



Our Values
Our People
Our Future



Company Profile

Intact Financial Corporation is the largest provider of property and casualty insurance in Canada and a leading provider of specialty insurance in North America, with over \$10 billion in total annual premiums. We serve more than five million personal, business and public sector clients through offices in Canada and the U.S. In Canada, Intact distributes insurance under the Intact Insurance brand through a wide network of brokers, including its wholly owned subsidiary BrokerLink, and directly to consumers through belairdirect. In the U.S., OneBeacon Insurance Group, a wholly owned subsidiary, provides specialty insurance products through independent agencies, brokers, wholesalers and managing general agencies.



Personal auto	37%
Personal property	22%
Commercial lines – CAN	26%
Commercial lines – US	15%



Approximately **14,000**
EMPLOYEES



Intact Insurance	63%
belairdirect	14%
OneBeacon	15%
BrokerLink	8%

¹ This is a non-IFRS financial measure. See glossary on page 170 for definition.

Annual dividend per common share

We are proud of our dividend growth track record, including a CAGR of 9% since 2009.

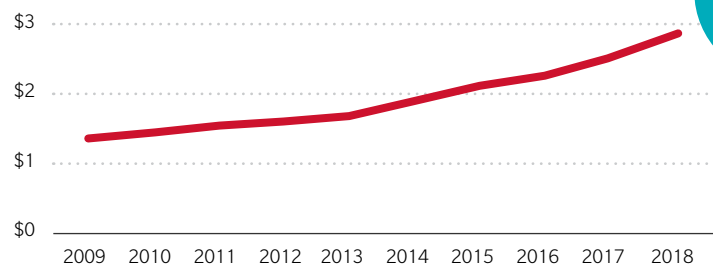
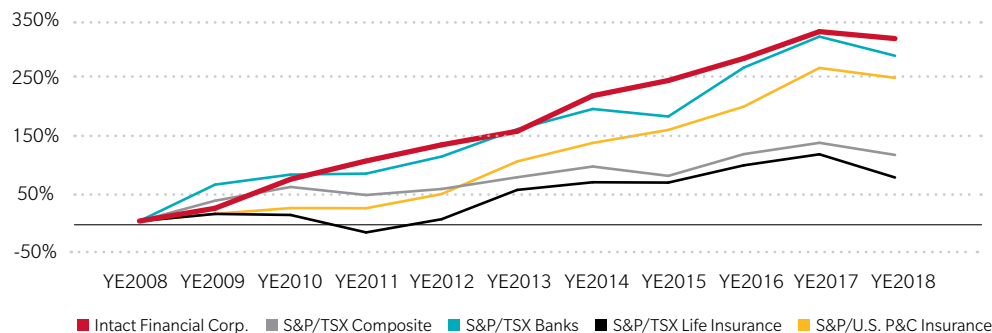


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Total shareholder return vs peers

On a total shareholder return basis (including dividends), our 15.3% CAGR over the past 10 years compares very favourably versus peers.



Certain statements made in this annual report are forward-looking statements. These statements include, without limitation, statements relating to the company's strategy, new products and services, lines of business, revenue, performance, profitability and growth projections, use of technology, data and artificial intelligence, funding of projects, position within the industry and markets where it operates, return on equity, net operating income per share and improved cross-border efficiencies, as well as the sharing economy, climate change and market conditions. All such forward-looking statements are made pursuant to the "safe harbour" provisions of applicable Canadian securities laws.

Forward-looking statements, by their very nature, are subject to inherent risks and uncertainties and are based on several assumptions, both general and specific, which give rise to the possibility that actual results or events could differ materially from our expectations expressed in or implied by such forward-looking statements as a result of various factors, including those discussed in the Company's most recently filed Annual Information Form and annual MD&A. As a result, we cannot guarantee that any forward-looking statement will materialize and we caution you against unduly relying on any of these forward-looking statements. Except as may be required by Canadian securities laws, we do not undertake any obligation to update or revise any forward-looking statements contained in this annual report, whether as a result of new information, future events or otherwise. Please read the cautionary note at the beginning of the annual MD&A.

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Why we are here

We are here to help people, businesses and society prosper in good times and be resilient in bad times.

What we believe

Insurance is not about things. Insurance is about people.

Our Values

Integrity | Respect | Customer driven | Excellence | Social responsibility

Our Strategy



OUR CUSTOMERS ARE OUR ADVOCATES

- Stay ahead of changing customer expectations
- Deliver experiences that are second-to-none
- Engage with our customers digitally



OUR PEOPLE ARE ENGAGED

- Be a best employer
- Be a destination for top talent and experts
- Create an inspiring and inclusive workplace



OUR SPECIALTY SOLUTIONS BUSINESS IS A LEADER IN NORTH AMERICA

- Achieve a combined ratio in the low 90s
- Attract and retain the best expertise
- Create \$3 B in annual premiums

OUR COMPANY IS ONE OF THE MOST RESPECTED



EXCEED

industry ROE by 5 points



GROW

NOIPS¹ 10% yearly over time



LEAD

in data, AI, and behavioural analytics

¹ This is a non-IFRS financial measure. See glossary on page 170 for the definition.

2018 Financial Highlights

DPW¹
\$10.1B ↑16%

NOIPS¹
\$5.74 ↑3%

OROE¹
12.1% ↓0.8pts

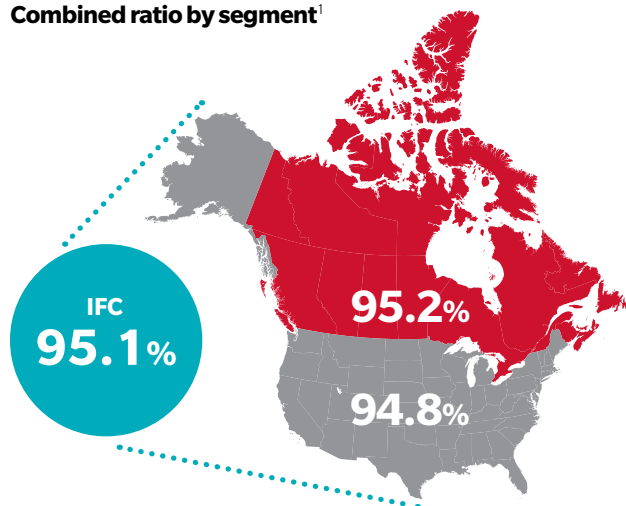
Underwriting income¹
\$474M ↓2%

Net investment income
\$529M ↑22%

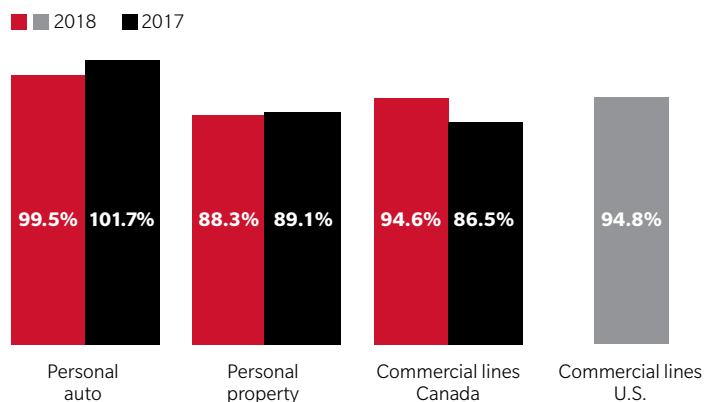
Net distribution income¹
\$146M ↑11%

Underwriting Performance

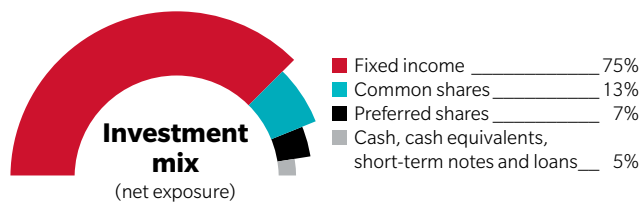
Combined ratio by segment¹



Combined ratio by line of business¹



Investment Portfolio



TOTAL INVESTMENTS
\$16.9B

Financial Strength

Book value per share
\$48.73

Debt-to-total capital ratio
22.0%

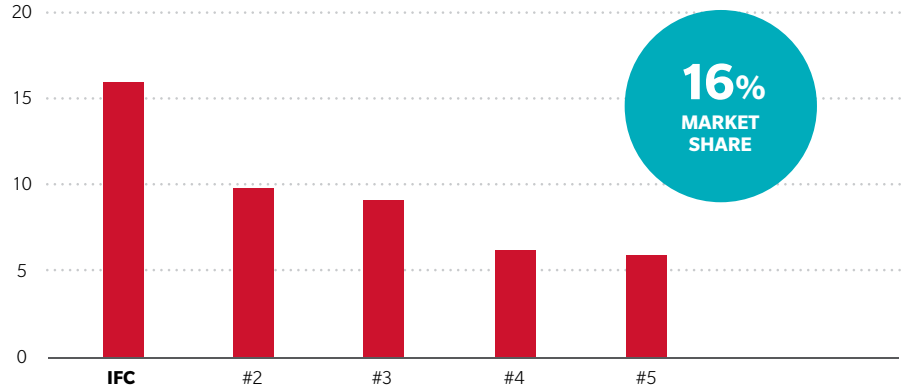
Total capital margin
\$1.3B

¹ These are non-IFRS financial measures. See glossary on page 170 for definitions.

Canadian Industry Outperformance

Market share by company (%)¹

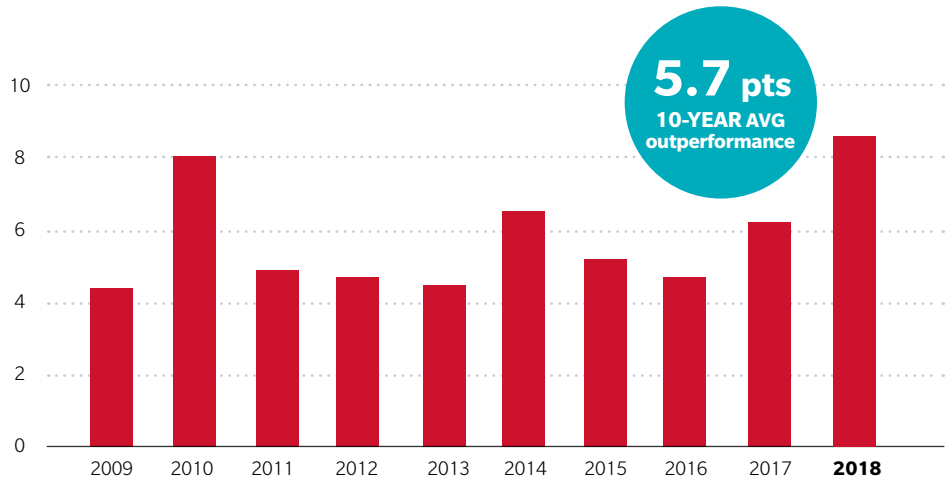
With a market share of 16%, we are 17 times the size of the average P&C insurer in Canada.



¹ Market share data is based on the latest available data from MSA Research Inc. (FY 2018).

Canadian combined ratio outperformance (in pts)¹

Our sophisticated pricing, underwriting discipline and in-house claims expertise have enabled us to outperform the industry benchmark's (top 20) combined ratio.

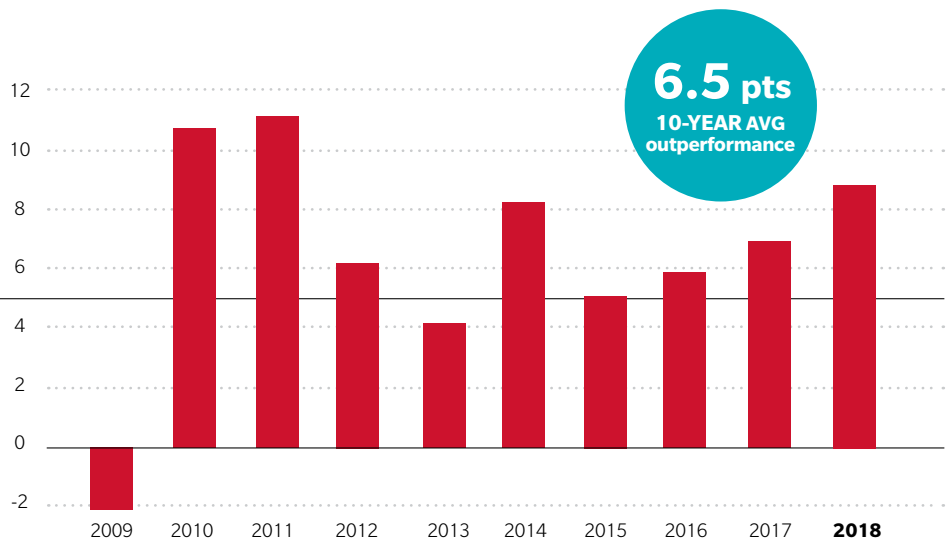


¹ Including MYA. Combined ratio is a non-IFRS financial measure. See glossary on page 170 for the definition.

Return on equity outperformance (in pts)¹

Our superior underwriting results, investment performance and capital management have led to a better ROE than the industry.

Target outperformance 5 pts →



¹ IFC's ROE is the consolidated adjusted return on equity ("AROE"), a non-IFRS financial measure. See glossary on page 170 for the definition.



Dear shareholders,

In 2018, Intact Financial Corporation (IFC) continued to grow, adapt and innovate to define the future of insurance, deliver second-to-none experiences for our customers, and help to build resilient communities.

Our success in 2018, and over the last 10 years, has been possible because of the foundation it is built on and the people who work here. As I write this letter, we are celebrating our 10th anniversary. I want to share with you what has transpired in that time and why it matters.

Ten years ago, with the support of employees, brokers and the financial markets, we raised \$2.4 billion and parted ways with our majority shareholder ING. We brought the leadership of property and casualty (P&C) insurance industry back to Canada – establishing IFC as an independent, widely held company.

The financial crisis was at its peak – the status quo was not an option and we had to move with lightning speed. The excitement was palpable, and it worked – because we created a company based on values and a belief that insurance is about people, not things.

People needed to know who we were and what we stood for. Within days of the transaction we announced our name, our colours and our values, and we used those to transform the organization and make it what it is today.

Our brands are now among the most recognized insurance brands in Canada – a testament to our focus on getting customers back on track. We have doubled the number of employees to 14,000, become a best employer and attracted a diverse and talented group of people. Our strategy – to deliver exceptional customer service, engage our employees and earn the right to be one of the most respected companies – has delivered strong returns for our shareholders.

Over the last decade, organic growth and six major acquisitions have driven a 10% CAGR in Direct Premiums Written (DPW)¹. With the acquisition of OneBeacon, we have launched a new growth pipeline in the U.S. We have outperformed the P&C industry on Return on Equity (ROE) by an average of 650 basis points (bps). Our market capitalization has quadrupled to \$14 billion, and we have delivered an average annual total shareholder return of over 15%, almost double that of the TSX60.

Over the next 10 years, we will build an unparalleled advantage in Canada by transforming the customer experience and extending our presence and expertise in the U.S. As we focus on excelling at the fundamentals, we will continue to challenge ourselves to stay ahead of changing consumer expectations. We will lead in artificial intelligence as the explosion of data and technology advancements continue rapidly. These big trends combined with the impacts of climate change will have

Our values guide our decision making and are the foundation of our success. They're embraced by our people as they work to build a safe and vibrant future for our customers, shareholders and communities.

¹ This is a non-IFRS financial measure. See glossary on page 170 for the definition.

a profound effect on the kinds of products we offer and the way we work. Our values, purpose and strategy will guide us as we tackle these trends, serve our customers and communities, and build a world-class P&C insurer.

2018 year in review

2018 was our first full year operating in both Canada and the U.S.

DPW grew by 16%, driven by the acquisition of OneBeacon and strong growth in both commercial and specialty lines in Canada. We saw improving market conditions as the year progressed and expect personal lines to be a greater contributor to growth in 2019.

Net Operating Income Per Share (NOIPS)¹ grew 3% to \$5.74, with solid underwriting performance in both Canada and the U.S., and improved net investment and distribution income.

Net investment income was up a strong 22% due to the growth resulting from the integration of our Canadian and U.S. investment portfolio, as well as investment optimization initiatives and higher yields.

The combined ratio¹ for Canada was 95.2%, with continued strong performance from personal property and significant improvement in personal auto. We are pleased with the profitability trajectory in auto and are focused on sustaining a mid-90s combined ratio in 2019. Canadian commercial lines experienced higher large losses and higher CAT losses in 2018, but the underlying fundamentals of the business remain strong.

OneBeacon, in its first full year, produced a combined ratio of 94.8%. We realized synergies in excess of US \$25 million in 2018, ahead of schedule. OneBeacon business segments under profit improvement plans are responding positively and claims initiatives are being rolled out and are gaining traction. NOIPS accretion from OneBeacon was roughly 6% in 2018 and we remain on track for a sustainable low 90s combined ratio by the end of 2020.

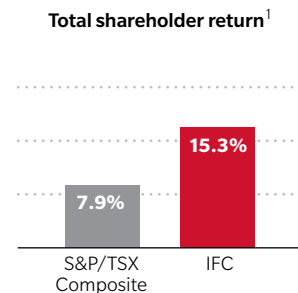
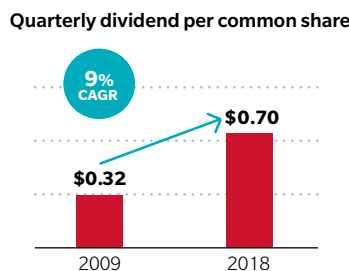
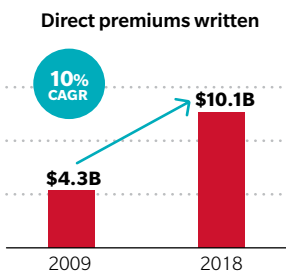
The Operating ROE (OROE)¹ was 12.1% in 2018, below our mid-teen expectations and historical track record. That being said, we outperformed the industry on ROE by close to 900 bps, a significant margin. We expect our OROE to improve in 2019 given the success of our profitability actions and the improving market outlook.

Our balance sheet is strong, with \$1.3 billion of total capital margin and debt-to-total capital of 22%. This strength fuels the execution of our strategy and gives us the flexibility to take advantage of consolidation opportunities in Canada moving forward. Our balance sheet, combined with good earnings momentum and a favourable growth outlook, led us to once again raise our quarterly dividend this year by 9% to \$0.76.

Favourable industry outlook supportive of growth and profitability initiatives

2018 was a challenging year for the Canadian P&C industry with a combined ratio of 102.1% and ROE of 2.8%. Industry-wide actions including rate increases have led to the firm conditions we now see across all lines. We expect to see at least mid single-digit premium growth for the Canadian industry in 2019.

In personal auto and commercial lines, profitability challenges are putting upward pressure on rates, while in personal property, companies continue to adjust to changing weather patterns. As industry rate increases catch up and our competitive position improves, we expect our growth in personal lines to improve in 2019.



¹ These are non-IFRS financial measures. See glossary on page 170 for definitions.

¹ Annualized, since December 31, 2008.

In U.S. Commercial, the pricing environment is competitive but stable, with modest upward pricing trends. We expect low to mid single-digit industry growth in the coming year, while our strategies in U.S. Specialty position us to do better than that.

Overall, we expect the industry's ROE to improve but remain below its long-term average of 10% over the next 12 months. While we maintain our 500 bps industry outperformance objective, our strategies, strong distribution networks and depth of talent across the organization should help us exceed this target and capture improving growth opportunities in 2019.

Our strategy shapes our success

In the medium term, we will continue to excel at the fundamentals and execute on our four strategic pillars to solidify our position as Canada's number one P&C insurer and a leading North American specialty insurer.

Our customers are our advocates

This year, substantial investments in technology, digital tools, design expertise and artificial intelligence (AI) helped us deliver industry-leading platforms and provide more convenience for customers. Our new Client Centre self-service app makes it easier for customers and brokers to do business with us. And our recently launched mobile Usage Based Insurance (UBI) 2.0 can now detect distracted driving and improve safety.

We are making things simpler for small and mid-sized business customers to get quotes through our new Quick Quote tool for commercial lines – pre-filling more than half the questions using geomatics and external data sources.

Our claims service is a key differentiator and is at the heart of what we promise. We continue to increase satisfaction by providing customers with options to tailor their experience – offering both online self-service options as well as face-to-face, full-service centres.

By 2020, we aim to have three out of four customers as advocates by delivering second-to-none experiences. Through awareness and digital adoption, we aim to have three out of four people actively digitally engaged.

Our people are engaged

Our people are central to the success of our customer driven transformation. They are the ones who help customers get back on track, develop new products, and make it easier to do business with us. We are a growing destination for top talent as a company that invests in the skills and tools of our employees, provides an inspiring environment and wants to be a force for good in society. We are actively recruiting people with a wide range of expertise, from those focused on the front-line customer service; to industry experts; to software engineers, designers and data scientists. We all share a common goal of wanting to shape the future of insurance and provide second-to-none customer experiences.

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A team that is engaged and inspired is central to that future. As our company grows and evolves, we continue to have strong engagement. In 2018, employees recognized our company as being customer driven, for living our values and for having leaders who care for people, are open and honest, take accountability and drive change. For the 4th year in a row, we were named one of Canada's Top 100 Employers and an Aon Best Employer –Canada 2019, Platinum level. And for the first time, we were named one of the 25 Best Places to Work in Canada by Glassdoor, as determined by those who know a company best – employees.

Our specialty solutions business is a leader in North America

Our Canadian specialty lines platform has grown close to 50% over the past five years. In 2017, we boosted our ambitions in specialty lines with the acquisition of OneBeacon. The transition has gone very well – our culture and values have been aligned from the beginning. It feels like we've been working together for a long time and we are seeing positive results.

Combined specialty lines premiums grew to \$2.3 billion in 2018, nearly a quarter of IFC's book of business. We are on track to reach our goal of \$3 billion and achieve a sustainable combined ratio in the low 90s in the medium term.

Having the right people with the right expertise is critical to the success of the specialty business. We are now better positioned to leverage the significant opportunities we see in specialty lines across North America including growing our Canadian cross-border business, expanding the most attractive OneBeacon product offerings in both the U.S. and Canada, and leveraging our sharing economy expertise.

Our company is one of the most respected

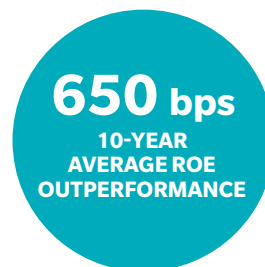
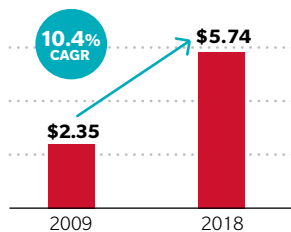
To be one of the most respected companies we must, above all, live our values in the marketplace every day. That includes putting in place strong governance and abiding by the highest ethical standards. As our Chairman notes in his letter, we have consistently performed well in external governance reviews.

We continue to drive change, increase broker satisfaction, and take customer experience to the next level across our personal and commercial businesses while deepening our strengths in pricing, risk selection, claims and investments.

We have laid out clear performance targets to earn respect including exceeding industry ROE by 500 bps in Canada and the U.S. and growing NOIPS 10% yearly over time. We have continued to perform well against those targets. In 2018, we exceeded industry ROE by close to 900 bps, taking average annual outperformance on this metric to 650 bps over the past decade. Since becoming Intact Financial in 2009, we've grown NOIPS at a compound annual growth rate just north of 10%.

This outperformance allows us to invest in transformation – including leveraging AI to design relevant products and services for customers. We aspire to be the best insurance AI shop in the world and we are building unique partnerships with leading universities in Canada to build a top talent pipeline of actuaries and data scientists, and to develop cutting-edge products.

Net operating income per share



Our team of data scientists and actuaries at the Data Lab are rolling out our latest rating algorithms. We see strong evidence that our investments in AI will drive efficiencies, growth and margin expansion in the years ahead through more accurate pricing to better reflect risk and a more personalized product for customers.

Making a difference

Making a difference is in our DNA, and it is reflected in our purpose and how we live our values. Those values help us make the right decisions whether we are talking about financial performance or supporting our communities. Employees and customers are increasingly looking to businesses to take the lead on important societal issues. We must challenge ourselves over the next 10 years to have a greater presence in our communities, and to be more generous of our time, our knowhow and our financial resources. So how do we begin to raise the bar?

Over the last 10 years, we have donated more than \$37 million to charitable causes, including more than \$6 million in 2018 alone. Climate change adaptation, addressing the root causes of child poverty, and supporting employee

citizenship through our community impact program are at the heart of our giving.

Supporting climate change adaptation initiatives has been, and will continue to be, at the top of our list. We saw the canary in the coal mine 10 years ago and we've been helping our customers manage the direct effects of increased flooding, fire and other extreme weather events ever since. We continue to see the benefits in our investment in the Intact Centre for Climate Adaptation at the University of Waterloo. Dr. Blair Feltmate and the team had outstanding success this year working with government partners to strengthen building codes and flood standards and to give homeowners practical tools and tips to protect their homes from flooding.

We are working with other global insurers, governments and non-government organizations on climate change. This year, we joined the United Nations Environment Programme Finance Initiative (UNEP FI) Task Force on Climate-related Financial Disclosures (TCFD) pilot, bringing together 16 of the world's largest insurers to better understand the impacts of climate change on their business and how to

account for them. We also co-hosted the Geneva Association Global Forum on Pathways to Climate-Resilient Critical Infrastructure in Toronto last September. We will continue to use our knowledge, experience and expertise in 2019 to work with our partners to find solutions.

Child poverty is another serious issue that needs immediate attention right here in our own backyard. Today one in five children in Canada lives in poverty. This year, Intact's donation to the United Way was designated to agencies that specifically address child poverty issues. And we will continue to build on our commitment in this area of focus.

In 2018, we also supported the Roméo Dallaire Child Soldiers Initiative to establish a regional centre of training and learning in Rwanda. These funds will help the Dallaire Initiative establish a permanent presence in Africa. This is a cause that has been widely embraced by our employees and I spent time in Rwanda last spring with the Dallaire Initiative and saw first-hand the importance of their work. While the problem of using children in wars is far from resolved, the General's team is moving the needle and making progress.

Climate change adaptation, addressing the root causes of child poverty, and supporting employee citizenship through our community impact program are at the heart of our giving.



Over the last 10 years we have donated more than **\$37 million** to charitable causes

We will challenge ourselves to do better in supporting climate change adaptation and addressing the root causes of child poverty in 2019 and beyond.

As beneficiaries of the power of AI, we will also turn more of our attention to the uncertainty this creates around the future of work. People are increasingly concerned about the impact of technology on jobs and whether they can continue to get ahead. It is up to companies like Intact to help our employees navigate this uncertainty and gain new skills, and for us to continue to grow and provide good jobs in the future.

Conclusion

Our values, our people and our strategy have been foundational to our success over the last 10 years and they will continue to underpin our work over the next 10.

Our customer driven culture and our care for our people during a period of transformational change are what will differentiate us. We are confident that this will fuel profitable growth and another decade of outperformance on our financial objectives as we establish ourselves as a world-class P&C insurance company.

I would like to thank our shareholders and brokers for their support over the last 10 years and our world-class team of employees across North America for their dedication to our customers and communities.



Charles Brindamour
Chief Executive Officer

Our strategy

- Launched self-service app
- Launched mobile UBI 2.0
- Maintained #1 and #2 brand consideration nationally for Intact Insurance and belairdirect



- Aon Best Employer
- Canada's Top 100 Employers
- Canada's Top Employers for Young People
- 25 Best Places to Work (Glassdoor)

- Combined ratio of 93.0% in 2018
- \$2.3B of DPW in 2018
- Steady improvement in OneBeacon performance



- NOIPS CAGR >10% since 2009
- Track record of exceeding 500 bps of ROE outperformance vs industry
- Ranked #2 in Corporate Governance out of all TSX listed companies
- Invested in machine learning and artificial intelligence



10 years of outperformance

Intact is celebrating its 10-year anniversary in 2019. It became an independent and widely held company in 2009 against the backdrop of the global financial crisis. It was a bold move that has consistently delivered strong growth for you over the last 10 years.

In 2018, Intact delivered solid results across underwriting, investments and distribution, in both Canada and the U.S. Net Operating Income Per Share (NOIPS)¹ of \$5.74 drove Operating Return on Equity (OROE)¹ of 12.1%, with over \$1.3 billion of total capital margin. In addition, the Company announced a 9% increase in the quarterly dividend for shareholders to \$0.76 per common share – the 14th consecutive annual increase.

Under the leadership of Charles Brindamour and his management team, the Company continues to excel, outperform and deliver value to you while staying grounded in its founding values – integrity, respect, customer driven, strive for excellence and socially responsible.

Despite continued challenges with extreme weather across North America, personal auto in Canada and recent market volatility, the Company is well-positioned to outperform in a changing environment, through enhanced risk selection, better segmentation and leveraging data analytics.

Intact continues to accelerate its digital offerings, investing in software engineering, machine learning and artificial intelligence to design relevant products and provide options for customers. With the successful integration of OneBeacon in the U.S. and close to \$2.3 billion in combined direct premiums written in 2018, Intact is making good strides towards achieving its goal of creating a leading specialty insurer in North America.

Recognizing the significance of climate change and the Company's expertise as a risk manager, Intact is participating in the United Nations Environment Programme Finance Initiative (UNEP FI) Task Force on Climate-related Financial Disclosures (TCFD) pilot to help better assess the intensifying impacts of climate change on the business.

Built on strong governance principles, and a high standard of compliance and ethics, Intact is today one of the most respected companies in Canada. The Company was ranked first (tie) by the Clarkson Centre for Board Effectiveness in its Board Shareholder Confidence Index 2018, for the third year running. This index examines the quality of corporate governance practices among Canadian public companies. As well, Intact maintained its second position in The Globe and Mail's 2018 Board Games report card.

Intact continues to accelerate its digital offerings, investing in software engineering, machine learning and artificial intelligence to design relevant products and provide options for customers.

¹ These are non-IFRS financial measures. See glossary on page 170 for definitions.

Intact was also recognized by Brendan Wood International (BWI) as one of five 2018 Global TopGun insurance companies for transparency and financial reporting. Louis Marcotte was also named a Global TopGun CFO by BWI.

Having engaged employees is integral to Intact's success. Besides retaining past awards – an Aon Best Employer in Canada at the platinum level, one of Canada's Top 100 Employers and Greater Toronto's Top Employers, and one of Canada's Top Employers for Young People, the Board is pleased to note that Intact was voted for the first time as one of the 25 Top-Rated Workplaces in Canada by Indeed, Canada's top job search site, as well as one of the 25 best places to work in Canada, by Glassdoor. Also, the Company was one of three companies awarded with Platinum Parity Certification by Women in Governance, recognized for its ongoing focus and progress in developing women in the workplace. These accolades speak to the Company's commitment to talent development, employee engagement and diversity.

I want to thank Louise Roy who retired from the Board in 2018. Louise served on the Board of the Company since its IPO in 2004 and brought her expertise to the Board's Human Resources and Corporate Governance committees during her tenure. Following Louise's retirement, we welcomed William L. Young, a director with extensive public company board and board leadership experience gained at several U.S., Canadian and European-based companies.

As Intact marks a decade of delivering for customers and outperforming, I want to pay tribute to the management team and employees at Intact, who deliver on the Company's purpose every day – helping people, businesses and society prosper in good times and be resilient in bad times. Your dedication, passion and commitment are most admirable and are what sets the Company apart in the marketplace.

To shareholders, customers and brokers, thank you for your trust and support over the last decade. It is with your continued trust that Intact will continue to grow, outperform and succeed in 2019, and for many years to come.



Claude Dussault
Chairman of the Board

The Company was one of three companies awarded with Platinum Parity Certification by Women in Governance, recognized for its ongoing focus and progress in developing women in the workplace.

Board of Directors

Claude Dussault

Chairman of the Board of Intact Financial Corporation and President of ACVA Investing Corporation

Charles Brindamour

Chief Executive Officer

Robert W. Crispin^{2,4}

Corporate Director

Janet De Silva^{2,3}

President & CEO of Toronto Region Board of Trade

Robert G. Leary^{1,4}

CEO, Olayan Group

Eileen Mercier^{1,4}

Corporate Director

Sylvie Paquette^{1,4}

Corporate Director

Timothy H. Penner^{2,3}

Corporate Director

Frederick Singer^{2,4}

CEO of Echo360

Stephen G. Snyder^{1,3}

Corporate Director

Carol Stephenson^{2,3}

Corporate Director

William L. Young^{1,3}

Corporate Director

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 Risk Management Committee

Complete biographies of the members of the Board of Directors available on www.intactfc.com.

Executive Committee Members

Charles Brindamour

Chief Executive Officer

Louis Gagnon

President, Canadian Operations

T. Michael Miller

President, U.S. and Specialty Solutions

Patrick Barbeau

Senior Vice President, Claims

Martin Beaulieu

Senior Vice President and Chief Risk Officer

Paul Brehm

Senior Vice President, Specialty Solutions

Sonya Côté

Senior Vice President and Chief Internal Auditor

Frédéric Cotnoir

Senior Vice President, Corporate and Legal Services and Secretary

Debbie Coull-Cicchini

Executive Vice President, Intact Insurance

Dennis Crosby

Senior Vice President, Specialty Solutions (U.S.)*

Luisa Currie

Senior Vice President, Western Canada**

Joe D'Annunzio

Senior Vice President, BrokerLink

Jean-François Desautels

Senior Vice President, Québec and Digital Distribution, Intact Insurance

Monika Federau

Senior Vice President and Chief Strategy Officer

Anne Fortin

Senior Vice President, Direct Distribution and Chief Marketing Officer

Don Fox

Executive Vice President

Darren Godfrey

Senior Vice President, Personal Lines

Natalie Higgins

Senior Vice President, Atlantic Canada***

Karim Hirji

Senior Vice President, International and Ventures

Mathieu Lamy

Executive Vice President and Chief Operating Officer

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 Group Chief Actuary

Werner Muehleemann

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

Carla Smith

Senior Vice President, Corporate Development

Mark A. Tullis

Vice Chairman

Peter Weightman

Senior Vice President, Specialty Solutions and Surety (Canada)

* As of January 1, 2019, transition to part-time status.

** Since June 1, 2018

*** Since April 2018

MD&A and Financial Statements

Please note that the following MD&A and Financial Statements are provided as distinct sections with individual pagination:

MD&A – pages 1 to 80;

Financial Statements – pages 1 to 71.

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INTACT FINANCIAL CORPORATION

Management's Discussion and Analysis for the year ended December 31, 2018

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

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, 2018. 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, 2018, compared to the corresponding periods in 2017. It should be read in conjunction with our Consolidated financial statements for our fiscal year ended December 31, 2018. This MD&A is dated February 5, 2019.

"Intact", the "Company", "IFC", "we" and "our" are terms used throughout the document to refer to Intact Financial Corporation and its subsidiaries. Further information about Intact Financial Corporation, including the Annual Information Form, may be found online on SEDAR at www.sedar.com.

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Non-IFRS financial measures

We use both IFRS and non-IFRS financial measures to assess our performance. Non-IFRS financial measures do not have any standardized meaning prescribed by IFRS and are unlikely to be comparable to any similar measures presented by other companies. The non-IFRS measures included in this MD&A are: direct premiums written (DPW), change or growth in constant currency, net earned premiums (NEP), total net claims, underlying current year loss ratio, underwriting expenses, underwriting income (loss), combined ratio, net distribution income, net operating income (NOI), net operating income per share (NOIPS), operating return on equity (OROE), adjusted net income, adjusted net income per share (AEPS), adjusted return on equity (AROE) and market based yield. *See Section 27 – Non-IFRS financial measures for the definition and reconciliation to the most comparable IFRS measures.* These measures and other insurance-related terms used in this MD&A are defined in the glossary available in the “Investors” section of our web site at www.intactfc.com.

Important notes

- Unless otherwise noted, DPW refer to DPW normalized for the effect of multi-year policies, excluding industry pools, fronting and exited lines (referred to as “DPW” in this MD&A). DPW for 2017 were adjusted to exclude fronting from P&C Canada, to enhance comparability with our current reporting. *See Table 29 for details on exited lines and Table 31 for the reconciliation to DPW, as reported under IFRS.* All underwriting results and related ratios exclude the MYA and the results of our U.S. Commercial exited lines, unless otherwise noted. The expense and general expense ratios are presented herein net of other underwriting revenues.
- Catastrophe claims are any one claim, or group of claims, equal to or greater than \$7.5 million for P&C Canada (US\$5 million for P&C U.S.) related to a single event (referred to as the “CAT threshold”), and can either be weather-related or not weather-related (“other than weather-related”). A non-catastrophe weather event is a group of claims, which is considered significant but that is smaller than the CAT threshold, related to a single weather event.
- A large loss is defined as a single claim larger than \$0.25 million for P&C Canada (US\$0.25 million for P&C U.S.) but smaller than the CAT threshold.
- When relevant, we present changes in constant currency, which exclude the impact of fluctuations in foreign exchange rates from one period to the other, to enhance the analysis of our results with comparative periods. *See Section 27 – Non-IFRS financial measures.*
- Regulatory Capital Ratios refer to MCT (as defined by OSFI and the AMF in Canada) and RBC (as defined by the NAIC in the U.S.). All references to “total capital margin” in this MD&A include the aggregate of capital in excess of company action levels in regulated entities (170% MCT, 200% RBC and other CALs in other jurisdictions) plus available cash in unregulated entities.
- Unless otherwise noted, market share and market related data for P&C Canada are based on the latest available data (YTD Q3-2018) from MSA Research Inc. (“MSA”) and excludes Lloyd’s Underwriters Canada, Insurance Corporation of British Columbia, Saskatchewan Government Insurance, Saskatchewan Auto Fund, Genworth Financial Mortgage Insurance Company Canada and Canada Guaranty Mortgage Insurance Company. MSA data excludes certain Québec regulated entities. Market share and market positioning reflect the impact of announced or completed acquisitions and are therefore presented on a *pro forma* basis.
- Certain totals, subtotals and percentages may not agree due to rounding. 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%.

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. Unless otherwise indicated, all forward-looking statements in this MD&A are made as at December 31, 2018 and are subject to change after that date.

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:

Management's Discussion and Analysis for the year ended December 31, 2018

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

- 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, floating rate securities 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 and severity, including in the personal auto line of business;
- 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 and provide services to the Company;
- the Company's ability to successfully pursue its acquisition strategy; the Company's ability to execute its business strategy; the Company's ability to successfully pursue its acquisition strategy;
- the Company's ability to execute its business strategy;
- the Company's ability to achieve synergies arising from successful integration plans relating to acquisitions;
- the Company's profitability following the acquisition (the "Acquisition") of OneBeacon Insurance Group, Ltd. ("OneBeacon");
- the Company's ability to improve its Combined Ratio in the United States in relation to the Acquisition;
- the Company's ability to retain business and key employees in the United States in relation to the Acquisition;
- undisclosed liabilities in relation to the Acquisition;
- 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 and frequency of catastrophe events, including a major earthquake;
- catastrophe losses caused by severe weather and other weather-related losses, as well as the impact of climate change;
- the Company's ability to maintain its financial strength and issuer credit ratings; the Company's access to debt and equity financing;
- 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 ability to contain fraud and/or abuse; the Company's reliance on information technology and telecommunications systems and potential failure of or disruption to those systems, including in the context of evolving cybersecurity risk;
- the impact of developments in technology and use of data on the Company's products and distribution;
- the Company's dependence on and ability to retain 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 and the ability of the Company's subsidiaries to pay dividends;
- the volatility of the stock market and other factors affecting the trading prices of the Company's securities;
- the Company's ability to hedge exposures to fluctuations in foreign exchange rates;
- future sales of a substantial number of its common shares;
- changes in applicable tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof.


All of the forward-looking statements included in this MD&A and the quarterly earnings press release dated February 5, 2019, are qualified by these cautionary statements and those made in the section entitled Risk management (**Sections 19-24**) of our MD&A for the year ended December 31, 2018. These factors are not intended to represent a complete list of the factors that could affect the Company. These factors should, however, be considered carefully. Although the forward-looking statements are based upon what management believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. When relying on forward-looking statements to make decisions, investors should ensure the preceding information is carefully considered. Undue reliance should not be placed on forward-looking statements made herein. The Company and management have no intention and undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Management's Discussion and Analysis for the year ended December 31, 2018

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

Glossary of abbreviations

Description		Description	
AEPS	Adjusted EPS	MD&A	Management's Discussion and Analysis
AFS	Available for sale	Moody's	Moody's Investor Service Inc.
AMF	Autorité des marchés financiers	MYA	Market yield adjustment
AOCI	Accumulated OCI	NAIC	National Association of Insurance Commissioners
AROE	Adjusted ROE	NCIB	Normal course issuer bid
BVPS	Book value per share	NEP	Net earned premiums
CAD	Canadian Dollar	NOI	Net operating income
CAGR	Compound annual growth rate	NOIPS	NOI per share
CAL	Company action level	OCI	Other comprehensive income
CAN	Canada	OROE	Operating ROE
CAT	Catastrophe	OSFI	Office of the Superintendent of Financial Institutions
DBRS	Dominion Bond Rating Services	P&C	Property & Casualty
DPW	Direct premiums written	PTOI	Pre-tax operating income
EPS	Earnings per share to common shareholders	PYD	Prior year claims development
Fitch	Fitch Ratings Inc.	RBC	Risk-based capital
FVTPL	Fair value through profit and loss	ROE	Return on equity
IFRS	International Financial Reporting Standards	S&P	Standard & Poor's
KPI	Key performance indicator	U.S.	United States
MCT	Minimum capital test	USD	U.S. Dollar

 This icon represents data relevant to environmental, social and governance (ESG) disclosure including its impact on our results where applicable.

OVERVIEW

Section 1 – About Intact Financial Corporation

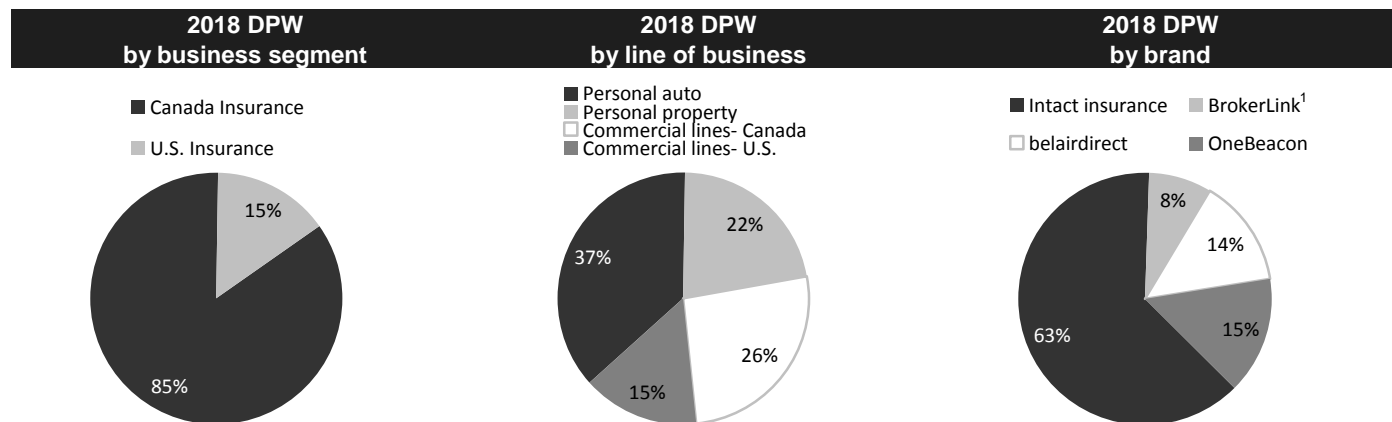
1.1 Who we are



- Largest provider of P&C insurance in Canada and a leading provider of specialty insurance in North America, with over \$10 billion in annual DPW.
- Approximately 14,000 full- and part-time employees who serve more than five million personal, business and public sector customers through offices in Canada and the U.S.
- In Canada, we distribute insurance under the Intact Insurance brand through a wide network of brokers, including our wholly-owned subsidiary BrokerLink, and directly to consumers through belairdirect. In the U.S., OneBeacon, a wholly-owned subsidiary, provides specialty insurance products through independent agencies, brokers, wholesalers and managing general agencies.
- We are a proven industry consolidator with a track record of 16 successful P&C acquisitions since 1988.

1.2 What we offer

With our comprehensive range of auto, home and business insurance products, we offer customers protection tailored to meet their unique needs. Across Intact, we share the same goal: We are here to help people, businesses and society prosper in good times and be resilient in bad times. Making a difference is important to us; it is our purpose.



¹ Represents Intact insurance premiums sold through BrokerLink

Management's Discussion and Analysis for the year ended December 31, 2018

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

1.3 Our business segments

We report our financial results under the business segments set out below. The composition of our segments is aligned with our management structure and internal financial reporting based on geography and the nature of our activities.

Intact Financial Corporation	
Canada (CAN)	<p>Comprised of underwriting (P&C Canada) and distribution activities in Canada</p> <ul style="list-style-type: none"> Underwriting of automobile, home and business insurance contracts to individual and businesses in Canada. Underwriting results in Canada are reported under three lines of business (<i>see Section 4</i>): <ul style="list-style-type: none"> Personal auto Personal property Commercial, which include Commercial auto and Commercial P&C Distribution operations, including the operating results of our wholly-owned broker, BrokerLink, as well as our share of results of broker affiliates.
U.S.	<p>Comprised of underwriting activities in the U.S. (P&C U.S.)</p> <ul style="list-style-type: none"> Underwriting of specialty contracts mainly to small and midsize businesses in the U.S., which are reported under: <ul style="list-style-type: none"> Commercial lines, which include the underwriting results of OneBeacon since September 28, 2017 (<i>see Section 5</i>).
Corporate and Other (Corporate)	<p>Comprised of the following activities, which are managed at the Corporate level</p> <ul style="list-style-type: none"> Investment management Treasury and capital management Other corporate activities, including internal reinsurance <p>Operating results include net investment income, finance costs, as well as other income and expenses (including corporate expenses and ancillary income) (<i>see Section 6</i>).</p>

We measure our consolidated performance mainly based on NOIPS and business segment performance based on pre-tax operating income (PTOI).

Table 1 – Operating performance by segment¹

For the years ended Dec. 31,				2018				2017
	CAN	U.S.	Corporate	Total	CAN	U.S.	Corporate	Total
DPW	8,601	1,489	-	10,090	8,423	307	-	8,730
NEP	8,332	1,380	3	9,715	8,204	326	-	8,530
Operating income								
Underwriting income	400	71	3	474	478	8	-	486
Net investment income	-	-	529	529	-	-	432	432
Net distribution income	146	-	-	146	132	-	-	132
Finance costs	-	-	(103)	(103)	-	-	(82)	(82)
Other income (expense)	-	-	(18)	(18)	-	-	5	5
Pre-tax operating income (PTOI)	546	71	411	1,028	610	8	355	973
Net operating income (NOI)				839				771
NOIPS (in dollars)				5.74				5.60

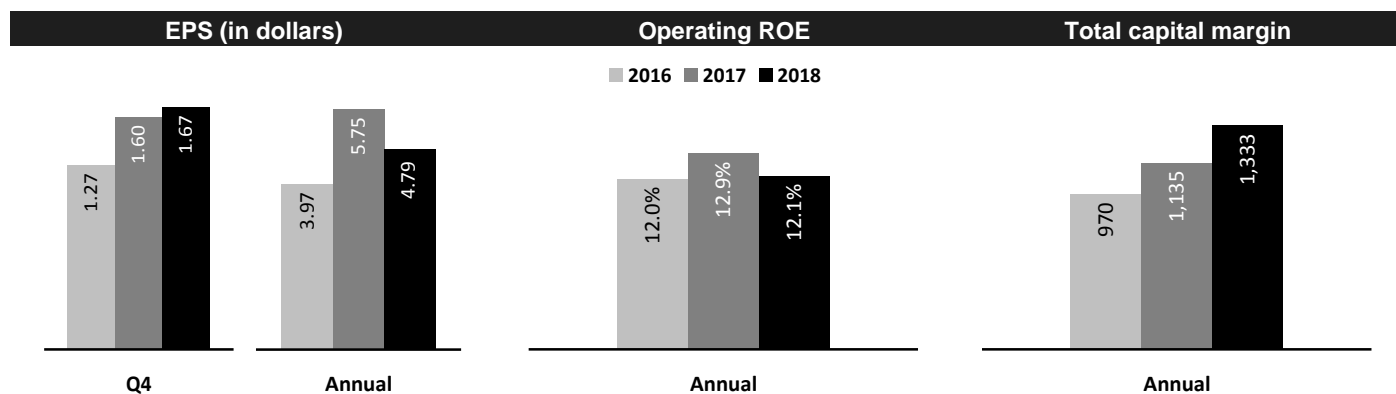
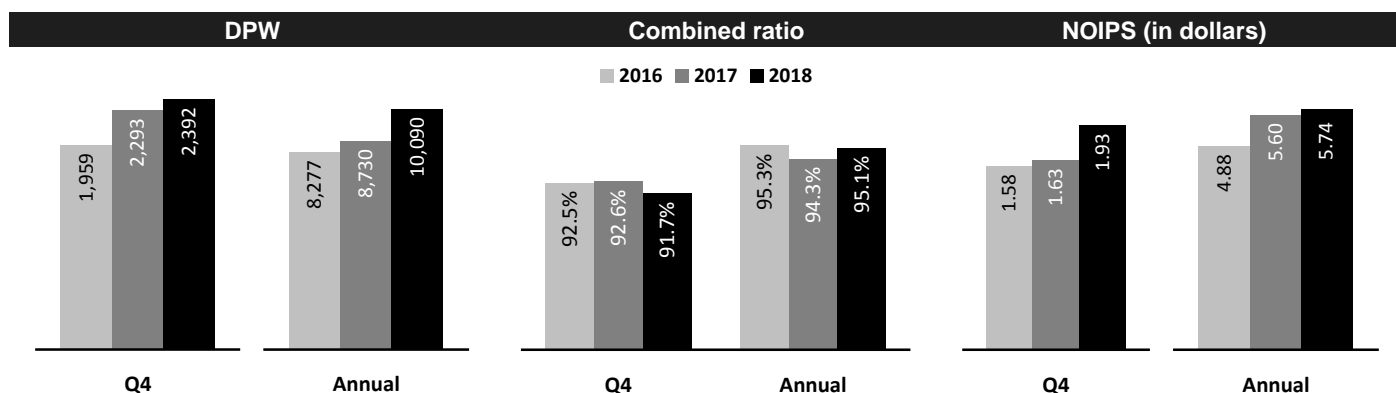
¹ Refer to Section 27 – Non-IFRS financial measures.

Section 2 – Our performance at a glance

Full year 2018 Highlights

DPW growth	NOIPS growth	OROE	Total capital margin	BVPS
+16%	+3%	12.1%	\$1.3 billion	+2%

- Net operating income per share up 19% to \$1.93 in Q4-2018 driven by solid operating results
- Premiums grew 4% in the quarter and 16% for the full year fuelled by commercial lines across North America
- Combined ratio of 91.7% in Q4-2018 with significant improvement in personal auto
- Full year NOIPS of \$5.74 drove Operating ROE of 12.1%, with over \$1.3 billion of total capital margin
- Quarterly dividend increased by 9% to \$0.76 per common share



Management's Discussion and Analysis for the year ended December 31, 2018

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

Section 3 – Consolidated performance

Table 2 – Consolidated performance¹

	Q4-2018	Q4-2017	Change	2018	2017	Change
DPW	2,392	2,293	4%	10,090	8,730	16%
NEP	2,509	2,400	5%	9,715	8,530	14%
Operating income						
Underwriting income	210	178	32	474	486	(12)
Net investment income	140	121	19	529	432	97
Net distribution income	36	28	8	146	132	14
Finance costs	(27)	(25)	(2)	(103)	(82)	(21)
Other income (expense)	(6)	2	(8)	(18)	5	(23)
PTOI	353	304	49	1,028	973	55
NOI	281	236	19%	839	771	9%
Non-operating gains (losses)	(42)	(58)	16	(142)	(31)	(111)
Effective income tax rate	21.5%	5.9%	15.6 pts	20.2%	15.9%	4.3 pts
Net income	244	232	5 %	707	792	(11)%
Underwriting ratios						
Claims ratio	62.7%	63.5%	(0.8) pts	65.3%	65.4%	(0.1) pts
Expense ratio	29.0%	29.1%	(0.1) pts	29.8%	28.9%	0.9 pts
Combined ratio	91.7%	92.6%	(0.9) pts	95.1%	94.3%	0.8 pts
Per share measures, basic and diluted (in dollars)						
NOIPS	1.93	1.63	19%	5.74	5.60	3%
EPS	1.67	1.60	4%	4.79	5.75	(17)%
BVPS	48.73	48.00	2%			
Return on equity for the last 12 months						
OROE	12.1%	12.9%	(0.8) pts			
ROE	9.9%	12.8%	(2.9) pts			
Total capital margin	1,333	1,135	198			
Debt-to-total capital ratio	22.0%	23.1%	(1.1) pts			

¹ Refer to Section 27 – Non-IFRS financial measures.

Table 3 – Performance by business segment¹

	Section	Q4-2018	Q4-2017	Change	2018	2017	Change
DPW growth in constant currency							
Canada	4.4	2,067	1,986	4%	8,601	8,423	2%
U.S.	5.3	325	307	2%	1,489	307	nm
		2,392	2,293	4%	10,090	8,730	16%
Combined ratio							
Canada	4.4	90.8%	91.9%	(1.1) pts	95.2%	94.2%	1.0 pts
U.S.	5.3	96.7%	97.4%	(0.7) pts	94.8%	97.4%	nm
		91.7%	92.6%	(0.9) pts	95.1%	94.3%	0.8 pts
PTOI							
Canada	4.3	232	198	17%	546	610	(10)%
U.S.	5.3	13	8	63%	71	8	nm
Corporate and Other	6.4	108	98	10%	411	355	16%
		353	304	16%	1,028	973	6%

¹ Refer to Section 27 – Non-IFRS financial measures.

Management's Discussion and Analysis for the year ended December 31, 2018

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

	Q4-2018 vs Q4-2017	2018 vs 2017
DPW growth	<ul style="list-style-type: none"> Our premiums grew 4% in the quarter with strong growth in commercial and specialty lines across North America. 	<ul style="list-style-type: none"> Our premiums grew 16% for the full year, mainly from the acquisition of OneBeacon which contributed 14% to our topline, and strong growth in both commercial and specialty lines in Canada.
Underwriting performance	<ul style="list-style-type: none"> Overall combined ratio was solid at 91.7%, with improved underlying performances in both Canada and the U.S. Combined ratio for Canada was strong at 90.8%, 1.1 points better than last year, reflecting significant improvement in personal auto, tempered by a deterioration in commercial lines. Combined ratio in the U.S. was 96.7%, as a healthy underlying performance was offset by 5.9 points of CAT losses. 	<ul style="list-style-type: none"> Overall combined ratio of 95.1% with solid underlying performances in both Canada and the U.S. Combined ratio for Canada deteriorated by one point to 95.2%, as the improvement in personal auto was more than offset by higher large losses and catastrophe losses in commercial lines. Solid combined ratio in the U.S. of 94.8%, in line with expectations for 2018, reflecting good progress towards our goal of achieving a sustainable combined ratio in the low-90s within 18-24 months.
Net investment income	<ul style="list-style-type: none"> Net investment income was up 16% from investment optimization initiatives and higher yields. 	<ul style="list-style-type: none"> Net investment income was up 22%, due to the growth in our investment portfolio following the acquisition of OneBeacon, as well as investment optimization initiatives and higher yields.
Net distribution income	<ul style="list-style-type: none"> Net distribution income was up 29% to \$36 million due to organic growth, improved margins and broker acquisitions. 	<ul style="list-style-type: none"> Net distribution income was up 11% to \$146 million, reflecting the continued growth of our broker network and improved profitability.
NOIPS	<ul style="list-style-type: none"> NOIPS of \$1.93 up 19%, due to improved underwriting performance and strong growth in both net investment income and net distribution income. 	<ul style="list-style-type: none"> NOIPS of \$5.74 improved by 3%, largely driven by the acquisition of OneBeacon, which delivered solid underwriting results and drove the strong growth in net investment income.
Effective income tax rate	<ul style="list-style-type: none"> Effective income tax rate of 21.5% for the quarter and 20.2% for the full year was largely in line with expectations. In 2017, the effective income tax rate was unusually low as it included a one-time income tax recovery related to the enactment of the U.S. Corporate tax reform as well as higher non-taxable gains. 	
Net income	<ul style="list-style-type: none"> Net income of \$244 million was up 5%, driven by solid operating earnings. 	<ul style="list-style-type: none"> Net income of \$707 million was down 11%, despite higher operating earnings. In 2017, we had benefited from one-time non-operating gains relating to the acquisition of OneBeacon.
OROE	<ul style="list-style-type: none"> Operating ROE for the 12 months ended December 31, 2018 was 12.1%, due to weak personal auto results in the earlier part of 2018, as well as elevated large losses in commercial lines. Our OROE remains well above the industry, though below our historical track record. 	
Financial condition	<ul style="list-style-type: none"> BVPS of \$48.73 increased 2% from a year ago as our earnings, net of common share dividends, were offset in part by the impact of unfavourable capital markets on our investment portfolio. Our debt-to-total capital ratio of 22.0% as at December 31, 2018 increased by 0.3 points in the quarter mainly due to the weaker capital markets, which resulted in a lower equity base. For the full year, it decreased by 1.1 points as we continue to track towards our goal of 20% in 2019. We ended the year in a strong financial position, with over \$1.3 billion of total capital margin. 	

Constant currency

With the acquisition of OneBeacon, approximately 15% of our premiums are written in USD. The impact of fluctuations in foreign exchange rates was not material to our consolidated performance for the year ended December 31, 2018. See [Section 5 – U.S.](#) for the impact on our U.S. results.

SEGMENT PERFORMANCE

Section 4 – Canada

4.1 Canada’s largest home, auto and business insurer

- Largest P&C insurer in Canada, with \$8.6 billion in annual DPW and an approximate market share of 17%.
- We distribute insurance in Canada under the Intact Insurance brand through a wide network of brokers, including our wholly-owned subsidiary BrokerLink, and directly to consumers through belairdirect.
- Largest private sector provider of P&C insurance in most provinces.

4.2 We offer a comprehensive range of insurance products

Personal auto

- We offer various levels of coverage to our customers for their vehicles including accident benefits, third party property and physical damage. Our coverage is also available for motor homes, recreational vehicles, motorcycles, snowmobiles, and all terrain vehicles.

Personal property

- Our customers can get protection for their homes and contents from risks such as fire, theft, vandalism, water damage and other damages, as well as personal liability coverage. Property coverage is also available for tenants, condominium owners, non-owner-occupied residences and seasonal residences.

Commercial lines (including specialty lines)

- We provide a broad range of coverages tailored to the needs of a diversified group of small and medium sized businesses including commercial landlords, manufacturers, contractors, wholesalers, retailers, transportation businesses, agriculture businesses and service providers.
- Commercial property coverages protect the physical assets of the business and include business interruption insurance. Liability coverages include commercial general liability, product liability, professional liability as well as cyber endorsement.
- Commercial vehicle coverages provide protection for commercial auto, fleets, garage operations, light trucks, public vehicles and the specific needs of the sharing economy.

4.3 Operating performance

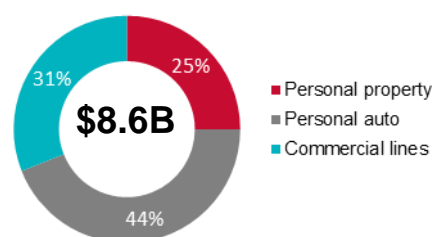
Table 4 – Operating performance

	Section	Q4-2018	Q4-2017	Change	2018	2017	Change
Canada							
P&C Canada	4.4	196	170	15%	400	478	(16)%
Distribution		36	28	29%	146	132	11%
PTOI		232	198	17%	546	610	(10)%

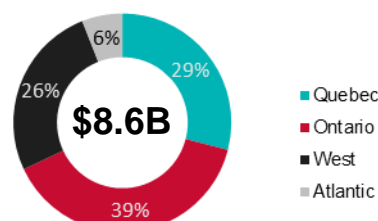


17%
Market share

2018 DPW by line of business



2018 DPW by geographic location



Management's Discussion and Analysis for the year ended December 31, 2018

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

4.4 P&C Canada

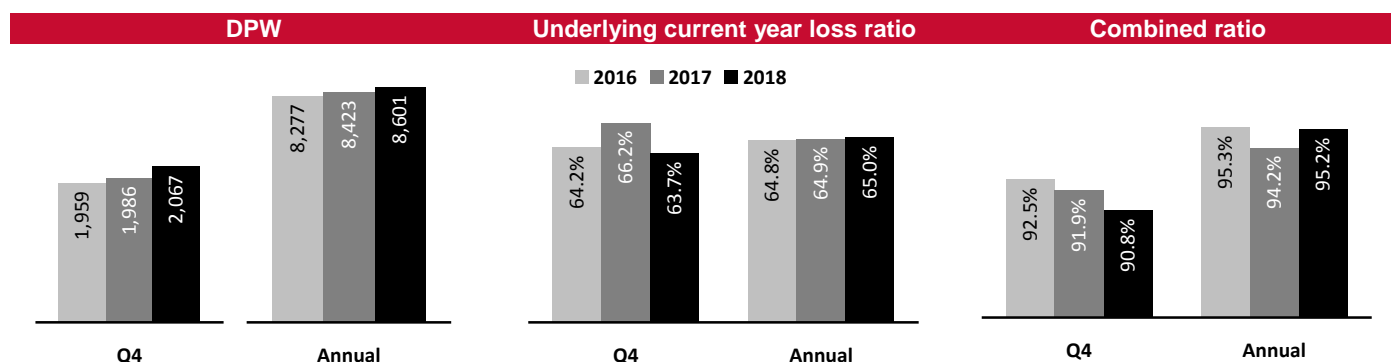
Table 5 – Underwriting results for P&C Canada¹

	Q4-2018	Q4-2017	Change	2018	2017	Change
DPW	2,067	1,986	4%	8,601	8,423	2%
NEP	2,129	2,074	3%	8,332	8,204	2%
Current year claims (excluding CAT claims)	1,356	1,372	(16)	5,411	5,321	90
Current year CAT claims	33	31	2	308	313	(5)
(Favourable) unfavourable PYD	(56)	(77)	21	(181)	(253)	72
Total net claims	1,333	1,326	7	5,538	5,381	157
Underwriting expenses	600	578	22	2,394	2,345	49
Underwriting income	196	170	26	400	478	(78)
Underwriting ratios						
Underlying current year loss ratio	63.7%	66.2%	(2.5) pts	65.0%	64.9%	0.1 pts
CAT loss ratio	1.6%	1.5%	0.1 pts	3.7%	3.8%	(0.1) pts
(Favourable) unfavourable PYD ratio	(2.7)%	(3.7)%	1.0 pts	(2.2)%	(3.1)%	0.9 pts
Claims ratio	62.6%	64.0%	(1.4) pts	66.5%	65.6%	0.9 pts
Commissions	14.9%	14.5%	0.4 pts	15.3%	15.2%	0.1 pts
General expenses	9.6%	9.7%	(0.1) pts	9.6%	9.7%	(0.1) pts
Premium taxes	3.7%	3.7%	- pts	3.8%	3.7%	0.1 pts
Expense ratio	28.2%	27.9%	0.3 pts	28.7%	28.6%	0.1 pts
Combined ratio	90.8%	91.9%	(1.1) pts	95.2%	94.2%	1.0 pts

¹ Refer to Section 27 – Non-IFRS financial measures.

Table 6 – Performance by line of business – Canada

	Section	Q4-2018	Q4-2017	Change	2018	2017	Change
DPW growth							
Personal auto	4.5	818	824	(1)%	3,750	3,818	(2)%
Personal property	4.6	517	505	2%	2,186	2,135	2%
Commercial lines	4.7	732	657	11%	2,665	2,470	8%
		2,067	1,986	4%	8,601	8,423	2%
Combined ratio							
Personal auto	4.5	97.3%	101.2%	(3.9) pts	99.5%	101.7%	(2.2) pts
Personal property	4.6	78.5%	79.7%	(1.2) pts	88.3%	89.1%	(0.8) pts
Commercial lines	4.7	91.6%	87.4%	4.2 pts	94.6%	86.5%	8.1 pts
		90.8%	91.9%	(1.1) pts	95.2%	94.2%	1.0 pts



Management's Discussion and Analysis for the year ended December 31, 2018

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

Q4-2018 vs Q4-2017	2018 vs 2017
<ul style="list-style-type: none"> • DPW growth of 4% reflected very strong growth in commercial lines, including specialty lines. Growth in personal lines remained tempered by our profitability actions in personal auto. • Underlying current year loss ratio improved by 2.5 points to 63.7%, reflecting 7 points of improvement in personal auto, offset in part by deterioration in commercial lines. • CAT loss ratio of 1.6% was in line with last year and expectations. • Lower favourable PYD ratios of 2.7% for the quarter and 2.2% for the full year, though they were in line with expectations. • Expense ratio of 28.2% in the quarter and 28.7% for the full year remained lower than historical levels thanks to our expense initiatives and to lower variable commissions. The increase in commissions in the quarter was due to improved profitability. • We delivered a very strong combined ratio of 90.8%, 1.1 points better than last year, with outstanding results in personal property and significant improvement in personal auto. This was tempered by a deterioration in commercial lines. 	<ul style="list-style-type: none"> • DPW growth of 2% reflected strong growth in commercial lines, while growth in personal lines was tempered by the impact of our profitability actions in personal auto. • Underlying current year loss ratio of 65.0% is essentially unchanged, as continued improvement in personal auto was offset by higher large losses and severe weather in commercial lines and personal property. • CAT loss ratio of 3.7% was mostly weather-related and comparable to last year, though it remains above expectations. • We completed the year with a combined ratio of 95.2%, up one point compared to last year, as strong results in personal lines including improvement in personal auto, were more than offset by higher large losses in commercial lines.

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



4.5 Personal auto

Table 7 – Underwriting results for personal auto

	Q4-2018	Q4-2017	Change	2018	2017	Change
DPW	818	824	(1)%	3,750	3,818	(2)%
Written insured risks (in thousands)	866	917	(6)%	4,159	4,319	(4)%
NEP	934	952	(2)%	3,727	3,782	(1)%
Underwriting income (loss)	26	(11)	nm	19	(64)	nm
Underlying current year loss ratio	74.4%	81.4%	(7.0) pts	74.7%	77.7%	(3.0) pts
CAT loss ratio	- %	0.2%	(0.2) pts	0.6%	0.7%	(0.1) pts
(Favourable) unfavourable PYD ratio	0.3%	(2.8)%	3.1 pts	1.3%	0.3%	1.0 pts
Claims ratio	74.7%	78.8%	(4.1) pts	76.6%	78.7%	(2.1) pts
Expense ratio	22.6%	22.4%	0.2 pts	22.9%	23.0%	(0.1) pts
Combined ratio	97.3%	101.2%	(3.9) pts	99.5%	101.7%	(2.2) pts

Q4-2018 vs Q4-2017

- **DPW declined by 1%**, as we remain ahead of the market in terms of rate increases. There is growing evidence of improving market conditions based on recent rate filings and growth in the risk sharing pools.
- **Underlying current year loss ratio of 74.4%** improved by 7.0 points, mostly attributable to our profitability actions. Our rate increases and other profitability actions have delivered another quarter of lower claims frequency and severity, strengthening our view that our actions are effective.
- **Unfavourable PYD ratio was minimal at 0.3%**.
- **Combined ratio of 97.3%** improved by 3.9 points, reflecting a significant improvement in underlying performance offset in part by a deterioration in PYD.
- **Our profitability actions have yielded results. We have reached a mid-90s combined ratio run-rate and are now focused on sustaining that performance.** We remain well positioned to capture potential growth opportunities as market conditions continue to improve.

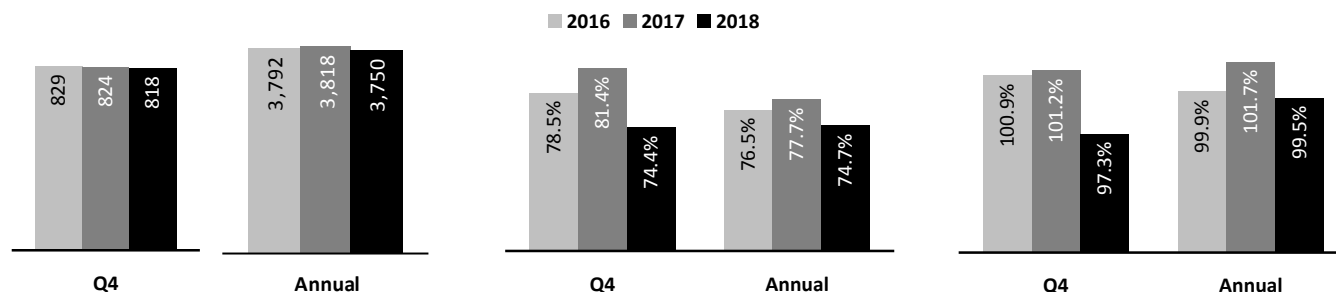
2018 vs 2017

- **DPW declined by 2%**, reflecting continued profitability actions including rate increases taken ahead of our competitors. Our segmentation initiatives, including changes to our regional and new business mix, have improved the portfolio quality while impacting unit growth.
- **Underlying current year loss ratio of 74.7%** improved by 3.0 points due to the continued benefits of our action plan including rate increases across the country. Weather-related losses were essentially in line with 2017.
- **Unfavourable PYD ratio of 1.3%**, mostly driven by unfavourable development on Ontario Accident Benefit (AB) files dating prior to the 2016 reform.
- **Combined ratio of 99.5%** improved by 2.2 points, as an improved underlying performance driven by the benefits of our profitability actions was offset in part by higher unfavourable PYD.

DPW

Underlying current year loss ratio

Combined ratio



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



4.6 Personal property

Table 8 – Underwriting results for personal property

	Q4-2018	Q4-2017	Change	2018	2017	Change
DPW	517	505	2%	2,186	2,135	2%
Written insured risks (in thousands)	547	556	(2)%	2,364	2,395	(1)%
NEP	534	522	2%	2,098	2,040	3%
Underwriting income	115	106	8%	246	222	11%
Underlying current year loss ratio	47.1%	49.3%	(2.2) pts	52.0%	49.6%	2.4 pts
CAT loss ratio	2.1%	1.9%	0.2 pts	7.6%	10.2%	(2.6) pts
(Favourable) unfavourable PYD ratio	(2.9)%	(3.2)%	0.3 pts	(3.7)%	(3.0)%	(0.7) pts
Claims ratio	46.3%	48.0%	(1.7) pts	55.9%	56.8%	(0.9) pts
Expense ratio	32.2%	31.7%	0.5 pts	32.4%	32.3%	0.1 pts
Combined ratio	78.5%	79.7%	(1.2) pts	88.3%	89.1%	(0.8) pts

Q4-2018 vs Q4-2017

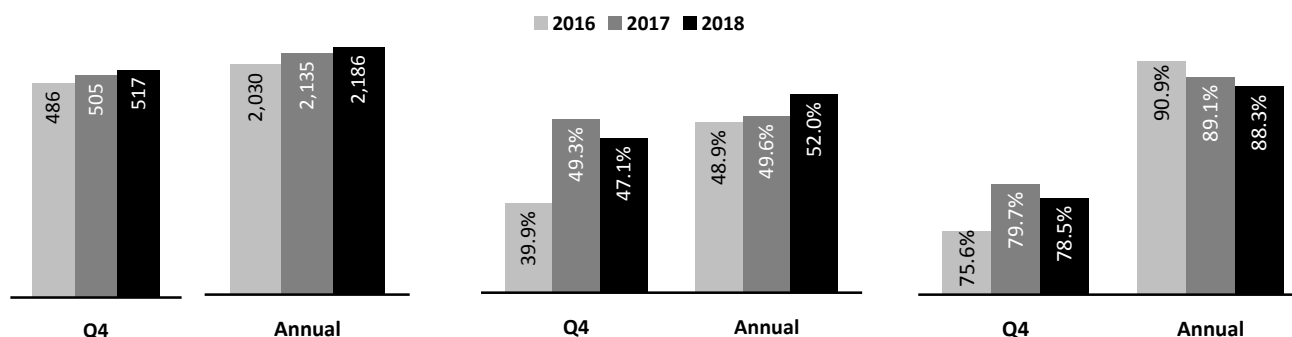
2018 vs 2017

- **DPW growth of 2% in the quarter and the full year** reflected continuing rate increases in firm market conditions, tempered by the impact of profitability actions in personal auto.
- **Underlying current year loss ratio was very strong at 47.1%** and improved by 2.2 points, despite an increase in weather-related losses of roughly 2 points.
- **CAT loss ratio of 2.1%** was essentially in line with last year.
- **Favourable PYD ratio of 2.9% in the quarter and 3.7% in the full year** remained healthy.
- **This line continues to perform very well with combined ratios of 78.5% in the quarter and 88.3% for the full year**, including the impact of severe weather. With market conditions remaining firm, this line is well positioned for the future.
- **Underlying current year loss ratio for the year remains solid at 52.0%**, though it deteriorated by 2.4 points from last year, due to an increase in weather-related claims and large losses.
- **CAT loss ratio of 7.6%** was lower than last year, though in line with expectations.

DPW

Underlying current year loss ratio

Combined ratio



Management's Discussion and Analysis for the year ended December 31, 2018

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

4.7 Commercial lines



Table 9 – Underwriting results for Commercial lines Canada, including Commercial P&C and Commercial auto

	Q4-2018	Q4-2017	Change	2018	2017	Change
DPW	732	657	11%	2,665	2,470	8%
Commercial P&C	502	462	9%	1,822	1,716	6%
Commercial auto	230	195	18%	843	754	12%
NEP	661	600	10%	2,507	2,382	5%
Underwriting income (loss)	55	75	(27)%	135	320	(58)%
Underlying current year loss ratio	62.0%	56.9%	5.1 pts	61.3%	57.5%	3.8 pts
CAT loss ratio	3.4%	2.9%	0.5 pts	4.9%	3.1%	1.8 pts
(Favourable) unfavourable PYD ratio	(6.7)%	(5.6)%	(1.1) pts	(6.0)%	(8.4)%	2.4 pts
Claims ratio	58.7%	54.2%	4.5 pts	60.2%	52.2%	8.0 pts
Expense ratio	32.9%	33.2%	(0.3) pts	34.4%	34.3%	0.1 pts
Combined ratio	91.6%	87.4%	4.2 pts	94.6%	86.5%	8.1 pts

Q4-2018 vs Q4-2017

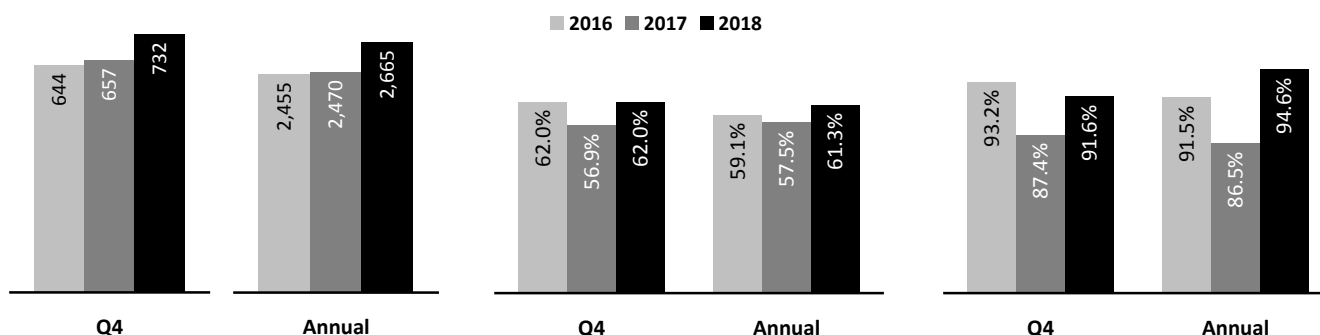
2018 vs 2017

- **Very strong DPW growth of 11%**, as we continue to benefit from rate momentum in firm market conditions and robust growth in specialty lines.
- **Underlying current year loss ratio of 62.0%** was healthy, though it deteriorated by 5.1 points from last year's strong performance.
- **CAT loss ratio was 3.4%**, roughly twice our expectations.
- **Favourable PYD of 6.7%** remained healthy.
- **Combined ratio of 91.6% deteriorated by 4.2 points** from last year's very strong performance, which had a lower level of large losses.
- **The underlying fundamentals of this business remain strong**, supported by firm market conditions and a high-quality portfolio.
- **Strong DPW growth of 8%**, as both segments are benefiting from rate momentum in firm market conditions and strong growth in specialty lines.
- **Underlying current year loss ratio of 61.3%** deteriorated by 3.8 points, mainly due to elevated large losses.
- **CAT loss ratio of 4.9%** was roughly twice the expected amount, and mostly driven by severe weather.
- **Favourable PYD of 6.0%** remained healthy, though lower than last year's elevated level.
- **Combined ratio of 94.6% deteriorated by 8.1 points** compared to last year's exceptionally strong performance, driven by elevated large losses and higher CAT losses.

DPW

Underlying current year loss ratio

Combined ratio



Management’s Discussion and Analysis for the year ended December 31, 2018

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

Section 5 – U.S.

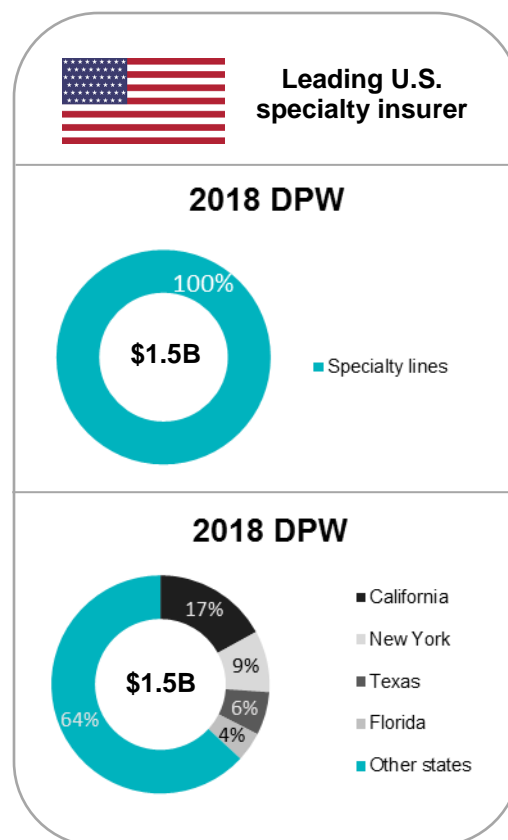
The acquisition of OneBeacon was completed on September 28, 2017.

5.1 A pure-play specialty lines insurer

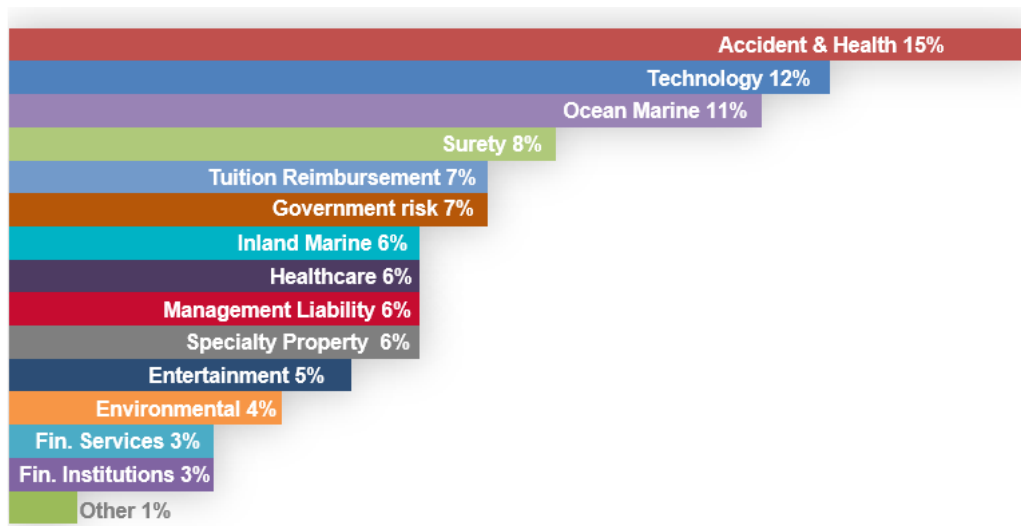
- Leading U.S. specialty insurer focused on small to midsized businesses, with US\$1.1 billion (CAD\$1.5 billion) in annual DPW.
- Distributes insurance products and services in the U.S. under the OneBeacon brand through independent agencies, regional and national brokers, wholesalers and managing general agencies.
- OneBeacon operates through five underwriting companies: Atlantic Specialty Insurance Company, Homeland Insurance Company of Delaware, Homeland Insurance Company of New York, OBI America Insurance Company and OBI National Insurance Company.

5.2 What we offer

- Specialty insurance to solve the unique needs of particular customers or industry groups including accident and health, technology, ocean and inland marine, public entities, and entertainment.
- Distinct specialty products and tailored coverages to a broad customer base across the U.S. in areas such as healthcare, tuition reimbursement, surety, management liability, financial services, specialty property, environmental and financial institutions.
- Each OneBeacon business unit is managed by an experienced team of specialty insurance professionals focused on a specific customer group or industry segment. Competitive factors for most of our insurance products are price, product terms and conditions, agency and broker relationships, claims service, company scale and financial stability.



DPW by business unit



Management's Discussion and Analysis for the year ended December 31, 2018

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



5.3 P&C U.S.

All figures in the table below are shown in CAD, using an average exchange rate of 1.32 for Q4-2018 and 1.30 for full year 2018 (Q4-2017 results were converted at 1.27). Percentage changes reported in constant currency exclude the impact of currency fluctuations. *See Section 27 – Non-IFRS financial measures.*

Table 10 – Underwriting results for P&C U.S. ¹

	Q4-2018	Q4-2017	Change	FY 2018	Q4-2017	Change ²
DPW	325	307	6%	1,489	307	nm
<i>Growth in constant currency</i>			2%			nm
NEP	379	326	16%	1,380	326	nm
<i>Growth in constant currency</i>			12%			nm
Current year claims	211	183	28	786	183	nm
Current year CAT claims	22	-	22	22	-	nm
(Favourable) unfavourable PYD	6	15	(9)	(4)	15	nm
Net claims incurred	239	198	41	804	198	nm
Underwriting expenses	127	120	7	505	120	nm
Underwriting income	13	8	5	71	8	nm
Underwriting ratios³						
Underlying current year loss ratio	55.6%	55.9%	(0.3) pts	56.9%	55.9%	nm
CAT loss ratio	5.9%	-	5.9 pts	1.6%	-	nm
(Favourable) unfavourable PYD ratio	1.5%	4.6%	(3.1) pts	(0.3)%	4.6%	nm
Claims ratio	63.0%	60.5%	2.5 pts	58.2%	60.5%	nm
Commissions	14.9%	16.8%	(1.9) pts	15.5%	16.8%	nm
General expenses	17.8%	18.2%	(0.4) pts	19.0%	18.2%	nm
Premium taxes	1.0%	1.9%	(0.9) pts	2.1%	1.9%	nm
Expense ratio	33.7%	36.9%	(3.2) pts	36.6%	36.9%	nm
Combined ratio	96.7%	97.4%	(0.7) pts	94.8%	97.4%	nm

¹ Excluding the results of exited lines (*see Section 27 – Non-IFRS financial measures*).

² Change for FY 2018 vs Q4-2017 is not meaningful, as 2017 includes only three months of results given the acquisition date of September 28, 2017.

³ The impact of currency fluctuations on underwriting ratios is minimal and is not considered significant.

Management's Discussion and Analysis for the year ended December 31, 2018

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

Q4-2018 vs Q4-2017	2018 ¹
<ul style="list-style-type: none"> • DPW growth of 2% on a constant currency basis with solid progress in our growth focus lines, tempered by the impact of our profitability improvement actions in other lines. • Underlying current year loss ratio was healthy at 55.6% in the quarter and 56.9% in the full year. • CAT loss ratio of 5.9% in the quarter, mainly reflected the impact of hurricane Michael and large commercial fires. From a full year perspective, CAT loss ratio of 1.6% in 2018 was slightly above our expectations. • Though PYD was unfavourable 1.5% in the quarter, it was slightly favourable for the full year. <i>Refer to Section 15.2 – Reinsurance for more details on the Adverse Development Coverage (ADC).</i> • Expense ratio of 33.7% reflected the seasonality of our operations, though it was slightly better than our expectations for the fourth quarter mainly due to business mix and a one-time favourable adjustment to premium taxes. • We have realized another US\$7 million of synergies in the quarter. On a run-rate basis, we have exceeded our target of US\$25 million of annual synergies, ahead of schedule. • Combined ratio of 96.7% improved marginally, after absorbing 5.9 points of CAT losses, thanks to a better expense ratio and lower unfavourable PYD. • We continue to realize the benefits of our underwriting profitability actions, the internalization of claims and our expense synergies. 	<ul style="list-style-type: none"> • DPW growth of 2% for the full year on a constant currency basis reflected strong new business, tempered by the impact of our profitability improvement actions. • Expense ratio of 36.6% reflected our continued focus on cost saving initiatives including realized synergies, and was slightly better than expectations. • Combined ratio of 94.8% was in line with our expectations for 2018. Though further progress remains, we are on track towards achieving our goal of a sustainable combined ratio in the low-90s within 18-24 months.

¹ 2018 full year performance is not comparable to 2017 performance, which only includes one quarter of results.

Management’s Discussion and Analysis for the year ended December 31, 2018

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

Section 6 – Corporate and Other

Comprised of the following activities, which are managed at the Corporate level:

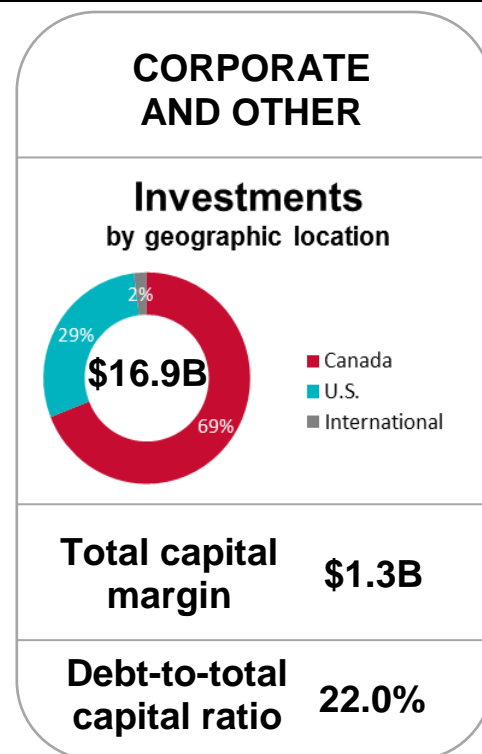
- Investing related to P&C insurance
- Treasury and capital management
- Other corporate activities, including internal reinsurance

Operating results include net investment income, finance costs, as well as other income and expenses, as shown in Table 11 below.

6.1 \$17 billion of high-quality investments strategically managed

Our investments totalled \$16.9 billion as at December 31, 2018, up \$123 million from December 31, 2017 despite the decline in capital markets in Q4-2018 (see Section 6.5 – Capital markets). Our approach to investment management continues to reflect our objective of maximizing after-tax returns and outperforming our peers’ investment returns over the long-term, while ensuring policyholder protection and maintaining strong regulatory capital levels.

We continue to manage our investment portfolio to achieve these objectives via appropriate asset allocation and active management investment strategies, while minimizing the potential for large investment losses with diversification and limits on our investment exposures. Such limits are specified in our investment policies and are designed to be consistent with our overall risk tolerance. Management monitors and ensures compliance with our investment policies.



6.2 Maximizing long-term shareholder value by optimizing capital

Our objectives when managing capital consist of:

- maintaining strong regulatory capital levels, while ensuring policyholders are well protected; and
- maximizing long-term shareholder value by optimizing capital used to operate and grow the Company.

6.3 Treasury management: evolving in an international context

We have a centralized best-in-class treasury management approach that ensures access to funds in multiple currencies and mitigates the impact of volatility in capital markets on our shareholder’s equity.

6.4 Operating performance

Table 11 – Corporate and other (operating performance)

	Section	Q4-2018	Q4-2017	Change	2018	2017	Change
Underwriting income ¹		1	-	1	3	-	3
Net investment income	6.6	140	121	19	529	432	97
Finance costs		(27)	(25)	(2)	(103)	(82)	(21)
Other income (expense) ²		(6)	2	(8)	(18)	5	(23)
Corporate and other		108	98	10	411	355	56

¹ Reflected the impact of our internal reinsurance treaty.

² Includes general corporate expenses, consolidation adjustments, regulatory fees related to our public company status, special projects and other operating items. These can fluctuate from quarter to quarter.

2018 vs 2017

- **Finance costs** increased in 2018 due to the issuance of the Series 7 medium term notes in Q2-2017.
- **Other expense increased in the quarter and the full year** mainly due to the impact of the unfavourable capital markets on restricted fund assets, and a one-time favourable adjustment in 2017.

Management's Discussion and Analysis for the year ended December 31, 2018

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

6.5 Capital markets

While the correlation between the performance of capital markets and the performance of our investment portfolio is not perfect, the following market indicators may be useful in understanding the overall performance of our investments. *Refer to Section 6.6 – Net investment income, Section 6.7 – Net gains (losses) and Section 14 – Investments for further details.*

Table 12 – Selected market indicators

Selected market Indicators	Q4-2018	Q4-2017	2018	2017
S&P/TSX Composite	(11)%	4%	(12)%	6%
S&P/TSX Financials	(12)%	5%	(13)%	9%
S&P/TSX Preferred Share Index	(11)%	1%	(12)%	8%
5Y Canada Sovereign Index (estimated variance in bps)	(41) bps	13 bps	8 bps	78 bps
5Y AA Corporate spread (estimated variance in bps)	26 bps	(5) bps	32 bps	(21) bps
DJ Dividend 100 Composite (U.S.)	(11)%	9%	(8)%	17%
5Y U.S. Sovereign Index (estimated variance in bps)	(44) bps	27 bps	31 bps	28 bps
Strengthening (weakening) of USD vs CAD	6%	1%	8%	(6)%

6.6 Net investment income

Table 13 – Net investment income

	Q4-2018	Q4-2017	Change	2018	2017	Change
Interest income	94	81	13	351	275	76
Dividend income	55	50	5	213	194	19
Investment income, before expenses	149	131	18	564	469	95
Expenses	(9)	(10)	1	(35)	(37)	2
Net investment income	140	121	19	529	432	97
Average net investments¹	16,623	16,644	-%	16,442	14,663	12%
Market-based yield²	3.58%	3.11%	47 bps	3.44%	3.20%	24 bps

¹ Defined as the mid-month average fair value of net equity and fixed-income securities held during the reporting period.

² Refer to Section 27 – Non-IFRS financial measures.

Q4-2018 vs Q4-2017	2018 vs 2017
<ul style="list-style-type: none"> Net investment income increased by \$19 million, mainly due to our optimization initiatives, as well as higher yields. Average net investments were flat at \$16.6 billion, as the increase from operations was impacted by the market decline in late 2018. The higher market-based yields in Q4-2018 and for the full year mainly reflected the benefit of higher bond rates captured through the optimization of our portfolio. <i>See Section 6.5 – Capital markets.</i> 	<ul style="list-style-type: none"> Net investment income increased by \$97 million, due to the growth of our investment portfolio following the acquisition of OneBeacon, our optimization initiatives, as well as higher yields. Average net investments were up 12%, mainly reflecting the addition of the OneBeacon portfolio.

Management's Discussion and Analysis for the year ended December 31, 2018

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

6.7 Net gains (losses)

Net investment gains (losses) are reported in Non-operating results and included the following items.

Table 14 – Net gains (losses)

	Q4-2018	Q4-2017	Change	2018	2017	Change
Realized and unrealized gains (losses) on:						
AFS bonds, net of derivatives	(6)	(3)	(3)	(26)	5	(31)
Equity securities, net of derivatives	(3)	25	(28)	127	123	4
Embedded derivatives	38	(15)	53	25	(50)	75
Net foreign currency gains on investments	-	1	(1)	-	33	(33)
Impairment losses on common shares	(21)	(12)	(9)	(47)	(20)	(27)
Currency derivative gain related to book value hedge of OneBeacon	-	1	(1)	-	65	(65)
Other gains (losses) ¹	3	17	(14)	19	40	(21)
Gains (losses) excluding FVTPL bonds	11	14	(3)	98	196	(98)
Realized and unrealized gains (losses) on FVTPL bonds	48	(20)	68	(85)	(127)	42
Net gains (losses)	59	(6)	65	13	69	(56)

¹ Including net gains (losses) on investments in associates and joint ventures.

Q4-2018	2018
<ul style="list-style-type: none"> • Net gains excluding FVTPL bonds of \$11 million reflected mark-to-market gains on our embedded derivatives related to our perpetual preferred shares, offset in part by impairment losses on common shares, both linked to weaker equity markets. <i>See Section 6.5 – Capital markets.</i> • Realized and unrealized gains on our FVTPL bonds of \$48 million were driven by declining interest rates in both Canada and the U.S. These gains were offset by the unfavourable impact of lower rates used to discount our claims liabilities (MYA). <i>See Section 26 – Non-operating results.</i> 	<ul style="list-style-type: none"> • Net gains excluding FVTPL bonds of \$98 million reflected gains realized from our portfolio optimization initiatives and from ordinary trading activities on AFS common shares, offset by impairment losses of \$47 million relating mainly to energy stocks. • One-time gains in 2017 were mainly related to the OneBeacon acquisition. • Realized and unrealized losses on our FVTPL bonds of \$85 million were driven by increasing rates throughout most of the year. These losses were offset by the positive impact of higher rates used to discount our claims liabilities (MYA). <i>See Section 26 – Non-operating results.</i>

ENVIRONMENT & OUTLOOK

Section 7 – Insurance industry at a glance

7.1 P&C insurance in Canada

Large and highly fragmented

- In 2017, it was a \$51 billion market representing approximately 3% of gross domestic product (GDP), according to MSA data.
- The top five insurers represent 48% of the market, and the top 20 have a combined market share of 84%. Intact is the largest player with approximately 17% market share.
- There has been consolidation in recent years and we expect more to come.

Evolving and growing over time

- Over the last 30 years, the industry has grown at about a 5% CAGR and delivered ROE of approximately 10%.
- While we distribute about 85% of our premiums through brokers, the P&C industry as a whole distributes about 64% of their premiums through this channel. In 2017, the broker channel represented about \$33 billion in premiums.
- Emerging technologies and innovations continue to transform the insurance landscape as they enable new ways to measure, control and price risk, engage with customers, reduce cost, improve efficiency, and expand insurability. This will fuel further innovation, transformation and consolidation within the industry.

Regulated

- Insurance companies are licensed under insurance legislation in each of the provinces and territories in which they conduct business.
- Home and commercial insurance rates are unregulated, while personal auto is regulated in most provinces. While the rate approval process and timing for personal auto vary by province, insurers must file for rate adjustments in Ontario and Alberta before they can be effected.
- Capital for federal insurance companies is regulated by OSFI and by provincial authorities in the case of provincial insurance companies (*see Section 18 – Capital management*).

7.2 U.S. specialty insurance

Highly fragmented with no clear leader

- In 2017, the U.S. commercial P&C insurance was a \$290 billion market, up 2.8% from 2016, with specialty insurance accounting for approximately 43%.
- U.S. commercial specialty industry is a fragmented industry. The top 10 players represent more than 45% of the market, with the largest player capturing roughly 7% in 2017. Outside of the top eight players, no single insurer contributes more than 3% of the total estimated market. The majority of the top 25 players have a market share between 1% and 2.5%.

Niche market with lucrative potential

- The specialty insurance market offers niche and unique products and services that are not written by most P&C insurance companies. These products generally require specialized underwriting knowledge compared with more traditional insurance products.
- The combined ratio (and in turn the ROE) of many specialty products have outperformed those typically offered in the standard market due to more pricing and policy form flexibility.
- This unique risk and specialty focus can also come with above-average earnings volatility.

Evolving and growing over time

- Over the last 20 years, the specialty insurance market has grown at a 4.4% CAGR.
- The market has experienced elevated merger and acquisition activity in recent years and this trend is likely to continue.
- The agency channel (independent agencies, brokers, wholesalers and managing general agencies) is the primary distribution channel for specialty insurance products.
- Trends in litigation, regulation, economic maturity, social and workforce issues, and technology will continue to support growth and drive product innovation.

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

Section 8 – Operating environment

8.1 Current year CAT losses

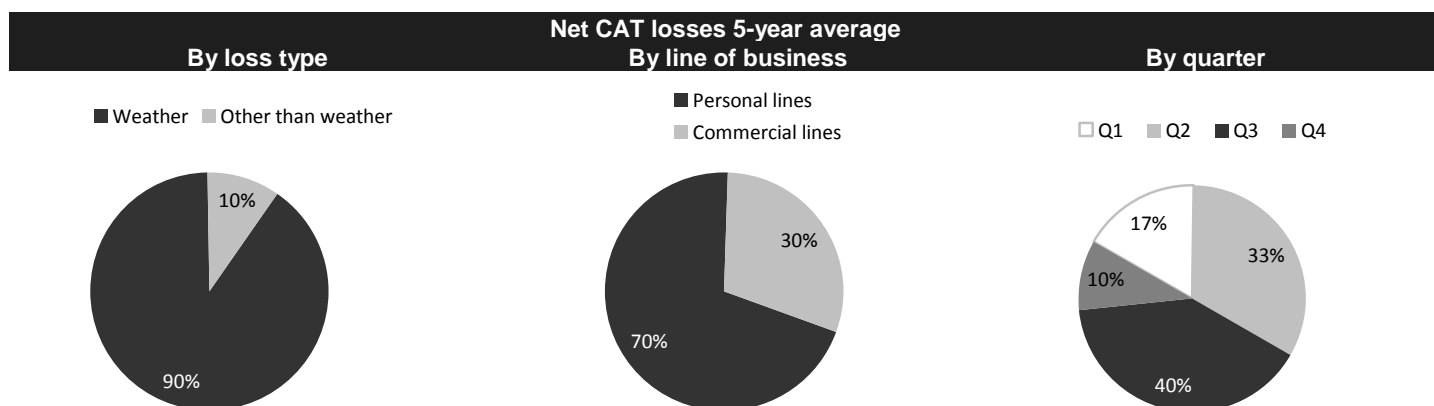
CAT losses can be caused by a variety of events, including weather (such as wildfires, hailstorms and floods) and non-weather events (such as industrial fires, surety and liability claims). The incidence and severity of CAT losses, while inherently unpredictable, can have a significant impact on our underwriting performance by quarter and by line of business. We generally seek to manage our exposure to CAT losses through individual risk selection and the purchase of CAT reinsurance (see Section 15.2 – Reinsurance hereafter for more details).

Table 15 – Net current year CAT losses

	2018	2017	2016	2015	2014
Net CAT losses	330	313	385	116	243
By loss type					
Weather	275	297	350	101	229
Non-weather ¹	55	16	35	15	14
By line of business					
Personal auto	26	27	73	37	41
Personal property	159	210	210	42	140
Commercial lines - Canada	123	76	102	37	62
Commercial lines - U.S.	22	-	n/a	n/a	n/a
By quarter					
Q1	36	88	21	11	75
Q2	142	105	164	22	33
Q3	97	89	166	81	125
Q4	55	31	34	2	10

¹ Mostly large commercial losses, including non-weather-related fires, surety and liability losses.

During the 2014-2018 period, average net current year CAT losses were **\$277 million**, and included net losses from the Fort MacMurray wildfires in 2016, the costliest insured natural disaster in Canadian history. During the 2009-2018 period, net current year CAT losses were closer to \$250 million on average.



8.2 CAT guidance

Over time, our expectation for total CAT losses (net of reinsurance) remains at **\$275 million per year, including both our Canadian and U.S. operations**. We continue to expect close to half to occur in the third quarter and approximately 75% to impact personal lines.

Management’s Discussion and Analysis for the year ended December 31, 2018

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

Section 9 – Outlook

	P&C insurance industry 12-month outlook	Our response
Personal auto	<ul style="list-style-type: none"> Industry growth exceeded 5% for the first three quarters of 2018. Industry profitability continues to be challenged with average direct loss ratios in the mid 70s for the first nine months of 2018. The market is firm with rate actions continuing, increases in residual market volumes and further tightening of capacity. We expect growth at a mid-single-digit level in 2019. 	<ul style="list-style-type: none"> Our actions continue on pricing, underwriting and claims to tackle trends. We are focused on sustaining a mid-90’s combined ratio in 2019, after reflecting seasonal variations. Rate actions ahead of the market are bringing some near-term pressure on growth but position us well as our competitive position is improving. Our brand investments and focus on customer driven digital leadership will continue to help selectively grow our market share. We are also investing in telematics, big data, and artificial intelligence to maintain our advantage in data and segmentation.
Personal property	<ul style="list-style-type: none"> Industry growth exceeded 5% in the first three quarters of 2018 with loss ratios close to 70%. We expect that the current firm market conditions will continue as companies are adjusting to changing weather patterns, leading to growth at a mid-single-digit level over the next 12 months. 	<ul style="list-style-type: none"> Product enhancements and pricing actions taken over time have positioned this business very well for the future. We expect to continue to capitalize on market conditions with rate increases to ensure our results remain sustainable even in severe weather conditions.
Commercial lines Canada	<ul style="list-style-type: none"> Industry growth exceeded 7% in the first nine months of 2018 with a loss ratio of approximately 70%. Market conditions are firm. We expect growth at a mid-single-digit rate in 2019. 	<ul style="list-style-type: none"> In such an environment we remain disciplined on pricing and underwriting of each risk, while we continue to capture opportunities where we see market inefficiencies. At the same time, our focus on loss prevention and service excellence remains. We have strengthened our capabilities and product suite in specialty lines following the OneBeacon acquisition while we continue to develop innovative products to address customer needs (e.g. cyber risk coverage and sharing economy).
Distribution	<ul style="list-style-type: none"> The broker channel represents approximately 64% of the total P&C industry and had higher growth than the direct channel in 2017. The broker industry remains fragmented with continuing opportunities for consolidation. 	<ul style="list-style-type: none"> Our multi-channel strategy means we are well positioned to capture opportunities as consumer and technology trends continue to evolve the distribution of insurance. We will continue to grow distribution income by supporting our brokers as they expand and grow their businesses, while actively participating in broker consolidation via BrokerLink and partners. Our brand and technology investments aim to bolster growth in our belairdirect business.

Management's Discussion and Analysis for the year ended December 31, 2018

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

	P&C insurance industry 12-month outlook	Our response
U.S. Commercial lines	<ul style="list-style-type: none"> The pricing environment remains competitive but stable, with modest upward trends continuing. Coupled with the current favourable economic environment, we expect low-to-mid single-digit industry growth in the coming year. 	<ul style="list-style-type: none"> Our objective is to grow the U.S. specialty business, and opportunities are being successfully pursued in the segments of the portfolio performing at or above expectations. Profitability actions on underperforming lines and claims improvement initiatives are well underway and gaining traction towards our goal to operate at a combined ratio in the low-90's on a sustainable basis within 18 to 24 months.
Investments	<ul style="list-style-type: none"> Investment yields remain low by historical standards, but there has been upward momentum on interest rates in 2018. Volatility in capital markets may put some pressure on investment market values and capital levels. 	<ul style="list-style-type: none"> We are continuously seeking to optimize the composition of our investment portfolio, taking into account factors including risk, return, capital, regulation and tax legislation changes. Our investment management team seeks to maximize after-tax returns while preserving capital and limiting volatility.
Overall	<ul style="list-style-type: none"> Overall, we expect the industry's ROE to improve but remain below its long-term average of 10% over the next 12 months. 	<ul style="list-style-type: none"> With our action plans and strategies, we expect to outperform the industry's ROE by more than 500 basis points in the coming year.

STRATEGY

Section 10 – Strategy update



10.1 What we are aiming to achieve

Our objectives by 2020

Our customers are our advocates

- 3 out of 4 customers are our advocates
- 3 out of 4 customers actively engage with us digitally

Our strategy

- Be easy to deal with and go beyond expectations to deliver a customer experience that is second to none.
- Be the recognized leader in small and mid-sized businesses and specialty lines through service, expertise and product.
- Build core brands to become trusted, household names.
- Leverage best-in-class digital distribution and service platforms for customers and brokers.
- Contribute to the resiliency and prosperity of communities by leading in climate adaptation initiatives.

Our people are engaged

- Be a best employer
- Be a destination for top talent and experts

Our strategy

- Be a destination for top talent and experts.
- Build an unrivalled team of insurance experts and leaders.
- Create a workplace where we are engaged and can contribute our best every day by delivering on our employee promise.
- Live our values and leadership success factors.

Our specialty solutions business is a leader in North America

- Achieve combined ratio in the low 90s
- Generate \$3 billion in annual DPW

Our strategy

- Deliver targeted synergies in back office and claims.
- Introduce new products to Canada and export Canadian lines to the U.S.
- Grow cross-border business.
- Retain key talent and management.

Our company is one of the most respected

- Grow NOIPS 10% yearly over time
- Exceed industry ROE by 5 points in Canada and the U.S.

Our strategy

- Deepen our strengths in pricing, risk selection, claims and investments.
- Simplify processes to become the most efficient operator.
- Lead in data, artificial intelligence (AI), and behavioural analytics.
- Leverage our size in claims through efficiencies in the supply chain.
- Manage capital opportunistically.
- Consolidate Canadian industry in manufacturing and distribution.

10.2 Progress on our 2020 objectives

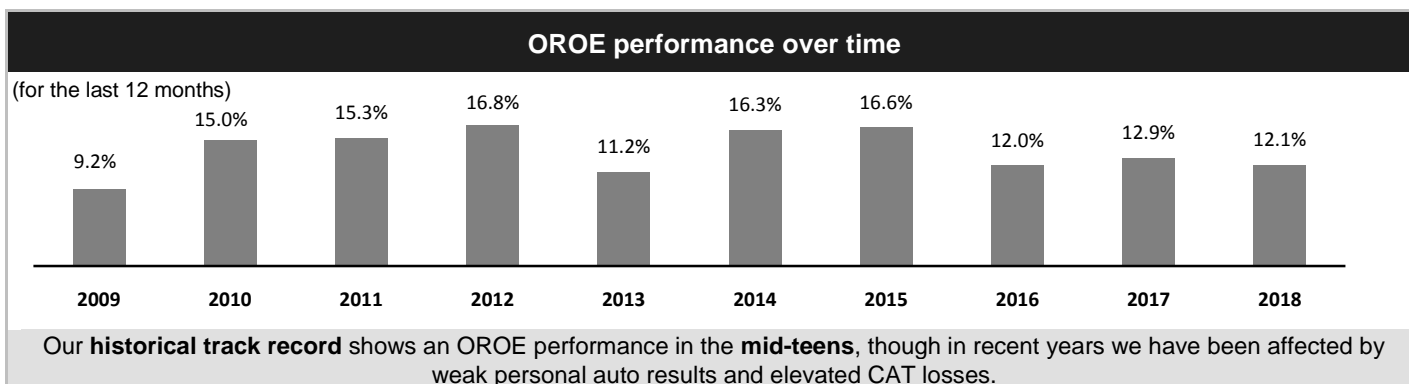


<p>Our customers are our advocates</p>	<ul style="list-style-type: none"> • 1.1 million advocates in 2018, up 1% from last year. • Maintained #1 and #2 brand consideration nationally for Intact Insurance and belairdirect in 2018. • In May 2018, we launched the Intact Insurance App, providing customers with a mobile-friendly way of accessing their insurance documents, accessing the status of their claims in real-time, and contacting their broker or adjuster. • In Q3-2018 we launched our UBI 2.0 product, using our mobile app, which improves the way that customers track their <i>my Driving Discount</i>. Almost half of our UBI customers log in daily to check in. • Net promoter score improved in 2018, for personal line customers who filed a claim during the year.
<p>Our people are engaged</p>	<p>In 2018, we were recognized:</p> <ul style="list-style-type: none"> • as an Aon Best Employer – Canada 2019, Platinum level, for the 4th year in a row. • as one of Canada’s top 100 employers by Mediacorp Canada Inc., for the 4th year in a row. • by Glassdoor as one of the ‘25 best places to work’ in Canada for the first time this year.
<p>Our specialty solutions business is a leader in North America</p>	<ul style="list-style-type: none"> • On track to achieve these objectives across North America: <ul style="list-style-type: none"> • Delivered a combined ratio of 93.0% in 2018. • Generated close to \$2.3 billion in DPW in 2018.
<p>Our company is one of the most respected</p>	<ul style="list-style-type: none"> • Over the past 5 years, our NOIPS has grown at a CAGR of 10%. • NOIPS in 2018 was up 3% over 2017, with a solid underwriting performance, strong growth in net investment income and solid net distribution income. • Outperformed the P&C insurance industry’s ROE by 750 bps in the first nine months of 2018. • Since 2009, we have regularly exceeded our 500 basis points ROE outperformance target versus the industry, due to our superior underwriting results, investment performance and capital management.

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

10.3 IFC’s OROE performance over time



10.4 IFC’s Canadian industry outperformance over time

Industry data below represents an IFC estimate based on MSA. Industry benchmark consists of the 20 largest comparable companies in the P&C industry based on industry data. *Refer to Important notes on page 2 of this MD&A for further details.*

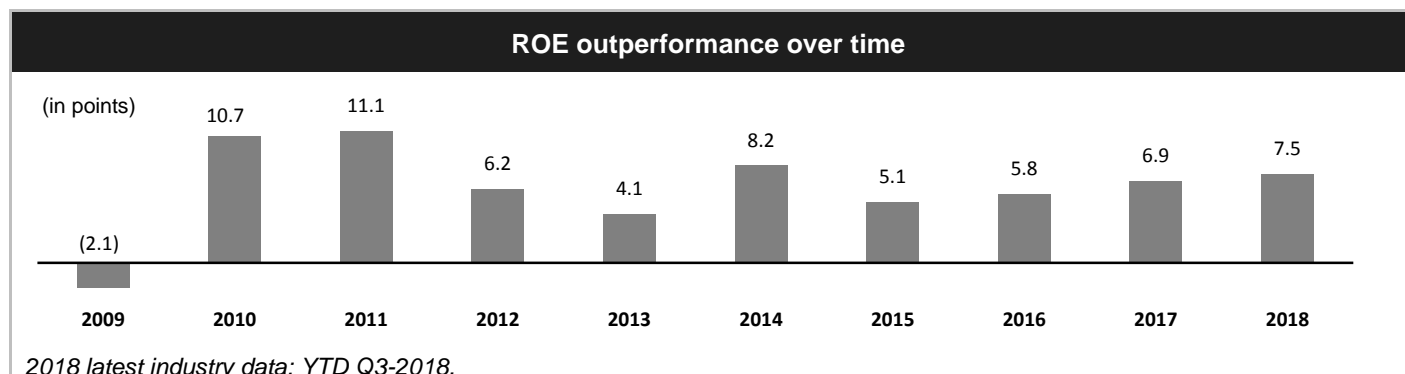
Table 16 – Canadian P&C Industry – IFC outperformance (underperformance)

	YTD Q3-2018	Full year 2017	Full year 2016	Full year 2015	Full year 2014
ROE (annualized)¹					
P&C Industry	7.5 pts	6.9 pts	5.8 pts	5.1 pts	8.2 pts
DPW growth (including industry pools)					
Industry benchmark	(4.3) pts	(2.4) pts	2.4 pts	3.4 pts	(1.5) pts
Combined ratio (including MYA)					
Industry benchmark	8.6 pts	6.2 pts	4.7 pts	5.2 pts	6.5 pts

AMF (Québec) chartered insurance companies are not required to report on Q1 and Q3 results. As such, we have included estimates for non-reporters in our Industry benchmark group, based on publicly available information. Actual results may vary.

¹ IFC’s ROE corresponds to the AROE.

- Our ROE outperformance of 7.5 points versus the P&C insurance industry is above our objective of 5 points and improved slightly from H1-2018, mainly due to our strong underwriting performance.
- Our growth underperformance against our industry benchmark was 4.3 points, reflecting robust profitability actions in personal auto, taken ahead of the industry.
- Our combined ratio outperformance against our industry benchmark was 8.6 points, an increase of 0.6 points from H1-2018. This solid outperformance is the result of the effectiveness of our disciplined profitability actions.



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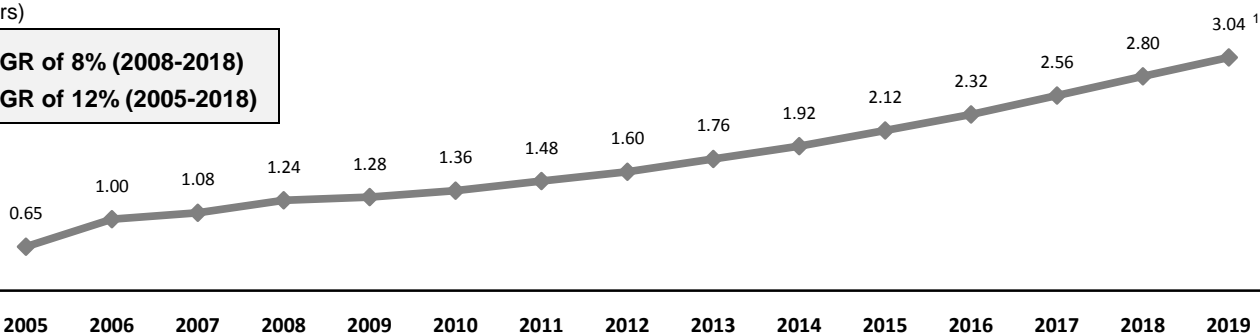
10.5 Delivering value to our shareholders

2019: our 14th consecutive annual dividend increase

- We strive to maintain our dividend track record through sustainable annual dividend increases. We have increased our common share dividends each year since going public, with a 9% increase in 2018.
- Our decision to increase common share dividends by 9% to \$0.76 per quarter in 2019 reflects the strength of our financial position and confidence in our ongoing operating earnings and capital generation.

(in dollars)

CAGR of 8% (2008-2018)
CAGR of 12% (2005-2018)



2004: Initial public offering on TSX (ING Group retained 70%).

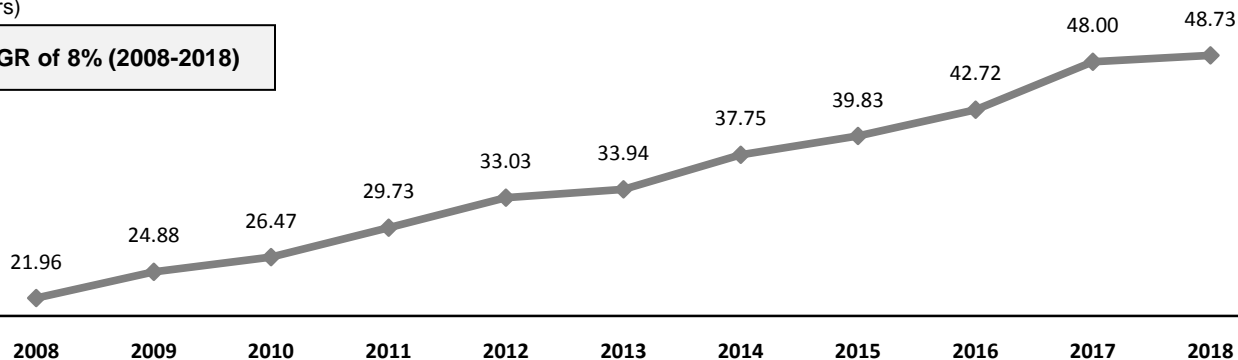
¹Annual dividend for 2019 is projected

Book value per share increase over time

- Our operating performance and financial strength have translated into more than \$1.6 billion in capital returned to common shareholders through dividends and share repurchases over the past five years.
- Our BVPS was up 2% to \$48.73 in 2018 driven mainly by our earnings, net of common share dividends, offset in part by the impact of unfavourable capital markets on our investment portfolio.
- We remained committed to our financial objectives in terms of ROE and NOIPS to enhance value to shareholders.

(in dollars)

CAGR of 8% (2008-2018)



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10.6 Other developments at a glance

Innovation

In line with our strategy to deliver a customer experience that is second to none and build a best in class digital distribution and service platform:

- In Q4-2018, we launched the **first car and home quick quote for belairdirect Ontario**, a tool that allows customers to get a bundled home and auto quote in 20 questions.
- Leveraging our leadership position in data and data science, we continue to roll-out our new **Machine Learning Algorithms in Rating**. These new algorithms will help us improve our accuracy in segmentation and accelerate profitable growth.
- **OneBeacon introduced new management liability products** that deliver a more comprehensive coverage to a broad range of private and not-for-profit organizations. The modular policy approach is designed to help minimize gaps in coverage, while providing flexibility to tailor solutions based on each client’s unique exposures.

Acquisition and financing activities

- In May, we completed a \$250 million offering of Rate Reset **Class A Series 7 Preferred Shares**. *Refer to Section 17.1 – Financing structure for further details.*
- **BrokerLink acquired several brokerages this year**, adding many new locations. BrokerLink’s scale and reputation, local experts, emphasis on customer service and community involvement were the deciding factors for the brokerages to join the team.
- **Subsequent to quarter-end, BrokerLink acquired two new brokers**, Alberta-based Challenge Insurance Group, and Ontario-based Insurance & Financial Group.

Awards and recognition

We were recognized:

- for the fourth year in a row, as an **Aon Best Employer – Canada 2019, Platinum level**, recognizing IFC for its strong level of employee engagement, leadership, performance culture and employment brand.
- for the fourth year in a row, by **Mediacorp Canada Inc.** as one of **Canada’s Top 100 Employers**.
- by the Globe and Mail, who awarded us top marks for governance, placing Intact second out of 242 publicly traded companies in their annual **“Board Games”** ranking.
- for a third year in a row, as one of **Canada’s Top Employers for Young People**, an award given to employers who offer the best workplaces and employee programs to young professionals starting their careers.
- for the first time, by **Glassdoor as one of the ‘25 best places to work’** in Canada. Winners are determined based on feedback from former and current employees who voluntarily and anonymously share insights and opinions about the companies they work for.
- our Intact Investment Management (IIM) team was selected as **one of ten TopGun Investments Teams of the Year**, which honours the most enlightened and disciplined professionals in the investment industry.
- by IR Magazine for **‘Best Financial Reporting’** (co-winner) at the annual IR Magazine Awards Gala, the largest gathering in Canada to recognize excellence in various aspects of investor relations.
- in the **Risk Manager Choice Award**, administered by the Flashpohler | NMG Research Group, which recognized OneBeacon for 3 of the 12 key factors studied; claims management (OneBeacon ranked #1), ease of doing business and relationship management.

See Section 12 – Social responsibility to see our actions and other developments regarding climate adaptation and social responsibility.

Section 11 – Unique advantages



We have several unique advantages which have enabled us to sustainably outperform other P&C insurers in Canada. These advantages are described in the table below.

Leading North American P&C Operator	
 <p>Seamless distribution strategy</p>	<ul style="list-style-type: none"> • Our multi-channel distribution strategy includes the most recognized broker and direct-to-consumer brands. This strategy maximizes growth in the market and enables us to appeal to different customer preferences while being more responsive to consumer trends and needs. • We have close to 2,000 broker relationships across Canada and the U.S. for customers that prefer the highly-personalized and community-based service that an insurance broker provides. • We provide our brokers with a variety of digital distribution service platforms, alongside sales training and financing to enable them to continue to grow and develop their businesses.
 <p>Digital first experiences</p>	<ul style="list-style-type: none"> • Our industry leading mobile and digital experiences separate us from our peers. Our ability to design, deliver and iterate on new experiences for brokers and customers makes us a preferred company to deal with. Speed, simplicity and transparency are core tenets of our focus.
 <p>Engaged & talented teams</p>	<ul style="list-style-type: none"> • Our people are the cornerstone to the execution of our strategy. We benefit from attracting, retaining and engaging some of the best talent both within and outside our industry. How we organize and behave provides a sustainable and replicable approach to continuous operational improvement.
 <p>Scaled & diversified core operations</p>	<ul style="list-style-type: none"> • Our large database of customer and claims information enables us to identify trends in claims and more accurately model the risk of each policy. • We can negotiate preferred terms with suppliers, including service and quality guarantees for repairs and workmanship, and lower material costs. • Our business is well diversified across geographic regions and business lines which provides significant financial flexibility.
 <p>Sophisticated data & analytics capabilities</p>	<ul style="list-style-type: none"> • Our superior data expertise and proprietary segmentation and machine learning models are used to price and manage risk which allows us to identify certain segments of the market that are more profitable than others and in turn establish a model that will both attract and maintain clients with profitable profiles.
 <p>Deep claims expertise & network</p>	<ul style="list-style-type: none"> • Substantially all of our claims are handled in house with our preferred network, which translates into a data advantage helping claims settle faster and at a lower cost, with a more consistent service experience for the customer.
 <p>Proven consolidator & integrator</p>	<ul style="list-style-type: none"> • We are a proven industry consolidator with 16 successful acquisitions since 1988. • Our primary strategy is to pursue consolidation in the Canadian market and expansion in foreign markets where we can deploy our expertise in pricing, risk selection, claims, distribution and digital expertise. With these acquisitions, we look to expand our product offering and improve customer experience. • Our outperformance is driven by three key factors: thorough due diligence to assess all the risks and opportunities; swift and effective integration with seamless impact to our customers; and financial benefit from significant synergies due to our scale.
 <p>Tailored investment management</p>	<ul style="list-style-type: none"> • In-house investment 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 maximize after-tax total return via appropriate asset allocation and active management of investment strategies.

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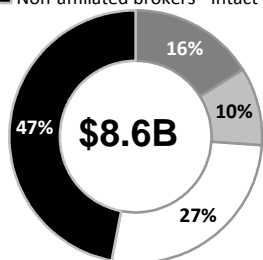
11.1 Canadian distribution strategy

Our multi-channel distribution strategy includes our broker and direct-to-consumer channels.

<p>We offer our customers a multitude of options to reach us: online, by phone or in person.</p>	<p>With our strong brands, our customers have coverage options: via our broker network with Intact Insurance, or with us directly via belairdirect.</p>	<p>We have a large network of brokerages, including our wholly-owned subsidiary, BrokerLink, which operates in Ontario, Alberta and Atlantic Canada.</p>
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2018 DPW by distribution channel

- Direct (belairdirect)
- BrokerLink
- Affiliated brokers - Intact insurance ¹
- Non-affiliated brokers - Intact insurance



¹Affiliated brokers are those to which we provide equity or debt financing.

Our broker channel

- Our scale and financial strength position us as a strong supporter of our broker partners in terms of brand, technology, products and expertise, business opportunities, as well as financial solutions.
- We invest in our broker network with equity and debt financing. Through these relationships, we are able to foster growth in their organizations, participate in the consolidation of the broker network, and enhance our product distribution.

Our direct channel

- We strive for digital leadership with a simplified, easy to use customer experience and a cost efficient platform.
- We continue to seek opportunities to double our direct-to-consumer business in the mid-term by expanding our reach and find innovative solutions to make it easy for our customers to protect the things they care about.

11.2 Innovation

Shaping our future in the age of big data

Artificial Intelligence (AI) and machine learning have transformational potential for the insurance industry, the economy and consumers. Our strategic partnerships with academia (such as Montreal’s IVADO, Laval University and the Vector Institute) and the Intact Data Lab position us to harness the potential of these emerging technologies now and into the future. While data has always been integral to assessing risk and determining pricing, these technologies can expand our data advantage to innovate and improve product offerings, so we can better serve customers. We are also using them to help increase our understanding of risk (including climate risk), and help reduce and prevent risk for customers.

Intact Ventures continues to help us accelerate

Launched in 2016, Intact Ventures Inc. (Intact Ventures), is focused on investing and/or partnering with companies that are redefining the P&C insurance landscape with innovative business models and new technology. Building relationships with ground-breaking companies will enable us to accelerate our learning, design smarter products and leverage unique technology.

In return, we will support the growth of these companies by providing them with access to our expertise and talent. We want to ensure that we continue to be a leader in a fast-paced industry to serve the best interests of our customers, as well as our portfolio of companies and partners.

Our goal is to connect with companies that are defining:

- the future of transportation;
- how we leverage big data and utilize artificial intelligence;
- how consumers and businesses will choose to purchase insurance in the future; and
- the sharing of risks, assets and expertise.

Section 12 – Social responsibility

We strive to create an environment where our employees live our values every day. Our values are organized according to five core themes, one being **Social responsibility**.

We respect the environment and its finite resources. We believe in making the communities where we live and work safer, healthier and happier. We encourage the involvement and citizenship of all our employees. Our commitment to social responsibility also serves as the mandate of the Intact Foundation, which principally donates to organizations that are committed to climate change adaptation and addressing the root causes of child poverty in Canada.



Some of our 2018 developments and initiatives are outlined below.

12.1 2018 developments and initiatives

- **Intact Centre on Climate Adaptation**

At IFC, we remain committed to helping people protect themselves from extreme weather caused by climate change. Our investment in the Intact Centre on Climate Adaptation™ ("Intact Centre") continues to foster innovative solutions to help reduce the physical, financial and social impacts of extreme weather on Canadian communities.

The Intact Centre has worked to establish a leading position on the climate change adaptation file in Canada.

2018 milestones include:

- The Intact Centre **presented to the Government of Canada** standing Senate committee on energy, environment and natural resources in February, discussing the financial and social need, and means, to mitigate flood risk across Canada.
- Chaired the Expert Panel on Climate Change Adaptation and Resilience Results, releasing recommendations to the Canadian federal government in June.
- Supported the development of the national guidelines on basement flood protection and risk reduction for Canada, published in July.
- Released two significant applied research reports to the Canadian public.
 - **After the flood:** a report profiling the impact of climate change on mental health and lost time from work, which found that more than half of flooded households took an average of seven days away from work, 10 times the Ontario average for non-flooded households.
 - **Combating Canada's rising flood costs: Natural infrastructure is an underutilized option:** a joint research report with the Insurance Bureau of Canada ('IBC'), which encourages communities to consider natural infrastructure to limit their flood risk and realize cost efficiencies. For example, naturally occurring ponds in Gibbons, B.C., provide up to \$4 million in stormwater storage services annually.
- Launched a home flood risk assessment training course with Seneca and Fleming Colleges in Ontario, to build a home flood risk assessment as a component of home inspector training.
- Entrenched our role as trusted advisors to the Canadian public by participating in over 100 media interviews to help educate Canadians on the importance of adapting to climate change.

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● *Other climate - related developments*

- We **co-hosted the global forum on climate-resilient critical infrastructure organized by the Geneva Association**, the leading international think tank of the insurance industry. Participants engaged in discussions on critical infrastructure, prioritizing climate change migration and adaptation, challenges and opportunities for scaling up private investments in climate-resilience, and the insurance industry's role as underwriters, risk managers and investors.
- Our CEO, Charles Brindamour, **addressed global political leaders and experts at the G7 Environment, Oceans and Energy Ministers meeting** in Halifax on September 19, 2018. On an Adaptation and Conserving Nature panel, he spoke about the role of the insurance industry and public-private partnerships to address the critical need of building climate resilient infrastructure.
- We signed to the **United Nations Environment Programme (UNEP) Finance Initiative Principles for Sustainable Insurance ("PSI")**. The PSI are a global framework for the insurance industry to address environmental, social and governance risks.
- We joined the **United Nations Environment Programme Finance Initiative (UNEP FI) Task force on Climate-related financial disclosures (TCFD)** insurance pilot, which brings together 18 of the world's largest insurers to better understand the impacts of climate change on their business.

● *Intact Foundation climate change grants*

- Beyond our funding to the Intact Centre, the Intact Foundation has provided over \$1 million in funding to eight projects nationally to further Canada's ability to be resilient to the impacts of climate change. Projects funded included FireSmart Canada, which provides detailed and customized wildfire risk assessments for homeowners and ALUS Canada, which encourages climate resiliency for inefficient farmlands.

● *Making our communities safer, healthier, and happier*

- Employees across Canada have donated over 4,000 hours through team volunteering initiatives and personal volunteer hours throughout the year.
- Intact reaffirmed its commitment to the Romeo Dallaire Child Soldiers Initiative with a \$1 million commitment to establish a regional centre of training and learning in Rwanda. The regional hub will serve as a meeting place for countries to exchange and learn how to prevent the recruitment and use of child soldiers.
- The Intact Foundation announced a \$500,000 partnership with UNICEF Canada to support two initiatives: "One Youth", a program with youth led initiatives to help make Canada the best country in the world to grow up and "UNdaunted", a program focused on improving the lives of girls and women in sub-Saharan Africa through education.

● *Intact receives top marks for good governance in Canada*

- The Globe and Mail awarded Intact with top marks for governance, placing Intact second out of 242 publicly traded companies in their annual "Board Games" ranking.
- The Clarkson Centre for Board Effectiveness ranked Intact first (tie) in its Board Shareholder Confidence Index 2018, an annual examination of governance practices among Canadian public companies, for the quality of its corporate governance practices.
- Intact was awarded a Certification of Parity, Platinum level by La Gouvernance au Féminin for its actions regarding the advancement of women in business.

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12.2 Climate-related governance and risk management

- **Governance**

Climate change risk management is part of the mandate of the risk management committee, which includes:

- reviewing the reports on risk management, reinsurance programs, implementation programs and progress reports;
- reviewing the risk matrix identifying the top and emerging enterprise risks (including the occurrence and severity of natural disasters that may be affected by climate change);
- reviewing catastrophe programs, exposure management tests and action plans;
- reviewing and approving the reinsurance risk management policy; and
- remaining informed of climate change adaptation and risk mitigation measures for the Canadian marketplace.

- **Risk management**

Climate change in Canada continues to create unpredictable weather patterns. In particular, our property insurance business has been impacted and increased the cost of claims associated with severe storms: water damage accounts for 40% of total claims on average. To address this, we have built initiatives in home insurance to adapt the nature of the product offered and its pricing. We are also reinforcing our claims capabilities, increasing our education and awareness efforts towards distribution partners and customers, and offering prevention discounts.

There are numerous areas where managing the impacts of climate change is integrated into IFC's business:

- **Corporate development:** as we pursue our growth strategy, we evaluate the strategic fit of potential acquisitions including the impact on our business mix. For example, the acquisition of OneBeacon last year resulted in further diversification of our insurance portfolio by increasing the contribution of specialty solutions and decreasing our exposure to weather events relative to our capital base.
- **Underwriting:** determines the risk drivers related to our new climate realities. For example, we use detailed flood maps to manage exposure related to our enhanced water damage endorsement.
- **Pricing:** reflects the scope of risks related to climate change impacts. We have implemented rate changes in our property insurance products to reflect recent trends in catastrophes and severe weather.
- **Claims management:** ensure claims can be managed efficiently and effectively across Canada. For example, we have designated teams in place across the country that deal efficiently with catastrophic events and ensure service reliability for customers.
- **Reinsurance:** we reinsure certain risks to limit our losses in the event of catastrophic events or other significant losses. *See Section 15.2 – Reinsurance for more details.*
- **Outreach and education:** we believe it is essential that Canadians adapt to climate change. As a result, we have launched many home insurance initiatives to help customers understand how to adapt. We continue to work with partners, such as the Intact Centre and the IBC, to promote climate change adaptation initiatives to governments. These initiatives include the development of tools for communities to assess the vulnerabilities of their infrastructure to climate change and prioritize investments in their modernization. By intensifying our education efforts and creating greater awareness of the risks our country faces and the preventative measures that we can adopt, we help Canadians adapt to severe weather caused by climate change.

More ESG information will be available in our 2018 Social Impact Report, our 2018 Annual Information Form and our 2019 Management Proxy Circular for the year ended December 31, 2018.

Management's Discussion and Analysis for the year ended December 31, 2018

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

FINANCIAL CONDITION

Section 13 – Financial position

2018 Highlights

Investment portfolio	Claims liabilities	BVPS for the last 12 months	Debt-to-total capital ratio
\$16.9 billion	\$10.6 billion	+2%	22.0%

13.1 Balance sheets

Table 17 – Balance sheets

As at	Section	December 31, 2018	December 31, 2017
Assets			
Cash, cash equivalents and short-term notes		461	380
Fixed-income securities		11,682	11,012
Preferred shares		1,165	1,330
Common shares		3,295	3,659
Loans		294	393
Investments	14	16,897	16,774
Premium receivables		3,358	3,351
Reinsurance assets	15.2	864	822
Deferred acquisition costs		903	881
Other assets		1,840	1,565
Intangible assets and goodwill		4,599	4,445
Total assets		28,461	27,838
Liabilities			
Claims liabilities	15.1	10,623	10,475
Unearned premiums		5,412	5,365
Financial liabilities related to investments		289	167
Other liabilities		2,118	2,127
Debt outstanding	17	2,209	2,241
Total liabilities		20,651	20,375
Shareholders' equity			
Common shares		2,816	2,816
Preferred shares		1,028	783
Contributed surplus		149	128
Retained earnings		3,776	3,520
AOCI		41	216
Shareholders' equity		7,810	7,463
Book value per share (in dollars)	29.4	48.73	48.00

Management's Discussion and Analysis for the year ended December 31, 2018

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

Section 14 – Investments

Our investment portfolio is mainly comprised of Canadian and U.S. securities. Our invested assets were \$16.9 billion as at December 31, 2018, essentially in line with December 31, 2017. The benefits from our optimization initiatives and higher yields were tempered by the decline in capital markets in Q4-2018.

- The Canadian securities mainly comprise a mix of cash and short-term notes, fixed-income securities, preferred shares, common shares and loans.
- The U.S. securities mainly comprise fixed-income securities (including asset-backed securities and corporate bonds) and common shares.

High-quality investment portfolio**Fixed income**

Our fixed-income portfolio includes high quality government and corporate bonds. Approximately 91% of our fixed-income portfolio was rated 'A-' or better as at December 31, 2018 (90% as at December 31, 2017). On a consolidated basis, the weighted-average rating of our fixed-income portfolio was 'AA' at December 31, 2018 and 2017. The average duration of our fixed-income portfolio was 3.70 years (3.53 years as at December 31, 2017), reflecting the integration of the OneBeacon portfolio.

Preferred shares

Our preferred share portfolio is made up of high-quality Canadian issuers. The weighted-average rating of our preferred share portfolio was 'P2' as at December 31, 2018 and 2017.

Net exposure by asset class

As part of our investment strategies, from time to time we take long/short equity positions in order to maximize the value added from active equity portfolio management, or to mitigate overall common share market volatility. We also use strategies where market risk from long common share positions is reduced through the use of swap agreements or other hedging instruments.

Table 18 – Investment mix by asset class (net exposure)

As at December 31,	2018	2017
Cash, cash equivalents, and short-term notes	3%	4%
Fixed-income	75%	72%
Preferred shares	7%	8%
Common equities	13%	14%
Loans	98%	98%
	2%	2%
	100%	100%

Management’s Discussion and Analysis for the year ended December 31, 2018

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

Net currency exposure

We hedge the currency exposure of all USD-denominated investments in our Canadian entities using foreign currency contracts, resulting in minimal currency gains or losses. As at December 31, 2018, on a net exposure basis, 81% of our portfolio is denominated in CAD, 17% in USD and 2% in other currencies (79% in CAD, 19% in USD and 2% in other currencies as at December 31, 2017).

Net sectoral exposure



Table 19 – Sector mix by asset class, excluding cash, short-term notes and loans (net exposure)

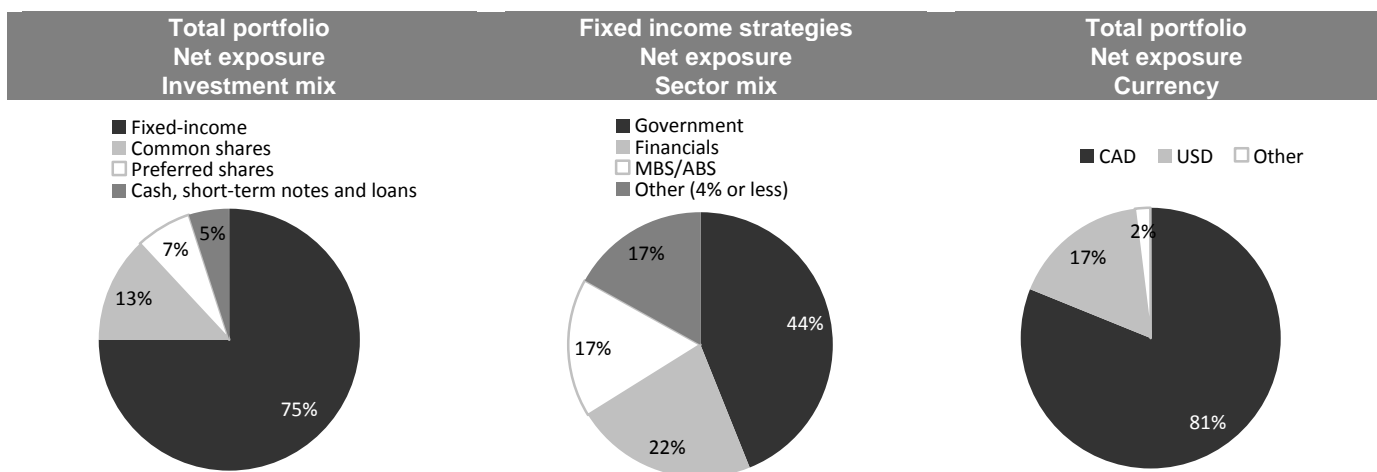
As at December 31,	Fixed-income securities	Preferred shares	Common shares	Total 2018	Total 2017
Government	44%	-	-	32%	33%
Financials	22%	77%	24%	31%	33%
ABS and MBS	17%	-	-	12%	11%
Energy	1%	13%	13%	3%	4%
Industrials	3%	-	10%	4%	4%
Consumer staples	2%	-	10%	3%	3%
Communication Services	1%	-	8%	2%	1%
Utilities	2%	10%	11%	4%	3%
Consumer discretionary	1%	-	6%	2%	3%
Materials	1%	-	5%	1%	1%
Information technology	3%	-	5%	3%	2%
Health care	3%	-	8%	3%	2%
	100%	100%	100%	100%	100%

Our fixed-income portfolio remains concentrated in the government and financial sectors providing liquidity and stability to our balance sheet.

Following the OneBeacon acquisition, our portfolio is comprised of more structured debt securities. As at December 31, 2018, these securities comprised \$689 million of asset-backed securities (“ABS”) and \$1,256 million of mortgage-backed securities (“MBS”). Residential MBS (“RMBS”) and Commercial MBS (“CMBS”) make up respectively 50% and 50% of our MBS portfolio. Approximately 99% of these structured debt securities are rated ‘A’ or better.

We continue to have no exposure to leveraged securities.

Our net exposure as at December 31, 2018, after reflecting the impact of hedging strategies related to investments and foreign subsidiaries, is outlined below.



Management's Discussion and Analysis for the year ended December 31, 2018

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

Net pre-tax unrealized gain (loss) on AFS securities

In determining the fair value of investments, we rely 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.

Table 20 – Net pre-tax unrealized gain (loss) on AFS securities

As at	Dec. 31, 2018	Sept. 30, 2018	June 30, 2018	March 31, 2018	Dec. 31, 2017
Fixed-income securities	17	(38)	(11)	2	22
Preferred shares	(83)	62	53	64	43
Common shares	(85)	148	117	54	212
Net pre-tax unrealized gain (loss) position	(151)	172	159	120	277

Quarter	Full year
Our pre-tax unrealized loss position of \$151 million increased by \$323 million in the quarter mainly due to:	Our pre-tax unrealized loss position of \$151 million increased by \$428 million in 2018 mainly due to:
<ul style="list-style-type: none"> mark-to-market losses on our common shares and preferred shares, reflecting the decline in capital markets, partly offset by: mark-to-market gains on fixed-income securities, reflecting lower interest rates. 	<ul style="list-style-type: none"> mark-to-market losses on our common shares and preferred shares, reflecting the decline in capital markets in Q4-2018, and: gains realized from ordinary trading activities in our common share portfolio.
<i>See Section 6.5 – Capital markets for more details.</i>	

Gains and losses in the common share portfolio are generally realized on an ongoing basis under normal capital market conditions.

Impairment recognition on AFS common shares

Table 21 – Aging of unrealized losses on AFS common shares

As at	Dec. 31, 2018	Sept. 30, 2018	June 30, 2018	Mar. 31, 2018	Dec. 31, 2017
Less than 25% below book value	148	70	73	78	34
More than 25% below book value for less than 6 consecutive months	55	2	1	3	4
More than 25% below book value for 6 consecutive months or more, but less than 9 consecutive months	18	10	1	1	13
Unrealized losses on AFS common shares	221	82	75	82	51

Impairment losses on AFS common shares amounted to \$47 million in 2018, compared to \$20 million in 2017. Since common shares are measured at fair value on our balance sheet, impairment losses have no impact on our BVPS. *Refer to Note 2 – Summary of significant accounting policies of the Consolidated financial statements for the year ended December 31, 2018, for additional details on our accounting policy regarding the impairment of financial assets.*

Management’s Discussion and Analysis for the year ended December 31, 2018

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

Section 15 – Claims liabilities and reinsurance

15.1 Claims liabilities

Assumptions

Claims liabilities were \$10.6 billion as at December 31, 2018, largely in line with those as at December 31, 2017.

The main assumption underlying the claims liability estimates is that our future claims development will follow a similar pattern to past claims development experience. Claims liability estimates are also based on various quantitative and qualitative factors, including:

- average claims cost, including claim handling costs (severity);
- average number of claims by accident year (frequency);
- trends in claims severity and frequency;
- payment patterns;
- other factors such as inflation, expected or in-force government pricing and coverage reforms, and level of insurance fraud;
- discount rate; and
- risk margin.

The total claims reserve is made up of two main elements:

- 1) reported claims case reserves, and
- 2) incurred but not reported (“IBNR”) reserves.

IBNR reserves supplement the case reserves by taking into account:

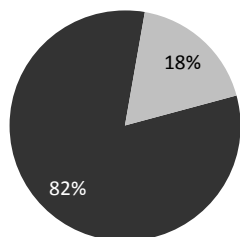
- possible claims that have been incurred but not yet reported to us by policyholders;
- expected over/under estimation in case reserves based on historical patterns; and
- other claims adjustment expenses or subrogation amounts not included in the initial case reserve.

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 the time value of money, using a rate that reflects the estimated market yield of the underlying assets backing these claims liabilities. IBNR and risk margin are reviewed and adjusted at least quarterly.

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. *See Section 26 – Non-operating results for more details on the impact of MYA on underwriting.*

Net claims liabilities by business segment

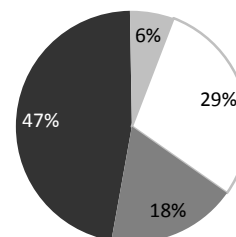
■ P&C Canada ■ P&C U.S.



Diversification reduces the uncertainty associated with the unfavourable development of claims liabilities for both our Canadian and U.S. operations.

Net claims liabilities by line of business

■ PA ■ PP □ CL CAN ■ CL U.S.



PA: Personal auto; PP: Personal property; CL: Commercial lines

Management's Discussion and Analysis for the year ended December 31, 2018

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

Prior year development

PYD can fluctuate from quarter to quarter and year to year and, therefore, should be evaluated over longer periods of time.

As yields have been increasing, we would expect average favourable PYD as a percentage of opening reserves to be in the 1%-3% range over the long term. We expect that the current accident year (CAY) loss ratio will be favourably impacted by these higher yields.

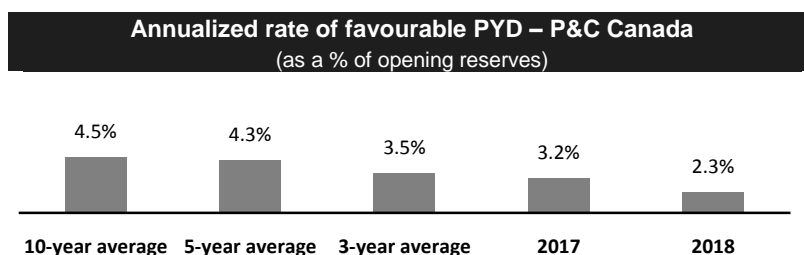


Table 22 – Unfavourable (favourable) PYD

	2018	2017	2016	2015	2014	5-year average P&C Canada	
						In \$	% NEP ¹
PYD	(185)	(238)	(389)	(477)	(364)		
P&C Canada	(181)	(253)	(389)	(477)	(364)	(333)	(4.3)%
P&C U.S.	(4)	15	-	-	-	n/a	n/a
By line of business							
Personal auto	49	10	(115)	(212)	(141)	(82)	(1.0)%
Personal property	(78)	(62)	(88)	(70)	(71)	(74)	(1.0)%
Commercial lines – Canada	(152)	(201)	(186)	(195)	(152)	(177)	(2.3)%
Commercial lines – U.S.	(4)	15	n/a	n/a	n/a	n/a	n/a
By quarter							
Q1	(75)	(82)	(163)	(189)	(141)	(130)	(1.7)%
Q2	(32)	(41)	(93)	(106)	(65)	(67)	(0.8)%
Q3	(28)	(53)	(71)	(107)	(80)	(68)	(0.9)%
Q4	(50)	(62)	(62)	(75)	(78)	(70)	(0.9)%

¹Expressed as a % of total annual NEP for P&C Canada.

Table 23 – PYD by line of business

	Q4-2018	Q4-2017	Change	2018	2017	Change
By line of business						
Personal auto	3	(27)	30	49	10	39
Personal property	(15)	(17)	2	(78)	(62)	(16)
Commercial lines – Canada	(44)	(33)	(11)	(152)	(201)	49
Commercial lines – U.S.	6	15	(9)	(4)	15	(19)
Total unfavourable (favourable) development	(50)	(62)	12	(185)	(238)	53
Unfavourable (favourable) annualized rate of PYD¹						
P&C Canada	(2.8)%	(3.8)%	1.0 pts	(2.3)%	(3.2)%	0.9 pts
P&C U.S.	1.5%	3.0%	(1.5) pts	(0.2)%	3.0%	(3.2) pts
Consolidated	(2.1)%	(2.5)%	0.4 pts	(1.9)%	(1.9)%	- pts

¹ As a % of opening reserves.

Management's Discussion and Analysis for the year ended December 31, 2018

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

15.2 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). Ceded reinsurance complies with regulatory guidelines. Furthermore, the reinsurance treaties call for timely reimbursement of ceded losses.

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 catastrophe event such as an earthquake could financially weaken a reinsurer, so distribution of risk is an important reinsurance strategy for us.

Annually, we review and adjust our reinsurance coverage as well as our net retention of risks in order to reflect our current exposures and our capital base. For multi-risk events and catastrophes, the coverage limits are well in excess of the regulatory requirements with respect to the earthquake risk as per our conservative approach.

In line with industry practice, our reinsurance recoverables with licensed Canadian reinsurers (\$169 million as at December 31, 2018, \$227 million as at December 31, 2017) 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. We have collateral in place to support amounts receivable and recoverable from unregistered reinsurers.

Since January 1, 2018, the Company's U.S. operations are covered by the multi-risk events and catastrophes reinsurance program. Until April 30, 2018, the losses resulting from any single catastrophe above US\$20 million and up to US\$130 million were being reinsured externally.

In connection with the acquisition of OneBeacon, we entered into a reinsurance contract pursuant to which a major reinsurer will assume 80% of negative reserve development with respect to OneBeacon's claims liabilities for accident years 2016 and prior. The maximum amount recoverable under the ADC is US\$200 million and is subject to some exclusions and limitations. As at December 31, 2018, significant capacity remains under this coverage.

For further details, see Note 14 – Reinsurance of the Consolidated Financial statements.

Management’s Discussion and Analysis for the year ended December 31, 2018

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

Section 16 – Employee future benefit programs



We sponsor a number of funded and unfunded defined benefit pension plans in Canada 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. We provide active employees in Canada a choice between a defined benefit and a defined contribution pension plan. We offer employees in the U.S. a 401(k) plan.

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. Because of the long-term nature of our pension obligations, movements in discount rates and investment returns could bring volatility in our balance sheet. The sharp decline in equity markets in late 2018 drove pre-tax OCI losses of \$127 million in Q4-2018, offsetting OCI gains recognized earlier in 2018.

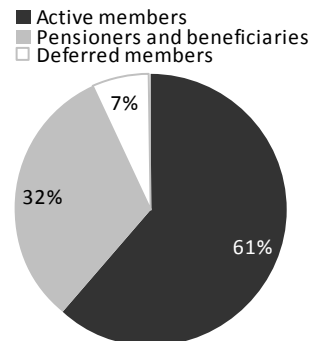
We have taken a multi-faceted approach to ensure the sustainability of our pension plans and gradually reduced the risk and volatility that stems from our pension liabilities and assets, including:

- 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;
- adding inflation sensitive assets;
- making voluntary contributions to improve the funding status of our pension plans; and
- amending pension plan benefits and conditions.

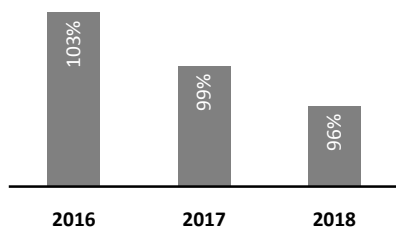
We regularly monitor the risks inherent in our defined benefit pension plans on an asset-liability basis. We continue to evaluate various alternatives to better manage the risk related to these plans.

Refer to Note 27 – Employee future benefits of the accompanying Consolidated financial statements for details on actuarial gains and losses recognized in OCI, assumptions used and sensitivity analysis, as well as risk management and investment strategy.

Defined benefit obligation
(as at the date of the latest actuarial valuation)

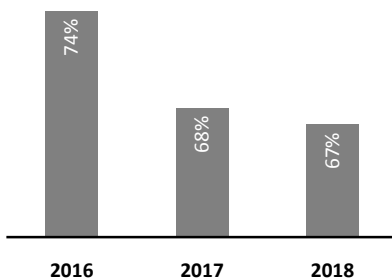


Funding ratio



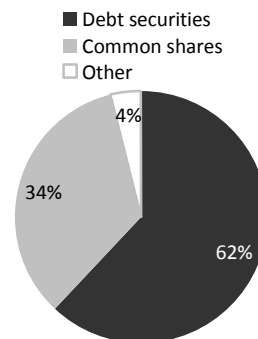
The lower funding ratio was mainly driven by the market decline in Q4-2018.

Interest rate hedge ratio



The hedge ratio was essentially in line with last year.

2018 pension plan asset mix



Pension plan asset mix is essentially unchanged from 2017.

Funding ratio: Plan assets as a percentage of funded plans’ obligations.

Interest rate hedge ratio: The duration of the pension asset portfolio divided by the duration of the registered pension plans’ obligation. Our objective is to remain in a modest range around our pension fund investment policy target of 70%, assuming the funding ratio is 100%. A lower hedge ratio increases our exposure to changes in interest rates.

Management’s Discussion and Analysis for the year ended December 31, 2018

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

Section 17 – Treasury management

17.1 Financing structure

2018 Financing structure

Debt-to-total capital ratio	Weighted-average debt maturity	Weighted-average debt coupon	Weighted-average preferred share coupon
22.0%	11 years	3.37% (after tax)	4.30% (after tax)

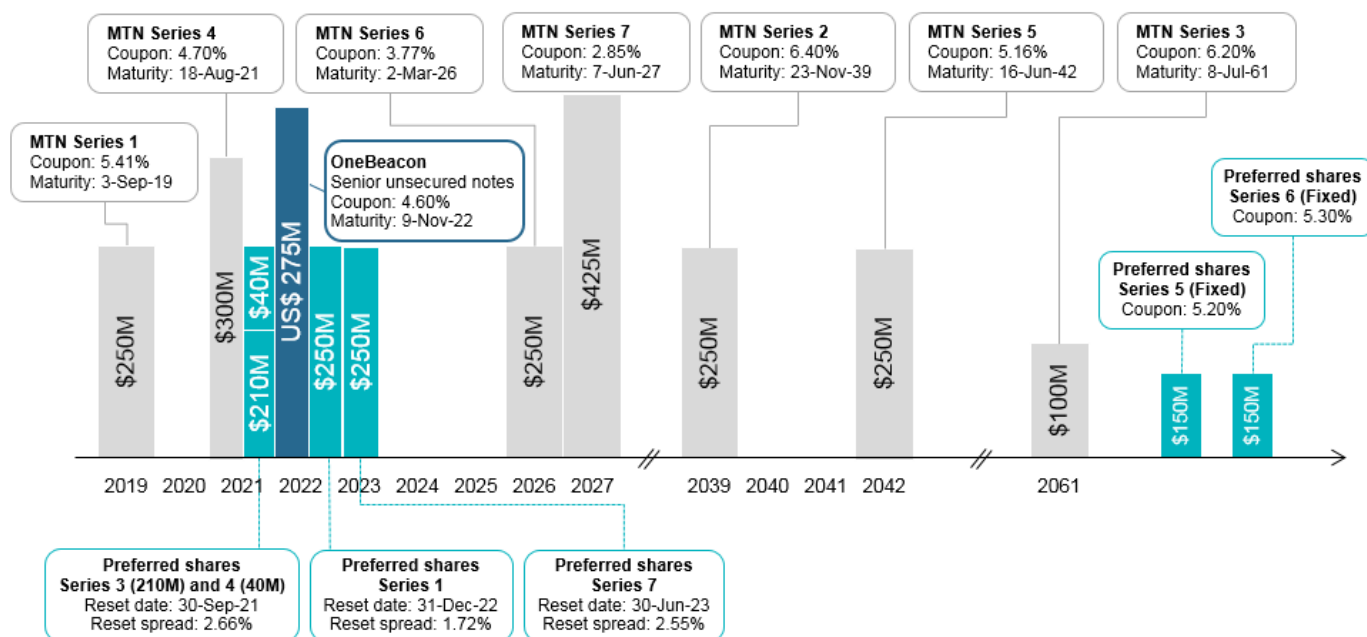
We believe that our optimal financing structure is one where the debt-to-total capital ratio is generally at 20%. We also expect to have approximately 10% of our total capital comprised of preferred shares. The debt-to-total capital ratio may occasionally exceed 20% with a firm plan to revert back to 20% within a short period of time; in the case of the OneBeacon acquisition, within 24 months following closing. Our debt-to-total capital ratio following this acquisition at the end of September 2017 was 24.7% and has decreased to 22.0% as at December 31, 2018 (23.1% as at December 31, 2017).

We have a diversified maturity profile with reasonable levels of debt and preferred shares, which improves our overall cost of capital:

- We currently have seven series of medium-term notes outstanding with maturities ranging between less than 1 year and 43 years.
- The notes carry a weighted average coupon of 4.61% (3.37% after tax).
- All debt tranches are prudent in size with no large peaks, reducing financing risk.
- Preferred shares provide flexibility in our capital structure at a reasonable cost.
- Debt and preferred shares represent about 30% of our total capital structure.

Our notes and preferred shares are presented in the table below.

Finance structure – Notes and preferred shares



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

Credit facility

Our \$750 million **credit facility** matures on August 28, 2023. There were no outstanding amounts under our credit facility as at December 31, 2018 (\$60 million as at December 31, 2017). As part of the covenants under the credit facility, we are required to maintain certain financial ratios, which were fully met as at December 31, 2018 and 2017.

Our credit facility may be drawn as follows:

<u>Type:</u>	<u>At a rate of:</u>
Prime loans	Prime rate plus a margin
Base rate (Canada) advances	Base rate plus a margin
Bankers’ acceptances	Bankers’ acceptance rate plus a margin
Libor advances	Libor rate plus a margin

Series 7 preferred shares

In May, we completed a \$250 million offering of Rate-Reset Class A Series 7 Preferred Shares. The holders of these shares will be entitled to receive fixed non-cumulative cash dividends on a quarterly basis, subject to Board approval, based on an annual rate of 4.90% until June 30, 2023. The dividend rate will be reset at this time and every five years thereafter. Further details, including conversion rights, can be found in the Prospectus Supplement dated May 22, 2018 filed by the Company and available on SEDAR at www.sedar.com.

17.2 Ratings

Independent third-party rating agencies assess our insurance subsidiaries’ ability to meet their ongoing policyholder obligations (“financial strength rating”) and our ability to honour our financial obligations (“senior unsecured debt rating”). Ratings are an important factor in establishing our competitive position in the insurance market, mainly in commercial insurance, and accessing capital markets at competitive pricing levels.

Table 24 – Ratings

	A. M. Best	DBRS	Moody’s	Fitch
Financial strength ratings				
IFC’s principal Canadian P&C insurance subsidiaries	A+	AA(low)	A1	AA-
OneBeacon U.S. regulated entities	A		A2	AA-
Senior unsecured debt ratings				
IFC	a-	A	Baa1	A-
OneBeacon	bbb+		Baa2	A-

Management's Discussion and Analysis for the year ended December 31, 2018

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

17.3 Understanding our cash flows

Cash flows used in operating activities mainly consist of insurance premiums less claims and expense payments, plus investment income. Cash is used to pay dividends on common and preferred shares. Cash may also be deployed for strategic purposes like business acquisitions, investments in brokerage firms and share buybacks, or to repay outstanding financing. Cash inflows in excess of these outflows are moved to our investment portfolio to generate additional investment income in the future.

Table 25 – Cash flows

	Q4-2018	Q4-2017	Change	2018	2017	Change
Net cash flows provided by operating activities	211	23	188	833	781	52
Cash flows generated from (deployed on):						
Acquisition of OneBeacon	-	-	-	-	(2,139)	2,139
Equity investments in brokerages and other, net	(13)	(25)	12	(78)	(108)	30
Purchases of intangibles and P&E, net	(36)	(24)	(12)	(117)	(98)	(19)
Dividends	(109)	(99)	(10)	(430)	(378)	(52)
Share-based payments in shares	(4)	(4)	-	(36)	(37)	1
NCIB	-	-	-	-	(7)	7
Issuance of common shares	-	-	-	-	731	(731)
Issuance of medium-term notes	-	-	-	-	422	(422)
Issuance of Class A Preferred shares	-	-	-	243	292	(49)
Amount drawn (repaid) under our credit facility	-	(150)	150	(60)	60	(120)
Net cash inflows (outflows) before investment portfolio sales/purchases	49	(279)	328	355	(481)	836
Excess capital deployed on OneBeacon acquisition	-	-	-	-	660	(660)
Proceeds from investment sales (investment purchases)	(43)	(76)	33	(90)	(184)	94
Net increase (decrease) in cash and cash equivalents	6	(355)	361	265	(5)	270

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.

17.4 Contractual obligations

The table below presents the expected timing of contractual liquidity requirements as at December 31, 2018.

Table 26 – Contractual obligations

	Total	Payments due by period			
		Less than 1 year	1 - 3 years	3 - 5 years	Thereafter
Principal repayment on notes outstanding	2,209	250	299	393	1,267
Interest payments on notes outstanding	1,184	97	171	128	788
Claims liabilities ¹	10,734	4,182	2,913	1,787	1,852
Operating leases and other commitments	1,191	214	261	189	527
Pension obligations ²	37	4	7	7	19
Total contractual obligations	15,355	4,747	3,651	2,504	4,453

¹ Represents the undiscounted value and includes incurred but not reported reserves.

² These amounts represent the annual mandatory funding required by regulators, based on the latest actuarial valuations and expected benefit payments for unfunded plans.

Section 18 – Capital management

18.1 Capital management objectives

Our objectives when managing capital consist of:

- maintaining strong regulatory capital levels (see Regulatory capital section below), while ensuring policyholders are well protected; and
- maximizing long-term shareholder value by optimizing capital used to operate and grow the Company.

We seek to maintain adequate capital levels to ensure that the probability of breaching the regulatory minimum requirements is very low. Such levels may vary over time depending on our evaluation of risks and their potential impact on capital. We also keep higher levels of capital when we foresee growth or actionable opportunities in the near term. Furthermore, we may return excess capital to shareholders through annual dividend increases and, when appropriate, through share buybacks.

Regulatory capital

The amount of capital in any particular company or country depends upon the Company's internal assessment of capital adequacy in the context of its risk profile and strategic plans, as well as local regulatory requirements. The Company's objective is to maintain the capitalization of its regulated operating subsidiaries above the relevant minimum regulatory capital requirements in the jurisdictions in which they operate (referred to as regulator supervisory minimum levels).

Canada

- Our federally chartered Canadian P&C insurance subsidiaries are subject to the regulatory capital requirements defined by OSFI and the Insurance Companies Act, while our Québec provincially chartered subsidiaries are subject to the requirements of the AMF and the Act respecting insurance.
- Federal and Québec regulated P&C insurers are required, at a minimum, to maintain a MCT ratio of 100%.
- OSFI and the AMF have also established a regulator supervisory target capital ratio of 150%, which provides a cushion above the minimum requirement.

U.S.

- Our U.S. insurance operations are subject to regulation and supervision in each of the states where they are domiciled and licensed to conduct business.
- State insurance departments have established the insurer solvency laws and regulatory infrastructure to maintain accredited status with the National Association of Insurance Commissioners ("NAIC").
- A key solvency-driven NAIC accreditation requirement is a state's adoption of RBC requirements.
- Dividends from our major U.S. insurance subsidiary are subject to the New York State Department of Financial Services' prior approval for a two-year period ending September 30, 2019.

Regulatory capital guidelines change from time to time and may impact our capital levels. We carefully monitor all changes, actual or proposed.

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18.2 Capital position

All our regulated P&C insurance subsidiaries were well capitalized on an individual basis with capital levels well in excess of regulator supervisory minimum levels, as well as Company action levels (CALs). CALs represent the thresholds below which regulator notification is required together with a company action plan to restore capital levels.

Table 27 – Estimated aggregated capital position

	December 31, 2018			September 30, 2018			December 31, 2017		
	Canada (MCT)	U.S. (RBC)	IFC capital margin	Canada (MCT)	U.S. (RBC)	IFC capital margin	Canada (MCT)	U.S. (RBC)	IFC capital margin
Regulatory capital ratios (RCRs)	201%	377%	-	196%	384%	-	205%	459%	-
Industry-wide supervisory minimum levels	150%	150%	-	150%	150%	-	150%	150%	-
CALs	170%	200%	-	170%	200%	-	170%	200%	-
Capital above CALs (capital margin)	530	396	926	469	381	850	618	438	1,056
Other regulated/unregulated entities ¹	-	-	407	-	-	327	-	-	79
Total capital margin²			1,333			1,177			1,135

¹ Other regulated entities include Split Rock Insurance, Ltd. (Bermuda) and IB Reinsurance Inc. (Barbados).

² Total capital margin includes the aggregate of capital in excess of company action levels in regulated entities (170% MCT, 200% RBC and other CALs on other jurisdictions) plus available cash in unregulated entities.

Total capital margin increased by \$156 million in Q4-2018 to \$1,333 million. Strong Canadian underwriting results and seasonal improvements in capital factors were tempered by a decline in equity markets.

On a full year basis, total capital margin increased by \$198 million, reflecting the proceeds of the preferred share issuance in Q2-2018, partly offset by the full repayment of the credit facility.

For details on our Own Risk and Solvency Assessment, refer to Section 22.8 – Own Risk and Solvency Assessment.

RISK MANAGEMENT

Section 19 – Overview

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, employees, shareholders, regulators and other stakeholders. Our risk management programs aim at mitigating 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 our 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 and risk transfer 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.

Section 20 – Risk management structure



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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.

The Board and Committee structures are reviewed periodically to be aligned with best practices, applicable laws and regulatory guidelines on corporate governance. The following structure is in place and remains largely unchanged from 2017.

Board of Directors	Main responsibility 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 our long-term viability, profitability and development.
Risk Management Committee	Assists the Board of Directors with its oversight role with respect to our management in order to build a sustainable competitive advantage, by fully integrating the Enterprise Risk Management policy into all of our business activities, strategic planning and our subsidiaries and operations, including our pension funds.
Compliance Review and Corporate Governance (CRCG) Committee	Ensures a high standard of governance, compliance and ethics in our company, including our pension, funds and that we meet our legal requirements and engage in best practices as determined by the Board of Directors. In this regard, the CRCG Committee oversees our governance framework and that of our pension funds, our compliance framework, our compliance programs which includes related party transactions (“RPT”), our market conduct programs and policies, as well as the implementation of corporate compliance initiatives.
Human Resources and Compensation Committee	Assists the Board of Directors in fulfilling its governance 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 consistent with our overall business objectives.
Audit Committee	Assists the Board of Directors with its oversight of the integrity of our financial statements and financial information, the accounting and financial reporting process, the qualifications, performance and independence of the external auditors, the performance of the internal audit function and the quality and integrity of internal controls.
Enterprise Risk Committee	This committee is composed of senior officers designated by the Board of Directors and is chaired by the Chief Risk Officer. 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 both in terms of the impact on financial resources and reputation; (iii) monitor risks; and (iv) manage risk in accordance with the risk appetite statement 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.
Other committees	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.

Section 21 – Corporate governance and compliance program



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 states, 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:

21.1 Corporate governance and compliance program

Corporate governance ensuring compliance with laws and regulatory requirements			
Sound corporate governance standards	Effective disclosure controls and processes	Sound corporate compliance structures and processes	Specialized resources independent from operations
<p>The Board of Directors and its committees are structured in accordance with sound corporate governance standards.</p> <p>Directors are presented with relevant information in all areas of our operations to enable them to effectively oversee our management, business objectives and risks. 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.</p>	<p>Disclosure controls and processes have been put in 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.</p>	<p>Effective corporate governance depends on sound corporate compliance structures and processes.</p> <p>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.</p>	<p>To manage the risks associated with compliance, regulatory, legal and litigation issues, we have specialized resources reporting to the SVP, Corporate and Legal services that remain independent of operations. The SVP, Corporate and Legal services reports 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.</p>

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.

Section 22 – Enterprise Risk Management



22.1 Mandate

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, regulators, and other stakeholders.

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.

Our risks are separated into four main categories: Strategic Risk, Insurance Risk, Financial Risk and Operational Risk.

22.2 Objectives

- 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 identified risks, major incidents and control 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.

22.3 A shared responsibility

Managing risk is a shared responsibility at Intact. The three lines of defence model is employed to clearly identify the roles and responsibilities of those involved in the risk management process.



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22.4 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:

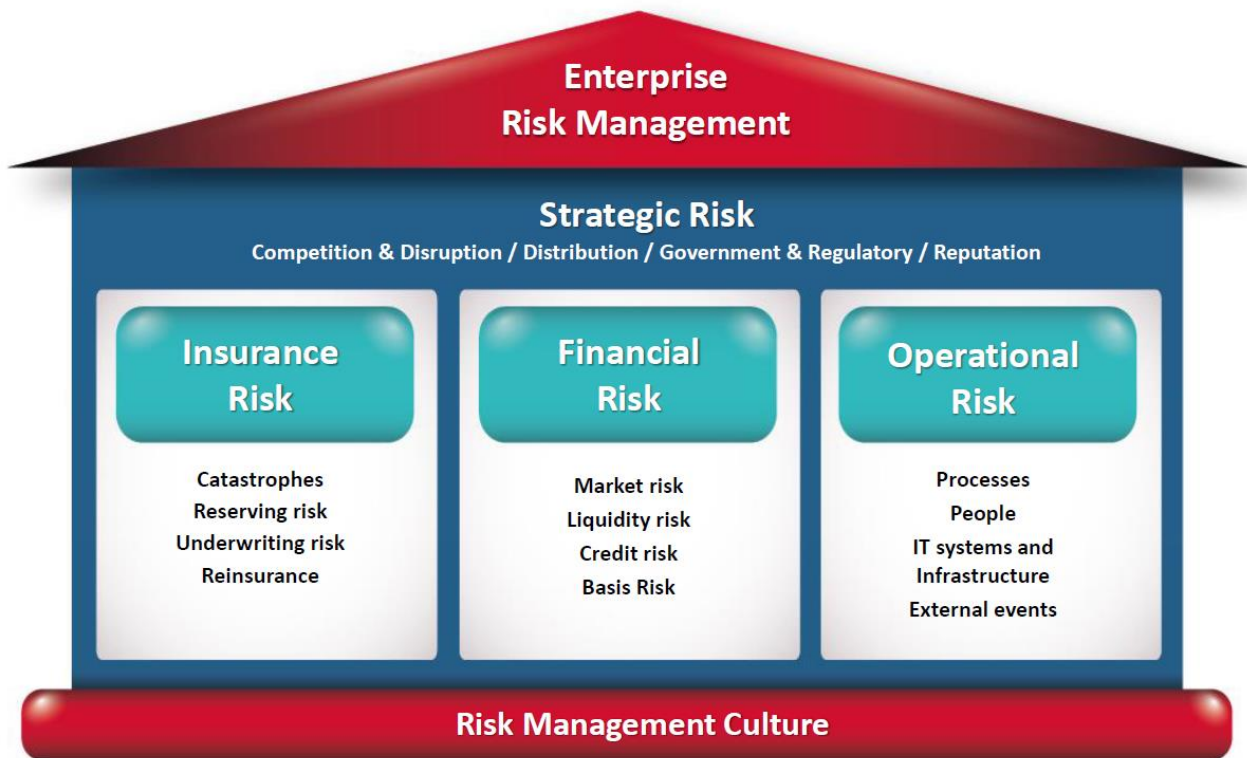
- we focus on our core competencies;
- we keep our overall risk profile in check;
- we protect ourselves against extreme events;
- we promote a strong risk management culture; and
- we maintain our ability to access capital markets at reasonable costs.

Consult our website for a more detailed discussion of our Risk Appetite under the Corporate Governance section.

22.5 Main risk factors and mitigating actions

Our practice is to regularly identify our top risks, assess the likelihood of occurrence and evaluate the potential impacts should they materialize both in terms of financial resources and reputation. We also consider potential emerging risks that are newly developing or changing risks which are inherently more difficult to quantify.

We then determine mitigation plans and assign accountability for each risk if deemed appropriate given our overall assessment, our risk appetite, and our business objectives.



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22.6 Top and emerging risks that may affect future results

Each year the Enterprise Risk Management Committee identifies the top risks that the Company faces. The following section presents the top and emerging risks identified with the most severe potential impact. In assessing the potential impact for each of the top risks, the presence and effectiveness of risk mitigation activities are taken into consideration. Our main risk factors together with our practices used to mitigate these risks are explained below.

TOP AND EMERGING RISKS

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Turbulence in financial markets.....	57
Reserve and pricing inadequacy	58
Governmental and/or regulatory intervention.....	59
Failure of an acquisition	61
Failure of a major technology initiative	61
Information technology and cyber security risk	62
Inability to contain fraud and/or abuse.....	63
Customer satisfaction risk	63
The emergence of autonomous vehicles and crash avoidance technology.....	64

Major earthquake		Insurance risk
<p>Risk we are facing</p> <p>The occurrence of a major earthquake may produce significant damage in large, heavily populated areas.</p>		
<p>Potential impact</p> <p>The occurrence of a major earthquake could have a significant impact on our profitability and financial condition and that of the entire P&C insurance industry in Canada. 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. In addition, we could be subject to increased assessments from the P&C Insurance Compensation Corporation (PACICC) leading to further costs if other insurers are unable to meet their contractual obligations with their clients. Based on our assessment, our exposure to a major earthquake in Western Canada has continued to increase slightly in 2018 versus the prior year.</p>	<p>How we manage this risk</p> <p>Our risk management strategy consists of regular monitoring of insured value accumulation and concentration of risks. We use earthquake risk models to help assess our possible losses at various return periods and use reinsurance to transfer a substantial amount of risk. Consequently, the diversification of risk among an appropriate number of reinsurers is vital for us. <i>See Section 15.2 – Reinsurance for more details on our reinsurance program.</i></p> <p>In 2017, we completed a comprehensive review of the models we use to evaluate our earthquake exposure. We concluded that the models we use to help us assess our risk are sound. Given the nature of earthquake risk, different models provide different assessments of the same exposure. We continue to maintain a prudent amount of reinsurance that exceeds our risk assessment of an earthquake in Western Canada, including the U.S. Pacific Northwest, at a 1-in-500 year return period.</p>	

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Catastrophe events risk **Insurance risk**



Risk we are facing

Climate change is a challenge faced by the entire P&C insurance industry. In particular, our property insurance business has been affected due to changing climate patterns and an increase in the number and cost of claims associated with severe storms and other natural disasters. Changing weather patterns has resulted in hotter, drier weather in some areas and more humid, wetter weather in other areas. The result has been more unpredictable weather and increasingly severe storms. These changes could negatively affect our property and automobile insurance results, which collectively contribute to a majority of our total annual premiums.

Catastrophe events include natural disasters and unnatural events.

- There are a wide variety of natural disasters including but not limited to hurricanes, wind storms, hailstorms, rainstorms, ice storms, floods, severe winter weather and forest fires.
- Unnatural catastrophe events including but not limited to hostilities, terrorist acts, riots, explosions, crashes and derailments, and wide scale cyber-attacks.

Despite the use of sophisticated models, the incidence and severity of catastrophe events are inherently unpredictable. The extent of losses from a catastrophe event 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 catastrophe events are restricted to small geographic areas; however, hurricanes and other storms may produce significant damage in large, heavily populated areas. Catastrophe events can cause losses in a variety of P&C insurance lines.

Potential impact

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

Over the last few years, we have witnessed a continued increase in the number and severity of weather events. Changing weather patterns may have an impact on the likelihood and severity of natural catastrophes, such as wildfires in the West and heavy precipitation in the East. The trend in climate change continues to pose a meaningful risk to our ability to meet our business objectives.

We began offering cyber risk insurance to our commercial customers in 2015 and have expanded our offerings in this space over time. The acquisition of OneBeacon expands further our exposure to this risk. We may be adversely affected by a large scale cyber-attack that simultaneously compromises the systems of many of our insureds.

In addition, we have exposure to terrorism risk in the U.S. through our U.S. specialty business. Terrorism can take many forms and both our property and workers’ compensation policies may be affected by an event.

How we manage this risk

To address this issue, we have ongoing initiatives including pricing and product changes to reflect new climate realities, regular reviews of claims processes and a greater focus on consumer loss prevention. Many initiatives have been implemented over the last several years including the expanded use of deductibles and sub-limits, and the introduction of depreciation schedules in personal property insurance across Canada. These initiatives should help mitigate, to some extent, P&C insurance losses resulting from water damage and harsh weather. As climate risk continues to evolve, we are continuously developing or acquiring new modelling tools to help better assess catastrophe risk. *See Section 12.2 – Climate-related governance and risk management for more details on our initiatives and ongoing management of the risks related to climate change.*

In addition, our reinsurance program offers protection against multi-risk events and catastrophes. *See Section 15.2 – Reinsurance for more details on our reinsurance program.*

To help mitigate the risks associated with our cyber risk insurance product, we focus on small to medium size companies with relatively modest policy limits. In addition, we purchase reinsurance specifically to transfer some of the risk in the event a large scale cyber-attack triggers a high volume of claims.

In addition to private reinsurance, we also participate in the U.S. federal government terrorism insurance backstop (TRIPRA) that mitigates our exposure under certain circumstances as outlined in U.S. federal legislation.

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Increased competition and disruption Strategic risk

Risk we are facing

The P&C insurance industry is highly competitive and we believe that it will remain so for the foreseeable future.

We 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 Canadian banks that are selling insurance products. These firms may use business models different than ours and sell products through various distribution channels, including aggregators, 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.

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 and web aggregators, as well as our ability to maintain our business relationships with them. 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.

Potential impact

Intense competition for our insurance products could harm our ability to maintain or increase our profitability, premium levels and written insured risk volume.

The entrance of a new player in the market or a shift in methods to purchase insurance could challenge our distribution model. The use of information technology in the distribution and pricing of insurance products (e.g. telematics, the use of Big Data, etc.) has increased over the last several years and this trend is expected to continue in the near future. Artificial intelligence is another area that is gaining much attention and could have a material impact on the insurance industry. Competitors may use these technologies more effectively than us or there may be negative reputational consequences arising from our initiatives.

Demutualization and further consolidation in the Canadian P&C industry remains likely which may result in an erosion of our competitive advantage.

The evolution of customer preferences for different distribution channels or alternate business models (e.g. peer-to-peer insurance) could lead to a material decline in our market share. 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.

How we manage this risk

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. We have established close relationships with our independent distributors by providing them with advanced technology, as well as 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.

We also have a number of initiatives that we are pursuing to help mitigate the risk of competition and disruption including:

- Investing significantly in promoting our brands with an increasing focus on using web and mobile technology to reach consumers;
- Promoting our own usage-based insurance (UBI) product to better meet customer needs;
- Increased digitalization of the customer experience;
- Opening innovative service centres in major Canadian cities to provide an unmatched customer experience; and
- Creating Intact Ventures (*see Section 11.2*) to be at the forefront of technological change as it applies to the P&C insurance industry.

We are continuously monitoring and analyzing competitor offerings in the marketplace to help ensure that we remain at the forefront of innovation in the P&C insurance marketplace.

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Turbulence in financial markets

Financial risk

Risk we are facing

Movements in interest rates, credit spreads, foreign exchange rates, inflation 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. 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. Severe deflation or unexpected inflation could materially impact both our assets and liabilities, including our employee defined benefit pension plans. In 2018, there was renewed financial market volatility that we had not experienced for several years. *See Section 6.5 – Capital markets for more details.*

Potential impact

Changes in the market variables mentioned above could adversely affect our investment income and/or the market value of our securities.

In addition to the risk related to investments discussed previously, an economic downturn and/or increase in the inflation rate have a significant impact on the funded status of our defined benefit pension plans. Consequently, this could impact our financial condition.

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.

Our preferred share portfolio depreciates in value as a result of negative developments in interest rate and/or credit markets.

Our fixed income portfolio may experience defaults resulting in impairments and lower income prospectively.

How we manage this risk

While our strategy is long-term in nature, it is regularly reviewed to adapt to the investment environment when necessary, especially in times of turbulence and increased volatility. We closely monitor concentration across and within asset classes and ensure that exposures remain within the risk tolerance stated in our investment policy.

Periodically, we employ several risk mitigation measures such as changes to our 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 our regulatory capital ratios to financial market volatility.

Regular stress testing of our investment risk exposures assists management in assessing the overall level of financial risk and helps to ensure that exposures remain within established risk tolerances. In 2018, we conducted comprehensive stress testing that considered exposures holistically across all geographies in which we invest and the potential impact on our capital position, both in local jurisdictions and on an aggregate basis for IFC.

The Company’s exposure to financial risk arising from its financial instruments together with the Company’s risk management policies and practices used to mitigate it are explained in our Consolidated financial statements. Consult the following sections for more information.

Reference to our Consolidated financial statements

Market risk
Notes 10.1 and 10.2

Credit risk
Note 10.4

Basis risk
Note 10.3

Liquidity risk
Note 10.5

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Reserve and pricing inadequacy

Insurance risk

Risk we are facing

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 (“LAE”) incurred with respect to premiums collected or due on the insurance policies that we write. Reserves do not represent an exact calculation of a 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.

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, or the introduction of new products that could adversely impact the future behaviour of policyholders.

Potential impact

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.

The following factors may have a substantial impact on our future actual losses and LAE experience:

- amounts of claims payments;
- expenses that we incur in resolving claims;
- legislative and judicial developments; and
- changes in economic variables such as interest rates and/or inflation.

To the extent that actual losses and LAE 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 will decrease by a corresponding amount. In addition, increasing or strengthening reserves causes a reduction in our P&C insurance subsidiaries’ regulatory capital. For example, there remains uncertainty related to the ultimate impact of the 2016 Ontario Auto Insurance reforms. As claims incurred after the reforms were enacted are settled, the uncertainty related to these specific changes in legislation declines. *See Section 15.1 – Claims liabilities for more details on the claims reserve and prior year claims development.*

Inadequate pricing may lead to material declines in underwriting income and/or deficient reserves.

How we manage this risk

Establishing an appropriate level of reserves is an inherently uncertain process. We continually refine our reserve estimates in an ongoing process as claims are reported and settled.

Our reserve review committee scrutinizes reserves by business segment, and analyzes trends and variations in losses to ensure that we maintain a sufficient level of claims reserve.

Our profitability committees review the results of each business line and determine if appropriate action is required in terms of product design or pricing to remediate poor underwriting performance.

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 use 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 and assumed risk-sharing pools in several automobile insurance markets including Ontario, Québec, Alberta, and the Maritimes.

In addition, on an annual basis, our external auditor provides an independent review of our reserves in the context of the audit of the Consolidated financial statements. This review includes establishing their own view of a reasonable range for the estimate.

Following the acquisition of OneBeacon, we purchased reinsurance to protect against adverse development for OneBeacon’s reserves from 2016 and prior years. During 2018, this risk mitigation strategy resulted in lower volatility in our U.S. dollar claims reserves.

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Governmental and/or regulatory intervention

Strategic Risk

Risk we are facing



Our subsidiaries and affiliates are subject to regulation and supervision by 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;
- are generally designed to protect policyholders and creditors, and are related to matters including:
 - requirements on privacy and the protection of personal information;
 - 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 upstream dividends from operating companies; and
 - transactions with affiliates.
- 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.

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. Solvency requirements are amended from time to time.

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

Governmental and/or regulatory intervention (cont’d)	Strategic risk
<p>Potential impact</p> <p>We believe that our subsidiaries are in material compliance with all applicable regulatory requirements. However, it is not possible to predict the future impact of changing federal, states, provincial and territorial regulations on our operations. Laws and regulations enacted in the future may be more restrictive than current laws. Overall, our business is heavily regulated and changes in regulation may reduce our profitability and limit our growth prospects.</p> <p>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 could materially adversely affect our business, results of operations and financial condition.</p> <p>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.</p> <p>In addition, our written premiums and profitability can be significantly affected by many factors, including:</p> <ul style="list-style-type: none"> • developing trends in tort and class action litigation; • changes in other laws or regulations or in the interpretation of existing laws including with respect to restrictions on the ownership of brokers by insurers and/or the compensation arrangements between insurers and brokers, limitations on the conduct of brokers, or claims handling procedures; • the adoption of consumer initiatives regarding rates charged for automobile or other insurance coverage or forced reductions in premiums or additional costs imposed by governments that limit our ability to properly price our insurance products; • modification of tax laws or a change in interpretation to existing tax laws, either retroactively or prospectively; and • nationalization of one or more of our business lines. <p>Furthermore, a significant increase in solvency requirements would increase the possibility of regulatory intervention and may reduce our ability to generate attractive returns for shareholders. This may also negatively impact our ability to execute our growth strategy and attain our financial objectives.</p>	<p>How we manage this risk</p> <p>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.</p> <p>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.</p> <p>We regularly monitor trends and make adjustments to our strategy and products, when deemed appropriate, to ensure the sustainability of insurance products and to avoid the potential for additional regulation that may negatively impact our reputation, profitability, and financial condition.</p> <p>To reduce the risk of breaching the regulatory capital requirements, we have Board approved thresholds for the regulatory capital ratios in all jurisdictions in which we operated. We operate above these thresholds under normal circumstances to reduce the likelihood of regulatory intervention. Our Enterprise Risk Committee regularly review risks related to solvency and uses stress testing to identify vulnerabilities and possibly areas for remediation. Our capital management 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.</p> <p>In addition, we conducted a full internal solvency assessment as described hereafter in <i>Section 22.8 – Own Risk and Solvency Assessment (ORSA)</i>.</p>

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Failure of an acquisition Strategic risk

Risk we are facing

Our primary strategy is to pursue consolidation in the Canadian market and expansion in foreign markets where we can deploy our expertise in pricing, underwriting, claims management and multi-channel management.

On September 28, 2017, we completed the US\$1.7 billion (\$2.3 billion) acquisition of OneBeacon, a specialty P&C insurance provider that offers a wide range of specialty insurance products in the United States. Failure on our part to manage this U.S. acquisition could have a material adverse effect on our business, results of operations and financial condition. In addition to specific country risks, we cannot be sure that we will be able to identify appropriate profitability targets or successfully integrate this acquired business into our operations.

Potential impact

With respect to the acquisition of OneBeacon, we are faced with a number of integration risks including but not limited to:

- the inability to derive the expected returns from the acquisition, which would lead to a lower future return on equity for shareholders;
- the inability to realize growth and profitability action plans, such as cross-border opportunities and underwriting profitability targets. Under certain adverse circumstances, this may lead to a write down of goodwill;
- challenges in harmonizing processes; and
- a departure of key employees during the integration phase.

In addition to the potential financial impact, our reputation may be adversely affected if such an event were to occur. Consequently, it may impact the cost or availability of capital for future acquisitions.

How we manage this risk

We are a proven industry consolidator with 16 successful P&C acquisitions since 1988. We have a dedicated corporate development team that follows a rigorous selection process. Our approach to conducting due diligence to assess all the risks and opportunities is well developed and is consistently executed. We also assign dedicated and experienced task forces to ensure a swift and effective integration with seamless impact to our customers. There is also strong oversight by the Board of Directors regarding acquisitions.

Failure of a major technology initiative Operational risk

Risk we are facing



To maintain our performance levels, we are required to regularly modernize our systems. Often significant time and investment is required for accomplishing these projects. Any unplanned delays, unforeseen costs, or unsuccessful execution of such projects could lead to a significant decline in service levels, impact employee morale negatively and reduce our competitiveness. There is no assurance that we will succeed in meeting our objectives for these projects.

Potential impact

Our technology strategy may take too long to execute or may not be adequate to maintain a competitive advantage. The complexity and interdependence of our infrastructure and applications may lead to higher costs and more errors. Implementation of new technology may introduce more complexity in the interim prior to simplification after decommissioning older systems.

We could decide to abandon one or more of our technology initiatives resulting in a material write down.

How we manage this risk

Senior management provides careful oversight and ensures that proper funding and resources are allocated to our key projects. Risk assessments and internal audits are regularly conducted to identify potential areas for remediation or the necessity for additional controls. A dedicated committee was created to ensure proper focus is devoted to major technology projects.

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Information technology and cyber security risk

Operational risk



Risk we are facing

Information technology and cyber security risks continue to be key risks for many companies. Criminal organizations, hackers, and other external actors have become more active and better equipped to attack even robust systems and networks. Our dependency on technology, network, telephony and critical applications makes our ability to operate and our profitability vulnerable to business interruptions, service disruptions, theft of intellectual property and confidential information, litigation and reputational damage.

The volume and sophistication of cyber-attacks continue to increase. These attacks may include targeted attacks on systems and applications, introduction of malicious software, denial of service attacks, and phishing attacks which could result in the fraudulent use or theft of data, and may involve attempts to fraudulently induce employees, customers or third-party service providers to disclose sensitive information in order to gain access to the Company’s data. Distributed Denial of Service (DDoS) and Ransomware attacks continue to increase in frequency and severity. These activities are designed to disrupt the operations of an organization and/or to benefit the attacker financially.

We may be unable to prevent cyber-attacks that result in system disruption or a breach of confidential information, whether personal or corporate in nature. Third party service providers and other suppliers may also be the subject of successful cyber-attacks leading to a material impact on our systems or the theft of confidential information.

Potential impact

Despite our commitment to information and cyber security, we may not be able to fully mitigate all risks associated with the increased sophistication and volume in the threat landscape. As such, we may be the subject to a cyber-attack resulting in system unavailability, data corruption or deletion, or the disclosure of confidential or personal information. Massive denial of service attacks and system intrusion attempts could compromise our ability to operate or we may be unable to safeguard personal and confidential information from public disclosure. Other potential consequences include our inability to provide customers with real-time access to information on their insurance policies, provide quotes for new insurance products or enable customers to report claims electronically.

These events and attacks may lead to wide ranging consequences including:

- financial loss, which also includes lost productivity, remediation costs, and costs associated with potential legal action;
- regulatory action, which may include regulatory fines and/or increased scrutiny by government; and
- reputational damage such as lost consumer confidence and lower customer retention.

How we manage this risk

To ensure the security and resilience of our systems, the safeguard of our confidential information and the integrity of our information and databases, dedicated teams plan, test and execute our continuity and security plans. This includes threat and vulnerability assessments and the implementation of appropriate mitigation actions. Our security teams constantly monitor our systems and are 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.

We continuously upgrade our applications to better protect our systems and information. We regularly monitor external trends in cyber security to ensure we are able to rapidly mitigate known vulnerabilities.

We benchmark our information security practices to assess areas of our cyber security program that require additional effort and to learn from industry leading practices.

Our Information Technology Security Committee oversees information security initiatives and ensures effective collaboration across teams. As part of our overall security program, we provide employee information security awareness and training to enhance our ability to resist cyber-attacks. In addition, our Enterprise Risk Committee oversees the establishment of our cyber security strategy and monitors the progress of our mitigation action plans.

In 2018, we conducted a cyber-security exercise to test our ability to respond to a major security incident and identify opportunities to further strengthen our resilience.

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Inability to contain fraud and/or abuse

Operational risk

Risk we are facing

As a property and casualty insurer, we may be subject to internal or external fraud. Our insureds may exaggerate claims for personal gain. Despite our efforts to control fraud and abuse, our staff, systems, and processes may be unable to accurately detect and prevent internal or external fraud.

Potential impact

Fraud may result in unanticipated losses and a negative impact on our reputation. Our written premiums and profitability can be significantly affected by regulatory regimes which limit our ability to detect and defend against fraudulent claims and fraud rings.

How we manage this risk

We have strong internal controls in place to prevent and detect potential internal fraud. Internal and external audits are performed to verify that the controls are followed.

Fraud detection software is used by our claims teams to detect potential external fraud and flag cases for further investigation. In Canada, we also have national investigative services and a number of investigative tools to help detect and root out fictitious losses or injuries, staged accidents and material misrepresentation or exaggeration of loss amounts or personal injury.

Government authorities also have an incentive to help reduce fraud in the system and maintain affordable insurance for consumers. Ontario Bill 15 - *Fighting Fraud and Reducing Automobile Insurance Rates Act* is one example of government action that aims to reduce auto insurance fraud.

Customer satisfaction risk

Strategic risk

Risk we are facing



Our insurance products and services are ultimately distributed to individual consumers and businesses. From time to time, unsatisfied customers, consumer advocacy groups or the media may generate negative publicity related to our claims handling or underwriting practices. Untimely or poor handling of such negative publicity may increase the impact of a situation and materially affect our reputation and growth prospects.

In addition, a lack of appropriate focus on customers’ needs and wants may threaten our ability to meet customer expectations, resulting in poor customer retention.

Potential impact

Negative publicity resulting from unsatisfied customers may result in increased regulation and legislative scrutiny of practices in the P&C insurance industry as well as increased litigation. Such events 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.

Social media could amplify the impact of a reputational issue. It could result in further damage to our reputation and impair our future growth prospects.

How we manage this risk

To mitigate these risks, we have established escalation procedures to help ensure that our customers have multiple channels to express any dissatisfaction. This includes a Customer Experience Team and an Ombudsman’s Office which both offer the opportunity for customer dissatisfaction to be resolved. In addition, management proactively identifies potential issues and performs an additional review to help ensure that our customers are treated fairly.

The wording of our insurance policies is reviewed periodically by management to detect and remediate potential issues before they arise.

New products and significant changes in existing products undergo a rigorous product development life-cycle including an independent review by the risk management function prior to launch. Potential reputational issues can be identified in the early stages of product development and, if required, changes are implemented prior to launch.

The Enterprise Risk Committee regularly monitors our operations to identify situations that can negatively affect customer satisfaction.

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The emergence of autonomous vehicles and crash avoidance technology Emerging risk

Risk we are facing



Commercialisation of fully- or semi-autonomous vehicles could profoundly change the transportation and auto insurance industries. The speed at which autonomous vehicles are adopted will depend on a number of factors including, but not limited to, the success of the new technology, the legal and regulatory environment, and customer preferences. These vehicles may have a dramatically different risk profile than current modes of transportation.

Potential impact

If the potential of autonomous vehicles and crash avoidance technology is realized, a number of changes may occur including a significant reduction in accident frequency and the emergence of new ways to provide automobile insurance coverage. This could cause a material decline in our written premiums.

How we manage this risk

We recognize the potential impact of this emerging technology and have been closely monitoring developments on this topic for some time. We devote part of our research agenda to include items such as the future of mobility insurance and autonomous vehicles. We believe it is crucial to understand this emerging technology and the possible implications to be able to adjust our corporate strategy accordingly.

In 2018, Intact ventures invested in a self-driving start-up, Voyage, to better position the Company as transportation evolves and insurance needs change.


We participate in the development of recommendations by the Insurance Bureau of Canada related to the regulation of automated vehicles.

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22.7 Other risk factors that may affect future results***Legal risk***

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 actions, including lawsuits, regulatory examinations, investigations, audits and reassessments by various parties including customers, suppliers, and government regulatory agencies and authorities, relating to our current and past business operations. 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.

Reinsurance risk


We use reinsurance to help manage our exposure to insurance risk, including major catastrophe events. The availability and cost of reinsurance is subject to prevailing market conditions, both in terms of price and available capacity, which can affect our premium volume, profitability and regulatory capital position. Both worldwide and Canadian catastrophe losses have an impact on the reinsurance market in North America. In recent years, the availability of alternative capital in the reinsurance market has helped maintain the supply of capital and added downward pressure on rates. However, 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. 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. In addition, the cost of reinsurance could increase significantly year over year, impacting our profitability if we are unable to pass on these costs to consumers. Furthermore, a significant decline in the availability of reinsurance could impact our premium volume, our profitability and our regulatory capital position. 

People risk

Our success has been, and will continue to be, dependent on our ability to retain the services of key employees and to attract additional qualified personnel in the future. In addition, a significant decline in employee morale could materially affect our operations including an increase in the risk of human error or deliberate acts that harm the company. 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. We also have a comprehensive succession planning program at various levels within the organization to ensure we are prepared for unplanned departures and retirements. Furthermore, our employee engagement surveys continue to reveal a high level of engagement among employees. IFC was recognized by multiple organizations as one of Canada's best employers. We believe that a high level of employee engagement helps mitigate some of the operational risks associated with people. However, there is no assurance that the Company will be successful in retaining and motivating our key talent across the organization.

Business interruption risk

We may experience an abrupt interruption of activities caused by unforeseeable and/or catastrophe events, an example of which being a global pandemic (e.g. the Ebola virus) or a large scale cyber-attack. Our service levels may decline materially resulting in negative financial and reputational consequences. 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. 

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We continuously monitor world events, such as the Ebola virus outbreak in 2014, to enable us to pro-actively adapt our response plan. 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.

Credit downgrade risk

Independent third-party rating agencies assess our ability to honour our financial obligations (the "senior unsecured debt rating") and our insurance subsidiaries' ability to meet their ongoing policyholder obligations (the "financial strength rating"). *See Section 17.2 – Ratings for more details.*

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.

This is more applicable to our commercial insurance where clients place a higher emphasis on such ratings. 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.

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. While no regulatory approval is required for dividend payments from the regulated insurance companies, notice to OSFI is required together with pro forma capital calculations showing internal target capital levels are maintained both before and after such dividends are paid out. In addition, for competitive reasons, our insurance subsidiaries maintain financial strength ratings which require us to maintain minimum capital levels in our insurance subsidiaries. These regulations and ratings targets limit the ability of our insurance subsidiaries to pay unlimited dividends or invest all of their capital in other ways. In certain stress scenarios limitations on our subsidiaries' ability to pay dividends to IFC could have a material adverse effect on our ability to pay shareholder dividends and may result in a material decline in the price of securities we have issued.

Deferred tax assets

We have a deferred tax asset related to net operating loss carryforwards and tax credit carryforwards as at December 31, 2018, that are subject to carryforward limitations in the U.S. Utilization of these assets and other assets included in our net deferred tax asset is dependent on generating sufficient future taxable income of the appropriate type (i.e. ordinary income or capital gains) in the appropriate jurisdiction. If it is determined that it is more likely that sufficient future taxable income will not be generated, we would be required to increase the valuation allowance (an offset to our deferred tax asset) in future periods, which could have an adverse effect on our results of operations.

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. From time to time we issue loans or take equity participation in certain brokers and consequently, we expose ourselves to other risks including financial risk and regulatory risk. For various reasons, the broker channel has been in a consolidation mode for the last few years and we believe that this situation will continue. The acquisition of brokers by others or even by other insurers may impact our relationship with some of them and harm our ability to grow our business. 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 arising from loans to brokers 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 activities periodically.

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22.8 Own Risk and Solvency Assessment

Since 2014, we have conducted our Own Risk and Solvency Assessments ("ORSA") at least annually. ORSA encompasses processes to identify, assess, monitor, and manage the risks we take in conducting our business. ORSA also covers the determination of our capital needs and solvency position. ORSA is an integral part of the implementation of our Enterprise Risk Management strategy. This exercise was conducted over and above the Dynamic Capital Adequacy Testing (DCAT) performed annually by the Appointed Actuary (*refer to Note 21 – Capital management to the accompanying Consolidated financial statements for details*).

Our ORSA revealed that the financial resources of our insurance subsidiaries are sufficient to meet policyholder obligations after adverse situations at a confidence level of 99.5 % Value-at-Risk (VaR) over a one-year time horizon. We considered all our material risk exposures in making this determination. We concluded that our overall risk is well balanced primarily between insurance risk and financial risk, while operational risk contributes a modest additional amount. Diversification and other adjustments modestly reduce our overall risk assessment.

Our 2018 assessment of capital required increased slightly compared to that of 2017, primarily driven by the acquisition of OneBeacon Insurance. Our capital sufficiency remains within the Board approved operating range as measured by the ratio of adjusted tangible equity to internal capital required.

The ORSA process is well integrated into our operations and influences the definition of our corporate risk tolerance, the target levels of capital by jurisdiction and in aggregate, and underwriting profit targets by line of business.

Section 23 – Off-balance sheet arrangements

23.1 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 \$1,155 million as at December 31, 2018 (\$1,087 million as at December 31, 2017).

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 \$1,215 million as at December 31, 2018 (\$1,144 million as at December 31, 2017).

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Section 24 – Sensitivity analyses

Sensitivity analyses are one risk management technique that assists management in ensuring that risks assumed remain within our risk tolerance level. Sensitivity analyses involve varying a single factor to assess the impact that this would have on our results and financial condition. No management action is considered. Actual results can differ materially from these estimates for a variety of reasons and therefore, these sensitivities should be considered as directional estimates.

Table 28 – Sensitivity analysis (after tax)

For the years ended December 31,				2018			2017		
	Net income	OCI	BVPS	Split by geography (total equity impact, estimated)			Net income	OCI	BVPS
				Canada	U.S.	Inter-national			
Equity price risk									
Common share prices (10% decrease) ¹	(11)	(202)	(1.53)	61%	31%	8%	(1)	(201)	(1.45)
Preferred share prices (5% decrease) ^{2,3}	8	(51)	(0.31)	100%	-	-	13	(62)	(0.35)
Interest rate risk (100 basis point increase)									
Debt securities ⁴	(188)	(174)	(2.60)	62%	38%	-	(167)	(116)	(2.03)
Preferred shares	6	(37)	(0.22)	100%	-	-	8	(37)	(0.21)
Net claims liabilities	168	-	1.21	84%	16%	-	168	-	1.20
Defined benefit pension plan obligation, net of related debt securities	-	87	0.63	100%	-	-	-	89	0.64
Currency risk (strengthening of the CAD by 10% vs all currencies) ⁵									
U.S. Investments supporting P&C Canada	-	-	-	-	-	-	6	(1)	0.04
International securities	-	(19)	(0.14)	-	-	100%	-	(19)	(0.14)
Book value of foreign operations	-	(196)	(1.41)	-	99%	1%	-	(176)	(1.26)

¹ Net of any equity hedges, including the impact of any impairment.

² Including the impact on related embedded derivatives.

³ The preferred share equity price risk sensitivity analysis includes the impact of interest rate movements.

⁴ Excludes the impact of debt securities related to the defined benefit pension plan.

⁵ After giving effect to forward-exchange contracts.

The above analyses were prepared using the following assumptions:

- shifts in the yield curve are parallel;
- interest rates, equity prices and foreign currency move independently;
- credit, liquidity, spread and basis risks have not been considered;
- impact on our pension plans has been considered; and
- risk reduction measures perform as expected, with no material basis risk and no counterparty defaults.

AFS debt or equity securities in an unrealized loss position, as reflected in AOCI may be realized through sales in the future.

A decline 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.

ADDITIONAL INFORMATION

Section 25 – Financial KPIs and definitions

25.1 Our financial KPIs

Our most relevant key performance indicators are outlined in the table below. DPW, Underlying current year loss ratio, NOI, NOIPS, OROE, ROE, AROE and AEPS are considered non-IFRS financial measures. *See Section 27 – Non-IFRS financial measures for the reconciliation to the most comparable IFRS measures.*

		2018	2017	2016	2015	2014
Growth	DPW growth	15.6%	5.5%	4.8%	6.2%	1.6%
	DPW growth in constant currency	15.4%	n/a	n/a	n/a	n/a
Underwriting performance	Underlying current year loss ratio	63.8%	64.5%	64.8%	66.1%	64.3%
	Claims ratio	65.3%	65.4%	64.9%	61.3%	62.6%
	Expense ratio	29.8%	28.9%	30.4%	30.4%	30.2%
	Combined ratio	95.1%	94.3%	95.3%	91.7%	92.8%
Consolidated performance	Net underwriting income	474	486	375	628	519
	Net investment income	529	432	414	424	427
	Net distribution income	146	132	111	104	75
	NOI	839	771	660	860	767
	NOIPS (in dollars)	5.74	5.60	4.88	6.38	5.67
	OROE	12.1%	12.9%	12.0%	16.6%	16.3%
	ROE	9.9%	12.8%	9.6%	13.4%	16.1%
	AROE	11.8%	13.0%	11.0%	14.3%	16.8%
	EPS (in dollars)	4.79	5.75	3.97	5.20	5.79
	AEPS (in dollars)	5.70	5.82	4.53	5.54	6.01
Financial strength	BVPS (in dollars)	48.73	48.00	42.72	39.83	37.75
	MCT (Canada)	201%	205%	218%	203%	209%
	RBC (U.S.)	377%	459%	n/a	n/a	n/a
	Total capital margin	1,333	1,135	970	625	681
	Debt-to-total capital ratio	22.0%	23.1%	18.6%	16.6%	17.3%

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25.2 Definitions of our financial KPIs

Our most relevant key performance indicators are defined below. *See Section 27 – Non-IFRS financial measures for the reconciliation to the most comparable IFRS measures.*

- **AEPS** and **AROE** are **adjusted measures**, meaning that they exclude the after-tax impact of acquisition-related items, such as amortization of intangible assets recognized in business combinations, as well as integration and restructuring costs.
- **NOI**, **NOIPS** and **OROE** are **operating measures**, meaning that they exclude non-operating items detailed in *Section 26 – Non-operating results*.
- **EPS** and **ROE** are **IFRS measures**, meaning that their definition is determined in accordance with IFRS.

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, specific targets, or a combination of both. *See Section 10.4 – IFC’s industry outperformance over time for more details on our performance versus the industry.*

Growth	DPW growth for a specific period	$\frac{\text{DPW for a specified period} - \text{DPW for the previous year}}{\text{DPW for the previous year}}$	Written insured risks growth for a specific period	$\frac{\text{\# of vehicles and premises in personal insurance} - \text{Total \# for the previous year}}{\text{Total \# for the previous year}}$

Underwriting results	Underlying current year loss ratio for a specific period	$\frac{\text{Current year claims ratio excluding CAT losses and PYD}}{\text{NEP before the impact of reinstatement premiums}}$	Expense ratio for a specific period	$\frac{\text{Underwriting expenses (including commissions, premium taxes and general expenses related to underwriting activities)}}{\text{NEP}}$
	Claims ratio for a specific period	$\frac{\text{Claims incurred (net of reinsurance)}}{\text{NEP}}$	Combined ratio for a specific period	$\text{Claims ratio} + \text{Expense ratio}$

**A combined ratio under 100% indicates a profitable underwriting result.
A combined ratio over 100% indicates an unprofitable underwriting result.**

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Consolidated performance	Net distribution income for a specific period	Operating income excluding interest and taxes from our wholly-owned broker (BrokerLink) + Operating income including interest and taxes from our broker associates	Net investment income for a specific period	As detailed in Table 13 – Net investment income
	PTOI for a specific period	As detailed in Table 2 – Consolidated performance	ROE for a 12-month period	$\frac{\text{Net income attributable to common shareholders}^1}{\text{Average common shareholders' equity}^2}$
	NOI for a specific period	As detailed in Table 30 – Reconciliation of NOI, NOIPS and OROE to net income	AROE for a 12-month period	$\frac{\text{Adjusted net income attributable to common shareholders}}{\text{Average common shareholders' equity}^2}$
	NOIPS for a specific period	$\frac{\text{NOI attributable to common shareholders}}{\text{WANSO}^3}$	EPS for a specific period	As reported in the accompanying Consolidated statements of income
	OROE for a 12-month period	$\frac{\text{NOI attributable to common shareholders}}{\text{Average common shareholders' equity}^2 \text{ (excluding AOCI)}}$	AEPS for a specific period	$\frac{\text{Adjusted net income attributable to common shareholders}}{\text{WANSO}^3}$

Financial strength	BVPS as at the end of a specific period	$\frac{\text{Common shareholders' equity}^4}{\text{Number of common shares outstanding at the same date}}$	Total capital margin as at the end of a specific period	Aggregate of capital in excess of company action levels in regulated entities (170% MCT, 200% RBC) plus available cash in unregulated entities.
	Regulatory capital ratio as at the end of a specific period	Minimum capital test (as defined by OSFI and the AMF in Canada) and Risk-based capital (as defined by the NAIC in the U.S.)	Debt-to-total capital ratio as at the end of a specific period	$\frac{\text{Total debt outstanding}}{\text{Sum of the total shareholders' equity}^4 \text{ and total debt outstanding as at the same date}}$

¹ Net income is determined in accordance with IFRS.

² 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. Shareholder's equity is determined in accordance with IFRS.

³ Weighted-average number of common shares outstanding during the same period.

⁴ Shareholder's equity is determined in accordance with IFRS.

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Section 26 – 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.

Table 29 – Non-operating results

	Q4-2018	Q4-2017	Change	2018	2017	Change
Net gains (losses) (Table 14)	59	(6)	65	13	69	(56)
Positive (negative) impact of MYA on underwriting	(36)	11	(47)	97	92	5
Amortization of intangible assets recognized in business combinations ¹	(24)	(25)	1	(89)	(62)	(27)
Integration and restructuring costs ²	(14)	(12)	(2)	(63)	(57)	(6)
Difference between expected return and discount rate on pension assets	(12)	(12)	-	(49)	(45)	(4)
Underwriting results of exited lines	(7)	(10)	3	(29)	(10)	(19)
Other	(8)	(4)	(4)	(22)	(18)	(4)
Non-operating gains (losses)	(42)	(58)	16	(142)	(31)	(111)
Income tax recovery (expense) on the above items	5	27	(22)	19	25	(6)
U.S. Corporate Tax reform	-	27	(27)	(9)	27	(36)
After-tax non-operating gains (losses)	(37)	(4)	(33)	(132)	21	(153)

¹ Includes \$10 million in Q4-2018 (\$36 million for 2018) in connection with the acquisition of OneBeacon.

² Includes \$10 million in Q4-2018 (\$51 million for 2018) in connection with the acquisition of OneBeacon.

- **Net 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.
- 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**. MYA is included in Net claims incurred in our consolidated statements of income.
- **Integration and restructuring costs** include items such as retention bonuses, the initial net impact of a reinsurance coverage which provides protection against certain negative reserve developments, pre-acquisition finance costs and acquisition-related expenses.
- The **difference between the expected return and discount rate on pension assets** is treated as non-operating results, as the gap in these measures is not reflective of our internal investment management expertise and management of our pension asset portfolio.
- **Underwriting results of exited lines** included the results of the U.S. Commercial's business units Programs, and Architects and Engineers. In our consolidated statements of income, underwriting results of exited lines are presented in several captions, namely Direct premiums written, Net earned premiums, Net claims incurred and Underwriting expenses.

Management's Discussion and Analysis for the year ended December 31, 2018

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Section 27 – Non-IFRS financial measures

The non-IFRS measures included in this MD&A are: DPW, change or growth in constant currency, NEP, total net claims, underlying current year loss ratio, underwriting expenses, underwriting income, combined ratio, net distribution income, NOI, net NOIPS, OROE, adjusted net income, AEPS, AROE and market-based yield.

These measures do not have standardized meanings prescribed by IFRS and may not be comparable to similar measures used by other companies in our industry. They 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.

NOI, NOIPS and OROE

- Exclude non-operating results (see Section 26 for details).

Table 30 – Reconciliation of NOI, NOIPS and OROE to net income

	Q4-2018	Q4-2017	2018	2017
Net income	244	232	707	792
Add (less) income tax expense (recovery)	67	14	179	150
Add non-operating losses	42	58	142	31
Pre-tax operating income	353	304	1,028	973
Tax impact	(72)	(68)	(189)	(202)
NOI	281	236	839	771
Less preferred share dividends	(11)	(10)	(40)	(27)
NOI to common shareholders	270	226	799	744
Divided by weighted-average number of common shares (in millions)	139.2	139.2	139.2	133.1
NOIPS, basic and diluted (in dollars)	1.93	1.63	5.74	5.60
NOI to common shareholders – last 12 months			799	744
Average common shareholders' equity, excluding AOCI			6,603	5,758
OROE for the last 12 months			12.1%	12.9%

All underwriting results and related ratios exclude the MYA and results of our U.S. Commercial exited lines, unless otherwise noted.

DPW

- Represents the total amount of premiums for new and renewal policies billed (written) during the reporting period, normalized for the effect of multi-year policies, excluding industry pools, fronting and exited lines. We consider that this measure better reflects the operating performance of our core operations, and that it is the most useful measure in terms of measuring growth, volume of business and market share.
- This measure matches DPW to the year in which coverage is provided, whereas under IFRS, the full value of multi-year policies is recognized in the year the policy is written.

Table 31 – Reconciliation of DPW and DPW growth to DPW, as reported under IFRS

	Q4-2018	Q4-2017	2018	2017
DPW, as reported under IFRS	2,377	2,301	10,125	8,748
Add (less) impact of industry pools and fronting	(31)	(3)	(105)	(19)
Less DPW of exited lines	(2)	(18)	(17)	(18)
DPW (full term)	2,344	2,280	10,003	8,711
Add impact of the normalization for multi-year policies	48	13	87	19
DPW	2,392	2,293	10,090	8,730
DPW growth	4%	17%	16%	5%

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Underlying current year loss ratio

- Represents our current year claims ratio excluding catastrophe losses, reinstatement premiums, and PYD.
- Catastrophe events are not predictable and subject to volatility, and as such, excluding them provides clearer insight into our analysis of current year performance.

Table 32 – Reconciliation of NEP before reinstatement premiums to NEP and of current year claims to net claims incurred, as reported under IFRS

	Q4-2018	Q4-2017	2018	2017
NEP, as reported under IFRS	2,516	2,428	9,765	8,558
Less NEP of exited lines	(7)	(28)	(50)	(28)
NEP	2,509	2,400	9,715	8,530
Add (deduct) reinstatement premiums ceded (recovered)	1	(2)	-	(2)
NEP, before reinstatement premiums	2,510	2,398	9,715	8,528
Net claims incurred, as reported under IFRS	1,624	1,552	6,340	5,538
Add positive (negative) impact of MYA on underwriting results	(36)	11	97	92
Less difference between expected return and discount rate on pension assets allocated to net claims incurred	(3)	(6)	(20)	(18)
Less net claims of exited lines	(13)	(33)	(75)	(33)
Total net claims	1,572	1,524	6,342	5,579
Less current year CAT claims	(55)	(31)	(330)	(313)
Add favourable (unfavourable) PYD	50	62	185	238
Current year claims (excluding CATs and PYD)	1,567	1,555	6,197	5,504
NEP, before reinstatement premiums	2,510	2,398	9,715	8,528
Underlying current year loss ratio	62.5%	64.8%	63.8%	64.5%
CAT loss ratio (including reinstatement premiums)	2.2%	1.3%	3.4%	3.7%
Unfavourable (favourable) PYD ratio	(2.0)%	(2.6)%	(1.9)%	(2.8)%
Claims ratio	62.7%	63.5%	65.3%	65.4%

Underwriting income (loss)

Table 33 – Reconciliation of underwriting expenses to underwriting expenses, as reported under IFRS

	Q4-2018	Q4-2017	2018	2017
Underwriting income, as reported under IFRS¹	155	167	493	523
Less impact of MYA on underwriting results	36	(11)	(97)	(92)
Add difference between expected return and discount rate on pension assets	12	12	49	45
Add underwriting results of exited lines	7	10	29	10
Underwriting income	210	178	474	486
Combined ratio	91.7%	92.6%	95.1%	94.3%

¹ Includes the following captions in the Consolidated statements of income: Net earned premiums, Other underwriting revenues, Net claims incurred and Underwriting expenses.

Underwriting expenses

Table 34 – Reconciliation of underwriting expenses to underwriting expenses, as reported under IFRS

	Q4-2018	Q4-2017	2018	2017
Underwriting expenses, as reported under IFRS	765	735	3,042	2,605
Less difference between expected return and discount rate on pension assets	(9)	(6)	(29)	(27)
Less other underwriting revenues	(28)	(26)	(110)	(108)
Less underwriting expenses of exited lines	(1)	(5)	(4)	(5)
Underwriting expenses	727	698	2,899	2,465
Expense ratio	29.0%	29.1%	29.8%	28.9%

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ROE

- Excludes the dividends declared on preferred shares.
- Average common shareholder's equity is the mean of the shareholder's equity at the beginning and the end of the period, adjusted for significant capital transactions, if appropriate.

Table 35 – Reconciliation of ROE to net income

	Q4-2018	Q4-2017	2018	2017
Net income	244	232	707	792
Less preferred share dividends	(11)	(10)	(40)	(27)
Net income attributable to common shareholders	233	222	667	765
Net income attributable to common shareholders – last 12 months	667	765		
Average common shareholders' equity	6,731	5,961		
ROE for the last 12 months	9.9%	12.8%		

AEPS and AROE

- Exclude the after-tax impact of amortization of intangible assets recognized in business combinations, as well as integration and other acquisition-related costs.
- We believe that these acquisition-related items are not appropriate in assessing our underlying performance.

Table 36 – Reconciliation of AEPS and AROE to net income

	Q4-2018	Q4-2017	2018	2017
Net income	244	232	707	792
Adjustments, net of tax				
Remove currency derivative gain related to the acquisition of OneBeacon	-	(7)	-	(62)
Add negative (positive) impact from U.S. Corporate Tax reform	-	(27)	9	(27)
Add amortization of intangibles recognized in business combinations	19	20	71	50
Add integration and other costs	10	7	47	49
Adjusted net income	273	225	834	802
Less preferred share dividends	(11)	(10)	(40)	(27)
Adjusted net income attributable to common shareholders	262	215	794	775
Divided by weighted-average number of common shares (in millions)	139.2	139.2	139.2	133.1
AEPS, basic and diluted (in dollars)	1.88	1.55	5.70	5.82
Adjusted net income attributable to common shareholders - LTM	794	775		
Average common shareholders' equity	6,731	5,961		
AROE for the last 12 months	11.8%	13.0%		

Market-based yield

- Represents the annualized total pre-tax investment income (before expenses), divided by the mid-month average fair value of net equity and fixed-income securities held during the reporting period (average net investments).
- This calculation provides users with a consistent measure of our relative investment performance.

Growth or change in constant currency

- Represents the growth or change between two figures, excluding the impact of foreign currency fluctuations. This is calculated by applying the exchange rate in effect for the current year to the results of the previous year. We believe that this measure enhances the analysis of our results with comparative periods, particularly with respect to the KPI of our U.S. segment (namely, DPW and NEP growth, as the impact of currency fluctuations on underwriting ratios is minimal and not considered significant).

Management’s Discussion and Analysis for the year ended December 31, 2018

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Section 28 – Accounting and disclosure matters

Reference to our Consolidated financial statements

<p>Significant accounting judgments, estimates and assumptions</p> <p><i>Note 3</i></p>	<p>Adoption of new accounting standards</p> <p><i>Note 4</i></p>	<p>Related-party transactions</p> <p><i>Note 30</i></p>	<p>Standards issued but not yet effective</p> <p><i>Note 33</i></p>
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28.1 New accounting standards effective January 1, 2018

On January 1, 2018, we adopted following new standards and amendments to existing standards:

- Amendments to IFRS 4 - Insurance Contracts for the application of IFRS 9 - Financial Instruments
- IFRS 15 - Revenue from contracts with customers
- Income tax consequences of payments on financial instruments classified as equity

For further details on these new standards, refer to Note 4 of our Consolidated financial statements.

28.2 Significant accounting judgments, estimates and assumptions

The preparation of financial statements in conformity with IFRS requires management to use judgments, estimates and assumptions that can have a significant impact on reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as at the balance sheet date, as well as 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:

Reference to our Consolidated financial statements

Description	Note	Description	Note
Business combinations	<i>Note 5.2</i>	Impairment of financial assets	<i>Note 23.2</i>
Valuation of claims liabilities	<i>Note 11.3</i>	Measurement of income taxes	<i>Note 24.3</i>
Impairment of goodwill and intangible assets	<i>Note 15.2</i>	Valuation of DB obligation	<i>Note 27.6</i>

28.3 Related-party transactions

We enter into transactions with associates and joint ventures in the normal course of business. Most of these related-party transactions are with entities associated with our distribution channel. These transactions mostly comprise of 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.

We also enter into transactions with key management personnel and post-employment plans. Our key management personnel comprise 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.

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28.4 Financial instruments

An important portion of our Consolidated balance sheets is composed of financial instruments. *For additional information, refer to our Consolidated financial statements.*

Reference to our Consolidated financial statements

Significant accounting policies	Derivative financial instruments	Fair value measurement
<i>Note 2</i>	<i>Note 7</i>	<i>Note 9</i>

28.5 Disclosure controls and procedures

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

Management, at the direction and under the supervision of the Chief Executive Officer and the Chief Financial Officer of the Company, has evaluated the effectiveness of our disclosure controls and procedures. The evaluation was conducted in accordance with the requirements of National Instrument 52-109 – *Certification of Disclosure in Issuer’s Annual and Interim Filings* (“NI 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, 2018. 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.

28.6 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 NI 52-109. 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, 2018.

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 ICFR during 2018 that have materially affected, or are reasonably likely to materially affect, the Company’s ICFR.

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Section 29 – Shareholder information

29.1 Authorized share capital

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

29.2 Outstanding share data

Table 37 – Outstanding share data (number of shares)

As at February 2, 2019	
Common shares	139,188,634
Class A	
Series 1 preferred shares	10,000,000
Series 3 preferred shares	8,405,004
Series 4 preferred shares	1,594,996
Series 5 preferred shares	6,000,000
Series 6 preferred shares	6,000,000
Series 7 preferred shares ¹	10,000,000

¹ Series 7 preferred shares were issued on May 29, 2018.

Refer to our Annual Information Form for more detailed information on the rights of shareholders and to Note 20 – Common shares and preferred shares to the accompanying Consolidated financial statements for additional information.

29.3 Dividends declared on common shares and preferred shares

Table 38 – Dividends declared per share

	Q1-2019	Q4-2018	FY 2018
Common shares	0.76	0.70	2.80
Class A			
Series 1 preferred shares	0.21225	0.21225	0.84900
Series 3 preferred shares	0.20825	0.20825	0.83300
Series 4 preferred shares	0.2695675	0.2627050	0.9687500
Series 5 preferred shares	0.325	0.325	1.300
Series 6 preferred shares	0.33125	0.33125	1.32500
Series 7 preferred shares	0.30625	0.30625	0.72245

29.4 BVPS

Table 39 – Evolution of BVPS (in dollars)

As at December 31,	Q4-2018	2018	2017	2016
BVPS, beginning of period	49.27	48.00	42.72	39.83
EPS	1.67	4.79	5.75	3.97
Dividends on common shares	(0.70)	(2.80)	(2.56)	(2.32)
Impact of market movements on AFS securities ¹	(1.72)	(2.49)	0.22	1.62
Net actuarial gains (losses) on employee future benefits ¹	(0.67)	(0.13)	(0.49)	(0.20)
Foreign exchange impact ¹	0.86	1.26	-	-
NCIB and other	0.02	0.10	(0.23)	(0.18)
Impact from issuance of common shares	-	-	2.59	-
BVPS, end of period	48.73	48.73	48.00	42.72
Period-over-period increase	(1)%	2%	12%	7%

¹ Reported in AOCI.

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Section 30 – Selected annual and quarterly information

30.1 Selected annual information

Table 40 – Selected annual information

	2018	2017	2016
Total revenues ¹	10,426	9,157	8,538
Underwriting income ²	474	486	375
Net income	707	792	541
EPS, basic and diluted (in dollars)	4.79	5.75	3.97
Cash dividends declared per share (in dollars)			
Common shares	2.80	2.56	2.32
Class A			
Series 1 Preferred Shares	0.85	1.05	1.05
Series 3 Preferred Shares	0.83	0.83	1.00
Series 4 Preferred Shares	0.97	0.81	0.20
Series 5 Preferred Shares	1.30	0.78	n/a
Series 6 Preferred Shares	1.33	0.49	n/a
Series 7 Preferred Shares	0.72	n/a	n/a

¹ Total revenues exclude other underwriting revenues and NEP of exited lines. Refer to Note 28 – Segment information to the accompanying Consolidated financial statements for details.

² Refer to Section 27 – Non-IFRS financial measures.

Table 41 – Selected annual information

As at December 31,	2018	2017	2016
Investments	16,897	16,774	14,386
Total assets	28,461	27,838	22,866
Debt outstanding	2,209	2,241	1,393
Shareholders' equity	7,810	7,463	6,088

30.2 Selected quarterly information

Table 42 – Selected quarterly information¹

	2018				2017			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
DPW	2,392	2,708	2,908	2,082	2,293	2,203	2,497	1,737
Total revenues ²	2,697	2,644	2,589	2,496	2,576	2,231	2,204	2,146
NEP	2,509	2,462	2,410	2,334	2,400	2,082	2,051	1,997
Current year CAT losses	55	97	142	36	31	89	105	88
Favourable PYD	(50)	(28)	(32)	(75)	(62)	(53)	(41)	(82)
Underwriting income	210	152	93	19	178	170	103	35
Combined ratio	91.7%	93.8%	96.1%	99.2%	92.6%	91.8%	95.0%	98.2%
Net investment income	140	133	134	122	121	101	105	105
Net distribution income	36	34	52	24	28	30	50	24
NOI	281	237	201	120	236	219	193	123
Net income	244	199	161	103	232	171	243	146
Per share measures, basic and diluted (in dollars)								
NOIPS	1.93	1.62	1.38	0.81	1.63	1.61	1.44	0.90
EPS	1.67	1.34	1.10	0.68	1.60	1.25	1.82	1.08

¹ Refer to Section 27 – Non-IFRS financial measures.

² Total revenues exclude other underwriting revenues and NEP of exited lines.

See also the discussion on seasonality of the business hereafter.

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



30.3 Seasonality of the P&C Canadian insurance business

The P&C Canadian insurance business is seasonal in nature. While NEP are generally stable from quarter to quarter, underwriting results are driven by weather conditions which may vary significantly between quarters.

The tables below present the unfavourable (favourable) seasonality indicators, in points of combined ratio. For instance, in 2018, Q1 and Q2 saw a higher combined ratio including CAT losses than Q3 and Q4, meaning that underwriting results were relatively less profitable in Q1-2018 and Q2-2018. When CAT losses are excluded, Q1-2018 saw a higher combined ratio than the other quarters in 2018, meaning that the underwriting results were relatively less profitable in Q1-2018 than the rest of the year.

Table 43 – Seasonal indicator, including CAT losses

	2018	2017	2016	2015	2014	3-year average	5-year average	10-year average
Q1	4.7 pts	4.1 pts	(2.9) pts	1.8 pts	4.5 pts	1.9 pts	2.4 pts	0.6 pts
Q2	1.3 pts	0.8 pts	4.1 pts	(0.1) pts	0.1 pts	2.1 pts	1.2 pts	0.3 pts
Q3	(1.3) pts	(2.5) pts	1.7 pts	1.6 pts	0.4 pts	(0.7) pts	- pts	1.5 pts
Q4	(4.7) pts	(2.4) pts	(2.9) pts	(3.3) pts	(5.0) pts	(3.3) pts	(3.6) pts	(2.4) pts

Table 44 – Seasonal indicator, excluding CAT losses

	2018	2017	2016	2015	2014	3-year average	5-year average	10-year average
Q1	7.0 pts	3.7 pts	1.2 pts	2.8 pts	3.7 pts	4.0 pts	3.7 pts	2.9 pts
Q2	(2.0) pts	(0.5) pts	(0.4) pts	0.2 pts	1.7 pts	(1.0) pts	(0.2) pts	(1.1) pts
Q3	(2.4) pts	(3.2) pts	(1.4) pts	(1.2) pts	(3.5) pts	(2.3) pts	(2.4) pts	(1.9) pts
Q4	(2.6) pts	- pts	0.6 pts	(1.8) pts	(1.9) pts	(0.7) pts	(1.1) pts	0.1 pts

30.4 Expected release dates of our financial results

Q1-2019	Q2-2019	Q3-2019	Q4-2019
May 7, 2019	July 30, 2019	November 5, 2019	February 4, 2020



Intact Financial Corporation
Consolidated financial statements
For the year ended December 31, 2018

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 independent 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 Appointed Actuary and the Group Chief Actuary, have full and unrestricted access to the Audit Committee, with and without the presence of management.

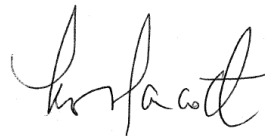
Pursuant to the Insurance Companies Act of Canada or to the Insurance Act (Québec) ("the Acts"), the Appointed Actuary, who is a member of management, is appointed by the Board of Directors. The Appointed Actuary is responsible for discharging the various actuarial responsibilities required by the Acts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

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 Auditor's Report to shareholders appears on the following page.

February 5, 2019



Charles Brindamour
Chief Executive Officer



Louis Marcotte
Senior Vice President and
Chief Financial Officer

Independent auditor's report

To the shareholders of
Intact Financial Corporation

Opinion

We have audited the consolidated financial statements of **Intact Financial Corporation** and its subsidiaries (the Group), which comprise the consolidated balance sheets as at December 31, 2018 and 2017, and the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2018 and 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis
- The information, other than the consolidated financial statements and our auditor's report thereon, in the Annual Report

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion & Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

The Annual Report is expected to be made available to us after the date of the auditor's report. If based on the work we will perform on this other information, we conclude there is a material misstatement of other information, we are required to report that fact to those charged with governance.



Responsibilities of management and those charged with Governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, 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.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Ted Di Giorgio.

*Ernst & Young LLP*¹

Montréal, Canada
February 5, 2019

¹ CPA auditor, CA, public accountancy permit no. A112431



INTACT FINANCIAL CORPORATION

Consolidated financial statements For the year ended December 31, 2018

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INTACT FINANCIAL CORPORATION

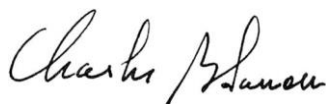
Consolidated balance sheets

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

As at December 31,	Note	2018	2017
Restated (see Note 5)			
Assets			
Investments	6		
Cash and cash equivalents		\$ 442	\$ 163
Debt securities		11,701	11,229
Preferred shares		1,165	1,330
Common shares		3,295	3,659
Loans		294	393
Investments		16,897	16,774
Premium receivables		3,358	3,351
Reinsurance assets	14	864	822
Income taxes receivable		88	24
Deferred tax assets	24	141	124
Deferred acquisition costs		903	881
Other assets	18	841	703
Investments in associates and joint ventures	16	600	550
Property and equipment	17	170	164
Intangible assets	15	2,200	2,161
Goodwill	15	2,399	2,284
Total assets		\$ 28,461	\$ 27,838
Liabilities			
Claims liabilities	11	\$ 10,623	\$ 10,475
Unearned premiums	12	5,412	5,365
Financial liabilities related to investments	8	289	167
Income taxes payable		15	262
Deferred tax liabilities	24	239	246
Other liabilities	18	1,864	1,619
Debt outstanding	19	2,209	2,241
Total liabilities		20,651	20,375
Shareholders' equity			
Common shares	20	2,816	2,816
Preferred shares	20	1,028	783
Contributed surplus		149	128
Retained earnings		3,776	3,520
Accumulated other comprehensive income			
Available-for-sale securities		(122)	224
Translation of foreign operations, net of hedges		166	(10)
Other		(3)	2
		7,810	7,463
Total liabilities and shareholders' equity		\$ 28,461	\$ 27,838

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 income

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

For the years ended December 31,	Note	2018	2017
Direct premiums written		\$ 10,125	\$ 8,748
Premiums ceded		(393)	(221)
Net premiums written		9,732	8,527
Changes in unearned premiums		33	31
Net earned premiums		9,765	8,558
Other underwriting revenues		110	108
Investment income	22		
Interest income		351	275
Dividend income		213	194
Other revenues		147	158
Total revenues		10,586	9,293
Net claims incurred	11	(6,340)	(5,538)
Underwriting expenses		(3,042)	(2,605)
Investment expenses		(35)	(37)
Net gains (losses)	23	13	69
Share of profit from investments in associates and joint ventures	16	25	16
Finance costs		(103)	(82)
Integration and restructuring costs		(63)	(57)
Other expenses		(155)	(117)
Income before income taxes		886	942
Income tax expense	24	(179)	(150)
Net income attributable to shareholders		\$ 707	\$ 792
Weighted-average number of common shares outstanding (in millions)	25	139.2	133.1
Earnings per common share, basic and diluted (in dollars)	25	\$ 4.79	\$ 5.75
Dividends paid per common share (in dollars)	20	\$ 2.80	\$ 2.56

See accompanying notes to the Consolidated financial statements.

INTACT FINANCIAL CORPORATION

Consolidated statements of comprehensive income

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

For the years ended December 31,	Note	2018	2017
Net income attributable to shareholders		\$ 707	\$ 792
Other comprehensive income (loss)			
Available-for-sale securities:			
net changes in unrealized gains (losses)		(408)	295
income tax benefit (expense)		104	(81)
reclassification of net losses (gains)		(60)	(251)
income tax benefit (expense)		18	66
		(346)	29
Cash flow hedges:			
net changes in unrealized gains (losses)		-	(200)
reclassification of net losses (gains)		-	200
		-	-
Foreign exchange gains (losses) on:			
translation of foreign operations		352	-
net investment hedges		(176)	(12)
income tax benefit (expense)		-	3
		176	(9)
Other, net of tax		(5)	5
Items that may be reclassified subsequently to net income		(175)	25
Net actuarial gains (losses) on employee future benefits	27	(25)	(89)
income tax benefit (expense)		7	24
Items that will not be reclassified subsequently to net income		(18)	(65)
Other comprehensive income (loss)		(193)	(40)
Total comprehensive income attributable to shareholders		\$ 514	\$ 752

See accompanying notes to the Consolidated financial statements.

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, 2018		\$ 2,816	\$ 783	\$ 128	\$ 3,520	\$ 216	\$ 7,463
Net income attributable to shareholders		-	-	-	707	-	707
Other comprehensive income (loss)		-	-	-	(18)	(175)	(193)
Total comprehensive income (loss)		-	-	-	689	(175)	514
Preferred shares issued	20	-	245	-	-	-	245
Dividends declared on:							
common shares	20	-	-	-	(390)	-	(390)
preferred shares	20	-	-	-	(40)	-	(40)
Share-based payments	26	-	-	21	(3)	-	18
Balance as at December 31, 2018		\$ 2,816	\$ 1,028	\$ 149	\$ 3,776	\$ 41	\$ 7,810
Balance as at January 1, 2017		\$ 2,082	\$ 489	\$ 129	\$ 3,197	\$ 191	\$ 6,088
Net income attributable to shareholders		-	-	-	792	-	792
Other comprehensive income (loss)		-	-	-	(65)	25	(40)
Total comprehensive income (loss)		-	-	-	727	25	752
Common shares issued	20	735	-	-	-	-	735
Preferred shares issued	20	-	294	-	-	-	294
Common shares repurchased for cancellation	20	(1)	-	-	(6)	-	(7)
Dividends declared on:							
common shares	20	-	-	-	(351)	-	(351)
preferred shares	20	-	-	-	(27)	-	(27)
Share-based payments	26	-	-	(1)	(6)	-	(7)
Acquisition of non-controlling interests		-	-	-	(14)	-	(14)
Balance as at December 31, 2017		\$ 2,816	\$ 783	\$ 128	\$ 3,520	\$ 216	\$ 7,463

See accompanying notes to the Consolidated financial statements.

INTACT FINANCIAL CORPORATION

Consolidated statements of cash flows

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

For the years ended December 31,	Note	2018	2017
Operating activities			
Income before income taxes		\$ 886	\$ 942
Income taxes received (paid), net		(382)	32
Contributions to the defined benefit pension plans	27	(55)	(60)
Share-based payments		(4)	(2)
Net losses (gains)	23	(13)	(69)
Adjustments for non-cash items	29	294	225
Changes in other operating assets and liabilities	29	112	(201)
Changes in net claims liabilities	11	(5)	(86)
Net cash flows provided by operating activities		833	781
Investing activities			
Business combinations, net of cash acquired	5	-	(2,139)
Proceeds from sale of investments		14,471	11,058
Purchases of investments		(14,561)	(10,582)
Purchases of brokerages and other equity investments, net		(78)	(108)
Purchases of intangibles and property and equipment, net		(117)	(98)
Net cash flows used in investing activities		(285)	(1,869)
Financing activities			
Proceeds from issuance of debt, net of issuance costs	19	-	422
Amount borrowed (repaid) on the credit facility, net	19	(60)	60
Proceeds from issuance of common shares, net of issuance costs	20	-	731
Proceeds from issuance of preferred shares, net of issuance costs	20	243	292
Common shares repurchased for cancellation	20	-	(7)
Common shares repurchased for share-based payments	26	(36)	(37)
Dividends paid on common shares	20	(390)	(351)
Dividends paid on preferred shares	20	(40)	(27)
Net cash flows provided by (used in) financing activities		(283)	1,083
Net increase (decrease) in cash and cash equivalents		265	(5)
Cash and cash equivalents, beginning of year		163	168
Exchange rate differences on cash and cash equivalents		14	-
Cash and cash equivalents, end of year		\$ 442	\$ 163
Composition of cash and cash equivalents			
Cash		205	114
Cash equivalents		237	49
Cash and cash equivalents, end of year		442	163
Other relevant cash flow disclosures – operating activities			
Interest paid		105	84
Interest received		347	277
Dividends received		228	207

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 property and casualty (“P&C”) insurance market and offers specialty insurance products mainly to small and midsize businesses in the United States. The Company, through its operating subsidiaries, principally underwrites automobile, home, as well as commercial P&C contracts to individuals and businesses. On September 28, 2017, the Company acquired all of the issued and outstanding shares of OneBeacon Insurance Group, Ltd. (“OneBeacon”), a leading U.S. specialty insurer. Further details of the acquisition are provided in *Note 5 – Business combinations*.

These Consolidated financial statements include the accounts of the Company and its subsidiaries. The Company’s significant operating subsidiaries are presented in *Note 28 – Segment information*.

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

Note 2 – Summary of significant accounting policies

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INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

Glossary of abbreviations

ABS	Asset-backed securities	IFRS	International Financial Reporting Standards
AFS	Available for sale	JV	Joint ventures
AMF	Autorité des marchés financiers	LAE	Loss adjustment expenses
AOCI	Accumulated other comprehensive income	LTIP	Long-term incentive plan
CAD	Canadian Dollar	MBS	Mortgage-backed securities
CALs	Company action levels	MCT	Minimum capital test
CGU	Cash generating unit	MYA	Market-yield adjustment
DB	Defined benefits	NCI	Non-controlling interest
DPW	Direct premiums written	NEP	Net earned premiums
DSU	Deferred share unit	OCI	Other comprehensive income
EPS	Earnings per share to common shareholders	OSFI	Office of the Superintendent of Financial Institutions
ESPP	Employee share purchase plan	PSU	Performance stock units
FA	Facility Association	RBC	Risk-based capital
FVTOCI	Fair value through other comprehensive income	ROE	Return on equity
FVTPL	Fair value through profit and loss	RSP	Risk sharing pools
IASB	International Accounting Standards Board	RSU	Restricted stock units
IBNR	Insurance claims incurred but not reported by policyholders	USD	U.S. Dollar

2.1 Basis of presentation

These Consolidated financial statements are prepared in accordance with IFRS, as issued by the 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 5, 2019.

The key accounting policies applied in the preparation of these Consolidated financial statements are described below. These policies have been applied consistently to all periods presented. Certain comparative figures have been reclassified to conform to the presentation adopted in the current year (*see Note 5 – Business combinations for details*).

2.2 Basis of consolidation

These Consolidated financial statements include the accounts of the Company and its subsidiaries. *Table 2.1* presents the basis of consolidation.

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.

Acquisitions or disposals of equity interests in a subsidiary that do not result in the Company obtaining or losing control are treated as equity transactions and reported as acquisitions or disposals of NCI in the Consolidated statements of changes in shareholders' equity.

All balances, transactions, income and expenses and profits and losses resulting from intercompany transactions and dividends are eliminated on consolidation.

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

Table 2.1 – Basis of consolidation

Investment category	Shareholding	Accounting policies
Subsidiaries		
Entities over which the Company:	Generally, more than 50% of voting rights	All subsidiaries are fully consolidated from the date control is transferred to the Company. They are deconsolidated from the date control ceases and any gain or loss is recognized in Net gains (losses).
1. has the power over the relevant activities of the investee;		
2. is exposed, or has rights to variable returns from its involvement with the investee; and		
3. has the ability to affect those returns through its power over the investee.		
Associates		
Entities over which the Company:	Generally, between 20% to 50% of voting rights	Equity method <i>Note 2.8 for details</i>
1. has the power to participate in the decisions over the relevant activities of the investee, but		
2. does not have control.		
Joint ventures		
Joint arrangements whereby the parties have:	Generally, an equal percentage of voting rights from each party to the joint arrangement	Equity method <i>Note 2.8 for details</i>
1. joint control of the arrangements, requiring unanimous consent of the parties sharing control for strategic and operating decision making; and		
2. rights to the net assets of the arrangements.		

2.3 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.

a) Revenue recognition and premium receivables

Premiums written are reported net of cancellations, promotional returns and sales taxes. Premiums written are recognized on the date coverage begins. Premiums written are deferred as Unearned premiums and recognized as NEP (net of reinsurance), on a pro rata basis over the terms of the underlying policies, usually 12 months.

Premium receivables consist of the premiums due for the remaining months of the contracts.

Other underwriting revenues include:

- fees collected from policyholders in connection with the costs incurred for the Company's yearly billing plans, which are recognized over the terms of the underlying policies; and
- fees received for the administration of a portion of the FA policies.

Other revenues include commission revenues received from external insurance providers by consolidated brokers recognized on an accrual basis.

Notes to the Consolidated financial statements

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

b) Claims liabilities

Claims liabilities are established to reflect the estimate of the full amount of all liabilities associated with the insurance contracts earned at the balance sheet date, including IBNR, 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 (usually referred to as loss adjustment expenses or LAE).

Claims liabilities are first determined on a case-by-case basis as insurance claims are reported. They are reassessed as additional information becomes known. Claims liabilities are estimated by the appointed actuaries using generally accepted actuarial standard techniques and are based on assumptions that represent best estimates of possible outcomes, such as historical loss development factors and payment patterns, claims frequency and severity, inflation, reinsurance recoveries, expenses, as well as changes in the legal and regulatory environment, taking into consideration the circumstances of the Company and the nature of the insurance policies.

The ultimate amount of these liabilities will vary from the best estimate made for a variety of reasons, including additional information with respect to the facts and circumstances of the insurance claims incurred. Actuaries are required to include margins in some assumptions to recognize the uncertainty in establishing this best estimate, to allow for possible deterioration in experience and to provide greater comfort that the actuarial liabilities are sufficient to pay future benefits.

Claims liabilities are discounted to consider the time value of money, using a rate that reflects the estimated market yield of the underlying assets backing these claims liabilities at the reporting date. Anticipated payment patterns are revised from time to time to reflect the most recent trends and claims environment. This ensures getting the most accurate and representative market yield-based discount rate.

Claims liabilities are deemed to be settled when the contract expires, is discharged or cancelled.

c) Reinsurance assets

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.

d) Deferred acquisition costs

Policy acquisition costs incurred in acquiring insurance premiums include commissions and premium taxes 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 written off when the corresponding contracts are settled or cancelled.

e) Liability adequacy test

At the end of each reporting period, a liability adequacy test is performed 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.

Notes to the Consolidated financial statements

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

2.4 Financial instruments

a) Classification and measurement of financial assets and financial liabilities

Table 2.2 – Classification of the Company's most significant financial assets and financial liabilities

Classification	Financial instruments	Description	Initial and subsequent measurement
AFS	Debt securities	Investments intended to be held for an indefinite period and which may be sold in response to liquidity needs or changes in market conditions.	Initially measured at fair value using transaction prices at the trade date. Subsequently measured at fair value using bid prices (except as noted below for Level 3 instruments) at end of period, with changes in fair value reported in OCI (when unrealized) or in Net gains (losses) when realized or impaired.
	Common shares and preferred shares	Investments neither classified nor designated as FVTPL.	
	Other instruments	Surplus notes, as well as investments in mutual and private funds.	<i>Refer to Note 2.4 b) (Level 3) hereafter for more details on the fair value measurement.</i>
Classified as FVTPL	Common shares	Investments purchased with the intention of generating profits in the near term.	Initially measured at fair value using transaction prices at the trade date.
	Derivative financial instruments	Derivatives used for economic 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.	Subsequently measured at fair value using bid prices (for financial assets) or ask prices (for financial liabilities) at end of period, with changes in fair value reported in Net gains (losses).
	Embedded derivatives	Embedded derivatives related to the Company's perpetual preferred shares. Treated as separate derivative financial instruments when their economic characteristics and risks are not clearly and closely related to those of the host instrument. These embedded derivatives are presented in Investments, with the related perpetual preferred shares, on the Consolidated balance sheets.	The effective portion of cash flow hedges, as well as net investment hedges in foreign operations is recorded in foreign exchange gains (losses) in OCI.
Designated as FVTPL on initial recognition	Debt securities backing its claims liabilities and some common shares	A portion of the Company's investments backing its claims liabilities has been voluntarily designated as FVTPL to reduce the volatility caused by fluctuations in fair values of underlying claims liabilities due to changes in discount rates. To comply with regulatory guidelines, the Company ensures that the weighted-dollar duration of debt securities designated as FVTPL is approximately equal to the weighted-dollar duration of claims liabilities.	
Cash and cash equivalents, loans and receivables	Cash and cash equivalents	Highly liquid investments that are readily convertible into a known amount of cash are subject to an insignificant risk of changes in value and have an original maturity of three months or less.	Initially measured at fair value using transaction prices at the trade date. Subsequently measured at amortized cost using the effective interest method, with changes in fair value reported in Net gains (losses) when realized or impaired.
	Loans and receivables	Financial assets with fixed or determinable payments not quoted in an active market.	

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Classification	Financial instruments	Description	Initial and subsequent measurement
Other financial liabilities	Debt outstanding	The Company's Senior and medium-term notes. Amount drawn under a credit facility.	Initially measured at fair value at the issuance date. Subsequently measured at amortized cost using the effective interest method, with changes in fair value reported in Net gains (losses) when the liability is extinguished.

b) 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. After initial recognition, the fair value of financial instruments is determined based on available information and categorized according to a three-level fair value hierarchy.

Table 2.3 – Three-level fair value hierarchy

Levels	Description	Type of financial instruments normally classified as such
Level 1	Quoted prices in active markets for identical assets or liabilities	<ul style="list-style-type: none"> • U.S. Treasuries, Canadian Federal and Canadian Agency housing trust debt securities • Common shares and preferred shares • Investments in mutual funds • Exchange-traded derivatives
Level 2	Valuation techniques for which all inputs that have a significant effect on the fair value are observable (either directly or indirectly)	<ul style="list-style-type: none"> • All Government and Corporate debt securities, except for U.S. Treasuries, Canadian Federal and Canadian Agency housing trust • Unsecured medium-term notes and 2012 U.S. Senior Notes • ABS and MBS • Over-the-counter derivatives
Level 3	Valuation techniques for which inputs that have a significant effect on the fair value are not based on observable market data	<ul style="list-style-type: none"> • Loans¹ • Embedded derivatives related to perpetual preferred shares with call option • Hedge and private funds • Surplus notes

¹ Measured at amortized cost with fair value disclosed.

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.

Level 2

Where the fair values of financial assets and financial liabilities 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.

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For discounted cash flow models, 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 condition of counterparties.
- Discount rates are influenced by risk free interest rates and credit risk.

The inputs to these models are derived from observable market data where possible. Inputs used in valuations include:

- prevailing market rates for bonds with similar characteristics and risk profiles;
- closing prices of the most recent trade date subject to liquidity adjustments; or
- average brokers' quotes when trades are too sparse to constitute an active market.

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. In these cases, judgment is required to establish fair values. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

- **Loans** – The fair value of loans is determined using a valuation technique based on the income approach. 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. The Company receives guarantees for loans.
- **Embedded derivatives related to perpetual preferred shares call options** – The fair value of the Company's perpetual preferred shares call options (which give the issuer the right to redeem the shares at a particular price) has to be measured separately from preferred shares and accounted for as an embedded derivative. To determine the fair value of embedded derivatives, the Company uses a valuation technique based on the implied volatility of underlying preferred shares. The implied volatility is an unobservable parameter that is calculated using an internally developed valuation model, which can be significantly affected by market conditions. Judgment is also required to determine the time period over which the volatility is measured.
- **Hedge funds and private funds** – Hedge funds and private funds are measured at fair value for which the net assets value ("NAV") is generally the practical expedient. The Company employs several procedures to assess the reasonableness of the NAV reported by the fund, including obtaining and reviewing periodic and audited financial statements and discussing each fund's pricing with the fund manager throughout the year. In the event, the Company believes that its estimate of the NAV differs from that reported by the fund due to the illiquidity or other factors, the Company will adjust the fund's reported NAV to more appropriately represent the fair value of its interest in the investment.
- **Surplus notes** – The fair value of the surplus notes is based on a discounted expected cash flow model using information as of the measurement date. The estimated fair value is sensitive to changes in public debt credit spreads, as well as changes in estimates with respect to other variables. These variables include a discount to reflect the lack of liquidity due to its private nature, the credit quality, as well as the timing, amount and likelihood of interest and principal payments on the notes which are subject to regulatory approval.

c) Derivative financial instruments and hedging

The Company enters a variety of derivative financial instruments to manage its exposure arising from financial assets and financial liabilities. Derivative financial instruments are financial contracts whose value is derived from an underlying interest rate, foreign exchange rate, equity or commodity instrument or index. The Company uses derivatives for economic 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. In certain circumstances, these hedges also meet the requirements for hedge accounting. Risk management strategies eligible for hedge accounting have been designated as cash flow hedges or net investment hedges in a foreign operation.

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Derivatives are initially measured at fair value at the trade date and subsequently remeasured at fair value at the end of each reporting date. Derivative financial instruments with a positive fair value are recorded as assets while derivative financial instruments with a negative fair value are recorded as liabilities. Changes in fair value are recorded in Net gains (losses) unless the derivative financial instruments are part of a qualified hedging relationship, as described below.

- **Net investment hedges**

The Company uses foreign currency derivatives to manage its book value exposure to the USD relative to the CAD. The effective portion of gains or losses on hedging derivatives, together with foreign exchange translation gains or losses on foreign operations, is recorded in Foreign exchange gains (losses) in OCI.

- **Cash flow hedges**

The Company has used foreign currency derivatives to hedge the OneBeacon purchase price exposure to fluctuations in the CAD/USD exchange rate. The effective portion of the change in the fair value of the hedging derivative, net of taxes, was recognized in OCI. The Company has elected to reclassify net losses accumulated in OCI at the time of closing to the acquisition cost of its investment in OneBeacon.

Where the Company has elected to apply hedge accounting, a hedging relationship is designated and documented at inception. Hedge effectiveness is evaluated at inception and throughout the term of the hedge. Hedge accounting is only applied when the Company expects that the hedging relationship will be highly effective in achieving offsetting changes in fair value or changes in cash flows attributable to the risk being hedged.

Hedge accounting is discontinued prospectively when it is determined that the hedging instrument is no longer effective as a hedge, the hedging instrument is terminated or sold, or upon the sale or early termination of the hedged item.

Derivatives that do not qualify for hedge accounting

Certain derivative instruments, while providing effective economic hedges, are not designated as hedges for accounting purposes. Changes in the fair value of such derivatives are recognized in Net gains (losses). *See Note 7 – Derivative financial instruments for details.*

d) Recognition of financial assets and financial liabilities

Refer to Table 2.2 for the initial recognition of financial assets and financial liabilities. Financial assets are no longer recorded when the rights to receive cash flows from the instruments have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership. Financial liabilities are no longer recorded when they have expired or have been cancelled.

Securities lending - Financial assets lent by the Company in the course of securities lending operations remain on the Consolidated balance sheet because the Company has not substantially transferred the risks and rewards related to the lent assets.

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 sheet. 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 or transferable, the Company keeps the liability and the corresponding asset on its financial statements.

e) Offsetting of financial assets and financial liabilities

Financial assets and financial 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
- an intention to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

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f) Revenue and expense recognition

Net investment income

- Interest income from debt securities and loans is recognized on an accrual basis.
- Premiums and discounts on debt securities classified as AFS, as well as premiums earned, or discounts incurred for loans and AFS securities are amortized using the effective interest method.
- Dividends are recognized when the shareholders' right to receive payment is established, which is the ex-dividend date.

Net gains (losses)

- Gains and losses on the sale of AFS debt and equity securities are generally calculated on a first in, first out basis, except for certain equity strategies.
- Transaction costs associated with the acquisition of financial instruments classified or designated as FVTPL are expensed as incurred; otherwise, transaction costs are capitalized on initial recognition and amortized using the effective interest method.
- Transaction costs incurred at the time of disposition of a financial instrument are expensed as incurred.
- If a business combination is achieved in stages, any previously held equity interest is remeasured as at its acquisition date fair value and any resulting gain or loss is recognized in income.

g) Impairment of financial assets other than those classified or designated as FVTPL

The Company determines, at each balance sheet date, whether there is objective evidence that a financial asset or a group of financial assets, other than those classified or designated as FVTPL, are impaired. Those financial assets are impaired according to either a debt, equity, or loans and receivables impairment model. The appropriate impairment model is determined based on the characteristics of each instrument, the capacity of the issuer to pay dividends or interest and the Company's intention to either hold the preferred shares for the long term or sell them. Objective evidence of impairment includes:

Debt impairment model

- One or more loss events (a payment default for example) that occurred after initial recognition and that has an impact on the estimated future cash flows of the financial asset.
- Increased probability that the future cash flows will not be recovered based on counterparty credit rating considerations.

Equity impairment model

- A significant, a prolonged, or a significant and prolonged decline in the fair value of an investment below cost.
- Information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which an issuer operates, indicating that the cost of an equity instrument may not be recovered.

Table 2.4 – Objective evidence of impairment for equity impairment model

Unrealized loss position	Common shares
Significant	Unrealized loss of 50% or more
Prolonged	Unrealized loss for 15 consecutive months or more
Significant and prolonged	Unrealized loss for 9 consecutive months or more and unrealized loss of 25%

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Loans and receivables impairment model

A payment default or when there are objective indications that the counterparty will not honour its obligations.

The following table summarizes the measurement and recognition of impairment losses.

Table 2.5 – Impairment models

	Debt	Equity	Loans and receivables
Application	<ul style="list-style-type: none"> Debt securities Preferred shares redeemable at the option of the holder Perpetual preferred shares purchased with the intent of holding for the long-term¹ 	<ul style="list-style-type: none"> Common shares Perpetual preferred shares not impaired using the debt impairment model¹ 	<ul style="list-style-type: none"> Loans and receivables: <ul style="list-style-type: none"> Significant (tested individually) Otherwise (grouped by similar characteristics for testing)
Loss measurement	Difference between amortized cost and current fair value less any unrealized loss on that security previously recognized	Difference between acquisition cost and current fair value less any impairment loss on that security previously recognized	Difference between amortized cost and the present value of the estimated future cash flows
Reported loss	Impairment loss removed from OCI and recognized in Net gains (losses)		Impairment loss recognized in Net gains (losses)
Subsequent fair value increases	Recognized in Net gains (losses) when there is observable positive development on the original impairment loss event. Otherwise, recognized in OCI	Recognized directly in OCI Impairment losses are not reversed	Provision can be reversed when the event that gave rise to its initial recognition subsequently disappears Recognized in Net 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

¹ Since the business model of the Company is to purchase preferred shares for the purpose of earning dividend income, with the intent of holding them for the long-term, virtually all preferred shares are assessed for impairment using a debt impairment model.

2.5 Business combinations

Business combinations are accounted for using the acquisition method. The purchase consideration is measured at fair value at acquisition date. At that date, the identifiable assets acquired, and liabilities assumed are estimated at their fair value. Acquisition-related costs are expensed as incurred. When the Company acquires a business, it assesses financial assets acquired and financial liabilities assumed for appropriate classification and designation in accordance with the contractual term, economic circumstances and relevant conditions at the acquisition date.

2.6 Goodwill and intangible assets

a) Goodwill

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 in a business combination. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is allocated to CGUs, or groups of CGUs, that are expected to benefit from the business combination in which they arose. Impairment testing is performed at least annually, on June 30, or more frequently if there are objective indicators of impairment, by comparing the recoverable amount of a CGU with its carrying amount. Impairment testing is undertaken at the lowest level at which goodwill is monitored for internal management purposes, which corresponds to the Company's operating segments.

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Upon disposal of a portion of a CGU, the carrying amount of goodwill related to the portion of the CGU sold is included in the determination of gains and losses on disposal. The carrying amount is determined based on the relative fair value of the disposed portion to the total CGU.

b) Intangible assets

The Company's intangible assets consist of distribution networks, trade names, customer relationships and internally developed software.

- Distribution networks represent the contractual agreements between the Company and unconsolidated brokers for the distribution of its insurance products.
- Customer relationships represent the relationships that exist with the policyholders, either directly (as a direct insurer) or indirectly (through consolidated brokers).

Intangible assets are initially measured at cost, except for intangible assets acquired in a business combination which 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. For each distribution network acquired, that assessment depends on the nature of the distribution network. When the related cash flows are expected to continue indefinitely, intangible assets are assessed as having an indefinite useful life.

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.

The amortization method and terms of intangible assets assessed as having finite useful lives are shown below.

Table 2.6 – Amortization methods and terms of intangible assets – finite useful life

Intangible assets	Method	Term
Distribution networks	Straight-line	20 to 25 years
Customer relationships	Straight-line	10 years
Internally developed software	Straight-line	3 to 10 years

Amortization of intangible assets is included in Other expenses in the Consolidated statements of income.

2.7 Foreign currency translation

The Consolidated financial statements are presented in Canadian dollars, which is the Company's presentation currency. The functional currency is the currency of the primary economic environment in which an entity operates. The functional currency of most foreign subsidiaries is their local currency, mainly the USD.

Foreign currency transactions

Transactions denominated in foreign currencies are initially recorded in the functional currency of the related entity using the exchange rates in effect at the date of the transaction.

- Monetary assets and liabilities denominated in foreign currencies are translated using the closing exchange rates. Any resulting exchange difference is recognized in income.
- Non-monetary assets and liabilities denominated in foreign currencies and measured at historical cost are translated using historical exchange rates, and those measured at fair value are translated using the exchange rate in effect at the date the fair value is determined.
- Revenues and expenses are translated using the average exchange rates for the period or the exchange rate at the date of the transaction for significant items.
- Net foreign exchange gains and losses are recognized in income except for AFS equity securities where unrealized foreign exchange gains and losses are recognized in OCI until the asset is sold or becomes impaired.

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Foreign operations

- Assets and liabilities of foreign operations whose functional currency is other than the Canadian dollar are translated into Canadian dollars using closing exchange rates.
- Revenues and expenses, as well as cash flows, are translated using the average exchange rates for the period.
- Translation gains or losses are recognized in OCI and are reclassified to income on disposal or partial disposal of the investment in the related foreign operation.

The exchange rates used in the preparation of the Consolidated financial statements were as follows:

Table 2.7 – Exchange rates used

	As at December 31,		Average rate for the years	
	2018	2017	2018	2017
USD vs CAD	1.36490	1.25730	1.29618	1.29832

2.8 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 or loss 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. The Company determines at each reporting date whether there is any objective evidence that investments in associates and joint ventures are impaired.

2.9 Property and equipment

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

Table 2.8 – Depreciation methods and terms of property and equipment

Property and equipment	Method	Term
Buildings	Straight-line	15 to 40 years
Furniture and equipment	Straight-line	2 to 7 years
Leasehold improvements	Straight-line	Over the terms of related leases
Finance leases	Straight-line	Over the terms of related leases

2.10 Leases

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. *Refer to Note 33.2 – Leases for more details on the IFRS 16 – Leases standard effective January 1, 2019.*

2.11 Income taxes

a) Income tax expense (benefit)

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

- **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 based on amounts expected to be paid to the tax authorities.

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- **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 entity for which there is a history of tax losses, deferred tax assets are only recognized in excess of deferred tax liabilities if there is convincing evidence that future profit will be available.

b) Recognition and offsetting of current tax assets and liabilities

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, entities concerned have a legally enforceable right to make or receive a single net payment and entities intend to make or receive such net payment or to recover the asset or settle the liability simultaneously.

2.12 Share-based payments

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

a) Long-term incentive plan

Certain key employees are eligible to participate in the LTIP. Participants are awarded notional share units referred to as PSUs and RSUs. The PSU payout is subject to the achievement of specific targets with regards to:

- the Company's estimated ROE outperformance versus the Canadian P&C industry, based on a three-year average; or
- the three-year average combined ratio of the U.S. operations compared to a specific target; or
- a combination of both.

Most RSUs automatically vest three years from the year of the grant. Vesting for RSUs is not linked to the Company's performance.

RSUs and PSUs - Subject to the Company's Board of Directors' approval, certain participants can receive cash in lieu of shares of the Company:

- based on the plan structure; or
- if they meet a defined share ownership threshold ("eligible participants") and elect to receive cash.

At the time of the payout, the plan administrator purchases in the market the number of common shares based upon the vested PSUs and RSUs, and elections of eligible participants.

The awards are estimated and 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 LTIP is accounted for as an equity-settled plan, except for the participants that are eligible to receive cash in lieu of shares of the Company (accounted for as a cash-settled plan).

Equity-settled plan

The cost of the awards is recognized as an expense over the vesting period, with a corresponding entry to Contributed surplus. 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 difference between the market price of the shares purchased and the cumulative cost for the Company of these vested units, net of income taxes, is recorded in Retained earnings.

Cash-settled plan

The cost of the awards is recognized as an expense over the vesting period, with a corresponding entry to Other liabilities. The liability is remeasured at each reporting period based on the number of awards that are expected to vest and the current share price, with any fluctuations in the liability also recorded as an expense until it is settled.

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b) Employee share purchase plan

Employees who are not eligible for the LTIP are entitled to make contributions to a voluntary ESPP. Eligible employees can contribute up to 10% of their annual base salary through a payroll deduction to purchase IFC common shares in the market. As an incentive to participate in the plan the Company matches, at the end of each year, a number of shares equal to 50% of the common shares purchased by the employees during the year (subject to certain conditions). During the following year, the common shares contributed by the Company are purchased by an independent broker at each pay period and deposited in the employee account evenly each pay. The common shares contributed by the Company are awarded and vested at the time they are deposited in the employee account.

Equity-settled plan

The fair value of awards is estimated at the grant date and 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 awards is recognized as an expense over the vesting period, with a corresponding entry to Contributed surplus. The difference between the market price of the common shares purchased and the cumulative cost for the Company of these vested awards, net of income taxes, is recorded in Retained earnings.

c) Deferred share unit plan

Non-employee directors of the Company are eligible to participate in the Company's DSU plan. A portion of the remuneration of non-employee directors of the Company must be received in DSUs or common shares of the Company. For the remainder of their compensation, the directors are given the choice of cash, common shares of the Company, DSUs or a combination of the three. Both DSUs and common shares vest at the time of the grant. The DSUs are redeemed upon director retirement or termination and are settled for cash afterwards. 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.

Cash-settled plan

The DSUs are cash-settled awards which are expensed at the time of granting with a corresponding financial liability reported in Other liabilities. This liability is remeasured 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.

2.13 Employee future benefits – pension

The actuarial determination of the DB obligation uses the projected unit credit method and management's best estimate assumptions.

DB pension expense

Cost recognized in Net income in the current period includes:

- service cost: benefits cost provided in exchange for employees' services rendered during the year (current service cost) or prior years (past service cost);
- net interest expense: change in the DB obligation and the plan assets resulting from the passage of time; and
- administrative expenses paid from the pension assets.

The discount rate methodology used to determine the DB expense is determined with reference to the yields on high quality corporate bonds with durations that match the various components of the DB expense.

Remeasurement of net DB liability (asset)

The rate used to discount the DB obligation is determined by reference to market yields on high quality corporate bonds with cash flows that match the timing and amount of expected benefit payments, determined at the end of each reporting period.

Remeasurements are recognized directly in OCI in the period in which they occur and include:

- return on plan assets, which represents the difference between the actual return on plan assets and the return based on the discount rate determined using high quality corporate bonds;
- actuarial gains and losses arising from plan experience; and
- changes in actuarial methods and assumptions, such as discount rate used to discount the DB obligation.

Such remeasurements are also immediately reclassified to Retained earnings as they will not be reclassified to Net income in subsequent periods.

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2.14 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.

Note 3 – Significant accounting judgments, estimates and assumptions

The preparation of financial statements in conformity with IFRS requires management to use judgments, estimates and assumptions that can have a significant impact on the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as at the balance sheet date, as well as 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 are as follows:

Description	Reference	Description	Reference
Business combinations	<i>Note 5.2</i>	Impairment of financial assets	<i>Note 23.2</i>
Valuation of claims liabilities	<i>Note 11.3</i>	Measurement of income taxes	<i>Note 24.3</i>
Impairment of goodwill and intangible assets	<i>Note 15.2</i>	Valuation of DB obligation	<i>Note 27.6</i>

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Note 4 – Adoption of new accounting standards

On January 1, 2018, the Company adopted the following new standards and amendments to existing standards:

4.1 Amendments to IFRS 4 – Insurance Contracts for the application of IFRS 9 – Financial Instruments

The Company has adopted the amendments to IFRS 4 – *Insurance Contracts* (“IFRS 4”) that address concerns of insurers about the different effective dates for IFRS 9 – *Financial Instruments* (“IFRS 9”) and IFRS 17 – *Insurance Contracts* (“IFRS 17”), the new insurance contracts standard. The amendments allow insurance entities to elect one of the two following approaches.

- The **deferral approach** provides entities whose predominant activities are to issue contracts within the scope of IFRS 4, a temporary exemption to continue using IAS 39 – *Financial Instruments: Recognition and Measurement* (“IAS 39”), instead of IFRS 9 until January 1, 2021.
- The **overlay approach** can be applied to eligible financial assets and provides an option for all issuers of insurance contracts to reclassify from profit or loss to OCI any additional accounting volatility that may arise from applying IFRS 9 before the new insurance contracts standard.

The Company has opted for the deferral approach and performed an assessment as at September 30, 2017, considering OneBeacon’s acquisition (see Note 5 – *Business combinations*). The Company concluded that its activities are predominantly connected with insurance, since the percentage of liabilities connected with insurance contracts over total liabilities is above the 80% threshold. This assessment is only updated if significant changes to activities of an entity occur.

Therefore, the Company will continue to apply IAS 39 to its financial instruments until January 1, 2021. In November 2018, the IASB tentatively decided that the mandatory effective date of IFRS 17 should be deferred by one year (see Note 33.3 – *Insurance contracts*) and consequently, the fixed expiry date for the temporary exemption in IFRS 4 should be amended to annual periods beginning on or after January 1, 2022, subject to public consultation.

Nevertheless, in the interim, the Company is required to present additional disclosure related to the classification and fair value of financial assets as well as their credit rating.

Disclosure	Reference
Classification and fair value of financial assets	<i>Note 6.2 – Carrying value of investments</i>
Credit rating of financial assets	<i>Note 10.4 b) – Credit risk (credit quality)</i>

Refer to Note 33.1 – Standards issued but not yet effective (Financial instruments) for more details on IFRS 9 – Financial instruments.

4.2 IFRS 15 – Revenue from contracts with customers

The Company has adopted the new IFRS 15 – *Revenue from Contracts with Customers* (“IFRS 15”). The standard supersedes IAS 18 – *Revenue*, IAS 11 – *Construction Contracts*, and a number of revenue-related interpretations. This new standard specifies how and when to recognize revenue and additional relevant disclosure requirements. IFRS 15 applies to nearly all contracts with customers, except for insurance contracts, financial instruments and leases.

IFRS 15 only applies to the Company’s Other revenues and its adoption had no impact on the Consolidated financial statements.

4.3 Income tax consequences of payments on financial instruments classified as equity

In December 2017, the IASB issued amendments to IAS 12 – *Income Taxes* (“IAS 12”) to clarify that an entity should account for the income tax on dividends in Net income, OCI or equity, according to where the entity originally recognized the past transactions that allowed for having the cash flows to declare a dividend.

The amendments apply to annual periods beginning on or after January 1, 2019, with earlier application permitted. The Company early adopted the amendments to IAS 12 and there was no significant impact.

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Note 5 – Business combinations

5.1 OneBeacon

On September 28, 2017, the Company completed the acquisition of OneBeacon, a leading U.S. specialty insurer, for a cash consideration of US\$1.7 billion (\$2.3 billion). OneBeacon became a wholly-owned subsidiary of the Company and the results of operations are included in the Consolidated financial statements from that date.

The following table summarizes the consideration paid for OneBeacon, and the amounts recognized for the assets acquired and liabilities assumed (determined in accordance with IFRS) as at the acquisition date. As required by IFRS 3 – *Business Combinations*, the provisional fair values have been reassessed considering new information obtained during the measurement period following the acquisition and the purchase price allocation is now final.

Table 5.1 – Business combination – OneBeacon

As at acquisition date	Final assessment of fair value	
	USD	CAD
Purchase price		
Cash consideration paid	1,702	2,128
Purchase price hedge	-	200
Total purchase price	1,702	2,328
Fair value of assets acquired, and liabilities assumed		
Investments ¹	2,706	3,383
Premium receivables	275	343
Reinsurance assets	287	358
Distribution networks and other intangibles	626	782
Other assets	328	410
Claims liabilities	(1,628)	(2,036)
Unearned premiums	(650)	(813)
Deferred tax liabilities	(18)	(21)
Debt outstanding	(292)	(364)
Other liabilities	(431)	(538)
Total identifiable net assets	1,203	1,504
Goodwill	499	824
Exchange rate (CAD/USD) as at the acquisition date		1.25030

¹ Included net cash acquired of US\$151 million.

During the third quarter of 2018, a measurement period adjustment was made which resulted in a decrease to the Surplus notes reported in Other assets of US\$51 million (\$64 million), a decrease to Deferred tax liabilities of US\$18 million (\$22 million) and a resulting increase to Goodwill of US\$33 million (\$42 million). The 2017 comparative balance sheet was restated to reflect these adjustments to the provisional amounts.

The fair value of the acquired distribution networks, trade names and other intangible assets are based on a discounted cash flow analysis. The distribution networks are amortized over a 20-year period. The fair value of the claims liabilities reflected the impact of discounting and risk margin. Goodwill reflects the quality of the acquired business and the synergies expected following the integration of OneBeacon. The goodwill is not deductible for tax purposes.

The integration costs in connection with the acquisition of OneBeacon are reported in Integration and restructuring costs in the Consolidated statements of income.

The Company has hedged the purchase price and book value exposure associated with CAD/USD exchange rate fluctuations.

5.2 Significant accounting judgments, estimates and assumptions

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 regarding 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.

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Note 6 – Investments

6.1 Classification of investments

Table 6.1 – Classification of investments

As at	Fair value			Amortized cost	Total carrying amount
	AFS	Classified as FVTPL	Designated as FVTPL	Cash and cash equivalents and loans	
December 31, 2018					
Cash and cash equivalents	-	-	-	442	442
Short-term notes	19	-	-	-	19
Fixed income					
Investment grade					
Government	2,248	-	2,899	-	5,147
Corporate	2,180	-	2,240	-	4,420
Asset-backed ¹	505	-	184	-	689
Mortgage-backed					
Agency ²	182	-	387	-	569
Non-agency	373	-	314	-	687
Non-rated	170	-	-	-	170
Debt securities	5,677	-	6,024	-	11,701
Investment grade					
Retractable	31	-	-	-	31
Fixed-rate perpetual	256	-	-	-	256
Other perpetual	878	-	-	-	878
Preferred shares	1,165	-	-	-	1,165
Common shares	2,316	123	856	-	3,295
Loans	-	-	-	294	294
	9,158	123	6,880	736	16,897
December 31, 2017					
Cash and cash equivalents	-	-	-	163	163
Short-term notes	120	97	-	-	217
Fixed income					
Investment grade					
Government	1,775	-	3,432	-	5,207
Corporate	1,505	-	2,368	-	3,873
Asset-backed ¹	500	-	487	-	987
Mortgage-backed					
Agency ²	90	-	250	-	340
Non-agency	109	-	218	-	327
Below investment grade					
Corporate	-	99	18	-	117
Mortgage backed – non-agency	-	-	7	-	7
Non-rated ³	122	-	32	-	154
Debt securities	4,221	196	6,812	-	11,229
Investment grade					
Retractable	24	-	-	-	24
Fixed-rate perpetual	271	-	-	-	271
Other perpetual	1,035	-	-	-	1,035
Preferred shares	1,330	-	-	-	1,330
Common shares	2,272	357	1,030	-	3,659
Loans	-	-	-	393	393
	7,823	553	7,842	556	16,774

¹ Credit card receivables and auto loans.

² Publicly traded MBS which carry the full faith and credit guarantee of the U.S. Government or are guaranteed by a government sponsored entity.

³ Included \$40 million of MBS as at December 31, 2017 (nil as at December 31, 2018).

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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 'P3L' are classified as investment grade.

6.2 Carrying value of investments

Table 6.2 – Carrying value of investments

As at	FVTPL				Other	Total
	investments	investments	investments	investments	investments	investments
	Carrying value	Amortized cost	Unrealized gains	Unrealized losses	Carrying value	Carrying value
December 31, 2018						
Cash and cash equivalents	-	442	-	-	442	442
Debt securities	6,024	5,660	44	(27)	5,677	11,701
Preferred shares	-	1,248	23	(106)	1,165	1,165
Common shares	979	2,401	136	(221)	2,316	3,295
Loans	-	294	-	-	294	294
	7,003	10,045	203	(354)	9,894	16,897
December 31, 2017						
Cash and cash equivalents	-	163	-	-	163	163
Debt securities	7,008	4,199	43	(21)	4,221	11,229
Preferred shares	-	1,287	71	(28)	1,330	1,330
Common shares	1,387	2,060	263	(51)	2,272	3,659
Loans	-	393	-	-	393	393
	8,395	8,102	377	(100)	8,379	16,774

The Company is currently assessing the cash flow characteristics test (solely payments of principal and interest or "SPPI" test). Based on its preliminary assessment, most of the debt securities would pass the SPPI test. The composition of debt securities may change significantly by the time IFRS 9 is adopted, which is expected to be on January 1, 2022.

6.3 Market neutral equity investment strategy

Table 6.3 – Market neutral equity investment strategy

As at December 31,	2018		2017	
	Fair value	Collateral	Fair value	Collateral
Long positions – reported in Common shares	104	-	121	-
Short positions – reported in Financial liabilities related to investments (Table 8.1)	(105)	(105)	(122)	126

6.4 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. Collateral, mainly consisting of government securities, is provided by the counterparty and 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 daily as the market value of underlying loaned securities fluctuates.

Table 6.4 – Securities lending

As at December 31,	2018		2017	
	Fair value	Collateral ¹	Fair value	Collateral ¹
Loaned securities – reported in Investments	1,155	1,215	1,087	1,144

¹ Representing approximately 105% of the fair value of the securities loaned as at December 31, 2018 and 2017.

Notes to the Consolidated financial statements

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

Note 7 – Derivative financial instruments

7.1 Types of derivatives used

Table 7.1 – Types of derivatives used

Derivatives	Description	Objective	Intent to hold instrument
Forwards	Contractual obligations to exchange:	Mitigate risk arising from foreign currency fluctuations on:	
Currency	one currency for another at a predetermined future date	<ul style="list-style-type: none"> foreign currency cash inflows and outflows impacting the Company's operations on the Company's net investment in foreign operations 	Risk management purposes Book value hedge
Futures	Contractual obligations to buy or sell:		
Interest rate	an interest rate sensitive financial instrument at a specified price and a predetermined future date	Modify or mitigate exposure to interest rate fluctuations	Mostly for risk management purposes
Equity	a specified amount of stocks, a basket of stocks or an equity index at an agreed price and a specified date	Mitigate exposure to equity market	Risk management purposes
Swaps	Over-the-counter contracts:		
Swap agreements	in which two counterparties exchange a series of cash flows based on a basket of stocks, applied to a notional amount	Mitigate exposure to equity market fluctuations	Risk management purposes
Credit default	that transfer credit risk related to an underlying financial instrument from one counterparty to another	Modify exposure to credit	Risk management purposes
Cross currency	in which two counterparties exchange interest and principal payments in two different currencies	Mitigate risk arising from foreign currency fluctuations on the Company's net investment in foreign operations	Book value hedge
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):		
Inflation caps	an index at a predetermined price, at or by a specified future date	Mitigate exposure to inflation risk	Trading purposes

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Notes to the Consolidated financial statements

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7.2 Fair value and notional amount of derivatives

Derivative financial assets are presented on the Consolidated balance sheets as part of Other assets and derivative financial liabilities are presented as part of Financial liabilities related to investments.

Table 7.2 – Fair value and notional amount of derivatives by nature of risk

As at December 31,	2018			2017		
	Notional amount	Fair value		Notional amount	Fair value	
		Asset	Liability		Asset	Liability
Foreign currency contracts						
Forwards	1,636	-	69	1,852	8	13
Cross currency swaps	392	-	16	-	-	-
Interest rate contracts						
Futures	505	-	-	1,317	-	-
Equity contracts						
Swap agreements	847	58	-	1,022	-	8
Futures	160	-	-	247	-	-
Credit contracts						
Swap agreements	-	-	-	-	-	-
Inflation options						
Options	28	-	-	63	-	-
	3,568	58	85	4,501	8	21
Held for risk management purposes ¹	3,492	58	85	4,337	8	21
Held for trading purposes	76	-	-	164	-	-
	3,568	58	85	4,501	8	21
Term to maturity:						
less than one year	3,568			4,279		
from one to five years	-			222		
over five years	-			-		
	3,568			4,501		

¹ Includes net investment hedges and cash flow hedges, using forwards and cross currency swaps.

Note 8 – Financial liabilities related to investments

Table 8.1 – Financial liabilities related to investments

As at December 31,	2018	2017
Equities sold short positions (<i>Table 6.3</i>)	105	122
Accounts payable to investment brokers on unsettled trades	99	24
Derivative financial liabilities (<i>Table 7.2</i>)	85	21
	289	167

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Notes to the Consolidated financial statements

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Note 9 – Fair value measurement

9.1 Categorization of fair values

Table 9.1 – Fair value hierarchy of financial assets and financial liabilities

As at	Level 1 Valued using quoted (unadjusted) market prices	Level 2 Valued using models (with observable inputs)	Level 3 Valued using models (without observable inputs)	Total
December 31, 2018				
Short-term notes	19	-	-	19
Fixed income				
Investment grade				
Government	2,667	2,480	-	5,147
Corporate	-	4,420	-	4,420
Asset-backed	-	689	-	689
Mortgage-backed				
Agency	-	569	-	569
Non-agency	-	687	-	687
Non-rated	-	-	170	170
Debt securities	2,686	8,845	170	11,701
Preferred shares¹	1,165	-	-	1,165
Common shares	3,262	-	33	3,295
Derivative financial assets (Table 7.2)	-	58	-	58
Total financial assets measured at fair value	7,113	8,903	203	16,219
Total financial liabilities measured at fair value	105	85	-	190
December 31, 2017				
Short-term notes	217	-	-	217
Fixed income				
Investment grade				
Government	2,902	2,305	-	5,207
Corporate	-	3,873	-	3,873
Asset-backed	-	987	-	987
Mortgage-backed				
Agency	-	340	-	340
Non-agency	-	327	-	327
Below investment grade				
Corporate	-	117	-	117
Mortgage backed – non-agency	-	7	-	7
Non-rated	-	43	111	154
Debt securities	3,119	7,999	111	11,229
Preferred shares¹	1,330	-	-	1,330
Common shares	3,595	35	29	3,659
Derivative financial assets (Table 7.2)	-	8	-	8
Total financial assets measured at fair value	8,044	8,042	140	16,226
Total financial liabilities measured at fair value	122	21	-	143

¹ Include perpetual preferred shares with call options amounting to \$1,017 million as at December 31, 2018 (\$1,182 million as at December 31, 2017). The fair value of the embedded derivatives component amounting to \$39 million as at December 31, 2018 (\$79 million as at December 31, 2017) was determined using a Level 3 methodology.

The fair value of loans was \$289 million as at December 31, 2018 (\$384 million as at December 31, 2017).

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Note 10 – Financial risk

The Company has a comprehensive risk management framework and internal control procedures designed to manage and monitor various risks 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. 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 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 and internal auditors.

Table 10.1 – Financial risk

	Market risk	Basis risk	Credit risk	Liquidity risk
Risk definition	Risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in equity market prices, interest rates or spreads, foreign exchange rates or commodity market.	Risk that offsetting investments in an economic hedging strategy will not experience price changes that entirely offset each other.	Risk that counterparties may not be able to meet payment obligations when they become due.	Risk that the Company will encounter difficulty in raising funds to meet obligations associated with financial liabilities.
Reference	<i>Notes 10.1 and 10.2</i>	<i>Note 10.3</i>	<i>Note 10.4</i>	<i>Note 10.5</i>

10.1 Market risk

Table 10.2 – Market risk

	Equity price risk	Interest rate risk	Currency risk
Risk definition	Risk of losses arising from changes in equity market prices.	Risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates or spreads.	Risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.
Risk exposure	Significant exposure to price changes for common shares and preferred shares, including pension plan equities.	Significant exposure to changes in interest rates from: <ul style="list-style-type: none"> debt securities and preferred shares; defined benefit pension plan obligations, net of related debt securities; and net claims liabilities. 	A portion of the Company's net investment in foreign operations. Investments supporting the Company's Canadian operations denominated in foreign currencies, mainly USD. A portion of foreign currency inflows and outflows impacting the Company's operations.
Risk management investment policy	Set forth limits in terms of equity exposure.	Set forth limits in terms of interest rate and credit spread duration.	Set forth limits in terms of currency exposure.
Risk mitigation	Through asset class and economic sector diversification and, in some cases, the use of derivatives.	Using interest-rate derivatives. Changes in the discount rate applied to the Company's claims liabilities offers a partial offset to the change in price of interest sensitive assets.	Using foreign currency derivatives.

The Operational Investment Committee and Compliance Review and Corporate Governance Committee regularly monitor and review compliance, respectively, with the Company's investment policies.

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a) Sensitivity analyses to market risk

Sensitivity analyses are one risk management technique that assists management in ensuring that risks assumed remain within the Company's risk tolerance level. Sensitivity analyses involve varying a single factor to assess the impact that this would have on the Company's results and financial condition. No management action is considered. Actual results can differ materially from these estimates for a variety of reasons and therefore, these sensitivities should be considered as directional estimates.

Table 10.3 – Sensitivity analyses (after tax)

For the years ended December 31,	2018		2017	
	Net income	OCI	Net income	OCI
Equity price risk				
Common share prices (10% decrease) ¹	(11)	(202)	(1)	(201)
Preferred share prices (5% decrease) ^{2,3}	8	(51)	13	(62)
Interest rate risk (100 basis point increase)				
Debt securities ⁴	(188)	(174)	(167)	(116)
Preferred shares	6	(37)	8	(37)
Net claims liabilities	168	-	168	-
Defined benefit pension plan obligation, net of related debt securities	-	87	-	89
Currency risk (strengthening of Canadian dollar by 10% vs all currencies)⁵				
U.S. investments supporting the Company's Canadian operations	-	-	6	(1)
International securities	-	(19)	-	(19)
Net assets of foreign operations	-	(196)	-	(176)

¹ Net of any equity hedges, including the impact of any impairment.

² Including the impact on related embedded derivatives.

³ The preferred share equity price risk sensitivity analysis includes the impact of interest rate movements.

⁴ Excludes the impact of debt securities related to the defined benefits pension plan.

⁵ After giving effect to foreign-exchange contracts.

These sensitivity analyses were prepared using the following assumptions:

- shifts in the yield curve are parallel;
- interest rates, equity prices and foreign currency move independently;
- credit, liquidity, spread and basis risks have not been considered;
- impact on the Company's pension plans has been considered; and
- risk reduction measures perform as expected, with no material basis risk and no counterparty defaults.

AFS debt or equity securities in an unrealized loss position, as reflected in AOCI, may be realized through sale in the future.

b) Exposure to currency risk

Table 10.4 – Net foreign currency and translation exposure to the USD

As at December 31,	USD	
	2018	2017
U.S. investments supporting the Company's Canadian operations	1,255	1,048
Less: foreign-currency derivatives, notional amount	(1,236)	(1,045)
	19	3
Consolidated net assets of OneBeacon	1,769	1,755
Less: foreign-currency derivatives, notional amount	(300)	(300)
	1,469	1,455
Other net assets denominated in USD	12	13
Total net currency exposure to the USD	1,500	1,471

In addition, the Company holds international securities amounting to \$254 million as at December 31, 2018 (\$344 million as at December 31, 2017).

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10.2 Interest risk

The following table presents the fair value and respective duration of the Company's assets and liabilities measured at fair value, as well as financial instruments that are sensitive to movements in interest rates.

Table 10.5 – Interest risk

As at December 31,	2018		2017	
	Fair value	Duration (in years)	Fair value	Duration (in years)
Investments:				
Debt securities	11,701	3.69	11,229	3.43
Preferred shares	1,165	3.59	1,330	2.94
Net claims liabilities (<i>Note 11.1</i>)	9,877	2.29	9,746	2.37
Defined benefit pension plans				
Debt securities (<i>Note 27.3</i>)	1,285	12.3	1,308	12.0
Obligation (<i>Note 27.2</i>)	2,271	17.7	2,263	17.3

The Company manages the interest rate risk exposure of its investment portfolio in accordance with its investment policies. Compliance with interest rate risk exposure ranges and targets established in these policies is monitored regularly.

10.3 Basis risk

The use of derivatives exposes the Company to a number of risks, including credit and market risks. The hedging of certain risks with derivatives results in basis risk. The imperfect correlation between the hedging instrument and hedged item 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 economic hedges on a regular basis. Basis risk is controlled by limits prescribed in the investment policy, which are monitored regularly.

10.4 Credit risk

The Company's credit risk exposure is concentrated primarily in its debt securities and preferred shares and, to a lesser extent, in its premium receivables, reinsurance assets, and structured settlement agreements entered with various life insurance companies. The Company is also subject to counterparty credit risk arising from reinsurance, over-the-counter derivatives, as well as securities lending and borrowing transactions. A counterparty is any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation to the Company. These exposures and the Company's risk management policy and practices used to mitigate credit risk are explained below.

a) Credit exposure

The table below presents the Company's maximum exposure to credit risk without considering any collateral held or other credit enhancements available to the Company to mitigate this risk. For on-balance sheet exposures, maximum exposure to credit risk is defined as the carrying value of the asset.

Table 10.6 – Maximum exposure to credit risk

As at December 31,	2018	2017
Cash and cash equivalents	442	163
Debt securities	11,701	11,229
Preferred shares	1,165	1,330
Loans	294	393
Premium receivables	3,358	3,351
Reinsurance assets	864	822
Other financial assets ¹	676	553
On-balance sheet credit risk exposure	18,500	17,841
Structured settlements	1,264	1,229
Off-balance sheet credit risk exposure	1,264	1,229

¹ Include restricted funds, other receivables and recoverables, financial assets related to investments, industry pools receivable, accrued investment income and Surplus notes.

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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. If 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. This credit risk is minimal since the Company deals with registered life insurers with credit rating of at least 'A-' at the inception of the contract.

b) Credit quality

The Company's risk management strategy is to invest in debt securities 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, all debt securities have a minimum credit rating of 'BBB' and of 'P3' for preferred shares. This credit quality restriction excludes indirect investments through debt funds. In the case of funds, specific policy limits apply to manage the overall exposure to these investments. Management monitors subsequent credit rating changes on a regular basis.

The following tables present the credit quality of the Company's debt securities and preferred shares.

Table 10.7 – Credit quality of debt securities

As at December 31,	2018	2017
Debt securities		
AAA	43%	41%
AA	31%	28%
A	17%	21%
BBB	7%	8%
BB and not rated	2%	2%
	100%	100%

Table 10.8 – Credit quality of preferred shares

As at December 31,	2018	2017
P2	84%	79%
P3	16%	21%
	100%	100%

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c) Credit risk concentration

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 industries.

Investments

The Company has a significant concentration of its investments in the financial sector and in Canada. These risk concentrations are closely monitored. To provide sector diversification, the Company holds investment-grade non-financial U.S. corporate bonds. The acquisition of OneBeacon, as well as the existing U.S. and international securities, reduce the concentration risk in Canada.

Table 10.9 – Investment breakdown by country of incorporation and by industry

As at December 31,	Investments		Pension assets	
	2018	2017	2018	2017
By country of incorporation				
Canada	69%	71%	85%	84%
U.S.	29%	25%	7%	8%
Other	2%	4%	8%	8%
	100%	100%	100%	100%
By industry				
Government	32%	33%	43%	44%
Financials	27%	28%	24%	23%
ABS and MBS	12%	10%	-%	-%
Energy	5%	6%	5%	6%
Other	24%	23%	28%	27%
	100%	100%	100%	100%

For the Company's regulated subsidiaries, the assets invested in any entity or group of related entities are limited by OSFI and AMF to 5% of the subsidiaries' assets. In the U.S. similar limitations exist and vary depending on the state. The Company also monitors aggregate concentrations of credit risk by country of issuer and by industry regardless of the asset class (see Note 14.4 – Risk management and counterparty credit risk). The Company applies limits against that aggregate exposure, which are more conservative than OSFI's limits. Investment portfolio diversification helps to mitigate credit risk and is monitored against established guidelines with respect to exposure to individual issuers.

Most of the investment portfolio is invested in well established, active and liquid markets.

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d) Counterparty credit risk

Counterparty credit risk arises from reinsurance (*see Note 14.4 – Risk management and counterparty credit risk*), over-the-counter derivatives, as well as securities lending and borrowing transactions.

Over-the-counter derivatives, as well as securities lending and borrowing transactions

Credit risk from over-the-counter 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.

Credit risk from securities lending and borrowing transactions arises when the counterparty can re-hypothecate or re-pledge the collateral externally. Credit risk from securities borrowing is the potential for the counterparty to default when the value of the collateral posted is higher than the value of the security borrowed.

The Company subjects its derivative-related, as well as securities lending and 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 or has a guarantee from a company rated 'A-' or better.

The Company uses netting clauses in master derivative agreements to reduce derivative-related credit exposure. Netting clauses in master derivative agreements 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 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 securities lending and borrowing transactions. Most of the Company's legal agreements allow for daily collateral movement. Consequently, the Company regularly validates 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 derivative positions when the value exceeds a specified threshold amount.

The aggregate credit risk exposure was \$135 million as at December 31, 2018 (\$95 million as at December 31, 2017) and is the sum of the replacement cost net of collateral 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.

10.5 Liquidity risk

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. Given the nature of the Company's P&C 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 to match them to its liabilities. This method maps the obligations towards insured clients to asset life and performance. The Company reviews the matching status on a quarterly basis. To manage its cash flow requirements, a portion of the Company's investments is maintained in short-term (less than one year) highly liquid money market securities. A large portion of the investments are 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 19.3 – Credit facility*).

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a) Investments and derivative financial assets by contractual maturity

Table 10.10 – Investments and derivative financial assets by contractual maturity

	Less than 1 year	From 1 to 5 years	Over 5 years	No specific maturity	Total
As at December 31, 2018					
Cash and cash equivalents	442	-	-	-	442
Debt securities	1,078	5,559	4,894	170	11,701
Preferred shares	11	12	8	1,134	1,165
Common shares	-	-	-	3,295	3,295
Loans	2	40	252	-	294
	1,533	5,611	5,154	4,599	16,897
Derivative financial assets	58	-	-	-	58
	1,591	5,611	5,154	4,599	16,955
As at December 31, 2017					
Cash and cash equivalents	163	-	-	-	163
Debt securities	1,338	5,781	3,999	111	11,229
Preferred shares	4	17	3	1,306	1,330
Common shares	-	-	-	3,659	3,659
Loans	11	42	340	-	393
	1,516	5,840	4,342	5,076	16,774
Derivative financial assets	8	-	-	-	8
	1,524	5,840	4,342	5,076	16,782

b) Financial liabilities by contractual maturity

Table 10.11 – Financial liabilities by contractual maturity

	Less than 1 year	From 1 to 5 years	Over 5 years	No specific maturity	Total
As at December 31, 2018					
Claims liabilities – undiscounted value	4,182	4,700	1,852	-	10,734
Debt outstanding	250	692	1,267	-	2,209
Other financial liabilities	950	77	31	599	1,657
	5,382	5,469	3,150	599	14,600
As at December 31, 2017					
Claims liabilities – undiscounted value	4,139	4,463	1,808	-	10,410
Debt outstanding	-	974	1,267	-	2,241
Other financial liabilities	753	81	35	568	1,437
	4,892	5,518	3,110	568	14,088

The expected maturity of claims liabilities is determined by estimating when claims liabilities will be settled. Unearned premiums have been excluded because they do not constitute actual obligations.

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Note 11 – Claims liabilities

On the Consolidated balance sheets, claims liabilities are reported gross of the reinsurers' share, which is included in Reinsurance assets. Changes in claims liabilities, net of reinsurance, are reported in Net claims incurred.

11.1 Movements in claims liabilities

Table 11.1 – Movements in claims liabilities

For the years ended	Direct	Ceded	Net
December 31, 2018			
Balance, beginning of year	10,475	729	9,746
Current year claims	6,783	180	6,603
Unfavourable (favourable) prior-year claims development	(115)	51	(166)
Increase (decrease) due to changes in discount rate (see Note 11.2)	(111)	(14)	(97)
Total claims incurred	6,557	217	6,340
Claims paid	(6,586)	(241)	(6,345)
Business combinations	(2)	-	(2)
Exchange rate differences	179	41	138
Balance, end of year	10,623	746	9,877
December 31, 2017			
Balance, beginning of year	8,536	465	8,071
Current year claims	5,705	54	5,651
Unfavourable (favourable) prior-year claims development	(299)	(46)	(253)
Increase (decrease) due to changes in discount rate (see Note 11.2)	(89)	(2)	(87)
Total claims incurred	5,317	6	5,311
Claims paid	(5,478)	(180)	(5,298)
Business combinations (see Note 5)	2,090	437	1,653
Exchange rate differences	10	1	9
Balance, end of year	10,475	729	9,746

11.2 Fair value of claims liabilities

The Company estimates that the fair value of its net claims liabilities approximates their carrying values.

Table 11.2 – Carrying value of claims liabilities

As at	Direct	Ceded	Net
December 31, 2018			
Undiscounted value	10,734	731	10,003
Effect of time value of money ¹	(693)	(64)	(629)
Risk margin	582	79	503
	10,623	746	9,877
December 31, 2017			
Undiscounted value	10,410	656	9,754
Effect of time value of money ¹	(553)	(33)	(520)
Risk margin	618	106	512
	10,475	729	9,746

¹ Using a discount rate of 2.73% for Canada and 3.25% for the U.S. as at December 31, 2018 (2.33% and 2.34% respectively as at December 31, 2017).

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11.3 Significant accounting judgments, estimates and assumptions

The Company establishes claims liabilities to cover the estimated liability for the payment of all losses, including LAE incurred with respect to insurance contracts underwritten by the Company. The ultimate cost of claims liabilities is estimated by using a range of standard actuarial claims projection techniques in accordance with generally accepted actuarial methods.

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 (severity) and average number of claims (frequency) based on the observed development of earlier years and expected loss ratios. Historical claims development is analyzed by accident years, by geographical area, as well as by significant business line and claim type. Catastrophic events are separately addressed, either by being reserved at the face value of loss adjuster estimates in the case of very large losses or separately projected to reflect their future development which might differ from historical data in the case of catastrophic events. Expected claim cost inflation is also considered when estimating claims liabilities.

Additional qualitative judgment is used to assess the extent to which past trends may not apply in the future to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, considering the uncertainties involved ("best estimate"). Actuaries are required to include margins in some assumptions to recognize the uncertainty in establishing this best estimate, to allow for possible deterioration in experience and to provide greater comfort that the actuarial liabilities are sufficient to pay future benefits.

The determination of the overall risk margin considers:

- the level of uncertainty in the best estimate due to estimation error, variability of key inflation assumptions and possible economic and legislative changes; and
- the volatility of each line of business and the diversification between the lines of business and geographic regions (referred to as diversification benefit).

At a fixed probability of adequacy, the appropriate risk margin for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. The level of diversification assumed between classes considers industry analysis, historical experience and the judgement of experienced and qualified actuaries. With operations in Canada and the U.S., the risk margin assumption used reflects this diversification benefit as at December 31, 2018 and 2017.

11.4 Sensitivity analysis

The claims liabilities' sensitivity to certain key assumptions is outlined below. It is not possible to quantify the sensitivity to certain assumptions such as legislative changes or uncertainty in the estimation process. The analysis 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 11.3 – Sensitivity analysis (claims liabilities net of reinsurance) – Impact on Net income

As at December 31,		2018		2017	
		Canada	U.S.	Canada	U.S.
Average claim costs (severity)	+5%	(282)	(19)	(279)	(20)
Average number of claims (frequency)	+5%	(52)	(61)	(54)	(62)
Discount rate	+1%	138	24	137	29

A portion of the Company's investments backing its claims liabilities has been voluntarily designated as FVTPL to reduce the volatility caused by fluctuations in the value of underlying claims liabilities due to changes in discount rates.

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11.5 Prior-year claims development

The claims development table below demonstrates the extent to which the original claim cost estimates in any one accident year has subsequently developed favourably (lower than originally estimated) or unfavourably. This table illustrates the variability and inherent uncertainty in estimating the claims estimate on a yearly basis. The ultimate claims cost for any accident year is not known until all claims payments have been made. For property insurance, payout of claims liabilities generally occurs shortly after the occurrence of the loss. For casualty (long-tailed) coverages, the loss may not be paid, or even reported, until well after the loss occurred. The estimated ultimate claims payments at the end of each subsequent accident year demonstrate how the original estimate has been revised over time.

The outstanding claims liabilities assumed and revised estimates resulting from a business acquisition are included in the claims development table from the date of acquisition. Prior years are adjusted to ensure comparability while avoiding the presentation of development in pre-acquisition accident years.

The following table presents the estimates of cumulative incurred claims, including IBNR, with subsequent developments during the periods and together with cumulative payments to date.

Table 11.4 – Prior-year claims development – net

As at December 31, 2018	Total	Accident year										
		2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	Earlier
Undiscounted claims liabilities outstanding at end of accident year	3,344	3,447	3,067	2,759	2,648	2,618	2,435	2,346	2,060	1,810		
Revised estimates												
One year later		3,298	3,104	2,656	2,577	2,557	2,402	2,247	1,945	1,751		
Two years later			3,110	2,691	2,571	2,521	2,322	2,176	1,918	1,750		
Three years later				2,712	2,588	2,512	2,280	2,092	1,882	1,726		
Four years later					2,599	2,508	2,254	2,052	1,858	1,690		
Five years later						2,518	2,231	2,020	1,814	1,667		
Six years later							2,227	1,990	1,790	1,639		
Seven years later								1,968	1,767	1,613		
Eight years later									1,752	1,600		
Nine years later										1,593		
Current estimate	3,344	3,298	3,110	2,712	2,599	2,518	2,227	1,968	1,752	1,593		
Claims paid to date		(1,268)	(1,594)	(1,657)	(1,882)	(2,049)	(1,955)	(1,812)	(1,646)	(1,523)		
Net undiscounted claims liabilities	10,003	3,344	2,030	1,516	1,055	717	469	272	156	106	70	268
Discounting and risk margin	(126)											
Net claims liabilities	9,877											

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.

To eliminate the distortion resulting from changes in foreign currency rates, all amounts denominated in currencies other than the CAD have been translated into CAD using the exchange rate in effect as at December 31, 2018.

11.6 Industry pools

Canadian operations – When certain automobile owners are unable to obtain insurance via the voluntary insurance market in Canada, they are insured via the FA. In addition, entities can choose to cede certain risks to the FA administered 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.

U.S. operations – As a condition of its license to do business in certain states in the U.S., the Company is required to participate in various mandatory shared market mechanisms commonly referred to as residual or involuntary markets. Each state dictates the type of insurance and the level of coverage that must be provided.

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Note 12 – Unearned premiums

12.1 Movements in unearned premiums

Unearned premiums represent the portion of DPW that the Company has not yet earned as it represents insurance coverage to be provided by the Company after the balance sheet date. There was no premium deficiency as at December 31, 2018 and 2017.

Table 12.1 – Movements in unearned premiums

For the years ended	Direct	Ceded	Net
December 31, 2018			
Balance, beginning of year	5,365	93	5,272
Premiums written	10,125	393	9,732
Premiums earned	(10,139)	(374)	(9,765)
Exchange rate differences	61	6	55
Balance, end of year	5,412	118	5,294
December 31, 2017			
Balance, beginning of year	4,573	17	4,556
Business combinations (Note 5)	813	71	742
Premiums written	8,748	221	8,527
Premiums earned	(8,774)	(216)	(8,558)
Exchange rate differences	5	-	5
Balance, end of year	5,365	93	5,272

Note 13 – Insurance risk

The Company principally underwrites automobile, home, as well as commercial P&C contracts to individuals and businesses in Canada. The Company also offers a wide range of insurance products in the U.S. through OneBeacon, a specialty P&C insurance provider.

Most of the insurance risk to which the Company is exposed is of a short-tail nature. The average duration of claims liabilities was approximately 2.4 years for Canadian operations and 2 years for the U.S. operations as at December 31, 2018 (2.4 years for Canada and 2.2 years for the U.S. as at December 31, 2017). Policies generally cover a 12-month period.

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

- underwriting and pricing (Note 13.1);
- fluctuation in the timing, frequency and severity of claims relative to expectations (Note 13.2);
- inadequate reinsurance protection (Note 14.4); and
- large unexpected losses arising from a single event such as a catastrophe (Note 13.3).

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 related to past insured events. 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 LAE 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 claim cost inflation is considered when estimating claims liabilities, thereby mitigating inflation risk. The composition of the Company's insurance risk, as well as the methods employed to mitigate risks, are described hereafter.

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13.1 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, guidance on pricing targets is provided by the Risk Management Department. Pricing targets are established using a return on equity model and an internal risk-based capital model.

a) Concentration by countries and lines of business

Table 13.1 – Concentration by countries and lines of business

As at December 31,	2018		2017	
	DPW	Net claims liabilities	DPW	Net claims liabilities
By countries				
Canada	84%	82%	96%	83%
U.S. ¹	16%	18%	4%	17%
	100%	100%	100%	100%
By lines of business				
Personal auto	36%	47%	44%	48%
Personal property	21%	6%	24%	7%
Commercial lines - Canada	27%	29%	28%	28%
Commercial lines - U.S. ¹	16%	18%	4%	17%
	100%	100%	100%	100%

¹ 2017 includes only Q4 results of our U.S. operations.

Risks associated with commercial lines and personal property insurance contracts may vary in relation to the geographical area of the risk insured by the Company. For automobile insurance, legislation is in place at a provincial level and this creates differences in the benefits provided among the provinces.

The Company's exposure to concentration 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. Diversification also reduces the uncertainty associated with the unfavourable development of claims liabilities for both our Canadian and U.S. operations.

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. Its mandate is to identify, measure and monitor risks, as well as avoid risks that are outside of the Company's risk tolerance level. Further, 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 to lower its risk.

13.2 Risk related to the timing, 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 could 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, 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.

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13.3 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, hail or wind storms, and acts of terrorism. Catastrophes can have a significant impact on the underwriting income of an insurer. Changing climate conditions may add to the unpredictability and frequency of natural disasters and create additional uncertainty as to future trends and exposures.

The Company manages 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). Ceded reinsurance complies with regulatory guidelines. Retention limits for the excess-of-loss reinsurance vary by product line. *See Note 14.1 – Company’s reinsurance net retention and coverage limits by nature of risk.*

13.4 Exposure 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 (severity);
- average number of claims by accident year (frequency);
- trends in claim severity and frequency;
- payment patterns;
- other factors such as inflation, expected or in-force government pricing and coverage reforms, and level of insurance fraud;
- discount rate; and
- risk margin (*see Note 11.3 for more details*).

See Note 11.4 for the sensitivity analysis of claims liabilities to certain key assumptions.

Most or all 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 insurance contracts that the Company underwrites. There may also be significant lags between the occurrence of the insured event and the time it is 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. Reserving policies are overseen by the Company’s Reserve Review Committee.

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Note 14 – Reinsurance

14.1 Company's reinsurance net retention and coverage limits by nature of risk

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

Table 14.1 – Company's reinsurance net retention and coverage limits by nature of risk

As at December 31	2018	2017
Single risk events		
Retentions in Canada:		
on property policies	7.5	7.5
on liability policies	5 - 10	3 - 10
Retentions in the U.S. (in USD):		
on property and liability policies	3	3
Multi-risk events and catastrophes		
Retention	100	100
Coverage limits	3,800	3,600

For certain special classes of business or types of risks, the retention for single risk events may be lower through specific treaties or the use of facultative reinsurance. For multi-risk events and catastrophes, the Company retains participations averaging 5.6% as at December 31, 2018 (5.1% as at December 31, 2017) on reinsurance layers between the retention and coverage limit. The coverage limit prudently exceeds the Company's risk assessment of an earthquake in Western Canada at a 1-in-500-year return period.

Since January 1, 2018, the Company's U.S. operations are covered by the multi-risk events and catastrophes reinsurance program. Until April 30, 2018, the losses resulting from any single catastrophe above US\$20 million and up to US\$130 million were being reinsured externally.

In connection with the acquisition of OneBeacon, the Company entered into a reinsurance contract pursuant to which a major reinsurer will assume 80% of negative reserve development with respect to OneBeacon's claims liabilities for accident years 2016 and prior. The maximum amount recoverable under the reinsurance agreement is US\$200 million and is subject to some exclusions and limitations.

14.2 Components of reinsurance assets

Reinsurance assets include the reinsurers' share of claims liabilities and unearned premiums.

Table 14.2 – Components of reinsurance assets

As at December 31,	2018	2017
Reinsurers' share of claims liabilities (<i>Note 11.1</i>)	746	729
Reinsurers' share of unearned premiums (<i>Note 12.1</i>)	118	93
	864	822

14.3 Net recovery (expense) from reinsurance

Table 14.3 – Net recovery (expense) from reinsurance

For the years ended December 31,	2018	2017
Ceded earned premiums (<i>Note 12.1</i>)	(374)	(216)
Ceded claims incurred (<i>Note 11.1</i>)	217	100
Commissions earned on ceded reinsurance	42	25
	(115)	(91)

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14.4 Risk management and counterparty credit risk

The Company relies on reinsurance to manage underwriting risk. Under reinsurance programs, management considers that 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 risks and it is reasonably possible that the reinsurer may realize a significant loss from the reinsurance.

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. There is no certainty that its reinsurers will pay all reinsurance claims on a timely basis or at all. As a result, the Company bears credit risk with respect to its reinsurers on potential future recoverables and collectability of balances due from reinsurers is important to the Company's financial strength.

The Company is selective with its reinsurers, placing reinsurance with only those reinsurers having a strong financial condition. 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 monitors the financial strength of its reinsurers on a regular basis. Uncollectible amounts historically have not been significant.

Management concluded that the Company was not exposed to significant loss from reinsurers for potentially uncollectible reinsurance as at December 31, 2018 and 2017.

The Company also has minimum rating requirements for its reinsurers. Substantially all reinsurers are required to have a minimum credit rating of 'A-' at inception of the contract. The Company also requires that its contracts include a special termination and security review clause allowing the Company to replace a reinsurer during the contract period should the reinsurer's credit rating fall below the level acceptable to the Company or for other reasons that might jeopardize the Company's ability to continue doing business with such reinsurer as intended at the time of entering into the reinsurance arrangement.

Canadian operations

The Company has collateral in place to support amounts receivable and recoverable from unregistered reinsurers. The Company is the assigned beneficiary of collateral consisting of cash, security agreements and letters of credit totalling \$95 million as at December 31, 2018 (\$114 million as at December 31, 2017) as guarantees from unregistered reinsurers. This collateral is held in support of policy liabilities of \$58 million as at December 31, 2018 (\$69 million as at December 31, 2017) and could be used should these reinsurers be unable to meet their obligations.

U.S. operations

The Company has collateral in place to support amounts receivable and recoverable mainly from unauthorized reinsurers. The Company is the assigned beneficiary of collateral consisting of cash, security agreements and letters of credit totalling \$154 million as at December 31, 2018 (\$96 million as at December 31, 2017) as guarantees from unauthorized reinsurers. This collateral is held in support of policy liabilities of \$136 million as at December 31, 2018 (\$87 million as at December 31, 2017) and could be used should these reinsurers be unable to meet their obligations.

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Note 15 – Goodwill and intangible assets

15.1 Summary of goodwill and intangible assets

Table 15.1 – Reconciliation of the carrying value of goodwill and intangible assets.

	Intangible assets				Total intangible assets
	Goodwill	Distribution networks and trade names	Customer relationships	Internally developed software	
Cost					
Balance as at January 1, 2018	2,284	1,719	407	517	2,643
Acquisitions and costs capitalized	39	-	22	75	97
Business combinations	4	-	-	-	-
Disposals and write-off	-	-	(1)	(55)	(56)
Exchange rate differences	72	67	-	6	73
Balance as at December 31, 2018	2,399	1,786	428	543	2,757
Accumulated amortization					
Balance as at January 1, 2018	-	(31)	(211)	(240)	(482)
Amortization expense	-	(41)	(34)	(45)	(120)
Disposals and write-off	-	-	1	52	53
Exchange rate differences	-	(3)	-	(5)	(8)
Balance as at December 31, 2018	-	(75)	(244)	(238)	(557)
Net carrying value	2,399	1,711	184	305	2,200
Cost					
Balance as at January 1, 2017	1,403	910	365	495	1,770
Acquisitions and costs capitalized	83	1	31	71	103
Business combinations ¹	795	804	12	18	834
Disposals and write-off	-	-	(1)	(67)	(68)
Exchange rate differences	3	4	-	-	4
Balance as at December 31, 2017	2,284	1,719	407	517	2,643
Accumulated amortization					
Balance as at January 1, 2017	-	(15)	(179)	(274)	(468)
Amortization expense	-	(16)	(32)	(33)	(81)
Disposals and write-off	-	-	-	67	67
Balance as at December 31, 2017	-	(31)	(211)	(240)	(482)
Net carrying value	2,284	1,688	196	277	2,161

¹ Including business combinations of OneBeacon as restated (see Note 5 – Business combinations) and InnovAssur, assurances générales inc.

Intangible assets under development amounted to \$53 million as at December 31, 2018 (\$103 million as at December 31, 2017). These intangible assets are not subject to amortization but are tested for impairment on an annual basis.

Notes to the Consolidated financial statements

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

15.2 Significant accounting judgments, estimates and assumptions

a) Allocation of goodwill and intangible assets with indefinite lives to the group of CGUs

Goodwill and intangible assets with indefinite lives are allocated to CGUs, or groups of CGUs, that are expected to benefit from the business combination in which they arose.

In 2017, following the acquisition of OneBeacon a new group of CGUs has been defined and the goodwill and intangible assets with indefinite useful lives acquired were allocated to it (see Note 5 – Business combinations).

Table 15.2 – Allocation of goodwill and intangible assets with indefinite lives to the groups of CGUs

As at December 31,	Goodwill		Intangible assets	
	2018	2017	2018	2017
Canada	1,499	1,461	820	820
U.S.	900	823	50	46
	2,399	2,284	870	866

b) Impairment testing of goodwill and intangible assets with indefinite lives

The Company determines whether goodwill and intangible assets with indefinite useful lives (not subject to amortization) are impaired at least annually and whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable at the CGU or group of CGUs level.

The annual impairment tests for the groups of CGUs were performed at the following dates:

- Canada – as at June 30, 2018 and 2017; and
- U.S. – as at June 30, 2018 and as at December 31, 2017, following the acquisition of OneBeacon.

The Canada and U.S. CGUs were tested for impairment by comparing their carrying value to their recoverable amount, which has been determined based on a value in use calculation using the following key estimates and assumptions:

- Cash flow projections for the next three years are based on financial budgets approved by the Board of Directors and determined using budgeted margins based on past performance and management expectations for the Canada and U.S. CGUs and their industry.
- Cash flow projections beyond the three-year period are extrapolated using estimated growth rates, based mainly on the Canadian and U.S. inflation, as well as demographic or gross domestic product growth perspectives.
- Pre-tax discount rate is based on the weighted-average cost of capital for comparable companies whose activities are similar to the Canada and U.S. CGUs.

Table 15.3 – Key assumptions used (groups of CGUs)

	Growth rate		Pre-tax discount rate	
	2018	2017	2018	2017
Canada	2.5%	2.5%	9.0%	9.1%
U.S.	3.9%	3.9%	11.6%	10.7%

No impairment loss on goodwill or intangible assets with infinite lives has been recognized for these CGUs for the years ended December 31, 2018 and 2017.

The key assumptions used to determine the recoverable amount of each group of CGUs were tested for sensitivity by applying a reasonably possible change to those assumptions, with all other assumptions held constant. The results of the sensitivity analysis would not have resulted in an impairment of the Canada and U.S. CGUs.

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Notes to the Consolidated financial statements

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

Note 16 – Investments in associates and joint ventures

Table 16.1 – Movement in investments in associates and joint ventures

As at December 31,	2018	2017
Balance, beginning of year	550	543
Acquisitions, net of sales	36	11
Dividends received	(15)	(14)
Share of profit (loss) recorded in:		
net income	25	16
OCI	4	(6)
Balance, end of year	600	550
Of which:		
associates	436	398
joint ventures	164	152

During 2018, there were no events or changes in circumstances that indicated that the carrying values of Company's investments in associates and joint ventures, all of which are investments in private entities, may not be recoverable.

Note 17 – Property and equipment

Table 17.1 – Net carrying value of property and equipment

As at December 31,	2018	2017
Land and buildings	35	37
Furniture and equipment	59	50
Leasehold improvements	61	63
Finance leases	15	14
	170	164

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Notes to the Consolidated financial statements

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

Note 18 – Other assets and other liabilities

18.1 Other assets

Table 18.1 – Components of other assets

As at December 31,	2018	2017
Financial assets related to investments	139	34
Industry pools receivable	104	100
Restricted funds	103	111
Reinsurance receivable	96	60
Other receivables and recoverables	92	112
Accrued investment income	80	76
Investments, at cost	66	54
Prepays	48	43
Premium and sale taxes receivable	41	38
Surplus notes ¹	28	31
Pension plans in a surplus position (<i>Note 27.1</i>)	-	5
Other	44	39
	841	703

¹ Recorded at fair value based on a discounted cash flow model using information as of the measurement date and classified in Level 3 of the fair value hierarchy (*see Note 5 – Business combinations*).

During 2018, there were no events or changes in circumstances that indicated that the carrying values of Investments at cost may not be recoverable.

18.2 Other liabilities

Table 18.2 – Components of other liabilities

As at December 31,	2018	2017
Deposits received in connection with insurance contracts ¹	366	197
Premium and sale taxes payable	251	233
Accrued salaries and related compensation	244	244
Commissions payable	196	199
Pension plans in a deficit position and unfunded plans (<i>Note 27.1</i>)	191	140
Account payables and accrued expenses	107	108
Industry pools payable	101	99
Other post-employment benefits and other post-retirement benefits	51	52
Deposits received from reinsurers	14	25
Other payables and other liabilities	343	322
	1,864	1,619

¹ Unrestricted collateral held by the Company primarily in relation with the surety business.

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Notes to the Consolidated financial statements

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

Note 19 – Debt outstanding

19.1 Summary of debt outstanding

Table 19.1 – Carrying value of debt outstanding

As at December 31,	Maturity date	Initial term (years)	Fixed rate	Coupon (payment)	Principal amount	Carrying value (net of fees)	
						2018	2017
Term notes							
Series 1	Sept. 2019	10	5.41%	Mar. & Sept.	250	250	250
Series 2	Nov. 2039	30	6.40%	May & Nov.	250	248	248
Series 3	July 2061	50	6.20%	Jan. & July	100	99	99
Series 4	Aug. 2021	10	4.70%	Feb. & Aug.	300	299	299
Series 5	June 2042	30	5.16%	June & Dec.	250	249	249
Series 6	Mar. 2026	10	3.77%	Mar. & Sept.	250	249	249
Series 7	June 2027	10	2.85%	June & Dec.	425	422	422
2012 U.S. Senior Notes	Nov. 2022	10	4.60%	May & Nov.	USD275	393	365
Credit facility (Note 19.3)						-	60
						2,209	2,241

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 the Government of Canada Yield at the date of redemption plus a margin or their par value.

Fair value of debt outstanding amounted to \$2,365 million as at December 31, 2018 (December 31, 2017 – \$2,449 million) and was established using valuation data from a benchmark firm. As at December 31, 2018 and 2017, the Company was in compliance with all debts covenants.

19.2 Movement in the Company's debt outstanding

Table 19.2 – Movement in the Company's debt outstanding

For the year ended December 31,	2018	2017
Balance, beginning of year	2,241	1,393
Cash flows from financing activities		
Proceeds from issuance of debt	-	422
Amount drawn (repaid) under a credit facility	(60)	60
Business combinations (Note 5)	-	364
Exchange rate differences	31	2
Other	(3)	-
Balance, end of year	2,209	2,241

19.3 Credit facility

In 2017, the Company increased the amount available under its unsecured revolving term credit facility from \$300 million to \$750 million. This five-year credit facility matures on August 28, 2023 and may be drawn as follows:

Type:	At a rate of:
Prime loans	Prime rate plus a margin
Base rate (Canada) advances	Base rate plus a margin
Bankers' acceptances	Bankers' acceptance rate plus a margin
Libor advances	Libor rate plus a margin

As part of the covenants of the loans under the credit facility, the Company is required to maintain certain financial ratios, which were fully met as at December 31, 2018 and 2017.

Notes to the Consolidated financial statements

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

Note 20 – Common shares and preferred shares

20.1 Authorized

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

20.2 New financing

Series 7 Preferred Shares	<ul style="list-style-type: none"> On May 29, 2018, the Company completed a Class A Series 7 offering of preferred shares (the "Series 7 Preferred Shares") by issuing and selling 10,000,000 Series 7 Preferred Shares, at a price of \$25.00 per share, for aggregate gross proceeds of \$250 million. Share issuance costs of \$7 million (\$5 million after tax), were accounted for as a reduction in preferred shares on the Consolidated financial statements. The holders of the Series 7 Preferred Shares will have the right, at their option, to convert their Series 7 Preferred Shares into Non-cumulative Floating Rate Class A Shares, Series 8 (the "Series 8 Preferred Shares"), subject to certain conditions, on June 30, 2023, and on June 30 every five years thereafter. The holders of Series 8 Preferred Shares will be entitled to receive quarterly floating rate non-cumulative preferential cash dividends, as and when declared by the Board of Directors of the Company, on the last day of March, June, September and December in each year at an annualized rate equal to the 90-day Canadian Treasury Bill rate plus 2.55%.
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20.3 Issued and outstanding

Table 20.1 – Issued and outstanding shares

As at December 31,	2018		2017	
	Number of shares	Amount (in millions)	Number of shares	Amount (in millions)
Common shares	139,188,634	2,816	139,188,634	2,816
Preferred shares - Class A Shares				
Series 1	10,000,000	244	10,000,000	244
Series 3	8,405,004	206	8,405,004	206
Series 4	1,594,996	39	1,594,996	39
Series 5	6,000,000	147	6,000,000	147
Series 6	6,000,000	147	6,000,000	147
Series 7	10,000,000	245	-	-
Total Class A	42,000,000	1,028	32,000,000	783

Issued and outstanding Class A shares rank in priority to common shares with regards to payment of dividends.

Table 20.2 – Reconciliation of number of shares outstanding

As at December 31,	Common shares (in shares)		Preferred shares Class A shares (in shares)	
	2018	2017	2018	2017
Balance, beginning of year	139,188,634	131,050,134	32,000,000	20,000,000
Issued	-	8,210,000	10,000,000	12,000,000
Repurchased for cancellation (Note 20.5)	-	(71,500)	-	-
Balance, end of year	139,188,634	139,188,634	42,000,000	32,000,000

On September 28, 2017, concurrent to the acquisition of OneBeacon, 8,210,000 subscription receipts ("receipts") were converted into 8,210,000 common shares. The Company had completed its offering of the 8,210,000 subscription receipts on May 11, 2017 at \$91.85 per receipt for gross proceeds of \$754 million. Share issuance costs of \$23 million (\$19 million after tax), were accounted for as a reduction in common shares on the Consolidated balance sheets.

On May 24, 2017, the Company completed a Series 5 offering of preferred shares (the "Series 5 Preferred Shares") by issuing and selling 6,000,000 Series 5 Preferred Shares, at a price of \$25.00 per share, for aggregate gross proceeds of \$150 million. Share issuance costs of \$4 million (\$3 million after tax), were accounted for as a reduction in preferred shares on the Consolidated balance sheets.

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Notes to the Consolidated financial statements

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

On August 18, 2017, the Company completed a Series 6 offering of preferred shares (the "Series 6 Preferred Shares") by issuing and selling 6,000,000 Series 6 Preferred Shares, at a price of \$25.00 per share, for aggregate gross proceeds of \$150 million. Share issuance costs of \$4 million (\$3 million after tax), were accounted for as a reduction in preferred shares on the Consolidated balance sheets.

20.4 Dividends declared and paid per share

Table 20.3 – Dividends declared and paid per share (in dollars)

For the years ended December 31,	2018	2017
Common shares	2.80	2.56
Preferred shares		
Series 1	0.85	1.05
Series 3	0.83	0.83
Series 4	0.97	0.81
Series 5	1.30	0.78
Series 6	1.33	0.49
Series 7	0.72	n/a

The holders of record of the Company preferred shares are entitled to receive non-cumulative preferential cash dividends on a quarterly basis, as and when declared by the Board of Directors of the Company.

- **Series 1 Preferred Shares** – The initial fixed-rate period ending on December 31, 2017 was based on an annual rate of 4.20%. The dividend rate that will prevail from and including December 31, 2017 to but excluding December 31, 2022 is 3.396%. Every five years thereafter, the dividend rate will reset at a rate equal to the five-year Government of Canada bond yield plus 1.72%.
- **Series 3 Preferred Shares** – The annual dividend rate for the five-year period from and including September 30, 2016 to but excluding September 30, 2021 is 3.332%.
- **Series 4 Preferred Shares** – The dividend rate for the 3-month floating rate period from and including September 30, 2018 to but excluding December 31, 2018 was 1.05082% (4.169% on an annualized basis). The floating quarterly dividend rate will be reset every quarter.
- **Series 5 Preferred Shares** – The annual dividend rate is 5.20% and is not subject to a rate reset.
- **Series 6 Preferred Shares** – The annual dividend rate is 5.30% and is not subject to a rate reset.
- **Series 7 Preferred Shares** – The annual dividend rate until June 30, 2023 is 4.90%, the dividend rate will be reset at this time and every five years thereafter. The initial dividend paid on September 28, 2018 amounted to \$0.4162 per share.

20.5 Normal course issuer bid (NCIB)

Following the announcement of the acquisition of OneBeacon on May 2, 2017, the Company suspended its NCIB in order to maintain excess capital prior to the closing date of the transaction. The NCIB program expired on February 12, 2018 and was not renewed.

Table 20.4 – Common shares repurchased for cancellation under the NCIB

As at December 31,	2018	2017
Common shares repurchased for cancellation (in shares)	-	71,500
Average price (in dollars)	-	94.05
Total consideration paid	-	7

Notes to the Consolidated financial statements

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

Note 21 – Capital management

21.1 Capital management objectives

The Company's objectives when managing capital consist of:

- maintaining strong regulatory capital levels (see Regulatory capital section below), while ensuring policyholders are well protected; and
- maximizing long-term shareholder value by optimizing capital used to operate and grow the Company.

The Company seeks to maintain adequate capital margin to ensure the probability of breaching the regulatory minimum requirements is very low. Such levels may vary over time depending on the Company's evaluation of risks and their potential impact on capital. The Company also keeps higher levels of capital margin when it foresees growth or actionable opportunities in the near term. Furthermore, the Company may return capital to shareholders through annual dividend increases and, when appropriate, through share buybacks.

Regulatory capital

The amount of capital deployed in any company or country is dependent upon local regulatory requirements, as well as the Company's internal assessment of capital requirements in the context of its risk profiles, requirements and strategic plans. The Company's practice is to maintain the capitalization of its regulated operating subsidiaries at a level that will exceed the relevant minimum regulatory capital requirements in the jurisdictions in which they operate (referred to as regulator supervisory minimum levels). Regulatory capital guidelines change from time to time and may impact the Company's capital levels. The Company carefully monitors all changes, actual or proposed.

Canada	The Company's federally chartered Canadian P&C insurance subsidiaries are subject to the regulatory capital requirements defined by OSFI and the Insurance Companies Act, while its Québec provincially chartered subsidiaries are subject to the requirements of the AMF and the <i>Act Respecting Insurance</i> . Federal and Québec regulated P&C insurers are required, at a minimum, to maintain a MCT ratio of 100%. OSFI and the AMF have also established a regulator supervisory target capital ratio of 150%, which provides a cushion above the minimum requirement.
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U.S.	The Company's U.S. insurance operations are subject to regulation and supervision in each of the states where they are domiciled and licensed to conduct business. State insurance departments have established the insurer solvency laws and regulatory infrastructure to maintain accredited status with the National Association of Insurance Commissioners ("NAIC"). A key solvency-driven NAIC accreditation requirement is a state's adoption of RBC requirements. Dividends from our major U.S. insurance subsidiary are subject to the New York State Department of Financial Services' prior approval for a two-year period ending September 30, 2019.
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21.2 Capital position

As at December 31, 2018 and 2017, all the Company's regulated P&C insurance subsidiaries were well capitalized on an individual basis with capital levels well in excess of regulator supervisory minimum levels, as well as CALs.

Table 21.1 – Estimated aggregate capital position

As at December 31,	2018			2017		
	Canada (MCT)	U.S. (RBC)	IFC Capital margin	Canada (MCT)	U.S. (RBC)	IFC Capital margin
Regulatory capital ratios	201%	377%	-	205%	459%	-
Industry-wide supervisory minimum levels	150%	150%	-	150%	150%	-
CALs	170%	200%	-	170%	200%	-
Capital above CALs (capital margin)	530	396	926	618	438	1,056
Other regulated / unregulated entities ¹	-	-	407	-	-	79
Total capital margin			1,333			1,135

¹ Other regulated entities include Split Rock Insurance, Ltd. (Bermuda) and IB Reinsurance Inc. (Barbados).

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Notes to the Consolidated financial statements

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

- **CALs** represent the thresholds below which regulator notification is required together with a company action plan to restore capital levels.
- **U.S. capital levels** comprise the RBC levels of OneBeacon's U.S. regulated entities consolidated in Atlantic Specialty Insurance Company.
- **IFC's total capital margin** represents the aggregate of capital in excess of CALs in regulated entities, as well as unrestricted cash and invested assets in unregulated entities.

Annually, the Company performs Capital Adequacy Testing 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 2018 results indicated that the Company's capital position is strong. In addition, the target, actual and forecasted capital position of the Company is subject to ongoing monitoring by management using stress and scenario analysis to ensure its adequacy.

Note 22 – Net investment income

Table 22.1 – Net investment income

For the years ended December 31,	2018	2017
Interest income from:		
debt securities		
designated or classified as FVTPL	190	161
classified as AFS	134	90
loans and cash and cash equivalents	27	24
Interest income	351	275
Dividend income (expense) from:		
common shares, net		
designated or classified as FVTPL	63	62
classified as AFS	94	78
preferred shares classified as AFS	60	61
equities sold short positions	(4)	(8)
investments, at cost	-	1
Dividend income	213	194
Expenses	(35)	(37)
	529	432

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Notes to the Consolidated financial statements

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

Note 23 – Net gains (losses)

23.1 Net gains (losses)

Table 23.1 – Net gains (losses)

Portfolios	2018			2017		
	Fixed Income	Equity	Total	Fixed Income	Equity	Total
Net gains (losses) from:						
financial instruments:						
designated as FVTPL	(82)	(179)	(261)	(127)	12	(115)
classified as FVTPL	(3)	4	1	-	9	9
classified as AFS	(20)	127	107	2	167	169
	(105)	(48)	(153)	(125)	188	63
derivatives ¹ :						
swap agreements	-	155	155	-	(47)	(47)
forwards and futures	(5)	22	17	5	(19)	(14)
other	-	(2)	(2)	-	1	1
	(5)	175	170	5	(65)	(60)
Embedded derivatives	-	25	25	-	(50)	(50)
Net foreign currency gains (losses)	(1)	-	(1)	(2)	33	31
Impairment losses on common shares	-	(47)	(47)	-	(20)	(20)
	(111)	105	(6)	(122)	86	(36)
Currency derivative gain related to book value hedge of OneBeacon			-			65
Other gains (losses) ²			19			40
			13			69

¹ Excluding foreign currency contracts, which are reported in the line Net foreign currency gains (losses).

² Including net gains (losses) on investments in associates and joint ventures.

23.2 Significant accounting judgments, estimates and assumptions

The Company determines, at each balance sheet date, whether there is objective evidence that financial assets, other than those classified or designated as 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. See Table 2.4 - Objective evidence of impairment for equity impairment model.

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

Note 24 – Income taxes

24.1 Income tax expense recorded in Net income

Table 24.1 – Components of income tax expense recorded in Net income

For the years ended December 31,	2018	2017
Current income tax expense		
Current year	168	216
Adjustments to prior years	(2)	4
Deferred income tax expense (benefit)		
Change related to temporary differences	2	(40)
Adjustments related to the U.S. Corporate Tax reform (see below)	9	(27)
Adjustments to prior years	2	(3)
	179	150

On December 22, 2017, the U.S. Tax Cuts and Jobs Act (“U.S. Corporate Tax reform”), which reduces the U.S. corporate tax rate from 35% to 21% effective January 1, 2018, was enacted. This change resulted in the initial recognition of a deferred tax benefit of \$27 million in 2017. In 2018, the deferred tax expense of \$9 million related to the finalization of the OneBeacon purchase price equation (see Note 5 – Business combinations for details).

24.2 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 following table presents the reconciliation of the effective income tax rate to the income tax expense calculated at statutory tax rates.

Table 24.2 – Effective income tax rate reconciliation

For the years ended December 31,	2018	2017
Income tax expense calculated at statutory tax rate	26.9%	26.9%
Increase (decrease) in income tax rates resulting from:		
non-taxable investment income	(4.7)%	(3.8)%
foreign income taxed at different rates	(1.7)%	(0.7)%
adjustments related to the U.S. Corporate Tax reform ¹	1.1%	(2.9)%
non-taxable income	(1.0)%	(0.7)%
non-deductible losses (non-taxable income) from subsidiaries	(0.8)%	(0.5)%
non-deductible losses (non-taxable gains)	(0.3)%	(3.5)%
non-deductible expenses	0.3%	1.0%
other	0.4%	0.1%
Effective income tax rate	20.2%	15.9%

¹ See Note 24.1 above for details.

24.3 Significant accounting judgments, estimates and assumptions

Management exercises judgment in estimating the provision for income taxes. The Company is subject to income tax law in 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.

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

24.4 Components of deferred tax assets and liabilities

Table 24.3 – Components of deferred tax assets and liabilities

As at December 31,	Consolidated balance sheets Asset (liability)		Consolidated statements of comprehensive income Expense (benefit)	
	2018	2017	2018	2017
Net claims liabilities	96	100	4	(92)
Difference between market value and book value of investments	32	15	(17)	-
Deferred expenses for tax purposes	55	58	3	(5)
Losses available for carry forward	155	140	(15)	(30)
DB plans	50	36	(14)	29
Other	6	13	7	11
Deferred tax assets	394	362	(32)	(87)
Intangible assets	(439)	(437)	2	119
Deferred income for tax purposes	-	-	-	140
Deferred gains and losses on specified debt obligations	(9)	(11)	(2)	2
Property and equipment	(44)	(36)	8	(11)
Difference between market value and book value of investments	-	-	-	5
Deferred tax liabilities	(492)	(484)	8	255
Net deferred tax asset (liability) / expense (benefit)	(98)	(122)	(24)	168

The Company believes that it is probable that it will generate sufficient taxable income in the future to realize the above deferred tax assets.

The Company recognizes a deferred tax liability on all temporary differences associated with investments in subsidiaries and associates unless it can control the timing of the reversal of these differences and it is probable that these differences will not reverse in the foreseeable future. As at December 31, 2018 and 2017, no deferred tax liability has been recognized on the temporary differences associated with investments in subsidiaries and associates.

24.5 Movement in the net deferred tax asset (liability)

Table 24.4 – Movement in the net deferred tax asset (liability)

As at December 31,	2018	2017
Balance, beginning of year	(122)	(262)
Income tax benefit (expense):		
recorded in net income	(13)	70
recorded in OCI	37	98
recorded in equity	5	9
Business combinations (Note 5)	(4)	(20)
Exchange rate differences and other	(1)	(17)
Balance, end of year	(98)	(122)
Reported in:		
deferred tax assets	141	124
deferred tax liabilities	(239)	(246)

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

24.6 Unused tax losses and credits

The following table presents a summary of unused tax losses and credits, as well as the amount for which a deferred tax asset was recognized on the Consolidated Balance sheets as at December 31, 2018 and 2017.

Table 24.5 – Unused tax losses and credits

As at December 31,	2018			2017		
	Total	Recognized	Expiry date	Total	Recognized	Expiry date
Unused net operating losses:						
U.S subsidiaries	426	426	2031 - 2037	434	434	2031 - 2035
Canada	117	111	2037 - 2038	60	57	2037
Unused tax credits:						
U.S subsidiaries	33	33	2030 - 2038	27	27	2030 - 2037
Unused allowable capital losses:						
Canada	93	-	No expiry date	81	-	No expiry date

Unused tax credits can be used to offset U.S. tax payable in the future. Unused allowable capital losses can be used to reduce future taxable capital gains in Canada.

Note 25 – Earnings per share

EPS was calculated by dividing the Net income attributable to common shareholders of the Company by the weighted-average number of common shares outstanding during the year. Dilution is not applicable and, therefore, diluted EPS is the same as basic EPS.

Table 25.1 – Earnings per share

For the years ended December 31,	2018	2017
Net income attributable to shareholders	707	792
Less: dividends declared on preferred shares, net of tax	40	27
Net income attributable to common shareholders	667	765
Weighted-average number of common shares outstanding (in millions)	139.2	133.1
EPS – basic and diluted (in dollars)	4.79	5.75

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

Note 26 – Share-based payments

26.1 Long-term incentive plan

a) Outstanding LTIP units and fair value at grant date

Table 26.1 – Outstanding units and weighted-average fair value at grant date by performance cycle

As at December 31, Performance cycles	2018			2017		
	Number of units	Weighted-average fair value at grant date (in \$)	Amount (in millions of \$)	Number of units	Weighted-average fair value at grant date (in \$)	Amount (in millions of \$)
2015 - 2017	-	-	-	227,572	77.89	19
2016 - 2018	248,005	90.36	22	216,886	90.36	20
2017 - 2019	246,137	93.30	23	210,592	93.30	20
2017 - 2022	119,733	103.88	12	119,733	103.88	12
2018 - 2020	473,736	105.14	50	-	-	-
	1,087,611	99.01	107	774,783	92.06	71

b) Movements in LTIP units

Table 26.2 – Movements in LTIP share units

For the years ended December 31,	2018 (in units)	2017 (in units)
Outstanding, beginning of year	774,783	702,246
Awarded	434,583	308,252
Net change in estimate of units outstanding	132,079	20,203
Units settled	(253,834)	(255,918)
Outstanding, end of year	1,087,611	774,783

c) LTIP expense recognized in Net income

The LTIP is accounted for as an equity-settled plan, except for the participants that are eligible to receive cash in lieu of shares of the Company (accounted for as a cash-settled plan).

Table 26.3 – LTIP expense recognized in Net income

For the years ended December 31,	2018	2017
Cash-settled plans	4	6
Equity-settled plans	42	14
	46	20

26.2 Employee share purchase plan

a) Movements in restricted common shares

Table 26.4 – Movements in restricted common shares

For the years ended December 31,	2018 (in units)	2017 (in units)
Outstanding, beginning of year	132,491	145,368
Accrued	133,871	134,865
Awarded and vested	(129,416)	(142,327)
Forfeited	(5,265)	(5,415)
Outstanding, end of year	131,681	132,491

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

b) ESPP expense recognized in Net income

The ESPP is accounted for as an equity-settled plan. For the years ended December 31, 2018, the ESPP expense was \$13 million (December 31, 2017 – \$14 million).

26.3 Deferred share unit

The DSU is accounted for as a cash-settled plan. For the years ended December 31, 2018, the expense was \$1 million (December 31, 2017 - \$2 million). The DSU provision amounted to \$10 million as at December 31, 2018 and 2017.

26.4 Common shares repurchased for share-based payments

The settlement in shares with regards to the Company's LTIP and ESPP plans is presented below.

Table 26.5 – Table Settlement in shares (LTIP and ESPP plans)

For the years ended December 31,	2018	2017
Value of common shares repurchased for share-based payments	36	37
Less: cumulative cost of the units for the Company	32	29
Excess of market price over the cumulative cost for the Company	4	8
Amount recognized in Retained earnings, net of taxes	3	6

The cumulative cost of the units that vested during the year and were settled through the plan administrator purchasing common shares on the market and remitting them to the participants was removed from Contributed surplus.

The difference between the market price of the shares and the cumulative cost for the Company of these vested units, net of income taxes, was recorded in Retained earnings.

Notes to the Consolidated financial statements

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

Note 27 – Employee future benefits

The Company has funded and unfunded DB pension plans in Canada that provide benefits to members in the form of a guaranteed pension payable for life based on final average earnings and contingent upon certain age and service requirements. In Canada, the Company provides active employees a choice between a DB and a defined contribution pension plan. In the U.S., the Company offers a 401(k) plan to its employees.

Subject to applicable pension legislation, the Canadian 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 in Canada require special payments from the Company to amortize any shortfall of registered plans' assets relative to the corresponding funding targets. Security in the form of letters of credit is permitted in lieu of those special payments, up to a limit of 15% of the actuarial liability used to determine the funding target.

Subject to applicable legal requirements in Canada, any balance of assets remaining after providing for the accrued benefits of the plan members may be returned to the Company upon termination of the plan. Pension legislation in certain provinces 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.

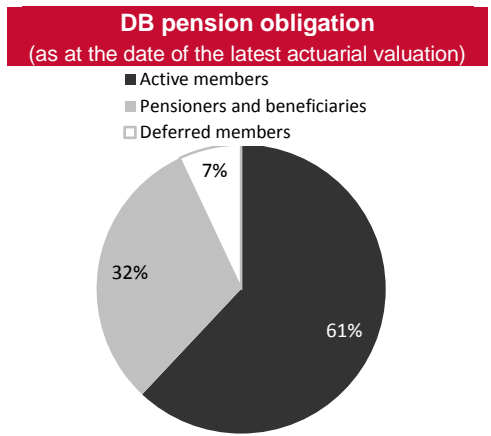
The Company also offers employer-paid post-retirement life insurance and health care benefit plans to a limited number of active employees and retirees as well as post-employment benefit plans that provide health and dental coverage to employees on disability for the duration of their leaves. These post-retirement and post-employment benefit plans are unfunded.

27.1 Funded status

The DB obligation, net of the fair value of plan assets, is recognized on the Consolidated balance sheets as an asset, when the plan is in a surplus position, or as a liability, when the plan is in a deficit position. This classification is determined on a plan-by-plan basis.

Table 27.1 – Movement in the DB obligation

As at December 31,	Pension plans	
	2018	2017
DB obligation	(2,271)	(2,263)
Fair value of plan assets	2,080	2,128
Net DB asset (liability)	(191)	(135)
Reported in:		
other assets – plans in a surplus position	-	5
other liabilities – plans in a deficit position and unfunded plans	(191)	(140)
	(191)	(135)
Funded status – funded plans	96%	99%



The measurement date for the DB pension plans is December 31. The latest actuarial valuations for the DB pension plans were performed as at December 31, 2017. The Company's liquidity risk with regards to pension plans is not significant, as inflows from contributions receivable generally outweigh 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.

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

27.2 DB obligation

The DB obligation is based on the current value of expected benefit payment cash flows to plan members over their expected lifetime.

Table 27.2 – Movement in the DB obligation

As at December 31,	Pension plans	
	2018	2017
Balance, beginning of year	2,263	2,014
Current service cost	76	65
Past service cost	-	1
Interest expense on DB obligation	77	72
Actuarial losses (gains) due to changes in:		
financial assumptions	(170)	103
plan experience	55	52
life expectancy	23	-
Employee contributions	27	27
Benefit payments	(80)	(71)
Balance, end of year	2,271	2,263

27.3 Fair value of plan assets

The Company makes contributions to the DB 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 following the advice of an actuary. Under the provisions of the pension plans, members may annually select between three different DB levels and are required to make contributions to their respective plans based on the benefit level selected. The Company must fund the excess of the required funding over the members' contributions.

a) Movement in the fair value of plan assets

Table 27.3 – Movement in the fair value of plan assets

As at December 31,	Pension plans	
	2018	2017
Balance, beginning of year	2,128	1,981
Employer contributions	55	60
Employee contributions	27	27
Actual return on plan assets		
Interest income on plan assets recognized in Net income	71	69
Actuarial gains (losses) recognized in OCI	(117)	66
Benefit payments	(80)	(71)
Other	(4)	(4)
Balance, end of year	2,080	2,128

b) Composition of pension plan assets

Table 27.4 – Composition of pension plan assets

As at December 31,	2018		2017	
	Fair value	% of total	Fair value	% of total
Cash and short-term notes	62	3%	43	2%
Fixed income				
Investment grade				
Government	823	40%	867	41%
Corporate	460	22%	438	21%
Asset-backed	2	-	3	-
Debt securities	1,285	62%	1,308	62%
Common shares	710	34%	749	35%
Derivative financial instruments	23	1%	28	1%
	2,080	100%	2,128	100%

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Notes to the Consolidated financial statements

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

Plan assets are essentially all quoted in an active market.

Based on the latest projections of the financial position of all its plans, total cash contributions by the Company are expected to be approximately \$51 million in 2019 compared to actual contributions of \$55 million in 2018. The contributions will vary depending on the number of active members accruing benefits and their level of pensionable earnings, the results of any new actuarial valuations, the impact of any funding rule changes, the 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.

27.4 Employee future benefit expense recognized in Net income

Table 27.5 – Employee future benefit expense recognized in Net income

For the years ended December 31,	Pension plans	
	2018	2017
Current service cost	76	65
Past service cost	-	1
Net interest expense		
Interest expense on DB obligation	77	72
Interest income on plan assets	(71)	(69)
Other	4	4
	86	73

27.5 Actuarial gains (losses) recognized in OCI

Table 27.6 – Actuarial gains (losses) recognized in OCI

For the years ended December 31,	Pension plans	
	2018	2017
Remeasurements related to:		
change in discount rate used to determine the benefit obligation	131	(110)
actual return on plan assets	(117)	66
changes in life expectancy (<i>Note 27.6</i>)	(23)	-
change in other financial assumptions	39	7
changes in plan experience	(55)	(52)
	(25)	(89)

27.6 Significant accounting judgments, estimates and assumptions

The cost of the DB plans and the DB obligation are calculated by the Company's independent actuaries using assumptions determined by management. The actuarial valuation involves making assumptions about discount rates, future salary increases, future inflation, the employees' age upon termination and retirement, mortality rates, future pension increases, disability incidence and health and dental care cost trends. If actual experience differs from the assumptions used, the expected obligation could increase or decrease in future years.

Due to the complexity of the valuation and its long-term nature, the DB obligation is highly sensitive to changes in the assumptions. Assumptions are reviewed at each reporting date.

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

a) Assumptions used and sensitivity analysis

Table 27.7 – Key weighted-average assumptions used in measuring the Company's pension plans

	Obligation		Expense	
	As at December 31,		For the years ended December 31,	
	2018	2017	2018	2017
Discount rate:				
determination of DB obligation	3.86%	3.53%	n/a	n/a
current service cost	n/a	n/a	3.58%	3.90%
interest expense on the DB obligation	n/a	n/a	3.30%	3.45%
Rate of increase in future compensation:				
next 3 years	2.75%	2.75%	2.75%	2.75%
beyond 3 years	2.39%	2.68%	2.68%	2.75%
Rate of inflation	1.64%	1.93%	1.93%	2.00%
Life expectancy for pensioners at the age of 65:				
male	22.2	21.7	21.7	21.6
female	24.6	24.1	24.1	24.1

The rate of compensation increase was based on financial plans approved by management for the next 3 years, and on inflation and long-term expectations of wage salary increase beyond 3 years.

Assumptions regarding life expectancy for pensioners are based on the standard Canadian private sector mortality table published in 2014 by the Canadian Institute of Actuaries ("CPM2014Priv table"). The assumptions as at December 31, 2018 also reflected the Company's recent mortality experience study conducted in 2018.

Table 27.8 – Sensitivity of the DB pension obligation to key assumptions

As at December 31,	Change	2018		2017	
		increase	decrease	increase	decrease
Discount rates	1%	(360)	482	(369)	503
Rate of increase in future compensation	1%	97	(85)	108	(107)
Rate of inflation	1%	74	(67)	76	(69)
Life expectancy	One year	53	(53)	60	(60)

The effect on the DB pension 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 has been approximated by measuring the impact of members being one year younger than their actual age on the valuation date.

27.7 Risk management and investment strategy

Employee DB 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 DB 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 actual 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 DB liabilities.

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Notes to the Consolidated financial statements

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

The DB 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 expectancy. It is based on estimates of market yields on highly rated corporate bonds.

The Management Pension Committee is responsible for the oversight of the pension plans, including the review of the funding policy and investment performance. The Statement of Investment Policies and Procedures of the pension plan (the "SIP&P") formulates investments 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 debt and equity market risks. Any deviation from the SIP&P 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 SIP&P and the review of the pension plans' investment performance.

The pension plans investment portfolio is managed by Intact Investment Management Inc., a subsidiary of the Company, in accordance with the SIP&P that focuses on asset diversification and asset-liability matching. The Company regularly monitors compliance with the SIP&P.

Asset diversification

The goal of asset diversification is to limit the potential of sustaining significant capital losses.

Debt 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 debt and equity securities, within credit concentration limit. The pension plans' risk management strategy is to invest in debt 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 SIP&P generally requires minimum credit ratings of 'BBB' for investments in debt securities and limits its concentration in any one investee or related group of investees to 5% of the cost of its total assets for debt 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 debt and equity securities, as well as off-balance sheet exposure.

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.

The Company also establishes asset allocation limits to ensure sufficient diversification (*see Note 10.4 – Credit risk*).

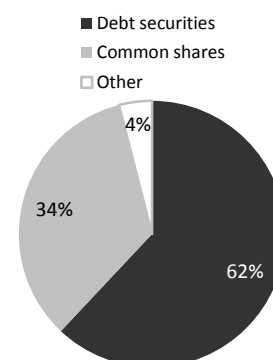
Asset-liability matching

One objective established in the SIP&P is to maintain an appropriate balance between the interest rate exposure of the plans' invested assets and the duration of its contractual liabilities. The Company calculates a hedge ratio as the interest rate duration of the pension asset portfolio divided by the duration of the funded registered pension plans' obligation. A lower hedge ratio increases the Company's exposure to changes in interest rates. The hedge ratio was 67% as at December 31, 2018 (December 31, 2017 – 68%).

A portion of the pension plan liabilities contain an indexation provision linked to the consumer price index (CPI). The Company invests in inflation sensitive assets to partially mitigate the risk of an unanticipated increase in inflation. As at December 31, 2018 and 2017, 10% of pension plan assets were invested in Canada Government Real Return Bonds.

Pension plan asset mix

(as at December 31, 2018)



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Notes to the Consolidated financial statements

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

Note 28 – Segment information

28.1 Reportable segments

The Company has two reportable segments, in line with its management structure and internal financial reporting which is based on country, and the nature of its activities.

Canada

- Underwriting of automobile, home and business insurance contracts to individuals and businesses in Canada distributed through a wide network of brokers and directly to consumers.
- Distribution operations, including the results from the Company's wholly-owned subsidiary (BrokerLink) and broker affiliates.

U.S.

- Underwriting of specialty contracts mainly to small and midsize businesses in the United States. The Company distributes insurance through independent agencies, brokers, wholesalers and managing general agencies.

Corporate and Other ("Corporate") consists of centralized investing, treasury and capital management activities, as well as other corporate activities.

28.2 Segment operating performance

Table 28.1 – Segment operating performance¹

For the years ended December 31,	2018				2017			
	Canada	U.S.	Corporate	Total	Canada	U.S.	Corporate	Total
Operating income								
NEP	8,332	1,380	3	9,715	8,204	326	-	8,530
Investment income	-	-	564	564	-	-	469	469
Other	136	-	11	147	124	-	34	158
Segment operating revenues	8,468	1,380	578	10,426	8,328	326	503	9,157
Net claims incurred (before MYA)	(5,538)	(804)	-	(6,342)	(5,381)	(198)	-	(5,579)
Underwriting expenses ²	(2,394)	(505)	-	(2,899)	(2,345)	(120)	-	(2,465)
Investment expenses	-	-	(35)	(35)	-	-	(37)	(37)
Share of profit from invest. in associates & JV	53	-	-	53	46	-	-	46
Finance costs	-	-	(103)	(103)	-	-	(82)	(82)
Other	(43)	-	(29)	(72)	(38)	-	(29)	(67)
PTOI³	546	71	411	1,028	610	8	355	973
Comprised of:								
underwriting income ⁴	400	71	3	474	478	8	-	486
net investment income	-	-	529	529	-	-	432	432
net distribution income	146	-	-	146	132	-	-	132
finance costs	-	-	(103)	(103)	-	-	(82)	(82)
other income (expense)	-	-	(18)	(18)	-	-	5	5
Investments	-	-	16,897	16,897	-	-	16,774	16,774
Net claims liabilities (Table 11.1)	8,151	1,726	-	9,877	8,098	1,648	-	9,746

¹ See Table 28.2 for the reconciliation to the Consolidated statements of income.

² Other underwriting revenues are netted against underwriting expenses when assessing segment performance.

³ See Section 27 – Non IFRS financial measures of the Company's MD&A for the definition of related operating measures.

⁴ 2017 includes only Q4 results of the Company's U.S. operations.

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Notes to the Consolidated financial statements

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

All segment revenues presented in *Table 28.1 – Segment operating performance* are generated from external customers.

Management measures the profitability of the Company's segments based on pre-tax operating income ("PTOI"). PTOI excludes elements that are not representative of the Company's operating performance because they relate to special items, bear significant volatility from one period to another, or because they are not part of the Company's normal activities.

The reconciliation of the segment information to the amounts reported in the Consolidated statements of income is presented in the table below. Other underwriting revenues are netted against underwriting expenses when assessing segment performance for MD&A presentation and, as such, are not included in segment operating revenues. Revenues and expenses not allocated to segments mainly represent non-operating items excluded from PTOI.

Table 28.2 – Reconciliation of segment information to amounts reported in the Consolidated statements of income

For the years ended December 31,	2018	2017
Segment operating revenues (Table 28.1)	10,426	9,157
Add: other underwriting revenues	110	108
Add: NEP exited lines	50	28
Revenues, as reported	10,586	9,293
Segment PTOI (Table 28.1)	1,028	973
Non-operating items:		
net gains (losses)	13	69
positive (negative) impact of MYA on underwriting	97	92
amortization of intangible assets recognized in business combinations	(89)	(62)
integration and restructuring costs	(63)	(57)
difference between expected return and discount rate on pension assets	(49)	(45)
underwriting results from OneBeacon exited lines	(29)	(10)
other non-operating costs	(22)	(18)
Pre-tax income, as reported	886	942

28.3 Information by geographic areas

Table 28.3 – Geographic areas

As at December 31,	Revenues		Total assets	
	2018	2017	2018	2017
Canada	9,060	8,923	22,023	21,814
U.S. ¹	1,526	370	6,438	6,024
	10,586	9,293	28,461	27,838

¹ 2017 includes only Q4 results of the Company's U.S. operations.

Revenues and assets are allocated based on the country where the risks originate. The Company's significant operating subsidiaries by geographic areas of operations are presented below.

Table 28.4 – Significant operating subsidiaries by geographic areas

Operations	Legal entities	
Canada	<ul style="list-style-type: none"> • Belair Insurance Company Inc. • Canada Brokerlink Inc. • Equisure Financial Network Inc. • Intact Insurance Company • IB Reinsurance Inc. 	<ul style="list-style-type: none"> • Jevco Insurance Company • Novex Insurance Company • The Nordic Insurance Company of Canada • Trafalgar Insurance Company of Canada
U.S.	<ul style="list-style-type: none"> • OneBeacon Insurance Group Holdings; Ltd. • Atlantic Specialty Insurance Company 	<ul style="list-style-type: none"> • OneBeacon U.S. Financial Services Inc. • Split Rock Insurance, Ltd.

INTACT FINANCIAL CORPORATION

Notes to the Consolidated financial statements

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

Note 29 – Additional information on the Consolidated statements of cash flows

29.1 Adjustments for non-cash items

Table 29.1 – Adjustments for non-cash items

For the years ended December 31,	2018	2017
Depreciation of property and equipment	38	34
Amortization of intangible assets	120	81
Net premiums on debt securities classified as AFS	20	15
DB pension expense	86	73
Share-based payments expense	59	34
Share of profit from investments in associates and joint ventures	(25)	(16)
Other	(4)	4
	294	225

29.2 Changes in other operating assets and liabilities

Table 29.2 – Changes in other operating assets and liabilities

For the years ended December 31,	2018	2017
Unearned premiums, net	(33)	(30)
Premium receivables, net	19	52
Deferred acquisition costs, net	(13)	(25)
Other operating assets	(13)	(26)
Other operating liabilities	137	(186)
Dividends received from investments in associates and joint ventures	15	14
	112	(201)

Note 30 – 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 pension plans. Transactions with related parties are at normal market prices and mostly comprise commissions for insurance policies and interest and principal payments on loans.

30.1 Transactions with associates and joint ventures

Table 30.1 – Transactions with associates and joint ventures

As at December 31,	2018	2017
Income and expenses reported in:		
net investment income	7	8
underwriting expenses	266	260
Assets and liabilities reported in:		
loans and other receivables	129	202
commissions payable	35	36

30.2 Compensation of key management personnel

Key management personnel comprise all members of the Board of Directors and certain members of the Executive Committee. The compensation of key management personnel comprises salaries, share-based awards, annual incentive plans and pension value. Total compensation amounted to \$28 million for the year ended December 31, 2018 (\$43 million for the year ended December 31, 2017).

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.

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Notes to the Consolidated financial statements

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

30.3 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 \$6 million for the year ended December 31, 2018 (\$7 million for the year ended December 31, 2017). The Company made contributions to pension plans of \$55 million for the year ended December 31, 2018 (\$60 million for the year ended December 31, 2017).

Note 31 – Commitments and contingencies

31.1 Commitments

The Company has entered into commercial operating leases and other commitments, with a remaining life ranging from one to 19 years.

Table 31.1 – Future minimum payments under non-cancellable operating leases and other commitments

As at December 31, 2018

	Operating leases	Other	Total
Less than 1 year	118	96	214
From 1 to 5 years	375	75	450
Over 5 years	512	15	527
	1,005	186	1,191

31.2 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 provisions 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.

Note 32 – Disclosures on rate regulation

32.1 Canada

The Company's Canadian insurance subsidiaries are licensed under insurance legislation in each of the provinces and territories in which they conduct business. Personal and commercial 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:

Table 32.1 – Rate filing categories

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

In Canada, essentially all provinces and territories use a "file and approve" rate setting mechanism except for Quebec, which uses a "use and file" mechanism. Automobile DPW covered by a "file and approve" rate setting mechanism totalled \$3.3 billion, or 74% of the Canadian Company's automobile DPW for the year ended December 31, 2018 (\$3.4 billion, or 75%, for the year ended December 31, 2017).

Notes to the Consolidated financial statements

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

32.2 U.S.

Nearly all states have insurance laws requiring property and casualty insurance companies to file their rates, rules and policy or coverage forms with the state's regulatory authority. In most cases, such rates, rules and forms must be approved prior to use. While pricing laws vary from state to state, their objectives are generally to ensure that rates are not excessive, unfairly discriminatory or used to engage in unfair price competition. The Company's ability to increase rates and the timing of the process are dependent upon the regulatory requirements in each state.

Note 33 – Standards issued but not yet effective

33.1 Financial instruments

IFRS 9 is a three-part standard that will replace IAS 39 and will be effective for annual periods beginning on or after January 1, 2018. However, the Company meets the eligibility criteria of the temporary exemption from IFRS 9 as provided by IFRS 4 and has elected to defer the application of IFRS 9 until the effective date of the new insurance contracts standards IFRS 17, on January 1, 2021 (see *Note 4.1 - Amendments to IFRS 4 – Insurance Contracts for the application of IFRS 9 – Financial Instruments*). The Company is currently evaluating the impact that IFRS 9, in conjunction with IFRS 17, will have on its Consolidated financial statements. Nevertheless, in the interim, the Company is required to present additional disclosures as described in *Note 4.1*.

Classification and measurement

The classification of debt instruments is dependent on the business model and the cash flows characteristics. A debt instrument will be classified in accordance with the table below if its contractual term gives rise on specific dates to cash flows that are solely payments of principal and interest. It would otherwise be classified as FVTPL.

Amortized cost	FVTOCI	FVTPL
Default classification when the objective of the business model is uniquely to receive contractual cash flows of principal and interest.	Default classification when the objective of the business model is equally to receive contractual cash flows of principal and interest and realize cash flows from the sale.	Classification when the debt instrument does not meet the objective of the amortized cost or FVTOCI business models, or election to measure them as FVTPL instead of amortized cost or FVTOCI if doing so eliminates or significantly reduces an accounting mismatch.

Cash and cash equivalents, deposits with financial institutions, and receivables pass the SPPI test and are held at amortized cost, whereby the amortized cost is assumed to approximate fair value due to the short-term nature of the assets.

Equity instruments and derivatives are usually measured at FVTPL. An entity can also elect on initial recognition to present fair value changes on an equity investment that is not held for trading directly and permanently in OCI, thus gains or losses are not recognized in income when the investment is disposed of.

Hedge accounting

The new model more closely aligns hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures (under IAS 39, hedging non-financial components is not permitted). It will enable more entities to:

- apply hedge accounting to reflect their actual risk management activities; and
- 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.

Notes to the Consolidated financial statements

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

Expected credit loss

This new impairment model applies only to financial assets classified as amortized cost and debt securities classified as FVTOCI. Under the expected credit loss model, a loss allowance will be established for all financial assets impaired based on a 12-month expected credit losses or life-time expected credit losses if the credit risk increases significantly.

As an exception from the general requirements, an entity may assume that the criterion for recognising lifetime expected credit losses is not met if the credit risk on the financial instrument is low ("investment grade") at the reporting date.

33.2 Leases

In January 2016, the IASB issued IFRS 16 – *Leases* ("IFRS 16"). IFRS 16 will replace IAS 17 – *Leases* and related interpretations. It requires lessees to recognize most leases on their balance sheets as right-of-use assets (representing the right to use the underlying assets), with the corresponding lease liabilities (representing the obligation to make lease payments). Generally, the recognition pattern for capitalized leases will be similar to today's finance lease accounting, with interest and depreciation expense recognized in Finance costs and Other expenses respectively in the Consolidated statements of income.

IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach. The Company will apply the modified retrospective approach, under which the cumulative effect of adoption will be recognized in opening Retained earnings as at January 1, 2019, with no restatement to the comparative figures.

The adoption of IFRS 16 will lead to the recognition of operating leases, mainly real estate leases. As a result, the Company expects to account for right-of-use assets of \$358 million, lease liabilities of \$441 million, write-off of net liabilities recognized under IAS 17 of \$29 million, and a reduction of shareholders' equity of \$40 million, net of income taxes.

33.3 Insurance contracts

In May 2017, the IASB published IFRS 17 a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure, which replaces IFRS 4 and introduces consistent accounting for all insurance contracts.

IFRS 17 provides a general model for the recognition of insurance contracts, as well as a simplified model (premium allocation approach) for short-duration contracts, which will be applicable to most property and casualty insurance contracts. The standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires a company to recognize profits as it delivers insurance services.

The main features of the simplified new accounting model for property and casualty insurance contracts are as follows:

- the concept of portfolio, which is a group of contracts covering similar risks and managed together as a single pool. As such, contracts will be grouped for allocation of deferred acquisition costs, the calculation of risk adjustment, the determination of onerous contracts and the application of the discount rate;
- insurance liabilities will be discounted at a rate that reflects the characteristics of the liabilities (as opposed to a rate based on asset returns) and the duration of each portfolio. Entities will record the effect of changes in discount rates either in Net income or in OCI, according to their accounting policy choice;
- changes in balance sheet presentation where the deferred acquisition costs, premium receivables, unearned premiums and claims liabilities will be presented together on a single line called insurance liabilities;
- direct premiums written will no longer be presented in profit or loss. The new insurance revenue will reflect services that have been provided during the period (similar to the current earned premiums). Also, insurance results will be presented without the impact of discounting. Amounts relating to financing and changes in discount rates will be shown separately;
- disclosure: extensive disclosures to provide information on the recognized amounts from insurance contracts and the nature and extent of risks arising from these contracts.

Notes to the Consolidated financial statements

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

The standard applies to annual periods beginning on or after January 1, 2021. Earlier application is permitted if IFRS 9 is also applied. In November 2018, the IASB tentatively decided to defer by one year the mandatory effective date of IFRS 17, subject to public consultation to address concerns and implementation challenges raised by stakeholders. Retrospective application is required. However, if full retrospective application for a group of insurance contracts is impracticable, then the entity is required to choose either a modified retrospective approach or a fair value approach. The Company plans to adopt the new standard on the required effective date together with IFRS 9 (see above). The Company started a project to implement IFRS 17 and has been performing a high-level impact assessment. The Company expects that the new standard will result in important changes to accounting policies for insurance contract liabilities, but the impact has not yet been determined.

33.4 Uncertainty over income tax treatments

In June 2017, the IASB issued IFRIC 23 – *Uncertainty over Income Tax Treatments* (“IFRIC 23”). This interpretation specifies that if an entity concludes it is probable that the taxation authority will accept an uncertain tax treatment, it shall determine the tax result consistently with the tax treatment used or planned to be used in its income tax filing. If it is not probable, the entity shall reflect the effect of uncertainty for each uncertain tax treatment by using either of the following methods, depending on which one the entity expects to better predict the resolution of the uncertainty:

- most likely amount: single most likely amount in a range of possible outcomes;
- expected value: sum of the probability-weighted amounts in a range of possible outcomes.

An entity shall apply IFRIC 23 for annual reporting periods beginning on or after January 1, 2019, with earlier application permitted. The Company will not early adopt IFRIC 23 and does not expect a significant impact.

33.5 Plan amendment, curtailment or settlement (amendments to IAS 19 – *Employee Benefits*)

In February 2018, the IASB issued amendments to IAS 19 – *Employee Benefits* (“IAS 19”) to specify how companies determine pension expense when changes to a defined benefit pension plan occur. A company now uses updated assumptions from the remeasurement of the net defined benefit asset (liability) to determine the current service cost and net interest for the period. Previously, it would not have updated its calculation of these costs until year-end.

The amendments are to be applied prospectively, effective for annual periods beginning on or after January 1, 2019, with earlier application permitted. The Company will not early adopt the amendments to IAS 19.

33.6 Definition of a business

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 – *Business Combinations*. The objective of the amendments is to assist entities in determining whether a transaction should be accounted for as a business combination or as an asset. The amendments apply prospectively to acquisitions that occur in annual periods beginning on or after January 1, 2020, with earlier application permitted. The Company is currently assessing the impact of these amendments.

33.7 Definition of material

In October 2018, the IASB issued amendments to IAS 1 – *Presentation of Financial Statements* and IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* to align the definition of “material” across the standards and to clarify certain aspects of the definition. The objective of this amendment is to improve disclosure effectiveness in the financial statements by improving the understanding of the existing requirements rather than to significantly impact an entity’s materiality judgements. The amendments apply prospectively to annual periods beginning on or after January 1, 2020, with earlier application permitted. The Company is currently assessing the impact of these amendments.

33.8 Conceptual framework for financial reporting

In March 2018, the IASB issued a comprehensive set of concepts for financial reporting: the revised Conceptual Framework for Financial Reporting (“Conceptual Framework”), which replaces its previous version. It assists companies in developing accounting policies when no IFRS standard applies to a particular transaction and it helps stakeholders more broadly to better understand the standards.

The revised Conceptual Framework’s effective date is January 1, 2020, with earlier application permitted. The Company does not expect any impact upon its adoption.

This glossary includes IFRS and non-IFRS financial measures, as well as other insurance-related terms used in our financial reports. See our MD&A for the year ended December 31, 2018 for further details.

Actuarial gains (losses)

Effect of changes in actuarial assumptions and experience adjustments (effect of differences between the previous actuarial assumptions and what has occurred).

Adjusted earnings per share (AEPS)¹

Calculated as net income for a specific period less preferred share dividends, adjusted for the after-tax impact on net income of amortization of intangible assets recognized in business combinations, integration costs, acquisition-related currency derivative gains or losses and the impact from the U.S. Corporate Tax reform, divided by the weighted-average number of common shares outstanding during the same period.

Adjusted return on equity (AROE)¹

Calculated as net income for a 12-month period less preferred share dividends, adjusted for the after-tax impact on net income of amortization of intangible assets recognized in business combinations, integration costs, acquisition-related currency derivative gains or losses and the impact from the U.S. Corporate Tax reform, 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.

Affiliated brokers

Brokers in which we hold an equity investment or provide financing.

Average shareholders' equity

Mean of shareholders' equity at the beginning and end of the period, adjusted for significant capital transactions, if appropriate. Shareholders' equity is determined in accordance with IFRS.

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.

Cash flow available for investment activities¹

Includes net cash flows from cash and cash equivalents and the investment portfolio.

CAT loss ratio¹

Current accident year catastrophe losses, including net reinstatement premiums, expressed as a percentage of Net earned premiums (MD&A basis) before reinstatement premiums.

Catastrophe losses

Any one claim or group of claims, equal to or greater than \$7.5 million for P&C Canada (US\$5 million for P&C U.S.) related to a single event.

Change in constant currency¹

The growth or change between two figures, excluding the impact of foreign currency fluctuations, calculated by applying the exchange rate in effect for the current period results to the results of the previous period.

Claims liabilities

Technical accounting provisions comprising: case reserves, claims incurred but not reported by policyholders ("IBNR"), and a risk margin as required by accepted actuarial practice. 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 at the reporting date.

Claims ratio¹

Claims incurred, net of reinsurance (as determined in accordance with IFRS), excluding the market yield adjustment, the difference between expected return and discount rate on pension assets and claims incurred from U.S. Commercial exited lines, during a specific period and expressed as a percentage of Net earned premiums (MD&A basis) for the same period.

Combined ratio¹

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.

Company action levels (CALs)

Thresholds below which regulator notification is required together with a company action plan to restore capital levels.

Debt-to-total capital ratio

Total debt outstanding divided by the sum of total shareholders' equity and total debt outstanding, at the same date.

Direct premiums written (DPW) (IFRS)

The total amount of premiums for new and renewal policies written during a specific period, as determined in accordance with IFRS.

Direct premiums written (DPW) (MD&A basis)¹

DPW (IFRS) normalized for the effect of multi-year policies, excluding industry pools, fronting and U.S. Commercial exited lines. This measure matches direct premiums written to the year in which coverage is provided, whereas under IFRS, the full value of multi-year policies is recognized in the year the policy is written.

Distribution EBITA¹

Operating results excluding interest and taxes from our consolidated brokers (including our wholly owned broker, BrokerLink), as well as our share of operating results excluding interest and taxes from our broker associates for a specific period.

Earnings per share to common shareholders ("EPS")

Net income attributable to common shareholders divided by the weighted-average number of common shares outstanding during the same period.

Expense ratio¹

Underwriting expenses, net of other underwriting revenues, including commissions, premium taxes and general expenses related to underwriting activities for a specific period and expressed as a percentage of Net earned premiums (MD&A basis) for the same period.

Frequency (of claims)

Average number of claims reported in a specific period.

Full-time equivalent number of employees

A unit of measurement equivalent to an employee with a full-time workload. If two employees each have a 50% workload, they would represent one full-time equivalent employee.

Funding ratio

Pension plan's assets expressed as a percentage of funded plans' obligations.

Incurred but not reported ("IBNR") claims reserve

Reserves for estimated claims that have been incurred but not reported by policyholders, including a reserve for future developments on claims which have been reported.

Industry pools

Canadian operations – When certain automobile owners are unable to obtain insurance via the voluntary insurance market in Canada, they are insured via the Facility Association ("FA"). In addition, entities can choose to cede certain risks to the FA administered Risk Sharing Pool ("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.

U.S. operations – As a condition of its license to do business in certain states in the U.S., the Company is required to participate in various mandatory shared market mechanisms commonly referred to as residual or involuntary markets. Each state dictates the type of insurance and the level of coverage that must be provided.

Interest rate hedge ratio

A ratio calculated by the Company as the duration of the pension asset portfolio divided by the duration of the registered pension plans' obligation. A lower hedge ratio increases the Company's exposure to changes in interest rates.

¹ These are non-IFRS financial measures, which do not have any standardized meaning prescribed by IFRS and are unlikely to be comparable to similar measures presented by other companies.

Large loss

A single claim larger than \$0.25 million for P&C Canada (US\$0.25 million for P&C U.S.) but smaller than the catastrophe threshold of \$7.5 million for P&C Canada (US\$5 million for P&C U.S.).

Market-based yield¹

The annualized total pre-tax investment income (before expenses) divided by the mid-month average fair value of net equity and fixed-income securities held during a period (average net investments).

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.

Minimum capital test ("MCT")

Ratio of total capital available to total capital required, as defined by the Office of the Superintendent of Financial Institutions (OSFI) and Autorité des marchés financiers (AMF).

Net distribution income¹

Operating income excluding interest and taxes from our consolidated brokers (including our wholly owned broker, BrokerLink) and our share of operating income including interest and taxes from our broker associates for a specific period.

Net earned premiums (NEP) (IFRS)

Net premiums written recognized for accounting purposes as revenue during a specific period including net reinstatement premiums, as determined in accordance with IFRS.

Net earned premiums (NEP) (MD&A basis)¹

NEP (IFRS), excluding net earned premiums of U.S. Commercial exited lines.

Net operating income ("NOI")¹

Calculated as net income for a specific period, excluding the after-tax impact Non-operating results.

Net operating income per share ("NOIPS")¹

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 written

Direct premiums written for a specific period less premiums ceded to reinsurers during the same period.

Non-catastrophe weather event

A group of claims, which is considered significant but that is smaller than the catastrophe threshold of \$7.5 million for P&C Canada (US\$5 million for P&C U.S.), related to a single weather event.

Non-operating results¹

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. These include the amortization of intangible assets recognized in business combinations, integration and restructuring costs, net gains (losses), difference between expected return and discount rate on pension assets, market yield adjustment, underwriting results of U.S. Commercial exited lines, the impact from the U.S. Corporate Tax reform, as well as other costs or revenues that are not representative of our operating performance.

Non-weather catastrophe losses

Catastrophe losses mostly related to large commercial losses, including non-weather-related fires, surety and liability losses.

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.

Operating return on equity ("OROE")¹

Calculated as net operating income for a 12-month period less preferred share dividends, divided by the average shareholders' equity (excluding preferred shares and accumulated other comprehensive income) over the same 12-month period.

Policies in force

The number of insurance policies in effect at a specific date. If two or more separate risks are covered under the same insurance policy, this counts as one policy in force.

Prior year claims development (PYD) (IFRS)

Change in total prior year claims liabilities during a specific period. A decrease to claims liabilities is referred to as favourable prior year claims development. An increase in claims liabilities is referred to as unfavourable prior year claims development.

Prior year claims development (PYD) (MD&A basis)¹

PYD (IFRS basis), adjusted to exclude the PYD related to U.S. Commercial exited lines.

PYD ratio¹

PYD (MD&A basis) expressed as a percentage of Net earned premiums (MD&A basis).

Regulatory capital ratios

Minimum capital test (MCT), as defined by the Office of the Superintendent of Financial Institutions (OSFI) and the Autorité des marchés financiers (AMF) in Canada, and Risk-based capital requirements (RBC) as defined by the National Association of Insurance Commissioners (NAIC) in the U.S.

Reinstatement premium

Premium payable to restore the original reinsurance policy limit as a result of a reinsurance loss payment under a catastrophe coverage. Reinstatement premiums are reported in Net earned premiums (IFRS).

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.

Risk-based capital ("RBC")

Risk-based capital as defined by the National Association of Insurance Commissioners (NAIC) in the U.S.

Severity (of claims)

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

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.

Total capital margin

Total capital margin includes the aggregate of capital in excess of company action levels in regulated entities (170% MCT, 200% RBC) plus available cash in unregulated entities.

Underlying current year loss ratio¹

Current year claims excluding catastrophe losses and prior year claims development, expressed as a percentage of Net earned premiums (MD&A basis) before reinstatement premiums.

Underwriting income (MD&A basis)¹

Net earned premiums less net claims incurred, commissions, premium taxes and general expenses, excluding market yield adjustment, the difference between the expected return and discount rate on pension assets and the underwriting results of U.S. Commercial exited lines.

Written insured risks

The number of vehicles in personal automobile insurance and the number of premises in personal property insurance written during a specific period.

¹ These are non-IFRS financial measures, which do not have any standardized meaning prescribed by IFRS and are unlikely to be comparable to similar measures presented by other companies.

FIVE-YEAR FINANCIAL HISTORY

This table contains non-IFRS financial measures. Refer to Section 27 – Non-IFRS financial measures of the MD&A for the year ended December 31, 2018 for details.

(In millions of Canadian dollars, except as noted)	2018	2017	2016	2015	2014	3-year average	5-year average	10-year average
Consolidated performance								
Direct premiums written ¹	10,090	8,730	8,277	7,901	7,441	9,032	8,488	7,044
Net earned premiums ¹	9,715	8,530	7,946	7,535	7,207	8,730	8,187	6,768
Underwriting income (loss) ¹	474	486	375	628	519	445	496	360
Net investment income	529	432	414	424	427	458	445	394
Net distribution income ¹	146	132	111	104	75	130	114	n/a
Net operating income ¹	839	771	660	860	767	757	779	622
Non-operating gains (losses) ¹	(142)	(31)	(152)	(216)	10	(108)	(106)	(85)
Effective tax rate	20.2%	15.9%	21.1%	19.3%	18.3%	19.1%	19.0%	18.7%
Net income attributable to shareholders	707	792	541	706	782	680	706	562
Combined ratio ¹	95.1%	94.3%	95.3%	91.7%	92.8%	94.9%	93.8%	94.9%
Per share measures (\$)								
Net operating income per share ¹	5.74	5.60	4.88	6.38	5.67	5.41	5.65	4.66
Earnings per share	4.79	5.75	3.97	5.20	5.79	4.84	5.10	4.21
Book value per share	48.73	48.00	42.72	39.83	37.75	46.48	43.41	36.51
Dividend per common share	2.80	2.56	2.32	2.12	1.92	2.56	2.34	1.92
Return on equity								
Operating return on equity ¹	12.1%	12.9%	12.0%	16.6%	16.3%	12.3%	14.0%	13.7%
Return on equity	9.9%	12.8%	9.6%	13.4%	16.1%	10.8%	12.4%	12.0%
Underwriting performance by line of business								
Personal auto								
Direct premiums written ¹	3,750	3,818	3,792	3,591	3,374	3,787	3,665	3,159
Net earned premiums	3,727	3,782	3,704	3,508	3,387	3,738	3,622	3,116
Combined ratio ¹	99.5%	101.7%	99.9%	95.4%	94.5%	100.4%	98.2%	96.4%
Personal property								
Direct premiums written ¹	2,186	2,135	2,030	1,864	1,715	2,117	1,986	1,637
Net earned premiums	2,098	2,040	1,880	1,736	1,617	2,006	1,874	1,539
Combined ratio ¹	88.3%	89.1%	90.9%	85.9%	89.0%	89.4%	88.6%	95.0%
Commercial lines – CAN								
Direct premiums written ¹	2,665	2,470	2,455	2,446	2,352	2,530	2,478	2,069
Net earned premiums	2,507	2,382	2,362	2,291	2,203	2,417	2,349	1,942
Combined ratio ¹	94.6%	86.5%	91.5%	90.3%	92.9%	90.9%	91.2%	92.5%
Commercial lines – U.S. (in CAD)								
Direct premiums written ¹	1,489	307	–	–	–	n/a	n/a	n/a
Net earned premiums ¹	1,380	326	–	–	–	n/a	n/a	n/a
Combined ratio ¹	94.8%	97.4%	–	–	–	n/a	n/a	n/a
Financial condition								
Total capital margin	1,333	1,135	970	625	681	1,146	949	800
Debt-to-total capital ratio	22.0%	23.1%	18.6%	16.6%	17.3%	21.2%	19.5%	18.4%
Investments								
Total investments	16,897	16,774	14,386	13,504	13,440	16,019	15,000	12,876
Market-based investment yield ¹	3.44%	3.20%	3.36%	3.55%	3.65%	3.33%	3.44%	3.72%

¹ These are non-IFRS financial measures. See glossary on page 170 for definitions.

THREE-YEAR QUARTERLY FINANCIAL HISTORY

This table contains non-IFRS financial measures. Refer to Section 27 – Non-IFRS financial measures of the MD&A for the year ended December 31, 2018 for details.

(In millions of Canadian dollars, except as noted)	2018				2017				2016			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Consolidated performance												
Direct premiums written ¹	2,392	2,708	2,908	2,082	2,293	2,203	2,497	1,737	1,959	2,188	2,455	1,675
Net earned premiums ¹	2,509	2,462	2,410	2,334	2,400	2,082	2,051	1,997	2,043	2,036	1,937	1,930
Underwriting income (loss) ¹	210	152	93	19	178	170	103	35	153	61	16	145
Net investment income	140	133	134	122	121	101	105	105	104	102	104	104
Net distribution income ¹	36	34	52	24	28	30	50	24	24	30	43	14
Net operating income ¹	281	237	201	120	236	219	193	123	212	137	114	197
Non-operating gains (losses) ¹	(42)	(36)	(45)	(19)	(58)	(61)	57	31	(52)	(16)	(26)	(58)
Effective tax rate	21.5%	22.3%	19.1%	14.2%	5.9%	22.3%	17.6%	19.3%	23.7%	19.9%	16.9%	21.6%
Net income attributable to shareholders	244	199	161	103	232	171	243	146	171	125	93	152
Combined ratio ¹	91.7%	93.8%	96.1%	99.2%	92.6%	91.8%	95.0%	98.2%	92.5%	97.0%	99.2%	92.5%
Per share measures (\$)												
Net operating income per share ¹	1.93	1.62	1.38	0.81	1.63	1.61	1.44	0.90	1.58	1.01	0.83	1.46
Earnings per share	1.67	1.34	1.10	0.68	1.60	1.25	1.82	1.08	1.27	0.91	0.67	1.11
Book value per share	48.73	49.27	48.64	47.32	48.00	46.56	42.16	43.14	42.72	41.47	40.57	40.06
Dividend per common share	0.70	0.70	0.70	0.70	0.64	0.64	0.64	0.64	0.58	0.58	0.58	0.58
Return on equity												
Operating return on equity ¹	12.1%	11.6%	11.9%	12.4%	12.9%	13.3%	12.1%	10.6%	12.0%	13.4%	14.6%	16.7%
Return on equity	9.9%	9.8%	10.0%	11.7%	12.8%	12.7%	12.3%	9.5%	9.6%	10.5%	10.5%	12.7%
Underwriting performance by line of business												
Personal auto												
Direct premiums written ¹	818	1,003	1,137	792	824	1,028	1,163	803	829	1,032	1,154	777
Net earned premiums	934	939	935	919	952	962	949	919	942	944	918	900
Combined ratio ¹	97.3%	99.9%	95.6%	106.4%	101.2%	105.1%	97.8%	102.6%	100.9%	104.3%	97.6%	96.4%
Personal property												
Direct premiums written ¹	517	606	640	423	505	591	625	414	486	569	592	383
Net earned premiums	534	531	521	512	522	517	506	495	494	483	447	456
Combined ratio ¹	78.5%	83.8%	102.7%	88.3%	79.7%	85.0%	99.5%	92.8%	75.6%	99.7%	106.7%	82.9%
Commercial lines – CAN												
Direct premiums written ¹	732	630	757	546	657	584	709	520	644	587	709	515
Net earned premiums	661	644	613	589	600	603	596	583	607	609	572	574
Combined ratio ¹	91.6%	94.9%	92.9%	99.5%	87.4%	76.5%	86.7%	95.9%	93.2%	83.5%	95.9%	93.9%
Commercial lines – U.S. (in CAD)												
Direct premiums written ¹	325	469	374	321	307	–	–	–	–	–	–	–
Net earned premiums ¹	379	347	340	314	326	–	–	–	–	–	–	–
Combined ratio ¹	96.7%	93.5%	93.8%	95.3%	97.4%	–	–	–	–	–	–	–
Financial condition												
Total capital margin	1,333	1,177	1,243	1,067	1,135	1,155	1,014	1,034	970	881	857	904
Debt-to-total capital ratio	22.0%	21.7%	22.5%	23.4%	23.1%	24.7%	22.8%	18.5%	18.6%	19.0%	19.3%	19.5%
Investments												
Total investments	16,897	16,999	16,946	16,424	16,774	17,093	14,890	14,227	14,386	14,342	13,812	13,630
Market-based investment yield ¹	3.58%	3.44%	3.51%	3.22%	3.11%	3.10%	3.30%	3.32%	3.27%	3.27%	3.43%	3.47%

¹ These are non-IFRS financial measures. See glossary on page 170 for definitions.

Credit rating

	A.M. Best	DBRS	Fitch	Moody's
IFC senior unsecured debt ratings	a-	A	A-	Baa1
OneBeacon senior unsecured debt ratings	a-	Not rated	A-	Baa2
IFC's principal Canadian P&C insurance subsidiaries' financial strength ratings	A+	AA(low)	AA-	A1
IFC's principal U.S. P&C insurance subsidiaries' financial strength ratings	A+	Not rated	AA-	A2

On March 8, 2019, A.M. Best upgraded IFC's principal U.S. P&C insurance subsidiaries' financial strength rating (FSR) to A+ (Superior) from A (Excellent) and the OneBeacon senior unsecured debt rating to "a-" from "bbb+".

DBRS has assigned a rating of "Pfd-2" with a Stable trend for the Non-cumulative Rate Reset Class A Series 1 preferred shares, Non-cumulative Rate Reset Class A Series 3 preferred shares, Non-cumulative Floating Rate Class A Series 4 preferred shares, Non-cumulative Class A Series 5 preferred shares, Non-cumulative Class A Series 6 preferred shares and Non-cumulative Class A Series 7 preferred shares (the "Series 1 Preferred Shares", "Series 3 Preferred Shares", "Series 4 Preferred Shares", "Series 5 Preferred Shares", "Series 6 Preferred Shares" and "Series 7 Preferred Shares", respectively) issued on July 12, 2011, August 18, 2011, September 30, 2016, May 24, 2017, August 18, 2017 and May 29, 2018, respectively.

Fitch Ratings has assigned a rating of "BBB" with a Stable outlook to the Series 1 Preferred Shares, Series 3 Preferred Shares, Series 4 Preferred Shares, Series 5 Preferred Shares, Series 6 Preferred Shares and Series 7 Preferred Shares.

Toronto Stock Exchange (TSX) listings

Common Shares Ticker Symbol: IFC
 Series 1 Preferred Shares Ticker Symbol: IFC.PR.A
 Series 3 Preferred Shares Ticker Symbol: IFC.PR.C
 Series 4 Preferred Shares Ticker Symbol: IFC.PR.D
 Series 5 Preferred Shares Ticker Symbol: IFC.PR.E
 Series 6 Preferred Shares Ticker Symbol: IFC.PR.F
 Series 7 Preferred Shares Ticker Symbol: IFC.PR.G

Annual meeting of the shareholders

Date: Wednesday, May 8, 2019
 Time: 11:30 a.m. (Eastern Time)
 Venue: Art Gallery of Ontario
 317 Dundas Street West
 Toronto, Ontario
 Canada M5T 1G4

Version française

Il existe une version française du présent rapport annuel à la section Investisseurs de notre site Web www.intactfc.com/French/accueil/default.aspx. Les personnes intéressées peuvent obtenir une version imprimée en appelant au 1 866 778 0774 ou en envoyant un courriel à ir@intact.net.

Common share dividend history

Record	Payable	Amount
Dec. 14, 2018	Dec. 31, 2018	\$0.70
Sept. 14, 2018	Sept. 28, 2018	\$0.70
June 15, 2018	June 29, 2018	\$0.70
Mar. 15, 2018	Mar. 29, 2018	\$0.70
Dec. 15, 2017	Dec. 29, 2017	\$0.64
Sept. 15, 2017	Sept. 29, 2017	\$0.64
June 15, 2017	June 30, 2017	\$0.64
Mar. 15, 2017	Mar. 31, 2017	\$0.64
Dec. 15, 2016	Dec. 30, 2016	\$0.58
Sept. 15, 2016	Sept. 30, 2016	\$0.58
June 15, 2016	June 30, 2016	\$0.58
Mar. 15, 2016	Mar. 31, 2016	\$0.58

Transfer agent and registrar

Computershare Investor Services Inc.
 100 University Avenue
 8th Floor, North Tower
 Toronto, Ontario M5J 2Y1
 1 800 564 6253

Auditors

Ernst & Young LLP

Earnings conference call dates

Q1 – May 8, 2019
 Q2 – July 31, 2019
 Q3 – November 6, 2019
 Q4 – February 5, 2020

Investor inquiries

Ken Anderson
 Vice President, Investor Relations & Treasurer
 855 646 8228, ext. 87383
kenneth.anderson@intact.net

Common share prices and volume

	High	Low	Close	Volume traded
2018 Q1	\$105.00	\$94.57	\$96.81	14,148,701
2018 Q2	\$98.85	\$92.53	\$93.25	12,649,563
2018 Q3	\$109.17	\$91.65	\$107.40	14,146,639
2018 Q4	\$107.69	\$95.75	\$99.19	16,274,245
2018 YE	\$109.17	\$91.65	\$99.19	57,219,148
2017 Q1	\$97.56	\$91.40	\$94.58	13,471,916
2017 Q2	\$98.29	\$91.41	\$97.96	15,096,910
2017 Q3	\$104.33	\$95.14	\$103.07	13,125,539
2017 Q4	\$109.33	\$99.35	\$104.99	15,359,434
2017 YE	\$109.33	\$91.40	\$104.99	57,053,799
2016 Q1	\$91.08	\$77.49	\$90.93	16,605,531
2016 Q2	\$94.16	\$84.88	\$92.29	13,312,286
2016 Q3	\$97.20	\$89.75	\$94.84	10,209,134
2016 Q4	\$97.34	\$90.00	\$96.10	13,065,874
2016 YE	\$97.34	\$77.49	\$96.10	53,192,825

Source: Toronto Stock Exchange Data items are not adjusted for stock splits and consolidations. This data is provided "AS IS". TSX, its affiliates, their respective service providers, suppliers and licensors: (i) make no warranties or representations of any kind, express, implied or otherwise regarding this data or its accuracy, completeness or timeliness, (ii) disclaim the implied warranties of merchantability and fitness for a particular purpose, and (iii) assume no liability in making this data available.

Media inquiries

Stephanie Sorensen
 Director, External Communications
 416 344 8027
stephanie.sorensen@intact.net

Dividend reinvestment

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

Social Impact



In 2018:



We donated over
\$6.1 million
to over 400 organizations
across North America



Our employees
volunteered over
4,000 hours
and donated
over \$1.4 million



**3 new standards
and guidelines**
were developed to address
flooding in Canada



\$1.3 million
was invested in
25 communities
to address root causes
of child poverty

Why Invest with Intact



LARGEST PROVIDER

of P&C insurance in Canada and a leading provider of specialty insurance in North America



Consistently

OUTPERFORMS INDUSTRY

due to disciplined underwriting, scale advantage and in-house claims expertise



TRACK RECORD

of strong capital generation and annual dividend increases



PROVEN

industry consolidator



FINANCIAL STRENGTH

reinforced by prudent risk management



Attracts and retains

TOP TALENT

as one of Canada's Top Employers



belairdirect.



See the full suite of our reports here:
intactfc.com

Intact Financial Corporation

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Toronto, Ontario M5G 0A1

