EGI Financial Holdings Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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EGI FINANCIAL HOLDINGS INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the three and twelve month periods ended December 31, 2012

EGI Financial Holdings Inc. ("EGI" or "the Company") prepares its financial statements in accordance with International Financial Reporting Standards (IFRS), issued and effective as of December 31, 2012 as set out in the Handbook of the Canadian Institute of Chartered Accountants (CICA Handbook).

The financial data for 2012 and 2011 in this discussion has been prepared in accordance with IFRS, and financial data for 2010 and prior has been prepared in accordance with Canadian GAAP effective then except for the non-GAAP measures noted below.

References to "EGI" or "the Company" in this Management's Discussion and Analysis of Financial Condition and Results of Operations refer to EGI Financial Holdings Inc. on a consolidated basis, both now and in its predecessor forms.

The following discussion should be read in conjunction with EGI's audited consolidated financial statements and the related notes. The following commentary is current as of February 25, 2013. Additional information relating to EGI is available on SEDAR at www.sedar.com. Certain totals, subtotals and percentages may not reconcile due to rounding.

EGI uses both IFRS and certain non-IFRS measures to assess performance. Securities regulators require that companies caution readers about non-IFRS measures that do not have a standardized meaning under IFRS and are unlikely to be comparable to similar measures used by other companies. EGI analyzes performance based on underwriting income and underwriting ratios such as combined, expense and loss ratios, which are non-IFRS measures. Underwriting income is defined as net earned premiums less net claims incurred, net acquisition expenses, general expenses and reversing any impact of change in discount rate on claims.

The following discussion contains forward-looking information that involves risk and uncertainties based on current expectations. This information includes, but is not limited to, statements about the operations, business, financial condition, priorities, targets, ongoing objectives, strategies and outlook for EGI in 2013 and subsequent periods.

This information is based upon certain material factors or assumptions that were applied in drawing a conclusion or making a projection as reflected in the forward-looking information. By its nature, this information is subject to inherent risks and uncertainties that may be general or specific. A variety of material factors, many of which are beyond EGI's control, affect the operations, performance and results of EGI and its business and could cause actual results to differ materially from the expectations expressed in any of this forward-looking information (see "Risk Factors").

Forward-looking information is provided for the purpose of providing information about management's current expectations and plans relating to the future. Readers are cautioned that such information may not be appropriate for other purposes. Additional information about the risks and uncertainties about EGI's business is provided in its disclosure materials, including its annual information form, filed with the securities regulatory authorities in Canada, available at www.sedar.com. EGI does not expect to update any forward-looking information.

In 2012, premiums relating to the U.S. division have been shown separately, and accordingly the 2010 presentation has been changed to conform to the 2011 and 2012 presentation. The restatement was made for comparative purposes only and does not affect net income after taxes.

Financial Highlights

	Year ended December 31				
($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	2012	2011	2010	2009	2008
Revenue					
Direct written and assumed premiums					
Personal Lines/Auto	129,606	126,220	134,041	117,291	121,410
Niche Products	48,352	44,678	51,423	46,571	49,320
International	28,052	–	–	–	–
U.S.	14,139	3,994	207	–	–
Total direct written premiums	220,149	174,892	185,671	163,862	170,730
Net written premiums	196,604	160,128	167,066	149,745	158,107
Net earned premiums	178,575	165,447	162,873	149,379	157,255
Underwriting expenses					
Incurred claims	113,169	105,415	118,642	108,203	104,913
Acquisition costs	40,835	37,178	35,834	34,429	37,026
Operating expenses	27,842	22,266	17,732	16,095	14,229
Total underwriting expense	181,846	164,859	172,208	158,727	156,168
Underwriting income (loss)	(3,271)	588	(9,335)	(9,348)	1,087
Impact of discount rate on claims	(3,887)	(1,843)	(488)	9	(924)
Investment income	34,044	13,867	17,465	17,771	10,009
Interest expense	–	–	568	1,212	1,216
Income before income taxes	26,886	12,612	7,074	7,220	8,956
Income tax expense (recovery)					
Current	8,800	5,136	1,641	3,531	3,453
Deferred	(1,280)	(44)	1,281	(826)	(476)
	7,520	5,092	2,922	2,705	2,977
Net income	19,366	7,520	4,152	4,515	5,979
Attributed to:					
Shareholders of the Company	20,353	7,733	4,152	4,515	5,979
Non-controlling interest	(987)	(213)	–	–	–
	19,366	7,520	4,152	4,515	5,979
Earnings per share attributable to shareholders of the Company:					
Net income per share – basic	$1.70	$0.64	$0.35	$0.38	$0.57
Net income per share – diluted	$1.68	$0.64	$0.34	$0.36	$0.53
Book value per share	$13.98	$12.85	$12.14	$11.12	$10.16
Net operating income (loss) (1)	7,725	8,585	939	(109)	9,807
Net operating income per share – diluted (2)	$0.72	$0.73	$0.08	$(0.01)	$0.87

(1) Net operating income is defined as net income plus or minus after-tax impact of change in discount rate on unpaid claims, realized losses or gains on sale of investments, unrealized fair value changes on Fair Value Through Profit or Loss (FVTPL) investments and one time non recurring charges.

(2) Net operating income is adjusted to that attributable to shareholders for per share calculation.

($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	Year ended December 31 2012	2011	2010	2009	2008
Net income	19,366	7,520	4,152	4,515	5,979
Add impact of change in discount rate	3,887	1,843	488	(9)	924
Add (deduct) net realized loss (gain) on investments	(20,990)	(144)	(5,089)	(6,860)	4,833
Fair value change on FVTPL	(227)	(209)	24	–	–
Severance & other expenses	1,383	–	–	–	–
Tax impact	4,306	(425)	1,364	2,245	(1,929)
Net operating income	7,725	8,585	939	(109)	9,807

($ THOUSANDS)	As at December 31 2012	2011	2010	2009	2008
Balance Sheet Data					
Cash and short-term deposits	19,578	30,839	17,033	46,885	29,111
Investments	412,728	365,058	351,563	292,419	257,731
Total assets	547,028	491,703	474,783	446,465	402,780
Provision for unpaid claims	268,580	254,519	239,036	207,220	185,255
Unearned premiums	94,085	71,644	78,335	72,643	71,154
Bank indebtedness	–	–	–	19,550	19,550
Total equity	165,403	154,820	146,366	133,431	118,604

The following table shows the Company's selected financial ratios and return on equity (ROE) data. These ratios are defined in the "Glossary of Selected Insurance Terms".

Selected Financial Ratios (1) and Return on Equity (ROE) Data (%)	Year ended December 31 2012	2011	2010	2009	2008
Loss ratio (2)	63.4	63.7	72.8	72.4	66.7
Expense ratio	38.5	35.9	32.9	33.9	32.6
Combined ratio (2)	101.9	99.6	105.7	106.3	99.3
ROE	12.7	5.0	3.0	3.6	5.4

(1) The underwriting ratios (the loss and expense ratios and the combined ratio) are all non-IFRS measures which are common insurance industry measures of performance. Expenses include all Corporate and overhead costs.

(2) Before impact of change in discount rate on claims adjustment for $3.9 million in 2012 and $1.8 million in 2011.

2012 Financial Overview

($ THOUSANDS)	Full Year 2012	Q4	Q3	Q2	Q1	Full Year 2011	Q4
Underwriting income (loss)(1)	(3,271)	1,833	181	(4,309)	(976)	588	1,450
Net income (loss)	19,366	4,513	13,879	(2,820)	3,794	7,520	3,254
Net Operating Income	7,725	4,402	2,570	(989)	1,742	8,585	2,436

(1) Before impact of change in discount rate on claims adjustment for $3.9 million in 2012 and $1.8 million in 2011.

Net operating income as defined above, has decreased over last year; from $8.6 million in 2011 to $7.7 million in 2012. This was due primarily to adverse development on cancelled Niche Products programs and start-up costs in the International and U.S. divisions, offset partially by improved profitability in Personal Lines.

Book value per share, which EGI Management considers the most appropriate metric to measure the performance of EGI Financial Inc., increased by approximately 9% in 2012, to $13.98 from $12.85 in 2011.

Net income after taxes for 2012 was $19.4 million, an increase of $11.9 million, or 158%, compared to net income of $7.5 million in 2011. The large increase is attributable to net realized gains on the disposal of investments of $21.0 million compared to net realized gains of $0.1 million in 2011, offset by an underwriting loss of $3.3 million in 2012, compared to an underwriting profit of $0.6 million in 2011.

A loss of $7.7 million was recorded in other comprehensive income (OCI), a decrease of $8.4 million compared to a gain of $0.7 million in 2011. The decrease can be attributed to the reclassification of realized gains on investments out of OCI and into net income in the year. The unrealized gains of $9.0 million on the investment portfolio in 2012 have increased by $8.0 million year-over-year. The positive overall increase in fair value of the investment portfolio reflects the performance of the investment markets and the strength of the Company's investment management.

At 2012 year end, total equity increased to $165.4 million compared to $154.8 million as at December 31, 2011, an increase of 7%.

Company Overview

EGI operates in the property and casualty ("P&C") insurance industry in Canada, the United States and Europe. The Company focuses primarily on non-standard automobile insurance and other specialty general insurance products. Founded in 1997 as an insurance and reinsurance broker and marketer, EGI has since developed its business to focus on underwriting opportunities not served by many of the larger, standard insurers.

EGI operates two businesses in Canada – Personal Lines and Niche Products. Personal Lines focuses on the underwriting of EGI's non-standard automobile insurance, and insurance for motorcycles, antique and classic vehicles, trailers, motor homes and recreational vehicles. Niche Products designs and underwrites specialized insurance programs, such as higher premium property, primary and excess liability, legal expense and accident and health insurance for a variety of businesses and consumers and extended warranty coverage for homes, consumer products and heavy equipment.

On May 1, 2012, the Company acquired CUISA Managing General Agency Corporation (CUISA MGA), a British Columbia specialty insurance operation. CUISA MGA was established in 1996 and provides insurance services to 160 credit-union-owned insurance broker offices in British Columbia. It provides brokers with access to insurance markets and unique products that they would have difficulty accessing individually. CUISA MGA offers a broad range of personal and commercial lines products, and has been an authorized distributor for EGI's subsidiary, Echelon General Insurance Company (Echelon), since 2006.

EGI reorganized its Canadian operations in the third quarter, integrating the operations of Personal Lines and Niche Products into one unit. Financially these two segments continue to be segregated. The expected benefits of the reorganization are:

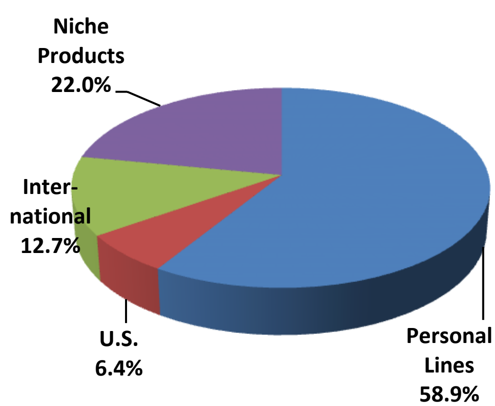
- A more integrated team approach and focused strategic direction;
- More effective sharing of best practices across our business;
- Greater consistency in underwriting practices and discipline;
- Standardized approaches to product pricing;
- Uniformity in the number and types of products that EGI provides;
- A coordinated national marketing approach for all business; and
- Synergies in operational efficiencies.

Outside of Canada, EGI operates U.S. and International businesses. The U.S. is focused on non-standard automobile insurance in the southeastern United States. It is currently writing insurance business in Florida and has licenses in Georgia, Alabama and Louisiana. It previously wrote business in Texas but, in Q3 2012 stopped accepting new applications and is not renewing the existing business in accordance with State regulations due to poor claims experience in the state.

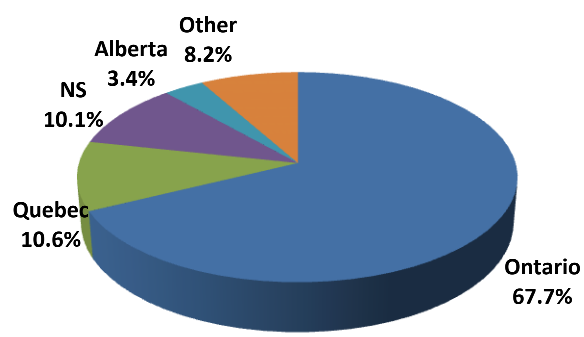
In 2012, EGI commenced writing insurance in various European countries through Qudos, a majority owned insurance subsidiary. The business of Qudos is very similar in nature to the business underwritten by EGI's Niche Products in Canada. Qudos' head office is located in Copenhagen, Denmark and it is regulated throughout the European Union by the Danish Financial Supervisory Authority. Approximately one-third of Qudos' business will be reinsured by EGI's 100% owned reinsurer CIM Re in Barbados, thereby retaining that portion of the business within EGI.

The breakdown of direct written premiums by category of business and by region during 2012 is illustrated below.

2012 Gross Written Premiums by Division



2012 Gross Written Premiums in Canada



On a Company-wide basis, 65% of gross written premiums in 2012 were attributed to the sale of Personal Lines automobile policies in Canada and the United States. Niche Products accounted for 22% of gross written premiums, and International accounted for 13%. The Company's core non-standard automobile businesses in Canada accounted for approximately 49% of total premiums written across the Company.

Outlook

In 2012, the automobile insurance industry showed improved results over 2011, as the auto reforms in Ontario that were implemented in September 2010 seemed to have a positive impact on accident benefit claims. The industry remains cautiously optimistic on the sustainability of the Ontario reforms, although certain issues are being closely monitored: i) a potentially offsetting impact in bodily injury claims as plaintiff counsels seek new avenues for awards, ii) a clear definition of claims that are deemed to be "catastrophic", iii) the combining or "stacking" of physical and psychological impairments in assessing whole person impairment, iv) the implementation of the recommendations of the Ontario Anti-Fraud Task Force, and v) a backlog of mediated claims at the Ontario regulator. These issues are expected to have the greatest impact in the Greater Toronto

Area, which is a territory where EGI has very little claims exposure.

Rate filings for increased premium rates have slowed in Ontario. This may imply an inflection point for "soft market" conditions. At the same time, the current low interest rate environment has limited the investment income of all insurance companies and has created a greater emphasis and discipline on underwriting results.

The acquisition of Jevco Insurance Company, a competitor to EGI, by Intact Insurance Company in 2012 will pose both strategic opportunities and threats for EGI and will continue to be closely monitored.

Having taken actions to successfully return its core non-standard auto business to profitability, EGI will continue to focus on profitable growth opportunities by expanding its existing business. In 2013, the U.S. division will continue its cautious and prudent approach to growing its operations organically in Florida. Florida Personal Injury Protection (PIP) reforms that took effect in January, 2013, are aimed at addressing rising accident benefits and fraud, which may help improve profitability. EGI's goal is to ensure that its U.S. operations are profitable and several management actions were taken in 2012 to achieve this goal including increasing PIP premium rates, being more selective in underwriting and limiting reinstatement of policies where the Company encountered payment issues with the policyholder. The Company will utilize its pricing analytics to establish conservative prices and underwriting templates and will adjust rates in selected areas over time, as experience emerges and market conditions evolve. The focus is on underwriting profits rather than growth.

The International division began writing business in 2012 and it is expected that the premium volume will continue to grow as it ramps up its business by adding programs and expanding geographically in Europe. The Company will look to continue this trend, achieved through well-established relationships with agents and brokers.

Strategy

EGI's business strategies and actions are guided by its vision: "to be recognized as a leading provider of specialized insurance solutions". EGI's objective is to deliver a return on shareholder equity that is superior to the average of the Canadian P&C insurance industry through a comprehensive specialized insurance offering.

The Company does not strive to compete on price. EGI's goal is to target niches that are currently underserved by the market and which require the high level of expertise of its organization.

For 2013, EGI's primary goal is to grow bottom line net income by delivering more consistent underwriting profits. This will be attained by i) focusing our time, resources and investments on our core Personal Lines business, ii) managing the claims run-off of the cancelled Niche Products businesses, iii) bringing Qudos to underwriting profitability and iv) addressing the underwriting losses in the U.S.

Over time, we need to right-size our capital base for the size of our business, accelerating our attention on acquisition opportunities in Canada and/or returning the excess capital to our shareholders.

Lastly, we will develop initiatives that will provide growth in the future. We will grow our top line by building deeper expertise in fewer, more focused product lines. We will continue to build infrastructure, investing in people and systems, with a focus on service and financial analytics.

EGI plans to achieve these objectives through market strategies and organizational strategies. Our market strategies are to: i) protect the core business, ii) grow ancillary products geographically, iii) establish underwriting profitability in the U.S. and Europe, and iv) strategically assess acquisitions.

Protect the Core Business

EGI maintains a dominant position in the Canadian non-standard auto insurance market, which has resulted in above-average underwriting margins over the long term. We will protect that position through sophisticated pricing analytics and quality personal service to our distributors. We will improve the sophistication of our pricing, utilizing predictive modeling techniques and a finer segmentation of risks than our competitors. We will make it easy for distributors to transact business with us, providing them with tools and integrating our business processes with theirs.

In Ontario, we will maintain our focus on the rural and small urban territories and avoid the risks of the Greater Toronto Area. We will test further expansion into the grey and standard markets with a focus on improving retention of our best customers. We will continue to differentiate ourselves as a non-standard auto insurer for new business but will also offer standard rates to our most profitable segments at renewal.

We will continue to grow non-standard auto outside of Ontario, with an emphasis on Nova Scotia and Quebec.

Grow Ancillary Products Geographically

The growth of our Canadian business will be supplemented by ancillary products. We will develop more standardized products and a nationally coordinated marketing approach.

In Personal Lines, we will concentrate our initial efforts on opportunities in Ontario, Alberta and Quebec in the following business lines: i) motorcycles, ii) commercial auto, and iii) specialty auto – antique autos, motorhomes, trailers, snowmobiles, all terrain vehicles. We will leverage the purchase of CUISA MGA to build a stronger presence in Western Canada.

In Niche Products, the Company will remain focused on its core operating principles – maintaining control of underwriting and claims, closely monitoring results and reacting quickly to emerging trends. We will continue to focus the business on fewer programs and fewer product lines with deeper expertise.

Establish Underwriting Profitability in the U.S. and Europe

We commenced writing premiums in Florida and Texas in 2010 with a goal to break even on underwriting profitability by 2013. We have since exited the Texas market, being dissatisfied with the claims results. We are currently focusing on the Florida market, where we have implemented many underwriting and pricing changes; and we are closely monitoring the regulatory reforms that took effect on January 1, 2013.

We expect that Qudos will be providing the vast majority of our international growth. The legal, regulatory and operations frameworks for Qudos have been established. We are monitoring the claims experience closely and managing risk through the use of external reinsurance.

Strategically Assess Acquisitions

We will seek and assess acquisition opportunities that accelerate our growth strategy in Canada. We will pursue small personal lines insurers, specialty insurers and specialty distributors.

Organizational Strategies

In addition to the market strategies outlined above, we have a number of organizational strategies – areas where we will invest and continue to develop core competencies that help to differentiate ourselves in the market. EGI's organizational strategies are: i) to increase the level of sophistication in the selection and management of underwriting risk, ii) improve service and ease of doing business with producers, and iii) developing people, systems and tools.

EGI's key to profitable growth is sophisticated pricing, underwriting and claims management.

We will continue to provide the optimum level of service to our customers, with a primary focus on our distributors and a secondary focus on policyholders. We provide a more personal service experience. We will invest in technology that makes it easier for brokers and customers to transact business with us.

We will invest in people. We will continue to develop a deeper and broader team of leaders, managers and technical professionals.

We will continue our recent investment in technology in the areas of: i) building a reliable and scalable infrastructure, ii) market opportunities, iii) selection and management of underwriting risk, iv) service and ease of doing business, and v) operational efficiency.

Competitive Strengths

EGI believes that it is uniquely positioned to be the market leader in the specialty P&C insurance industry for the following reasons:

Specialized insurance offering. EGI offers its producers a comprehensive line of insurance products comprised of non-standard and specialty auto insurance and specialized non-auto insurance programs. We utilize specialized underwriting techniques, allowing us to effectively assess risks that don't fit the fully-automated processes of larger, standard insurers.

Entrepreneurial culture. EGI fosters a responsive, team environment which encourages experimentation and allows the flexibility to provide unique, tailor-made solutions. Our Company values are teamwork, speed, innovation and integrity.

Personalized customer service. EGI believes that its strong reputation for customer service with its producers is a differentiating factor from both an underwriting and a claims standpoint. We provide a more personalized service experience, allowing producers direct access to underwriters and managers with decision-making authority.

Financial strength. EGI has a strong capital base with shareholder equity of $165 million. The Minimum Capital Test (MCT) ratio of Echelon as at December 31, 2012, was 241% which is well in excess of the Office of the Superintendent of Financial Institutions' (OSFI) supervisory target. All other insurance subsidiaries are well capitalized and there is approximately $25 million of excess capital invested in cash and liquid securities in the holding company and our Barbados reinsurance company, CIM Re. EGI's net Premiums-to-Capital ratio is a conservative 1.2:1. It has a high quality investment portfolio with over 97% of its fixed income portfolio is investment grade with an average rating of AA. It has no debt on its balance sheet, little goodwill and intangible assets consisting mostly of computer software. Echelon has an A.M. Best financial strength rating of B++ (Good). EGI intends to maintain its strong balance sheet through appropriate pricing, underwriting discipline and conservative accounting and loss reserving practices.

Experienced management team. EGI has a seasoned group of managers with strong knowledge of the non-standard auto and specialty insurance industry in Canada and internationally.

Personal Lines

The non-standard automobile segment currently targeted by EGI is high-premium insurance for drivers who, because of inexperience or a poor driving record, are not able to obtain insurance from standard insurers. EGI provides coverage for private passenger vehicles as well as single commercial vehicles and small commercial and farm fleets. Management believes that EGI's underwriting discipline, claims expertise, strict controls and experienced management team, who are well-versed in the nuances of non-standard auto, enable the Company to select those drivers in the higher premium categories who have a proportionally lower potential claims risk. Concurrently, the Company has steadily expanded its reach into targeted "grey" market segments. To date, these efforts have produced profitable results and reduced dependence on purely non-standard risks.

For applicants paying the higher premiums for non-standard automobile insurance, price is the single most important consideration. EGI provides selected drivers with a lower premium option than the higher premium coverage offered by the Facility Association (or the Groupement in Quebec), the industry-operated pools that serve as the "markets of last resort." EGI targets drivers most likely to be "reformers" not "repeaters". These non-standard auto risks fall between Facility Association and the applicants normally targeted by standard market insurers. The likely reformer expresses concern with respect to his or her poor driving record and will exhibit a sincere desire to improve so as to re-enter the standard market at standard rates. EGI trains its brokers and agents to select qualifying risks. EGI then employs the experience of its underwriting personnel to ensure that complete and accurate underwriting and rating information has been developed.

EGI only writes business through contracted brokers. In recent years, EGI has focused on appointing brokers and agents in rural and smaller urban centres as experience has shown that these areas are consistently more profitable. This strategy has resulted in enhanced underwriting margins that, on average, exceed the industry average.

EGI will maintain and grow its Personal Lines business by employing the following strategies:

- Protect its dominant position in non-standard auto markets;
- Accelerate investments in technology to provide seamless interaction with distributors;
- Improve retention of its best customers through careful expansion into targeted "grey" market segments;
- Expand specialty auto products in Ontario, Alberta, Quebec and Nova Scotia;
- Leverage its recent purchase of CUISA MGA to build a stronger presence in Western Canada; and
- Continue to develop sophisticated pricing techniques such as predictive analytics.

Niche Products

Niche Products provides specialized commercial and personal insurance products and programs. It works with P&C insurance brokers and managing general agents (MGAs) and warranty product distributors to design insurance solutions that respond to unique distribution opportunities and gaps in the insurance market created by traditional insurers' focus on standardized coverage. EGI seeks distributors who have developed a portfolio of business focused on a particular niche in the market. The distributor must have a demonstrable expertise to distribute, underwrite and administer the portfolio of business successfully. EGI combines its market research and underwriting skills with the distributor's specialized expertise to create consumer-oriented product offerings.

EGI has identified niche market segments within five product areas that offer opportunities for profitable growth: property insurance; general liability insurance; casualty insurance; accident and health insurance; and warranty products. The Company has recently exited several lines of unprofitable business, including Long-Term Disability and Emergency Travel Health, and cut exposure to Host Liquor coverage and significantly reduced the number and type of professions to which it provides Errors & Omissions insurance. EGI occasionally enters into risk-sharing agreements with distributors allowing them to participate as an underwriting risk partner. This helps to ensure the distributor's commitment to service and adherence to program and underwriting guidelines.

EGI has witnessed increased competition in the specialized niche markets in recent years, as soft market conditions prevail in many commercial property and casualty insurance markets. EGI's key competitors vary significantly by product and line of business.

U.S.

EGI operates in the United States through American Colonial Insurance Company ("ACIC"). ACIC is licensed to transact business in Florida, Georgia, Alabama and Louisiana. EGI has established an MGA in Florida to transact and manage business on behalf of the insurance company. EGI's management team has extensive past experience with the successful operation of U.S. non-standard auto carriers.

EGI began selling insurance in Florida and Texas in 2010. In September, 2012, EGI exited the Texas market as claims experience was not trending toward profitability as quickly as desired. Since 2010, a series of changes, such as underwriting restrictions and targeted premium rate increases, have been implemented in Florida. In addition, new regulatory reforms have been introduced that are expected to limit claims severity and legal costs.

The premium rate structure in the U.S. utilizes traditional rating variables such as territory, age, sex, marital status, driving record and type of vehicle. However, EGI also calculates rates based on a combination of financial responsibility score, prior insurance and prior liability limits.

EGI distributes its U.S. products through independent agents. Agents are vetted and appointed by marketing representatives based on established criteria. Target market geographical areas are selected and prioritized for each marketing representative within their respective region of responsibility.

EGI processes new and renewal business through a fully-automated, paperless system. It allows the agent to quote prospective clients and bind coverage with the initial payments for those policies being transferred from the agency's bank account. It will verify the existence of prior insurance and run a motor vehicle report to uncover any traffic violations or accidents. Once the policies are issued, the agents are able to access the policies online and make changes to existing policies, or in the case of a customer, make a premium payment in the agent's office and request EGI to charge the agency's account for the payment due.

The business is monitored through a sophisticated data mining system that allows EGI to view each agent's production and results on a variety of segmented measures. Automobile insurance written through independent agents is an extremely competitive segment in the U.S. Agents utilize comparative rating systems to compare the rates of several carriers to help determine where to place the business. Competition varies greatly by territory, although EGI's competitors are often small regional insurers.

The Company is currently focused on Florida and will use its sophisticated pricing methodologies to establish conservative prices and underwriting templates and will adjust its rates over time as experience emerges and market conditions evolve.

International

In 2012, EGI began writing premiums in Europe through its investment in Qudos. Qudos' objective is to deliver superior return on equity through specialized insurance programs distributed through managing general agencies. With the advent of the European Union's Third Directive, the European insurance industry is essentially a single market.

As at December 31, 2012, the majority of the business is motorcycles, taxis, non-standard auto and home warranties in the United Kingdom and Denmark. Qudos' objective is to capitalize on opportunities in the European insurance, economic and regulatory environment to build a geographically diverse product portfolio that is capital efficient under the European Union's Solvency II regulatory framework.

Although the introduction of Solvency II has been postponed until 2014, insurers are already adjusting their underwriting and pricing in anticipation of the increase in required capital margins. Qudos has an advantage over its competitors in that, as a new entrant, it does not have any capital issues related to EU economic conditions and does not have any legacy issues associated with Solvency II and therefore can structure its product mix to achieve a high ROE under Solvency II. Qudos is already compliant with Solvency II.

The risks associated with a fast-growing operation will be partially mitigated through quota share reinsurance with high quality external reinsurers. A portion of Qudos' business is reinsured to CIM Reinsurance Company, EGI's wholly owned captive reinsurance subsidiary, domiciled in Barbados.

Segmented Financial Information

PERSONAL LINES

	3 months ended December 31				12 months ended December 31			
($THOUSANDS)	2012	2011	$Variance	%Variance	2012	2011	$Variance	%Variance
Net earned premiums	29,792	32,576	(2,784)	(8.5)%	123,937	128,970	(5,033)	(3.9)%
Underwriting income(1)	4,827	3,260	1,567	48.1%	11,898	7,046	4,852	68.9%
Loss ratio(1)	49.8%	59.3%			58.1%	65.1%		
Expense ratio	34.0%	30.7%			32.3%	29.4%		
Combined ratio(1)	83.8%	90.0%			90.4%	94.5%		

(1) Before impact of change in discount rate on claims adjustment for $0.1 million in the quarter and $3.2 million in 2012 and $0.5 million in the quarter and $1.5 million in 2011.

Fourth Quarter 2012

Personal Lines recorded an underwriting profit in the fourth quarter of 2012 of $4.8 million. The result represents a $1.6 million, or 48.1%, increase in underwriting income over the $3.3 million recorded in the fourth quarter of 2011. This significant increase was primarily due to the improved performance of non-standard auto, which recorded a combined ratio of 74.9% in the fourth quarter compared to 98.7% in the fourth quarter of 2011, primarily due to the positive impact on loss ratios from Ontario auto insurance reforms This improvement was partially offset by an increase in underwriting loss in motorcycle with a combined ratio of 139.0% compared to 34.2% in 2011, due to a few large losses incurred in the fourth quarter 2012. Personal Lines recorded a $2.6 million positive development of prior year claims in the fourth quarter of 2012 compared to positive claim development $1.7 million in the same period in 2011. The expense ratio increased to 34.0% compared to 30.7% in the same quarter in 2011 mainly due to one time unusual expenses of $0.9 million incurred for severance and other expenses.

2012

Personal Lines recorded an underwriting income in 2012 of $11.9 million. The result represents a $4.9 million, or 68.9%, increase in underwriting income compared to underwriting income of $7.0 million recorded in 2011. This significant increase was primarily due to the performance of non-standard auto, which recorded a combined ratio of 86.7% compared to 93.6% in 2011 primarily due to the positive impact on loss ratios from Ontario auto insurance reforms that came into place in September 2010, along with management actions to ensure profitability in this business. This improvement was partially offset by an increased motorcycle combined ratio in the year of 113.9% compared to 103.2% in 2011 due to a few large losses. Personal Lines recorded an $8.5 million positive development of prior year claims in 2012 compared to positive claim development of $4.0 million in 2011. The full year expense ratio increased to 32.3% compared to 29.4% in 2011 mainly due to one-time unusual expenses of $1.1 million incurred for severance and other expenses.

NICHE PRODUCTS

	3 months ended December 31				12 months ended December 31			
($THOUSANDS)	**2012**	**2011**	**$Variance**	**%Variance**	**2012**	**2011**	**$Variance**	**%Variance**
Net earned premiums	9,310	8,812	498	5.7%	34,636	34,201	435	1.3%
Underwriting income (loss) [(1)]	(606)	162	(768)	(474.1)%	(6,050)	(1,244)	(4,806)	(386.3)%
Loss ratio[(1)]	51.5%	52.2%			66.5%	56.6%		
Expense ratio	55.0%	46.0%			51.0%	47.0%		
Combined ratio[(1)]	106.5%	98.2%			117.5%	103.6%		
Combined ratio Active Programs[(1)]	100.5%	99.2%			94.1%	92.6%		
Combined ratio Cancelled Programs[(1)]	180.0%	90.0%			310.8%	168.9%		

(1) Before impact of change in discount rate on claims adjustment for $0.1 million in the quarter and $0.7 million in 2012 and $0.1 million in the quarter and $0.3 million in 2011.

Fourth Quarter 2012

Niche Products recorded an underwriting loss of $0.6 million compared to a gain of $0.2 million recorded in the fourth quarter of 2011. The reduction in profitability was partially due to one-time unusual charges to the expense ratio related to severance and other costs of $0.2 million increasing the expense ratio to 55.0% from 46.0% in 2011. Cancelled programs also accounted for $0.6 million of the underwriting loss in this quarter of 2012 compared to income of $0.1 in the fourth quarter of 2011. Overall, the division experienced no development of prior year claims in the quarter compared to $0.2 million of positive claim development in the same period of 2011.

2012

Niche Products recorded underwriting loss of $6.1 million compared to an underwriting loss of $1.2 recorded in the same period in 2011. Several factors negatively impacted the results in 2012. Negative developments on previously cancelled programs created underwriting losses of $7.9 million in 2012 compared to $3.4 million in 2011. The most notable deterioration was experience in the Liability and Errors and Omissions lines of business. One-time unusual charges to the expense related to severances and other costs of $0.3 million increased the expense ratio to 51.0% in 2012 from 47.0% in 2011. Overall the division experienced $2.6 million negative development of prior year claims in 2012, due to $6.0 million runoff development on cancelled programs, compared to $2.1 million of positive claim development in 2011.

U.S.

	3 months ended December 31				12 months ended December 31			
($THOUSANDS)	2012	2011	$Variance	%Variance	2012	2011	$Variance	%Variance
Net earned premiums	3,631	987	2,644	267.9%	12,567	2,276	10,291	452.2%
Underwriting income (loss) (1)	(925)	(1,272)	347	27.3%	(4,553)	(3,299)	(1,254)	(38.0)%
Loss ratio(1)	91.1%	117.8%			101.5%	90.3%		
Expense ratio	34.6%	N/A(2)			34.7%	N/A(2)		
Combined ratio(1)	125.7%	N/A(2)			136.2%	N/A(2)		

(1) Before impact of change in discount rate on claims adjustment for $nil in the quarter and $nil in 2012 and $nil in the quarter and $nil in 2011.

(2) Due to start up operations these are not meaningful

Fourth Quarter 2012

The U.S. continued to record quarter-over-quarter growth in earned premiums. The division's loss ratio was 91.1% in the fourth quarter of 2012 and 117.8% in the same period in 2011. The U.S. division recorded an underwriting loss of $0.9 million in the fourth quarter compared to a loss of $1.3 million in the comparable period in 2011. The division began writing business in 2010. Expenses and loss ratios are higher for new business than for renewal business and EGI expects the combined ratio for the U.S. division will continue to improve as the mix of renewal business increases. EGI has also shifted its attention and resources away from Texas and toward the more profitable Florida market. Florida PIP reforms take effect in January 2013 which may help improve profitability. The division experienced $0.2 million negative development of prior year claims in the fourth quarter compared to $nil in the same period of 2011.

2012

The U.S. recorded an underwriting loss of $4.6 million in 2012, compared to a loss of $3.3 million in 2011. This was due to a combination of expenses being high relative to the volume of business, as the division is still in its start-up phase, and poor claims experience in Texas. Florida auto reforms took effect in January 2013 which may help improve profitability. The division experienced $0.3 million positive development of prior year claims in 2012 compared to $nil in 2011.

INTERNATIONAL

	3 months ended December 31				12 months ended December 31			
($THOUSANDS)	**2012**	**2011**	**$Variance**	**%Variance**	**2012**	**2011**	**$Variance**	**%Variance**
Net earned premiums	3,980	–	3,980	N/A	7,435	–	7,435	N/A
Underwriting income(1)	(1,226)	(422)	(804)	(190.5)%	(3,136)	(422)	(2,714)	(643.1)%
Loss ratio(1)	78.3%	N/A(2)			71.9%	N/A(2)		
Expense ratio	52.5%	N/A(2)			70.2%	N/A(2)		
Combined ratio(1)	130.8%	N/A(2)			142.1%	N/A(2)		

(1) Before impact of change in discount rate on claims adjustment for $nil in the quarter and $nil in 2012 and $nil in the quarter and $nil in 2011.

(2) Due to start up operations these are not meaningful

Fourth Quarter 2012

The International division underwriting loss of $1.2 million in the fourth quarter as a result of start-up costs associated with the development of the International operations together with a loss ratio of 78.3%. The division began writing premiums in 2012 and experienced start-up expenses of $1.0 million. Although net earned premiums were $4.0 million, gross written premiums were $9.3 million in the quarter which will be earned in the future.

2012

The International division underwriting loss of $3.1 million in 2012 is the result of development expenses for this start-up operation and a loss ratio of 71.9%. The division began writing premiums in 2012 and recorded expenses of $3.1 million. Although net earned premiums were $7.4 million, gross written premiums were $28.1 million in the year which will be earned in the future. 45% of the International division's premiums were related to a motorcycle MGA which started in April, missing the traditionally low loss first quarter in 2012.

Revenue

Revenue reflected in the consolidated financial statements includes net earned premiums, investment income, realized gains and losses on the sale of investments, and other revenue.

($ THOUSANDS)	**2012**	**2011**
Gross premiums written	220,149	174,892
Net premiums written	196,604	160,128
Net premiums earned	178,575	165,447
Net interest and dividends	12,774	13,334
Realized and unrealized gains on investments	21,217	353
Foreign exchange gains (losses)	53	180
Total revenue	212,619	179,314

The main source of revenue was earned premiums from the sale of insurance policies. Gross written premiums totaled $220.1 million, an increase of 25.9% compared to $174.9 million of last year. The increase in gross premium was primarily due to the newly-formed International division writing $28.1 million in 2012 and nil in 2011. The U.S. also wrote $14.1 million in 2012, $10.1 million more premium than the $4.0 million in 2011.

Personal Lines recorded $129.6 million of premiums in 2012 compared to $126.2 million in 2011 an increase of $3.4 million or 2.7%. Niche Products also recorded an increase in gross written premiums of $3.7 million, or 8.2%, in 2012 compared to 2011 of which $5.3 million came from increases in property premiums mainly due to the acquisition of CUISA MGA.

Net earned premiums increased $13.2 million, or 7.9% in 2012, to $178.6 million from $165.4 million in 2011, mainly due to the International division's earned premium of $7.4 million compared to nil in 2011 and the U.S. division's earned premium of $12.6 million compared to $2.3 million in 2011 partially offset by a decrease in Personal Lines earned premiums to $123.9 million from $129.0 million in 2011. Niche Products earned premiums were little changed from 2011.

The second largest source of revenue was investment income, which constituted approximately 16.0% of EGI's total revenue in 2012. EGI recognizes investment income from interest, dividends, realized gains and losses on the invested assets, fair value change in investments classified as FVTPL, and foreign exchange gains and losses. Market fluctuations in interest rates affect EGI's returns on, and the market value of, fixed income and short-term investments. The fair market value of EGI's exposure to preferred and common shares and other equity investments fluctuates as a result of changes in the overall level of the equity markets. Net realized and unrealized gains on invested assets totaled $21.2 million compared to gains of $0.4 million last year. Included in realized gains was Impairment provisions of $2.2 million in 2012 compared to $6.6 million were recorded in 2011.

Expenses

EGI's expenses consist of incurred claims, acquisition costs and operating expenses.

($ THOUSANDS)	2012	2011
Expenses		
Incurred claims(1)	113,169	105,415
Acquisition expense	40,835	37,178
Operating expense	27,842	22,266
	181,846	164,859

Selected Underwriting Ratios	2012	2011
Incurred claims ratio(1)	63.4%	63.7%
Acquisition expense ratio	22.9%	22.5%
Operating expense ratio	15.6%	13.4%
Combined ratio(1)	101.9%	99.6%

(1) Before impact of change in discount rate on claims adjustment for $3.9 million in 2012 and $1.8 million in 2011

The combined ratio for EGI increased in 2012 to 101.9% from 99.6% in 2011. The loss ratio decreased to 63.4% in 2012 compared to 63.7% in 2011. In Personal Lines, the auto line of business loss ratio decreased to 54.3% in 2012 from 64.6% in 2011 due to continued improvements noted from actions initiated by management to improve automobile underwriting results as well as Government of Ontario auto reforms that took effect in September of 2010. Niche Products recorded an increase in the loss ratio to 66.5% in 2012 compared to 56.6% in 2011. As noted earlier, this higher loss ratio was primarily due to negative development of previously cancelled programs in the year.

Incurred claims, also referred to as losses, are the amounts payable under insurance policies relating to insured events. Loss adjustment expenses, also referred to as claims expenses, are the expenses of settling claims, including allocated (i.e. external) loss adjustment expenses and unallocated (i.e. internal) loss adjustment expenses (together, LAE). Achieving profitable results depends on EGI's ability to manage future claims and other costs through innovative product design, strict underwriting criteria and efficient claims management.

Acquisition costs consist mainly of commissions and premium taxes which are directly related to the acquisition of premiums. Commissions are the amounts paid to producers for selling insurance policies. The amount of commission is generally a percentage of the premium of the insurance policy sold or renewed. Contingent commissions are paid to brokers and MGAs on an annual basis if they meet certain targets. In general, these producers have to meet or exceed certain criteria, including written premium targets and profitability, on average over three years, to qualify for this compensation. Premium taxes are paid by EGI to provincial and state governments, calculated as a percentage of direct written premiums.

Operating expenses are the non-commission selling, underwriting and administrative expenses incurred to support EGI's business. A significant portion of these expenses is related to employee compensation and benefits. The effective control and management of these expenses can enhance the underwriting results from the operation. The increase in operating expenses in 2012 compared to 2011 was due to costs relating to investment in the infrastructure to support future strategic initiatives as well as one-time unusual expenses relating to severances and other expenses.

Regulation

The industry in which EGI operates is regulated for the sale of P&C insurance. Changes in these regulations may significantly affect the operations and financial results of EGI. Government reforms in Ontario aimed at addressing the rapidly escalating costs of automobile insurance claims were enacted to apply to coverages issued on and after September 1, 2010. This has lowered the claims costs of accident benefits in the year. PIP reforms have been undertaken in Florida effective January 1, 2013, to address rising fraud in that state.

Critical Accounting Estimates and Assumptions

EGI's significant accounting policies are disclosed in note 4 to the consolidated financial statements for the years ended December 31, 2012 and 2011.

The preparation of the Company's consolidated financial statements requires management to use estimates that affect the amounts reported in the financial statements. These estimates principally relate to the establishment of reserves for claims and expenses, impairments of investment securities, amounts recoverable from reinsurers and income taxes. As more information becomes known, these estimates could change and impact future results.

Policy Liabilities

Policy liabilities consist of provisions for unpaid claims.

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

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

The provision for unpaid claims and adjustment expenses is discounted to take into account the time value of money. In 2012, the discount rate used was 1.65% (2011 – 1.9%). Changes in market interest rates and investment portfolio yield are the primary factors influencing the discount rate. Based on the net provision for unpaid claims and adjustment expenses as at December 31, 2012, a 1% increase in the discount rate would result in a decrease in the net provision of $5.8 million and a 1% decrease in the discount rate would increase the net provision by $6.1 million. It also includes a provision for adverse deviation, as required by Canadian accepted actuarial practice.

Impairment of Financial Assets

The Company considers an impairment if there is objective evidence that an available-for-sale financial asset is impaired, including in the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its carrying value. The Company considers an impairment if there is objective evidence that a loan or receivable collectability is impaired at which time the Company will write down the loan or receivable to the expected recoverable cost.

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

a) significant financial difficulty of the issuer or obligor;

b) a breach of contract, such as a default or delinquency in interest or principal payments;

c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;

d) it becoming probable that the borrower will enter bankruptcy or other financial reorganization;

e) the disappearance of an active market for that financial asset because of financial difficulties; or

f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

   (i) adverse changes in the payment status of borrowers in the group (e.g., an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or

   (ii) national or local economic conditions that correlate with defaults on the assets in the group (e.g., an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).

Reinsurance

Reinsurer's share of the provision for unpaid claims include amounts for expected recoveries related to provision for unpaid claims. Amounts recoverable from reinsurers are estimated in a manner consistent with claim and claim adjustment expense reserves. The ceding of an insurance liability to a reinsurer does not discharge the Company's primary liability to the policyholders. The Company's policy is to record an estimated allowance for doubtful accounts on the basis of periodic evaluations of balances due from reinsurers, reinsurer solvency, credit ratings of reinsurers, collateral held by the Company, management's experience and current economic conditions.

The Company is exposed to disputes on, and defects in, contracts with reinsurers and the possibility of default by reinsurers.

Income Taxes

Deferred income taxes, accumulated as a result of temporary differences, which are probable to reverse, are included in the consolidated balance sheet. In addition, the consolidated statements of income contains items that are non-taxable or non-deductible for income tax purposes, which cause the income tax provision to differ from what it would be if based on statutory rates. Recoverability of deferred tax assets is primarily based on current and expected profitability applicable to the Company and its ability to utilize any recorded tax assets taking into consideration tax planning strategies and the expiry date of tax losses.

Summary of Quarterly Results

	2012				2011			
($ THOUSANDS EXCEPT PER SHARE DATA)	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Direct written and assumed premiums	52,326	57,778	66,106	43,939	44,324	46,966	52,751	30,850
Net earned premiums and other revenue	46,713	45,735	43,957	42,170	42,375	41,672	41,057	40,344
Underwriting income (loss)(1)	1,833	181	(4,309)	(976)	1,450	471	(1,218)	(113)
Income (loss) before income taxes	6,428	19,057	(3,583)	4,984	6,097	165	2,062	4,289
Net income (loss)	4,513	13,879	(2,820)	3,794	3,254	(171)	1,410	3,028
Earnings (loss) per adjusted share								
(a) Basic	$0.40	$1.17	($0.20)	$0.33	$0.29	$(0.01)	$0.12	$0.25
(b) Diluted	$0.38	$1.17	($0.20)	$0.33	$0.29	$(0.01)	$0.12	$0.25
Selected financial ratios (%)								
Loss ratio(1)	55.8%	61.4%	71.3%	65.7%	59.2%	63.0%	67.1%	65.7%
Expense ratio	40.3%	38.3%	38.5%	36.6%	37.4%	35.9%	35.9%	34.6%
Combined(1)	96.1%	99.7%	109.8%	102.3%	96.6%	98.9%	103.0%	100.3%

(1) Before impact of change in discount rate on claims adjustment for $3.9 million in 2012 and $1.8 million in 2011

Quarter Ended December 31, 2012, compared To Quarter Ended December 31, 2011

The following financial information compares the results for the fourth quarter 2012 with the fourth quarter 2011.

($THOUSANDS)	Q4 2012	Q4 2011	Variance $	Variance %
Direct written and assumed premiums	52,326	44,324	8,002	18.1%
Net written premiums	48,638	40,629	8,009	19.7%
Net earned premiums	46,713	42,375	4,338	10.2%
Claims incurred	26,056	25,085	971	3.9%
Acquisition costs	10,319	9,295	1,024	11.0%
Operating expenses	8,505	6,542	1,963	30.0%
Underwriting income	1,833	1,450	383	26.4%
Investment income	4,792	5,245	(453)	(8.6)%
Impact of discount rate on claims	(197)	(598)	401	(67.1)%
Net income before income taxes	6,428	6,100	328	5.4%
Income taxes	1,915	2,843	(928)	(32.6)%
Net income	4,513	3,257	1,256	38.6%
Net Operating Income	4,402	2,436	1,966	80.7%

Insurance Operation

Written Premiums

In the fourth quarter of 2012, direct written premiums increased $8.0 million, or 18.1%, to $52.3 million compared to $44.3 million in the same period last year. The increase was primarily the result of increases in premiums generated by the International division of $9.3 million.

In Personal Lines, written premiums decreased by $3.1 million, or 9.9%, in the fourth quarter of 2012 compared to the same period in 2011. The decrease was in the non-standard line of business mainly related to Ontario auto which has challenged EGI to review ways to retain existing policy holders.

Niche Products showed an increase of $0.9 million or 7.5% in direct written premiums in the final quarter of 2012 compared to the same period in 2011. The premium increases was due to increased volume generated from the acquisition of CUISA MGA.

The U.S. recorded an increase of $0.9 million of written premiums in the fourth quarter of 2012, as more Florida-related business was generated than in the same quarter in 2011.

For the three months ended December 31, 2012, net written premiums increased $8.0 million or 19.7% to $48.6 million compared to $40.6 million for the last quarter of 2011. This increase was consistent with the increase in direct written and assumed premiums noted above.

Earned Premiums

Net earned premiums for the three months ended December 31, 2012, were $46.7 million, an increase of $4.3 million, or 10.2%, compared to the fourth quarter of 2011. The increase in net earned premiums was less than the increase in net written premiums as the growth in the International division earned premium has yet to catch up to the growth in written premium but it will earn in future years.

Incurred Claims Expense

For the quarter ended December 31, 2012, net claims expense increased $1.0 million or 3.9% to $26.1 million compared to $25.1 million for the fourth quarter of 2011. This resulted in a loss ratio of 55.8% for the three months ended December 31, 2012 compared to 59.2% for the same period in 2011.

The loss ratio in Personal Lines was 49.8% in the three-month period ended December 31, 2012, compared to 59.3% in the same period of 2011. Personal Lines recorded a $2.6 million positive development of prior year claims in the final quarter of 2012 compared to $1.7 million positive development in the same period in 2011.

Niche Products' loss ratio was 51.5% in the last three months of 2012 compared to 52.2% in the same period last year. Niche Products recorded minimal development of prior year claims in the final quarter of 2012 compared to $0.2 million of positive development in the same period in 2011.

The U.S. recorded negative development of prior year claims of $0.2 million in the last quarter of 2012 compared to minimal development in the same period in 2011.

On a consolidated basis, net favourable development of prior year claims of $2.4 million was recorded in the fourth quarter of 2012 compared to favourable development of $1.9 million in the same period in 2011.

Acquisition Costs

Net acquisition costs, which consist mainly of commissions and premium taxes, increased $1.0 million or 11.0% to $10.3 million in the quarter ended December 31, 2012, compared to $9.3 million in the same period in 2011. The increase is in line with the increase in net earned premiums of 10.2%.

Operating Expenses

For the fourth quarter of 2012, operating expenses were $8.5 million compared to $6.5 million in the same period in 2011, an increase of 30.0%. The increase is due primarily to one-time unusual charges in 2012 of $1.1 million plus increases in IT related investments to improve systems.

Underwriting Income

The quarter ended December 31, 2012, earned an underwriting income of $1.8 million, compared to an underwriting income of $1.5 million in the same quarter of 2011, an increase of 26.4%. As detailed above, the significant increase was attributable to the decrease in the loss ratio in Personal Lines.

Investment Income

In the final quarter of 2012, income from investments decreased to $4.8 million compared to $5.2 million in the final quarter of 2011. The decrease was due to a decrease in the realization of net gains, on the disposal of investments, to $1.6 million in the quarter compared to net realized gains of $1.8 million in the final quarter of 2011.

Income from interest and dividends net of investment expenses totaled $3.1 million in the fourth quarter of 2012 compared to $3.3 million in the same period in 2011, reflecting the decrease in yield in 2012 compared to 2011.

Net Income before Income Taxes

For the quarter ended December 31, 2012, income before income taxes was $6.4 million compared to $6.1 million for the final quarter of 2011. This increase was largely the result of an increase in underwriting income of $0.4 million, with a decrease in impact of discount rate on claims of $0.4 million, offset by a lower investment income of $0.5 million compared to the same period in 2011.

Income Taxes

For the quarter ended December 31, 2012, the provision for income taxes reflects an expense of $1.9 million compared to an expense of $2.8 million for the same period last year. The approximate effective tax rate was 28.5% for the last quarter of 2012 and 29.1% for the same period last year.

Year Ended December 31, 2012 compared to 2011

The following financial information compares results for the full year 2012 and 2011.

($ THOUSANDS)	2012	2011	Variance $	Variance %
Direct written premiums	220,149	174,892	45,257	25.9%
Net written premiums	196,604	160,128	36,476	22.8%
Net earned premiums	178,575	165,447	13,128	7.9%
Claims incurred	113,169	105,415	7,754	7.4%
Acquisition costs	40,835	37,178	3,657	9.8%
Operating expenses	27,842	22,266	5,576	25.0%
Underwriting income (loss)	(3,271)	588	(3,859)	(656.3)%
Impact of discount rate on claims	(3,887)	(1,843)	(2,044)	(110.9)%
Investment income (loss)	34,044	13,867	20,177	145.5%
Net income before income taxes	26,886	12,612	14,274	113.2%
Income taxes	7,520	5,092	2,428	47.7%
Net income	19,366	7,520	11,846	157.5%
Net operating income	7,725	8,585	(860)	(10.0)%

Insurance Operation

Written Premiums

Direct written and assumed premiums increased $45.3 million or 25.9% to $220.1 million for the year ended December 31, 2012 compared to $174.9 million for 2011. The increase in premium was primarily due to the newly-formed International division writing $28.1 million in 2012 and nil in 2011. The U.S. also wrote $14.1 million in 2012, an increase of $10.1 million in 2012. Personal Lines recorded $129.6 million of premiums in 2012, compared to $126.2 million in 2011, an increase of $3.4 million or 2.7%. Niche Products also recorded an increase in written premiums of $3.7 million, or 8.2%, in 2012 compared to 2011, of which $5.3 million came from increases in property premiums mainly due to the acquisition of CUISA MGA.

Within Personal Lines, non-standard automobile premiums in 2012 increased to $108.2 million compared to $105.6 million in the prior year, while motorcycle premiums increased to $17.6 million in 2012 compared to $16.7 million in 2011. The remaining premiums for Personal Lines are from other vehicle types.

Net written premiums increased $36.5 million or 22.8% to $196.6 million for the year ended December 31, 2012, compared to $160.1 million for the same period in 2011. The increase in net written premiums was consistent with the decrease in gross written premiums.

Earned Premiums

Net earned premiums for 2012, were $178.6 million, an increase of $13.1 million or 7.9% from 2011. The increase is primarily due to increased earned premiums in the U.S. and International divisions of $10.3 million and $7.4 million respectively from 2011. Earned premiums in Personal Lines decreased by $5.1 million in the year despite the increase in written premiums.

Incurred Claims Expense

Net incurred claims expense increased $7.8 million, or 7.4%, to $113.2 million for 2012, compared to $105.4 million for 2011. The resulting loss ratio of 63.4% for 2012 represents an improvement of 0.3% over the 2011 loss ratio of 63.7%.

Personal Lines recorded a decrease in its loss ratio to 58.1% compared to 65.1% in 2011. Lower claims costs, particularly in Ontario Auto, were the primary factor leading to year-over-year improved results. In addition favourable claims development related to prior year claims continued for Personal Lines products in 2012, with total net positive development of $8.5 million, being higher than the positive development of $4.0 million in 2011. The 2012 positive development in Personal Lines is primarily due to positive developments in Ontario Accident Benefits as a result of the Ontario Auto reforms, partially offset by negative development in 2012 for Motorcycle.

Niche Products' loss ratio increased to 66.5% for the year compared to 56.6% in 2011. This was due to previously cancelled programs which had loss ratios of 186.5% in 2012. The division also experienced adverse development of $2.6 million in 2012 primarily in the E&O liability cancelled programs compared to positive development of $2.1 million in 2011.

On a Company-wide consolidated basis, net favourable development of prior year claims of $6.1 million was recorded in 2012 compared to favourable development of $6.4 million in 2011.

Acquisition Costs

Net acquisition costs, consisting mainly of commissions and premium taxes, increased $3.7 million or 9.8% to $40.8 million for 2012, compared to $37.2 million in 2011. The increase is higher than the increase in net earned premiums of 7.9% compared to 2011, primarily due to the change in mix of business in the Niche Products and International divisions.

Operating Expenses

Operating expenses, increased $5.6 million or 25.0% to $27.8 million compared to $22.3 million for 2011. The increase was due to additional performance incentive accrued in 2012 and costs relating to investment in infrastructure to support future strategic initiatives, and one-time unusual charges relating to severances and other expenses.

Underwriting Income

Underwriting results reflect the revenues from net earned premiums less claims, acquisition and operating expenses. Overall underwriting performance decreased by $3.8 million to a loss of $3.3 million for the year ended December 31, 2012, compared to an underwriting gain of $0.5 million for 2011. The underwriting results for 2012 and 2011 were net of corporate and other expenses of $1.4 million and $1.5 million in 2012 and 2011, respectively.

Personal Lines recorded underwriting income of $11.9 million for the year ended December 31, 2012, representing an improvement of $4.9 million compared to income of $7.0 million for 2011. Its combined ratio decreased to 90.4% in 2012 compared to 94.5% in 2011. This is the result of management actions taken and Ontario Auto reforms as stated earlier.

The underwriting loss from Niche Products for the year ended December 31, 2012, was $6.0 million, compared to an underwriting loss of $1.2 million in 2011. This result was primarily due to an increase in acquisition costs due to the change in mix of business. This result was adversely impacted by claims development on discontinued programs.

The U.S. incurred an underwriting loss of $4.6 million compared to a loss of $3.3 million 2011 due to increased earned premiums with 101.5% loss ratios. The International division recorded an underwriting loss of $3.1 million in 2012 compared to $0.4 million in 2011. Qudos started writing premiums in April 2012. 45% of the International division's premiums were related to a motorcycle MGA which started in April, missing the traditionally low loss first quarter in 2012, negatively impacting the full year results.

Investment Income

Investment income increased by $20.2 million, to $34.0 million in 2012 compared to $13.9 million in 2011.

Net gains on investments totaled $21.0 million in 2012 compared to $0.1 million in 2011. Impairment provisions of $2.2 million were recorded in 2012 compared to $6.6 million in 2011.

Income from interest and dividends was $14.4 million in 2012 compared to $15.0 million in 2011. The result reflected the lower interest rate environment in the year despite higher invested assets in 2012 compared to 2011. The total fair value of the investment portfolio as at December 31, 2012, (including cash and short-term and premium financing receivable) was $438.6 million compared to $404.1 million as at December 31, 2011.

Income before Income Taxes

Income before income taxes was $26.9 million in 2012, compared to $12.6 million in 2011.

For the year ended December 31, 2012, an underwriting loss of $3.3 million, less impact of discount rate on claims of $3.9 million, plus investment income of $34.0 million, comprised income before income taxes of $26.9 million. This is compared to an underwriting gain of $0.5 million, less discount rate impact on claims of $1.8 million, plus investment income of $13.9, which comprised income before income taxes of $12.6 million in 2011.

Income Taxes

The provision for income taxes for the year ended December 31, 2012, was $7.5 million compared to $5.1 million for 2011. The approximate effective tax rate decreased to 28.0% for 2012 from 40.4% for the previous year. In 2011, tax expense included a write down of deferred tax asset. Corporate tax rates for the Company decreased from 28.5% in 2011 to 27.0% in 2012 and other tax rate differences for income from foreign jurisdictions contributed to the lower effective tax rate for 2012.

Net Operating Income

Net operating income decreased $0.9 million to $7.7 million in 2012 from $8.6 million in 2011.

Year Ended December 31, 2011 Compared to 2010

The following financial information compares results for the full year 2011 and 2010.

($ THOUSANDS)	2011	2010	Variance $	Variance %
Direct written premiums	174,892	185,671	(10,779)	(5.8)%
Net written premiums	160,128	167,066	(6,938)	(4.2)%
Net earned premiums	165,447	162,873	2,574	1.6%
Claims incurred	105,415	118,642	(13,227)	(11.1)%
Acquisition costs	37,178	35,834	1,344	3.8%
Operating expenses	22,266	17,732	4,534	25.6%
Underwriting income (loss)	588	(9,335)	9,923	106.3%
Impact of discount rate on claims	1,843	488	1,355	277.7%
Investment income (loss)	13,867	17,465	(3,598)	(20.6)%
Interest expense	–	568	(568)	N/A
Net income before income taxes	12,612	7,074	5,538	78.3%
Income taxes	5,092	2,922	2,170	74.3%
Net income	7,520	4,152	3,368	81.1%
Net operating income	8,585	939	7,646	814.3%

Insurance Operation

Written Premiums

Direct written and assumed premiums decreased $10.8 million, or 5.8%, to $174.9 million for the year ended December 31, 2011 compared to $185.7 million for 2010. Personal Lines and Niche Products recorded decreases in premiums in 2011 of $7.8 and $6.7 million, respectively, compared to the prior year; while the U.S. division, in start up mode, recorded written premium of $4.0 million in 2011. The decrease in Personal Lines premiums written was the result of the division beginning to issue six- month policies for Ontario Auto in the fourth quarter of 2010 that had the effect of reducing written premium in the first six months of 2011 when compared to the same period in 2010. This is also the result of management actions taken in 2011 by cancelling policies and brokers to improve underwriting results. Non-standard automobile premiums in 2011 decreased to $105.6 million compared to $114.8 million in the prior year, while motorcycle premiums increased to $16.7 million in 2011 compared to $15.9 million in 2010. The remaining premiums for Personal Lines are from other vehicle types.

Niche Products recorded a decrease in direct written premiums of $6.7 million to $44.7 million compared to $51.4 million in 2010. The Commercial Auto line of business accounted for $5.6 million of the decrease as the program was discontinued in the beginning of 2011, as part of management's decision to cancel unprofitable programs to improve the underwriting results.

As noted earlier, the U.S. division is slowly building up the business. As a result, direct written premiums of $4.0 million were recorded in 2011.

Net written premiums decreased $6.9 million or 4.2% to $160.1 million for the year ended December 31, 2011, compared to $167.0 million for the same period last year. The decrease in net written premiums was consistent with the decrease in gross written premiums.

Earned Premiums

Net earned premiums for 2011, were $165.4 million, an increase of $2.6 million or 1.6% from 2010. As noted earlier, the decrease in written premiums due to the change to six-month policies in Ontario Auto has no impact on earned premiums. Personal Lines increased its rates in the third quarter of 2010 and the second quarter of 2011, which offset management actions to cancel some of its policies resulting in an increase in earned premiums.

Incurred Claims Expense

Net incurred claims expense decreased $13.2 million, or 11.1%, to $105.4 million for 2011, compared to $118.6 million for 2010. The resulting loss ratio of 63.7% for 2011 represents a significant improvement of 9.4% over the 2010 loss ratio of 73.1%.

Personal Lines recorded a decrease in its loss ratio to 65.1% compared to 78.3% in 2010. Lower claims costs, particularly in Auto, was the primary factor leading to year-over-year improved results. In addition favourable claims development related to prior year claims continued for Personal Lines products in 2011, with total net positive development of $3.9 million, being higher than the positive development of $1.7 million in 2010.

Niche Products' loss ratio decreased to 56.6% for the year compared to 59.9% in 2010. This result was primarily due to cancellation of the largest program in the Commercial Auto line in the first quarter of 2011 due to unprofitable performance.

On a Company-wide consolidated basis, net favourable development of prior year claims of $6.4 million was recorded in 2011 compared to favourable development of $4.1 million in 2010.

Acquisition Costs

Net acquisition costs, consisting mainly of commissions and premium taxes, increased $1.3 million or 3.8% to $37.2 million for 2011, compared to $35.8 million in 2010. The increase is higher than the increase in net earned premiums of 1.6% compared to 2010, primarily due to the change in mix of business in Niche Products.

Operating Expenses

Operating expenses, increased $4.5 million or 25.6% to $22.3 million compared to $17.7 million for 2010. The increase was due to additional performance incentive accrued in 2011 and costs relating to investment in infrastructure to support future strategic initiatives.

Underwriting Income

Underwriting results reflect the revenues from net earned premiums less claims, acquisition and operating expenses. The overall underwriting loss improved by $9.9 million to a gain of $0.5 million for the year ended December 31, 2011, compared to an underwriting loss of $9.3 million for 2010. The underwriting results for 2011 and 2010 were net of corporate and other expenses of $1.5 million and $1.2 million in 2011 and 2010, respectively.

Personal Lines recorded underwriting income of $7.0 million for the year ended December 31, 2011, representing an improvement of $14.5 million compared to a loss of $7.5 million for 2010. Its combined ratio decreased to 94.5% in 2011 compared to 106.0% in 2010. This is the result of management actions taken as stated earlier, to improve underwriting results.

The underwriting loss from Niche Products for the year ended December 31, 2011, was $1.2 million, compared to income of $0.2 million in 2010. This result was primarily due to an increase in acquisition costs due to the change in mix of business. This was offset partially by improved claims experience as the division discontinued its commercial auto line.

The U.S. division incurred an underwriting loss of $3.3 million compared to a loss of $1.3 million 2010 due to start up expenses.

Investment Income

Investment income decreased by $3.6 million, to $13.9 million in 2011 compared to $17.5 million in 2010.

The decrease in investment income compared to 2010 resulted from a decline in net realized gains of $5.0 million. Net gains on investments totaled $0.1 million in 2011 compared to $5.1 million in 2010. Impairment provisions of $6.6 million charged to net realized gains were recorded in 2011 with none booked in 2010. Partially offsetting the net gains on investments in 2011 were foreign exchange gains of $0.2 million, compared to losses of $0.4 million in 2010, derived from funds held in U.S. currency and the impact of the weaker Canadian dollar and fair value gain on investments classified as held for sale.

Income from interest and dividends was $15.0 million in 2011 compared to $14.1 million in 2010. The result reflected the impact of higher invested assets in 2011 compared to 2010. The total fair value of the investment portfolio as at December 31, 2011, (including cash and short term and premium financing receivable) was $404.1 million compared to $391.8 million as at December 31, 2010.

Interest Expense

During 2011, no interest expense related to bank indebtedness was incurred compared to $0.6 million in 2010. In October 2007, EGI entered into a non-revolving term loan facility with a major Canadian bank in the amount of $19.5 million. During the three-year term of the facility, interest of 6.2% per annum was to be paid monthly. The loan facility was repaid in full during 2010, utilizing internal funds. The Company had no bank indebtedness as at December 31, 2010.

Income before Income Taxes

Income before income taxes was $12.6 million in 2011, compared to $7.1 million in 2010.

For the year ended December 31, 2011, an underwriting gain of $0.6 million, less discount rate impact of $1.8 million, plus investment income of $13.9 million, with no reduction from interest expenses on bank indebtedness, comprised income before income taxes of $12.6 million. This is compared to an underwriting loss of $9.3 million, less discount rate impact of $0.5 million, plus investment income of $17.5 million, reduced by interest expense of $0.6 million in 2010, which comprised income before income taxes of $7.1 million in 2010.

Income Taxes

The provision for income taxes for the year ended December 31, 2011, was $5.1 million compared to $2.9 million for 2010. The approximate effective tax rate decreased to 40% for 2011 from 41% for the previous year as corporate tax rates in Canada decreased in 2011.

Net Operating Income

Net operating income increased $7.7 million to $8.6 million in 2011 from $0.9 million in 2010.

Balance Sheet Analysis

Investments

EGI has an investment policy that seeks to provide a stable income base to support EGI's liabilities without incurring an undue level of investment risk. In addition to this risk-return analysis, the chosen asset mix also considers the amount of regulatory capital that is required. The two most important methods used to reduce the level of risk without reducing the rate of return in EGI's portfolio are diversification and the use of proven investment professionals.

EGI has outsourced buy/sell decisions on individual securities to a small number of reputable professional investment managers. Using the "prudent person" approach, EGI monitors the performance of each manager, measuring his or her performance against an appropriate market index benchmark.

Each of EGI's investment managers operates under an investment management agreement which provides the investment manager with a discretionary mandate to hold one or more types of securities and/or cash. The investment manager's engagement is subject to immediate cancellation by EGI, without penalty, upon giving written notice.

EGI's investment portfolio is invested in well-established, active and liquid markets in Canada, the United States and Europe. Fair value for most investments is determined by reference to other than quoted market prices. The external investment managers invest on a total return basis, viewing realized gains and losses as important and recurring components of the return on investments and, consequently, of income. The timing of the realization of gains and losses may be unpredictable, and changes in the overall levels of fixed income or equity markets generally result in corresponding changes in realized gains and losses.

Fair value of Investments

The following table provides a comparison as at December 31, 2012, and December 31, 2011:

	As at December 31	
	2012	2011
($ THOUSANDS)	Fair value	Fair value
Bonds		
Canadian		
Federal	111,034	97,337
Provincial	62,393	62,483
Municipal	16,851	10,357
Corporate	167,372	111,046
	357,650	281,223
United States		
Federal	2,262	2,635
Corporate	10,729	10,395
	12,991	13,030
Total Bonds	370,641	294,253
Preferred shares	–	917
Common shares		
Canadian	11,889	57,591
United States	5,052	1,443
	16,941	59,034
Total Available for Sale	387,582	354,204
FVTPL		
Preferred shares	25,146	10,854
Total investments at fair value	412,728	365,058

EGI's portfolio is constructed in a manner that seeks to ensure that its objectives of producing a competitive rate of return are met, while at the same time protecting and enhancing statutory underwriting capital on a long-term basis. This is achieved through diversification principles that ensure each asset class has limited exposure by region, industry, issuer and type of underlying security. Target ranges are set for each asset class and economic sector and are monitored by the Investment Committee to ensure that EGI's investment managers comply with these guidelines. Each manager is required to satisfy EGI's liquidity needs while adhering to all regulatory requirements.

Impaired assets and provisions for losses

EGI has an established policy to write down or make a provision for any investment with objective evidence that the value of the investment is impaired.

Management has reviewed currently available information and the advice of its investment managers regarding those investments whose estimated fair values are less than carrying values. For those securities whose decline in fair value was considered to be objective evidence that the value of the investment is impaired, the Company recorded the difference between the carrying amount of the investment and its fair value as an impairment which reduces investment income in the year recorded.

Impairment provisions of $2.2 million were recorded by EGI in 2012 and $6.6 million in 2011.

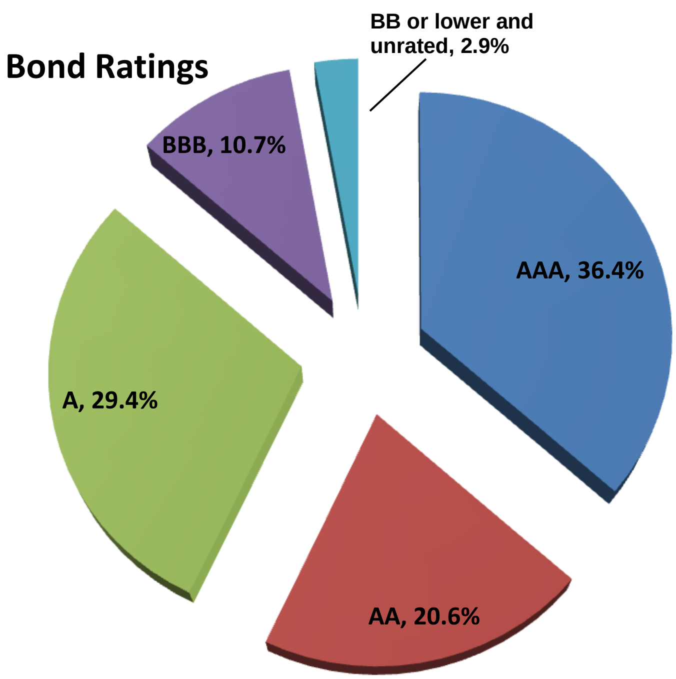
A gross unrealized loss of $0.5 million on investments held as at December 31, 2012, is recorded, net of tax, in the amount of $0.4 million (2011 – $3.8 million) in Accumulated Other Comprehensive Income. The Company has concluded based on its review that these fair value deficiencies do not meet the criteria for impairment and they will be monitored on an ongoing basis.

Fixed Income Securities

EGI holds fixed income securities to provide a steady, predictable level of income and reasonable liquidity with minimum risk of loss and a fixed sum at maturity. EGI's portfolio is diversified by selecting various types of government and corporate bonds. Constraints on types of issuers take liquidity, diversification and risk into account by limiting the portfolio mix by issuer.

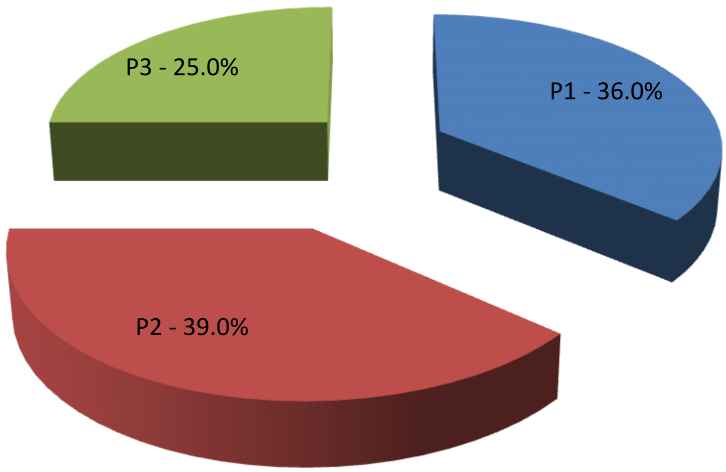
EGI's portfolio maintains a high overall credit quality level as measured by Dominion Bond Rating Service (DBRS). Constraints are placed on the percentage of bonds which can be held in the rating classes as follows: Class A or better – no maximum; Class BBB or lower – maximum 10%.

The following chart sets forth EGI's fixed income portfolio by credit quality according to DBRS as at December 31, 2012.



Fixed Income Portfolio

The following chart sets forth EGI's preferred share portfolio by credit quality according to DBRS as at December 31, 2012.



Common Shares

Common shares are a key component of EGI's portfolio to enhance the capital appreciation opportunities of EGI's invested assets. Diversification by industry sector also reduces the overall risk level inherent in EGI's common share portfolio.

Common Share Portfolio

The following table outlines EGI's Canadian common share exposure to industry sectors as at December 31, 2012, and 2011.

	As at December 31			
	2012		2011	
($ THOUSANDS)	**Fair value and carrying amount**	**% of fair value**	**Fair value and carrying amount**	**% of fair value**
Energy	970	6	16,063	27
Financial services	–	–	13,913	24
Materials	–	–	14,325	24
Other	15,971	94	14,733	25
Total	16,941	100	59,034	100

As at December 31, 2012 EGI's common share portfolio primarily consisted of Canadian and U.S. dividend exchange traded funds (ETFs).

Recoverable from Reinsurers

	As at December 31	
($ THOUSANDS)	**2012**	**2011**
Reinsurers' share of unpaid claims	30,283	33,269
Reinsurers' share of unearned premiums	9,169	5,089
Total	39,452	38,358

As at December 31, 2012, the amount recoverable from reinsurers increased by $1.1 million, or 2.9%, to $39.4 million from $38.4 million at December 31, 2011. The increase was due to increased reliance on reinsured premiums in the International division partially offset by reduced reliance on Personal Lines division claims reinsurance as older claims, with higher reinsurance, run off. All reinsurers, with balances due, have a rating of A^{-} or above as determined by Standard & Poor's and A.M. Best, except for several Niche Products distributors who share a portion of the risk with EGI, for whom EGI holds deposits.

Accounts Receivables

	As at December 31	
($ THOUSANDS)	**2012**	**2011**
Premium financing receivables	16,316	17,518
Agents and brokers	13,749	4,872
Other	5,512	3,657
Total	35,577	26,047

Premium financing receivables was the largest component of this asset as at December 31, 2012, representing approximately 45.9% of total receivables. Premium financing receivables decreased to $16.3 million at December 31, 2012, from $17.5 million at December 31, 2011, due to the move to six-month policy terms beginning in 2011. The majority of the automobile business is billed directly to policyholders and remitted on a monthly basis. The increase in agent and broker receivables from $4.9 million in 2011 to $13.7 million in 2012 was due mainly to increase in balances due to Qudos.

Provision for Unpaid Claims

EGI establishes loss reserves to provide for future amounts required to pay claims related to insured events that have occurred and been reported but have not yet been settled, as well as for those related to events that have occurred but have not yet been reported to the insurer. Claims provisions (i.e. reserves for claims liability) are established at the individual file level by the "case method" as claims are reported. The provisions are subsequently adjusted as additional information affecting the estimated amount of a claim becomes known during the course of its settlement. With the assistance of EGI's consulting actuary, a reserve provision is also made for management's calculation of factors affecting the future development of claims, including a provision for IBNR claims, based on the volume of business currently in force and the historical experience on claims. Reserves are also established for the estimated internal and external loss adjustment expenses which will be incurred during the claims settlement process.

The provision for unpaid claims and adjustment expenses is discounted to take into account the time value of money as required by EGI's primary insurance regulator. It also includes a provision for adverse deviation as required by accepted Canadian actuarial practice. EGI's consulting actuary reports on the adequacy of EGI's claims reserves on a quarterly basis. As time passes, more information about the claims becomes known and provisional estimates are appropriately adjusted upward or downward. Adjustments to reserves are reflected in the results of operations in the periods in which the estimates are changed.

The development of the provision for claims is shown by the difference between estimates of reserves as of the initial year-end and the re-estimated liability at each subsequent year-end. This is based on actual payments in full or partial settlement of claims, plus re-estimates of the reserves required for claims still open or claims still unreported. Favourable development means that the original reserve estimates were higher than subsequently indicated. Unfavourable development means that the original reserve estimates were lower than subsequently indicated.

For further discussion of EGI's reserving methods and underlying assumptions, see "Critical Accounting Estimates and Assumptions – Policy Liabilities".

The table below shows the development of the provision for claims reserves including loss adjustment expenses as at December 31 in each year of the six-year periods and for the year ended December 31, 2012.

	Calendar Year							
	2005 & prior	2006	2007	2008	2009	2010	2011	2012
Provision for claims including LAE	129,173	146,101	169,091	185,255	207,220	239,036	254,519	268,580
Reserve Re-estimate as of:								
1 year later	113,839	138,483	163,465	186,446	203,920	232,472	246,972	
2 years later	113,817	134,769	162,916	189,093	201,044	239,117		
3 years later	112,224	133,932	164,290	186,429	206,039			
4 years later	110,157	134,173	161,852	190,342				
5 years later	110,577	131,660	163,440					
6 years later	107,647	133,355						
7 years later	109,096							
Cumulative favourable (unfavourable) development	$ 20,077	12,746	5,651	(5,087)	1,181	(81)	7,547	–

Claims development table, net of reinsurance

	Calendar Year							
	2005 & prior	2006	2007	2008	2009	2010	2011	2012
Provision for claims including LAE	75,130	97,716	120,630	143,354	168,484	202,884	221,250	238,297
Reserve re-estimate as of:								
1 year later	63,060	85,726	115,530	142,641	164,393	196,517	215,191	
2 years later	60,693	81,199	112,960	143,980	162,651	203,632		
3 years later	57,706	79,470	112,595	142,924	166,901			
4 years later	56,094	77,794	111,267	144,486				
5 tears later	55,325	76,878	110,883					
6 years later	53,882	76,584						
7 years later	53,790							
Cumulative favourable (unfavourable) development	21,340	21,132	9,747	(1,132)	1,583	(748)	6,059	

(1) Amounts include Provision for Adverse Deviation (PfAD) of $27,282 for 2012, $28,291 for 2011, $25,560 for 2010; $22,688 for 2009; $20,102 for 2008; $17,401 for 2007; and $14,756 for 2006.

The uncertainties regarding EGI's reserves could result in a liability exceeding the reserves by an amount that would be material to EGI's financial condition or results of operations in a future period. Future development could be significantly different from the past, due to many unknown factors (see "Risk Factors").

Reinsurance

EGI has reinsurance treaties with several unaffiliated reinsurers, all of whom are selected on the basis of their creditworthiness. EGI purchases reinsurance to reduce its exposure to the insurance risks that it assumes in writing business. For 2012, the maximum net retention on a single risk was $1.5 million (2011 – $1.5 million).

In accordance with industry practice, EGI's reinsurance recoverables with Canadian licensed reinsurers are generally unsecured because Canadian regulations require these reinsurers to maintain minimum asset and capital balances in Canada to meet their Canadian obligations. However, policy liabilities rank in priority to any subordinate creditors a reinsurer may have. For reinsurance recoverables with non-licensed reinsurers, EGI maintains high quality collateral against reinsurance recoverables in the form of cash, letters of credit and/or assets held in trust accounts. At December 31, 2012, EGI was the assigned beneficiary of such trust accounts totaling $4.3 million (December 31, 2011 – $5.2 million) in guarantees from unlicensed reinsurers.

Excess of loss and catastrophe reinsurance is used to limit an insurer's exposure to a maximum dollar value per claim and per occurrence. Quota share is a form of proportional reinsurance often used by an insurer to build a book of business larger than can be supported by the insurer's own capital.

EGI purchases renewable excess of loss and catastrophe reinsurance from third-party reinsurers, covering its automobile and general liability business. In both 2012 and 2011, such coverage was for a total of $23 million. Other than general liability, coverages for the programs of the Niche Products division are reinsured on a program-by-program basis when necessary.

Using reinsurance, EGI's policy is to limit its loss exposure in any one claim to not more than 2% of its shareholders' equity.

EGI depends upon the financial stability of its reinsurers in the same way that EGI's insureds rely upon EGI.

Accordingly, EGI carefully selects its reinsurers and only deals with creditworthy reinsurers. EGI's Reinsurance Committee is responsible for evaluating and approving companies to which EGI cedes reinsurance. The committee consults with AON Benfield Canada regarding the financial ratings of EGI's reinsurers. Reinsurers are selected based on their financial strength ratings, services, reputation and prices offered on the required reinsurance. EGI's reinsurance broker reported that all reinsurers providing coverage under EGI's 2013 excess of loss and catastrophe treaties were rated A^{-} or better by A.M. Best as at December 2012.

EGI believes that there is currently adequate reinsurance capacity in the marketplace for those classes of business which the Company underwrites, and management is not aware of any developments that might cause a serious shortage of capacity in the future. EGI believes that, through its reinsurance program, it is adequately protected against major underwriting losses arising from a large claim under a single policy or claims under a group of policies arising from a single event.

Share Capital

As of February 22, 2013, there were 11,904,732 common shares issued and outstanding. See also note 12 to the consolidated financial statements.

Liquidity and Capital Resources

The purpose of liquidity management is to ensure there is sufficient cash to meet all of EGI's financial commitments and obligations as they come due. EGI believes that it has the flexibility to obtain, from internal sources, the funds needed to fulfill its cash requirements, during the following financial year and to satisfy regulatory capital requirements.

Contractual obligations include operating leases, for which \$1.5 million is due in less than a year and \$6.8 million is due over the next nine years.

EGI is primarily a holding company and, as such, has limited direct operations of its own. EGI's principal assets are the shares of its insurance, reinsurance and insurance management subsidiaries. Accordingly, its future cash flows depend in part upon the availability of dividends and other statutorily permissible distributions from the insurance subsidiaries. The ability to pay such dividends and to make such other distributions is limited by applicable laws and regulations of the jurisdictions in which the insurance subsidiaries are domiciled, which subject the insurance subsidiaries to significant regulatory restrictions. These laws and regulations require, among other things, that the insurance subsidiaries maintain minimum solvency requirements and may also limit the amount of dividends that the insurance subsidiaries can pay to EGI.

Normal Course Issuer Bid

On March 30, 2012, the Company received approval from the TSX to commence a normal course issuer bid to repurchase and cancel up to 671,147 common shares, representing approximately 10% of its public float of issued and outstanding common shares at that time.

Up to February 22, 2013, the Company has purchased and canceled 165,300 common shares under the normal course issuer bid at an average cost of \$9.05 per share for a total cost of \$1.5 million.

The Company believes that it is in the best interest of the Company to purchase shares for cancellation because management believes the shares are trading at a significant discount relative to their value.

Transactions with Related Parties

EGI has entered into transactions with two related parties, The Co-operators Group Limited (Co-operators) and Purves Redmond Limited (Purves Redmond). These transactions are carried out in the normal course of operations and are measured at cost which approximates fair value. The transactions involving Co-operators, which is a significant shareholder of EGI, principally consist of an agent distribution channel, support services and investment management. Purves Redmond is involved in arranging insurance coverage for the companies within the EGI group. Robert Purves, a shareholder and director of EGI and a director of Echelon, is also a shareholder and the Chairman of Purves Redmond.

Risk Management

EGI has developed a comprehensive process of risk management and internal control which emphasizes the proactive identification of risks facing the organization and the effective management and control of these risks. The foundation of the process is the ongoing thorough operational analysis by senior management committees and a structured oversight process undertaken by the Board of Directors and appointed committees. Underlying this structure are internal control procedures which are designed to safeguard EGI's assets and protect the organization and its stakeholders from risk.

As a provider of insurance products, effective risk management is fundamental to EGI's ability to protect the interests of EGI's customers and shareholders. The Company is exposed to risks of loss pertaining to insurance products. EGI is exposed to potential loss from various market risks, including interest rate and equity market fluctuation risk, credit risk, liquidity risk and, to a lesser extent, foreign currency risk.

Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency exchange rates, and other relevant market rate or price changes. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying assets are traded.

The primary market risk to the investment portfolio is the interest rate risk associated with investments in fixed income securities. The Company's exposure to unhedged foreign exchange risk is not significant. EGI has predominantly completed its transition to a new policy asset mix that began in the third quarter of 2012. The new investment policy is more capital efficient and minimizes interest rate mismatch risk. EGI has significantly improved its Asset Liability duration matching on its investment portfolio in 2012 thereby making the Company less exposed to market risk from change in interest rates. Management does not currently anticipate significant changes in EGI's primary market risk exposures or in how those exposures are managed in future reporting periods based upon what is known or expected to be in effect in future reporting periods.

Interest Rate and Equity Market Fluctuation

Movements in short and long-term interest rates, as well as fluctuations in the value of equity securities, affect the level and timing of recognition of gains and losses on securities that EGI holds, and cause changes in realized and unrealized gains and losses. Generally, the Company's investment income will be reduced during sustained periods of lower interest rates as higher yielding fixed income securities are called, mature, or are sold and the proceeds are reinvested at lower rates. During periods of rising interest rates, the market value of EGI's existing fixed income securities will generally decrease and the realized gains on fixed income securities will likely be reduced. Realized losses will be incurred following significant increases in interest rates. This will be offset by lower values on the Company's discounted actuarial liabilities.

Generally, declining interest rates result in unrealized gains in the value of the fixed income securities EGI continues to hold, as well as realized gains to the extent the relevant securities are sold. General economic conditions, political conditions and many other factors can also adversely affect the stock markets and, consequently, the value of the equity securities EGI owns.

Credit Risk

Credit risk is the possibility that counterparties may not be able to meet payment obligations when they become due. EGI assumes counterparty credit risk in many forms. A counterparty is any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation to the Company. The credit risk exposure is concentrated primarily in the fixed income and preferred share investment portfolios and, to a lesser extent, in reinsurance recoverables.

EGI's risk management strategy and investment policy 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. The Company attempts to limit its credit exposure by imposing fixed income portfolio limits on individual corporate issuers based upon credit quality (see "Investments" – "Fixed Income Securities" and "Reinsurance" sections).

Foreign Exchange Risk

Foreign exchange risk is the possibility that changes in exchange rates may produce an unintended effect on earnings and equity when measured in domestic currency. This risk is largest when asset backing liabilities are payable in one currency and are invested in financial instruments of another currency.

EGI is exposed to foreign exchange risk, through its U.S. operation with the commencement of an insurance and management services company in Florida and in its International division's operations in Europe. As at December 31, 2012, EGI has provided capital of U.S. $10.6 million to its Florida-based insurance company and capital of EURO $11.9 million to its Danish-based insurance company.

Risk Factors

Careful consideration should be given to the following factors, which must be read in conjunction with the detailed information appearing elsewhere in this report. Any of the matters highlighted in these risk factors could have a material adverse effect on EGI's results of operations, business prospects or financial condition.

Nature of the Industry

The P&C insurance business in Canada is affected by many factors which can cause fluctuations in the results of operations of EGI. Many of these factors are beyond EGI's control. An economic downturn in those jurisdictions in which EGI writes business could result in less demand for insurance and lower policy amounts. As a P&C insurance company, EGI is subject to claims arising out of catastrophes, which may have a significant impact on its results of operations and financial condition. These factors, together with the industry's historically cyclical competitive pricing, could result in fluctuations in the underwriting results and net income of EGI. A significant portion of the earnings of insurance companies is derived from the income from their investment portfolios. EGI's investment income will fluctuate depending on the returns and values of securities in its investment portfolio.

Regulation

EGI is subject to the laws and regulations of the jurisdictions in which it carries on business. These laws and regulations cover many aspects of its business, including premium rates for automobile insurance; the assets in which it may invest; the levels of capital and surplus and the standards of solvency that it must maintain; and the amount of dividends which it may declare and pay.

Changes to laws or regulations are impossible to predict and could materially adversely affect EGI's business, results of operations and financial condition. Where OSFI is concerned about an unsafe course of conduct or an unsound practice in conducting the business of a federally regulated insurance company, OSFI may direct the insurance company to refrain from a course of action or to perform acts necessary to remedy the situation. In certain circumstances, OSFI may take control of the assets of an insurance company or take control of the company itself. More restrictive laws, rules or regulations may be adopted in the future that could make compliance more difficult and/or expensive. Specifically, recently adopted legislation addressing privacy issues, among other matters, is expected to lead to additional regulation of the insurance industry in the coming years, which could result in increased expenses or restrictions on EGI's operations.

Competition

The P&C insurance business is highly competitive with pricing being a primary means of competition. Other elements of competition include availability and quality of products, quality and speed of service, financial strength, distribution systems and technical expertise.

EGI competes with many other insurance companies. Certain of these competitors are larger and have greater financial resources than EGI has.

In addition, certain competitors have from time to time decreased their prices in an apparent attempt to gain market share.

As competitors introduce new products and as new competitors enter the market, the Company and its insurance subsidiaries may encounter additional and more intense competition. There can be no assurance that EGI will continue to increase revenues or be profitable. To a large degree, future revenues of EGI are dependent upon its ability to continue to develop and market its products and to enhance the capabilities of its products to meet changes in customer needs.

EGI expects to encounter competition from other entities having a business objective similar to that of EGI. Many of these entities are well established and have extensive experience in connection with identifying and effecting business acquisitions directly or through affiliates. Many of these competitors possess greater financial resources, technical personnel and other resources than EGI and there can be no assurance that EGI will have the ability to compete successfully. EGI's financial resources will be relatively limited when contrasted with those of many of its competitors. Although EGI's business strategy assumes that the industry will generate competition, there can be no assurance on how any level of competition may impact the future revenues of EGI.

Cyclicality

Historically, the results of companies in the P&C insurance industry have been subject to significant fluctuations and uncertainties. The profitability of P&C insurers can be affected significantly by many factors, including regulatory regimes, developing trends in tort and class action litigation, adoption of consumer initiatives regarding rates or claims handling procedures, and privacy and consumer protection laws that prevent insurers from assessing risk, or factors that have a high correlation with risks considered, such as credit scoring.

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

Unpredictable Catastrophic Events

Catastrophes can be caused by various natural and unnatural events. Natural catastrophic events include hurricanes, windstorms, earthquakes, hailstorms, explosions, severe winter weather and fires. Unnatural catastrophic events include hostilities, terrorist acts, riots, crashes and derailments. The incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes, windstorms and earthquakes may produce significant damage in large, heavily populated areas. Catastrophes can cause losses in a variety of P&C

insurance lines. For example, the ice storm in eastern Canada in 1998 caused P&C insurance losses in several lines of business, including business interruption, personal property, automobile and commercial property. Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in EGI's financial results for any fiscal quarter or year and could materially reduce EGI's profitability or harm EGI's financial condition. EGI's ability to write new business also could be affected. EGI may experience an abrupt interruption of activities caused by unforeseeable and/or catastrophic events. EGI's operations may be subject to losses resulting from such disruptions. Losses can relate to property, financial assets, trading positions and also to key personnel. If EGI's business continuity plans cannot be put into action or do not take such events into account, losses may further increase.

Interest Rates

An increase in interest rates may result in lower values for EGI's bond portfolio and increased costs of borrowing for EGI on future debt instruments or credit facilities. Such increased costs would negatively affect EGI's operating results.

Negative Publicity in the Industry

EGI's products and services are ultimately distributed to individual consumers. From time to time, consumer advocacy groups or the media may focus attention on EGI's products and services, thereby subjecting its industry to periodic negative publicity. EGI also may be negatively impacted if its industry engages in practices resulting in increased public attention to its business. Negative publicity may also result in increased regulation and legislative scrutiny of practices in the P&C insurance industry as well as increased litigation. Such consequences may increase EGI's costs of doing business and adversely affect EGI's profitability by impeding its ability to market its products and services or increasing the regulatory burdens under which EGI operates.

Reliance on Brokers

EGI distributes its products primarily through a network of brokers. These brokers sell EGI's competitors' products and may stop selling EGI products altogether. Strong competition exists among insurers for brokers with demonstrated ability to sell insurance products. Premium volume and profitability could be materially adversely affected if there is a material decrease in the number of brokers that choose to sell EGI products. In addition, some P&C insurance companies offer their products through dedicated, captive sales organizations. If the number of such P&C insurance companies increases, EGI's revenues may decrease, which could have a material adverse effect on EGI's business, financial condition and results of operations. EGI's strategy of distributing through Co-operators' agent channel may also adversely impact its relationship with brokers who distribute EGI products.

Product and Pricing

EGI prices its products taking into account numerous factors, including claims frequency and severity trends, product line expense ratios, special risk factors, the capital required to support the product line, and the investment income earned on that capital. EGI's pricing process is designed to ensure an appropriate return on capital and long-term rate stability, avoiding wide fluctuations in rate unless necessary. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

However, pricing for automobile insurance must be submitted to each provincial government regulator and in certain provinces pre-approved by the regulator. It is possible that, in spite of EGI's best efforts, regulator decisions may impede automobile rate increases or other actions that EGI may wish to take. Also, during periods of intense competition for any product line to gain market share, EGI's competitors may price their products below the rates EGI considers acceptable. Although EGI may adjust its pricing up or down to maintain EGI's competitive position, EGI strives to ensure its pricing will produce an appropriate return on invested capital. There is no assurance that EGI will not lose market share during periods of intense pricing competition.

Underwriting and Claims

EGI is exposed to losses resulting from the underwriting of risks being insured and the exposure to financial loss resulting from greater than anticipated adjudication, settlement and claims costs. EGI's success depends upon its ability to accurately assess the risks associated with the insurance policies that EGI writes.

EGI's underwriting objectives are to develop business within EGI's target markets on a prudent and diversified basis and to achieve profitable underwriting results (i.e. a combined operating ratio below 100%). EGI underwrites automobile business after a review of the applicant's driving record reports and claims experience. There can be no assurances that EGI will properly assess the risks associated with the insurance policies that it writes and may, therefore, experience increased adjudication, settlement and claims costs.

Loss Reserves and Claims Management

The amounts established and to be established by EGI for loss and loss adjustment expense reserves are estimates of future costs based on various assumptions, including actuarial projections of the cost of settlement and the administration of claims, estimates of future trends in claims severity and frequency, and the level of insurance fraud. Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact EGI's ability to accurately assess the risks of the policies that it writes. In addition, future adjustments to loss reserves and loss adjustment expenses that are unanticipated by management could have an adverse impact upon the financial condition and results of operations of EGI. Although EGI's management believes its overall reserve levels as at December 31, 2011, are adequate to meet its obligations under existing policies, actual losses may deviate, perhaps substantially, from the reserves reflected in EGI's financial statements. To the extent reserves prove to be inadequate, EGI would have to increase such reserves and incur a charge to earnings.

Errors and Omissions Claims

Where EGI acts as a licensed insurance agency, it is subject to claims and litigation in the ordinary course of business resulting from alleged errors and omissions in placing insurance and handling claims. The placement of insurance and the handling of claims involve substantial amounts of money. Since errors and omissions claims against EGI may allege EGI's potential liability for all or part of the amounts in question, claimants may seek large damage awards and these claims can involve significant defense costs. Errors and omissions could include, for example, EGI's employees or sub-agents failing, whether negligently or intentionally, to place coverage or file claims on behalf of customers, to appropriately and adequately disclose insurer fee arrangements to its customers, to provide insurance providers with complete and accurate information relating to the risks being insured or to appropriately apply funds that it holds for its customers on a fiduciary basis. It is not always possible to prevent or detect errors and omissions, and the precautions EGI takes may not be effective in all cases.

EGI's business, financial condition and/or results may be negatively affected if in the future its errors and omissions insurance coverage proves to be inadequate or unavailable. In addition, errors and omissions claims may harm EGI's reputation or divert management resources away from operating the business.

EGI maintains liability insurance covering errors or omissions that may occur while acting in its role as an insurance consultant. This coverage has an aggregate limit of liability of $2 million.

Investments

EGI's investment assets are exposed to any combination of risks related to interest rates, foreign exchange rates and changing market values.

EGI's investment portfolio consists of diversified investments in fixed-income securities and preferred and common stocks. Investment returns and market values of investments fluctuate from time to time. A decline in returns could reduce the overall profitability of EGI. A change in interest rates, market values or foreign exchange rates may affect Echelon's regulatory strength tests.

Reinsurance

Consistent with industry practice, EGI utilizes reinsurance to manage its claims exposure and diversifies its business by types of insurance and geographic area. The availability and cost of reinsurance are subject to prevailing market conditions that are generally beyond the control of EGI and may affect EGI's level of business and profitability. There can be no assurance that developments may not occur in the future which might cause a shortage of reinsurance capacity in those classes of business which EGI underwrites, which could result in the curtailment of issuing of policies in a certain line of business or containing limits above a certain size.

Reinsurer Credit Risk

EGI's reinsurance arrangements are with a limited number of reinsurers. This reinsurance may cause an adverse effect on EGI's results of operations if one or more of its reinsurers are unable to meet its financial obligations. Although all of its reinsurers were rated A– or higher by A.M. Best at the time of entering into the reinsurance arrangements, these ratings are subject to change and may be lowered.

Although reinsurance makes the assuming reinsurers liable to EGI to the extent of the risk each reinsurer assumes, EGI is not relieved of its primary liability to its insureds as the direct insurer. As a result, EGI bears credit risk with respect to its reinsurers. EGI cannot ensure that its reinsurers will pay all reinsurance claims on a timely basis or at all. EGI evaluates each reinsurance claim based on the facts of the case, historical experience with the reinsurer on similar claims, and existing law and includes in its reserve for uncollectible reinsurance any amounts deemed uncollectible. The inability to collect amounts due to EGI under reinsurance arrangements would reduce EGI's net income and cash flow.

Technology

EGI is heavily dependent on systems technology to process large volumes of transactions and there would be a risk if the technology employed is inadequate or inappropriate to support current and future business needs and objectives. EGI continues to implement new computer applications as part of a comprehensive approach to improve systems technology. EGI regularly tests and improves its Disaster Recovery and Business Continuity Plan to protect itself, its producers and policyholders in the event of a technology failure; however, there is no assurance that EGI will be able to respond to technology failures effectively and with minimal disruption.

Liquidity

EGI manages its cash and liquid assets in an effort to ensure there is sufficient cash to meet all of EGI's financial obligations as they fall due. As a federally regulated insurance company, Echelon is required to maintain an asset base comprised of liquid securities that can be used to satisfy its ongoing commitments. EGI believes that internally generated funds provide the financial flexibility needed to fulfill cash commitments on an ongoing basis. EGI has no material commitments for capital expenditures. However, there can be no assurances that EGI's cash on hand and liquid assets will be sufficient to meet any future obligations that may come due.

Future Capital Requirements

EGI's future capital requirements will depend upon many factors, including the expansion of EGI's sales and marketing efforts and the status of competition. There can be no assurance that financing will be available to EGI on acceptable terms, or at all. If additional funds are raised by issuing equity securities, further dilution to the existing stockholders will result. If adequate funds are not available, EGI may be required to delay, scale back or eliminate its programs. Accordingly, the inability to obtain such financing could have a material adverse effect on EGI's business, financial condition and results of operations.

Corporate Governance

Active oversight remains a priority for the Board of Directors. The board is directly involved, through its committees, in overseeing all aspects of EGI's operation. The objective of the board is to meet or exceed best practices in corporate governance. There is independent oversight from the board and the respective committees to key corporate functions such as financial reporting, compliance, risk assessment and management, as well as human resources and succession planning.

EGI's Board of Directors has established the following committees to ensure that risks are effectively identified, monitored, controlled and reported on:

Audit and Risk Committee*:* The Audit and Risk Committee reviews all financial information, monitors internal controls and provides oversight of management's risk control processes, specifically focusing on financial related risks. Echelon also has an Audit and Risk Committee of its directors in accordance with the requirements of the Insurance Companies Act (Canada).

Governance Committee*:* The Governance Committee is responsible for director nominations, monitoring related party transactions, officer compensation, benefit plans and the monitoring of regulatory compliance and market conduct programs put in place by management to ensure their effectiveness.

Investment Committee*:* The Investment Committee ensures that risks associated with the investment of corporate and policyholder funds are effectively managed to accomplish EGI's investment objectives of prudent, conservative management of funds and compliance with regulatory restrictions while achieving competitive rates of return.

Reinsurance Committee*:* This committee of senior executives works closely with AON Benfield Canada, EGI's reinsurance brokers, to ensure that effective reinsurance programs are in place, which facilitate the desired growth of EGI's business and provide EGI with protection against the occurrence of significant and unusual claims risk and development.

In addition to these committees, management has formed a number of working committees which have been assigned the responsibility of identifying and managing specific corporate risks, including (i) underwriting and claims committees to manage the risks associated with the development and pricing of EGI's products, claims adjudication and reserving; (ii) a technology committee and a system prioritization committee to ensure the prioritization and implementation of effective technology solutions; (iii) an Enterprise Risk Management committee to instill a consistent approach to risk management and appropriate processes and procedures are in place to ensure compliance with all applicable regulatory requirements. EGI has established a Disaster Recovery Plan and a Business Continuity Plan with the objectives of protecting critical Company information and infrastructure and resuming business operations in a timely effective manner in the event of a catastrophic event.

Future Changes in Accounting Policies and Disclosure

Accounting standards issued but not yet applied

Management has assessed the following standards and expect they will not have a significant impact on the financial reporting of the Company, other than some changes in presentation.

Amendment to IAS 1 Presentation of Financial Statements

In June 2011, the International Accounting Standards Board (IASB) issued an amendment to IAS 1 that changes the presentation of items in the consolidated statement of comprehensive income. This amendment requires the components of other comprehensive income to be presented in two separate groups, based on whether or not the components may be recycled to the consolidated statement of earnings in the future. Companies will continue to have a choice of whether to present components of OCI before or after tax. Those that present components of OCI before tax will be required to disclose the amount of tax related to the two groups separately. This amendment is effective for annual periods beginning on or after July 1, 2012, is applied retrospectively, with early adoption permitted. The Company is currently evaluating the impact of this amendment to IAS 1 on its consolidated financial statements.

IFRS 13 Fair Value Measurement

In May 2011, the IASB published IFRS 13, a comprehensive standard on how to measure and disclose fair values. IFRS 13 applies to IFRSs that require or permit fair value measurement, but does not address when to measure fair value or require additional use of fair value. The new standard requires disclosures similar to those in IFRS 7 *Financial Instruments: Disclosures*, but applies to all assets and liabilities measured at fair value, whereas IFRS 7 applied only to financial assets and liabilities measured at fair value. IFRS 13 is effective for annual periods beginning on or after January 1, 2013, is applied prospectively as of the beginning of the annual period in which it is adopted, with early adoption permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

New and revised Reporting Entity standards

In May 2011 the IASB published a package of five new and revised standards that address the scope of the reporting entity. The new standards in the package are IFRS 10 C*onsolidated Financial Statements,* IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities.* The revised standards are IAS 28 *Investments in Associates and Joint Ventures* and *Joint Ventures and* IAS 27 *Separate Financial Statements.*

The requirements contained in the package of five standards are effective for annual periods beginning on or after January 2013, with early adoption permitted so long as the entire package is early adopted together. The five standards are described below. The Company is currently evaluating the impact of these new and revised standards on its consolidated financial statements.

IFRS 10 *Consolidated Financial Statements*

IFRS 10 introduces a single consolidation model that uses the same criteria to determine control for entities of all types, irrespective of whether the investee is controlled by voting rights or other contractual arrangements. The principle that a consolidated entity presents a parent and its subsidiaries as a single entity remains unchanged, as do the mechanics of consolidation. IFRS 10 supersedes existing guidance under IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation – Special Purpose Entities*.

IFRS 11 Joint Arrangements

IFRS 11 establishes principles for financial reporting by parties to a joint arrangement, and only differentiates between joint operations and joint ventures. The option to apply proportionate consolidation when accounting for joint ventures has been removed; equity accounting is now applied in accordance with IAS 28 *Investments in*

Associates and Joint Ventures. IFRS 11 supersedes existing guidance under IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly Controlled Entities – Non Monetary Contributions by Venturers.*

IFRS 12 Disclosure of Interests in Other Entities

IFRS 12 sets out the disclosure requirements under IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements* and IAS 28 *Investments in Associates and Joint Ventures.* The enhanced disclosures in the new standard are intended to help financial statement readers evaluate the nature, risks and financial effects of an entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. Entities are permitted to incorporate any of the disclosure requirements in IFRS 12 into their financial statements without early adopting IFRS 12.

IAS 28 Investments in Associates and Joint Ventures

IAS 28 has been amended in line with the changes to accounting for joint arrangements in IFRS 11. The amended standard prescribes the accounting for investments in associates and provides guidance on the application of the equity method when accounting for investments in associates and joint ventures.

IAS 27 Separate Financial Statements

IAS 27 has been amended to provide guidance on the accounting and disclosure requirements for investments in subsidiaries, associates and joint ventures when an entity prepares separate financial statements. The amended standard requires an entity preparing separate financial statements to account for investments at cost or in accordance with IFRS 9 *Financial Instruments.*

IFRS 9 *Financial Instruments*

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

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

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

Controls and Procedures

Disclosure Controls and Procedures

EGI's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by EGI is recorded, processed, summarized and reported in a timely manner. This includes controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2012, an evaluation was carried out, under the supervision of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as defined under National Instrument 52-109. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures was effective.

Internal Controls over Financial Reporting

As at the financial year ended December 31, 2012, the Chief Executive Officer and the Chief Financial Officer evaluated the design and operating effectiveness of the Company's internal control over financial reporting. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the internal control over financial reporting was effective as at December 31, 2012, and provided reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

There have been no changes in the Company's internal control over financial reporting during the year ended December 31, 2012, that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

Capital Resources

The total capitalization of EGI at December 31, 2012, was $165.4 million compared to $154.8 million at December 31, 2011. The elements that increased equity consist of net income of $19.4 million, the increase in common share and contributed surplus of $0.3 million and comprehensive loss of $7.7 million in 2012, reflecting (i) an increase in the fair value of investments designated as available-for-sale investments of $9.1 million, net of income tax, (ii) a reclassification for gains realized in 2012 of $21.0 million, net of income tax, to net income in the year, and (iii) unrealized losses of $0.5 million on translation of financial statements whose functional currency was not Canadian dollars.

The continued growth in capitalization reflects the strengthening of EGI's balance sheet and provides for better capital adequacy as a P&C insurance underwriter. A common measure of capital adequacy is the net written premium ratio to surplus or equity. This ratio was 1.2:1 as at December 31, 2012, compared to 1.0:1 in 2011. This level of leverage continues to be well below the 2.5:1 ratio which management feels is fully leveraged capital. Therefore, EGI's current capitalization provides it with adequate financial resources for planned growth.

Equity	**As at December 31**	
($ THOUSANDS)	**2012**	**2011**
Common shares	68,244	69,133
	(11,914,932 shares)	(12,066,013 shares)
Retained earnings	91,237	71,410
Contributed surplus	1,068	724
Accumulated other comprehensive income (loss)	6,054	13,766
Non-controlling Interest	(1,200)	(213)
Total capitalization	165,403	154,820

GLOSSARY OF SELECTED INSURANCE TERMS

"Case method" means establishing a reserve liability equal to the most probable expected outcome for an individual claim.

"Cede" means the act of an insurer transferring or assigning part or all of the risk on an insurance policy written by it to a reinsurer by purchasing insurance from such reinsurer to cover the risk or part thereof.

"Combined ratio" of an insurer for any period means the sum of the loss ratio and the expense ratio of the insurer for such period.

"Direct written premiums" of an insurer for any period means the total premiums on insurance, including assumed reinsurance, written by the insurer during such period.

"Expense ratio" for any period means the sum of expenses, including commissions, premium taxes and operating expenses incurred, expressed as a percentage of net earned premiums.

"Facility Association" refers to an organization of the Canadian automobile insurance industry which exists to ensure that all drivers can obtain basic insurance, even if their application fails to meet the criteria of individual insurance companies.

"Groupement" refers to a Quebec organization of the automobile insurance industry which exists to ensure that all drivers in Quebec can obtain basic insurance, even if their application fails to meet the criteria of individual insurance companies.

"Loss adjustment expenses" or **"LAE"** means the expense of settling claims, including certain legal and other fees and the expense of administering the claims adjustment process.

"Loss ratio" for any period means the sum of claims and claims adjustment expenses incurred, net of reinsurance, expressed as a percentage of net earned premiums.

"Minimum Capital Test" means the OSFI's Minimum Capital Test (MCT) Guideline under which a federally regulated insurer is measured for the adequacy of its capital.

"Net earned premiums" of an insurer means the portion of the written premium equal to the expired portion of the time for which insurance or reinsurance was in effect.

"Net written premiums" of an insurer means direct written premiums less amounts ceded to reinsurers.

"Producers" refers to, collectively, insurance brokers, agents and managing general agencies**.**

"Quota share" means a type of reinsurance where the reinsurer agrees to assume the risk on a fixed portion of a specified line of business in return for the same portion of the ceding company's premium for that line of business.

"Reinsurance" means an arrangement in which an insurance company, the reinsurer, 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.

"Retention" means the amount of liability for which an insurance company will be responsible after it has completed its reinsurance arrangements.

"Return on equity" or "ROE" for a period means net income expressed as a percentage of the average total shareholder equity in that period.

"Underwriting" means the assumption of risk for designated loss or damage by issuing a policy of insurance in respect thereof.

"Unearned premiums" means the portion of premiums received relating to the period of risk in subsequent accounting periods and which is deferred to such subsequent accounting periods.