Unaudited Condensed Consolidated Interim Financial Statements of

Echelon Financial Holdings Inc.

For six months ended June 30, 2016 and 2015

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Balance Sheets
(Unaudited, in thousands of Canadian dollars)

	Note	June 30, 2016	December 31, 2015
Assets			
Cash and short–term deposits	6	60,643	4,210
Accounts receivable		43,447	33,966
Investments	6	332,871	402,529
Due from insurance companies		1,551	1,821
Deferred policy acquisition costs		28,688	24,918
Income taxes recoverable		2,178	3,390
Prepaid expenses and other assets		1,353	2,671
Reinsurers' share – unearned premiums		7,802	8,178
– provision for unpaid claims	9	30,605	29,222
Property and equipment		938	577
Intangible assets	11	6,874	6,238
Deferred income taxes		5,663	5,221
Assets of the disposal group held for sale	19	369,833	348,316
Total assets		892,446	871,257
Liabilities			
Derivative Financial Instrument	7	28	—
Accounts payable and accrued liabilities		14,301	12,192
Payable to insurance companies		780	1,093
Unearned premiums		114,131	100,846
Unearned commission		2,133	1,964
Provision for unpaid claims	9	263,546	260,848
Liabilities of the disposal group held for sale	19	340,139	305,604
Total liabilities		735,058	682,547
Equity			
Share capital		70,009	69,653
Contributed surplus		366	436
Retained earnings		79,108	108,551
Accumulated other comprehensive income	16	3,958	6,060
Equity attributed to shareholders of the Company		153,441	184,700
Non-controlling interest	20	3,947	4,010
Total equity		157,388	188,710
Total liabilities and equity		892,446	871,257

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Income and Comprehensive Income
(Unaudited, in thousands of Canadian dollars)

		3 months ended June 30		6 months ended June 30	
		2016	**2015**	**2016**	**2015**
Revenue					
Gross written and assumed premiums		67,791	63,378	109,912	105,604
Less: Premiums ceded to reinsurers		(4,247)	(5,247)	(7,659)	(9,107)
Net written and assumed premiums		63,544	58,131	102,253	96,497
(Increase) in gross unearned premiums		(18,725)	(16,255)	(13,284)	(11,945)
Increase (decrease) in unearned premiums, reinsurers' share		428	1,264	(374)	1,129
Change in provision for unearned premiums		(18,297)	(14,991)	(13,658)	(10,816)
Net earned premiums		45,247	43,140	88,595	85,681
Investment income	6	4,916	3,782	8,861	8,942
Other income		—	748	—	748
Total revenue		50,163	47,670	97,456	95,371
Expenses					
Gross claims incurred		31,667	29,546	61,663	65,693
Less: claims recoveries from reinsurers		(3,425)	(3,082)	(5,118)	(7,820)
Net incurred claims		28,242	26,464	56,545	57,873
Gross acquisition costs		11,666	11,353	22,758	22,179
Less: acquisition cost recoveries from reinsurers		(1,400)	(1,153)	(2,708)	(2,287)
Net acquisition costs		10,266	10,200	20,050	19,892
Operating costs	14	8,269	6,205	17,053	12,979
Total expenses		46,777	42,869	93,648	90,744
Income before taxes and discount rate impact on claims		3,386	4,801	3,808	4,627
Impact of change in discount rate on claims(1)		—	(1,056)	—	(1,056)
Income before interest expense and income taxes		3,386	3,745	3,808	3,571
Interest expense	8	53	—	97	—
Income tax expense (recovery)	12	1,135	(110)	596	(1,162)
Net income on continued operations		2,198	3,855	3,115	4,733
Net (loss) income on discontinued operations	19	(23,937)	1,258	(29,383)	3,535
Net income (loss)		(21,739)	5,113	(26,268)	8,268
Attributed to:					
Shareholders of the Company - continued		1,813	3,646	2,773	4,941
Shareholders of the Company - discontinued		(23,939)	1,157	(29,293)	3,367
Non-controlling interest - continued	20	385	209	342	(208)
Non-controlling interest - discontinued		2	101	(90)	168
Net income (loss)		(21,739)	5,113	(26,268)	8,268
Other comprehensive income (loss), net of taxes that may be classified subsequently to net income					
Available-for-sale investments:					
Change in net unrealized (losses) gains		3,188	(2,438)	1,770	2,908
Reclassification of net realized (gains) to net income		(2,396)	(1,908)	(4,729)	(4,631)
Cumulative translation gain (loss)		(172)	(281)	(394)	(178)
Foreign exchange forward	7	831	—	4,314	—
Tax impact		(277)	1,164	23	341
Other comprehensive income (loss) on continued operations		1,174	(3,463)	984	(1,560)
Other comprehensive (loss) income on discontinued operations		(2,331)	(853)	(3,126)	(1,354)
Other comprehensive (loss)		(1,157)	(4,316)	(2,142)	(2,914)

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Income and Comprehensive Income
(Unaudited, in thousands of Canadian dollars, except per share amounts)

Attributed to:					
Shareholders of the Company - continued operations		1,179	(3,461)	984	(1,622)
Shareholders of the Company - discontinued operations		(2,301)	(829)	(3,086)	(1,322)
Non-controlling interest - continued operation	20	(10)	(26)	—	30
Non-controlling interest - discontinued operation		(25)	—	(40)	—
Other comprehensive (loss)		(1,157)	(4,316)	(2,142)	(2,914)
Total comprehensive (loss) income		(22,896)	797	(28,410)	5,354
Attributed to:					
Shareholders of the Company - continued operations		2,992	185	3,757	3,319
Shareholders of the Company - discontinued operations		(26,240)	328	(32,379)	2,045
Non-controlling interest - continued operation	20	375	183	342	(178)
Non-controlling interest - discontinued operation		(23)	101	(130)	168
Total comprehensive (loss) income		(22,896)	797	(28,410)	5,354
Earnings per share attributable to shareholders of the Company	17				
Earnings per share continuing operations - basic		$0.15	$0.31	$0.24	$0.42
Earnings per share - basic		$(1.89)	$0.41	$(2.26)	$0.71
Earnings per share continuing operations - diluted		$0.15	$0.30	$0.23	$0.41
Earnings per share - diluted		$(1.89)	$0.40	$(2.26)	$0.69
Net income (loss)		(21,739)	5,113	(26,268)	8,268

(1) As the interest rate changes every year there is an impact to the incurred claims. Management believes it is beneficial to the user to see the impact of this change separately in order to understand the true movement in claims incurred.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Changes in Equity
(Unaudited, in thousands of Canadian dollars)

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Shareholders' Equity	Non-controlling Interest	Total Equity
Balance at January 1, 2016	69,653	436	6,060	108,551	184,700	4,010	188,710
Net income (loss)	—	—	—	(26,515)	(26,515)	247	(26,268)
Other comprehensive income (loss)	—	—	(2,102)	—	(2,102)	(40)	(2,142)
Total comprehensive income (loss)	—	—	(2,102)	(26,515)	(28,617)	207	(28,410)
Common shares repurchased	(292)	—	—	(384)	(676)	—	(676)
Dividends paid	—	—	—	(2,814)	(2,814)	—	(2,814)
Investment in subsidiary - Qudos	—	—	—	270	270	(270)	—
Common shares issued on stock options exercised	648		—		648	—	648
Stock compensation expense	—	(70)	—	—	(70)	—	(70)
Balance at June 30, 2016	70,009	366	3,958	79,108	153,441	3,947	157,388

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Shareholders' Equity	Non-controlling interest	Total Equity
Balance at January 1, 2015	67,153	2,192	8,917	105,354	183,616	3,856	187,472
Net income (loss)	—	—	—	8,308	8,308	(40)	8,268
Other comprehensive income (loss)	—	—	(2,944)	—	(2,944)	30	(2,914)
Total comprehensive income (loss)	—	—	(2,944)	8,308	5,364	(10)	5,354
Common shares repurchased	(250)	—	—	(339)	(589)	—	(589)
Dividends paid	—	—	—	(2,589)	(2,589)	—	(2,589)
Investment in subsidiaries - ICPEI	—	—	—	—	—	250	250
Common shares issued on stock options exercised	1,509	—	—	—	1,509	—	1,509
Stock options expense	—	444	—	—	444	—	444
Balance at June 30, 2015	68,412	2,636	5,973	110,734	187,755	4,096	191,851

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

ECHELON FINANCIAL HOLDINGS INC.
Consolidated Statements of Cash Flows
(Unaudited, in thousands of Canadian dollars)

		June 30, 2016	June 30, 2015
Cash provided by (used in):			
Operating activities			
Net income (loss)		3,115	4,733
Adjusted for:			
Reinsurers' share of unearned premiums		376	(359)
Reinsurers' share of unpaid claims		(1,383)	(5,394)
Provision for unpaid claims		2,698	446
Unearned premiums		13,285	11,175
Deferred income taxes		(442)	441
Unearned commissions		169	157
Deferred policy acquisition costs		(3,770)	(2,086)
Amortization on property plant equipment and intangible assets		1,893	2,558
Amortization of premiums on bonds		961	1,055
Fair value change on FVTPL investments		(2,271)	3,854
Options expense		(70)	444
Currency translation		(394)	(178)
Foreign exchange forward		4,314	—
Prepaid expenses & other assets		1,318	(476)
		16,684	11,637
Cash flow from changes in			
Accounts receivable		(9,481)	3,200
Net realized (gains) losses		278	(4,646)
Income taxes (recoverable) payable		1,235	(7,303)
Due to insurance companies		(43)	631
Other liabilities		2,137	(1,923)
Cash (used in) continuing operating activities		13,925	6,329
Financing activities			
Proceeds from issue of common shares for stock options		648	1,509
Common share dividends		(2,814)	(2,589)
Share repurchases		(676)	(589)
Additional investment in ICPEI by minority interest		—	250
Cash (used in) financing activities		(2,842)	(1,419)
Investing activities			
Purchases of property, equipment and intangible assets		(2,890)	(1,566)
Purchases of investments		(148,147)	(228,375)
Sale/maturity of investments		215,877	242,930
Cash provided by investing activities		64,840	12,989
Cash flow from discontinued operations	19	(654)	(10,063)
(Decrease) increase in cash and short-term deposits		75,269	7,836
Cash and short-term deposits, beginning of period		23,373	27,326
Cash and short-term deposits, end of period		98,642	35,162
Supplementary information			
Operating activities			
Income taxes paid (recovered)		(78)	5,509

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

1 Nature of operations

Echelon Financial Holdings Inc. ("the Company"), formerly EGI Financial Holdings Inc., was incorporated on August 18, 1997, under the Business Corporations Act (Ontario) and is incorporated and domiciled in Canada. The Company is principally engaged, through its subsidiaries, in property and casualty insurance in Canada and Europe. The Company's head office is located at 2680 Matheson Blvd. East, Suite 300, Mississauga, Ontario.

The Company's wholly-owned subsidiaries are Echelon Insurance ("Echelon"), CIM Reinsurance Company Ltd. ("CIM Re") and CUISA Managing General Agency Corporation ("CUISA MGA"). The Company also owns 75% of The Insurance Company of Prince Edward Island ("ICPEI") and all of the preferred shares, in addition to 98.7% of the common shares of QIC Holdings ApS ("QIC"). QIC owns 100% of Qudos Insurance A/S ("Qudos") that is headquartered in Denmark and underwrites insurance products primarily in the United Kingdom, Ireland, and Denmark. The Company's ownership has increased to 98.7% from 97.5% at the beginning of the year due to capital injected to maintain its solvency ratio.

2 Basis of preparation

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting. The condensed consolidated interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2015, which have been prepared in accordance with IFRS.

These consolidated financial statements have been authorized for issue by the Board of Directors, on August 4, 2016.

3 Summary of significant accounting policies

The accounting policies adopted are consistent with those of the previous financial year end and the Company has consistently applied the same accounting policies through all periods presented except as described below.

Discontinued Operations

Assets and liabilities are classified as held for sale (discontinued operations) if their carrying amounts are recovered through a sales transaction rather than through continuing use. This condition is satisfied when the asset is available for immediate sale in its present condition, management is committed to the sale and it is highly probably to occur within one year. Assets and liabilities classified as held-for-sale are measured at their lower of their previous carrying amount and fair value, less costs to sell, and are presented separately from other assets on our Consolidated Balance Sheets.

A disposal group is classified as a discontinued operation if it meets the following conditions: (a) it is a component that can be distinguished operationally and financially from the rest of our operations, and (b) it represents either a separate major line of business or is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations.

Standards, amendments and interpretations not yet adopted or effective

IFRS 9, Financial Instruments

In July 2014 the IASB published the complete version of IFRS 9 which is effective for annual periods beginning on or after January 1, 2018, with retrospective application. The new standard includes requirements on the classification and measurement of financial assets and liabilities, an expected credit loss model that replaces the existing incurred loss impairment model and new hedge accounting guidance. The Company is currently evaluating the impacts of IFRS 9 on its consolidated financial statements, as well as the implementation options for insurers proposed in the December 2015 Exposure Draft Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Proposed amendments to IFRS 4).

IFRS 15, Revenue from contracts with customers

IFRS 15, Revenue from contracts with customers deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018. The Company has not yet assessed the impact of the standard or determined whether it will adopt the standard early.

IFRS 16, Leases

In January 2016, the IASB published IFRS 16 which is effective January 1, 2019. The new standard requires the capitalization of all leases by recognizing the present value of the lease payments and showing them as lease assets, and recognizing a financial liability representing an obligation to make future lease payments. The Company is currently evaluating the impact of IFRS 16 on its Consolidated Financial Statements.

4 Critical accounting estimates and assumptions

The preparation of the Company's condensed consolidated interim financial statements requires management to use estimates and judgements that affect the amounts reported in the financial statements. These estimates and judgements 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 and judgements could change and impact future results.

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying accounting policies and the key sources of estimation uncertainty were the same as those applied to the annual 2015 consolidated financial statements.

5 Seasonality

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

(in thousands of Canadian dollars, except per share amounts)

6 Investments

The following table provides a breakdown of the investment portfolio as at June 30, 2016, and December 31, 2015.

	Fair values	
Available-for-sale	**As at June 30, 2016**	**As at December 31, 2015**
Fixed income		
Canadian		
Federal	45,297	45,524
Provincial	58,105	55,976
Municipal	530	1,386
Corporate	135,525	171,789
	239,457	274,675
Fixed income lent through securities lending program		
Federal	14,416	14,231
Provincial	3,614	3,800
Municipal	853	—
Corporate	6,334	4,673
	25,217	22,704
Foreign fixed income		
Corporate	2,737	21,384
	2,737	21,384
Total fixed income	267,411	318,763
Commercial mortgages pooled funds	17,298	17,017
Money market pooled funds	159	403
Short-term fixed income and mortgage pooled funds	17,201	16,934
Total pooled funds	34,658	34,354
Common shares		
Canadian	270	2,656
U.S.	—	8,012
Total common shares	270	10,668
Total available-for-sale	302,339	363,785
Fair value through profit or loss		
Preferred shares	30,496	38,400
Preferred shares lent through securities lending program	36	344
Total preferred shares	30,532	38,744
Total investments	332,871	402,529
Cash and short-term deposits	60,643	4,210
Total investments including cash and short-term deposits	393,514	406,739

In accordance with the securities lending agreement, the amount of the collateral must be at least 105% of the fair value of the securities loaned. As at June 30, 2016, the Company had collateral of $26,760 (June 30, 2015 – $41,427) for the loaned securities or approximately 106% of the fair value of the loaned securities.

The Company invests in high-quality U.S. corporate bonds as a means to provide geographic diversification to its investment portfolio of Canadian Operations, which is mainly comprised of Canadian securities. As at June 30, 2016, the Company held $2.7 million (CDN) in U.S. fixed-income securities (December 31, 2015 – $14.8 million). Foreign currency exposure in the U.S. fixed-income portfolio is mitigated through the use of foreign-currency forward contracts

(in thousands of Canadian dollars, except per share amounts)

Fair value

The Company is responsible for determining the fair value of its investment portfolio by utilizing market-driven fair value measurements from active markets, where available, by considering other observable and unobservable inputs and by employing valuation techniques which make use of current market data. The Company uses a fair-value hierarchy to categorize the inputs used in valuation techniques to measure fair value. A description of the inputs used in the valuation of financial instruments is as follows:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities. The fair value of the Company's common and preferred shares is determined based on quoted prices in active markets obtained from external pricing sources.

Level 2 – Inputs, other than quoted prices, that are observable for the investment either directly or indirectly. These inputs include quoted prices for similar instruments exchanged in active markets; quoted prices for identical or similar instruments exchanged in inactive markets; inputs other than quoted prices that are observable for the instruments, such as interest rates and yield curves, volatilities, prepayment speeds, loss severities, credit risks and default rates where available; and inputs that are derived principally from or corroborated by observable market data and correlation or other means.

The Company's investments in government securities (including federal, provincial and municipal bonds), corporate securities, commercial mortgage pooled funds, money market pooled fundsand infrequently traded securities are priced using publicly traded, over-the-counter prices or broker-dealer quotes which are based on market observable inputs. Observable inputs such as benchmark yields, reported trades, broker dealer quotes, issuer spreads and bids are available for these investments.

Level 3 – Inputs that are not based on observable market data. Management is required to use assumptions regarding unobservable inputs as there is little, if any, market activity in these investments or related observable inputs that can be corroborated at the measurement date. Unobservable inputs require management to make certain projections and assumptions about the information that would be used by market participants in pricing assets. To verify pricing, the Company assesses the reasonability of the fair values by comparing to industry-accepted valuation models, to movements in credit spreads and to recent transaction prices for similar assets where available.

The following table provides the classification of the Company's investments within the fair value hierarchy, as outlined above, as at June 30, 2016, and December 31, 2015:

June 30, 2016				
	Level 1	**Level 2**	**Level 3**	**Total**
Fixed income	—	267,411	—	267,411
Commercial mortgages pooled funds	—	17,298	—	17,298
Money market pooled funds	—	159	—	159
Short-term fixed income and mortgage pooled funds	—	17,201	—	17,201
Equities	270	—	—	270
Preferred Shares	30,532	—	—	30,532
	30,802	302,069	—	332,871

(in thousands of Canadian dollars, except per share amounts)

December 31, 2015				
	Level 1	**Level 2**	**Level 3**	**Total**
Fixed income	—	318,763	—	318,763
Commercial mortgages pooled funds	—	17,017	—	17,017
Money market pooled funds	—	403	—	403
Short-term fixed income and mortgage pooled funds	—	16,934	—	16,934
Equities	10,668	—	—	10,668
Preferred Shares	38,744	—	—	38,744
	49,412	353,117	—	402,529

The fair value of the Company's investments, determined with the use of unobservable market information as inputs, is $nil (December 31, 2015 – $nil) of the total investment portfolio. All investments in a commercial mortgages pooled fund with a fair value of $17,017 are in level 2.

A reconciliation of Level 3 investments for the years ended June 30, 2016, and December 31, 2015, with the use of significant unobservable inputs from January 1 to June 30, is as follows:

	June 30, 2016	**December 31, 2015**
Balance at beginning of period	—	2,173
Addition during the year	—	—
Disposal / Reclassification during the year	—	(2,173)
Net unrealized gains included in other comprehensive income	—	—
Balance at end of period	—	—

Investment in commercial mortgages pooled funds is valued using the Company's share of the net asset value of the commercial mortgage pooled fund as of June 30, 2016, and December 31, 2015.

The Company's policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. There were no transfers during the six months ended June 30, 2016 or 2015. There were no transfers from Level 2 to Level 1, or vice versa in the period.

The fair values of cash and short-term deposits, account receivables and financial liabilities, other than the provision for unpaid claims, approximate their carrying values due to their short-term nature.

Impaired assets and provisions for losses

Management has reviewed currently available information regarding those financial assets where estimated fair values are less than amortized cost. For those investments that are considered impaired, the Company has recorded the difference between the amortized cost of the financial assets and its fair value as an impairment, which reduces investment income recorded in the period.

No impairments on AFS investments were recognized for the period ended June 30, 2016 (June 30, 2015 – $nil). A remaining gross unrealized loss of $942 on AFS investments held as at June 30, 2016 (June 30, 2015 – $1,355) is recorded, net of tax, in the amount of $687 (June 30, 2015 – $1,117) in Accumulated Other Comprehensive Income.

(in thousands of Canadian dollars, except per share amounts)

Investment income

The table below provides additional details on net investment income:

	3 months ended June 30		6 months ended June 30	
	2016	**2015**	**2016**	**2015**
Interest income	2,710	3,063	5,862	6,271
Dividend income	555	744	1,019	1,347
Net realized (losses) gains	(2,292)	1,913	(278)	4,646
Fair value change on FVTPL investments	4,174	(1,977)	2,271	(3,854)
Realized and unrealized foreign exchange gains	(8)	311	459	1,099
Investment expenses	(223)	(272)	(472)	(567)
Investment income	4,916	3,782	8,861	8,942

7 Derivative Financial Instrument

On January 21, 2016, the Company entered into a three month foreign exchange forward contract to manage the foreign currency risk on its investment in its European subsidiary, Qudos. The Company agreed to buy $47.8 million (CAD) and sell €30 million (EUR). The fair value of the forward was $3.5 million as at March 31, 2016. The contract was an effective hedge and there was no ineffectiveness. The contract matured on April 22, 2016, with a realized value of $4.3 million.

The Company has entered into a revolving three month foreign exchange forward contract to manage the foreign currency risk on its investment in foreign fixed income securities. The Company agreed to buy $2.7 million (CAD) and sell $2.1 million (USD). The contract matures on September 21, 2016. The fair value of the forward was $28 thousand as at June 30, 2016.

8 Line of credit

The Company has a $10 million two-year secured revolving term credit facility effective June 30, 2015, maturing on July 1, 2017. This credit facility may be drawn at the prime rate plus a margin or as bankers' acceptances rate plus a margin. This facility was undrawn as at June 30, 2016. As part of the covenants of the loans under the credit facilities, the Company is required to maintain certain ratios and limits. All financial limits and ratios have been met as at June 30, 2016.

For the quarter ending June 30, 2016, the Company has expensed $0.1 million related to the maintenance of the credit.

9 Provision for unpaid claims

The fair value of the provision for unpaid claims approximates the carrying value determined in accordance with generally accepted actuarial methods in Canada, which discounts future cash flows and includes a margin for adverse deviation.

The Company determines the discount rate based on the expected return on its investment portfolio of assets with appropriate assumptions for interest rates relating to reinvestment of maturing investments. The Company discounts its best estimate as follows for each entity, which is for all lines of business within reporting entity:

(in thousands of Canadian dollars, except per share amounts)

Entity	June 30, 2016	December 31, 2015
Echelon Insurance	2.44%	2.44%
ICPEI	1.63%	1.63%

The Company recorded a $9,342 reduction to the net provision for unpaid claims relating to redundancies in prior years' estimates (June 30, 2015 – $5,990).

To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience, and to provide greater comfort that the actuarial liabilities are adequate to pay future claims, the Company includes provisions for adverse deviations (PFADs) in some assumptions relating to claims development, reinsurance recoveries and future investment income. The PFADs selected are in the mid-range of those recommended by the Canadian Institute of Actuaries. The aggregate impact of the provision for adverse deviation is to increase the provision for unpaid claims on a net basis by $19,558 as at June 30, 2016 (December 31, 2015 – $21,818).

Claims development

Provision for unpaid claims analysis	June 30, 2016	June 30, 2015
Unpaid claims, beginning of year, net	231,626	251,740
Favourable prior year claims development	9,342	5,990
Provision for claims occurring in current period	47,203	52,939
Paid on claims occurring during		
Current year	(20,416)	(17,740)
Prior year	(34,814)	(46,138)
Unpaid claims, end of period, net	232,941	246,791
Reinsurers' share	30,605	29,153
Gross unpaid claims	263,546	275,944

The development of insurance liabilities provides a measure of the Company's ability to estimate the ultimate value of claims.

Assumptions used to develop the provision estimate for unpaid claims and adjustment expenses are selected by class of business and geographic location. Consideration is given to the characteristics of the risks, historical trends, and the amount of data available on individual claims, inflation and any other pertinent factors. Some assumptions require a significant amount of judgement such as the expected impacts of future judicial decisions and government legislation. The diversity of these considerations results in it not being practical to identify and quantify all individual assumptions that are more likely than others to have a significant impact on the measurement of the Company's insurance contracts. There were no new assumptions identified in the period as having a potential or identifiable material impact on the overall claims estimate.

10 Risk management

As a provider of insurance products, effective risk management is fundamental to the Company's ability to protect the interests of its customers and shareholders. The Company is exposed to risks of loss pertaining to insurance products. These include risks surrounding product and pricing, underwriting and claims, catastrophic exposure, and matching of assets and liabilities. The Company is also exposed to potential loss from various risks, including interest rate risk, equity market fluctuation risk, credit risk, liquidity risk, and foreign exchange risk.

(in thousands of Canadian dollars, except per share amounts)

The Company has written principles for overall risk management, as well as written policies covering specific areas such as underwriting, reinsurance, foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non–derivative financial instruments and investment of excess liquidity.

Insurance risk

The risk under any one insurance contract is the possibility that the event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, the risk is random and therefore unpredictable. The principal risk that the Company faces under its insurance contract is that the actual claims payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or the severity of the claims is greater than estimated. Insurance events are random and the actual number and amount of claims will vary from year to year from the estimate.

The concentration of insurance risk by product line, country, province or state, and underlying currency, will also impact financial results depending on the nature and location of events.

Compared to year end there was no material change to insurance risk.

Interest rate risk

Fluctuations in interest rates have a direct impact on the fair valuation and future cash flow of the Company's fixed income investment portfolio. Generally, the Company's investment income will be reduced during sustained periods of lower interest rates as higher yielding fixed income investments mature or are sold and the proceeds are reinvested at lower rates. During periods of rising interest rates, the fair value of the Company's existing fixed income investments will generally decrease and gains on fixed income securities will likely be reduced.

The sensitivity analysis for interest rate risk as set out in the table below illustrates the impact of changes in interest rates on OCI relating to the fixed income investment portfolio as at June 30, 2016, and December 31, 2015, based on parallel 200 basis point shifts in interest rates up and down in 100 basis point increments.

Change in interest rates	Fair value of fixed income	Hypothetical change on fair value	Effect on OCI net of tax
As at June 30, 2016			
200 basis point rise	251,255	(6)%	(11,794)
100 basis point rise	259,334	(3)%	(5,896)
No change	267,411	—	—
100 basis point decline	275,491	3%	5,898
200 basis point decline	283,570	6%	11,796

Change in interest rates	Fair value of fixed income	Hypothetical change on fair value	Effect on OCI net of tax
As at December 31, 2015			
200 basis point rise	300,095	(6)%	(13,628)
100 basis point rise	309,430	(3)%	(6,814)
No change	318,763	—	—
100 basis point decline	328,099	3%	6,814
200 basis point decline	337,433	6%	13,628

(in thousands of Canadian dollars, except per share amounts)

Liquidity risk

Liquidity risk is the risk that the Company may not have sufficient liquid financial resources to meet its obligations when they fall due, or would have to incur excessive costs to do so. The Company's liquidity management strategy is to ensure that there is sufficient cash to meet its financial commitments as they become due. To manage cash flow requirements, the Company maintains a portion of invested assets in liquid investments.

The maturity profile of bonds as at June 30, 2016, and December 31, 2015, are as follows:

June 30, 2016	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	24,798	86,397	106,149	50,067	267,411
Percentage of total	9%	32%	40%	19%	100%

December 31, 2015	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	34,163	88,757	97,216	98,627	318,763
Percentage of total	11%	28%	30%	31%	100%

The following tables summarize the expected timing of cash flows arising from insurance obligations, on an undiscounted basis, as at June 30, 2016, and December 31, 2015:

June 30, 2016	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	86,182	92,845	49,034	27,658	255,719
Less: Reinsurance recoverable (undiscounted)	12,215	10,250	4,796	2,708	29,969
Net actuarial liabilities	73,967	82,595	44,238	24,950	225,750

December 31, 2015	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	84,690	91,529	48,349	27,265	251,833
Less: Reinsurance recoverable (undiscounted)	11,421	9,836	4,572	2,534	28,363
Net actuarial liabilities	73,269	81,693	43,777	24,731	223,470

All other financial liabilities are for duration of one year or less. The contractual maturities for lease commitments are listed in note 15.

Equity price risk

Fluctuations in the value of equity investments affect the level and timing of recognition of gains and losses on securities held, and cause changes in realized and unrealized gains and losses. General economic conditions, political conditions and many other factors can also adversely affect the stock and bond markets and, consequently, the value of the equity and fixed income investments held.

The Company has policies to limit and monitor its exposure to individual issuers and classes of issuers of equity securities.

(in thousands of Canadian dollars, except per share amounts)

The table below summarizes the potential impact of a 10% change in the value of the equity securities (common and preferred shares) on net income and OCI for the six months ended June 30, 2016, and the year ended December 31, 2015. Certain shortcomings are inherent in the method of analysis presented, as the analysis is based on the assumption that all equity holdings increased/decreased by 10% with all other variables held constant.

Change in equity holdings	Effect on net income (loss) net of tax		Effect on OCI net of tax	
	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
10% rise	2,229	2,828	20	779
10% decline	(2,229)	(2,828)	(20)	(779)

Credit risk

The Company is exposed to credit risk principally through its investment securities and balances receivable from policyholders and reinsurers. The Company has policies to limit and monitor its exposure to individual issuers and classes of issuers of investment securities which do not carry the guarantee of a national or Canadian provincial government. The Company's credit exposure to any one individual policyholder is not material. The Company has policies that limit its exposure to individual reinsurers and regular review processes to assess the creditworthiness of reinsurers with whom it transacts business.

The Company is exposed to risk from reinsurers' inability to cover balances. 99.8% of the Company's reinsurance balances are from registered reinsurers. The Company holds sufficient collateral to cover the 0.2% of reinsurance balances from unregistered reinsurers.

The following table sets forth the Company's fixed income securities portfolio by credit quality as at June 30, 2016, and December 31, 2015.

Fixed income portfolio

A breakdown of the fixed income portfolio by credit rating is shown below:

	As at June 30, 2016		As at December 31, 2015	
	Fair value	Fair value	Fair value	Fair value
AAA	80,171	30%	89,413	28%
AA	63,904	24%	74,209	23%
A	67,451	25%	69,918	22%
BBB	55,885	21%	51,718	16%
BB	—	—%	13,808	4%
B	—	—%	9,187	3%
CCC	—	—%	537	0%
Unrated	—	—%	9,973	3%
Total	267,411	100%	318,763	100%

(in thousands of Canadian dollars, except per share amounts)

Preferred share portfolio

A breakdown of the preferred shares portfolio by credit rating is shown below:

	As at June 30, 2016		As at December 31, 2015	
	Fair value	Fair value	Fair value	Fair value
P2	30,141	99%	30,702	79%
P3	391	1%	8,042	21%
Total	30,532	100%	38,744	100%

11 Intangible assets

	Opening cost	Purchases	Sales	End of period cost	Accumulated amortization	Net
Software						
June 30, 2016	23,014	2,327	—	25,341	18,867	6,474
December 31, 2015	19,430	3,584	—	23,014	17,176	5,838
Goodwill						
June 30, 2016	400	—	—	400	—	400
December 31, 2015	400	—	—	400	—	400
Total intangible assets						
June 30, 2016	23,414	2,327	—	25,741	18,867	6,874
December 31, 2015	19,830	3,584	—	23,414	17,176	6,238

12 Income taxes

The income tax (recovery) is as follows:

	3 months ended June 30		6 months ended June 30	
	2016	**2015**	**2016**	**2015**
Current	918	(997)	867	(1,265)
Deferred	217	887	(271)	103
	1,135	(110)	596	(1,162)

The effective income tax rates are different from the combined federal and provincial income tax rates.

The consolidated statements of income and comprehensive income contain items that are non-taxable or non-deductible for income tax purposes, which cause the income tax expense to differ from what it would have been if based on statutory rates.

(in thousands of Canadian dollars, except per share amounts)

The difference is broken down as follows:

	3 months ended June 30		6 months ended June 30	
	2016	**2015**	**2016**	**2015**
Income tax expense calculated at statutory rates	27.0 %	27.0 %	27.0 %	27.0 %
Increase (decrease) in income tax rates resulting from:				
Non-taxable dividend income	4.5 %	(4.3)%	2.7 %	(6.8)%
Non-taxable (income) loss	(9.0)%	(11.5)%	(23.2)%	(27.9)%
Non-deductible expenses	4.1 %	(2.0)%	7.7 %	1.9 %
Tax benefit of losses not previously recognized	(0.8)%	(16.5)%	(1.9)%	(16.2)%
Statutory rate differences	2.0 %	(1.7)%	1.3 %	(1.5)%
Non-taxable portion of capital gains	(0.8)%	(5.1)%	(1.9)%	(5.9)%
Other	0.1 %	11.5 %	4.2 %	4.3 %
Effective income tax rate	27.1 %	(2.6)%	15.9 %	(25.1)%

13 Related party transactions

The Co-operators Group Limited and Co-operators General Insurance Company (collectively Co-operators), significant shareholders of the Company, provide services to the Company, including but not limited to product distribution and investment management services under arms length contracts. Direct written premiums derived from Co-operators' agents were $2,353 (June 30, 2015 – $3,106); commissions paid were $269 (June 30, 2015 – $358) and investment management fees were $128 (June 30, 2015 – $133).

14 Operating Costs by nature

The table below presents operating costs by major category:

	Three Months Ended June 30		Six Months Ended June 30	
	2016	**2015**	**2016**	**2015**
Salaries and benefits	3,408	3,266	7,828	7,412
Systems costs	1,992	1,759	3,689	3,415
Professional fees	312	152	606	443
Occupancy	265	392	575	723
Severance	1,028	—	2,512	—
Other expenses	1,264	633	1,842	986
	8,269	6,202	17,052	12,979

Corporate expenses include $0.1 million (2015 - $nil) relating to positive development on prior year claims reserves of ICPEI, that in accordance with terms of the share purchase agreement are payable to SGI Canada on January 1, 2019, up to a maximum of the lesser of $1.5 million or 75% of the surplus. The indemnification liability is offset by positive development of the reserve in ICPEI. In the event that prior period losses are greater than the reserves held at June 30, 2014, SGI Canada will be required to pay the Company the difference on January 1, 2019, to a maximum of the lesser of $1.5 million or 75% of the deficiency.

(in thousands of Canadian dollars, except per share amounts)

15 Lease commitments

The Company is committed under lease agreements for office premises and computer equipment with minimum lease payments of $11,529 as follows:

Lease commitments	
2016	725
2017	1,372
2018	1,371
2019	1,290
2020	1,200
2021 and thereafter	5,571
	11,529

16 Accumulated other comprehensive income

A breakdown of the accumulated other comprehensive income is shown below.

	As at June 30, 2016	As at December 31, 2015
Gross unrealized gains	2,543	4,208
Foreign currency translation adjustments	(2,955)	2,151
Foreign exchange forward	4,314	—
Tax impact	56	(299)
Ending balance	3,958	6,060

17 Earnings per share

	3 months ended June 30		6 months ended June 30	
	2016	2015	2016	2015
Basic earnings per share on continuing operations:				
Net income available to shareholders	1,813	3,646	2,773	4,941
Average number of common shares	11,723	11,737	11,731	11,674
Basic earnings per share on continuing operations	$0.15	$0.31	$0.24	$0.42
Diluted earnings per share:				
Average number of common shares	11,723	11,737	11,731	11,674
Average number of dilutive common shares under employee stock compensation plan	262	301	267	308
Average number of diluted common shares	11,985	12,038	11,998	11,982
Diluted earnings per share on continuing operations	$0.15	$0.30	$0.23	$0.41

(in thousands of Canadian dollars, except per share amounts)

	3 months ended June 30		6 months ended June 30	
	2016	**2015**	**2016**	**2015**
Basic earnings per share:				
Net income available to shareholders	(22,126)	4,803	(26,520)	8,308
Average number of common shares	11,723	11,737	11,731	11,674
Basic earnings (loss) per share	$(1.89)	$0.41	$(2.26)	$0.71
Diluted earnings per share:				
Average number of common shares	11,723	11,737	11,731	11,674
Average number of dilutive common shares under employee stock compensation plan	262	301	267	308
Average number of diluted common shares	11,985	12,038	11,998	11,982
Diluted earnings (loss) per share	$(1.89)	$0.40	$(2.26)	$0.69

(in thousands of Canadian dollars, except per share amounts)

18 Subsequent event

On August 4, 2016 the Company entered into a definitive stock purchase agreement to sell the Qudos Insurance A/S. The transaction will consist of a 100% sale of the company's shares in Qudos Insurance A/S and will consist of the sale of the entire operations and net assets of the company (to be updated based on facts and circumstances). The sale is subject to regulatory approval and certain closing conditions (if applicable) and is expected to close in the fall.

The assets and liabilities of the disposal group held for sale have been recorded on the consolidated balance sheet at fair value less cost to sell and as a result the sale price is expected to be approximately equal to the carrying value of the net assets.

19 Held for sale classification and discontinued operations

During the quarter a decision was made to sell the European operations and all net assets were recorded as Held for Sale and recorded at the lower of the fair value less cost to sell and the carrying value. This reclassification for the discontinued operations resulted in a $21 million impairment being recorded against the unearned premiums included within the liabilities of the disposable group held for sale. An additional $1 million of transaction costs was recorded to reflect the costs to dispose the operations.

Assets and liabilities of the disposal group held for sale

The assets and liabilities of the disposal group classified as held for sale included in the consolidated balance sheet as at June 30, 2016 was as follows:

	As at June 30, 2016	As at December 31, 2015
Assets of the disposal group held for sale		
Cash and short-term deposits	38,000	19,163
Investments	124,636	110,570
Reinsurers' share of unearned premiums	70,767	81,775
Reinsurers' share of unpaid claims	87,546	60,936
All other Assets	48,884	75,872
Total assets of disposal group held for sale	369,833	348,316
Liabilities of the disposal group held for sale		
Accounts payable and accrued liabilities	16,437	22,074
Unearned premiums	109,941	107,435
Provision for unpaid claims	174,419	136,366
All other Liabilities	39,342	39,729
Total liabilities of disposal group held for sale	340,139	305,604

Net income (loss) from discontinued operations

The components of the net income (loss) from discontinued operations included in the consolidated statements of income and comprehensive income are as follows:

(in thousands of Canadian dollars, except per share amounts)

	3 months ended June 30		6 months ended June 30	
	2016	**2015**	**2016**	**2015**
Revenue				
Gross written and assumed premiums	81,185	74,381	133,464	123,041
(Increase) in provision for unearned premium	(41,417)	(41,496)	(57,647)	(63,500)
Net earned premiums	39,768	32,885	75,817	59,541
Investment income	354	169	1,594	921
Total revenue	40,122	33,054	77,411	60,462
Expenses				
Net incurred claims	27,619	18,105	56,776	31,214
Impact of change in discount rate on claims		175	—	175
Net acquisition costs	13,521	11,555	25,875	21,514
Operating costs	1,817	1,816	4,229	3,580
Total expenses	42,957	31,651	86,880	56,483
(Loss) income before income taxes	(2,835)	1,403	(9,469)	3,979
Income tax (recovery) expense	(898)	145	(2,086)	444
Net (loss) income on discontinued operations	(1,937)	1,258	(7,383)	3,535
Impairment of the net assets of disposal group held for sale	(22,000)	—	(22,000)	—
Net (loss) income on discontinued operations	(23,937)	1,258	(29,383)	3.535

Cash flow from discontinued operations

The details of the cash flow of the discontinued operations included in the consolidated statement of cash flows was as follows:

	June 30, 2016	**June 30, 2015**
Discontinued cash provided by (used in):		
Net (loss) income	(29,383)	3,535
Operating activities	42,475	(11,616)
Financing activities	—	—
Investing activities	(13,746)	(1,982)
Cash flow from discontinued operations	**(654)**	**(10,063)**

(in thousands of Canadian dollars, except per share amounts)

20 Non-controlling interest

The Company has non-controlling interests attributable to the subsidiaries of ICPEI, please refer to Note 1.

	3 months ended June 30		6 months ended June 30	
	2016	**2015**	**2016**	**2015**
Revenue				
Gross written and assumed premiums	2,226	2,046	3,687	3,446
Net earned premiums	1,640	1,582	3,177	3,129
Investment income	134	46	142	34
Total revenue	1,774	1,628	3,319	3,163
Expenses				
Net incurred claims	613	821	1,611	2,413
Net acquisition costs	377	357	731	724
Operating costs	251	165	505	359
Total expenses	1,241	1,343	2,847	3,496
Income (loss) before income taxes	533	285	472	(333)
Income tax expense (recovery)	148	76	129	(125)
Net income (loss) attributable to NCI	385	209	343	(208)
OCI attributable to NCI	(10)	(26)	—	30
Comprehensive income attributable to NCI	375	183	343	(178)

	As at June 30, 2016	As at December 31, 2015
Assets		
Cash and investments	8,970	8,337
Other assets	4,474	4,417
Total assets	13,444	12,754
Liabilities		
Unearned premium	3,669	3,428
Unpaid claims	5,735	5,682
Other liabilities	415	362
Total liabilities	9,819	9,472
Equity		
Share capital	—	—
AOCI	9	9
Retained earnings	3,616	3,273
Total equity	3,625	3,282
Total liabilities and equity	13,444	12,754

(in thousands of Canadian dollars, except per share amounts)

	As at June 30, 2016	As at December 31, 2015
	ICPEI	ICPEI
Cash flow from operating activities	647	(581)
Cash flow from investing activities	(37)	(201)
Cash flow from financing activities	—	250
Net increase (decrease) in cash and short-term deposits	610	(532)

21 Segmented information

The Company operates through two segments: Personal Lines and Commercial Lines businesses. Through its Personal Lines segment, the Company is engaged primarily in the underwriting of high premium, non-standard automobile insurance.

Through its Commercial Lines, the Company designs and underwrites specialized non-auto insurance programs, such as higher premium property, primary and excess liability, legal expense, creditor insurance and warranty coverage.

The European operations are considered to be discontinued and not disclosed.

The effect of reinsurance is reflected in the revenue and results of each segment. The investment activities consist of managing the investment portfolio for the Company as a whole. Investment income is shown net of investment expenses. The corporate and other activities include holding company expenses not attributable to a division.

(in thousands of Canadian dollars, except per share amounts)

	3 months ended June 30		6 months ended June 30	
	2016	**2015**	**2016**	**2015**
Revenue				
Earned premiums				
– Personal Lines	34,614	34,092	67,974	67,130
– Commercial Lines	10,633	9,048	20,621	18,551
Total earned premium	45,247	43,140	88,595	85,681
Net claims Incurred				
– Personal Lines	23,758	21,772	45,690	48,285
– Commercial Lines	4,484	4,692	10,855	9,588
Total net claims incurred	28,242	26,464	56,545	57,873
Net expenses				
– Personal Lines	11,425	10,504	22,110	20,695
– Commercial Lines	4,563	4,102	8,926	8,265
Total	15,988	14,606	31,036	28,960
Corporate Expenses	1,519	1,799	3,554	3,911
Total net expenses	17,507	16,405	34,590	32,871
Income (loss) before income taxes				
– Personal Lines	(569)	1,816	174	(1,850)
– Commercial Lines	1,586	254	840	698
Total Canada	1,017	2,070	1,014	(1,152)
Corporate and other	(1,519)	(1,799)	(3,554)	(3,911)
Underwriting (loss) income	(502)	271	(2,540)	(5,063)
Impact of change in net claims discount rate[1]	—	(1,056)	—	(1,056)
Other income	—	748	—	748
One-time expense	(1,028)	—	(2,512)	—
Investment income	4,916	3,782	8,861	8,942
Total income before income taxes	3,386	3,745	3,809	3,571

[1] As the interest rate changes every year, there is an impact to the incurred claims. Management believes it is beneficial to the user to see the impact of this change separately in order to understand the true movement in claims incurred.

Segmented long-term assets

	As at June 30, 2016	As at December 31, 2015
Personal Lines	6,746	6,240
Commercial Lines	1,067	575
Total segmented long-term assets	7,813	6,815