¹

One of our core beliefs is that customers are our best advocates, and to that end, we are unwavering in our commitment to deliver an experience that is second to none. We have

disaster recovery plans in place to make sure that we are there for our customers and brokers, when and where they need us, even in the event of a catastrophe.

Supporting our brokers

We continued to provide financial support to brokers in their quest to grow and succeed. We put our capital behind our partners because we believe that we can be stronger together.

We conduct broker surveys every two years to better understand what we are doing right and what we can do better for our broker constituency. The national broker survey, which we conducted in 2012, showed that broker satisfaction with Intact was at record highs. The Ontario broker survey released this year showed that, for the second consecutive time, Ontario's brokers rated Intact Insurance number one overall. We are thankful for the support the brokers have given us, and are confident that we will continue to provide the product excellence and diversity, workflow efficiencies and financial resources necessary to help our broker partners grow and prosper.

Life is full of unexpected events. Big or small, Intact will be there. Nicole Larivé, a broker at RPB Assurances, has peace of mind referring clients to Intact because she knows that in the event of a claim, "Intact will take care of them, and let me know about it right away."



Speciality Solutions Vice President, Antonio D'Agostino, and Yves Monette of the firm Pratte Morrissette Inc. are seen here at a reception held for the top 50 commercial brokers. The event was well attended and showcased what Antonio says are the four key competitive advantages that Intact has in specialty lines: "strong products, strong expertise, synergies between teams, and local decision-making."

¹ Ipsos Brand Tracker, Q3 - 2013

Together with communities...

Intact is part of the community. Across the country, wherever our customers, brokers and employees live and work, we show our commitment to communities through our efforts to respect the environment, to make communities healthier and happier and to encourage the involvement of our employees. We believe the positive changes we help make today will lead to a better, more sustainable future.

"Helping kids is an investment in our future that pays off for everyone," says Rhonda Hutchinson (below left), CSC-Unit Claims Manager for Intact in Calgary and President of the Raïdo Society. With support from Intact, Raïdo House gives homeless youth a safe place to live and helps them build the skills needed for responsible independence.



Working with Raïdo House Team Leaders like Tina McMartin (right), Rhonda (left) plays a key role in projects like setting up Raïdo House's new games room, which has been a big hit with staff and residents. "I grew up in a strong family," observes Hutchinson. "Not everyone is so lucky. I appreciate that, through Intact, I have an opportunity to help people and give back to my community."





Rhonda Hutchinson, CSC—Unit Claims Manager, with Raído House residents Morgan and Delaina (above left).

The Intact Foundation has a strong mandate to make the communities in which we operate safer, happier and healthier, and encourages our employees to get involved in the philanthropic endeavours of their choice.



We are a lead partner for the Youthworks initiative at Raising the Roof – Chez Toit, a national Canadian charity focused on long-term solutions to homelessness. Pictured here are several of the hundreds of our employees who went out in their communities selling toques and socks on Toque Tuesday.



The Intact Foundation is an integral part of our commitment to communities. One of the ways that the Foundation does this is by funding endeavours that foster vibrant Canadian communities by encouraging independence and well-being among at-risk youth.

designed to reduce the physical, financial and human impacts of extreme weather events. The projects focus on reducing the impact of torrential precipitations, restoring urban wetlands and water channels, and deploying green infrastructure initiatives, such as rain gardens and bioswales.

But our focus on the environment doesn't end there. We continue to look for other initiatives to scale back our own footprint on the environment. Over the last five years, we have reduced the intensity of our carbon emissions by almost 10% every year. Last year we brought our offices in Halifax, Quebec City and Vancouver into more modern and energy efficient buildings. Ongoing discussions with our landlords help to generate ways in which to increase possible energy efficiencies. We also introduced eco-friendly hybrid cars to our corporate fleet to reduce gas consumption.

Earlier this year, Intact was named one of the 100 most sustainable corporations in the world by Corporate Knights, a Toronto-based media and investment advisory company. Additionally, we were ranked among the best in corporate citizenship, coming in at 18 on the Best 50 Corporate Citizens in Canada, awarded through a separate study also done by Corporate Knights.

Creating vibrant and resilient communities

Homelessness is a problem that costs the Canadian economy \$7 billion annually, and a situation that as many as 1.3 million Canadians have experienced at some point during the past five years.

For the fourth year in a row, Intact has signed on as Raising the Roof's national partner for its Toque Tuesday campaign, to help fund initiatives that will find long-term solutions to homelessness. In 2013, hundreds of Intact employees once again hit the streets to sell toques in subway stations and busy intersections across the country.

Intact has also been the lead partner in Raising the Roof's Youthworks Private Sector Engagement Initiative for the last three years. In 2013, the Intact Foundation financially supported the implementation of a number of

Promoting climate change adaptation

As weather patterns change and severe storms become more frequent, their impact on Canadian society continues to be a significant issue for all of us. The unprecedented weather catastrophes of the past year reinforced our commitment to climate change adaptation. Through ongoing public education and raising awareness of the issues with our clients, we continue to help Canadians become less vulnerable to future events.

Intact and the University of Waterloo have been partnering for the past four years on the Climate Change Adaptation Project which, through a distinguished team of climate change experts, outlined a roadmap of priorities and recommendations for adapting to climate change.

As a followup to the report, Intact and the University of Waterloo are embarking on a national initiative involving the implementation of 12 climate change adaptation projects

its recommendations. The funding went to four agencies which will increase their collaboration with the private sector to provide work for at-risk youth.

We continue to pursue the funding of charitable organizations across the country that provide shelter to youth at-risk. Raido House, Eva's Initiatives, Covenant House, Service d'hébergement St-Denis and the YMCA are but a few of the many deserving charities we are happy to support.

We further help communities across the country through our annual United Way campaign, which works to create opportunities for a better life for everyone in our communities. Last year, our internal fundraising events, employee donations and Foundation match amounted to an impressive \$1.9 million.

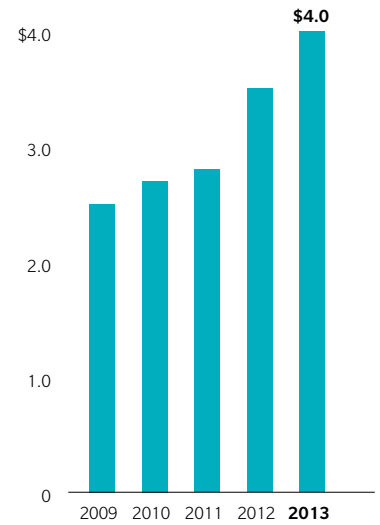
Employee involvement and citizenship

Encouraging the involvement and citizenship of our employees in their philanthropic initiatives is one of Intact's core values. Employees can get involved through our Team Volunteer Day by volunteering at a charitable event of their choice, be it at a local soup kitchen or planting trees in a nearby park.

The Employee Giving Program supplements financial donations made by employees to registered charities. In 2013, Intact and our employees generously gave to the Typhoon Haiyan relief efforts. Similarly, the tragedies that followed the train derailment in Lac-Mégantic and the Southern Alberta floods were met with an immediate donation by Intact and our staff. These are just several examples of the many ways our employees are proving, time and time again, their passion and commitment to helping those in need.

Total donations

(\$ millions)



Loss Prevention Consultants Jean Lefrançois and Pierre Dubeau go the extra mile not only for customers, but also for their community – literally! 50 of our employees took part in a 135-kilometre cycling challenge known as La Boucle du Grand défi Pierre Lavoie, whose mission is to encourage young people to adopt healthy life habits.

Financial review

Please note that the following “MD&A” and “Financial Statements” are provided as distinct sections with individual pagination: MD&A – pages 1 to 59 and Financial Statements – pages 1 to 67.



Intact Financial Corporation
Management's Discussion and Analysis

For the year ended December 31, 2013

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Table of contents

Section 1 – Profile	3
Section 2 – Key performance indicators.....	4
Section 3 – Overview of our consolidated performance.....	6
Section 4 – Operating results	8
Section 5 – Non-operating results	14
Section 6 – Non-IFRS financial measures	15
Section 7 – Business developments and operating environment	17
Section 8 – Strategy and outlook	20
Section 9 – Financial condition.....	22
Section 10 – Liquidity and capital resources	30
Section 11 – Capital management	32
Section 12 – Risk management.....	34
Section 13 – Off-balance sheet arrangements.....	50
Section 14 – Accounting and disclosure matters	51
Section 15 – Investor information	57
Section 16 – Selected annual and quarterly information.....	58

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

February 4, 2014

The following MD&A is the responsibility of management and has been reviewed and approved by the Board of Directors (or "Board") for the year ended December 31, 2013. 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, 2013, compared to the corresponding periods in 2012. It should be read in conjunction with our Consolidated financial statements for our fiscal year ended December 31, 2013. 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 6 – *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, MCT, and debt-to-capital, as well as other non-IFRS financial measures, namely AEPS, NOIPS, ROE, AROE, OROE, NOI, Non-operating results, Underlying current year loss ratio, Cash flow available for investment activities, and Market-based yield. 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.

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; synergies arising from, and the Company's integration plans relating to the AXA Canada Inc. ("AXA Canada") and Jevco Insurance Company ("Jevco") acquisitions; management's estimates and expectations in relation to resulting accretion, IRR and debt-to-capital ratio since closing of the AXA Canada and Jevco acquisitions; actions to be taken or requirements to be met in connection with the AXA Canada and Jevco acquisitions and integrating the Company, Jevco 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 12 - *Risk management*, hereafter. 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Glossary of abbreviations

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

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

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 meaningful (nm) is used to indicate that the current and prior year figures are not comparable, not meaningful, or if the percentage change exceeds 1,000%. "Intact", the "Company", "IFC", "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, 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 outside of the P&C insurance subsidiaries, unless otherwise noted.
- All relevant comparatives have been restated for the impact of IAS 19 – *Employee benefits* (see Section 14 – *Accounting and disclosure matters*).

Section 1 – Profile

1.1 Overview

We are the largest provider of P&C insurance in Canada with \$7.3 billion in annual 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 our 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 \$12.3 billion.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 6 – *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 3 – <i>Components of NOI</i> .
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 a 12-month period less preferred share dividends, 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 accompanying 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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.
Underlying current year loss ratio	Current year claims ratio excluding catastrophe losses and prior year claims development, calculated using net premiums earned before the impact of reinstatement premiums.

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 the 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 7 – *Business developments and operating environment* for more details on our performance versus the industry.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Section 3 – Overview of our consolidated performance

3.1 Highlights

- Operating ROE of 11.2% in 2013 despite incurring \$530 million in pre-tax catastrophe losses
- Net operating income per share of \$1.05 in Q4-2013 with a combined ratio of 96.3%
- Quarterly dividend raised 9% to \$0.48 per share
- AXA Canada and Jevco integration activities now complete

3.2 Consolidated financial results

Table 1 – Financial highlights

	Q4-2013	Q4-2012	Change	2013	2012	Change
Selected highlights						
DPW	1,702	1,690	1%	7,319	6,868	7%
Underwriting income (Table 5)	67	138	(51)%	142	451	(69)%
Combined ratio	96.3%	92.1%	4.2 pts	98.0%	93.1%	4.9 pts
Net investment income (Table 11)	104	102	2%	406	389	4%
NOI (Table 3) ¹	143	194	(26)%	500	675	(26)%
Income before income taxes (Table 2)	130	223	(42)%	465	712	(35)%
Income tax expense	23	46	(50)%	34	141	(76)%
Effective income tax rate	17.6%	20.6%	(3.0) pts	7.3%	19.8%	(12.5) pts
Net income	107	177	(40)%	431	571	(25)%
Preferred share dividends	(5)	(5)	nm	(21)	(21)	nm
Net income attributable to common shareholders	102	172	(41)%	410	550	(25)%
Per share measures, basic and diluted (in dollars)						
NOIPS ¹	1.05	1.42	(26)%	3.62	5.00	(28)%
EPS	0.77	1.29	(40)%	3.10	4.20	(26)%
AEPS ¹	0.88	1.49	(41)%	3.44	5.02	(31)%
ROE for the last 12 months	9.3%	13.5%	(4.2) pts			
AROE for the last 12 months ¹	10.3%	16.1%	(5.8) pts			
OROE for the last 12 months ¹	11.2%	16.8%	(5.6) pts			
Book value per share (in dollars)	33.94	33.03	3%			
MCT ²	203%	205%	(2.0) pts			
Debt-to-capital-ratio	18.7%	18.9%	(0.2) pts			

¹ Refer to Section 6 – *Non-IFRS financial measures*.

² Estimated aggregate MCT ratio of our P&C insurance subsidiaries.

Fourth quarter 2013

We reported a 96.3% combined ratio in Q4-2013, versus 92.1% in Q4-2012. The active winter season across much of Canada contributed to a \$39 million increase in catastrophe losses and also negatively impacted the underlying current year loss ratio. In addition, we recorded \$19 million lower favourable prior year claims development in the quarter. Partly offsetting these factors was a 2.4 point improvement in our expense ratio compared to the fourth quarter of 2012, driven by lower variable commissions resulting from a reduced level of profitability.

DPW were negatively impacted by one point on a reported basis due to our decision to no longer offer two-year property policies in Québec. At renewal, these policies are converted to one-year policies with corresponding lower written premium, though earned premiums are not affected. We expect this will continue to impact DPW by 1-2 points throughout 2014 as the remaining two-year policies roll off. DPW growth was tempered by the final phase of re-underwriting Jevco business, a process which had not yet begun in Q4-2012.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Net investment income of \$104 million in the fourth quarter was 2% higher than a year ago, as the improvement from migrating the additional investments from the Jevco acquisition into our higher-yielding asset mix was largely offset by declining yields. The market-based yield of 3.7% compares to 3.8% in Q3-2013 and 3.6% in Q4-2012. Investments amounted to \$12.3 billion, down \$0.7 billion from one year ago.

We ended 2013 in a solid financial position, with an estimated MCT of 203%, \$550 million in excess capital and book value per share of \$33.94. Our debt-to-capital ratio at the end of the year was 18.7%, below our internal target level of 20%. We reported an operating ROE of 11.2% in 2013 despite incurring \$530 million in pre-tax catastrophe losses, more than twice the level from 2012.

Full year 2013

Underwriting income declined by \$309 million in 2013 with a combined ratio of 98.0% versus 93.1% in 2012. The decrease was driven by a significant increase in catastrophe losses and by more seasonal weather conditions in Q1-2013 compared to the unusually mild Q1-2012. The underlying current year loss ratio was up to 64.9% from 63.5% in 2012.

DPW growth of 7% reflects the addition of Jevco as well as organic growth. We estimate that Jevco represented approximately four points of the DPW growth in 2013.

Net investment income was \$406 million in 2013, 4% higher than 2012, primarily from the addition of Jevco's assets into our investment mix. We reported a market-based yield of 3.7% in 2013, up from 3.6% in 2012.

3.3 Income before income taxes

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

Table 2 – Changes in income before income taxes (year-over-year)

	Q4-2013	2013
Income before income taxes, as reported in 2012	223	712
Operating results		
Change in pre-tax operating income (Table 4)	(66)	(294)
Non-operating results		
Change in pre-tax non-operating loss (Table 12)	(27)	47
Income before income taxes, as reported in 2013	130	465

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Section 4 – Operating results

4.1 Net operating income

The details of NOI and related indicators are as follows:

Table 3 – Components of NOI

	Q4-2013	Q4-2012	Change	2013	2012	Change
Underwriting income (Table 5)	67	138	(51)%	142	451	(69)%
Net investment income (Table 11)	104	102	2%	406	389	4%
Finance costs	(16)	(16)	nm	(64)	(60)	nm
Other income (expense), net ¹	25	22	14%	76	74	3%
Pre-tax operating income (Table 4)	180	246	(27)%	560	854	(34)%
Tax impact	(37)	(52)	nm	(60)	(179)	nm
NOI²	143	194	(26)%	500	675	(26)%
Preferred share dividends	(5)	(5)	nm	(21)	(21)	nm
NOI to common shareholders	138	189	(27)%	479	654	(27)%
Weighted-average number of common shares (in millions)	131.5	133.3	(1.8)	132.4	130.8	1.6
NOIPS, basic and diluted (in dollars)²	1.05	1.42	(26)%	3.62	5.00	(28)%

¹ Includes corporate expenses and distribution results.

² Refer to Section 6 – *Non-IFRS financial measures*.

The change in pre-tax operating income for the quarter was primarily driven by the \$71 million decline in underwriting income (described in Sections 4.2 - 4.4 below). Other income of \$25 million was 14% higher year-over-year due to growth in income from the distribution network and the timing of accruals.

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

Table 4 – Changes in pre-tax operating income (year-over-year)

	Q4-2013	2013
Pre-tax operating income, as reported in 2012¹	246	854
Changes in underwriting income:		
Change in favourable prior year claims development	(19)	2
Change in catastrophe losses	(39)	(241)
Other changes in underwriting income	(13)	(70)
Total change in underwriting income	(71)	(309)
Change in net investment income	2	17
Change in finance costs	-	(4)
Change in other income, net	3	2
Total change in pre-tax operating income	(66)	(294)
Pre-tax operating income, as reported in 2013¹	180	560

¹ Refer to Section 6 – *Non-IFRS financial measures*.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

4.2 Underwriting results

Table 5 – Components of underwriting results

	Q4-2013	Q4-2012	Change	2013	2012	Change
Net premiums earned, before reinstatement premiums	1,805	1,742	4%	7,058	6,581	7%
Reinstatement premiums	(1)	-	nm	(44)	(10)	nm
Net premiums earned, as reported	1,804	1,742	4%	7,014	6,571	7%
Net claims:						
Current year claims (excluding catastrophes)	1,220	1,121	9%	4,580	4,179	10%
Underlying current year loss ratio¹	67.6%	64.4%	3.2 pts	64.9%	63.5%	1.4 pts
Current year catastrophes	55	16	244%	486	245	98%
Favourable prior year claims development	(66)	(85)	nm	(374)	(372)	nm
Total net claims	1,209	1,052	15%	4,692	4,052	16%
Claims ratio	67.0%	60.4%	6.6 pts	66.9%	61.6%	5.3 pts
Commissions, premium taxes and general expenses	528	552	(4)%	2,180	2,068	5%
Expense ratio	29.3%	31.7%	(2.4) pts	31.1%	31.5%	(0.4) pts
Underwriting income	67	138	(51)%	142	451	(69)%
Combined ratio	96.3%	92.1%	4.2 pts	98.0%	93.1%	4.9 pts

¹ Underlying current year loss ratio is calculated using the Net premiums earned, before reinstatement premiums. Refer to Section 6 – Non IFRS financial measures.

Fourth quarter 2013

Underwriting income of \$67 million in Q4-2013 was down 51% from Q4-2012. The decline was due to a 3.2 point increase in the underlying current year loss ratio, a \$39 million increase in catastrophe losses and \$19 million less favourable prior year claims development. Catastrophe losses of \$55 million were attributable primarily to the December ice storm and an early-November wind and rain storm.

Favourable prior year claims development, at 3.6% of opening reserves on an annualized basis, was below the 5.2% recorded in Q4-2012 but in line with our historical level of 3%-4%.

The expense ratio of 29.3% improved 2.4 points in the fourth quarter of 2013 versus Q4-2012, driven by lower variable commissions resulting from a reduced level of profitability.

Table 6 – Components of expense ratio

	Q4-2013	Q4-2012	Change	2013	2012	Change
Commissions	15.0%	17.5%	(2.5) pts	16.8%	17.5%	(0.7) pts
Premium taxes	3.5%	3.5%	-	3.6%	3.6%	-
General expenses	10.8%	10.7%	0.1 pts	10.7%	10.4%	0.3 pts
Expense ratio	29.3%	31.7%	(2.4) pts	31.1%	31.5%	(0.4) pts

Full year 2013

Net premiums earned were up 7% in 2013, in line with the increase in direct premiums written. Underwriting income of \$142 million was well down from \$451 million in 2012 due to significantly higher catastrophe losses and a slight weakening in the underlying current year loss ratio.

Favourable prior year claims development, at 5.1% of opening reserves on an annualized basis, was slightly below the 5.7% recorded in 2012 but above our historical level of 3%-4%.

The expense ratio of 31.1% for 2013 was 0.4 points improved from 2012, driven by lower variable commissions resulting from a reduced level of profitability. Partly offsetting the decline in commissions was a 0.3 point increase in general expenses, as the 0.5 point improvement from acquisition-related synergies was offset by the timing of accruals for variable compensation related to our industry outperformance and higher information technology expenses including non-recoverable sales tax. For 2013, the favourable impact of synergies was evenly split between loss adjustment expense reductions, which impact the claims ratio, and general expense related synergies.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

4.3 Underwriting results by line of business – personal lines

Table 7 – Underwriting results for personal lines

	Q4-2013	Q4-2012	Change	2013	2012	Change
DPW						
Automobile	734	722	2%	3,373	3,093	9%
Property	374	375	-	1,621	1,562	4%
Total	1,108	1,097	1%	4,994	4,655	7%
Written insured risks (in thousands)¹						
Automobile	836	783	7%	3,902	3,584	9%
Property	518	527	(2)%	2,221	2,225	-
Total	1,354	1,310	3%	6,123	5,809	5%
Net premiums earned						
Automobile	861	825	4%	3,349	3,077	9%
Property	394	377	5%	1,519	1,462	4%
Total	1,255	1,202	4%	4,868	4,539	7%
Underwriting income (loss)						
Automobile	14	(25)	nm	228	132	73%
Property	54	124	(56)%	(66)	94	nm
Total	68	99	(31)%	162	226	(28)%

¹ Comparable periods in 2012 do not include written insured risks related to Jevco.

Table 8 – Underwriting ratios for personal lines

	Q4-2013	Q4-2012	Change	2013	2012	Change
Personal auto						
Claims ratio	75.3%	77.4%	(2.1) pts	68.0%	70.0%	(2.0) pts
Expense ratio	23.1%	25.7%	(2.6) pts	25.2%	25.7%	(0.5) pts
Combined ratio	98.4%	103.1%	(4.7) pts	93.2%	95.7%	(2.5) pts
Personal property						
Claims ratio	52.5%	31.7%	20.8 pts	69.0%	57.8%	11.2 pts
Expense ratio	33.9%	35.4%	(1.5) pts	35.4%	35.7%	(0.3) pts
Combined ratio	86.4%	67.1%	19.3 pts	104.4%	93.5%	10.9 pts
Personal lines – total						
Claims ratio	68.1%	63.0%	5.1 pts	68.3%	66.1%	2.2 pts
Expense ratio	26.5%	28.8%	(2.3) pts	28.4%	28.9%	(0.5) pts
Combined ratio	94.6%	91.8%	2.8 pts	96.7%	95.0%	1.7 pts

Fourth quarter 2013

DPW growth in personal auto was 2% year-over-year in Q4-2013, reflecting the final phase of re-underwriting related to Jevco and a timing impact related to two-year policies (which benefited Q4-2012). The combined ratio of 98.4% was 4.7 points improved from last year's 103.1%, largely due to \$14 million of favourable prior year claims development, versus \$29 million of unfavourable development in Q4-2012. The underlying current year loss ratio was higher by 2.1 points, driven by the more severe winter driving conditions.

Personal property DPW remained flat as a result of the conversion of two-year policies to one-year policies in Québec. This decision reduced our reported DPW by approximately four points in the quarter. Our efforts to improve the performance in this line of business also included meaningful rate action, which resulted in a 2% decline in units in Q4-2013. The quarter's combined ratio was strong at 86.4%, but above the exceptional 67.1% from a year ago which benefited from an unusual level of favourable prior year claims development. We also experienced a \$36 million increase in catastrophe losses related to an early-November wind and rain storm and the late-December ice storm. The underlying current year loss ratio was higher by 4.4 points versus last year, reflective of more severe winter weather and the corresponding elevated level of large losses related to fires.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Full year 2013

Personal auto underwriting results were solid in 2013 with a combined ratio of 93.2%, an improvement of 2.5 points versus 2012. Higher favourable prior year claims development more than offset a decline in current year results. The underlying current year loss ratio was higher by 1.6 points versus 2012, as claims frequency increased in Q1-2013 while claims severity increased in Q2-2013 and Q3-2013. DPW increased 9% versus 2012, reflecting the addition of Jevco and solid organic growth.

Underwriting results in personal property deteriorated 10.9 points from 2012 with a combined ratio of 104.4% as catastrophe losses of \$272 million were well above last year's \$151 million. Excluding catastrophe losses and prior year claims development, the underlying current year loss ratio of 54.7% in 2013 was slightly weaker than the strong underwriting performance in 2012. DPW increased 4% versus 2012 as units remained relatively constant despite rate increases.

4.4 Underwriting results by line of business – commercial lines

Table 9 – Underwriting results for commercial lines

	Q4-2013	Q4-2012	Change	2013	2012	Change
DPW						
Automobile	150	146	3%	612	552	11%
P&C	444	447	(1)%	1,713	1,661	3%
Total	594	593	-	2,325	2,213	5%
Written insured risks (in thousands)¹						
Automobile	124	120	3%	526	477	10%
P&C	111	113	(2)%	466	443	5%
Total	235	233	1%	992	920	8%
Net premiums earned						
Automobile	154	146	5%	603	536	13%
P&C	395	394	-	1,543	1,496	3%
Total	549	540	2%	2,146	2,032	6%
Underwriting income						
Automobile	(1)	23	nm	40	99	(60)%
P&C	-	16	(100)%	(60)	126	nm
Total	(1)	39	(103)%	(20)	225	(109)%

¹ Comparable periods in 2012 do not include written insured risks related to Jevco.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Table 10 – Underwriting ratios for commercial lines

	Q4-2013	Q4-2012	Change	2013	2012	Change
Commercial auto						
Claims ratio	75.1%	54.7%	20.4 pts	64.2%	51.6%	12.6 pts
Expense ratio	25.3%	29.5%	(4.2) pts	29.1%	29.9%	(0.8) pts
Combined ratio	100.4%	84.2%	16.2 pts	93.3%	81.5%	11.8 pts
Commercial P&C						
Claims ratio	60.4%	54.4%	6.0 pts	63.6%	51.9%	11.7 pts
Expense ratio	39.6%	41.5%	(1.9) pts	40.3%	39.7%	0.6 pts
Combined ratio	100.0%	95.9%	4.1 pts	103.9%	91.6%	12.3 pts
Commercial lines – total						
Claims ratio	64.5%	54.5%	10.0 pts	63.7%	51.8%	11.9 pts
Expense ratio	35.6%	38.2%	(2.6) pts	37.2%	37.1%	0.1 pts
Combined ratio	100.1%	92.7%	7.4 pts	100.9%	88.9%	12.0 pts

Fourth quarter 2013

DPW growth in commercial auto was 3% versus Q4-2012, reflecting our final re-underwriting efforts related to Jevco, particularly in taxi and trucking fleets. The combined ratio of 100.4% was up significantly from last year's 84.2% due to weaker current year results and a reduction in favorable prior year claims development. The underlying current year loss ratio deteriorated 14.9 points year-over-year, as severe winter driving conditions led to an increased frequency of claims while we also recorded an elevated level of large losses in the quarter.

Commercial P&C DPW declined 1% in Q4-2013 versus the same quarter of 2012 as our efforts to reduce the earthquake exposure of our portfolio were successful. Though our efforts will continue into the first half of 2014, more than half of the desired reduction has already occurred. The combined ratio of 100.0% was up 4.1 points from last year as we reported \$28 million less favourable prior year claims development largely due to an adjustment made on a file dating back several years. The underlying current year loss ratio of 66.1% was unchanged versus Q4-2012.

Full year 2013

DPW growth in commercial auto was strong at 11% versus 2012, on a 10% increase in units, reflecting the addition of Jevco and organic growth. The combined ratio in 2013 was 93.3% compared to 81.5% in 2012. The year-over-year change was largely driven by a \$31 million decrease in favourable prior year claims development compared to 2012. The underlying current year loss ratio deteriorated by 6.4 points year-over-year driven by higher claims severity.

Commercial P&C DPW increased 3% versus 2012 driven by the addition of Jevco, partly offset by efforts to reduce our earthquake exposure. The combined ratio increased from 91.6% in 2012 to 103.9% in 2013. A \$117 million increase in catastrophe losses and a \$73 million reduction in favourable prior year claims development drove the 12.3 point increase in the combined ratio. The underlying current year loss ratio improved by 1.5 points year-over-year.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

4.5 Net investment income

As at December 31, 2013, all of our investments are managed internally by our 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 that pay dividends and in preferred shares.

Table 11 – Net investment income

	Q4-2013	Q4-2012	Change	2013	2012	Change
Interest income	70	72	(3)%	275	276	-
Dividend income	43	40	8%	168	144	17%
Investment income, before expenses	113	112	1%	443	420	5%
Expenses	(9)	(10)	nm	(37)	(31)	nm
Net investment income	104	102	2%	406	389	4%
Average net investments¹	12,036	12,179	1%	11,962	11,487	4%
Market-based yield²	3.7%	3.6%	0.1 pts	3.7%	3.6%	0.1 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 6 – *Non-IFRS financial measures*.

Fourth quarter 2013

Net investment income of \$104 million in the fourth quarter was 2% higher than a year ago, as the improvement from migrating the additional investments from the Jevco acquisition into our higher-yielding asset mix was largely offset by declining yields. The market-based yield of 3.7% compares to 3.8% in Q3-2013 and 3.6% in Q4-2012.

Full year 2013

Net investment income was \$406 million in 2013, 4% higher than 2012, primarily from the addition of Jevco assets into our investment mix (see Section 9.2 – *Investments* for asset mix details). We reported a market-based yield of 3.7% in 2013, up from 3.6% in 2012.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Section 5 – Non-operating results

Non-operating results, a non-IFRS financial measure, include elements that are not representative of our operating performance because they relate to special items, bear significant volatility from one period to another, or because they are not part of our normal activities. As a result, these elements are excluded from the calculation of NOI and related non-IFRS financial measures.

The details of non-operating results are as follows:

Table 12 – Non-operating results

	Q4-2013	Q4-2012	Change	2013	2012	Change
Net investment gains (losses) (Table 13)	(29)	6	(35)	(83)	37	(120)
Positive (negative) impact of MYA on underwriting (Section 5.2)	5	11	(6)	75	(17)	92
Integration and restructuring costs (Section 5.4)	(12)	(29)	17	(35)	(108)	73
Difference between expected return and discount rate on pension assets (Section 5.3)	(7)	(5)	(2)	(27)	(22)	(5)
Amortization of intangible assets recognized in business combinations	(7)	(6)	(1)	(25)	(21)	(4)
Change in fair value of contingent consideration	-	-	-	-	(11)	11
Non-operating loss	(50)	(23)	(27)	(95)	(142)	47

5.1 Net investment gains (losses)

Table 13 – Net investment gains (losses)

	Q4-2013	Q4-2012	Change	2013	2012	Change
Fixed-income strategies						
Gains on AFS securities	11	13	(2)	10	25	(15)
Losses on FVTPL fixed-income securities	(9)	(24)	15	(115)	(35)	(80)
Impairment recovery	7	-	7	7	-	7
Losses on derivatives	(26)	(2)	(24)	(34)	(2)	(32)
Losses on fixed-income strategies and related derivatives	(17)	(13)	(4)	(132)	(12)	(120)
Equity strategies						
Gains, net of derivatives	12	33	(21)	115	102	13
Impairment losses	(27)	(12)	(15)	(79)	(42)	(37)
Gains (losses) on embedded derivatives	3	(2)	5	13	(11)	24
Gains (losses) on equity strategies and related derivatives	(12)	19	(31)	49	49	-
Net investment gains (losses)	(29)	6	(35)	(83)	37	(120)
Net investment gains (losses) excluding FVTPL fixed-income securities	(20)	30	(50)	32	72	(40)

Fourth quarter 2013

Our \$20 million net investment loss excluding FVTPL fixed-income securities in Q4-2013 compared to a gain of \$30 million in Q4-2012. The decline is due to lower realized gains on our equity portfolios, including higher impairment charges, as well as losses on our fixed-income portfolios resulting from rising rates.

Full year 2013

The \$40 million decrease year-over-year in net investment gains excluding FVTPL fixed-income securities is the result of higher losses on our fixed-income portfolio, as gains on our equity strategies and related derivatives were offset by impairment charges.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

5.2 Impact of MYA on underwriting

Claims liabilities are discounted at the estimated market yield of the assets backing these liabilities. The impact of changes in the discount rate used to discount claims liabilities based on the change in the market-based yield of the underlying assets is referred to as MYA. The MYA to claims liabilities should be evaluated with gains and losses on FVTPL fixed-income securities with the expectation that these items offset each other with a minimal overall impact to income.

5.3 Difference between expected return and discount rate on pension assets

We continue to manage our pension asset investment portfolio with a target asset return based on a target asset allocation. We continue to measure NOI using a pension expense based on our expected return on the plan assets to better reflect our management of the portfolio.

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 \$12 million of such expenses in the fourth quarter of 2013 (\$6 million related to Jevco and \$6 million related to AXA Canada) and \$35 million for the full year 2013, in line with our expectations.

Section 6 – 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. Further, they provide users with an enhanced understanding of our results and related trends and increase transparency and clarity into the core results of the business.

- 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). We believe that these excluded items are not appropriate in assessing our underlying performance.
- NOI, NOIPS and OROE exclude the impact of net investment gains (losses), the positive (negative) effect of MYA on underwriting, the difference between expected return and discount rate on pension assets, the amortization of intangible assets recognized in business combinations, integration and restructuring costs, as well as the change in fair value of contingent consideration. Investment gains and losses as well as the effect of MYA on underwriting arise mostly from changes in market conditions, which can be volatile to earnings. We also exclude the difference between expected return and discount rate on pension assets, as we believe the gap in these measures is not reflective of our internal investment management expertise and management of our pension investment asset portfolio (see Section 14.1 – *New accounting standards effective January 1, 2013* for further details).
- 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. This calculation provides users with a consistent measure of our relative investment performance.
- The underlying current year loss ratio is our current year claims ratio excluding catastrophe losses, reinstatement premiums, and prior year claims development. Catastrophe events are beyond our control, and as such, excluding them provides clearer insight into our analysis of current year performance. See Section 4.2 – *Underwriting results* for a reconciliation of this non-IFRS financial measure.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Table 14 – Reconciliation of AEPS to net income

	Q4-2013	Q4-2012	2013	2012
Net income	107	177	431	571
Add amortization of intangible assets recognized in business combinations, net of tax	6	4	19	16
Add integration and restructuring costs, net of tax	8	22	26	80
Add change in fair value of contingent consideration	-	-	-	11
Adjusted net income	121	203	476	678
Less preferred share dividends	(5)	(5)	(21)	(21)
Adjusted net income attributable to common shareholders	116	198	455	657
Divided by weighted-average number of common shares (in millions)	131.5	133.3	132.4	130.8
AEPS, basic and diluted (in dollars)	0.88	1.49	3.44	5.02
Average common shareholders' equity	4,435	4,087		
ROE for the last 12 months	10.3%	16.1%		

Table 15 – Reconciliation of NOIPS to net income

	Q4-2013	Q4-2012	2013	2012
Net income	107	177	431	571
Add income taxes	23	46	34	141
Deduct net investment gains/ add net investment losses (Table 13)	29	(6)	83	(37)
Deduct positive (add negative) impact of MYA on underwriting (Section 5.2)	(5)	(11)	(75)	17
Add difference between expected return and discount rate on pension assets (Section 5.3)	7	5	27	22
Add amortization of intangible assets recognized in business combinations	7	6	25	21
Add integration and restructuring costs	12	29	35	108
Add change in fair value of contingent consideration	-	-	-	11
Pre-tax operating income	180	246	560	854
Tax impact on operating income	(37)	(52)	(60)	(179)
NOI	143	194	500	675
Less preferred share dividends	(5)	(5)	(21)	(21)
NOI to common shareholders	138	189	479	654
Divided by weighted-average number of common shares (in millions)	131.5	133.3	132.4	130.8
NOIPS, basic and diluted (in dollars)	1.05	1.42	3.62	5.00
Average common shareholders' equity, excluding AOCI	4,287	3,892		
ROE for the last 12 months	11.2%	16.8%		

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Section 7 – Business developments and operating environment

7.1 AXA Canada and Jevco integration update

The integration activities for both AXA Canada and Jevco are now complete. During 2013, we converted all remaining AXA Canada policies into IFC systems and are on track to reach our after-tax synergies target of \$100 million for AXA Canada in early 2014 as we continue to make progress on decommissioning the AXA Canada systems. Our after-tax synergies run-rate as at December 31, 2013 was estimated to be \$94 million.

Formal integration of Jevco began in the fall of 2012 and the process of converting policies into IFC systems is mostly completed, meeting targeted broker service and customer retention levels. During 2013, we reviewed rates and segmentation and worked to re-underwrite portions of the Jevco portfolio, where required. We remain on track to decommission the Jevco systems throughout 2014. Our after-tax synergies run-rate estimate at the end of 2013 was \$17 million, surpassing our initial estimate of \$15 million by the end of 2014.

7.2 Canadian P&C insurance industry results – YTD Q3-2013 comparison

The Canadian P&C insurance results for YTD Q3-2013 are available. Highlights are as follows:

Table 16 – Canadian P&C insurance results

	P&C industry ¹	Industry Benchmark ²	IFC
DPW growth	2.0%	2.4%	7.1%
Combined ratio ³	102.8%	102.8%	97.2%
Return on equity ⁴	4.1%	3.3%	10.1%

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 outperformed our P&C insurance industry benchmark in the first three quarters of 2013. Our acquisition of Jevco provided meaningful DPW growth, while we delivered a combined ratio 5.6 points better than our industry benchmark. The combination of superior underwriting, investment results and capital management led to an ROE outperformance in the first nine months of 2013 of 6.8 points versus our industry benchmark and 6.0 points versus the P&C industry.

7.3 Ontario personal auto environment

In September 2010, the Ontario government implemented auto reforms, 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 increased costs and led to higher premiums.

Our positive view of the effectiveness of the 2010 Ontario auto reforms has not changed. We continue to see the benefits of the reforms and our actions; however, we remain prudent in our approach to the business, as uncertainty remains in the system.

Total FSCO pending arbitrations essentially doubled in the first ten months of 2013, while IFC pending arbitrations have increased only 17%, given our proactive approach to managing our files in dispute. The growing number of files rolling over to arbitration results in a fair level of uncertainty with respect to the interpretation of the regulations implemented through the 2010 reforms. FSCO is taking measures to increase arbitration capacity by outsourcing arbitration to private Dispute Resolution Services firms. The volume is expected to normalize by the second quarter of 2014. In addition, the government is expected to release its review of the Alternative Dispute Resolution System in February of 2014.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Separately, in August 2013, the Ontario government introduced a rate and cost reduction mandate to lower personal auto insurance rates by 15% on average after 2 years, while also reducing costs to insurers. Insurers will be asked to file for new rates, reflecting new cost reduction measures in the system. This process has begun with an average 4% industry reduction approved in Q4-2013, effective on new business and renewals through the first half of 2014. We expect most companies that have not yet taken a rate reduction will do so in the coming months, to largely meet the government's mid-term target of a cumulative average 8% reduction by August 2014. IFC will be reducing rates by 5% on average, targeting discounts to safe drivers. One strategy to identify safer drivers will be our launch of usage based insurance in Ontario in April 2014. We continue to believe we can protect our profitability in the Ontario auto book of business, but the implementation of additional cost reduction measures is important.

7.4 Home insurance

Table 17 illustrates that prior initiatives to improve the combined ratio from the 2008 level by our stated objective of 10-15 points were successful. 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 higher levels of favourable prior year claims development, without which, reported results would be less favourable.

Table 17 – Composition of combined ratios - personal property

	2013	2012	2011	2010	2009	2008
Combined ratio excluding catastrophe losses and PYD (defined below)	90.8%	89.2%	93.6%	94.6%	101.2%	104.3%
Impact of catastrophe losses	17.9%	10.3%	13.3%	5.9%	8.6%	8.7%
Impact of prior year claims development (PYD)	(4.3)%	(6.0)%	(3.4)%	(4.0)%	(0.8)%	0.6%
Reported combined ratio	104.4%	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 the elevated levels experienced since 2011. To attain this objective, we are taking action by implementing the following initiatives with ultimate benefits generated over the next 18-24 months:

Ongoing:

- renewing at the higher rates;
- increasing education and awareness campaigns, including the launch of “insuranceevolving.com”; and
- reducing earthquake exposure and increasing rates to reflect the rise in earthquake reinsurance costs.

Targeted for 2014:

- revise product wordings to present specific weather and water-related perils – including hail, wind and sewer back-up, increased base deductibles and deductibles associated with weather and water-related perils, and display premium per peril to provide customers with more transparent pricing;
- reduce maximum coverage available for some specific perils in higher risk areas;
- claims management initiatives: reduce reliance on external field adjusters and improve field technology to better enable us to deal with catastrophes by improving our service and reducing leakage; and
- tie prevention to pricing.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

7.5 Capital markets

The Canadian equity market continued to climb in the fourth quarter of 2013, as the S&P/TSX Index rose 6.5%, with particular strength in industrials and financials, while slightly higher bond yields pressured the preferred share index 1.5% lower. Movements in our equity investment values are generally in line with the equity markets' performance, although our exposures to individual sectors may be different. Our pre-tax unrealized gain of \$70 million in the quarter was largely due to higher equity prices on common shares. Tables 13, 28 and 29 provide detailed information on the net investment gains (losses) and unrealized gains (losses) of our investment portfolio.

7.6 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 2013, the net impact of industry pools on personal auto underwriting income was relatively unchanged versus Q4-2012, excluding MYA. Results for industry risk sharing pools tend to fluctuate between periods.

7.7 Weather conditions

Q4-2013 experienced weather conditions that were generally colder with below-average levels of precipitation. The average daily temperatures in Canada's seven largest cities were approximately two degrees Celsius below historical levels and one degree colder than Q4-2012, while precipitation was 20% lower than levels experienced over the past 10 years, and declined by more than 23% when compared with Q4-2012. Catastrophe losses were elevated, however, as a result of an ice storm in late-December that left hundreds of thousands without power in Toronto and parts of Eastern Canada, in addition to severe wind and rain events in Ontario and Québec during the month of November.

7.8 Seasonality of the business

The P&C insurance business is seasonal in nature. While net premiums earned are generally stable from quarter to quarter, underwriting results are driven mainly by weather conditions which may vary significantly between quarters. The underlying seasonality in our combined ratio is best illustrated by excluding the impact of catastrophe losses (see Table 19).

Table 18 – Seasonal indicator, including catastrophe losses

	2013	2012	2011	2010	2009	2008	2007	2006	Eight-year average
Q1	0.97	0.99	1.00	0.98	1.00	1.03	1.01	1.02	1.00
Q2	1.00	0.99	1.03	0.98	0.97	0.98	0.99	0.92	0.98
Q3	1.05	1.03	0.99	1.01	1.07	0.97	1.02	1.01	1.02
Q4	0.98	0.99	0.98	1.03	0.96	1.02	0.98	1.05	1.00

Table 19 – Seasonal indicator, excluding catastrophe losses

	2013	2012	2011	2010	2009	2008	2007	2006	Eight-year average
Q1	1.04	1.02	1.04	1.00	1.02	1.03	1.02	1.03	1.03
Q2	0.97	0.98	0.96	0.99	0.99	0.97	0.98	0.93	0.97
Q3	0.97	0.97	0.99	0.98	1.00	0.97	1.01	0.99	0.99
Q4	1.02	1.03	1.01	1.03	0.99	1.03	0.99	1.05	1.01

7.9 Normal course issuer bid

On May 13, 2013 we commenced an NCIB to repurchase for cancellation up to 6,666,683 common shares during the next 12 months, ending May 12, 2014, representing approximately 5% of our issued and outstanding common shares. We repurchased a total of 1,790,531 common shares in 2013. See Section 15.4 – *NCIB program* for further details.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Section 8 – Strategy and outlook

8.1 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 and outlook
Market environment (12-month outlook)	<ul style="list-style-type: none"> Industry premiums are likely to increase at a low single digit rate, with low single digit growth in personal auto and commercial lines and upper single digit growth in personal property. We expect premium reductions in Ontario auto to largely be commensurate with additional cost reduction measures and, as such, we do not foresee a material deterioration in profitability. We expect the current hard market conditions in personal property to accelerate meaningfully as the magnitude of 2013 catastrophe losses negatively impacts industry results. We believe continued low interest rates and the impact on commercial lines loss ratios from elevated catastrophe losses in 2013 could translate into firmer conditions over time, following several years of soft market conditions. 	<ul style="list-style-type: none"> 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 are taking 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 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 meaningfully grow in the mid-sized segment and in specialty lines.
Capital markets	<ul style="list-style-type: none"> Recent economic data and comments from the Bank of Canada lead us to believe that the overnight lending rate is likely to remain low for the foreseeable future. We estimate that the industry's pre-tax investment yield will remain relatively flat, given its asset mix and duration. Capital markets remain volatile, as economic data suggest that more time is required for the global recovery to take hold. Industry capital levels could be negatively impacted if volatility results in downward pressure on market values. Global capital requirements are continuing to influence the asset decisions of many companies. 	<ul style="list-style-type: none"> We maintain a solid financial position with \$550 million in excess capital and a debt-to-capital ratio of 18.7% as at the end of Q4-2013. Our \$12.3 billion investment portfolio is largely Canadian dollar-denominated. We do not expect growth in our net investment income over the next 12 months. We expect our MCT to remain in the 195%-205% range in the next 12 months.
Overall	<ul style="list-style-type: none"> The level of catastrophe losses is likely to diminish in 2014 versus a record high in 2013 of more than \$3 billion. This should lead to combined ratio improvement in 2014 at the industry level. The level of investment income is unlikely to improve materially versus 2013. Overall, we expect the industry's ROE to trend back toward its long-term average of 10% in 2014. 	<ul style="list-style-type: none"> We believe we will outperform the industry's ROE by at least 500 basis points in the next 12 months.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

8.2 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 claims expertise	Substantially all of our claims are handled in-house. This translates to claims being settled faster and at a lower cost, and a more consistent service experience 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 acquisition strategy	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 an 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 a 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 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.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Section 9 – Financial condition

9.1 Condensed balance sheets

The table below shows the significant Consolidated balance sheets captions.

Table 20 – Condensed balance sheets

As at	Reference	December 31, 2013	December 31, 2012
Assets			
Investments	Section 9.2	12,261	12,959
Premium receivables		2,764	2,670
Reinsurance assets		505	320
Deferred acquisition costs		718	705
Other assets		1,409	1,083
Intangible assets and goodwill		2,117	2,076
Total assets		19,774	19,813
Liabilities			
Claims liabilities	Section 9.3	7,996	7,656
Unearned premiums		4,125	4,046
Financial liabilities related to investments		234	486
Other liabilities		1,322	1,589
Debt outstanding	Section 10.1	1,143	1,143
Total liabilities		14,820	14,920
Shareholders' equity			
Common shares	Section 10.1	2,090	2,118
Preferred shares		489	489
Contributed surplus		116	121
Retained earnings		2,147	1,982
AOCI		112	183
Shareholders' equity	Section 15	4,954	4,893
Book value per common share (in dollars)		33.94	33.03

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

9.2 Investments

As at December 31, 2013, our total investments declined to \$12.3 billion from \$13.0 billion a year ago. The decrease is mainly attributable to operational cash requirements, driven by the settlement of claims related to significant catastrophe events as well as an increase in income taxes paid and a voluntary cash contribution to our pension plans. Our investment portfolio is mainly comprised of Canadian securities and includes a mix of cash and short-term notes, fixed-income securities, preferred and common shares. Most of our 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, 2013, we have \$193 million (\$276 million at December 31, 2012) in asset-backed securities mostly comprised of Canadian credit card and auto loan receivables (\$151 million as at December 31, 2013, \$217 million as at December 31, 2012) and mortgage-backed securities (\$42 million as at December 31, 2013, \$59 million as at December 31, 2012). All of these are rated 'AAA' as at December 31, 2013 and 2012.

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, called, or sold to take advantage of market opportunities. The preferred share portfolio is comprised entirely of Canadian issuers with over 90% 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 21 – Investment mix

As at	December 31, 2013	As a % of total	December 31, 2012	As a % of total
Short-term notes, including cash and cash equivalents	141	1%	386	3%
Fixed-income securities	7,867	64%	8,543	66%
Preferred shares	1,190	10%	1,263	10%
Common shares	2,644	22%	2,376	18%
Loans	419	3%	391	3%
Total investments	12,261	100%	12,959	100%

As part of our investment strategies, from time to time we may take long/short equity positions in order to maximize the value added from active equity portfolio management, or to mitigate overall equity market volatility. We also use strategies where long equity positions are economically hedged using swap agreements or other hedging instruments.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 22 – Investment mix net of hedging positions and financial liabilities related to investments

As at	December 31, 2013	As a % of total	December 31, 2012	As a % of total
Short-term notes, including cash and cash equivalents	291	2%	386	3%
Fixed-income securities	8,759	73%	9,214	74%
Preferred shares	1,142	10%	1,195	10%
Common shares	1,440	12%	1,299	10%
	11,632	97%	12,094	97%
Loans	419	3%	391	3%
Total investments net of hedging positions and financial liabilities related to investments	12,051	100%	12,485	100%

The investment mix as at December 31, 2013 is essentially unchanged compared to December 31, 2012.

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

Table 23 – Reconciliation between total investments and total investments net of hedging positions and financial liabilities related to investments

As at	December 31, 2013	December 31, 2012
Total investments (Table 21)	12,261	12,959
Deduct equities sold short positions	-	(301)
Deduct swap agreements and other derivatives	(59)	(68)
Deduct net asset value attributable to third party unit holders	(151)	(105)
Total investments net of hedging positions and financial liabilities related to investments (Table 22)	12,051	12,485

Net asset value attributable to third party unit holders represents third party interests in a closed mutual fund for which we hold the majority of the units and for which we act as investment manager.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

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, 2013.

Table 24 – 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	56%	-	-	-	43%
Financials	37%	78%	13%	35%	37%
Energy	1%	15%	37%	25%	7%
Telecommunication	-	-	13%	5%	2%
Industrials	1%	-	6%	8%	2%
Utilities	1%	7%	5%	2%	2%
Consumer discretionary	1%	-	10%	5%	2%
Materials	-	-	12%	12%	2%
Consumer staples	1%	-	4%	3%	1%
Information technology	1%	-	-	2%	1%
Health care	1%	-	-	3%	1%
Total	100%	100%	100%	100%	100%
Total	8,801	1,142	1,440	nm	11,383

Our fixed-income investment portfolio is concentrated mainly in the government and financial sectors in order to provide liquidity and stability to our balance sheet and our equity portfolio has a focus on dividend-paying Canadian companies.

Portfolio credit quality

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

Table 25 – Credit quality of the fixed-income securities

	December 31, 2013		December 31, 2012	
	Fair value	As a % of total	Fair value	As a % of total
Fixed-income securities¹				
AAA	3,705	47%	3,701	43%
AA	3,031	39%	3,467	41%
A	1,052	13%	1,268	15%
BBB	70	1%	93	1%
Non-rated	9	-	14	-
Total	7,867	100%	8,543	100%

¹ Source: S&P or DBRS.

As at December 31, 2013 the weighted-average rating of our fixed-income portfolio was 'AA+', unchanged since December 31, 2012. The average duration of our bond portfolio was 3.91 (4.40 including the impact of derivatives used to increase overall interest rate exposure).

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

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

Table 26 – Credit quality of the preferred share portfolio

	December 31, 2013		December 31, 2012	
	Fair value	As a % of total	Fair value	As a % of total
Preferred shares¹				
P1	100	8%	369	29%
P2	1,042	88%	797	63%
P3	47	4%	89	7%
Non-rated	1	-	8	1%
Total	1,190	100%	1,263	100%

¹ Source: S&P or DBRS.

The weighted-average rating of our preferred share portfolio was 'P2' as at December 31, 2013, unchanged since December 31, 2012. The increase in the proportion of 'P2', relative to 'P1' preferred shares, is due to a reduction by DBRS of the credit rating of preferred shares issued by certain large financial institutions.

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

Table 27 – Portfolio breakdown by region of issuer

As at	December 31, 2013	December 31, 2012
Canada	93%	97%
U.S.	3%	-
Europe ¹	3%	2%
Other	1%	1%
Total	100%	100%

¹ European Government debt represents less than 3% of our total portfolio as at December 31, 2013 and 2012.

Our investment portfolio is mainly comprised of Canadian securities. We do not invest in leveraged securities and our exposure to the U.S. market remains minimal, with principally non-financial corporate U.S. bonds.

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

As at	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012
Fixed-income securities	10	17	20	95	81
Preferred shares	38	43	61	110	121
Common shares	120	38	(4)	89	63
Net pre-tax unrealized gain position	168	98	77	294	265

During Q4-2013, our pre-tax unrealized gain position increased by \$70 million. This increase is mainly due to higher equity prices on common shares.

The \$97 million decrease year-over-year in our pre-tax unrealized gain position stems principally from the impact of higher rates on the prices of our fixed-income securities and preferred shares, partially offset by strong equity markets contributing to positive development on our common shares.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

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 if there are reasons to believe that the decline in the market value is temporary. Based on our assessment, we recorded impairment losses on AFS common shares amounting to \$23 million and \$57 million in Q4-2013 and full year 2013, respectively.

Table 29 – Aging of unrealized losses on AFS common shares

As at	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012
Less than 25% below book value	30	40	32	27	17
More than 25% below book value for less than 6 consecutive months	2	4	21	6	1
More than 25% below book value for 6 consecutive months or more	1	20	27	-	9
Unrealized losses on AFS common shares	33	64	80	33	27

9.3 Claims liabilities

Claims liabilities amounted to \$8.0 billion as at December 31, 2013, up \$0.3 billion from the December 31, 2012 level, reflecting growth and the additional claims provision for the catastrophe events of 2013.

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 5.2 – *Impact of MYA on underwriting*). 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 30 – Prior year claims development (excluding MYA)

	Total	Accident year									
		2012	2011	2010	2009	2008	2007	2006	2005	2004	2003 & earlier
Original reserve		2,470	2,411	2,120	1,835	1,652	1,458	1,300	1,190	1,161	2,643
Favourable development during Q4-2013	(66)	(12)	(22)	(13)	(10)	(16)	(12)	(6)	(5)	(8)	38
Favourable development during 2013	(374)	(108)	(94)	(48)	(44)	(43)	(25)	(21)	(15)	(11)	35
Cumulative development as a % of original reserve		(4.4)%	(10.1)%	(10.3)%	(8.4)%	(8.3)%	(7.4)%	(9.7)%	(16.6)%	(27.1)%	(16.9)%

Table 31 – Annualized rate of favourable prior year claims development (annualized rate)

	Q4-2013	Q4-2012	2013	2012
Favourable prior year claims development (as a % of opening reserves)	3.6%	5.2%	5.1%	5.7%

Favourable prior year claims development for the quarter, at 3.6% of opening reserves on an annualized basis, was below the 5.2% recorded in Q4-2012, but in line with our historical level of 3% to 4%. The favourable development, amounting to \$66 million, was composed of \$32 million in commercial P&C, \$17 million in personal property, \$14 million in personal auto, and \$3 million in our commercial auto line of business.

Favourable prior year claims development for the year, at 5.1%, was also below 2012, but above our historical level of 3% to 4%.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

9.4 Employee future benefit programs

We sponsor a number of funded (registered) and unfunded defined benefit pension plans that provide benefits to members in the form of a guaranteed level of pension payable for life based on final average earnings and contingent upon certain age and service requirements.

Because of the long-term nature of our pension obligations, movements in discount rates and investment returns could bring volatility in our balance sheet. In recent years, we have taken a multi-faceted approach to ensure the sustainability of our pension plans and gradually reduce the risk and volatility that stems from our pension liabilities and assets, including:

- increasing the target allocation of fixed-income securities to reduce our exposure to market volatility;
- improving our pension asset-liability matching to reduce our interest-rate exposure;
- making voluntary contributions to improve the funding status of our pension plans (we made a voluntary contribution of \$114 million in December 2012); and
- amending pension plan benefits and conditions.

As at December 31, 2013, 62% of our pension plan assets were invested in fixed-income securities and our hedge ratio stood at 73%. We calculate the hedge ratio of our pension plans by dividing the dollar-duration of the pension asset portfolio by the dollar-duration of the funded pension plans' obligation.

Plan assets are highly dependent on the level of contributions and on the pension fund's asset performance. In 2012 and 2013, we contributed over \$330 million in our pension plans, including a discretionary contribution of \$114 million. As at December 31, 2013, the fair value of our pension plan assets amounted to \$1.4 billion. Based on the latest projections, our total cash contributions to pension plans are expected to be approximately \$60 million in 2014. The level of contributions will vary depending on funding relief measures, if any, and decisions taken to use or not letters of credit as permitted by legislation.

The following table presents the movement in the accounting funding status of our funded pension plans during the 2013 year.

Table 32 – Change in surplus (deficit) – funded pension plans

Deficit, as at January 1, 2013¹	(54)
Employer contributions	117
Impact of change in discount rates ²	216
Impact of change in mortality assumptions ²	(50)
Current service cost	(66)
Interest expense on defined benefit obligation	(58)
Negative return on plan assets ³	(4)
Other	(13)
Surplus, as at December 31, 2013¹	88

¹ Excludes the unfunded pension plans' obligation amounting to \$60 million as at December 31, 2013 (\$61 million as at December 31, 2012).

² Recognized in OCI.

³ Comprised of the interest income credited on pension assets (\$55 million) recognized in income and of re-measurement (return on plan assets) (negative \$59 million) recognized in OCI.

As at December 31, 2013, we have a net surplus of \$88 million, or 107%, for funded pension plans, compared to a net deficit of \$54 million, or 96%, as at December 31, 2012. The improvement in the funded status is mainly driven by the impact of change in discount rates and by employer contributions, partially offset by the impact of change in mortality assumptions.

Beginning in 2014, all employees have a choice between a defined benefit or a defined contribution pension plan.

We also offer employer-paid post-retirement benefit plans providing life insurance and health and dental benefits to a limited number of active employees and retirees that are now closed to new entrants, as well as post-employment benefit plans that provide health and dental coverage to employees on disability. As at December 31, 2013 our net benefit liability in respect of those plans amounted to \$32 million (December 31, 2012 - \$34 million). The post-retirement and post-employment benefit plans are unfunded.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Benefit obligations arising from our defined benefit plans are dependent on assumptions, such as the discount rate, life expectancy of pensioners, inflation and 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. Mortality rates have been established in accordance with the draft private sector table and improvement scale published in 2013 by the Canadian Institute of Actuaries following its Canadian pensioner mortality study.

Table 33 – Impact of changes in key assumptions

As at December 31, 2013	Impact on net benefit liability
Discount rate:	
1% increase	(248)
1% decrease	302
Rate of compensation increase:	
1% increase	64
1% decrease	(61)
Rate of inflation:	
1% increase	54
1% decrease	(51)
Life expectancy of pensioners:	
One-year increase	35

Refer to Note 22 – *Employee future benefits* to the accompanying Consolidated financial statements for more details on our pension plans, post-retirement and post-employment benefit plans.

Section 10 – Liquidity and capital resources

10.1 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 with a goal to return to our target within a reasonable time frame.

As at December 31, 2013, we had a debt-to-capital ratio of 18.7%, compared to 18.9% as at December 31, 2012.

Credit Facilities

We have a \$300-million four-year unsecured revolving term credit facility maturing on October 26, 2016. This credit facility may be drawn as a prime loan at the prime rate plus a margin or as bankers' acceptances at the bankers' acceptance rate plus a margin. This facility was undrawn as at December 31, 2013 and 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, 2013 and 2012.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

10.2 Credit ratings

On November 27, 2013, DBRS reaffirmed its ratings of Intact Financial Corporation and maintained the outlook as stable.

During 2013 A.M Best and Moody's also reaffirmed their respective ratings for financial strength and long-term issuer credit for IFC and its principal operating subsidiaries.

Table 34 – Credit ratings

	A. M. Best	Moody's¹	DBRS
Long-term issuer credit ratings of IFC	a-	Baa1	A (low)
Financial strength ratings of IFC's principal insurance subsidiaries	A+	A1	n/a

¹ Jevco and companies previously owned by AXA Canada are not rated by Moody's.

10.3 Base shelf prospectus and medium-term note supplement

On August 13, 2013, 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 \$3.0 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 a medium-term note program that would allow us to issue up to \$850 million in unsecured medium-term notes. As at December 31, 2013, the amounts available under the respective prospectuses were \$3.0 billion and \$850 million.

10.4 Cash flows

Table 35 – Selected cash inflows (outflows)

	Q4-2013	Q4-2012	Change	2013	2012	Change
Operating activities						
Net cash flows provided by (used in) operating activities	(27)	204	(231)	185	723	(538)
Financing activities						
Proceeds from the issuance of debt	-	-	-	-	249	(249)
Repayment of term loan facilities	-	-	-	-	(400)	400
Proceeds from issuance of common shares	-	-	-	-	227	(227)
Dividends paid on common shares and preferred shares	(63)	(58)	(5)	(254)	(231)	(23)
Common shares repurchased for cancellation	-	-	-	(106)	-	(106)
Common shares repurchased for share-based payments	(6)	2	(8)	(37)	(26)	(11)
Other activities						
Business combination, net of cash acquired	-	-	-	-	(507)	507
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	(62)	(17)	(45)	(159)	(134)	(25)
Cash flow available for investment activities¹	(158)	131	(289)	(371)	201	(572)
Purchase of investments, net of proceeds from sales	50	(241)	291	298	(235)	533
Net decrease in cash and cash equivalents	(108)	(110)	2	(73)	(34)	(39)

¹ A non-IFRS financial measure which includes net cash flows from cash and cash equivalents and the investment portfolio.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Fourth quarter 2013

Cash flow available for investment activities decreased by \$289 million versus Q4-2012. This is mainly due to the settlement of claims from the catastrophes of the second and third quarter.

Full year 2013

The full year Cash flow available for investment activities decreased by \$572 million over last year. This is mostly due to a decrease in operating cash flows reflecting the settlement of claims related to significant catastrophe events as well as an increase of income taxes paid of \$192 million and a voluntary cash contribution of \$114 million to our pension plans.

10.5 Contractual obligations

Table 36 – 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
Interest payments on debt	1,244	63	188	121	872
Claims liabilities ²	4,704	1,886	1,157	715	946
Operating leases on premises and equipment	798	105	190	165	338
Pension obligations ³	141	46	71	11	13
Total contractual obligations	8,030	2,100	1,606	1,012	3,312

¹ Principal 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 11 – Capital management

11.1 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 an aggregate 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 of the AMF and the *Act respecting insurance*. OSFI and the 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 there is minimal risk of breaching the supervisory target MCT, we have established a minimum internal threshold of 170%, in our principal insurance subsidiaries, in excess of which, under normal circumstances, we will maintain our capital.

Intact Financial Corporation
Management’s Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Our goal is to maintain adequate excess capital levels to ensure 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 intend to maintain capital levels well above our minimum internal threshold to absorb fluctuations in equity markets or interest rates. Our intent is also to keep higher levels of excess capital if we foresee growth or actionable opportunities in the near term. Finally, we intend to return excess capital to shareholders first through annual dividend increases and then through share buy-backs when excess capital levels permit. Consistent with this, we believe that an NCIB program provides a flexible means to return capital to shareholders allowing us to manage our excess capital while benefiting from market conditions. For further details on our progress to date under the current NCIB program, please refer to section 15.4 – *NCIB program* hereafter.

2015 MCT Guidelines

MCT guidelines change from time to time and may impact our capital levels. We therefore monitor all changes, actual or planned, very carefully. On December 20, 2013, OSFI released a draft MCT guideline proposing changes to the MCT framework beginning in 2015. The comment period for public consultation on the proposed guideline closes on March 15, 2014 and a final guideline is expected in fall 2014. Based on our initial assessment of the proposals contained in the draft guideline, our MCT would improve but impacts are proposed to be phased in over eight quarters beginning Q1-2015.

11.2 Capital position

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

Table 37 – Aggregate MCT

As at	December 31, 2013	December 31, 2012
Total capital available	3,750	3,764
Total capital required	1,849	1,840
MCT %	203%	205%
Excess capital at 100%	1,901	1,924
Excess capital at 150%	977	1,004
Excess capital at 170%	607	636

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, 2013, 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 aggregate MCT level as at December 31, 2013 remained solid at an estimated 203%. The decrease from 205% at December 31, 2012 mainly reflects elevated catastrophe losses, the decline in our investment portfolio due to rising yields and weak equity markets, and capital returned to shareholders through the NCIB program. These were partly offset by the positive impact arising from pension accounting changes and operating profit.

Including net liquid assets outside of the P&C insurance subsidiaries, we had an estimated total of \$550 million in excess capital at an MCT of 170% as at December 31, 2013, compared to total excess capital of \$599 million as at December 31, 2012. The decrease in total excess capital position mainly reflects the variance from the aggregate MCT described above.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

11.3 MCT sensitivity

The MCT is impacted by many factors including changes in equity market performance, interest rates and underwriting profitability. Based on our estimated aggregate MCT of 203% as at December 31, 2013, 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 38 – Sensitivity to interest rates and equity markets

	Interest rates 1% increase ¹	Equity markets decline ²
MCT ³	(4) pts	(4) 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 2013 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 12 – Risk management

12.1 Introduction

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

Effective risk management rests on identifying, understanding and communicating all material risks we are 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 our management has put appropriate risk management programs in place. The Board of Directors, directly and in particular through its Risk Management Committee oversees our 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 our key risks and the processes for managing and mitigating them is outlined below.

The risks described below and all other information contained in our public documents including our Consolidated financial statements 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 we employ 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

12.2 Risk management structure

The Board of Directors is responsible for the oversight of risk management to ensure that risks are properly measured, monitored and reported. In this regard, the Board is supported by its Risk Management Committee that covers enterprise wide risks. In addition, we have an internal Enterprise Risk Committee composed of senior executives.

In 2013, the Board and Committee structures were reviewed to be aligned with best practices, the applicable laws and the new OSFI Corporate Governance Guideline. The following structure is in place:

- **Board of Directors:** The main responsibility of the Board is to oversee our management of business and affairs, including our pension funds. In this regard, the Board establishes policies, reporting mechanisms and procedures in view of safeguarding our assets and ensuring its long-term viability, profitability and development.
- **Audit Committee:** The Audit Committee is a committee that is responsible for reviewing our Financial Statements and financial information including our pension funds. The Audit Committee is responsible for overseeing our accounting and financial reporting process and, in this regard, reviews, evaluates and oversees such processes; it is also responsible for evaluating the integrity of our Financial Statements and for overseeing the quality and integrity of internal controls.
- **Human Resources and Compensation Committee:** The Human Resources and Compensation Committee is a committee of the Board of the Company the primary function of which is to assist the Board in fulfilling its supervisory responsibilities for strategic oversight of our human capital, including organization effectiveness, succession planning and compensation, and the alignment of compensation with our philosophy and programs.
- **Compliance Review and Corporate Governance Committee:** The Compliance Review and Corporate Governance Committee ("CRCG Committee") is responsible for ensuring a high standard of governance, compliance and ethics in our company, including our pension funds. In this regard, the CRCG Committee is responsible for overseeing our governance framework, it is also responsible for overseeing our compliance framework as well as our compliance programs including Related Party Transactions ("RPT"), our market conduct programs and policies, as well as the governance framework of our pension plans and the implementation of corporate compliance initiatives.
- **Risk Management Committee:** The Risk Management Committee is a committee of the Board of Directors whose primary function is to assist the Board with its oversight role with respect to our management in order to build a sustainable competitive advantage, by fully integrating the Enterprise Risk Management Strategy into all our business activities and strategic planning and our subsidiaries and operations, including our pension funds.
- **Enterprise Risk Committee** (refer to figure 1): This committee is composed of senior officers and is chaired by the Chief Risk Officer designated by the Board of Directors. It meets regularly and oversees 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 Risk Management Committee. The Enterprise Risk Committee evaluates our overall risk profile, aiming for a balance between risk, return, and capital, and approves risk policies. The Enterprise Risk 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) manages risk in accordance with the risk tolerance level determined by the 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 Enterprise Risk Committee to access the expertise throughout our company and to operate more efficiently in addressing key risks.

In addition, we have 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Figure 1: Committees involved in risk management



12.3 Corporate governance ensuring compliance with laws and regulatory requirements

We believe that sound corporate governance and compliance monitoring related to legal and regulatory requirements are paramount for maintaining the confidence of different stakeholders including our investors. Legal and regulatory compliance risk arises from non-compliance with the laws, regulations or guidelines applicable to us as well as the risk of loss resulting from non-fulfilment of a contract. We are subject to strict regulatory requirements and detailed monitoring of our operations in all provinces and territories where we conduct business, either directly or through our subsidiaries. Our 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 our operations to enable them to effectively oversee our 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 we meet our 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. We have 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 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, we have 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. We also use third party legal experts and take provisions when deemed necessary or appropriate.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

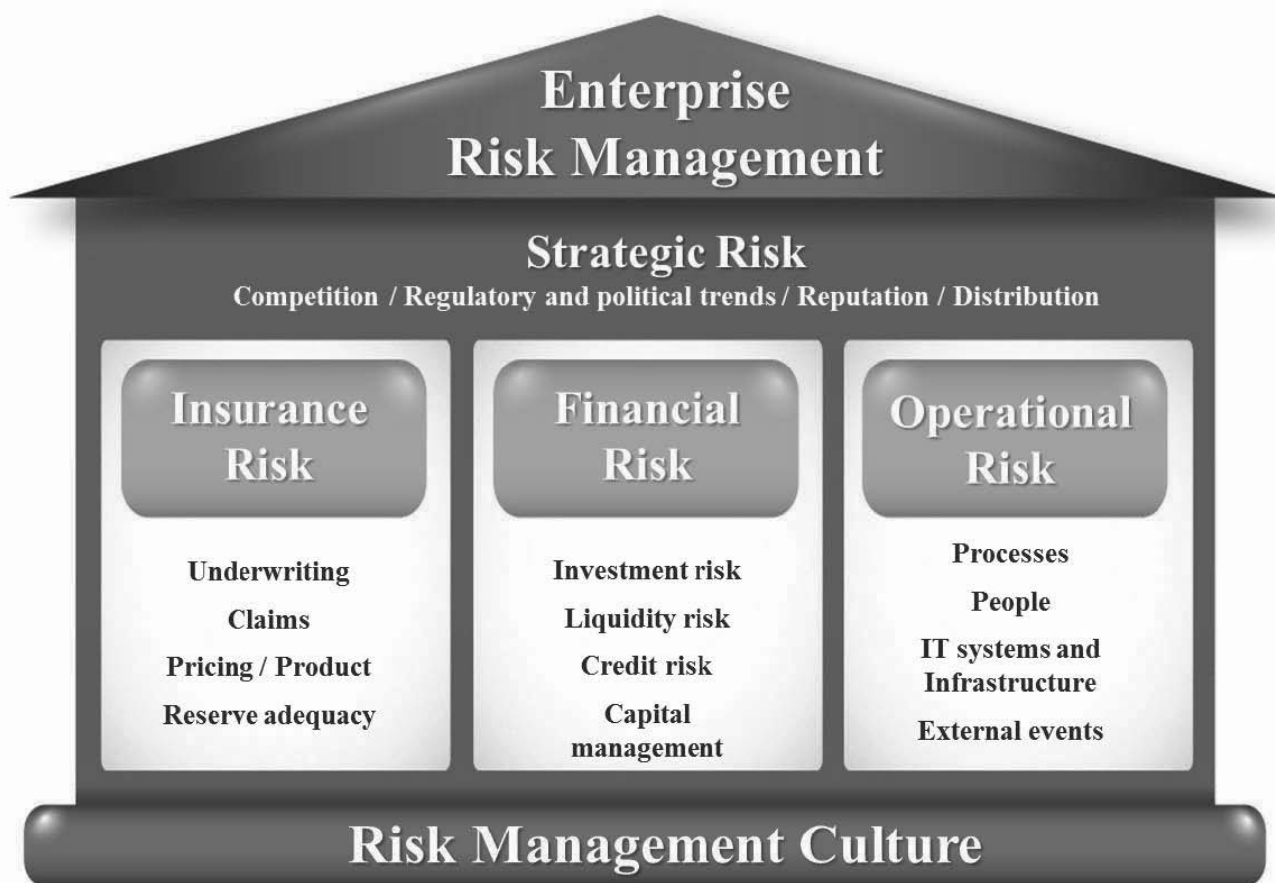
While senior management has ultimate responsibility for compliance, it is a responsibility that each individual employee shares. This is clearly set out in our core Business Values and Code of Conduct and employees sign a confirmation that they have reviewed and complied with them annually.

12.4 Mandate of Enterprise Risk Management

Our business strategies and capital management decisions are tied to the risks we are 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 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



Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 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 with 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 3 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

12.5 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 management culture; and
- we maintain our ability to access capital markets at reasonable costs.

12.6 Main risk factors and mitigating actions

Our main risk factors together with our risk management practices used to mitigate these risks are explained below.

Insurance risk

Catastrophe 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, wind storms, earthquakes, hailstorms, rainstorms, ice storms, floods, explosions, severe winter weather and fires. Unnatural catastrophe events include but are not limited to 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 Alberta Flood in June 2013 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 or Québec could have a significant impact on our profitability and financial condition. Depending on the magnitude of the earthquake, its epicentre, and on 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.

Our 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 us. See Section 12.7 – *Reinsurance* for more details on our 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 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 9.3 – *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, our 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 our home insurance claims.

Over the last few years, we have witnessed a continued increase in the number and severity of weather events. Heavy wind and rain in various parts of the country during 2013 resulted in significant claims, particularly in our property insurance portfolio. The trend in climate change poses a meaningful risk to our ability to meet our business objectives.

To address this issue, we have 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. These initiatives accelerated in 2013, however, there is no guarantee that they will succeed.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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. 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 us. Although worldwide catastrophe losses were lower in 2013 than in the previous year, the cost of catastrophes in Canada increased which has resulted in some pressure on reinsurance pricing locally.

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 12.7 – *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. We invest significantly in promoting our brands with an increasing focus on using web and mobile technology to reach consumers.

Consolidation in the Canadian P&C industry continued in 2013. As competitors gain scale, it may erode our competitive advantage.

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. We have adopted policies which specify our retention limits and risk tolerance and our application depends on training and the discipline of our underwriting teams. Once the retention limits have been reached, we turn 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 our profitability objectives. This risk may be due to an inadequate assessment of market needs, new business context, a poor estimate of the future experience of several factors, as well as the introduction of new products that could adversely impact the future behaviour of policyholders.

New products are reviewed by Senior Management and the risk is primarily managed by regularly analyzing the pricing adequacy of our 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.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Financial risk

Market risk

Movements in interest rates, credit spreads, foreign exchange rates and equity prices cause changes in realized and unrealized gains and losses. Generally, our 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 we continue 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 our existing fixed-income securities will generally decrease and our realized gains on fixed-income securities will likely be reduced or result in realized losses. Changes in credit spreads would have similar impacts as those described above for changes in interest rates. 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. Recently, in 2013, interest rates rose considerably. A continued and significant increase in interest rates could materially affect the value of our investments.

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 we own 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 our 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 our investments were negatively impacted by these events resulting in losses.

While our strategy is long-term in nature, it is reviewed periodically to adapt to the investment environment when necessary, especially in times of turbulence and increased volatility. Periodically, we employ several risk mitigation measures such as changes to its strategic asset mix, hedging of interest rate, foreign exchange, 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 our risk tolerance level. Sensitivity analysis involves varying a single factor to assess the impact that this would have on our results and financial condition.

For example, a 100 basis point variation in interest rates would normally impact Net income and OCI as follows:

Table 39 - Sensitivity analysis for interest rate risk

For the years ended December 31,	2013		2012	
	Net income	OCI	Net income	OCI
100 basis-point increase	(21)	(127)	-	(138)
100 basis-point decrease	21	127	-	138

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

- The 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.
- Risk reduction measures perform as expected, with no material basis risk and no counterparty defaults.
- For our FVTPL fixed-income securities, the estimated impact on net income is assumed to be offset by the market-yield adjustment.
- AFS fixed income securities in an unrealized loss position, as reflected in AOCI may, at some point in the future, be realized through a sale or impairment.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Shocks of 10% and 25% applied to the price of all common shares, net of any equity hedges, combined respectively with shocks of 5% and 10% applied to the price of all preferred shares and related imbedded derivatives, including the impact of any impairment, would impact Net income and OCI as follows:

Table 40 - Sensitivity analysis for equity price risk

For the years ended December 31,	2013		2012	
	Net income ¹	OCI	Net income ¹	OCI
Price of all common shares:				
10% increase	(16)	152	(14)	141
10% decrease	3	(140)	12	(138)
25% increase	(42)	361	(30)	325
25% decrease	10	(329)	14	(309)

¹ Declines in the price of AFS perpetual preferred shares is recorded in OCI and would normally lead to a lower valuation for associated embedded derivative liabilities which are recorded as gains in Net income. Conversely, an increase in the price of these preferred shares is also recorded in OCI and would normally lead to a higher valuation for associated embedded derivative liabilities which are recorded as losses in Net income.

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

- Interest rates and equity prices move independently.
- Credit and liquidity risks have not been considered.
- Impact on our pension plans is not included.
- Risk reduction measures perform as expected, with no material basis risk and no counterparty defaults.
- AFS equities in an unrealized loss position, as reflected in AOCI may, at some point in the future, be realized through a sale.

We also use stress tests to determine the impact of various market scenarios on our financial and capital position. See MCT monitoring discussion in Section 11 – *Capital management*.

To mitigate these risks, our investment policies set forth limits for each type of investment and compliance with the policies is closely monitored by the Investment Risk Management Committee. We manage market risk through asset class and economic sector diversification and, in some cases, the use of derivatives. We also monitor and review the duration of our fixed-income securities and our 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 we are exposed to some foreign exchange risks arising from fixed-income securities denominated in U.S. dollars, the general policy is to minimize foreign currency exposure. We mitigate foreign exchange price risk or cash flow risk by buying or selling successive monthly foreign currency forward contracts.

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. Our credit risk exposure is concentrated primarily in our debt portfolios, preferred share portfolios, over the counter derivatives and, to a lesser extent, in our premium receivables, reinsurance recoverables and structured settlements agreements entered into with various life insurance companies.

Our 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 25 and 26 for more details on the breakdown of credit quality of fixed-income securities and preferred shares. In addition, we set 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. Our investments could be sensitive to changing conditions in specific geographic regions or specific industries. We have a significant concentration of investments in the financial sector and in Canada. We closely monitor this risk concentration and we hedge some of the risk as we deem necessary. See Table 24 for more details on the breakdown of investments by economic sector. See Table 27 for more details on the breakdown of investments by geographic region.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 us. 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, we 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.

We subject our derivative-related credit risk to the same credit approval, limit and monitoring standards that we use 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 monthly review by the Operational 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 our financial obligations toward the counterparty to such an agreement can be set off against obligations such counterparty has toward us. We use 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 our agreements with some counterparties provide us 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.

We enter into annuity agreements with various Canadian life insurance companies, which have credit ratings of at least 'A-' or higher, to provide for fixed and recurring payments to claimants. Under such arrangements, we no longer record the liability in our Consolidated balance sheet as the liability to the claimants is substantially discharged, although we remain exposed to the credit risk that life insurers may fail to fulfill their obligations.

Use of derivatives

We use derivatives principally to mitigate certain of the above mentioned risks. Our use of derivatives exposes us 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. We monitor the effectiveness of our hedges on a regular basis.

Credit downgrade risk

Independent third party rating agencies assess our ability to honour our financial obligations (the "issuer credit rating") and our 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 our ability to raise capital or may result in an increase in the cost of raising capital with negative implications for shareholders and other stakeholders.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Liquidity risk

Liquidity risk is the risk that we will encounter difficulty in raising funds to meet obligations associated with financial liabilities. To manage our cash flow requirements, we maintain a portion of our investments in liquid securities.

Our 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 our operational requirements. A large portion of the investments are held in highly liquid federal and provincial government debt to protect against any unanticipated large cash requirements. We also have an unsecured committed credit facility.

We have issued term notes to finance acquisitions and for general corporate purposes. To manage liquidity risk, we have 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 we have issued.

Strategic risk

Distribution risk

Distribution risk is the risk related to the distribution of our 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 our 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 our 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 we issue loans or take equity participation in certain brokers and by doing so, we expose ourselves 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 we generally receive guarantees and use standard agreements which contain general security and oversight clauses. The Board of Directors participates in this oversight process by reviewing these loan and equity arrangements annually. For different 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.

We have established and maintain close relationships with our independent distributors by providing technology and training to help strengthen their market position. We closely monitor pricing gaps between our various channels and manage the different channels under different brand names including BrokerLink, our wholly owned broker network.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 taxing authorities regarding our tax liabilities and tax assets; and
- disputes relating to certain businesses acquired or disposed of by us.

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

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

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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 our defined benefit pension plans. Consequently, this could impact our 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. We are required to submit regular reports to the regulatory authorities regarding our solvency, and publish our solvency ratio every quarter. The minimum solvency ratio that we targeted is 170%, which is higher than the regulatory MCT requirement of 150%. The appointed actuary must present an annual report to the Risk Management Committee and the Enterprise Risk Committee on our current and future solvency and mitigating measures. In 2011, we adopted a capital management policy. The policy contains guidelines to help ensure that we maintain adequate capital to withstand adverse event scenarios and has documented procedures to take corrective actions 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 our disclosure practices and procedures, its role includes maintaining awareness and understanding of corporate disclosure rules and guidelines, educating and informing employees about our disclosure practices, determining whether corporate developments constitute material information and reviewing and approving all our material disclosure releases or statements. In addition, the Enterprise Risk Committee monitors our operations to identify situations that can negatively affect our reputation. If necessary, the Enterprise Risk Committee approves policies and implements procedures to mitigate reputation risk.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

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 our 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, we follow a specific framework that is composed of different steps including identification, assessment, response, and monitoring.

For early detection of and clear insight into our 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 assessments of our critical functions. It also monitors and measures our risks on an ongoing basis through key risk indicators which enable management to proactively initiate effective actions. We have 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. In 2013, we created an Operational Risk Committee to support the Enterprise Risk Committee in the oversight and management of operational risk.

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 we 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.

Information security risks for financial institutions have increased in recent years. Criminal organizations, hackers, and other external actors have become more active and better equipped to attack even robust systems and networks. We and the third parties that provide services to us may be the subject of information security breaches. Such incidents could result in financial loss, government and regulatory action, and reputational damage.

To ensure the security and the resilience of our systems, the safeguard of our confidential information and the integrity of our information and databases, various dedicated teams plan, test and execute our continuity and security plans, including threat and vulnerability assessments and appropriate mitigation actions. 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, 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 our 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 organization and to the type of events we may have to manage.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

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.

We have 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.

12.7 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 per typical practice and regulatory guidelines. Under such programs, management considers that in order for a contract to reduce exposure to risk, it must be structured to ensure that the reinsurer assumes significant insurance risk related to the underlying reinsured policies and it is reasonably possible that the reinsurer may realize a significant loss from the reinsurance. Furthermore, the reinsurance treaties call for timely reimbursement of ceded losses.

In addition, we have minimum rating requirements for our 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 financial analysis performed by our specialized reinsurance brokers and other qualitative information are also considered in the selection of our reinsurers. The treaties have special termination clauses and a security review clause allowing us 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 our 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 us.

In line with industry practice, our reinsurance recoverable with licensed Canadian reinsurers (\$357 million as at December 31, 2013, \$240 million as at December 31, 2012) 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 unregistered reinsurers (\$149 million as at December 31, 2013, \$80 million as at December 31, 2012) are secured with cash, letters of credit and/or assets held in trust accounts or under security agreements of \$238 million as at December 31, 2013 (\$173 million as at December 31, 2012).

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.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Table 41 - Reinsurance net retention and coverage limits by nature of risk

	January 1, 2014	December 31, 2013
Single risk events¹		
Retentions:		
On property policies	7.5	5
On liability policies	2 - 10	2 - 10
Multi-risk events and catastrophes²		
Retention	100 ³	100 ³
Coverage limits	3,250	3,300

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

² Excludes a reinsurance treaty in place for a specific portfolio in British Columbia.

³ We retain participations averaging 8% as at January 1, 2014 (December 31, 2013 - 4%) on reinsurance layers between the retention and the coverage limits.

Section 13 – Off-balance sheet arrangements

13.1 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 Consolidated financial statements, with a fair value of \$1.6 billion as at December 31, 2013 (\$2.2 billion as at December 31, 2012). 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 \$1.7 billion as at December 31, 2013 (\$2.3 billion as at December 31, 2012).

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Section 14 – Accounting and disclosure matters

14.1 New accounting standards effective January 1, 2013

Effective January 1, 2013, we adopted the following new accounting standards:

Employee benefits

Under the amended version of IAS 19 – *Employee benefits* (“IAS 19”), the asset return component of the pension expense is computed using the discount rate used to measure the defined benefit obligation at year-end rather than the expected return on plan assets, and actuarial gains and losses are recognized in OCI as the option to defer the recognition of actuarial gains and losses, formerly known as the “corridor method,” is no longer available. We applied the amendments retrospectively, in accordance with IAS 19.

The use of the discount rate in calculating the asset return results in an increase in employee future benefit expense recognized in Net income and a corresponding decrease in OCI, with no overall change in Total comprehensive income. We continue to manage our pension asset investment portfolio with a target asset return based on a target asset allocation. The discount rate-based computation of the asset return component is not reflective of our internal investment management expertise and management of our pension investment asset portfolio. We continue to measure NOI using a pension expense based on the expected return on plan assets to better reflect our operating performance. As a result, the adoption of the new standard has no impact on NOI and related measures. Any difference between the expected return on pension assets and the return based on the discount rate is treated as a non-operating item. Comparative figures have been restated accordingly.

As actuarial gains and losses were already recognized in OCI, the adoption of the amended version of IAS 19 did not result in any change on our opening Consolidated balance sheet as at January 1, 2012, which is therefore not presented.

2012 impact

Retroactive adjustments to the Consolidated statements of comprehensive income, as well as the impact on our key performance measures for the quarter and year ended December 31, 2012 are as follows:

Table 42 - Impact of the adoption of IAS 19

	Q4-2012			Full year 2012		
	Published	Impact	Revised	Published	Impact	Revised
Net income	181	(4)	177	587	(16)	571
OCI	41	4	45	(26)	16	(10)
Total comprehensive income	222	-	222	561	-	561
NOI	194	-	194	675	-	675
Per share measures, basic and diluted (in dollars)						
EPS	1.32	(0.03)	1.29	4.33	(0.13)	4.20
AEPS	1.51	(0.02)	1.49	5.15	(0.13)	5.02
NOIPS	1.42	-	1.42	5.00	-	5.00
ROE for the last 12 months	13.8%	(0.03) pts	13.5%			
AROE for the last 12 months	16.5%	(0.04) pts	16.1%			
OROE for the last 12 months	16.8%	-	16.8%			
Book value per share	33.03	-	33.03			

2013 impact

For the three- and twelve-month periods ended December 31, 2013, the use of the discount rate in calculating the asset return resulted in an increase of \$7 million (\$5 million after tax) and \$27 million (\$20 million after tax), respectively, in employee future benefit expense recognized in Net income and a corresponding decrease in OCI, with no overall change in Total comprehensive income.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Consolidated financial statements

IFRS 10 – *Consolidated financial statements* (“IFRS 10”) replaces IAS 27 – *Consolidated and separate financial statements* and SIC-12 – *Consolidation – special purpose entities*. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. The adoption of IFRS 10 did not result in any change in our scope of consolidation and on our consolidated financial statements.

Joint arrangements

IFRS 11 – *Joint arrangements* (“IFRS 11”) replaces IAS 31 – *Interest in joint ventures* and SIC-13 – *Jointly controlled entities – non-monetary contributions by venturers*. IFRS 11 is to be applied when the entity is party to a joint arrangement, whereby two or more parties have joint control. As per IFRS 11, a joint arrangement is either a joint operation (line-by-line accounting of underlying assets and liabilities) or a joint venture (equity method of accounting). The adoption of IFRS 11 did not result in any change in the status and accounting method of our joint arrangements.

Disclosure of interests in other entities

IFRS 12 – *Disclosure of interests in other entities* (“IFRS 12”), 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. Disclosure can mainly be found in Note 2 – *Basis of presentation* and Note 12 – *Investments in associates and joint ventures* to our accompanying Consolidated financial statements, and is similar to prior years.

Fair value measurement

IFRS 13 – *Fair value measurement* (“IFRS 13”) regroups all the guidance related to fair value measurement of assets and liabilities. Fair value is defined 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. In adopting IFRS 13, we reviewed our fair value measurement methods, which remained unchanged. See Note 7 – *Fair value measurement* to the accompanying Consolidated financial statements for further details.

14.2 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 number of claims 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 the uncertainties involved.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

Valuation of pension benefit obligation

The cost of defined benefit plans and the present value of the defined benefit obligation are determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, 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, the 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 22.6 – *Assumptions used* to the accompanying 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 14 – *Goodwill and intangible assets* to the accompanying Consolidated financial statements.

Financial assets

We determine, at each balance sheet date, whether there is objective evidence that financial assets, other than those classified or designated as at FVTPL, are impaired. Considerations which form the basis of these objective evidence judgments include a significant or prolonged decline in fair value, a loss event that has occurred which has impaired the expected cash flows, as well as other considerations such as liquidity risk and credit risk.

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. The value of the option liability has 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 the 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 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 recognized in income. The detail on assets acquired and liabilities assumed is presented in Note 23 – *Business combination* to the accompanying Consolidated financial statements.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

14.3 Financial instruments

An important portion of our 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 premium 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 12.6 – *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 primarily used 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;
- Options are used to modify our exposure to interest rate risk; and
- 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 fair value or amortized cost depending on the classification of the financial instruments. Financial instruments classified as 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 7 – *Fair value measurement* to the accompanying Consolidated financial statements.

Where the fair values of financial assets and financial liabilities reported on the 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 4 – *Summary of significant accounting policies*, Note 6 – *Derivative financial instruments* and Note 7 – *Fair value measurement* to the accompanying Consolidated financial statements for details on the classification and measurement of financial instruments.

Intact Financial Corporation

Management's Discussion and Analysis for the year ended December 31, 2013

(in millions of dollars, except as otherwise noted)

14.4 Standards issued but not yet effective

Financial instruments

IFRS 9 – *Financial instruments* (“IFRS 9”) is a three-part standard that will replace IAS 39 – *Financial instruments: Recognition and measurement* (“IAS 39”). The new standard will reduce complexity by replacing the many different rules in IAS 39. Two out of the three parts of this standard have been issued, namely Classification and measurement and Hedge accounting described hereafter. The effective date of the standard is to be determined when the entire IFRS 9 will be closer to completion. We are currently evaluating the impact that this standard will have on our Consolidated financial statements.

Classification and measurement

In November 2009, the IASB issued the Classification and measurement part of IFRS 9. 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 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 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.
- 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.

Hedge accounting

In November 2013, the IASB issued the Hedge accounting part of IFRS 9. The new model more closely aligns hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures (IAS 39 allows components of financial items to be hedged, but not components of non-financial items). It will enable more entities to apply hedge accounting to reflect their actual risk management activities. The new IFRS 9 model also enables an entity to use information produced internally for risk management purposes as a basis for hedge accounting, compared to IAS 39 which imposes eligibility and compliance based on metrics that are designed solely for accounting purposes.

Investment entities

In January 2013, IFRS 10 – *Consolidated Financial Statements* was amended to include criteria for determining whether an entity is an investment entity and to introduce an exception to the consolidation of subsidiaries for investment entities. IFRS 12 – *Disclosure of Interests in Other Entities* and IAS 27 – *Separate Financial Statements* were also amended accordingly. These amendments are effective for annual periods beginning on or after January 1st, 2014 and are not expected to have an impact on our financial statements.

14.5 Related-party transactions

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

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

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 our insurance products offered in the normal course of business. The terms and conditions of such transactions are essentially the same as those available to our clients and employees. Transactions with post-employment plans comprise the contributions paid to these plans.

Note 25 – *Related-party transactions* to the accompanying Consolidated financial statements provides additional information on related-party transactions.

14.6 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, 2013. 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.

14.7 Internal controls over financial reporting

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

Management has evaluated the design and operating effectiveness of its ICFR (as defined in *Regulation 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings*). The evaluation was based on the criteria established in the "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer of the Company with the assistance of other Company Management and staff to the extent deemed necessary. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the ICFR were appropriately designed and operating effectively, as at December 31, 2013.

In spite of its evaluation, Management does recognize that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives.

No significant changes were made to our ongoing internal controls over financial reporting during 2013 that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

Section 15 – Investor information

15.1 Authorized share capital

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

15.2 Outstanding share data

The following table presents the outstanding share data as at February 4, 2014.

Table 43 – Outstanding share data
(number of shares)

Common shares	131,543,134
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 16 – *Common shares and preferred shares* to the accompanying Consolidated financial statements for additional information.

15.3 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, 2013.

Table 44 – Dividends declared per share
(in dollars)

Common shares	1.76
Class A	
Series 1 Preferred shares	1.05
Series 3 Preferred shares	1.05

On February 4, 2014, the Board of Directors increased the quarterly dividend by 9%, or four cents, to 48 cents per common share on our outstanding common shares. The decision reflected the strength of our financial position, the quality of our ongoing operating earnings, and our objective to continue to create value for shareholders. This is the ninth consecutive year we have increased our dividend.

15.4 NCIB program

During the year ended December 31, 2013, 1.8 million common shares had been repurchased for cancellation under the NCIB at an average price of \$59.37 per common share for a total consideration of \$106 million. No common shares were repurchased for cancellation under the NCIB during the year ended December 31, 2012. For further details, please see Note 16 – *Common shares and preferred shares* of the accompanying Consolidated financial statements.

Shareholders may obtain a copy of the notice submitted to the Toronto Stock Exchange (TSX) with respect to the NCIB, at no cost, by contacting the Investor Relations Department of the Company by telephone toll-free at 1-866-778-0774 ((416) 941-5336 outside North America) or by email at ir@intact.net.

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

15.5 Long-term incentive plans

The following table shows the outstanding units and fair value for each of the performance cycles as at December 31, 2013.

Table 45 – Outstanding units and fair value by performance cycle

Performance cycles	Number of units	Weighted-average fair value at grant date (in \$)	Amount (in millions of \$)
2011-2013	275,770	48.06	13
2012-2014	255,829	57.75	15
2013-2015	208,190	62.08	13
Total	739,789	55.36	

Refer to Note 18 – *Share-based payments* to the accompanying Consolidated financial statements for additional details.

15.6 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, 2014	May 7, 2014
Second quarter results, for the period ending June 30, 2014	July 30, 2014
Third quarter results, for the period ending September 30, 2014	November 5, 2014
Year-end results, for the period ending December 31, 2014	February 4, 2015

Section 16 – Selected annual and quarterly information

16.1 Selected annual information

The following table presents selected annual information for the years ended December 31.

Table 46 – Selected annual information

	2013	2012	2011
Total revenues	7,434	7,127	5,532
Underwriting income	142	451	273
Net income from continuing operations	431	571	457
Net income attributable to shareholders	431	571	465
EPS from continuing operations, basic and diluted (in dollars)	3.10	4.20	3.89
EPS, basic and diluted (in dollars)	3.10	4.20	3.96
Cash dividends declared per share (in dollars)			
Common shares	1.76	1.60	1.48
Class A			
Series 1 Preferred Shares	1.05	1.05	0.49
Series 3 Preferred Shares	1.05	1.05	0.39

Intact Financial Corporation
Management's Discussion and Analysis for the year ended December 31, 2013
(in millions of dollars, except as otherwise noted)

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

Table 47 – Selected annual information

As at December 31	2013	2012	2011
Investments	12,261	12,959	11,828
Total assets	19,774	19,813	19,753
Debt outstanding	1,143	1,143	1,293
Shareholders' equity	4,954	4,893	4,341

16.2 Selected quarterly information

Table 48 – Selected quarterly information

	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Written insured risks (in thousands)	1,589	1,899	2,165	1,462	1,543	1,794	2,018	1,374
DPW	1,702	1,911	2,182	1,524	1,690	1,798	1,977	1,403
Total revenues	1,897	1,908	1,769	1,860	1,877	1,791	1,723	1,736
Net premiums earned	1,804	1,784	1,723	1,703	1,742	1,640	1,599	1,590
Current year catastrophes	71	261	136	18	16	150	62	17
Favourable prior year claims development	(66)	(103)	(95)	(110)	(85)	(70)	(83)	(134)
Underwriting income	67	(50)	42	83	138	67	123	123
Combined ratio	96.3%	102.8%	97.5%	95.1%	92.1%	95.9%	92.3%	92.3%
Net investment income	104	104	102	96	102	92	95	100
NOI	143	59	123	175	194	122	180	179
Net income attributable to shareholders	107	47	103	174	177	92	129	173
Per share measures, basic and diluted (in dollars)								
NOIPS	1.05	0.41	0.89	1.27	1.42	0.89	1.35	1.34
EPS	0.77	0.32	0.73	1.27	1.29	0.67	0.95	1.30

See also the discussion on seasonality of the business in Section 7 – *Business developments and operating environment*.



Intact Financial Corporation

Consolidated financial statements

For the year ended December 31, 2013

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 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, as well as the preparation and presentation of financial information.

The Audit 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 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 his results to management and the Audit Committee.

The Office of the Superintendent of Financial Institutions Canada for the federally regulated property and casualty ("P&C") subsidiaries and l'Autorité des marchés financiers for the Québec regulated P&C subsidiaries 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 Committee to discuss the results of their audit, financial reporting and related matters. The Independent Auditors' Report to shareholders appears on the following page.

February 4, 2014



Charles Brindamour
Chief Executive Officer



Mark A. Tullis
Executive Vice President Governance and
Capital Management



Louis Marcotte
Senior Vice President and
Chief Financial Officer

INDEPENDENT AUDITORS' REPORT

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, 2013 and 2012, and the consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the years ended December 31, 2013 and 2012, 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, 2013 and 2012 and its financial performance and its cash flows for the years ended December 31, 2013 and 2012 in accordance with International Financial Reporting Standards.

Ernst & Young LLP¹

Montréal, Canada
February 4, 2014

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



Intact Financial Corporation
Consolidated financial statements
For the year ended December 31, 2013

Table of contents

Consolidated balance sheets.....	2
Consolidated statements of comprehensive income.....	3
Consolidated statements of changes in shareholders' equity.....	4
Consolidated statements of cash flows.....	5

Notes to the consolidated financial statements

Note 1 – Status of the Company.....	6
Note 2 – Basis of presentation.....	6
Note 3 – Adoption of new accounting standards	7
Note 4 – Summary of significant accounting policies.....	8
Note 5 – Financial instruments	20
Note 6 – Derivative financial instruments	24
Note 7 – Fair value measurement	26
Note 8 – Financial risk	30
Note 9 – Insurance risk.....	37
Note 10 – Claims liabilities and unearned premiums.....	41
Note 11 – Other assets and other liabilities	45
Note 12 – Investments in associates and joint ventures	46
Note 13 – Property and equipment.....	47
Note 14 – Goodwill and intangible assets.....	48
Note 15 – Debt outstanding.....	49
Note 16 – Common shares and preferred shares.....	51
Note 17 – Capital management.....	52
Note 18 – Share-based payments	53
Note 19 – Earnings per share.....	54
Note 20 – Revenue.....	55
Note 21 – Income taxes.....	55
Note 22 – Employee future benefits	57
Note 23 – Business combination	63
Note 24 – Integration and restructuring costs.....	64
Note 25 – Related-party transactions	64
Note 26 – Additional information on the Consolidated statements of cash flows.....	66
Note 27 – Contingencies and commitments	66
Note 28 – Disclosures on rate regulation.....	67

Intact Financial Corporation

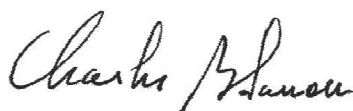
Consolidated balance sheets

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

As at December 31,	Note	2013	2012
Assets			
Investments	5	\$ 99	\$ 172
Cash and cash equivalents		7,909	8,757
Debt securities		1,190	1,263
Preferred shares		2,644	2,376
Common shares		419	391
Loans		12,261	12,959
Investments		64	66
Accrued investment income		2,764	2,670
Premium receivables		505	320
Reinsurance assets	10	343	105
Income taxes receivable		56	129
Deferred tax assets	21	718	705
Deferred acquisition costs		581	412
Other assets	11	255	266
Investments in associates and joint ventures	12	110	105
Property and equipment	13	1,164	1,153
Intangible assets	14	953	923
Goodwill	14	19,774	19,813
Total assets		\$ 19,774	\$ 19,813
Liabilities			
Claims liabilities	10	\$ 7,996	\$ 7,656
Unearned premiums	10	4,125	4,046
Financial liabilities related to investments	5	234	486
Income taxes payable		8	35
Deferred tax liabilities	21	60	140
Other liabilities	11	1,254	1,414
Debt outstanding	15	1,143	1,143
		14,820	14,920
Shareholders' equity			
Common shares	16	2,090	2,118
Preferred shares	16	489	489
Contributed surplus		116	121
Retained earnings		2,147	1,982
Accumulated other comprehensive income		112	183
		4,954	4,893
Total liabilities and shareholders' equity		\$ 19,774	\$ 19,813

See accompanying notes to the Consolidated financial statements.

On behalf of the Board:



Charles Brindamour
Director



Eileen Mercier
Director

Intact Financial Corporation
Consolidated statements of comprehensive income
(in millions of Canadian dollars, except as otherwise noted)

For the years ended December 31,	Note	2013	2012 ¹
Direct premiums written	20	\$ 7,305	\$ 6,854
Net premiums earned	20	6,972	6,561
Net claims incurred	10	(4,604)	(4,070)
Underwriting expenses		(2,183)	(2,085)
Underwriting results		185	406
Net investment income	5	405	388
Net investment gains (losses)	5	(83)	37
Share of profit from investments in associates and joint ventures	12	26	22
Other revenues		77	88
Other expenses		(46)	(50)
Finance costs		(64)	(60)
Integration and restructuring costs	24	(35)	(108)
Change in fair value of contingent consideration		-	(11)
Income before income taxes		465	712
Income tax expense	21	(34)	(141)
Net income attributable to shareholders		\$ 431	\$ 571
Weighted-average number of common shares, basic and diluted (in millions)	19	132.4	130.8
Earnings per common share, basic and diluted (in dollars)	19	\$ 3.10	\$ 4.20
Dividends paid per common share (in dollars)		\$ 1.76	\$ 1.60
Net income attributable to shareholders		\$ 431	\$ 571
Other comprehensive income (loss)			
Available-for-sale securities:			
Net changes in unrealized gains (losses)		(13)	52
Reclassification to income of net gains		(85)	(87)
Derivatives designated as cash flow hedges:			
Net changes in unrealized gains		1	1
Income tax benefit	21	27	11
Share of other comprehensive loss from investments in associates and joint ventures	12	(1)	-
Items that may be reclassified subsequently to net income attributable to shareholders		(71)	(23)
Net actuarial gains on employee future benefits	22	104	17
Income tax expense	21	(28)	(4)
Items that will not be reclassified subsequently to net income attributable to shareholders		76	13
Other comprehensive income (loss)		5	(10)
Total comprehensive income attributable to shareholders		\$ 436	\$ 561

See accompanying notes to the Consolidated financial statements.

¹ Restated (see Note 3 – Adoption of new accounting standards for details).

Intact Financial Corporation
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, 2013		\$ 2,118	\$ 489	\$ 121	\$ 1,982	\$ 183	\$ 4,893
Net income attributable to shareholders		-	-	-	431	-	431
Other comprehensive income (loss)		-	-	-	76	(71)	5
Total comprehensive income (loss)		-	-	-	507	(71)	436
Common shares repurchased for cancellation	16	(28)	-	-	(78)	-	(106)
Dividends declared on common shares	16	-	-	-	(233)	-	(233)
Dividends declared on preferred shares	16	-	-	-	(21)	-	(21)
Share-based payments	18	-	-	(5)	(10)	-	(15)
Balance as at December 31, 2013		\$ 2,090	\$ 489	\$ 116	\$ 2,147	\$ 112	\$ 4,954
Balance as at January 1, 2012		\$ 1,889	\$ 489	\$ 115	\$ 1,642	\$ 206	\$ 4,341
Net income attributable to shareholders		-	-	-	571	-	571
Other comprehensive income (loss)		-	-	-	13	(23)	(10)
Total comprehensive income (loss)		-	-	-	584	(23)	561
Common shares issued	16	229	-	-	-	-	229
Dividends declared on common shares	16	-	-	-	(210)	-	(210)
Dividends declared on preferred shares	16	-	-	-	(21)	-	(21)
Share-based payments	18	-	-	6	(13)	-	(7)
Balance as at December 31, 2012		\$ 2,118	\$ 489	\$ 121	\$ 1,982	\$ 183	\$ 4,893

See accompanying notes to the Consolidated financial statements.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

Consolidated statements of cash flows

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

For the years ended December 31,	Note	2013	2012
Operating activities			
Income before income taxes		\$ 465	\$ 712
Income tax paid, net		(309)	(117)
Adjustments for non-cash items	26	228	105
Changes in other operating assets and liabilities	26	(352)	(116)
Changes in net claims liabilities	10	153	139
Net cash flows provided by operating activities		185	723
Investing activities			
Business combination, net of cash acquired	23	-	(507)
Proceeds from sale of investments		11,260	12,303
Purchases of investments		(10,962)	(12,538)
Proceeds from sale of discontinued operations		-	300
Purchases of brokerages and books of business, net of sales		(61)	(61)
Purchases of intangibles and property and equipment, net		(98)	(73)
Net cash flows provided by (used in) investing activities		139	(576)
Financing activities			
Proceeds from issuance of debt	15	-	249
Repayment of debt	15	-	(400)
Proceeds from issuance of common shares	16	-	227
Common shares repurchased for share-based payments	18	(37)	(26)
Common shares repurchased for cancellation	16	(106)	-
Dividends paid on common shares	16	(233)	(210)
Dividends paid on preferred shares	16	(21)	(21)
Net cash flows used in financing activities		(397)	(181)
Net decrease in cash and cash equivalents		(73)	(34)
Cash and cash equivalents, beginning of year		172	206
Cash and cash equivalents, end of year	26	\$ 99	\$ 172

See accompanying notes to the Consolidated financial statements.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

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’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., Jevco Insurance Company (“Jevco”) and IB Reinsurance Inc.

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

Note 2 – Basis of presentation

2.1 Statement of compliance

These Consolidated financial statements are prepared in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”). These Consolidated financial statements and the accompanying notes were authorized for issue in accordance with a resolution of the Board of Directors on February 4, 2014.

2.2 Preparation and presentation of financial statements

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

Subsidiaries are entities over which the Company has the power over the relevant activities of the investee and is exposed, or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. This generally involves a shareholding of more than 50% of the voting rights. Associates are entities over which the Company has the power to participate in the decisions over the relevant activities of the investee, but does not have control. Joint ventures are joint arrangements whereby the parties that have joint control of the arrangements have the rights to the net assets of the arrangements. Associates generally involve a shareholding of 20% to 50% of the voting rights, while joint ventures generally involve an equal percentage of participation from each party to the joint arrangement. In some cases, voting rights in themselves are not sufficient to assess power or significant influence over the relevant activities of the investee or the sharing of control in a joint arrangement. In such cases, judgment is applied through the analysis of management agreements, the effectiveness of voting rights, the significance of the benefits to which the Company is exposed and the degree to which the Company can use its power to affect its returns from investees.

All subsidiaries 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. See Note 4.1c) – *Investments in associates and joint ventures* for accounting policy details.

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

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 3 – Adoption of new accounting standards

Effective January 1, 2013, the Company adopted the following new accounting standards:

3.1 Employee benefits

Under the amended version of IAS 19 – *Employee benefits* (“IAS 19”), the asset return component of the pension expense is computed using the discount rate used to measure the defined benefit obligation at year end rather than the expected return on plan assets, and actuarial gains and losses are recognized in other comprehensive income (“OCI”) as the option to defer the recognition of actuarial gains and losses, formerly known as the “corridor method” is no longer available.

The amendments were applied retrospectively by the Company, in accordance with IAS 19. The use of the discount rate in calculating the asset return results in an increase in employee future benefit expense recognized in Net income and a corresponding decrease in OCI, with no overall change in Total comprehensive income. As actuarial gains and losses were already recognized in OCI by the Company, the adoption of the amended version of IAS 19 did not result in any change on the Company’s opening balance sheet as at January 1, 2012, which is therefore not presented.

2012 Impact

Retroactive adjustments to the Consolidated statements of comprehensive income are as follows:

Table 3.1 – Retroactive adjustments

For the year ended December 31, 2012	As published	IAS 19 adjustments	Restated
Net income	587	(16)	571
OCI	(26)	16	(10)
Total comprehensive income	561	-	561
Earnings per common share, basic and diluted (in dollars)	4.33	(0.13)	4.20

2013 Impact

For the year ended December 31, 2013, the use of the discount rate in calculating the asset return resulted in an increase of \$27 million (\$20 million after tax) in employee future benefit expense recognized in Net income and a corresponding decrease in OCI, with no overall change in Total comprehensive income.

3.2 Consolidated financial statements

IFRS 10 – *Consolidated financial statements* (“IFRS 10”) replaces IAS 27 – *Consolidated and separate financial statements* and SIC-12 – *Consolidation – special purpose entities*. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. The adoption of IFRS 10 did not result in any change in the Company’s scope of consolidation and on the Company’s Consolidated financial statements.

3.3 Joint arrangements

IFRS 11 – *Joint arrangements* (“IFRS 11”) replaces IAS 31 – *Interest in joint ventures* and SIC-13 – *Jointly controlled entities – non-monetary contributions by venturers*. IFRS 11 is to be applied when the entity is party to a joint arrangement, whereby two or more parties have joint control. As per IFRS 11, a joint arrangement is either a joint operation (line-by-line accounting of underlying assets and liabilities) or a joint venture (equity method of accounting). The adoption of IFRS 11 did not result in any change in the status and accounting method of the Company’s arrangements.

3.4 Disclosure of interests in other entities

IFRS 12 – *Disclosure of interests in other entities* (“IFRS 12”), 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. Disclosure can mainly be found in Note 2 – *Basis of presentation* and Note 12 – *Investments in associates and joint ventures*, and is similar to prior years.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

3.5 Fair value measurement

IFRS 13 – *Fair value measurement* (“IFRS 13”) regroups all the guidance related to fair value measurement of assets and liabilities. Fair value is defined 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. In adopting IFRS 13, the Company reviewed its fair value measurement methods, which remained unchanged. IFRS 13 also requires new disclosure for both financial and non-financial assets and liabilities, which were integrated in Note 7 – *Fair value measurement*.

Note 4 – Summary of significant accounting policies

4.1 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. They are deferred as Unearned premiums and recognized in Underwriting results 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 recognized on the date 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. The unearned reinsurance commissions are recorded in Other liabilities.

Other commission revenue is recorded on an accrual basis and included in Other revenues.

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 by policyholders (“IBNR”), 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 are 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 aggregate of these margins is referred to as the provision for adverse deviations (PfAD).

Intact Financial Corporation

Notes to the Consolidated financial statements

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

On the Consolidated balance sheets, claims liabilities are reported gross of the reinsurers' share and the reinsurers' share is reported in Reinsurance assets. Changes in claims liabilities and the impact of change in the discount rate are recognized in Net claims incurred. The claims liabilities are considered to be settled when the contract expires, is discharged or 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.

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 for 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 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 FA and RSP insurance it assumes as it does to insurance policies issued by the Company directly to policyholders. In accordance with the Office of the 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 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 to provide for fixed and recurring payments to claimants. When the annuity agreements are non-commutable, non-assignable and non-transferable, the Company is released by the claimant for the settlement of the claim amount. As a result, the liability to its claimants is substantially discharged and the Company removes that liability from its Consolidated balance sheets. However, the Company remains exposed to the credit risk that life insurers may fail to fulfill their obligations. When the annuity agreements are commutable, assignable and transferable, the Company keeps the liability and the corresponding asset on its financial statements. Refer to Note 8 – *Financial risk* for further details about credit risk for structured settlements.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

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 Consolidated statements of comprehensive income based on the classification category.

Table 4.1 – 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 OCI 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 excluding for cash	Reported in Net investment gains (losses) when realized or impaired (except for cash and cash equivalents 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 securities lending operations remain on the balance sheets because the Company has not substantially transferred the risks and rewards related to the lent assets.

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 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.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

Financial instruments

AFS

Instruments classified as AFS include debt and equity securities. Debt securities classified as AFS 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 changes in market conditions. Equity investments classified as AFS are those that 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 so designated 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 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 daily 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 futures, forwards, swaps and options.

Derivative financial instruments are recognized on the 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 in Net investment gains (losses) during the period in which they arise. See Note 6 – *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 financial liabilities classified as at FVTPL.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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.

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 7 – *Fair value measurement*.

Where the fair values of financial assets and financial liabilities reported on the 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 Net investment gains (losses).

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 twelve-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, for an amount equal to the unrealized loss. The impairment loss is reported in Net investment gains (losses). Impairments on equity instruments are not reversed.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

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 to the higher of 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 when applicable. 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 4.2 – 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)	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	Impairment loss removed from OCI and recognized in Net investment gains (losses)	Recognized directly in OCI. Impairment losses are not reversed.
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)	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)	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 are recognized on an accrual basis. Premiums and discounts on fixed income instruments classified as AFS are amortized using the effective interest method. Dividends received, dividends paid and interest income are reported in Net investment income.

Transaction costs associated with financial instruments classified or designated as at FVTPL are recognized in net 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.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated using the exchange rates in effect at the balance sheet date. Non-financial, as well as non-monetary assets and liabilities are translated using the exchange rates in effect on the transaction dates. Revenue and expenses are translated using the exchange rates in effect on the transaction dates. Exchange differences on translation are included in Net investment gains (losses) or OCI in accordance with IFRS.

c) Investments in associates and joint ventures

The Company's investments in associates and joint ventures are initially recorded at the amount of consideration paid, which includes the fair value of tangible assets, intangible assets and goodwill identified on acquisition, plus post-acquisition changes in the Company's share of their net assets. They are subsequently measured using the equity method. The Company's profit from such investments is shown in Share of profit from investments in associates and joint ventures and reflects the after-tax share of the results of operations of the associates and joint ventures. Profits or losses resulting from transactions between the Company and its associates and joint ventures are eliminated to the extent of its interest in the associate and joint venture. The Company determines at each reporting date whether there is any objective evidence that 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 in Integration and restructuring costs as incurred.

When the Company acquires a business, it assesses the financial assets and financial liabilities assumed for appropriate classification and designation in accordance with the contractual term, economic circumstances and relevant 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 recognized in 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 14 – *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.

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 intangible assets 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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

The Company's intangible assets consist of distribution networks, customer relationships and internally developed software. The useful life of each distribution network acquired is assessed as finite or indefinite depending on the nature of the distribution network acquired. The distribution network for which the related cash flows are expected to continue indefinitely is assessed as having an indefinite useful life. The amortization methods and terms of the intangible assets assessed as having finite useful lives are shown below.

Table 4.3 – Amortization of intangible assets

	Method	Term
Distribution network (finite useful life)	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 4.4 – Depreciation of property and equipment

	Method	Rate or term
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 reported in Underwriting expenses.

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 term.

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 recognized on a straight-line basis over the lease term and reported in Underwriting expenses.

h) 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 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 expensed when incurred.

i) Income taxes

Income tax expense (benefit) comprises current and deferred tax. Income tax is recognized in Net income, except to the extent that it relates to items recognized in OCI or directly to equity, where it is recognized in OCI or equity.

Current income tax is based on current year's results of operations, 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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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.

j) Employee future benefits

Pension and post-retirement plans

For the defined benefit pension and other retirement plans, the present value of the defined benefit obligation, net of the fair value of plan assets, is recognized on the balance sheets as an asset, if positive, or as a liability, if negative. The actuarial determination of the defined benefit obligation for pension and other retirement benefits uses the projected unit credit method and management's best estimate assumptions.

Cost recognized in Net income for employee future benefit plans includes:

- service costs, which encompasses current and past service costs (the cost of pension benefits provided in exchange for employees' services rendered during the year or prior years), as well as gains or losses on non-routine settlements; and
- net interest expense, which represents the change in the defined benefit obligation and the plan assets as a result of the passage of time, determined by multiplying the net defined benefit liability (asset) by the discount rate reference to market yields on high quality corporate bonds determined at the beginning of the year.

Re-measurements, comprising the return on plan assets (excluding interest arising from the passage of time), the effect of the asset ceiling, as well as 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 re-measurements are also immediately reclassified to Retained earnings as they will not be reclassified to Net income in subsequent periods.

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 recognized in Net income in the period the absence commences.

k) Share-based payments

The Company has three types of share-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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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 over the vesting period, with a corresponding entry in Contributed surplus. 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 twelve 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 retirement or termination and are settled for cash or shares at that time. 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. When directors elect to receive shares, the Company makes instalments to the plan administrator for the purchase of shares of the Company on behalf of the directors.

l) Current vs 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. 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.

m) Operating segments

The Company's business activities are directed towards P&C insurance operations. These activities are captured within a sole reporting and 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.

4.2 Standards issued but not yet effective

a) Financial instruments

IFRS 9 – *Financial instruments* ("IFRS 9") is a three-part standard that will replace IAS 39 – *Financial instruments: Recognition and measurement* ("IAS 39"). The new standard will reduce complexity by replacing the many different rules in IAS 39. Two out of the three parts of this standard have been issued, namely Classification and measurement and Hedge accounting described hereafter. The effective date of the standard is to be determined when the entire IFRS 9 will be closer to completion. The Company is currently evaluating the impact that this standard will have on its Consolidated financial statements.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

i) Classification and measurement

In November 2009, the IASB issued the Classification and measurement part of IFRS 9. 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 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 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.
- 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.

ii) Hedge accounting

In November 2013, the IASB issued the Hedge accounting part of IFRS 9. The new model more closely aligns hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures (IAS 39 allows components of financial items to be hedged, but not components of non-financial items). It will enable more entities to apply hedge accounting to reflect their actual risk management activities. The new IFRS 9 model also enables an entity to use information produced internally for risk management purposes as a basis for hedge accounting, compared to IAS 39 which imposes eligibility and compliance based on metrics that are designed solely for accounting purposes.

b) Investment entities

In January 2013, IFRS 10 – *Consolidated Financial Statements* was amended to include criteria for determining whether an entity is an investment entity and to introduce an exception to the consolidation of subsidiaries for investment entities. IFRS 12 – *Disclosure of Interests in Other Entities* and IAS 27 – *Separate Financial Statements* were amended accordingly. These amendments are effective for annual periods beginning on or after January 1st, 2014 and are not expected to have an impact on the Company's financial statements.

4.3 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:

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 number of claims 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 the uncertainties involved.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

b) Valuation of pension benefit obligation

The cost of the defined benefit plans and the present value of the defined benefit obligation are determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, 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, the defined benefit obligation is highly sensitive to changes in the assumptions. Assumptions are reviewed at each reporting date. Details of the key assumptions used in the estimates are contained in Note 22.6 – *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 CGUs to which the assets are allocated. The assumptions used in this estimation of the recoverable amount are discussed in Note 14 – *Goodwill and intangible assets*.

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. Considerations which form the basis of these objective evidence judgments include a significant or prolonged decline in fair value, a loss event that has occurred which has impaired the expected cash flows, as well as other considerations such as liquidity and credit risk.

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. The value of the option liability has 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 combination

Upon initial recognition, the acquiree's assets and liabilities have been included in the 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 recognized in income. The detail on assets acquired and liabilities assumed is presented in Note 23 – *Business combination*.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

Note 5 – Financial instruments

5.1 Investments

The following tables summarize the Company's investments.

Table 5.1 – Investments by classification

	AFS	Classified as at FVTPL	Designated as at FVTPL	Cash and cash equivalents, loans and receivables	Total
As at December 31, 2013					
Cash and cash equivalents	-	-	-	99	99
Short-term notes	42	-	-	-	42
Fixed income					
Investment grade					
Government	1,690	-	3,172	-	4,862
Corporate	1,229	-	1,575	-	2,804
Asset-backed	154	-	38	-	192
Non-rated	8	-	1	-	9
Debt securities	3,123	-	4,786	-	7,909
Investment grade					
Retractable	102	-	-	-	102
Fixed-rate perpetual	285	-	-	-	285
Other perpetual	802	-	-	-	802
Non-rated	1	-	-	-	1
Preferred shares	1,190	-	-	-	1,190
Common shares	1,588	153	903	-	2,644
Loans	-	-	-	419	419
	5,901	153	5,689	518	12,261
As at December 31, 2012					
Cash and cash equivalents	-	-	-	172	172
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
Debt securities	4,309	-	4,448	-	8,757
Investment grade					
Retractable	117	-	-	-	117
Fixed-rate perpetual	296	-	-	-	296
Other perpetual	842	-	-	-	842
Non-rated	8	-	-	-	8
Preferred shares	1,263	-	-	-	1,263
Common shares	1,301	405	670	-	2,376
Loans	-	-	-	391	391
	6,873	405	5,118	563	12,959

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Table 5.2 – Carrying value of investments

	FVTPL	Other investments				Total
	instruments	Amortized	Unrealized	Unrealized	Net unrealized	investments
	At fair value	cost	gains	losses	gains (losses)	At carrying value
As at December 31, 2013						
Cash and cash equivalents	-	99	-	-	-	99
Short-term notes	-	42	-	-	-	42
Fixed income						
Investment grade						
Government	3,172	1,694	21	(25)	(4)	4,862
Corporate	1,575	1,218	12	(1)	11	2,804
Asset-backed	38	151	3	-	3	192
Non-rated	1	8	-	-	-	9
Debt securities	4,786	3,113	36	(26)	10	7,909
Investment grade						
Retractable	-	100	2	-	2	102
Fixed-rate perpetual	-	250	38	(3)	35	285
Other perpetual	-	801	21	(20)	1	802
Non-rated	-	1	-	-	-	1
Preferred shares	-	1,152	61	(23)	38	1,190
Common shares	1,056	1,468	153	(33)	120	2,644
Loans	-	419	-	-	-	419
	5,842	6,251	250	(82)	168	12,261
As at December 31, 2012						
Cash and cash equivalents	-	172	-	-	-	172
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
Debt securities	4,448	4,228	82	(1)	81	8,757
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
Preferred shares	-	1,142	133	(12)	121	1,263
Common shares	1,075	1,238	90	(27)	63	2,376
Loans	-	391	-	-	-	391
	5,523	7,171	305	(40)	265	12,959

Intact Financial Corporation

Notes to the Consolidated financial statements

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

As of December 31, 2013, asset-backed securities consist of mortgage-backed securities, auto loan receivables and credit card receivables. These asset-backed securities are 'AAA' rated as at December 31, 2013 and 2012.

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.

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

Table 5.3 – Maturity of investment portfolio

	Less than 1 year	From 1 to 5 years	Over 5 years	No specific maturity	Total
As at December 31, 2013					
Cash and cash equivalents	99	-	-	-	99
Short-term notes	42	-	-	-	42
Fixed-income securities	782	4,128	2,957	-	7,867
Preferred shares	14	70	19	1,087	1,190
Common shares	-	-	-	2,644	2,644
Loans	5	128	281	5	419
	942	4,326	3,257	3,736	12,261
As at December 31, 2012					
Cash and cash equivalents	172	-	-	-	172
Short-term notes	214	-	-	-	214
Fixed-income securities	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
	1,186	4,726	3,527	3,520	12,959

5.2 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. The Company has loaned securities with a fair value of \$1,617 million as at December 31, 2013 (December 31, 2012 – \$2,176 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 amounts to \$1,698 million as at December 31, 2013 (December 31, 2012 – \$2,285 million).

Intact Financial Corporation

Notes to the Consolidated financial statements

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

5.3 Equities sold short

Among the Company's various investment strategies is a market neutral equity investment strategy, which consists of having both long and short equity positions.

Table 5.4 – Long and short positions

	2013		2012	
	Fair value	Debt securities pledged as collateral	Fair value	Debt securities pledged as collateral
As at December 31,				
Long positions	-	-	300	-
Short positions	-	-	(301)	308

5.4 Financial liabilities related to investments

Table 5.5 – Financial liabilities related to investments

As at December 31,	2013	2012
Net asset value attributable to third party unit holders	151	105
Embedded derivatives (Note 6.3)	48	68
Accounts payable to investment brokers on unsettled trades	18	5
Derivative financial liabilities (Table 6.1)	17	7
Equities sold short positions (Table 5.4)	-	301
	234	486

5.5 Investment results

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

Table 5.6 – Net investment income

For the years ended December 31,	2013	2012
Interest income from:		
Financial instruments at FVTPL	158	147
AFS financial instruments	94	106
Loans and receivables	22	22
Interest income	274	275
Dividend income (expense) from:		
AFS financial instruments	120	111
Financial instruments at FVTPL, net	54	41
Equities sold short	(9)	(10)
Long-term investments, at cost	3	2
Dividend income	168	144
Expenses	(37)	(31)
	405	388

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

The following table provides additional details about the items reported in Net investment gains (losses).

Table 5.7 – Net investment gains (losses)

For the years ended December 31,	2013	2012
Net realized gains (losses) from:		
Derivative financial instruments	(211)	(20)
AFS financial instruments	164	127
Financial instruments designated as at FVTPL	11	(48)
Financial instruments classified as at FVTPL	11	21
Embedded derivatives	13	(11)
Impairment losses from:		
Common shares	(57)	(40)
Preferred shares	(22)	(2)
Impairment reversal – debt securities	7	-
Other net gains	1	10
	(83)	37

Note 6 – Derivative financial instruments

6.1 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 futures exchanges.

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

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

The Company uses forwards 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.

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, either to 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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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.

6.2 Fair value and notional amounts of derivatives

The following table shows the fair values and the notional amounts of derivatives by term to maturity and nature of risk. Positive fair values are reported in Financial assets related to investments and negative fair values are reported in Financial liabilities related to investments.

Table 6.1 – Fair values and notional amounts of derivatives (held for non-trading purposes) by term to maturity and nature of risk

	Fair value		Notional amount			Total
	Positive	Negative	Less than 1 year	From 1 to 5 years	Over 5 years	
As at December 31, 2013						
Foreign currency contracts						
Forwards	-	-	508	-	-	508
Interest rate contracts						
Futures	-	-	1,370	-	-	1,370
Swaps	1	-	-	130	-	130
Equity contracts						
Total return swaps	-	17	617	286	-	903
Futures	-	-	150	-	-	150
Options	-	-	4	4	-	8
Inflation contracts						
Options	-	-	69	144	24	237
	1	17				
As at December 31, 2012						
Foreign currency contracts						
Forwards	-	-	31	-	-	31
Interest rate contracts						
Futures	-	-	117	-	-	117
Swaps	2	-	-	130	-	130
Equity contracts						
Total return swaps	-	6	671	-	-	671
Options	-	-	2	7	-	9
Credit contracts						
Credit default swaps	-	1	-	249	-	249
Inflation contracts						
Options	-	-	36	164	53	253
	2	7				

6.3 Embedded derivatives

An embedded derivative is a component of an hybrid (combined) instrument that also includes a non-derivative host contract. Some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified financial variable. The fair value of embedded derivatives amounted to \$48 million as at December 31, 2013 (December 31, 2012 – \$68 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 fair value of these perpetual preferred shares which amounted to \$1,040 million as at December 31, 2013 (December 31, 2012 – \$1,069 million). Embedded derivatives are reported in Financial liabilities related to investments.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 7 – Fair value measurement

7.1 Determination of fair value and fair value hierarchy

In accordance with IFRS 13, 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 fair value are observable, either directly or indirectly; and
- Level 3: valuation techniques which use inputs which have a significant effect on the fair value that are not based on observable market data.

a) Level 1

A financial instrument is regarded as quoted in an active market if quoted prices for that financial instrument are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. When an 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. This is the case for most equity instruments and exchange-traded derivative instruments, unless they have stale prices, have ceased trading, are delisted, or are subjected to any other similar event. Investments in mutual funds are categorized as Level 1 instruments as their underlying assets are all traded on active markets. Debt securities for which the prices reflect recent transactions (unadjusted prices) are categorized as Level 1 or Level 2 instruments depending on the market trading volume statistics of the last month for each reporting period.

b) Level 2

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 financial instruments comprise some debt securities such as government bonds, corporate bonds and asset-backed securities which are not considered as actively traded or for which fair values are based on valuation techniques. Inputs used in their valuation include:

- prevailing market rates for bonds 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.

Over-the-counter derivatives are categorized as Level 2 instruments as their valuations are based on models with significant observable inputs, such as equity prices, interest rates, or foreign exchange rates, and reflect the estimated amounts that the Company would receive or might have to pay to terminate the contracts as at the reporting date. For greater certainty, the Company compares the values of its over-the-counter derivatives with those of its counterparties on a systematic basis.

For the Term notes issued by the Company, the valuation data from a benchmark firm is used.

c) Level 3

In limited circumstances, the Company uses input parameters that are not based on observable market data. 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 for the same instrument nor based on available market data.

Level 3 instruments include 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. To determine the fair value of embedded derivatives, the Company uses a valuation technique that relies predominantly on the implied volatility of the underlying preferred shares, which is an unobservable parameter that is calculated using an internally developed valuation model.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Loans are also categorized as Level 3 instruments. They are measured using a valuation technique based on the income approach. The future inflows of principal and interest are discounted using a pre-tax risk-free rate from the Government of Canada bonds curve plus a risk premium that is based on the credit risk to which the Company would be exposed from the borrowers. The Company ensures that the discount rate is consistent with borrowing rates on similar loans issued by financial institutions.

7.2 Categorization of fair values

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

Table 7.1 – Fair value hierarchy of financial assets and financial liabilities measured at fair value

	Level 1	Level 2	Level 3	Total
As at December 31, 2013				
Short-term notes	42	-	-	42
Fixed income				
Investment grade				
Government	3,472	1,390	-	4,862
Corporate	710	2,094	-	2,804
Asset-backed	-	192	-	192
Non-rated	-	9	-	9
Debt securities	4,224	3,685	-	7,909
Preferred shares	1,142	-	48	1,190
Common shares	2,644	-	-	2,644
Derivative financial assets	-	1	-	1
Financial assets measured at fair value	8,010	3,686	48	11,744
Derivative financial liabilities	-	17	48	65
Net asset value attributable to third party unit holders	151	-	-	151
Financial liabilities measured at fair value	151	17	48	216
As at December 31, 2012				
Short-term notes	214	-	-	214
Fixed income				
Investment grade				
Government	4,224	1,409	-	5,633
Corporate	371	2,249	-	2,620
Asset-backed	32	244	-	276
Non-rated	-	14	-	14
Debt securities	4,841	3,916	-	8,757
Preferred shares	1,195	-	68	1,263
Common shares	2,376	-	-	2,376
Derivative financial assets	-	2	-	2
Financial assets measured at fair value	8,412	3,918	68	12,398
Derivative financial liabilities	-	7	68	75
Net asset value attributable to third party unit holders	105	-	-	105
Equities sold short positions	301	-	-	301
Financial liabilities measured at fair value	406	7	68	481

Intact Financial Corporation

Notes to the Consolidated financial statements

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

In 2013, the Company elected to increase the market trading volume threshold for categorizing debt securities traded in an active market as Level 1 instruments. December 31, 2012 figures have been revised to conform to the change in the threshold and resulted in a reclassification of \$2,305 million of debt securities from Level 1 to Level 2.

As at the end of each reporting period, the Company determines if reclassifications have occurred between levels in the hierarchy based on the application of the classification criteria.

Table 7.2 – Reclassifications between Level 1 and Level 2

As at December 31, 2013

Reclassification of debt securities from Level 1 to Level 2	605
Reclassification of debt securities from Level 2 to Level 1	471

The fair value of financial assets and financial liabilities measured at cost, for which fair value is disclosed, is presented below.

Table 7.3 – Fair value hierarchy of financial assets and financial liabilities measured at cost, for which fair value is disclosed

	Level 1	Level 2	Level 3	Total
As at December 31, 2013				
Financial assets				
Cash and cash equivalents	99	-	-	99
Loans	-	-	418	418
Financial liabilities				
Debt outstanding – Term notes	-	1,267	-	1,267
As at December 31, 2012				
Financial assets				
Cash and cash equivalents	172	-	-	172
Loans	-	-	396	396
Financial liabilities				
Debt outstanding – Term notes	-	1,324	-	1,324

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

7.3 Level 3 financial instruments

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

Table 7.4 – Reconciliation of Level 3 financial instruments

	Asset component (preferred shares)	Embedded derivatives (financial liabilities)
Carrying value as at January 1, 2013	68	(68)
Gains reported in Net investment gains (losses)	6	13
Losses reported in OCI	(19)	-
Purchases	13	(13)
Sales	(20)	20
Carrying value as at December 31, 2013	48	(48)
Carrying value as at January 1, 2012	67	(67)
Gains (losses) reported in Net investment gains (losses)	14	(11)
Losses reported in OCI	(3)	-
Purchases	7	(7)
Sales	(17)	17
Carrying value as at December 31, 2012	68	(68)

Changes in the fair value of embedded derivatives are reported in Net investment gains (losses). Changes in fair value of the asset components are reported in OCI when they are unrealized and in Net investment gains (losses) when they are realized.

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 OCI and Net investment gains (losses) would be impacted in the event of a significant change in this non-observable valuation parameter.

Table 7.5 – Sensitivity analysis for embedded derivatives

Increase (decrease)	10% increase in volatility	10% decrease in volatility
As at December 31, 2013		
Asset component		
Preferred shares	8	(8)
OCI	8	(8)
Embedded derivatives		
Financial liabilities related to investments	8	(8)
Net investment gains (losses)	(8)	8
As at December 31, 2012		
Asset component		
Preferred shares	11	(10)
OCI	11	(10)
Embedded derivatives		
Financial liabilities related to investments	11	(10)
Net investment gains (losses)	(11)	10

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 8 – 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 material 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 Risk Management 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 7 – *Fair value measurement* for information on how the Company categorizes its fair value measurements according to a three-level hierarchy.

8.1 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 Operational Investment Committee and the Risk Management Committee regularly monitor 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 analysis involves varying a single factor to assess the impact that this would have on the Company's results and financial condition.

Shocks of 10% and 25% applied to the price of all common shares, net of any equity hedges, combined respectively with shocks of 5% and 10% applied to the price of all preferred shares and related embedded derivatives, including the impact of any impairment, would impact Net income and OCI as follows:

Table 8.1 – Sensitivity analysis for equity price risk

For the years ended December 31,	2013		2012	
	Net income ¹	OCI	Net income ¹	OCI
Price of all common shares:				
10% increase	(16)	152	(14)	141
10% decrease	3	(140)	12	(138)
25% increase	(42)	361	(30)	325
25% decrease	10	(329)	14	(309)

¹ Declines in the price of available for sale perpetual preferred shares is recorded in OCI and would normally lead to a lower valuation for associated embedded derivative liabilities which are recorded as gains in Net income. Conversely, an increase in the price of these preferred shares is also recorded in OCI and would normally lead to a higher valuation for associated embedded derivative liabilities which are recorded as losses in Net income.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

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

- Interest rates and equity prices move independently.
- 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.
- AFS equities in an unrealized loss position, as reflected in Accumulated other comprehensive income ("AOCI") may, at some point in the future, be realized through a sale.

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 Risk Management 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 may use derivatives.

A 100 basis-point variation in interest rates would normally impact Net income and OCI as follows:

Table 8.2 – Sensitivity analysis for interest rate risk

For the years ended December 31,	2013		2012	
	Net income	OCI	Net income	OCI
100 basis-point increase	(21)	(127)	-	(138)
100 basis-point decrease	21	127	-	138

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.
- AFS fixed income securities in an unrealized loss position, as reflected in AOCI may, at some point in the future, be realized through a sale or impairment.

The Company's exposure to the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates is detailed in Table 8.3.

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 in Table 8.3 where applicable. The effective rates shown in the table hereafter 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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Table 8.3 – Contractual repricing and maturity schedule

	Floating rates	Fixed rates			Non-rate sensitive	Total
		Less than 1 year	From 1 to 5 years	Over 5 years		
As at December 31, 2013						
Assets						
Cash and cash equivalents	98	1	-	-	-	99
Effective interest rate		0.91%				
Short-term notes	-	42	-	-	-	42
Effective interest rate		0.41%				
Fixed-income securities	14	780	4,116	2,957	-	7,867
Effective interest rate		1.42%	1.82%	2.87%		
Preferred shares	65	14	807	304	-	1,190
Effective interest rate		5.14%	5.07%	5.23%		
Common shares	-	-	-	-	2,644	2,644
Loans	69	5	106	239	-	419
Effective interest rate		4.04%	5.76%	5.19%		
Reinsurance assets	-	202	201	102	-	505
Effective interest rate		2.57%	2.57%	2.57%		
Other assets	1	-	-	-	7,007	7,008
	247	1,044	5,230	3,602	9,651	19,774
Liabilities and shareholders' equity						
Claims liabilities	-	3,207	3,182	1,607	-	7,996
Effective interest rate		2.57%	2.57%	2.57%		
Debt outstanding	-	-	-	1,143	-	1,143
Effective interest rate				5.45%		
Financial liabilities related to investments	24	-	25	16	169	234
Effective interest rate			5.09%	5.27%		
Other liabilities	-	-	-	-	5,447	5,447
Shareholders' equity	-	-	-	-	4,954	4,954
	24	3,207	3,207	2,766	10,570	19,774
Net long (short) exposure	223	(2,163)	2,023	836	(919)	-
As at December 31, 2012						
Assets						
Cash and cash equivalents	161	11	-	-	-	172
Effective interest rate		0.96%				
Short-term notes	-	214	-	-	-	214
Effective interest rate		0.95%				
Fixed-income securities	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
	277	1,153	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	14	-	37	24	411	486
Effective interest rate			5.11%	4.92%		
Other liabilities	-	-	-	-	5,635	5,635
Shareholders' equity	-	-	-	-	4,893	4,893
	14	3,101	3,160	2,599	10,939	19,813
Net long (short) exposure	263	(1,948)	2,452	1,264	(2,031)	-

Intact Financial Corporation

Notes to the Consolidated financial statements

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

c) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company is not significantly exposed to changes in foreign exchange rates. The Company is exposed to some foreign exchange risks arising from fixed-income securities denominated in U.S. dollars; however, the general policy is to minimize foreign currency exposure. The Company mitigates foreign exchange price risk or cash flow risk by buying or selling successive monthly foreign currency forward contracts.

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

Table 8.4 – Exposure to currency risk

As at December 31,	2013	2012
Net fixed-income securities denominated in U.S. dollars	509	13
Less: U.S. dollar foreign currency forward contracts, notional amount	(508)	(13)
Net currency exposure – U.S. dollar	1	-
Currency exposure – other currencies	-	-
Net currency exposure on foreign-denominated investments	1	-

8.2 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.

8.3 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, over-the-counter derivatives and, to a lesser extent, in its premium receivables, reinsurance recoverables and structured settlements agreements entered into with various life insurance companies.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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. Details on these credit risk exposures, including information on how the Company mitigates these are given in the remaining part of the note.

Table 8.5 – Maximum exposure to credit risk

As at December 31,	2013	2012
Cash equivalents	99	172
Debt securities	7,909	8,757
Preferred shares	1,190	1,263
Loans	419	391
Derivative financial assets (Table 6.1)	1	2
Premium receivables	2,764	2,670
Reinsurance assets	505	320
Other financial assets ¹	794	511
On-balance sheet credit risk exposure	13,681	14,086
Structured settlements	905	676
Off-balance sheet credit risk exposure	905	676

¹ Other financial assets comprise Industry pools receivable, Other receivables and recoverables, Accrued investment income, and Income taxes receivable.

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 with credit rating of at least 'A-' at the inception of the contract, this credit risk is minimal.

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 issuer and by industry (see Table 8.6 hereafter).

The Company receives guarantees for loans.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

d) Counterparty credit risk

Counterparty credit risk arises from over-the-counter derivative and stock borrowing transactions. 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 an over-the-counter 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. On the other hand, credit risk from stock borrowing arises if the counterparty is allowed to re-hypothecate or re-pledge the collateral externally. Credit risk from stock borrowing is the potential for the counterparty to default when the value of the collateral posted is higher than the value of the stock borrowed.

The Company subjects its derivative-related and stock borrowing 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 monthly review by the Operational 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 Company's rigorous collateral management process is another significant credit mitigation tool used to manage counterparty credit risk arising from over-the-counter derivative and stock borrowing transactions. Most of the Company's legal agreements allow for daily collateral movement. Consequently, the Company regularly validate that the collateral that it pledges is not too high and that mark-to-market provisions for derivatives are sufficient. Mark-to-market provisions 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 credit risk exposure was \$96 million as at December 31, 2013 (December 31, 2012 – \$103 million) and is the sum of the replacement cost plus an add-on amount for potential future credit exposure. The risk-weighted amount represents the credit risk equivalent, weighted according to the creditworthiness of the counterparty, as prescribed by OSFI.

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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

The Company is the assigned beneficiary of collateral consisting of cash, security agreements and letters of credit totalling \$238 million as at December 31, 2013 (December 31, 2012 – \$173 million) as guarantees from unregistered reinsurers. This collateral is held in support of policy liabilities of \$149 million as at December 31, 2013 (December 31, 2012 – \$80 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 and in Canada. This risk concentration is closely monitored by the Company and it hedges some of the risk as it deems necessary.

Table 8.6 – Concentrations of credit risk for investments

As at December 31,	2013	2012
By country of issuer		
Canada	93%	97%
U.S.	3%	-
Other	4%	3%
	100%	100%
By industry		
Government	42%	48%
Banks, insurance and diversified financial services	35%	34%
Energy	9%	8%
Other	14%	10%
	100%	100%

8.4 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 for cash inflows and outflows. The Company invests in various types of assets in order to match them to its liabilities. This method maps the obligations towards insured clients to asset life and performance. The Company reviews the status of the matching on a quarterly basis.

To manage its cash flows 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 unencumbered and 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 15.3 – *Credit facilities*.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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

Table 8.7 – 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, 2013					
Claims liabilities	3,207	3,182	1,607	-	7,996
Financial liabilities related to investments	35	-	-	199	234
Income taxes payable	-	8	-	-	8
Debt outstanding	-	-	1,143	-	1,143
Other financial liabilities	829	19	-	301	1,149
	4,071	3,209	2,750	500	10,530
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
	4,073	3,417	2,579	499	10,568

Note 9 – Insurance risk

9.1 Insurance risk and management

The Company principally underwrites automobile, home, as well as commercial P&C 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 twelve-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 approximately 2.4 years as at December 31, 2013 and 2012.

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.

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 hereafter.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

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 P&C 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 9.1 – Concentrations of insurance contracts on the basis of direct premiums written

For the years ended December 31,	2013	2012
By line of business		
Personal Automobile	46%	45%
Personal Property	22%	23%
Commercial P&C	24%	24%
Commercial Automobile	8%	8%
	100%	100%
By province		
Ontario	42%	40%
Quebec	29%	30%
Alberta	17%	17%
British Columbia	6%	7%
Other	6%	6%
	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 Enterprise Risk 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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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 policyholders 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 unregistered reinsurers.

d) Catastrophe risk

Catastrophe risk is the risk of occurrence of a catastrophe defined as any one claim, or group of claims related to a single event such as large fires, hurricanes, earthquakes and hail or wind storms. 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. The placement of ceded reinsurance is almost exclusively on an excess-of-loss basis (per event or per risk) as per typical practice. Ceded reinsurance complies with regulatory guidelines. Retention limits for the excess-of-loss reinsurance vary by product line and territory. The following table shows the Company's reinsurance net retention and coverage limits by nature of risk.

Table 9.2 – Reinsurance net retention and coverage limits by nature of risk

	2013	2012
Single risk events¹		
Retentions:		
On property policies	5	5
On liability policies	2 - 10	2 - 10
Multi-risk events and catastrophes²		
Retention	100 ³	50
Coverage limits	3,300	3,300

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

² Excludes a reinsurance treaty in place for a specific portfolio in British Columbia.

³ The Company retains participations averaging 4% on reinsurance layers between the retention and the coverage limits.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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;
- discount 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 claims liabilities' sensitivity to certain key assumptions is 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. Movements in these assumptions may be non-linear and may be correlated with one another.

Table 9.3 – Sensitivity analysis

Sensitivity factors	Change in assumptions	Impact on Net income
As at December 31, 2013		
Average number of claims (frequency)	+5%	(52)
Average claim cost (severity)	+5%	(259)
Discount rate	+1%	127
As at December 31, 2012		
Average number of claims (frequency)	+5%	(50)
Average claim cost (severity)	+5%	(253)
Discount rate	+1%	129

Intact Financial Corporation

Notes to the Consolidated financial statements

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

Note 10 – Claims liabilities and unearned premiums

10.1 Summary of claims liabilities

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

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

Table 10.1 – Movements in claims liabilities

	Direct	Ceded	Net
As at December 31, 2013			
Balance, beginning of year	7,656	297	7,359
Current year claims	5,395	340	5,055
Unfavourable (favourable) prior year claims development	(371)	5	(376)
Decrease due to changes in discount rate	(77)	(2)	(75)
Total claims incurred	4,947	343	4,604
Claims paid	(4,607)	(156)	(4,451)
Balance, end of year	7,996	484	7,512
As at December 31, 2012			
Balance, beginning of year	6,886	368	6,518
Current year claims	4,511	79	4,432
Favourable prior year claims development	(472)	(93)	(379)
Increase due to changes in discount rate	18	1	17
Total claims incurred	4,057	(13)	4,070
Claims paid	(4,018)	(87)	(3,931)
Business combination (Note 23)	731	29	702
Balance, end of year	7,656	297	7,359

The following table presents claims liabilities by line of business.

Table 10.2 – Claims liabilities by line of business

	Direct	Ceded	Net
As at December 31, 2013			
Automobile	4,353	56	4,297
Property	698	119	579
Personal lines	5,051	175	4,876
Automobile	655	12	643
P&C	2,290	297	1,993
Commercial lines	2,945	309	2,636
	7,996	484	7,512
As at December 31, 2012			
Automobile	4,301	44	4,257
Property	594	42	552
Personal lines	4,895	86	4,809
Automobile	649	18	631
P&C	2,112	193	1,919
Commercial lines	2,761	211	2,550
	7,656	297	7,359

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

10.2 Summary of unearned premiums

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

Table 10.3 – Movements in unearned premiums

	Direct	Ceded	Net
As at December 31, 2013			
Balance, beginning of year	4,046	23	4,023
Premiums written	7,305	252	7,053
Premiums earned	(7,226)	(254)	(6,972)
Balance, end of year	4,125	21	4,104
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 combination (Note 23)	204	2	202
Balance, end of year	4,046	23	4,023

The following table presents unearned premiums by line of business.

Table 10.4 – Unearned premiums by line of business

	Direct	Ceded	Net
As at December 31, 2013			
Automobile	1,972	-	1,972
Property	979	-	979
Personal lines	2,951	-	2,951
Automobile	300	1	299
P&C	874	20	854
Commercial lines	1,174	21	1,153
	4,125	21	4,104
As at December 31, 2012			
Automobile	1,928	1	1,927
Property	961	-	961
Personal lines	2,889	1	2,888
Automobile	294	1	293
P&C	863	21	842
Commercial lines	1,157	22	1,135
	4,046	23	4,023

Intact Financial Corporation

Notes to the Consolidated financial statements

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

10.3 Fair value of claims liabilities

The Company estimates that the fair value of its net claims liabilities approximate their carrying values. There was no premium deficiency as at December 31, 2013 and 2012.

Table 10.5 – Carrying value of claims liabilities

	Direct	Ceded	Net
As at December 31, 2013			
Undiscounted value	7,756	468	7,288
Effect of time value of money using a discount rate of 2.57%	(447)	(15)	(432)
Provision for adverse deviations (PfAD)	687	31	656
	7,996	484	7,512
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 deviations (PfAD)	721	31	690
	7,656	297	7,359

10.4 Net gain (loss) from reinsurance

The net gain (loss) arising from reinsurance ceded included in Underwriting results is detailed as follows:

Table 10.6 – Net gain (loss) from reinsurance

For the years ended December 31,	2013	2012
Ceded earned premiums	(254)	(241)
Ceded claims incurred	343	(13)
Commission earned on ceded reinsurance	21	27
	110	(227)

Intact Financial Corporation

Notes to the Consolidated financial statements

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

10.5 Prior-year claims development

The following tables show the estimates of cumulative incurred claims, including IBNR, for the seven 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 in 2011. The claims development information disclosed is being increased from five years to ten years over the period 2012 – 2016.

Table 10.7 – Prior-year claims development – Direct

	Accident year							2007 & earlier
	Total	2013	2012	2011	2010	2009	2008	
Undiscounted claims liabilities outstanding at end of accident year		2,758	2,419	2,399	2,067	1,864	1,639	4,619
Revised estimates								
One year later		-	2,400	2,290	1,961	1,800	1,643	4,443
Two years later		-	-	2,207	1,939	1,801	1,614	4,370
Three years later		-	-	-	1,901	1,774	1,604	4,291
Four years later		-	-	-	-	1,737	1,584	4,214
Five years later		-	-	-	-	-	1,548	4,044
Six years later		-	-	-	-	-	-	4,046
Current estimate		2,758	2,400	2,207	1,901	1,737	1,548	4,046
Paid claims in subsequent periods								
One year later		-	(918)	(876)	(584)	(599)	(619)	(1,175)
Two years later		-	-	(280)	(297)	(184)	(157)	(570)
Three years later		-	-	-	(241)	(214)	(145)	(481)
Four years later		-	-	-	-	(206)	(170)	(343)
Five years later		-	-	-	-	-	(99)	(328)
Six years later		-	-	-	-	-	-	(355)
Cumulative payment to date		-	(918)	(1,156)	(1,122)	(1,203)	(1,190)	(3,252)
Direct undiscounted claims liabilities Discounting and PfAD	7,756 240	2,758	1,482	1,051	779	534	358	794
Claims liabilities - Direct	7,996							

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Table 10.8 – Prior-year claims development – Net

	Total	Accident year						2007 & earlier
		2013	2012	2011	2010	2009	2008	
Undiscounted claims liabilities outstanding at end of accident year		2,499	2,357	2,299	2,031	1,796	1,624	4,291
Revised estimates								
One year later		-	2,325	2,201	1,916	1,737	1,623	4,134
Two years later		-	-	2,130	1,888	1,736	1,594	4,066
Three years later		-	-	-	1,853	1,712	1,584	3,983
Four years later		-	-	-	-	1,676	1,560	3,908
Five years later		-	-	-	-	-	1,523	3,819
Six years later		-	-	-	-	-	-	3,803
Current estimate		2,499	2,325	2,130	1,853	1,676	1,523	3,803
Paid claims in subsequent periods								
One year later		-	(885)	(827)	(554)	(568)	(607)	(1,137)
Two years later		-	-	(269)	(292)	(177)	(155)	(559)
Three years later		-	-	-	(239)	(211)	(144)	(462)
Four years later		-	-	-	-	(199)	(169)	(334)
Five years later		-	-	-	-	-	(94)	(317)
Six years later		-	-	-	-	-	-	(322)
Cumulative payments to date		-	(885)	(1,096)	(1,085)	(1,155)	(1,169)	(3,131)
Net undiscounted claims liabilities	7,288	2,499	1,440	1,034	768	521	354	672
Discounting and PfAD	224							
Claims liabilities - Net	7,512							

Note 11 – Other assets and other liabilities

11.1 Components of other assets

Table 11.1 – Components of other assets

As at December 31,	2013	2012
Industry pools receivable	221	202
Other receivables and recoverables	166	138
Employee future benefit assets (Note 22)	96	11
Long-term investments, at cost	44	19
Prepays	18	21
Financial assets related to investments	9	3
Other	27	18
	581	412

During 2013, there were no events or changes in circumstances that indicated that the carrying values of long-term investments may not be recoverable.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

11.2 Components of other liabilities

Table 11.2 – Components of other liabilities

As at December 31,	2013	2012
Commissions payable	249	290
Industry pools payable	231	222
Premium and sale taxes payable	176	190
Employee future benefit liabilities (Note 22)	100	160
Restructuring provision (Note 24)	13	30
Contingent consideration	-	11
Other payables	485	511
	1,254	1,414

Note 12 – Investments in associates and joint ventures

Investments in associates and joint ventures are investments in private entities. The following table presents aggregate financial information related to the Corporation's interest in associates and joint ventures, which are not individually material for the Company.

Table 12.1 – Financial information related to interests in associates and joint ventures

	Associates	Joint ventures	Total
As at December 31, 2013			
Share of profit (loss) from investments in associates and joint ventures			
Net income	21	5	26
OCI	-	(1)	(1)
Total comprehensive income	21	4	25
Carrying amount of investments in associates and joint ventures	203	52	255
As at December 31, 2012			
Share of profit from investments in associates and joint ventures			
Net income	17	5	22
OCI	-	-	-
Total comprehensive income	17	5	22
Carrying amount of investments in associates and joint ventures	204	62	266

During 2013, there were no events or changes in circumstances that indicated that the carrying values of these investments may not be recoverable.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 13 – Property and equipment

Table 13.1 – Reconciliation of the carrying value of property and equipment

	Cost	Accumulated depreciation	Carrying value
As at December 31, 2013			
Computer equipment	61	47	14
Furniture and equipment	129	78	51
Leasehold improvements	77	32	45
	267	157	110
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
	236	131	105

Table 13.2 – Reconciliation of movements in property and equipment

	Land and buildings	Computer equipment	Furniture and equipment	Leasehold improvements	Total
As at December 31, 2013					
Carrying value, beginning of year	18	16	39	32	105
Acquisitions	-	8	23	20	51
Transfer to Asset held for sale (Other assets)	(10)	-	-	-	(10)
Depreciation expense	(3)	(10)	(11)	(7)	(31)
Business combination (Note 23)	(5)	-	-	-	(5)
Carrying value, end of year	-	14	51	45	110
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 combination (Note 23)	18	1	2	3	24
Carrying value, end of year	18	16	39	32	105

Intact Financial Corporation

Notes to the Consolidated financial statements

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

Note 14 – Goodwill and intangible assets

14.1 Summary of goodwill and intangible assets

Table 14.1 – Reconciliation of the carrying value of goodwill and intangible assets

	Cost	Accumulated amortization	Carrying value
As at December 31, 2013			
Goodwill	953	-	953
Distribution network – indefinite useful life	820	-	820
Distribution network – finite useful life	85	4	81
Distribution networks - Total	905	4	901
Customer relationships	228	96	132
Internally developed software	300	169	131
Intangible assets	1,433	269	1,164
As at December 31, 2012			
Goodwill	923	-	923
Distribution network – indefinite useful life	820	-	820
Distribution network – finite useful life	85	1	84
Distribution networks	905	1	904
Customer relationships	205	74	131
Internally developed software	270	152	118
Intangible assets	1,380	227	1,153

Table 14.2 – Reconciliation of movements in goodwill and intangible assets

	Goodwill	Intangible assets			Total intangible assets
		Distribution networks Total	Customer relationships	Internally developed software	
As at December 31, 2013					
Carrying value, beginning of year	923	904	131	118	1,153
Acquisitions and costs capitalized	25	-	23	47	70
Business combination (Note 23)	5	-	-	-	-
Amortization expense	-	(3)	(22)	(34)	(59)
Carrying value, end of year	953	901	132	131	1,164
As at December 31, 2012					
Carrying value, beginning of year	794	820	134	114	1,068
Acquisitions and costs capitalized	26	-	20	34	54
Dispositions	(2)	-	(3)	-	(3)
Business combination (Note 23)	105	85	-	-	85
Amortization expense	-	(1)	(20)	(30)	(51)
Carrying value, end of year	923	904	131	118	1,153

Intact Financial Corporation

Notes to the Consolidated financial statements

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

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 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.

14.2 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, 2013. 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% as at June 30, 2013 and 2012, 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 13.0% was used (June 30, 2012 – 13.4%).

The test results indicate that the recoverable amount of the P&C insurance operations CGU exceeds its carrying value. No impairment loss for goodwill or intangible assets has been recognized for the year ended December 31, 2013 or prior.

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 15 – Debt outstanding

15.1 Unsecured medium term notes ("term notes")

Table 15.1 – 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

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 term notes. On September 10, 2012, the Company issued an additional \$50 million principal amount, bringing the total offering to \$250 million.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

15.2 Summary of debt outstanding

The following table presents the summary of debt outstanding.

Table 15.2 – Fair value and carrying value of debt outstanding

As at December 31,	2013		2012	
	Carrying value	Fair value	Carrying value	Fair value
Series 1	249	279	249	289
Series 2	248	301	248	310
Series 3	99	117	99	125
Series 4	298	320	298	335
Series 5	249	250	249	265
	1,143	1,267	1,143	1,324

The term notes are accounted for at amortized cost which equals their carrying value. They 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.

Interest expense on term notes is presented as Finance costs.

15.3 Credit facilities

The Company has a \$300-million four-year unsecured revolving term credit facility maturing on October 26, 2016. This credit facility may be drawn as a prime loan at the prime rate plus a margin or as bankers' acceptances at the bankers' acceptance rate plus a margin. This facility was undrawn as at December 31, 2013 and 2012.

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, 2013 and 2012.

During the year ended December 31, 2012, the Company repaid in full the \$100 million two-year term loan facility, as well as the full \$300 million on the three-year term loan facility. This completed the full repayment of the short-term financing related to the AXA Canada Inc. ("AXA Canada") acquisition.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 16 – Common shares and preferred shares

16.1 Authorized

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

16.2 Issued and outstanding shares

Table 16.1 – Issued and outstanding shares, by classes

	Number of shares	Amount (in millions \$)	Dividends declared per share (amount in \$)
As at December 31, 2013			
Common	131,543,134	2 090	1.76
Series 1 Preferred	10,000,000	244	1.05
Series 3 Preferred	10,000,000	245	1.05
Class A	20,000,000	489	
As at December 31, 2012			
Common	133,333,665	2,118	1.60
Series 1 Preferred	10,000,000	244	1.05
Series 3 Preferred	10,000,000	245	1.05
Class A	20,000,000	489	

Common shares

Table 16.2 – Reconciliation of number of common shares outstanding

As at December 31,	2013 (in shares)	2012 (in shares)
Balance, beginning of year	133,333,665	129,553,665
Shares issued	-	3,780,000
Shares repurchased for cancellation	(1,790,531)	-
Balance, end of year	131,543,134	133,333,665

On September 4, 2012, on the date of the closing of the acquisition of Jevco, 3,780,000 subscription 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 subscription 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.

Class A shares

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

Series 1 Preferred

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 5-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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Series 3 Preferred

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 5-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.

16.3 Normal course issuer bid

On May 13, 2013, the Company commenced a normal course issuer bid ("NCIB") to purchase during the next 12 months ending May 12, 2014 up to 6,666,683 common shares, representing approximately 5% of its issued and outstanding common shares. During the year ended December 31, 2013, 1,790,531 common shares, at an average price of \$59.37 per common share, were repurchased for cancellation for a total consideration of \$106 million (none during the year ended December 31, 2012). Total cost paid, including fees, was first charged to Share capital to the extent of the average carrying value of the common shares repurchased for cancellation and the excess of \$78 million was charged to Retained earnings.

Note 17 – 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 its strong position in the Canadian P&C insurance industry.

The capital is managed on an aggregate 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*. Quebec 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 Minimum Capital Test ("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 it attains its objectives, the Company has established a minimum internal threshold of 170% in its principal subsidiaries, in excess of which, under normal circumstances, the Company will maintain its capital.

The following table presents the capital position of the Company's P&C insurance subsidiaries.

Table 17.1 – Capital position

As at December 31,	2013	2012
Total capital available	3,750	3,764
Total capital required	1,849	1,840
MCT %	203%	205%
Excess capital at 100%	1,901	1,924
Excess capital at 150%	977	1,004
Excess capital at 170%	607	636

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, 2013, 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 thresholds.

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 2013 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.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 18 – Share-based payments

18.1 Long-term incentive plans

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

Table 18.1 – Outstanding units and fair value by performance cycle

Performance cycles	Number of units	Weighted-average fair value at grant date (in \$)	Amount (in millions of \$)
As at December 31, 2013			
2011–2013	275,770	48.06	13
2012–2014	255,829	57.75	15
2013–2015	208,190	62.08	13
	739,789	55.36	
As at December 31, 2012			
2010–2012	447,829	35.06	16
2011–2013	396,820	50.84	20
2012–2014	244,124	57.76	14
	1,088,773	45.90	

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

Table 18.2 – Movements in LTIP share units

As at December 31,	2013 (in units)	2012 (in units)
Outstanding, beginning of year	1,088,773	1,015,691
Awarded	201,188	323,490
Net change in estimate of units outstanding	18,618	162,693
Units settled	(568,790)	(413,101)
Outstanding, end of year	739,789	1,088,773

The amount charged to Underwriting expenses for LTIP was \$18 million for the year ended December 31, 2013 (December 31, 2012 – \$16 million).

During the year ended December 31, 2013, the Company settled LTIP units granted in 2010 that vested through the plan administrator by purchasing common shares on the market and remitting them to the participants. The cumulative cost of the vested units, amounting to \$23 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 \$10 million, net of \$4 million of income taxes, was recorded in Retained earnings.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

During the year ended December 31, 2012, the Company settled LTIP units granted in 2009 that vested through the plan administrator by purchasing common shares on 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.

18.2 Employee share purchase plan

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

Table 18.3 – Movements in restricted common shares

As at December 31,	2013 (in units)	2012 (in units)
Outstanding, beginning of year	141,814	120,317
Awarded	153,322	126,242
Vested or forfeited	(127,253)	(104,745)
Outstanding, end of year	167,883	141,814

The amount charged to Underwriting expenses for the ESPP was \$9 million for the year ended December 31, 2013 (December 31, 2012 – \$7 million).

18.3 Deferred share unit plan

The deferred share units are cash-settled awards for which the provision recorded as at December 31, 2013 is \$5 million (December 31, 2012 – \$4 million). The amount charged to Underwriting expenses was \$1 million for the years ended December 31, 2013 and 2012.

Note 19 – Earnings per share

Earnings per common share were calculated by dividing the net income attributable to common shareholders 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 basic earnings per common share. The net income attributable to common shareholders and the weighted-average number of common shares outstanding at the end of the year are calculated as follows:

Table 19.1 – Earnings per share

For the years ended December 31,	2013	2012¹
Net income attributable to shareholders	431	571
Less: Dividends declared on preferred shares, net of tax	21	21
Net income attributable to common shareholders	410	550
Number of common shares outstanding at the beginning of the year	133,333,365	129,553,665
Adjustment to weighted-average number of common shares for:		
Issued at the date of acquisition of Jevco (3,780,000 shares)	-	1,218,689
Repurchased under the NCIB program (1,790,531 shares)	(965,327)	-
Weighted-average number of common shares outstanding during the year	132,368,038	130,772,354
Earnings per common share – basic and diluted (in dollars)	3.10	4.20

¹ Restated (see Note 3 – Adoption of new accounting standards for details).

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 20 – Revenue

Table 20.1 – Total revenue

For the years ended December 31,	2013	2012
Net premiums earned	6,972	6,561
Interest income (Table 5.6)	274	275
Dividend income (Table 5.6)	168	144
Net investment gains (losses) (Table 5.7)	(83)	37
Share of profit from investments in associates and joint ventures (Table 12.1)	26	22
Other revenues	77	88
	7,434	7,127

Table 20.2 – Premiums written and earned

For the years ended December 31,	2013	2012
Premiums written		
Direct	7,305	6,854
Ceded	(252)	(221)
Net	7,053	6,633
Changes in unearned premiums	(81)	(72)
Net premiums earned	6,972	6,561

Note 21 – Income taxes

21.1 Income tax expense (benefit) recorded in Net income

The following table shows the major components of income tax expense (benefit) recorded in Net income.

Table 21.1 – Composition of income tax expense (benefit) recorded in Net income

For the years ended December 31,	2013	2012
Current year	65	118
Prior year adjustment	(3)	(5)
Benefit arising from a previously unrecognized tax loss or temporary difference	-	(5)
Current tax expense	62	108
Origination and reversal of temporary differences	(28)	33
Deferred tax expense (benefit)	(28)	33
	34	141

21.2 Income tax expense (benefit) recorded in OCI

The following table shows the major components of income tax expense (benefit) recorded in OCI.

Table 21.2 – Composition of income tax expense (benefit) recorded in OCI

For the years ended December 31,	2013	2012
Reclassification to income of net gains on AFS instruments	(21)	(24)
Current tax benefit	(21)	(24)
Net changes in unrealized gains (losses) on AFS instruments	(6)	13
Net actuarial gains on employee future benefits	28	4
Deferred tax expense (benefit)	22	17
	1	(7)

Intact Financial Corporation

Notes to the Consolidated financial statements

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

21.3 Effective income tax rate

The effective income tax rates are different from the combined Canadian federal and provincial income tax rates. The 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 21.3 – Effective income tax rate reconciliation

For the years ended December 31,	2013	2012
Income tax expense calculated at statutory tax rates	26.5%	26.4%
Increase (decrease) in income tax rates resulting from:		
Non-taxable dividend income	(10.0)%	(5.5)%
Tax losses carried back to prior years	(6.7)%	-
Non-taxable income	(2.4)%	(1.5)%
Non-deductible expenses	0.9%	1.6%
Non-taxable portion of capital gains	(0.6)%	(0.1)%
Recovery of tax asset not previously recognized	-	(0.5)%
Other	(0.4)%	(0.6)%
Effective income tax rate	7.3%	19.8%

21.4 Components of deferred tax assets and liabilities

Table 21.4 – Components of deferred tax assets and liabilities

As at December 31,	Consolidated balance sheets		Consolidated statements of comprehensive income	
	2013	2012	2013	2012
Net claims liabilities	94	91	(3)	(11)
Deferred expenses for tax purposes	72	74	(2)	12
Losses available for carry forward	51	29	(22)	(14)
Post-employment benefit plans	2	40	38	39
Other	5	3	(2)	-
Deferred tax assets	224	237	9	26
Intangible assets	156	154	2	16
Deferred income for tax purposes	39	59	(20)	4
Deferred gains and losses on specified debt obligations	18	20	(2)	(2)
Property and equipment	13	15	(2)	6
Investments	2	-	2	-
Deferred tax liabilities	228	248	(20)	24
Reported in:				
Deferred tax assets	56	129		
Deferred tax liabilities	60	140		
Net income			(28)	33
OCI			17	17
Shareholders' equity	(4)	(6)		
Business combination	-	3		

The Company had allowable capital losses of \$34 million as at December 31, 2013 (December 31, 2012 – \$37 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.

The Company had not recognized a deferred tax asset of \$2 million as at December 31, 2013 (December 31, 2012 – \$1 million) for unused non-capital losses. The Company has recognized a deferred tax asset for all other unused non-capital losses as at December 31, 2013 and 2012.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 22 – Employee future benefits

The Company has a number of funded and unfunded defined benefit pension plans that provide benefits to members in the form of a guaranteed level of pension payable for life based on final average earnings and contingent upon certain age and service requirements. As at the date of the latest actuarial valuation, the defined benefit obligation for the pension plans comprises 66% in respect of active members, 28% in respect of pensioners and beneficiaries and 6% in respect of deferred members.

Subject to applicable pension legislation, plans are administered either by the Company or by a pension committee, with assets held in a pension fund that is legally separate from the Company. The assets cannot be used for any purpose other than payment of pension benefits and related administrative fees.

Provincial minimum funding regulations require special payments from the Company to amortize any shortfall of registered plans' assets relative to the cost of settling all accrued benefit entitlements through the purchase of annuities or payment of an equivalent lump sum value. Security in the form of letters of credit is permitted in lieu of those special payments, up to a limit of 15% of defined benefit assets.

Subject to applicable legal requirements, any balance of assets remaining after providing for the accrued benefits of the plan members may be returned to the Company. Pension legislation may require that the Company submit a proposal to the members and beneficiaries regarding the allocation of surplus assets. However, on an ongoing basis, a portion of such surplus may be recoverable by the Company through a reduction in future contributions or through payment of eligible administrative expenses.

The Company also offers employer-paid post-retirement benefit plans providing life insurance and health and dental benefits to a limited number of active employees and retirees and are now closed to new entrants, as well as post-employment benefit plans that provide health and dental coverage to employees on disability. These 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 ("defined benefit plans") is December 31. The latest actuarial valuations for defined benefit plans were performed as at December 31, 2012 or 2011 depending on the plan.

22.1 Funded status

The following table shows the aggregate funded status of the Company's defined benefit plans as well as the net deficit amount reported in Other assets and Other liabilities.

Table 22.1 – Funded status

As at December 31,	Defined benefit plans	
	2013	2012
Present value of defined benefit obligation	(1,423)	(1,506)
Fair value of plan assets (net of reserve against asset)	1,419	1,357
Net defined benefit liability	(4)	(149)
Reported on the Consolidated balance sheets in:		
Other assets	96	11
Other liabilities ¹	(100)	(160)

¹ As at December 31, 2013, the amount reported in Other liabilities is composed of \$68 million relating to pension plans (December 31, 2012 – \$126 million) and \$32 million relating to post-retirement and post-employment benefit plans (December 31, 2012 – \$34 million).

The Company makes contributions to the defined benefit pension plans to secure the benefits. The amount and timing of the Company's contributions are made in accordance with applicable pension and tax legislation and on the advice of an actuary. Under the provisions of the pension plans, members may annually select between three different benefit levels and may be required, depending on the benefit level selected, to make contributions to their plans. The Company must fund the excess of the required funding over the members' contributions.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Employer contributions to its defined benefit plans amounted to \$121 million for the year ended December 31, 2013 (December 31, 2012 – \$210 million, including discretionary pension contributions of \$114 million). Based on the latest projections of the financial position of all its plans, total cash contributions by the Company are expected to be approximately \$60 million in 2014. The contributions will vary depending on the results of the December 31, 2013 actuarial valuations, use of funding relief measures, if any, and decisions taken by the Company to use or not use letters of credit as permitted by legislation. The Company is also expected to meet the cost of eligible administrative expenses through the pension funds.

The present value of the defined benefit obligation is based on the current value of expected benefit payment cash flows to plan members over 60 to 70 years.

22.2 Present value of defined benefit obligation

The movement of the present value of defined benefit obligation is as follows:

Table 22.2 – Movement of the present value of defined benefit obligation

As at December 31,	Defined benefit plans	
	2013	2012
Balance, beginning of year	1,506	1,406
Current service cost	68	60
Past service cost	-	(14)
Interest expense on defined benefit obligation	62	63
Re-measurements recognized in OCI arising from actuarial gains and losses from changes in:		
demographic assumptions	57	(17)
financial assumptions	(226)	45
Employee contributions	14	12
Benefit payments	(58)	(49)
Balance, end of year	1,423	1,506

22.3 Fair value of plan assets

The movement of the fair value of plan assets is as follows:

Table 22.3 – Movement of the fair value of plan assets

As at December 31,	Defined benefit plans	
	2013	2012
Balance, beginning of year	1,357	1,093
Employer contributions	121	210
Employee contributions	14	12
Interest income on plan assets	55	49
Re-measurements recognized in OCI – return on plan assets	(59)	46
Benefit payments	(58)	(49)
Other	(5)	(4)
Balance, end of year	1,425	1,357

Re-measurements on the fair value of plan assets represent the difference between the actual return on plan assets and the interest income credited on plan assets at the rate used to discount the defined benefit obligation. The actual return on pension plan assets for the year ended December 31, 2013 was negative \$4 million (December 31, 2012 – positive \$95 million).

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

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

Table 22.4 – Composition of pension plan assets

As at December 31,	2013		2012	
	Fair value	% of total	Fair value	% of total
Cash and short-term notes	18	1%	134	10%
Fixed income				
Investment grade				
Government	697	49%	572	42%
Corporate	184	13%	136	11%
Asset-backed	3	-	4	-
Debt securities	884	62%	712	53%
Common shares	510	36%	484	36%
Derivative financial instruments	7	1%	21	1%
	1,419	100%	1,351	100%

Plan assets are essentially all quoted on an active market.

22.4 Employee future benefit expense recognized in Net income

The following table details the components of the employee future benefits expense for defined benefit plans recognized in Net income.

Table 22.5 – Employee future benefit expense recognized in Net income

For the years ended December 31,	Defined benefit plans	
	2013	2012
Current service cost	68	60
Net interest expense on the net defined benefit obligation	7	14
Other	5	3
	80	77

There were no plan amendments, curtailments or settlements during the year that affect the results presented herein.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

22.5 Actuarial gains (losses) recognized in OCI

Table 22.6 – Actuarial gains (losses) recognized in OCI

For the years ended December 31,	Defined benefit plans	
	2013	2012
Balance, beginning of year ¹	(163)	(180)
Re-measurements related to:		
actuarial gains (losses) from changes in demographic assumptions	(57)	17
actuarial gains (losses) from changes in financial assumptions	226	(46) ²
return on plan assets	(59)	46
increase in asset reserve	(6)	-
Actuarial gains recognized in OCI	104	17
Balance, end of year¹	(59)	(163)

¹ Net actuarial losses on employee future benefits recognized in OCI are immediately reclassified to Retained earnings as they will not be reclassified subsequently to Net income in future periods.

² Net actuarial gains on employee future benefits recognized in OCI also include \$1 million loss from share of associates and joint ventures.

22.6 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 22.7 – Assumptions

As at December 31,	Pension plans		Post-retirement and post-employment benefit plans	
	2013	2012	2013	2012
To determine benefit obligation at end of period				
Discount rate	4.8%	4.0%	4.4%	3.7%
Rate of increase in future compensation	3.0%	3.0%	3.0%	3.0%
Rate of inflation	2.0%	2.0%	2.0%	2.0%
Life expectancy for pensioners at the age of 65 – male	21.3	19.8	21.3	19.8
Life expectancy for pensioners at the age of 65 – female	23.5	22.1	23.5	22.1
Health care cost trend rate	n/a	n/a	7.5%	8.0%
Dental care cost trend rate	n/a	n/a	4.5%	4.5%
To determine benefit expense for the 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%
Life expectancy for pensioners at the age of 65 – male	19.8	19.8	19.8	19.8
Life expectancy for pensioners at the age of 65 – female	22.1	22.1	22.1	22.1
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%

Mortality rates have been established in accordance with the draft private sector table and improvement scale published in 2013 by the Canadian Institute of Actuaries following its Canadian pensioner mortality study.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

22.7 Description of risks and sensitivity analysis

Employee defined benefit provisions expose the Company to actuarial risks, such as longevity risk, interest rate risk, inflation risk and market investment risk.

The ultimate cost of the defined benefit provisions to the Company will depend upon future events rather than on the assumptions made. In general, the risk to the Company is that the assumptions underlying the disclosures or the calculation of contribution requirements are not borne out in practice and the cost to the Company is higher than expected. This could result in higher contributions required from the Company and a higher deficit disclosed.

Assumptions which may vary significantly include:

- the return on plan assets;
- decrease in asset values not being matched by a similar decrease in the value of liabilities; and
- unanticipated future changes in mortality patterns leading to an increase in the defined benefit liabilities.

The defined benefit obligation and the service cost are sensitive to the assumptions made about salary growth levels and inflation, as well as the assumptions made about life expectation. It is also sensitive to the discount rate, which depends on market yields on 'AA' corporate bonds.

The following table presents the sensitivity of the defined benefit obligation to key assumptions:

Table 22.8 – Impact of changes in key assumptions

As at December 31,	2013	2012
Discount rate		
1% increase	(248)	(256)
1% decrease	302	312
Rate of compensation increase		
1% increase	64	74
1% decrease	(61)	(70)
Rate of inflation		
1% increase	54	61
1% decrease	(51)	(58)
Life expectancy of pensioners		
One-year increase	35	41

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

The effect on the defined benefit obligation at the end of the year has been calculated by changing one assumption for the sensitivity but without changing any other assumptions.

The impact of a one-year increase in life expectancy of pensioners has been calculated by determining the adjustment to be made to the mortality rates of a pensioner aged 65 in order to increase the life expectancy by one year and then applying this adjustment to all mortality rates.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

22.8 Risk management and investment strategy

The Management Pension Committee is responsible for the oversight of the pension plans, including the review of the funding policy and investment performance, and compliance with the Investment policy of the pension plan assets (the "Policy"). The Policy formulates investment principles, guidelines and monitoring procedures to meet the funds needs and objectives, in conformity with applicable rules. It also establishes principles and limits pertaining to fixed-income and equity market risks. Any deviation from the Policy is reviewed by the Operational Investment Committee. The Risk Management Committee, which is a committee of the Company's Board of Directors, is responsible for the approval of the Policy and the review of the pension plans investment performance.

Intact Investment Management Inc., a subsidiary of the Company, is responsible for the determination of the investment strategy and the administration of the plan assets. The pension plans investment portfolio is managed in accordance with investment policies that focus on asset diversification and asset-liability matching.

The goal of asset diversification is to limit the potential to have material capital losses. The fixed-income securities in the pension plans are significantly exposed to changes in interest rates and movements in credit spreads. Investment policies seek a balanced target investment allocation between fixed-income and equity securities, within credit concentration limit. The pension plans' risk management strategy is to invest in fixed-income instruments 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 adopted investment policy generally requires minimum credit ratings of 'BBB' for investments in fixed income securities and limits its concentration in any one investee or related group of investees to 5% of the cost of its total assets for fixed income securities (except for those that are issued or guaranteed by the Government of Canada or by a province of Canada having at least an 'A' rating). The Company has overall limits on credit exposure that include fixed income and equity securities, as well as off-balance sheet exposure.

The Company also establishes asset allocation limits to ensure sufficient diversification. Sensitivity analysis is one risk management technique that assists management in ensuring that equity risks assumed remain within the pension plans' risk tolerance level. The Company's pension plans have a significant concentration of their investments in Canada as well as in the Government sector. This risk concentration is closely monitored.

Table 22.9 – Concentration of credit risk by countries and industries

As at December 31,	2013	2012
By country of issuer		
Canada	84%	86%
U.S.	8%	2%
Other	8%	12%
	100%	100%
By industry		
Government	51%	53%
Banks, insurance and diversified financial services	19%	20%
Energy	7%	7%
Other	23%	20%
	100%	100%

One objective established in the Policy is to maintain an appropriate balance between the interest rate exposure of the Company's invested assets and the duration of its contractual liabilities. The Company calculates a hedge ratio as the dollar-duration of the pension asset portfolio divided by the dollar-duration of the funded pension plans' obligation. A lower hedge ratio increases the Company's exposure to changes in interest rates. The hedge ratio was 73% as at December 31, 2013.

Liquidity risk is the risk that the pension plans will encounter difficulty in raising funds to meet obligations associated with the pension obligation arising from their defined benefit plans. The Company's liquidity risk with regards to pension plans is not significant, as the inflows from the contributions receivable generally outweigh the outflows for benefit payments. A large portion of the investments are held in short-term notes and highly liquid federal and provincial government debt to protect against any unanticipated large cash requirements.

The Company regularly monitors compliance with investment policies.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 23 – Business combination

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 a 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 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 23.1 – Business combination – Jevco

As at	December 31, 2013	December 31, 2012
Purchase price – cash consideration paid	530	530
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	27	26
Deferred acquisition costs	33	33
Property and equipment	19	24
Intangible asset – distribution network (net of deferred tax liabilities \$23 million)	62	62
Other assets	83	84
Claims liabilities	(731)	(731)
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	427	432
Goodwill	103	98

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 is complete.

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 24 – Integration and restructuring costs

Following the announcements of the acquisitions of Jevco in September 2012 and AXA Canada in September 2011, the Company established integration plans directed at integrating the acquired businesses 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.

Table 24.1 – Integration and restructuring costs

For the years ended December 31,	2013	2012
AXA Canada	14	79
Jevco	21	29
	35	108

The restructuring provision has been established in relation to the acquisitions of AXA Canada and Jevco, based on the decisions communicated as at December 31, 2013 and 2012. The restructuring provision is recorded in Other liabilities.

Table 24.2 – Movement of the restructuring provision

As at December 31,	2013	2012
Balance, beginning of the year	30	27
Additional provision	4	26
Payments	(17)	(19)
Reversals for unused amounts	(4)	(4)
Balance, end of year	13	30

Note 25 – Related-party transactions

The Company enters into transactions with associates and joint ventures in the normal course of business, as well as with 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.

25.1 Transactions with associates and joint ventures

Income and expenses with associates and joint ventures are as follows:

Table 25.1 – Income and expenses with associates and joint ventures

For the years ended December 31,	2013	2012
Reported in:		
Income		
Net investment income	5	7
Expenses		
Underwriting expenses	172	151

Assets and liabilities with associates and joint ventures are as follows:

Table 25.2 – Assets and liabilities with associates and joint ventures

As at December 31,	2013	2012
Reported in:		
Assets		
Loans	94	115
Liabilities		
Other liabilities	53	68

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

25.2 Compensation of key management personnel

Key management personnel comprise 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 25.3 – Compensation of key management personnel

For the years ended December 31,	2013 ¹	2012
Salaries	3	3
Share-based awards	4	3
Annual incentive plans	4	3
Pension value	2	2
	13	11

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 2014. The Company's Management Proxy Circular will reflect the final figures. 2012 comparatives have been restated to 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.

25.3 Pension plans

Intact Investment Management Inc., a subsidiary of the Company, manages the investment portfolio of the pension plans' Master Trust in return for investment advisory fees charged to the pension plans, for a total of \$4 million for the year ended December 31, 2013 (December 31, 2012 - \$3 million).

The Company made contributions to pension plans of \$121 million for the year ended December 31, 2013 (December 31, 2012 – \$210 million, including discretionary pension contributions of \$114 million).

Intact Financial Corporation
Notes to the Consolidated financial statements
(in millions of Canadian dollars, except as otherwise noted)

Note 26 – Additional information on the Consolidated statements of cash flows

The following table provides additional details on the items included in net cash flows provided by (used in) operating activities.

Table 26.1 – Additional information on the Consolidated statements of cash flows

For the years ended December 31,	2013	2012
Net investment losses (gains)	83	(37)
Depreciation of property and equipment	31	25
Amortization of intangible assets	59	51
Net premiums on debt securities classified as AFS	28	35
Share-based payments	18	16
Other	9	15
Adjustments for non-cash items	228	105
Unearned premiums, net	81	72
Deferred acquisition costs, net	(13)	(20)
Premium and other receivables	(94)	(83)
Contributions to the pension plans	(235)	(96)
Other operating assets	(134)	(32)
Other operating liabilities	43	43
Changes in other operating assets and liabilities	(352)	(116)
Composition of cash and cash equivalents		
Cash	98	161
Cash equivalents	1	11
Cash and cash equivalents, end of year	99	172
Other relevant cash flow disclosures		
Interest paid	64	59
Interest received	276	277
Dividends received	168	142

Note 27 – Contingencies and commitments

27.1 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.

Intact Financial Corporation

Notes to the Consolidated financial statements

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

27.2 Operating lease commitments

The Company has entered into commercial operating leases on certain property and equipment. These leases have a life ranging from one to 13 years with renewal options included in the contracts. Future minimum rental payments under non-cancellable operating leases as at the end of the year are as follows:

Table 27.1 – Operating lease rental payments

As at December 31,	2013
Less than 1 year	105
From 1 to 5 years	355
Over 5 years	338
	798

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 \$3,952 million as at December 31, 2013 (December 31, 2012 – \$3,539 million) and represented approximately 99.3% as at December 31, 2013 (December 31, 2012 – 97.1%) of automobile direct 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
Quebec	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, 2013 and 2012, 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
	2013	2012	2011	2010	2009
Consolidated performance					
Written insured risks (thousands)	7,115	6,729	5,084	4,614	4,604
Direct premiums written	7,319	6,868	5,099	4,498	4,275
Net premiums earned	7,014	6,571	4,880	4,231	4,055
Favourable prior year claims development	(374)	(372)	(223)	(193)	(94)
Underwriting income (loss)	142	451	273	193	54
Combined ratio	98.0%	93.1%	94.4%	95.4%	98.7%
Net investment income	406	389	326	294	293
Net investment gains (losses)	(83)	37	204	182	(173)
Income before income taxes	465	712	594	637	140
Effective tax rate	7.3%	19.8%	23.1%	22.0%	9.4%
Net operating income	500	675	460	402	282
Net income attributable to shareholders	431	571	465	498	127
Net operating income per share (\$)	3.62	5.00	3.91	3.49	2.35
Earnings per share (\$)	3.10	4.20	3.96	4.32	1.06
Weighted-average number of common shares outstanding (millions)	132.4	130.8	115.3	115.1	119.9
Operating return on equity	11.2%	16.8%	15.3%	15.1%	9.2%
Return on equity	9.3%	13.5%	14.3%	16.9%	4.5%
Personal lines – total					
Written insured risks (thousands)	6,123	5,809	4,465	4,089	4,098
Direct premiums written	4,994	4,655	3,627	3,308	3,121
Net premiums earned	4,868	4,539	3,535	3,139	2,993
Combined ratio	96.7%	95.0%	95.0%	97.5%	99.3%
Underwriting income (loss)	162	226	179	76	21
Personal auto					
Written insured risks (thousands)	3,902	3,584	2,723	2,475	2,455
Direct premiums written	3,373	3,093	2,419	2,236	2,127
Net premiums earned	3,349	3,077	2,406	2,157	2,067
Combined ratio	93.2%	95.7%	90.9%	98.1%	94.9%
Underwriting income (loss)	228	132	219	41	105
Personal property					
Written insured risks (thousands)	2,221	2,225	1,742	1,614	1,643
Direct premiums written	1,621	1,562	1,208	1,072	994
Net premiums earned	1,519	1,462	1,129	982	926
Combined ratio	104.4%	93.5%	103.5%	96.5%	109.0%
Underwriting income (loss)	(66)	94	(40)	35	(84)
Commercial lines – total					
Written insured risks (thousands)	992	920	619	525	506
Direct premiums written	2,325	2,213	1,472	1,190	1,154
Net premiums earned	2,146	2,032	1,345	1,092	1,062
Combined ratio	100.9%	88.9%	93.0%	89.3%	96.9%
Underwriting income (loss)	(20)	225	94	117	33
Commercial auto					
Written insured risks (thousands)	526	477	325	282	269
Direct premiums written	612	552	396	336	322
Net premiums earned	603	536	384	326	315
Combined ratio	93.3%	81.5%	86.5%	86.0%	79.8%
Underwriting income (loss)	40	99	52	46	64
Commercial P&C					
Written insured risks (thousands)	466	443	294	243	237
Direct premiums written	1,713	1,661	1,076	854	832
Net premiums earned	1,543	1,496	961	766	747
Combined ratio	103.9%	91.6%	95.6%	90.7%	104.1%
Underwriting income (loss)	(60)	126	42	71	(31)
Financial condition					
Total excess capital (over 170% MCT)	550	599	435	809	859
MCT %	203%	205%	197%	233%	232%
Cash provided by (used in) operating activities	185	723	532	360	538
Debt-to-capital ratio	18.7%	18.9%	22.9%	14.3%	11.8%
Book value per share (\$)	33.94	33.03	29.73	26.47	24.88
Investments					
Performance					
Market-based investment yield	3.7%	3.6%	4.0%	4.2%	4.5%
Total investments	12,261	12,959	11,828	8,653	8,057
Portfolio mix (net of hedging positions)					
Short-term notes, including cash and cash equivalents	2%	3%	4%	6%	3%
Fixed-income securities	73%	74%	73%	61%	64%
Preferred shares	10%	10%	11%	16%	19%
Common shares	12%	10%	9%	13%	10%
Loans	3%	3%	3%	4%	4%

TWO-YEAR QUARTERLY REVIEW

(Excluding MYA. In millions of Canadian dollars, except as noted)

	IFRS				IFRS			
	2013				2012			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Consolidated performance								
Written insured risks (thousands)	1,589	1,899	2,165	1,462	1,543	1,794	2,018	1,374
Direct premiums written	1,702	1,911	2,182	1,524	1,690	1,798	1,977	1,403
Net premiums earned	1,804	1,784	1,723	1,703	1,742	1,640	1,599	1,590
Favourable prior year claims development	(66)	(103)	(95)	(110)	(85)	(70)	(83)	(134)
Underwriting income (loss)	67	(50)	42	83	138	67	123	123
Combined ratio	96.3%	102.8%	97.5%	95.1%	92.1%	95.9%	92.3%	92.3%
Net investment income	104	104	102	96	102	92	95	100
Net investment gains (losses)	(29)	(3)	(94)	43	6	16	3	12
Income before income taxes	130	41	121	173	223	111	161	217
Effective tax rate	17.6%	(14.6)%	14.9%	(0.6)%	20.6%	17.1%	19.9%	20.3%
Net operating income	143	59	123	175	194	122	180	179
Net income attributable to shareholders	107	47	103	174	177	92	129	173
Net operating income per share (\$)	1.05	0.41	0.89	1.27	1.42	0.89	1.35	1.34
Earnings per share (\$)	0.77	0.32	0.73	1.27	1.29	0.67	0.95	1.30
Weighted-average number of common shares outstanding (millions)	131.5	131.6	133.0	133.3	133.3	130.6	129.6	129.6
Operating return on equity	11.2%	12.7%	14.4%	16.0%	16.8%	16.4%	17.3%	16.2%
Return on equity	9.3%	11.2%	12.4%	12.9%	13.5%	11.7%	12.7%	13.5%
Personal lines – total								
Written insured risks (thousands)	1,354	1,656	1,870	1,243	1,310	1,573	1,747	1,179
Direct premiums written	1,108	1,367	1,516	1,003	1,097	1,277	1,362	919
Net premiums earned	1,255	1,237	1,196	1,180	1,202	1,132	1,104	1,101
Combined ratio	94.6%	102.9%	95.2%	93.9%	91.8%	103.0%	94.1%	91.4%
Underwriting income (loss)	68	(35)	57	72	99	(34)	66	95
Personal auto								
Written insured risks (thousands)	836	1,035	1,226	805	783	954	1,102	745
Direct premiums written	734	911	1,037	691	722	843	907	621
Net premiums earned	861	849	831	808	825	765	744	743
Combined ratio	98.4%	93.0%	87.2%	94.1%	103.1%	94.9%	89.0%	95.2%
Underwriting income (loss)	14	60	106	48	(25)	39	82	36
Personal property								
Written insured risks (thousands)	518	621	644	438	527	619	645	434
Direct premiums written	374	456	479	312	375	434	455	298
Net premiums earned	394	388	365	372	377	367	360	358
Combined ratio	86.4%	124.7%	113.3%	93.5%	67.1%	119.8%	104.5%	83.5%
Underwriting income (loss)	54	(95)	(49)	24	124	(73)	(16)	59
Commercial lines – total								
Written insured risks (thousands)	235	243	295	219	233	221	271	195
Direct premiums written	594	544	666	521	593	521	615	484
Net premiums earned	549	547	527	523	540	508	495	489
Combined ratio	100.1%	102.5%	102.9%	98.0%	92.7%	80.3%	88.2%	94.4%
Underwriting income (loss)	(1)	(15)	(15)	11	39	101	57	28
Commercial auto								
Written insured risks (thousands)	124	127	165	110	120	114	146	97
Direct premiums written	150	144	186	132	146	132	159	115
Net premiums earned	154	155	149	145	146	133	129	128
Combined ratio	100.4%	86.0%	89.6%	97.3%	84.2%	77.0%	79.6%	85.2%
Underwriting income (loss)	(1)	21	16	4	23	31	26	19
Commercial P&C								
Written insured risks (thousands)	111	116	130	109	113	107	125	98
Direct premiums written	444	400	480	389	447	389	456	369
Net premiums earned	395	392	378	378	394	375	366	361
Combined ratio	100.0%	109.0%	108.2%	98.2%	95.9%	81.4%	91.3%	97.6%
Underwriting income (loss)	-	(36)	(31)	7	16	70	31	9
Financial condition								
Total excess capital (over 170% MCT)	550	515	486	744	599	598	649	595
MCT %	203%	199%	197%	214%	205%	201%	205%	205%
Cash provided by (used in) operating activities	(27)	413	275	(476)	204	367	279	(127)
Debt-to-capital ratio	18.7%	19.0%	19.0%	18.5%	18.9%	19.5%	19.8%	19.1%
Book value per share (\$)	33.94	33.25	33.15	34.15	33.03	31.81	30.30	30.40
Investments								
Performance								
Market-based investment yield	3.7%	3.8%	3.8%	3.4%	3.6%	3.6%	3.7%	3.7%
Total investments	12,261	12,285	12,283	12,532	12,959	12,844	11,668	11,513
Portfolio mix (net of hedging positions)								
Short-term notes, including cash and cash equivalents	2%	5%	3%	1%	3%	5%	5%	3%
Fixed-income securities	73%	71%	73%	74%	74%	72%	72%	73%
Preferred shares	10%	9%	10%	10%	10%	10%	10%	11%
Common shares	12%	11%	11%	12%	10%	10%	9%	10%
Loans	3%	4%	3%	3%	3%	3%	4%	3%

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”) A non-IFRS financial measure calculated as 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”) A non-IFRS financial measure calculated as 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 Basis risk is the risk that offsetting investments in a hedging strategy will not experience price changes in entirely opposite directions from each other.

Book value per share 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 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.

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 same 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 same 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 futures 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, Québec, New Brunswick and Nova Scotia. These pools are managed by the Facility Association, except for the Québec RSP.

Interest rate forwards and futures

contracts Contractual obligations to buy or sell interest-rate-sensitive financial instruments 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.

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”) A non-IFRS financial measure calculated as 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), difference between expected return and discount rate on pension assets, and MYA.

Net operating income per share (“NOIPS”)

A non-IFRS financial measure calculated as 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 during the same 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”) A non-IFRS financial measure calculated as 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.

Reinstatement premium Premium payable to restore the original reinsurance policy limit as a result of a reinsurance loss payment under a catastrophe cover. Reinstatement premiums are reported in Net premiums earned.

Reinsurer An insurance company that agrees 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.

Underlying current year loss ratio A non-IFRS financial measure calculated as current year claims ratio excluding catastrophe losses, reinstatement premiums and prior year claims development.

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 Brindamour⁴

Chief Executive Officer

Yves Brouillette^{1,5}

President, Placements Beluca Inc.

Robert W. Crispin^{1,4,5}

Corporate Director

Dr. Janet De Silva^{2,5}

Dean of Ivey Asia, Ivey Business School at Western University

Claude Dussault

Chairman of the Board and President, ACVA Investing Corporation

Eileen Mercier^{1,4,5}

Chair of the Board, Ontario Teachers' Pension Plan

Timothy H. Penner^{2,5}

Corporate Director

Louise Roy^{2,3}

Chancellor and Chair of the Board, Université de Montréal, and Invited Fellow, Center for Interuniversity Research and Analysis on Organizations

Frederick Singer^{1,3}

Chief Executive Officer of Echo360

Stephen Snyder^{1,3}

Corporate Director

Carol Stephenson^{2,3}

Corporate Director

EXECUTIVE COMMITTEE MEMBERS

Charles Brindamour

Chief Executive Officer

Patrick Barbeau

Senior Vice President, Personal Lines

Martin Beaulieu

Senior Vice President and Chief Operating Officer, Direct to Consumer Distribution

Alan Blair

Senior Vice President, Atlantic Canada

Jean-François Blais

President, Intact Insurance

Debbie Coull-Cicchini

Senior Vice President, Ontario

Jean-François Desautels

Senior Vice President, Québec

Claude Désilets

Senior Vice President and Chief Risk Officer

Monika Federau

Senior Vice President and Chief Strategy Officer

Anne Fortin

Senior Vice President, Marketing and Strategic Relationships, Direct to Consumer Distribution

Louis Gagnon

President, Service and Distribution

Françoise Guénette

Senior Vice President, Corporate and Legal Services, and Secretary

Byron Hindle

Senior Vice President, International Development

Mathieu Lamy

Senior Vice President, Claims

Alain Lessard

Senior Vice President, Commercial Lines

Louis Marcotte

Senior Vice President and Chief Financial Officer

Lucie Martel

Senior Vice President and Chief Human Resources Officer

Benoit Morissette

Senior Vice President and Chief Internal Auditor

Jennie Moushos

Senior Vice President, Western Canada

Jack Ott

Senior Vice President and Chief Information Officer

Marc Provost

Senior Vice President and Chief Investment Officer

Lilia Sham

Senior Vice President, Corporate Development

Mark A. Tullis

Executive Vice President, Governance and Capital Management

Peter Weightman

President, BrokerLink

Notes:

1 Denotes member of the Audit Committee

2 Denotes member of the Compliance Review and Corporate Governance Committee

3 Denotes member of the Human Resources and Compensation Committee

4 Denotes member of the Investment Committee (until May 8, 2013)

5 Denotes member of the Risk Management Committee (as of May 8, 2013)

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

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 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 and 3 (the "Series 1 and 3 Preferred Shares") issued on July 12, 2011 and August 18, 2011, respectively.

Toronto Stock Exchange (TSX) listings

Common Shares Ticker Symbol: IFC
 Class A Series 1 Preferred Shares Ticker Symbol: IFC.PR.A
 Class A Series 3 Preferred Shares Ticker Symbol: IFC.PR.C

Annual and Special Meeting of Shareholders

Date: Wednesday, May 7, 2014
 Time: 2 pm PT
 Location/Venue: Pan Pacific Hotel Vancouver, Crystal Pavilion A, 999 Canada Place, Suite 300, Vancouver, British Columbia V6C 3B5

Version française

Il existe une version française du présent rapport annuel à la section Relations investisseurs de notre site Web www.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, North Tower
 Toronto, Ontario M5J 2Y1
 1 800 564 6253

Auditors

Ernst & Young LLP

Earnings release dates

Q1 – Wednesday, May 7, 2014
 Q2 – Wednesday, July 30, 2014
 Q3 – Wednesday, November 5, 2014
 Q4 – Wednesday, February 4, 2015

Investor inquiries

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Media inquiries

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 Vice President, Corporate Communications
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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	\$ 66.82	\$ 61.65	\$ 62.25	16,033,974
Q2	\$ 64.27	\$ 56.44	\$ 59.25	31,134,095
Q3	\$ 63.36	\$ 56.53	\$ 61.78	17,048,486
Q4	\$ 69.74	\$ 61.48	\$ 69.37	14,762,433
Year 2013	\$ 69.74	\$ 56.44	\$ 69.37	78,978,988
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

Source: Toronto Stock Exchange



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GREY POWER



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Intact Financial Corporation 2013 Annual Report