Broker-centric

insurance solutions

2016 Annual Report

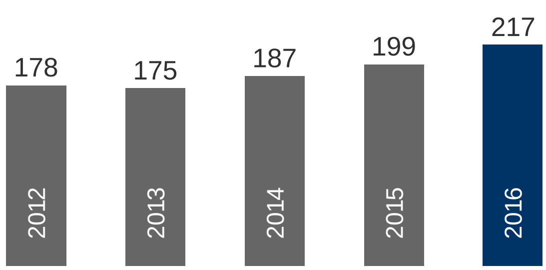
Echelon Financial
Holdings Inc.

echelon
Insurance

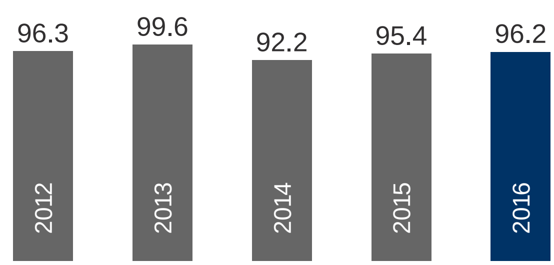
Company Profile and Financial Highlights

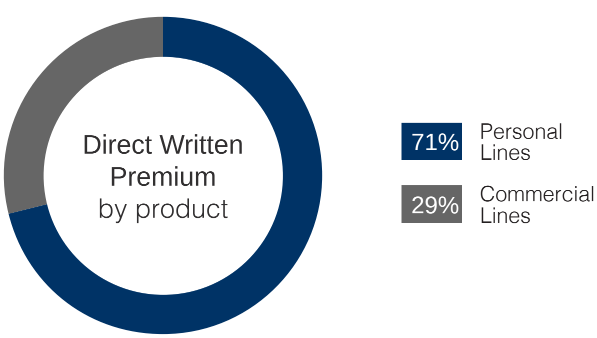
Echelon Insurance operates in the Property and Casualty Insurance Industry, underwriting Personal and Commercial Insurance products across Canada. Our products are sold under the Echelon Insurance and ICPEI brands across Canada, exclusively through insurance brokers.

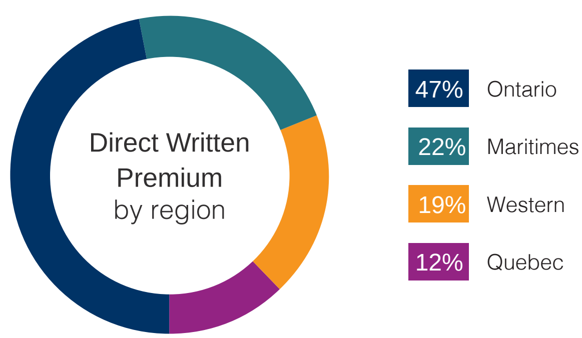
Direct Written Premiums | $ millions



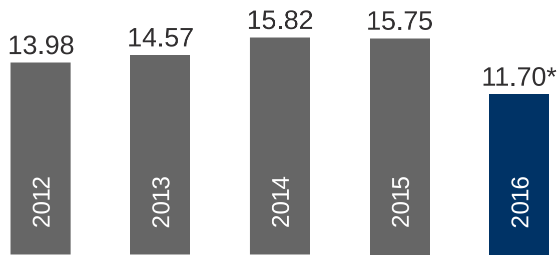
Combined Ratio | %



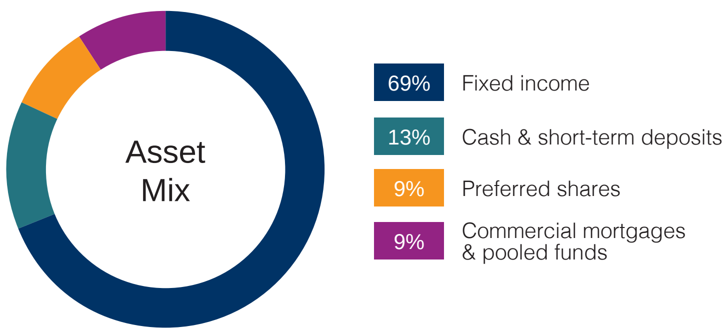




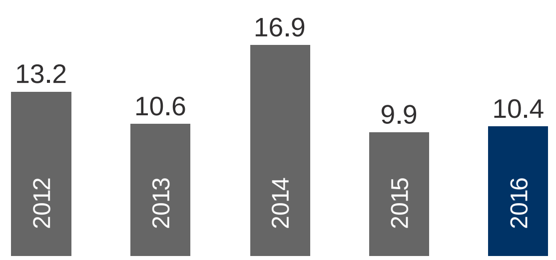
Book Value | $ per share

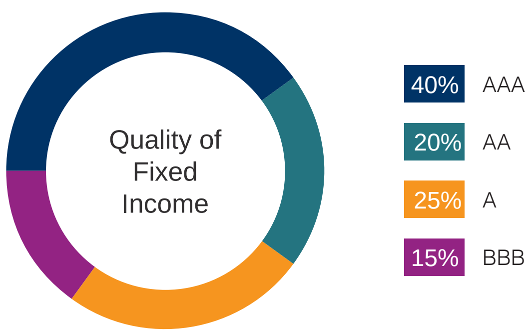


*After divestiture of European operations



Net Operating Income | $ millions





Strong Balance Sheet

237%
Echelon Minimum Capital Test Ratio

340%
ICPEI Minimum Capital Test Ratio

B++
A.M. Best financial strength rating

* Financial Highlights reflect Echelon's Canadian Operations

Redefined Strategy

In 2016, Echelon introduced a new strategy to respond to the changing insurance market and the evolving needs of our broker partners and their customers.

Under the leadership of Serge Lavoie, our new President and CEO, important groundwork was laid this past year to ensure the success of Echelon's new strategy.

We built an experienced leadership team, fostered stronger broker relationships, and set the stage for enhanced broker connectivity with the introduction of our new policy management system.

Experienced Leadership

To support our new lines of business and strengthen our existing operations, we brought together a team of industry experts.

With decades of experience, long-standing broker relationships, and nuanced technical expertise, our new team is well-positioned to drive Echelon's profitable growth. To learn about our seasoned leaders, visit echeloninsurance.ca/leadership.

Stronger Broker Relationships

As one of the few remaining insurers dedicated solely to the broker channel, strong broker relationships are essential to Echelon's success.

In 2016, we strengthened our relationships with our existing brokers and formed new partnerships to support our newest business lines. We also worked to better understand the needs of our brokers and their customers, so to better respond to gaps in the marketplace.

Enhanced Connectivity

Echelon is committed to adopting more agile technology to better support our brokers. We recently introduced a new policy management system to support enhanced connectivity and a more seamless workflow.

By streamlining our policy administration process with full upload and download capabilities, brokers are receiving more timely responses to submissions, with which they can better serve their customers.

Front row	
Jamal Madbak	*VP, Commercial Property*
Lenora Shipka	*Director, Western Canada*
Serge Lavoie	*President and CEO*
Josee Roy	*VP, Commercial Automobile and Long Haul Trucking*

Back row	
Darryll McDonald	*VP, Surety*
Jim Revell	*CEO, ICPEI*
Alvin Sharma	*CFO*
Grace Kemp	*VP, Personal Lines*
Ron Pavelack	*VP, Quebec*

Letter to Shareholders

Preparing for the future and focusing on our core Canadian business

With the divestiture of our European subsidiary complete, we are able to fully focus management time and resources on continuing to build our Canadian business in 2017. We are confident that our sound Canadian strategy will be reflected in our future results, and that our strong balance sheet will provide us with a solid launching pad for 2017 and beyond.

We accomplished a great deal in 2016, to set our Canadian operations on a path towards growth and profitability. Important groundwork was laid to support the introduction of new products, the delivery of our new policy management system, and the development of stronger broker relations.

As our 2016 financial statements show, Echelon generated organic growth in excess of 9%, an accomplishment that we are proud of. Much of this growth was attributed to our new Long Haul Trucking and Surety lines. We are now ready to launch these business lines across the country, alongside an expanded commercial offering to support complete account solutions for our brokers and their clients.

The broker community has expressed a growing need for these products. Echelon is pleased to be able to count on their support in all regions, and excited to pursue additional opportunities with our existing partners and the broader Canadian broker community.

Recent enhancements to our senior management team have given us the internal expertise to underwrite more complex risks, significantly reducing our reliance on the MGA model. With less dependence on external expertise, Echelon will be better positioned to serve the broker community and create value for our shareholders.

The Canadian market is in dire need of a new broker-committed provider, as a number of large insurers are delving into a direct business model. Echelon is ready to respond to this need with a broad range of products and enhanced technology, backed by a steadfast commitment to the broker channel.

We are in the process of rolling out our policy management system to the majority of our brokers in Ontario, Quebec and Alberta, which will greatly improve our ability to transact seamlessly with them. We believe this is important to our target market. Our ability to be flexible, nimble and efficient will be key to our ongoing growth; and with the measures taken during the year, we are more than ready to provide enhanced service to our broker friends.

Thank you to our shareholders for your continued support throughout our transition, which we are confident will result in the steady growth and profitability of our business.

I would also like to take this opportunity to thank our employees for their dedication and hard work, and our Board of Directors for their ongoing advice and support of our new strategy. We are excited for what the future holds for Echelon.

Serge Lavoie
President & CEO
Echelon Insurance

Chairman's Report

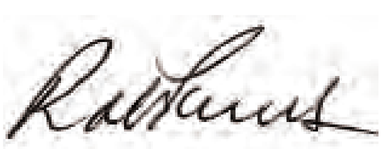
In the past 18 months, your Board has worked diligently alongside of management, in order to address issues of the strategic direction of the Company and the resources and personnel required to carry this out.

Four new board members, Andrew Pastor, Sharon Ranson, Brian Reeve and Murray Wallace came on to the Board during this period. The Board, while working with an outside professional consultant, adopted new governance standards, policies and mandates along with conducting strategic workshops to assist management in developing a new, wholly-Canadian, vision for Echelon Insurance.

The Board and I commend our executive management team, headed by CEO, Serge Lavoie, in their diligence in rationalizing the International division while being able to move Canadian operations ahead on its new strategic path–all stakeholders look forward to seeing the fruits of their labour in the ensuing few years.

This year, the tenure of three of our Board members will expire: Peter Crawford, Ani-Hotoyan-Joly and Angus Ross. Peter and Angus were original directors of Echelon Insurance and have contributed immensely over the years in financial and risk management oversight. Ani came to us three years ago and drove forward our examination and revisions in governance practices and policy.

After five years as Board Chair, I have decided to step down from the Board in favour of a new Chair and a clean slate of independent directors to oversee the new, established strategy. I am confident that the new Board, with its recent new members and current nominees, will be one of the best in the Canadian P&C sector and that they, along with our excellent management team and our dedicated employees, will ensure a great future for Echelon Insurance.



Robert Purves
Chairman of the Board

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

For the period ending December 31, 2016

Echelon Financial Holdings Inc. ("EFH" or "the Company") prepares its financial statements in accordance with International Financial Reporting Standards (IFRS), issued and effective as of December 31, 2016, as set out in the Handbook of the Chartered Professional Accountants (CPA Handbook).

The financial data for 2016, 2015 and 2014 in this discussion has been prepared in accordance with IFRS.

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

The following discussion should be read in conjunction with EFH's audited consolidated financial statements and the related notes. The following commentary is current as of February 16, 2017. Additional information relating to EFH is available on SEDAR at www.sedar.com. Certain totals, subtotals and percentages may not reconcile due to rounding.

The Company 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. EFH analyzes performance based on underwriting income and underwriting ratios such as combined, expense and loss ratios, which are non-IFRS measures. Net operating income is defined as underwriting income plus interest and dividend income, net of tax. 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 and foreign exchange on claims and excludes impact of change in claims discount rates, FX on unpaid claims and investments, and non-recurring items. Net investment income consists of interest income, dividend income and premium financing charges, less interest expense, as per note 6 of the Company's Financial Statements. Net operating income is adjusted to that attributable to shareholders for per share calculation.

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 the Company in 2016 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 EFH's control, affect the operations, performance and results of the Company 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 EFH'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. EFH does not expect to update any forward-looking information.

COMPANY OVERVIEW

EFH operates in the property and casualty ("P&C") insurance industry in Canada and Europe. A divestiture process of the European business is awaiting regulatory approval. The Company underwrites automobile insurance and other specialty insurance products, with a focus on niche underserved markets. On August 4, 2016, EFH announced that it signed a definitive stock purchase agreement for the sale of its European operations, subject to customary closing. The European operation results and balance sheet fair value impairment associated with its sale are referred to as discontinued operations in this document.

EFH operates in Canada through Echelon Insurance ("Echelon"), a federally regulated P&C insurance company and The Insurance Company of Prince Edward Island ("ICPEI"), a provincially regulated P&C insurance company. It has two lines of insurance business in Canada—Personal Lines and Commercial Lines. Personal Lines focuses on the underwriting of non-standard automobile insurance and insurance for motorcycles, antique and classic vehicles, trailers, motorhomes, recreational vehicles and personal property. Commercial Lines designs and underwrites specialized insurance programs, such as commercial property, commercial automobile, long-haul trucking, surety, liability, creditor insurance, and extended warranty.

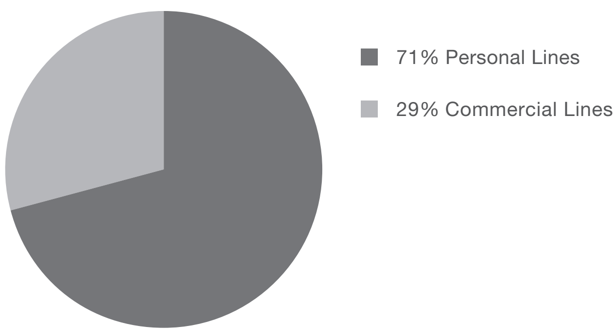
The breakdown of direct written premiums by category of business and by region in 2016 is shown below:

The International segment underwrites specialty insurance programs in Europe through Qudos Insurance A/S ("Qudos"), a majority-owned insurance company. Qudos is domiciled in Denmark and is regulated throughout the European Union by the Danish Financial Supervisory Authority. Products underwritten include non-standard auto, personal property and warranty insurance for new and existing homes. It commenced writing premiums in 2012 and, to date, the majority of the business written is in the United Kingdom, Ireland and Scandinavia. As mentioned above, the Company signed a definitive stock purchase agreement on August 4, 2016 for the sale of its European operations and is awaiting regulatory approval.

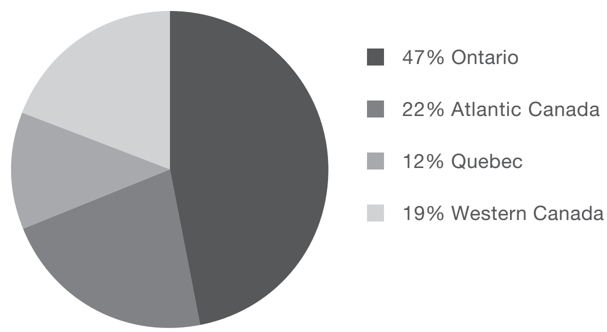
On a Consolidated basis, 71% of EFH's direct written premiums in 2016 were attributable to the sale of Personal Lines policies and Commercial Lines accounted for 29% of direct written premiums.

Results relating to the discontinued International division have been excluded, and accordingly prior year comparatives have been restated to current year presentation. The restatement was made for comparative purposes only and does not affect net income after taxes.

CATEGORY OF BUSINESS



REGION



FOURTH QUARTER HIGHLIGHTS

- Net operating income on continued operations of $0.40 per share compared to an income of $0.39 per share in the fourth quarter of 2015.
- A Canadian combined operating ratio of 90% compared to 88% in the fourth quarter of 2015 driven by exceptionally strong commercial lines results in the quarter, offset by weaker performance in Ontario auto.
- A 15% increase in direct written premiums over the same period in 2015 to $49.4 million, primarily driven by additional new commercial lines products across Canada.
- Total pre-tax loss on invested assets of $0.6 million in the quarter compared to a pre-tax gain of $6.2 million in the fourth quarter of 2015, largely due to higher government bond yields and lower gains on preferred shares compared to prior year quarter.
- Closing book value per share of $11.70.
- We are awaiting approval from the Danish Financial services authority for the sale of the European operations. We have recognized an impairment of $23.4 million relating to the European operations in 2016.

The following financial information compares three months ended December 31, 2016, results with the same period in 2015.

	3 months ended Dec. 31		Change	
($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	**2016**	2015	$	%
Direct written and assumed premiums	**49,403**	43,100	6,303	15
Net written premiums	**44,476**	37,304	7,172	19
Net earned premiums	**46,013**	43,905	2,108	5
Net claims incurred	**25,654**	23,683	1,971	8
Net acquisition costs	**10,680**	9,476	1,204	13
Operating expenses	**7,124**	7,549	(425)	(6)
Underwriting income	**2,555**	3,197	(642)	(20)
Severance expense	**(769)**	—	(769)	—
Investment income	**3,159**	6,277	(3,118)	(50)
Impact of discount rate on claims	**(1,370)**	2,080	(3,450)	(166)
Net income before interest and income taxes	**3,575**	11,554	(7,979)	(69)
Interest expense	**63**	—	63	—
Income tax expense	**911**	2,747	(1,836)	(67)
Net income	**2,601**	8,807	(6,206)	(70)
Net income attributable to shareholders	**2,598**	8,628	(6,030)	(70)
Net operating income attributable to shareholders	**4,857**	4,705	152	3
Earnings per share				
Basic	**$0.22**	$0.74	$(0.52)	(70)
Diluted	**$0.22**	$0.72	$(0.50)	(69)
Net operating income per share – diluted (1)	**$0.40**	$0.39	$0.01	3
Trailing twelve-month return on equity (ROE) – continuing operations (2)	**4.2%**	6.7%		

(1) Net operating income is defined as underwriting income plus interest and dividend income, net of tax. Underwriting income excludes impact of change in claims discount rates, FX on unpaid claims and investments, and non-recurring items. Net investment income consists of interest income, dividend income and premium financing charges, less interest expense, as per note 6 of the Company's Financial Statements. Net operating income is adjusted to that attributable to shareholders for per share calculation.

(2) ROE calculated on rolling twelve-month basis

INSURANCE OPERATIONS

Direct Written, Net Written and Net Earned Premiums

In the fourth quarter of 2016, direct written premiums increased by 15% compared to the same period last year, while net written premiums increased by 19% to $44.5 million. The increase in premium was driven by growth in commercial lines, primarily through the introduction of new surety and commercial auto products.

Claims Incurred

For the quarter ended December 31, 2016, net claims expense increased by 8%, primarily driven by weaker results in Ontario personal auto.

Net favourable development of prior year claims of $3.4 million was recorded in the fourth quarter of 2016 compared to net favourable development of $8.3 million in the same period in 2015.

Acquisition Costs

Acquisition costs, which consist mainly of commissions, premium taxes and a portion of general expenses related to policy acquisitions, increased by 13%, in the quarter ended December 31, 2016, due to increase in premium and change of mix of business.

Operating Expenses

Operating expenses decreased by $0.4 million or 6%, to $7.1 million in the fourth quarter of 2016 compared to $7.6 million in the comparative quarter.

Underwriting Income

Underwriting income of $2.6 million was recorded in the fourth quarter of 2016 compared to an underwriting income of $3.2 million in the same period in 2015. The decrease was due to lower redundancy of claim reserves in the current period compared to the comparative quarter last year.

Investment Income

There was investment income of $3.2 million in the fourth quarter of 2016 compared to $6.3 million in the same period in 2015, primarily due to lower preferred shares gains in the quarter compared to prior year quarter.

Net Income before Income Taxes

For the quarter ended December 31, 2016, net income before taxes was $3.6 million compared to income of $11.6 million in the fourth quarter of 2015. This was primarily driven by lower underwriting income and investment income in the quarter.

Income Taxes

For the quarter ended December 31, 2016, the provision for income taxes reflects an expense of $0.9 million compared to an expense of $2.7 million for the same period last year.

SEGMENTED FINANCIAL INFORMATION (Continued Operations)

The segmented results below exclude corporate expenses.

CANADIAN OPERATIONS

	3 months ended Dec. 31				12 months ended Dec. 31			
($THOUSANDS)	**2016**	2015	$Change	%Change	**2016**	2015	$Change	%Change
Direct written premiums	**49,403**	43,100	6,303	15	**217,486**	199,473	18,013	9
Net earned premiums	**46,013**	43,905	2,108	5	**181,060**	176,468	4,592	3
Net claims:								
Current year claims	**29,096**	32,003	(2,907)	(9)	**128,015**	130,135	(2,120)	(2)
Current year loss ratio	**63.2%**	72.9%			**70.7%**	73.7%		
Favourable prior year claims development	**3,442**	8,320	(4,878)	(59)	**17,243**	20,308	(3,065)	(15)
Total net claims	**25,654**	23,683	1,971	8	**110,772**	109,827	945	1
Claims ratio	**55.8%**	53.9%			**61.2%**	62.2%		
Expense ratio	**34.5%**	33.6%			**35.0%**	33.2%		
Combined ratio	**90.3%**	87.5%			**96.2%**	95.4%		
Underwriting income	**4,326**	5,501	(1,175)	(21)	**6,814**	8,198	(1,384)	(17)

PERSONAL LINES

	3 months ended Dec. 31				12 months ended Dec. 31			
($THOUSANDS)	**2016**	2015	$Change	%Change	**2016**	2015	$Change	%Change
Direct written premiums	**31,171**	30,300	871	3	**154,992**	146,578	8,414	6
Net earned premiums	**35,285**	33,726	1,559	5	**139,616**	134,791	4,825	4
Net claims:								
Current year claims	**26,059**	27,292	(1,233)	(5)	**106,017**	105,467	550	1
Current year loss ratio	**73.9%**	81.0%			**76.0%**	78.3%		
(Unfavourable) favourable prior year claims development	**(1,560)**	7,510	(9,070)	(121)	**8,194**	15,847	(7,653)	(48)
Total net claims	**27,619**	19,782	7,837	40	**97,823**	89,620	8,203	9
Claims ratio	**78.3%**	58.7%			**70.1%**	66.5%		
Expense ratio	**31.8%**	31.6%			**32.2%**	31.0%		
Combined ratio	**110.1%**	90.3%			**102.3%**	97.5%		
Underwriting income	**(3,530)**	3,303	(6,833)	(207)	**(3,177)**	3,309	(6,486)	(196)

Fourth quarter 2016

Personal Lines reported an underwriting loss of $3.5 million compared to an underwriting income of $3.3 million in the same period last year.

This segment's combined ratio increased to 110% in the quarter as a result of the following factors:

1. Weaker performance in Ontario auto in the quarter compared to the prior year quarter due to increased severity in claims, offset by strong results in the personal property line of business.
2. Adverse development on prior year claims of $1.6 million in 2016 compared to redundancies on prior year claims of $7.5 million in 2015.

Year-to-Date 2016

Personal Lines reported an underwriting loss of $3.2 million compared to an underwriting income of $3.3 million in 2015, a decrease of $6.5 million.

This segment's combined ratio has increased to 102% in the year as a result of the following factors:

1. Weaker performance in Ontario auto in the year compared to the prior year offset by strong results in personal property.
2. $1.0 million of claims relating to Fort McMurray fires.
3. Lower redundancies on prior year claims, a reduction to $8.2 million compared to $15.8 million in the prior year.

COMMERCIAL LINES

	3 months ended Dec. 31				12 months ended Dec. 31			
($THOUSANDS)	**2016**	2015	$Change	%Change	**2016**	2015	$Change	%Change
Direct written premiums	**18,232**	12,800	5,432	42	**62,494**	52,895	9,599	18
Net earned premiums	**10,728**	10,179	549	5	**41,444**	41,677	(233)	(1)
Net claims:								
Current year claims	**3,037**	4,711	(1,674)	(36)	**21,998**	24,668	(2,670)	(11)
Current year loss ratio	**28.3%**	46.3%			**53.1%**	59.2%		
Favourable prior year claims development	**5,002**	810	4,192	518	**9,049**	4,461	4,588	103
Total net claims	**(1,965)**	3,901	(5,866)	(150)	**12,949**	20,207	(7,258)	(36)
Claims ratio	**(18.3)%**	38.3%			**31.2%**	48.5%		
Expense ratio	**45.2%**	40.1%			**44.7%**	39.8%		
Combined ratio	**26.9%**	78.4%			**75.9%**	88.3%		
Underwriting income	**7,856**	2,198	5,658	257	**9,991**	4,889	5,102	104

Fourth quarter 2016

Commercial Lines recorded an underwriting income in the fourth quarter of $7.9 million, an increase of $5.7 million. Direct written premiums increased by 42% in the quarter primarily due to the launch of new products in commercial auto and surety lines.

This segment reported an exceptional combined ratio of 27% in the quarter due to:

1. Strong property and liability results in each region compared to the prior year quarter.
2. Increased redundancies on prior year claims of $5.0 million compared to redundancies on prior year claims of $0.8 million in the same period in 2015.

Year-to-Date 2016

Commercial Lines recorded an underwriting income of $10.0 million, compared to underwriting income of $4.9 million in the same period last year, an increase of $5.1 million.

This combined ratio of 76% was due to:

1. Strong performance in Ontario commercial auto, Atlantic commercial auto and property and liability results compared to the same period in 2015.
2. Increased redundancies on prior year claims of $9.0 million compared to redundancies of prior year claims of $4.5 million in the same period in 2015.
3. Offset partially by a $1.0 million impact on commercial lines from the Fort McMurray wild fire.

SEGMENTED FINANCIAL INFORMATION (Discontinued Operations)

The Company signed a definitive stock purchase agreement on August 4, 2016, for the sale of its European operations and is awaiting regulatory approval from the Danish Financial Services Authority.

SUMMARY OF QUARTERLY RESULTS

A summary of the Company's last eight quarters is as follows:

				2016				2015
($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	**Q4**	**Q3**	**Q2**	**Q1**	Q4	Q3	Q2	Q1
Direct written and assumed premiums	**49,403**	**58,171**	**67,791**	**42,121**	43,100	50,769	63,378	42,226
Net earned premiums and other revenue	**46,013**	**46,452**	**45,247**	**43,348**	43,905	46,882	43,140	42,541
Underwriting income (loss)	**2,555**	**(429)**	**(502)**	**(2,038)**	3,197	1,420	271	(5,334)
Income (loss) before interest expense and income taxes	**3,575**	**1,621**	**3,386**	**423**	11,554	(1,186)	3,745	(175)
Net income (loss)	**2,601**	**1,401**	**2,198**	**918**	8,807	(1,277)	3,855	877
Net operating income (loss)	**4,857**	**1,580**	**2,873**	**1,043**	4,705	3,558	2,569	(910)
Earnings (loss) per adjusted share								
(a) Basic	**$0.22**	**$0.10**	**$0.15**	**$0.08**	$0.74	($0.11)	$0.31	$0.11
(b) Diluted	**$0.22**	**$0.10**	**$0.15**	**$0.08**	$0.72	($0.11)	$0.30	$0.11
Net operating income (loss) per share – diluted	**$0.40**	**$0.01**	**$0.24**	**$0.08**	$0.39	$0.30	$0.21	($0.06)
Selected financial ratios								
Loss ratio	**55.8%**	**61.5%**	**62.4%**	**65.3%**	53.9%	60.3%	61.4%	73.8%
Expense ratio	**38.6%**	**39.4%**	**38.7%**	**39.4%**	38.8%	36.7%	38.0%	38.7%
Combined ratio	**94.4%**	**100.9%**	**101.1%**	**104.7%**	92.7%	97.0%	99.4%	112.5%
Book value per share	**$11.70**	**$12.90**	**$13.08**	**$15.16**	$15.75	$15.55	$16.00	$16.11

The quarterly results reflect the seasonality of the Company's business. While net earned premiums are relatively stable from quarter to quarter, except for acquisition-related growth, underwriting results vary significantly by quarter as they are affected by changes in weather conditions.

NET OPERATING INCOME

($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	**Q4 2016**	**2016**	2015	2014	2013	2012
Net investment income	**2,439**	**11,502**	14,050	13,650	13,349	12,277
Underwriting income (loss)	**2,555**	**(414)**	(447)	8,106	(2,980)	6,081
Add: CAT losses	**1,334**	**3,334**	—	—	—	—
Pre-tax operating income	**6,328**	**14,422**	13,603	21,756	10,369	18,358
Income tax	**(1,468)**	**(3,556)**	(3,673)	(5,874)	(2,800)	(4,957)
Net operating income	**4,860**	**10,866**	9,930	15,882	7,569	13,401
Minority interest	**(3)**	**(512)**	(8)	(129)	—	—
Net operating income attributable to shareholders	**4,857**	**10,354**	9,922	15,753	7,569	13,401
Net operating income per share – diluted	**$0.40**	**$0.86**	$0.83	$1.31	$0.63	$1.11

2016 FINANCIAL OVERVIEW

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)	Q4 2016	2016	2015
Gross premiums written	**49,403**	**217,486**	199,473
Net premiums written	**44,476**	**199,601**	180,336
Net earned premiums	**46,013**	**181,060**	176,468
Net interest and dividends	**2,439**	**11,502**	14,050
Realized and unrealized gains (losses) on investments	**345**	**4,150**	(1,380)
Foreign exchange gains	**375**	**855**	(57)
Other	**—**	**—**	748
Total revenue	**49,172**	**197,567**	189,829

The main source of revenue was earned premiums from the sale of insurance policies. Gross written premiums totaled $217.5 million, an increase of 9% compared to $199.5 million last year. The increase in gross premium was primarily due to the introduction of the surety and commercial auto lines.

Personal Lines recorded $155.0 million of premiums in 2016 compared to $146.6 million in 2015, an increase of 6%. Commercial Lines recorded $62.5 million of premiums in 2016 compared to $52.9 million in 2015, an increase of 18%.

Net earned premiums increased $4.6 million, or 3% in 2016, to $181.1 million from $176.5 million in 2015.

Investment income constituted approximately 8% of EFH's total revenue in 2016. Market fluctuations in interest rates and equity markets affect EFH's returns on the market value of fixed income, preferred shares, equity markets and short-term investments. Net realized and unrealized gains on invested assets totaled $5.0 million compared to net realized and unrealized loss of $1.4 million last year.

EXPENSES

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

($ THOUSANDS)	Q4 2016	2016	2015
Expenses			
Incurred claims (1)	**25,654**	**110,772**	109,827
Acquisition expense	**10,680**	**41,545**	39,448
Operating expense (2)	**7,124**	**29,157**	27,639
	43,458	**181,474**	176,914

Selected Underwriting Ratios	Q4 2016	2016	2015
Incurred claims ratio (1)	**55.8%**	**61.2%**	62.2%
Acquisition expense ratio	**23.2%**	**22.9%**	22.4%
Operating expense ratio	**15.4%**	**16.1%**	15.7%
Combined ratio (1)	**94.4%**	**100.2%**	100.3%

(1) Before impact of change in discount rate decreasing unpaid claims by $2.8 million in 2016 and increasing unpaid claims by $1.0 million in 2015.
(2) Operating expenses do not include severance costs of $4.3 million in 2016, nil in 2015.

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 EFH'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 Managing General Agents (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 to qualify for this compensation. Premium taxes are paid by EFH to provincial governments, calculated as a percentage of direct written premiums.

Operating expenses are the non-commission selling, underwriting and administrative expenses incurred to support EFH'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.

YEAR ENDED DECEMBER 31, 2016 COMPARED TO 2015

2016 HIGHLIGHTS

- Net operating income increased by 4% to $0.86 per share from $0.83 per share.
- A Canadian combined ratio of 96% compared to 95% driven by weak performance in Ontario auto, offset by strong commercial lines results.
- An increase of direct written premium of 9% in 2016, primarily driven by the introduction of new commercial line products during the year.
- Total pre-tax return of invested assets of $7.5 million compared to $6.0 million in 2015 driven by strong preferred shares returns in the year.

The following financial information compares results for the full year 2016 and 2015.

($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	**2016**	2015	$Change	%Change
Direct written and assumed premiums	**217,486**	199,473	18,013	9
Net written premiums	**199,601**	180,336	19,265	11
Net earned premiums	**181,060**	176,468	4,592	3
Net claims incurred	**110,772**	109,827	945	1
Net acquisition costs	**41,545**	39,448	2,097	5
Operating expenses	**29,157**	27,639	1,518	5
Underwriting (loss)	**(414)**	(447)	33	7
Other income	**—**	748	(748)	(100)
Severance expense	**(4,266)**	—	(4,266)	—
Investment income	**16,507**	12,613	3,894	31
Impact of discount rate	**(2,822)**	1,024	(3,846)	(376)
Net income before interest expense and income taxes	**9,005**	13,938	(4,933)	(35)
Interest expense	**217**	—	217	—
Income taxes expense	**1,670**	1,676	(6)	0
Net income	**7,118**	12,262	(5,144)	(42)
Net income attributable to shareholders	**6,606**	12,254	(5,648)	(46)
Net operating income attributable to shareholders	**10,354**	9,922	432	4
Earnings per share				
Basic	**$0.56**	$1.05	$(0.49)	(47)
Diluted	**$0.55**	$1.02	$(0.47)	(46)
Net operating income per share – diluted	**$0.86**	$0.83	$0.03	4
Trailing twelve-month return on equity (ROE) – continuing operations (1)	**4.2%**	6.7%		

(1) ROE calculated on rolling twelve-month basis

INSURANCE OPERATIONS

Direct Written and Net Earned Premiums

Direct written premiums increased by $18.0 million, or 9%, to $217.5 million compared to $199.5 million in the same period last year, attributable predominantly to new product lines in surety and commercial auto and stronger broker relationships. Net earned premiums increased by $4.6 million, or by 3%, to $181.1 million.

Claims Incurred

Net claims expense increased by $0.9 million, or 1%, to $110.8 million compared to $109.8 million in 2015. The resulting loss ratio of 61.2% for 2016 represents an improvement of 1.0% over 2015. Included in the claims incurred was approximately $3.3 million relating to catastrophic losses, primarily relating to the Fort McMurray fire.

On a consolidated basis, lower net favourable development of prior claims of $17.2 million was recorded in the year compared to $20.3 million in 2015.

Acquisition Costs

Acquisition costs, which consist mainly of commissions, premium taxes and a portion of general expenses related to policy acquisitions, increased by 5% primarily due to an increase in net earned premiums and a change of mix of business in Commercial Lines.

Operating Expenses

Operating expenses increased $1.5 million or 5% to $29.2 million in 2016 due to costs associated of upgrading and rolling out of a new policy management system.

Corporate expenses include $0.5 million (2015 – $1.0 million) relating to positive development on prior year claims reserves of ICPEI, that in accordance with the 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.

Underwriting Income

Overall underwriting performance has remained unchanged for the year ended December 31, 2016, compared to 2015. The underwriting results for 2016 and 2015 include corporate and other expenses of $7.2 million and $8.6 million, respectively. Details by line of business are shown in the segmented financial section.

Investment Income

Investment income increased by $3.9 million, to $16.5 million in 2016 compared to $12.6 million in 2015. Net gains on investments totaled $0.3 million in 2016 compared to $5.9 million in 2015.

Income from fair value change on FVTPL investments, primarily preferred shares investments increased by $11.2 million to an income of $3.9 million compared to a loss of $7.3 million in the same period of 2015. The total fair value of the investment portfolio as at December 31, 2016, (including cash and short-term and premium financing receivables) was $410.0 million compared to $536.0 million as at December 31, 2015.

Net Income before Income Taxes

Income before taxes was $9.0 million in 2016, compared to $13.9 million in 2015. This was primarily due to $4.3 million of severance expenses incurred in 2016 compared to nil in 2015.

Income Taxes

The provision for income taxes for the year ended December 31, 2016, was an expense of $1.7 million compared to an expense of $1.7 million for the same period last year. The approximate effective rate increased to 19% for 2016 from 11% for the previous year.

BALANCE SHEET ANALYSIS

The Balance Sheet analysis that follows should be read in conjunction with the audited consolidated financial statements for the fourth quarter of 2016, and notes therein.

BALANCE SHEET HIGHLIGHTS

Selected balance sheet highlights and book value per share details are as follows:

($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	**2016**	2015	2014	2013	2012
Cash and short-term deposits	**50,588**	23,373	27,326	18,156	19,578
Investments	**336,535**	513,099	504,290	454,317	412,728
Total assets	**800,219**	923,795	740,299	619,928	548,852
Provision for unpaid claims	**255,129**	397,214	344,692	296,857	268,580
Unearned premiums	**120,184**	264,584	168,555	127,247	94,085
Total equity attributable to shareholders	**137,414**	180,935	183,616	172,360	168,427
Book value per share (1)	**$11.70**	$15.75	$15.82	$14.57	$13.98
MCT Ratio – Echelon Insurance	**237%**	241%	211%	219%	250%
– ICPEI	**340%**	296%	229%	N/A	N/A

(1) Shareholders' equity divided by the number of shares issued and outstanding.

INVESTMENTS

EFH has an investment policy that seeks to provide a stable income base to support EFH'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.

EFH's investment portfolio is invested in well-established, active and liquid markets in Canada. Fair value for most investments is determined by reference to observable market data.

FAIR VALUE OF INVESTMENTS

The following table sets forth EFH's invested assets as at December 31, 2016, and December 31, 2015.

($ THOUSANDS)

				Fair values
Available-for-sale	**As at Dec. 31, 2016**	**% of Total**	As at Dec. 31, 2015	% of Total
Canadian				
Federal	**67,826**		45,524	
Provincial	**44,147**		55,976	
Municipal	**519**		1,386	
Corporate	**136,984**		171,789	
	249,476		274,675	
Fixed income lent through securities lending program				
Federal	**15,390**		14,231	
Provincial	**998**		3,800	
Municipal	**845**		—	
Corporate	**1,885**		4,673	
	19,118		22,704	
Foreign fixed income				
Government	**—**		17,555	
Corporate	**—**		114,399	
	—		131,954	
Total fixed income	**268,594**	**69%**	429,333	80%
Commercial mortgages pooled funds	**17,423**		17,017	
Money market pooled funds	**200**		403	
Short-term fixed income and mortgage pooled funds	**17,229**		16,934	
Total pooled funds	**34,852**	**9%**	34,354	6%
Common shares				
Canadian	**312**		2,656	4%
U.S.	**—**		8,012	
Total common shares	**312**	**—%**	10,668	2%
Total available-for-sale	**303,758**		474,355	
Fair value through profit or loss				
Preferred shares	**32,678**		38,400	
Preferred shares lent through securities lending program	**99**		344	
Total preferred shares	**32,777**	**8%**	38,744	7%
Total investments	**336,535**	**86%**	513,099	95%
Cash and short-term deposits	**50,588**	**14%**	23,373	5%
Total investments including cash and short-term deposits	**387,123**	**100%**	536,472	100%

IMPAIRMENT ASSETS AND PROVISIONS FOR LOSSES

EFH 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.

There was no impairment loss recognized during the twelve months ended December 31, 2016 . In year 2015 impairment loss of $0.3M was recognized.

A gross unrealized loss of $1.7 million (December 31, 2015 – $3.2 million) on investments held as at December 31, 2016, is recorded, net of tax, in the amount of $1.2 million (December 31, 2015 – $2.5 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.

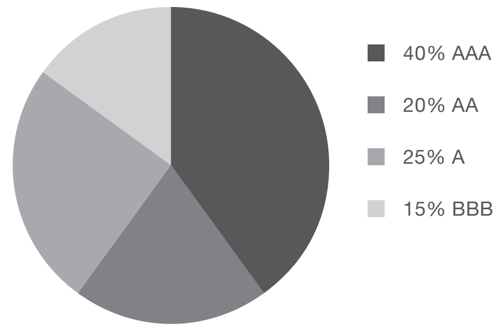
FIXED INCOME SECURITIES

EFH holds fixed income securities to provide a steady, predictable level of income with reasonable liquidity and minimal risk of loss and a fixed sum at maturity. EFH'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.

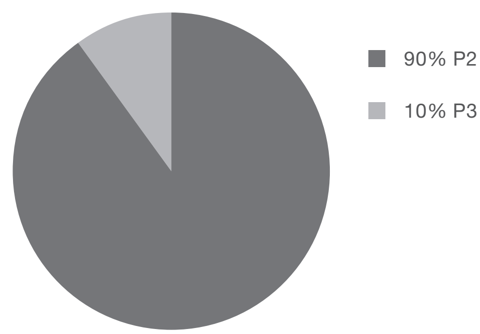
EFH's bond portfolio has a high overall credit quality with an average rating of AA. The preferred shares have an average rating of P2. The duration of the bond portfolio is 3 years.

The chart below shows EFH's fixed income portfolio by credit quality as at December 31, 2016.

BOND RATINGS Q4 2016



PREFERRED SHARES Q4 2016



SECTOR MIX BY ASSET CLASS

The following table shows sector exposure by asset class as at December 31, 2016:

Sector	Fixed Income Securities and Pooled Funds	Preferred Shares	Common Shares	Total
Government	45%	—%	—%	41%
Financial Services	28%	63%	68%	31%
Infrastructure	10%	1%	—%	9%
Telecomunication	3%	—%	—%	2%
Consumer Discretionary	—%	—%	—%	—%
Energy	3%	—%	21%	3%
Industrial Products	4%	8%	—%	4%
Pipelines	1%	12%	—%	2%
Utilities	—%	16%	11%	2%
Other	6%	—%	—%	6%
Total	100%	100%	100%	100%
Total	$303,180	$32,777	$312	$336,269

(1) Fixed income securities and pooled funds do not include any cash being carried by the pooled funds, $0.3 million as at December 31, 2016.

COMMON SHARE PORTFOLIO

As at December 31, 2016, 100% of the common share portfolio was invested in Canadian equities.

FAIR VALUE IMPAIRMENT

The fair value impairment on sale of discontinued operations of $23.4 million, including all costs to dispose the operations, is being recorded against the unearned premiums included within the liabilities of the disposable group held for sale.

RECOVERABLE FROM REINSURERS

($ THOUSANDS)	**As at Dec. 31, 2016**	As at Dec. 31, 2015
Reinsurers' share of unpaid claims	**27,023**	90,158
Reinsurers' share of unearned premiums	**8,975**	89,953
Total	**35,998**	180,111

As at December 31, 2016, the recoverable from reinsurers decreased by $144.1 million, or 80%, to $36.0 million from $180.1 million as at December 31, 2015. The decrease was due to reclassification of discounted operations. 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 Specialty Programs distributors who share a portion of the risk with EFH, for whom the Company holds deposits as collateral.

ACCOUNTS RECEIVABLE

($ THOUSANDS)	**As at Dec. 31, 2016**	As at Dec. 31, 2015
Premium financing receivables	**26,335**	18,355
Agents and brokers	**15,668**	78,849
Other	**4,702**	8,096
Total	**46,705**	105,300

Premium financing receivables represents 56% of total receivables as at December 31, 2016. Premium financing receivables increased to $26.3 million at December 31, 2016, from $18.4 million at December 31, 2015 due to the introduction of new products. Agent and broker receivables decreased from $78.8 million in 2015 to $15.7 million in 2016 due to reclassification of discontinued operations.

PROVISION FOR UNPAID CLAIMS

EFH 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, and related to events that have occurred but have not yet been reported to EFH. Provision for unpaid claims consists of the aggregate amount of individual case reserves established and management's estimate of claims incurred but not reported, based on the volume of business currently in force and historical claims experience and are determined by EFH's appointed actuary. Provisions for unpaid claims are discounted to present value. The discount rates used for December 31, 2016 and 2015 for the following entities are below:

Entity	**As at Dec. 31, 2016**	As at Dec. 31, 2015
Echelon Insurance	**1.90%**	2.44%
ICPEI	**1.75%**	1.63%

SHARE CAPITAL

As of February 16, 2017, there were 11,749,736 common shares issued and outstanding.

LIQUIDITY AND CAPITAL MANAGEMENT

The purpose of liquidity management is to ensure there is sufficient cash to meet all of EFH's financial commitments and obligations as they come due. EFH 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 $1.6 million is due in less than a year and $9.9 million is due over the next nine years.

EFH is primarily a holding company and, as such, has limited direct operations of its own. EFH's principal assets are the shares of its insurance and reinsurance subsidiaries. Accordingly, its future cash flows depend in part upon the availability of dividends and other statutorily permissible distributions from its 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 EFH.

CAPITAL MANAGEMENT

The total capitalization of EFH at December 31, 2016, was $141.4 million compared to $184.9 million at December 31, 2015.

The Minimum Capital Test (MCT) ratio of the Company's Canadian subsidiary, Echelon Insurance, as at December 31, 2016, was 237%, which comfortably exceeds the supervisory regulatory capital level required by the Office of the Superintendent of Financial Institutions (OSFI). ICPEI's MCT ratio of 340% was in excess of provincial supervisory targets. In addition to any excess capital at Echelon Insurance, the Company has approximately $5.0 million of excess deployable capital invested in liquid assets in the holding company.

NORMAL COURSE ISSUER BID (NCIB)

On August 19, 2014, the Company received approval from the TSX to commence an NCIB to repurchase and cancel up to 703,792 common shares, representing 10% of its public float issued and outstanding common shares at that time. This was in force until August 20, 2015.

On October 8, 2015, the Company received approval from the TSX to commence an NCIB to repurchase and cancel up to 619,265 common shares, representing 10% of its public float issued and outstanding common shares at that time. This was in force until October 7, 2016.

In 2016 there were 55,867 common shares repurchased at an average cost of $13.24 per share for a total consideration of $0.7 million. From October 8, 2015 to February 16, 2017, the Company purchased and canceled 115,700 common shares under the NCIB program at an average cost of $13.65 per share for a total consideration of $1.6 million.

YEAR ENDED DECEMBER 31, 2015 COMPARED TO 2014

The following chart compares results for the full year 2015 and 2014:

($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	2015	2014	$ Variance	% Variance
Direct written and assumed premiums	199,473	187,344	12,129	6%
Net written premiums	180,336	171,396	8,940	5%
Net earned premiums	176,468	167,517	8,951	5%
Net claims incurred	109,827	92,966	16,861	18%
Net acquisition costs	39,448	40,824	(1,376)	(3)%
Operating expenses	27,639	25,621	2,018	8%
Underwriting income (loss)	(447)	8,106	(8,553)	106%
Severance	—	(1,166)	1,166	100%
ICPEI integration expense	—	(1,347)	1,347	100%
Investment income	12,613	22,019	(9,406)	(43)%
Impact of discount rate – increase in claims	1,024	(2,391)	3,415	(143)%
Other income	748	—	748	—
Net income before income taxes	13,938	25,221	(11,283)	(45)%
Income taxes expense	1,676	5,051	(3,375)	(67)%
Net income	12,262	20,170	(7,908)	(39)%
Net income attributable to shareholders	12,254	18,722	(6,468)	(35)%
Net operating income attributable to shareholders	9,922	15,753	(5,831)	(37)%
Earnings per share				
Basic	$1.05	$1.72	$(0.67)	(39)%
Diluted	$1.02	$1.67	$(0.65)	(39)%
Net operating income per share – diluted (1)	$0.83	$1.31	$(0.48)	(37)%
Trailing twelve month return on equity (ROE) (2)	6.7%	10.5%		

(1) Net operating income is defined as net income excluding the impact of the change in discount rate and foreign exchange rates on unpaid claims and investments, realized losses or gains on sale of investments, discontinued operations, unrealized fair value changes on FVTPL investments and one-time, non-recurring items. Net operating income is adjusted to that attributable to shareholders for per share calculation.

(2) ROE calculated on rolling twelve-month basis.

5-YEAR FINANCIAL HIGHLIGHTS

($ THOUSANDS EXCEPT PER SHARE AMOUNTS)	**2016**	2015	2014	2013	2012
				Year ended Dec. 31	
Revenue					
Direct written and assumed premiums					
Personal Lines	**154,992**	146,578	133,275	134,902	129,606
Commercial Lines	**62,494**	52,895	54,069	39,702	48,352
Total direct written premiums	**217,486**	199,473	187,344	174,604	177,958
Net written premiums	**199,601**	180,336	171,396	157,117	161,623
Net earned premiums	**181,060**	176,468	167,517	154,137	158,573
Underwriting expenses					
Incurred claims	**110,772**	109,827	92,966	101,363	95,066
Acquisition costs	**41,545**	39,448	40,824	36,799	37,277
Operating expenses	**29,157**	27,639	25,621	18,955	20,149
Total underwriting expense	**181,474**	176,915	159,411	157,117	152,492
Underwriting income (loss)	**(414)**	(447)	8,106	(2,980)	6,081
Impact of discount rate on claims	**(2,822)**	1,024	(2,391)	207	(3,887)
ICPEI Integration Cost	**—**	—	(1,347)	—	—
Severance expense	**(4,266)**	—	(1,166)	—	—
Investment income	**16,507**	12,613	22,019	17,474	33,556
Other income	**—**	748	—	—	—
Income before interest expense and income taxes	**9,005**	13,938	25,221	14,701	35,750
Interest expense	**217**	—	—	—	—
Income tax expense (recovery)					
Current	**1,738**	1,555	5,300	4,129	9,523
Deferred	**(68)**	121	209	(895)	(646)
	1,670	1,676	5,509	3,234	8,877
Net income on continued operations	**7,118**	12,262	19,712	11,467	26,873
Net income (loss) on discontinued operations attributable to shareholders of the Company	**(36,646)**	(5,677)	(980)	(7,742)	(7,507)
Net income	**(29,528)**	6,585	18,732	3,725	19,366
Attributed to:					
Shareholders of the Company	**6,606**	12,254	18,722	4,681	20,353
Non-controlling interest	**512**	8	10	(956)	(987)
	7,118	12,262	18,732	3,725	19,366
Earnings per share attributable to shareholders of the Company:					
Net income per share continued operations basic	**$0.56**	$1.05	$1.72	$0.97	$2.24
Net income per share continued operations diluted	**$0.55**	$1.02	$1.67	$0.95	$2.22
Book value per share	**$11.70**	$15.75	$15.82	$14.57	$13.98
Net operating income (1)	**10,354**	9,922	15,753	7,569	13,401
Net operating income per share – diluted (2)	**$0.86**	$0.83	$1.31	$0.63	$1.11

(1) Net operating income is defined as underwriting income plus interest and dividend income, net of tax. Net operating income is adjusted to that attributable to shareholders for per share calculation.
(2) Net operating income is adjusted to that attributable to shareholders for per share calculation.

OUTLOOK

EFH's target is to deliver a minimum 12% after-tax return on shareholder's equity and a 95% combined ratio on its underwriting operations. The Company has made significant progress in the past year focusing on its core business in Canada and a return to sustainable profitability. In 2017, we will continue to execute on the strategy outlined below with a focus on underwriting profitability and maximizing our return on equity. We have a strong balance sheet that will provide us with a solid launching pad for 2017 and beyond.

STRATEGY

EFH's mission is to focus on targeted solutions where it can differentiate itself in the market and that require the high level of expertise of the Company. It will differentiate itself through specialized underwriting, personalized service and the sophisticated management of risk. It will operate in a responsible, ethical manner while aiming to generate high growth, strong underwriting results and a superior return on shareholders' equity.

EFH is focused on growing its Canadian specialty insurance business.

EFH's products are distributed exclusively through insurance brokers and agents. With a growing number of insurers selling directly to consumers, EFH's commitment to the broker channel differentiates Echelon and ICPEI from competitors and forms a foundation for mutually beneficial relationships. On this commitment, the Company has built and maintained an effective network of distribution partners by:

FOCUS ON CANADA OFFERING DIVERSE PRODUCTS THAT SATISFY UNMET NEEDS

The bulk of EFH's products are designed to respond to the unmet needs of our distribution partners.

EFH has excelled in the non-standard auto market by delivering expertly underwritten coverage for hard-to-insure drivers. ICPEI's nuanced understanding of Maritime families and businesses has shaped the products and coverages that meet the unique needs of Atlantic Canadians. Now, EFH has identified new areas where brokers are unsatisfied with existing products and service, and is responding by launching Surety and Long Haul Trucking (LHT) solutions.

INVESTING IN TALENT AND LEVERAGING RELATIONSHIPS

EFH's management and underwriting teams have the skillsets to understand and effectively underwrite risks. EFH and ICPEI benefit from this seasoned expertise, but also from employee reputations and longstanding relationships in their industries. With the addition of LHT and Surety teams in 2016, EFH gained a number of new broker relationships.

IMPROVING TECHNOLOGY AND CONNECTIVITY

EFH is committed to investing in technology to connect more seamlessly with its brokers and agents. In 2015, Echelon purchased and launched a new policy management system (GIS) that will be instrumental in streamlining how brokers and agents write business with EFH. EFH has rolled out the GIS system across Canada and by 2018, GIS will be EFH's sole policy management system, greatly simplifying broker system interactions.

The type and number of distributors that EFH partners with varies by business line. *Property and Automobile* products are marketed through a broad network of insurance brokers and agents across Canada, including Co-operators agents with whom Echelon has a distribution agreement. Specialty products, including *Long Haul Trucking* and *Surety* are distributed exclusively through specialty brokers at this time. These specialty distributors have both the expertise to underwrite good risks, and the volume of premium to support good loss ratios in these business lines.

LINES OF BUSINESS

Personal lines

EFH offers standard and specialty private passenger vehicle coverage through ICPEI in the Maritime provinces and Echelon Insurance in the rest of Canada, respectively. Both brands also provide coverage for specialty and recreational vehicles.

In addition to automobile products which form the bulk of EFH's Personal Lines business, Property coverage is offered in select provinces.

Personal Automobile

Non-standard automobile insurance is the largest single component of EFH's business, with approximately $100.0 million in direct premiums written over the 12 months ended December 31, 2016. Offered through Echelon Insurance, the non-standard automobile product targets drivers of private passenger and single commercial vehicles who are unable to obtain coverage from standard insurers.

EFH writes specialty automobiles and recreational vehicles through both Echelon and ICPEI. Coverage is available for motorcycles, antique and classic cars, trailers, motorhomes, snowmobiles and all-terrain vehicles. Standard personal and commercial automobile insurance is offered across the Maritimes through ICPEI only.

Moving forward, the Company intends to increase focus on profitable automobile products, evaluating whether these could be successfully expanded into new regional markets within Canada. At the same time, unprofitable products will be reviewed and refined.

Personal Property

EFH offers homeowners, condo and tenant packages through ICPEI in the Maritimes and through Echelon in Quebec and British Columbia.

Commercial Lines

EFH writes commercial property, liability and automobile coverage for small- to mid-sized businesses under the Echelon and ICPEI brands.

In addition to standard commercial policies, Echelon also excels in niche business lines, including Surety, Long Haul Trucking, and Specialty Programs. In 2016, the Company grew its Commercial Lines Management and underwriting teams to include seasoned experts with proven track-records and deep networks in their respective markets.

With a now-profitable portfolio and an experienced and connected management team, steps are underway to expand the Company's commercial product offering into Ontario, Quebec and Alberta. Echelon will target underserved and specialty brokers, offering flexible, risk-underwritten coverage.

Commercial Property

EFH offers commercial property coverage in the Maritimes, Quebec and British Columbia, differentiating from competitors by applying risk vs. class underwriting. Simple, low-touch packages target small- to mid-sized businesses like contractors and professional service providers. Coverages can be customized to meet the more unique needs of larger businesses.

Commercial Automobile

The Company offers commercial automobile coverage through Echelon in Alberta, Ontario and Quebec, and through ICPEI in the Maritimes. Coverage is available for single vehicles, cargo trailers and small fleets, and both standard and non-standard risks are written.

Long-Haul Trucking (LHT)

In response to growing market demands, Echelon expanded its Commercial Automobile offering to include LHT products. Echelon writes policies for both fleets and owner operators that package commercial automobile, motor truck cargo liability, commercial general liability, and garage coverages, as well as special endorsements. The head of Echelon's LHT line brings 35 years of experience and strong relationships with specialty brokers, which has led to rapid growth in 2016.

Specialty Programs

Echelon partners with MGAs across Canada to underwrite a range of specialty and warranty programs including home, home system and major appliance warranties. In 2017, Echelon will continue to grow its warranty programs by building deeper expertise and operational infrastructure in home, product and equipment warranty.

Surety

In early 2016, Echelon introduced a Surety division to meet growing demand for mid-market surety bonds. Initially, Echelon will focus on distributing contract bonds through specialty surety brokers and will expand to include commercial bonds, and access will be extended to a broader group of brokers.

Organizational Strategies

EFH's key to profitable growth is personalized service and sophisticated pricing, underwriting and claims management. EFH will invest in its business and its people. It will continue to develop a sophisticated and scalable operational platform to grow. EFH will continue to invest aggressively in technology, with a focus on service and financial analytics.

COMPETITIVE STRENGTHS

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

SPECIALIZED PRODUCTS AND UNDERWRITING

EFH offers its producers a comprehensive line of specialty auto insurance products such as non-standard auto, motorcycles, trailers, motorhomes, ATVs, snowmobiles and the like. It utilizes specialized underwriting techniques, allowing it to effectively assess risks that don't fit the fully automated processes of larger, standard insurers.

ENTREPRENEURIAL CULTURE

EFH fosters a responsive, team environment which encourages experimentation and allows the flexibility to provide unique, tailor-made solutions. The Company's values are teamwork, speed, innovation and integrity.

PERSONALIZED CUSTOMER SERVICE

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

FINANCIAL STRENGTH

EFH has a strong capital base with shareholder equity of $137.4 million. The Minimum Capital Test (MCT) ratio of Echelon Insurance as at December 31, 2016, was 237% comfortably in excess of the Office of the Superintendent of Financial Institutions' (OSFI) supervisory target. In addition to any excess capital at Echelon, the Company has approximately $5.0 million of excess deployable capital invested in liquid assets in the holding company.

It has a high quality investment portfolio with 100% of its fixed income portfolio in investment grade, 85% rated A and above and the average rating of the fixed income portfolio is 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). EFH intends to maintain its strong balance sheet through appropriate pricing, underwriting discipline, conservative accounting and loss reserving practices.

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 EFH'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 EFH. Many of these factors are beyond EFH's control. An economic downturn in those jurisdictions in which EFH writes business could result in less demand for insurance and lower policy amounts. As a P&C insurance company, EFH 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 EFH. A significant portion of the earnings of insurance companies is derived from the income from their investment portfolios. EFH's investment income will fluctuate depending on the returns and values of securities in its investment portfolio.

REGULATION

EFH 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 EFH's business, results of operations and financial condition. Should OSFI be 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 EFH'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.

EFH competes with many other insurance companies. Certain of these competitors are larger and have greater financial resources than EFH 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 EFH will continue to increase revenues or be profitable. To a large degree, future revenues of EFH 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.

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. EFH'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 EFH'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. Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in EFH's financial results for any fiscal quarter or year and could materially reduce EFH's profitability or harm EFH's financial condition. EFH's ability to write new business also could be affected. EFH may experience an abrupt interruption of activities caused by unforeseeable and/or catastrophic events. EFH'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 EFH'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 EFH's bond portfolio and increased costs of borrowing for EFH on future debt instruments, preferred shares or credit facilities. Such increased costs would negatively affect EFH's operating results.

NEGATIVE PUBLICITY IN THE INDUSTRY

EFH's products and services are ultimately distributed to individual consumers. From time to time, consumer advocacy groups or the media may focus attention on EFH's products and services, thereby subjecting its industry to periodic negative publicity. EFH 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 EFH's costs of doing business and adversely affect EFH's profitability by impeding its ability to market its products and services or increasing the regulatory burdens under which EFH operates.

RELIANCE ON BROKERS

EFH distributes its products primarily through a network of brokers. These brokers sell EFH's competitors' products and may stop selling EFH 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 EFH products.

PRODUCT AND PRICING

EFH 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. EFH'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 EFH's best efforts, regulator decisions may impede automobile rate increases or other actions that EFH may wish to take. Also, during periods of intense competition for any product line to gain market share, EFH's competitors may price their products below the rates EFH considers acceptable. Although EFH may adjust its pricing up or down to maintain EFH's competitive position, EFH strives to ensure its pricing will produce an appropriate return on invested capital. There is no assurance that EFH will not lose market share during periods of intense pricing competition.

UNDERWRITING AND CLAIMS

EFH 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. EFH's success depends upon its ability to accurately assess the risks associated with the insurance policies that EFH writes.

EFH's underwriting objectives are to develop business within EFH's target markets on a prudent and diversified basis and to achieve profitable underwriting results (i.e. a combined operating ratio below 100%). EFH underwrites automobile business after a review of the applicant's driving record reports and claims experience. There can be no assurances that EFH 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 EFH 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 EFH'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 EFH. Although EFH's management believes its overall reserve levels as at December 31, 2016, are adequate to meet its obligations under existing policies, actual losses may deviate, perhaps substantially, from the reserves reflected in EFH's financial statements. To the extent reserves prove to be inadequate, EFH would have to increase such reserves and incur a charge to earnings.

ERRORS AND OMISSIONS CLAIMS

Where EFH 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 EFH may allege EFH'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, EFH'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 EFH takes may not be effective in all cases.

EFH'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 EFH's reputation or divert management resources away from operating the business.

EFH 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 $2.0 million.

INVESTMENTS

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

EFH'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 EFH. A change in interest rates, market values or foreign exchange rates may affect Echelon's regulatory strength tests.

REINSURANCE

Consistent with industry practice, EFH 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 EFH and may affect EFH'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 EFH 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

EFH's reinsurance arrangements are with a limited number of reinsurers. This reinsurance may cause an adverse effect on EFH'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 EFH to the extent of the risk each reinsurer assumes, EFH is not relieved of its primary liability to its insureds as the direct insurer. As a result, EFH bears credit risk with respect to its reinsurers. EFH cannot ensure that its reinsurers will pay all reinsurance claims on a timely basis or at all. EFH 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 EFH under reinsurance arrangements would reduce EFH's net income and cash flow.

TECHNOLOGY AND CYBER SECURITY RISK

EFH 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. EFH continues to implement new computer applications as part of a comprehensive approach to improve systems technology. EFH 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 EFH will be able to respond to technology failures effectively and with minimal disruption.

The threat of Cyber attacks is a major Infrastructure Risk. As with all financial services, EFH faces continual challenges to protect its data and customer information. These attacks can come through hacking security controls and identity theft, including installing ransomware technology within our network. To ensure the Company is protected from these attacks, EFH has implemented cyber security programs to respond and manage through immediate detection of such threats, using sound best practices software and notification technologies.

LIQUIDITY

EFH manages its cash and liquid assets in an effort to ensure there is sufficient cash to meet all of EFH'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. EFH believes that internally generated funds provide the financial flexibility needed to fulfill cash commitments on an ongoing basis. EFH has no material commitments for capital expenditures; however, there can be no assurances that EFH's cash on hand and liquid assets will be sufficient to meet any future obligations that may come due.

FUTURE CAPITAL REQUIREMENTS

EFH's future capital requirements will depend upon many factors, including the expansion of EFH's sales and marketing efforts and the status of competition. There can be no assurance that financing will be available to EFH 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, EFH 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 EFH's business, financial condition and results of operations.

REGULATION

The industry in which EFH operates is regulated for the sale of P&C insurance. Changes in these regulations may significantly affect the operations and financial results of EFH.

RISK MANAGEMENT

EFH 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 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 EFH's assets and protect the organization and its stakeholders from risk.

As a provider of insurance products, effective risk management is fundamental to EFH's ability to protect the interests of EFH's customers and shareholders. The Company is exposed to risks of loss pertaining to insurance products. EFH 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. This risk is mitigated by matching liabilities and assets.

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. The investment policy is capital efficient and minimizes interest rate mismatch risk. Management does not currently anticipate significant changes in EFH'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 EFH 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 EFH's existing fixed income securities will generally decrease and the realized gains on fixed income securities will likely be reduced. These will be partially offset by changes on the Company's discounted actuarial liabilities. General economic conditions, political conditions and many other factors can also adversely affect the stock markets and, consequently, the value of the equity securities EFH owns.

Credit Risk

Credit risk is the possibility that counterparties may not be able to meet payment obligations when they become due. The credit risk exposure is concentrated primarily in the fixed income and preferred share investment portfolios and, to a lesser extent, in reinsurance recoverables.

EFH'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.

EFH is exposed to foreign exchange risk, through its International segment's operations in Europe. The Company entered into forward contracts for hedging the sales proceeds of its European subsidiary. The gain of $0.4 million has been booked in the investment income in FX gains. The net payable on the contracts as at December 31, 2016 is $0.3 million.

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 EFH'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.

EFH'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 EFH'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 EFH's reinsurance brokers to ensure that effective reinsurance programs are in place, which facilitate the desired growth of EFH's business and provide EFH 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 EFH'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. EFH 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

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.

CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

Our disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by EFH 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, 2016, 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 Multilateral Instrument 52-109. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design of these disclosure controls and procedures was effective.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

As at the quarter ended December 31, 2016, the Chief Executive Officer and the Chief Financial Officer evaluated the design 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 design of internal controls as at December 31, 2016, was effective to provide 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 quarter ended December 31, 2016, that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

EFH's significant accounting policies are disclosed in note 3 to the consolidated financial statements for the years ended December 31, 2016 and 2015.

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 EFH'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. 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, 2016, a 1% increase in the discount rate would result in a decrease in the net provision of $4.7 million and a 1% decrease in the discount rate would increase the net provision by $4.9 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.

DEFERRED POLICY ACQUISITION COST

Portion of the deferred policy acquisition costs include general expenses that are capitalized based on management judgement.

GLOSSARY OF SELECTED INSURANCE TERMS

"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.

"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 Operating Income" means net income plus or minus the after tax impact of change in discount rate on unpaid claims, realized losses or gains on sale of investments, discontinued operations, unrealized fair value changes on FVTPL investments and one-time non-recurring charges.

"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.

"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.

"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.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

ROLES OF MANAGEMENT, BOARD OF DIRECTORS AND AUDIT AND RISK COMMITTEE

Management is responsible for the preparation and fair presentation of the financial statements, Management's Discussion and Analysis and other information in the annual report. The financial statements of Echelon Financial Holdings Inc. ("the Company") were prepared in accordance with International Financial Reporting Standards. Where necessary, these financial statements reflect amounts based on the best estimates and judgement of management.

In meeting its responsibility for the reliability of the consolidated financial statements, management maintains the necessary system of internal controls. These controls are designed to provide management with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The Audit and Risk Committee, composed of directors who are not officers or employees of the Company, meets, as required, with management, the Appointed Actuary and the external auditor to review actuarial, accounting, reporting and internal control matters. The Audit and Risk Committee is responsible for reviewing the financial statements and Management's Discussion and Analysis and recommending them to the Board of Directors for approval.

ROLE OF APPOINTED ACTUARY

The Actuary is appointed by the Board of Directors, pursuant to the Insurance Companies Act. The Appointed Actuary is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives. The Appointed Actuary is also required to provide an opinion regarding the appropriateness of the policy liabilities to meet all policyholder obligations of the Company at the balance sheet date. Examination of supporting data for accuracy and completeness and consideration of the Company's assets are important elements of the work required to form this opinion. The Appointed Actuary uses the work of the external auditor in verifying data used for valuation purposes. Policy liabilities include unearned premiums, provision for unpaid claims, reinsurers' share of unearned premiums and provision for unpaid claims and deferred policy acquisition costs.

ROLE OF EXTERNAL AUDITOR

PricewaterhouseCoopers LLP, external auditor, has been appointed by the shareholders to conduct an independent audit of the consolidated financial statements of the Company in accordance with Canadian generally accepted auditing standards and report to the shareholders regarding the fairness of the annual financial statements. The external auditor considers the work of the Appointed Actuary in respect of policy liabilities included in the financial statements, on which the Appointed Actuary has rendered an opinion.

Serge Lavoie
Chief Executive Officer

Alvin Sharma
Chief Financial Officer

Toronto, Ontario
February 16, 2017

INDEPENDENT AUDITOR'S REPORT

February 16, 2017

TO THE SHAREHOLDERS OF ECHELON FINANCIAL HOLDINGS INC.

We have audited the accompanying consolidated financial statements of Echelon Financial Holdings Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2016 and 2015 and the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Echelon Financial Holdings Inc. and its subsidiaries as at December 31, 2016 and 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants,
Licensed Public Accountants

APPOINTED ACTUARY'S REPORT

TO THE SHAREHOLDER OF ECHELON FINANCIAL HOLDINGS INC.

I have valued the policy liabilities and reinsurance recoverables of the following subsidiary insurance operations of Echelon Financial Holdings Inc.: Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc., for their statement of financial position at December 31, 2016 and their changes in the statements of income and comprehensive income for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods. Qudos Insurance Company's policy liabilities were valued by management. The basis for the evaluation differs from Canadian standards. In my opinion, the amount of policy liabilities for Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc. make appropriate provision for all their policy obligations. The financial statements of Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc. fairly present the results of those companies. The consolidated financial statements are the sum of my valuation for Echelon Insurance, Insurance Company of Prince Edward Island and the Warranty business of Echelon Financial Holdings Inc., and those of management with regard to Qudos Insurance.

Pierre Laurin
Fellow, Canadian Institute of Actuaries

Toronto, Ontario
February 16, 2017

CONSOLIDATED BALANCE SHEETS

(in thousands of Canadian dollars)

	Note	Dec. 31, 2016	Dec. 31, 2015
Assets			
Cash and short–term deposits	6	**50,588**	23,373
Accounts receivable		**46,705**	105,300
Investments	6	**336,535**	513,099
Due from insurance companies		**1,587**	1,821
Deferred policy acquisition costs	9	**30,689**	77,456
Income taxes recoverable		**867**	4,329
Prepaid expenses and other assets		**2,270**	4,596
Reinsurers' share – unearned premiums	10	**8,975**	89,953
– provision for unpaid claims	11	**27,023**	90,158
Property and equipment		**881**	1,032
Intangible assets	14	**8,197**	6,238
Deferred income taxes	15	**5,860**	6,440
Assets of the disposal group held for sale	26	**280,042**	—
Total assets		**800,219**	923,795
Liabilities			
Derivative financial instruments	7	**268**	—
Accounts payable and accrued liabilities		**17,332**	34,266
Payable to insurance companies		**450**	19,097
Unearned premiums	10	**120,184**	264,584
Unearned commission	9	**2,288**	23,689
Provision for unpaid claims	11	**255,129**	397,214
Liabilities of the disposal group held for sale	26	**263,194**	—
Total liabilities		**658,845**	738,850
Equity			
Share capital	16	**70,227**	69,653
Contributed surplus		**322**	436
Retained earnings		**71,935**	104,786
Accumulated other comprehensive income	24	**(5,070)**	6,060
Equity attributed to shareholders of the Company		**137,414**	180,935
Non-controlling interest	27	**3,960**	4,010
Total equity		**141,374**	184,945
Total liabilities and equity		**800,219**	923,795

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

On behalf of the Board of Directors:

Serge Lavoie
Chief Executive Officer

Robert Purves
Director

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

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

	Note	2016	2015
Revenue			
Gross written and assumed premiums		**217,486**	199,473
Less: Premiums ceded to reinsurers		**(17,885)**	(19,137)
Net written and assumed premiums		**199,601**	180,336
(Increase) in gross unearned premiums		**(19,338)**	(5,787)
Increase in unearned premiums, reinsurers' share		**797**	1,919
Change in provision for unearned premiums		**(18,541)**	(3,868)
Net earned premiums		**181,060**	176,468
Investment income	6	**16,507**	12,613
Other income		**—**	748
Total revenue		**197,567**	189,829
Expenses			
Gross claims incurred		**114,587**	121,273
Less: claims recoveries from reinsurers		**(3,815)**	(11,446)
Net incurred claims		**110,772**	109,827
Gross acquisition costs		**47,227**	44,263
Less: acquisition cost recoveries from reinsurers		**(5,682)**	(4,815)
Net acquisition costs		**41,545**	39,448
Operating costs	19	**33,423**	27,640
Total expenses		**185,740**	176,915
Income before taxes and discount rate impact on claims		**11,827**	12,914
Impact of change in discount rate on claims [(1)]		**(2,822)**	1,024
Income before interest expense and income taxes		**9,005**	13,938
Interest expense	8	**217**	—
Income tax expense	15	**1,670**	1,676
Net income on continued operations		**7,118**	12,262
Net (loss) on discontinued operations	26	**(36,646)**	(5,677)
Net (loss) income		**(29,528)**	6,585
Attributed to:			
Shareholders of the Company – continued operations		**6,606**	12,254
Shareholders of the Company – discontinued operations		**(36,414)**	(5,629)
Non-controlling interest – continued operations	27	**512**	8
Non-controlling interest – discontinued operations		**(232)**	(48)
Net (loss) income		**(29,528)**	6,585
Other comprehensive income (loss), net of taxes that may be classified subsequently to net income			
Available-for-sale investments:			
Change in net unrealized (losses)		**(459)**	(170)
Reclassification of net realized (gains) to net income		**(5,597)**	(6,140)
Cumulative translation gain (loss)		**(395)**	1,379
Foreign exchange forward	7	**4,314**	—
Tax impact		**291**	1,408
Other comprehensive (loss) on continued operations		**(1,846)**	(3,523)
Other comprehensive (loss) income on discontinued operations		**(9,459)**	672
Other comprehensive (loss)		**(11,305)**	(2,851)

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

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

	Note	2016	2015
Attributed to:			
Shareholders of the Company – continued operations		**(1,794)**	(3,512)
Shareholders of the Company – discontinued operations		**(9,336)**	655
Non-controlling interest – continued operation	27	**(52)**	(11)
Non-controlling interest – discontinued operation		**(123)**	17
Other comprehensive (loss)		**(11,305)**	(2,851)
Total comprehensive (loss) income		**(40,833)**	3,734
Attributed to:			
Shareholders of the Company – continued operations		**4,812**	8,742
Shareholders of the Company – discontinued operations		**(45,750)**	(4,974)
Non-controlling interest – continued operation	27	**460**	(3)
Non-controlling interest – discontinued operation		**(355)**	(31)
Total comprehensive (loss) income		**(40,833)**	3,734
Earnings per share attributable to shareholders of the Company	25		
Earnings per share continued operations – basic		**$0.56**	$1.05
(Loss) per share discontinued operations – basic		**$(3.17)**	$(0.48)
(Loss) earnings per share – basic		**$(2.54)**	$0.57
Earnings per share continued operations – diluted		**$0.55**	$1.02
(Loss) per share discontinued operations – diluted		**$(3.17)**	$(0.48)
(Loss) earnings per share – diluted		**$(2.54)**	$0.55
Net (loss) income		**(29,528)**	6,585

(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 consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(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**	**104,786**	**180,935**	**4,010**	**184,945**
Net (loss) income	**—**	**—**	**—**	**(29,808)**	**(29,808)**	**280**	**(29,528)**
Other comprehensive (loss)	**—**	**—**	**(11,130)**	**—**	**(11,130)**	**(175)**	**(11,305)**
Total comprehensive (loss) income	**—**	**—**	**(11,130)**	**(29,808)**	**(40,938)**	**105**	**(40,833)**
Common shares repurchased	**(292)**	**—**	**—**	**(384)**	**(676)**	**—**	**(676)**
Dividends paid	**—**	**—**	**—**	**(2,814)**	**(2,814)**	**—**	**(2,814)**
Investment in subsidiary – Qudos	**—**	**—**	**—**	**155**	**155**	**(155)**	**—**
Common shares issued on stock options exercised	**866**	**(170)**	**—**		**696**	**—**	**696**
Stock compensation expense	**—**	**56**	**—**	**—**	**56**	**—**	**56**
Balance at December 31, 2016	**70,227**	**322**	**(5,070)**	**71,935**	**137,414**	**3,960**	**141,374**

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Shareholders' Equity	Non-controlling interest	Total Equity
Amended balance at January 1, 2015	67,153	2,192	8,917	103,222	181,484	3,856	185,340
Net income (loss)	—	—	—	6,625	6,625	(40)	6,585
Other comprehensive income (loss)	—	—	(2,857)	—	(2,857)	6	(2,851)
Total comprehensive income (loss)	—	—	(2,857)	6,625	3,768	(34)	3,734
Common shares repurchased	(642)	—	—	(871)	(1,513)	—	(1,513)
Dividends paid	—	—	—	(5,171)	(5,171)	—	(5,171)
Investment in subsidiaries – ICPEI	—	—	—	—	—	250	250
– Qudos	—	—	—	62	62	(62)	—
Common shares issued on stock options exercised	3,142	(1,834)	—	919	2,227	—	2,227
Stock options expense	—	78	—	—	78	—	78
Balance at December 31, 2015	69,653	436	6,060	104,786	180,935	4,010	184,945

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of Canadian dollars

	Dec. 31, 2016	Dec. 31, 2015
Cash provided by (used in):		
Operating activities		
Net income from continuing operations	**7,118**	12,262
Net loss from discontinued operations	**(36,646)**	(5,677)
Adjusted for:		
Reinsurers' share of unearned premiums	**(797)**	(1,919)
Reinsurers' share of unpaid claims	**2,199**	(5,463)
Provision for unpaid claims	**(5,719)**	(14,651)
Unearned premiums	**19,338**	5,788
Deferred income taxes	**(639)**	460
Unearned commissions	**324**	949
Deferred policy acquisition costs	**(5,771)**	(1,378)
Amortization on property plant equipment and intangible assets	**4,136**	4,478
Amortization of premiums on bonds	**1,897**	2,084
Fair value change on FVTPL investments	**(3,870)**	7,315
Options expense	**56**	78
Currency translation	**(395)**	1,379
Foreign exchange forward	**4,314**	—
Prepaid expenses & other assets	**401**	(357)
	15,474	(1,237)
Cash flow from changes in		
Accounts receivable	**(12,739)**	(3,285)
Net realized (gains)	**(280)**	(5,935)
Income taxes (recoverable) payable	**2,817**	(5,846)
Due to insurance companies	**(409)**	835
Other liabilities	**5,408**	961
Cash provided (used) by continuing operating activities	**17,389**	(2,245)
Cash provided in discontinued operating activities	**488**	27,660
Cash inflow from operating activities	**17,877**	25,415
Financing activities		
Proceeds from issue of common shares for stock options	**696**	2,227
Common share dividends	**(2,814)**	(5,171)
Share repurchases	**(676)**	(1,513)
Additional investment in ICPEI by minority interest	**—**	250
Cash (used) in continuing financing activities	**(2,794)**	(4,207)
Cash from discontinued financing activities	**—**	—
Cash outflow from financing activities	**(2,794)**	(4,207)
Investing activities		
Purchases of property, equipment and intangible assets	**(6,397)**	(4,015)
Purchases of investments	**(344,787)**	(402,673)
Sale/maturity of investments	**406,975**	420,050
Cash provided by continuing investing activities	**55,791**	13,362
Cash provided (used) from discontinued investing activities	**43,388**	(38,523)
Cash inflow (outflow) from investing activities	**99,179**	(25,161)
Increase (decrease) in cash and short-term deposits	**114,262**	(3,953)
Cash and short-term deposits, beginning of period	**23,373**	27,326
Cash and short-term deposits, end of period	**137,635**	23,373
Supplementary information		
Operating activities		
Income taxes paid (recovered)	**(1,712)**	5,712

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

1 NATURE OF OPERATIONS

Echelon Financial Holdings Inc. ("the Company") 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 in QIC has increased to 98.7% from 97.5% at the beginning of the year due to capital injected to maintain its solvency ratio.

On August 4, 2016, the Company entered into a definitive share purchase agreement to sell its European operations and is awaiting regulatory approval.

2 BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and IFRS Interpretations Committee (IFRS IC) interpretations applicable to companies reporting under IFRS.

These consolidated financial statements have been authorized for issue by the Board of Directors on February 16, 2017.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF MEASUREMENT

The consolidated financial statements have been prepared under the historical cost convention, except for investments and insurance contracts which are carried at fair value and in accordance with IFRS 4, respectively. Discontinued operations are held for sale 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 probable to occur within one year. Assets 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 coordinated plan to dispose of a separate major line of business or geographical area of operations.

BALANCE SHEET PRESENTATION

The Company does not classify its assets and liabilities as current and non-current on its balance sheets. As a financial institution, the Company provides insurance services over a period of years, rather than within a clearly identifiable short-term operating cycle. The consolidated statement of financial position is presented in the order of liquidity, based on expectations regarding recovery or settlement within 12 months after the reporting date, and more than 12 months after the reporting date as presented in the respective notes.

The maturity profile of the investment portfolio is described in note 13 based on expected settlements. The estimated payment period for insurance claims, less related reinsurance recoverable, is provided in note 13. Property and equipment assets are charged to expense over their estimated useful lives of up to three years. Intangible assets with definite useful lives are charged to expense over their estimated useful lives of two years while an impairment analysis is done on all other intangible assets. Cash and short-term deposits, accounts receivables due from insurance companies, income taxes receivables and payable, accounts payable and accrued liabilities are expected to be recovered or settled within twelve months of the period end.

CONSOLIDATION

The consolidated financial statements of the Company consolidate the accounts of Echelon Financial Holdings Inc. and its subsidiaries. All inter-company transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Subsidiaries are those entities which Echelon Financial Holdings Inc., through its investment in the entity, are exposed or has rights to variable returns from its involvement with the investee, and has the ability to affect those returns through its power over the investee. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether Echelon Financial Holdings Inc. controls another entity. Subsidiaries are fully consolidated from the date on which control is obtained by Echelon Financial Holdings Inc. and are deconsolidated from the date that control ceases.

Non-controlling interests represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of equity. Changes in the parent company's ownership interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions.

SEGMENT REPORTING

Operating segments are reported in a manner consistent with the internal reporting provided to senior management, the Chief Executive Officer and Board of Directors of the Company.

BUSINESS COMBINATIONS

Consideration transferred in a business combination is measured at fair value at the date of acquisition and includes any cash paid plus the fair value of assets given, liabilities incurred and equity instruments issued by the Company. The consideration transferred also includes contingent consideration arrangements, if any, recorded at fair value. Directly attributable acquisition-related costs are expensed in the current period and reported within operating expenses. At the date of acquisition, the Company recognizes the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired business. The identifiable assets acquired and the liabilities assumed are initially recognized at fair value. The excess of the consideration paid over the fair value of net assets acquired is recorded as goodwill. Where the fair value of consideration paid is less than the fair value of net assets acquired, the difference is recognized in the income statement. Any pre-existing equity interests in an acquiree are re-measured to fair value at the date of the business combination and any resulting gain or loss is recognized in the income statement.

FOREIGN CURRENCY TRANSLATION

(i) Functional and presentation currency

Items included in the financial statements of each consolidated entity of the Company are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency.

The financial statements of subsidiaries that have a functional currency different from the presentation currency of the Company ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the balance sheet; and, income and expenses – at the average rate of the period (as this is considered a reasonable approximation to actual rates). The accumulated gains or losses arising from translation of functional currencies to the presentation currency are included as a separate component of OCI within equity.

QIC's, Qudos' and CIM Re's functional currency is Danish Krone and is subject to foreign currency translation adjustments upon consolidation.

When an entity disposes of its entire interest in a foreign operation, or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in OCI related to the foreign operation are recognized in the income statement. If an entity disposes of part of an interest in a foreign operation which remains a subsidiary, a proportionate amount of foreign currency gains or losses accumulated in OCI related to the subsidiary are reallocated between controlling and non-controlling interests.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates in effect at the date the transactions occurred. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at period-end exchange rates of monetary assets and liabilities are recognized in investment income in the consolidated statements of income and comprehensive income. Exchange gains and losses related to non-monetary investments classified as available for sale (AFS) are recorded in OCI. Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in carrying amount are recognized in OCI.

CASH AND SHORT-TERM DEPOSITS

Cash and short-term deposits include cash on hand, cash balances with banks and short-term investments. Short-term investments are defined as loans of less than one year to maturity at the time of acquisition. These financial assets are classified as loans and receivables and are recorded at an amortized cost which approximates fair value.

INVESTMENTS UNDER SECURITIES LENDING PROGRAM

Securities lending transactions are entered into on a collateralized basis. The securities lent are not derecognized on the consolidated balance sheet given that the risks and rewards of ownership are not transferred from the Company to the counterparties in the course of such transactions. Securities received from counterparties as collateral are not recorded on the consolidated balance sheet given that the risks and rewards of ownership are not transferred from the counterparties to the Company in the course of such transactions.

In the event that any loan made pursuant to the securities lending agreement is terminated and the loaned Security, or any portion thereof, is not returned to the Company for any reason (including, without limitation, the insolvency or bankruptcy of the Borrower) within the time specified by the applicable Borrowing Agreement, the agent shall be jointly and severally liable, at its expense to:

(i) Promptly replace such Security, or any portion thereof, not so returned with other securities of the same issuer, class, and denomination and with the same interest/dividend rights and other economic benefits as such, should the security have been returned, or

(ii) If it is unable to purchase such Security on the open market, the agent will credit Echelon in cash with the market value of such unreturned security, such market value to be determined as of the close of business on the date on which such security was required to be returned, including any future economic benefits that the company would have earned on holding the security.

FINANCIAL INSTRUMENTS

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit or loss (FVTPL): A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term, or if it is designated at FVTPL by management. The Company has designated as FVTPL under the fair value option financial assets which contain embedded derivatives that significantly alter the cash flows of the underlying asset.

Financial instruments in this category are recognized initially and subsequently at fair value. Gains and losses arising from changes in fair value are presented in the consolidated statements of income and comprehensive income within investment income in the period in which they arise. The Company's investments in preferred shares are classified as FVTPL.

(ii) Available-for-sale investments: AFS investments are non-derivative financial assets that are either designated in this category or not classified in any of the other categories. The Company's AFS assets comprise marketable securities and investments in debt and common equity securities.

AFS investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in OCI.

Interest on AFS investments, calculated using the effective interest method, is recognized in the consolidated statements of income and comprehensive income within investment income. Dividends on AFS equity instruments are recognized in the consolidated statements of income and comprehensive income as part of investment income when the Company's right to receive payment is established. When an AFS investment is sold or impaired, the accumulated gains or losses are moved from accumulated OCI to the consolidated statements of income and comprehensive income and included within investment income.

(iii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables are comprised of accounts receivables, due from insurance companies, and cash and short-term deposits. Loans and receivables are initially recognized at fair value plus transaction costs. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less any provision for impairment.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable. Accounts payable are initially recognized at fair value. Subsequently, accounts payable are measured at amortized cost using the effective interest method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

IMPAIRMENT OF FINANCIAL ASSETS AND ACCRUED LIABILITIES

The Company determines, at each reporting date, whether there is objective evidence that financial assets and accrued liabilities are impaired. The criteria used to determine if objective evidence of an impairment loss include:

1. Significant financial difficulty of the obligor;
2. Delinquencies in interest, principal or dividend payments; and
3. It becomes probable that the borrower will enter bankruptcy or other financial reorganization.

For equity securities, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired.

If such evidence exists, the Company recognizes an impairment loss, as follows:

AFS investments: The impairment loss is the difference between the amortized cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the consolidated statements of income and comprehensive income. This amount represents the cumulative loss in accumulated OCI that is reclassified to the consolidated statements of income and comprehensive income.

Loans and receivables carried at amortized costs: The loss is the difference between the amortized cost of the loan and receivables and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets and accrued liabilities carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases or the fair value of financial assets and accrued liabiliites carried at amortized cost increases and the decrease/increase can be related objectively to an event occurring after the impairment was recognized. In contrast, impairment losses on AFS equity instruments are not reversed.

INSURANCE CONTRACTS

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk arises when the Company agrees to compensate a policyholder if a specified uncertain future event adversely affects the policyholder. Significant risk is defined as the possibility of having to pay significantly more in a scenario where the insured event occurs than when it does not occur.

PROVISION FOR UNPAID CLAIMS

Provision for unpaid claims, including adjustment expenses, represents the estimated amounts required to settle all outstanding and unreported claims incurred to the end of the period. Unpaid claims liabilities are discounted to take into account the time value of money. It also includes a provision for adverse deviation. Expected reinsurance recoveries on unpaid claims and adjustment expenses, net of any required provision for doubtful amounts, are recognized as assets at the same time, using principles consistent with the Company's method for establishing the related liability.

STRUCTURED SETTLEMENTS

In the normal course of claims adjudication, the Company settles certain obligations to claimants through the purchase of annuities from third party life insurance companies under structured settlement arrangements (structured settlements). In accordance with OSFI Guideline D-5, these contracts are categorized as either Type 1 or Type 2 based on the characteristics of the claim settlement. When the Company does not retain a reversionary interest under the contractual arrangement to any current or future benefits of the annuity, and the Company has obtained a legal release of the obligation from the claimant, it will be classified as a Type 1 structured settlement. For such contracts, any gain or loss arising on the purchase of an annuity is recognized in the consolidated statement of income at the date of purchase and the related claims liabilities are derecognized. All other structured settlements that do not meet these criteria are classified as Type 2, with the Company recognizing the annuity contract in other investments within invested assets. A corresponding liability representing the outstanding obligation to the claimant is recognized in insurance contracts.

REINSURANCE

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

REVENUE RECOGNITION

Premiums and unearned premiums

Insurance premiums written are deferred as unearned premiums and recorded in income as the premium is earned on a straight line basis over the terms of the underlying policies, except on certain long-term policies for which premiums are earned using an actuarial risk assessment that matches claim expectations. The portion of the premiums related to the unexpired term of the policy at the end of the period is reflected in unearned premiums.

Ceded Premiums and reinsurers' share of unearned premiums

The reinsurers' share of unearned premiums, net of a provision for doubtful amounts, is recognized as an asset at the same time and using principles consistent with the Company's method for determining the unearned premium liability.

DEFERRED POLICY ACQUISITION COSTS

Commissions, premium taxes and general expenses incurred in the writing of premiums are deferred only to the extent that they are expected to be recovered from unearned premiums and are amortized to income as the related premiums are earned. If unearned premiums are not sufficient to pay expected claims and expenses, including policy maintenance expenses and unamortized policy acquisition costs, a premium deficiency is said to exist. Premium deficiency is recognized by a charge to income initially by writing down deferred policy acquisition costs. If the premium deficiency is greater than the deferred policy acquisition costs, a liability would be accrued for the excess deficiency.

UNEARNED COMMISSION

Unearned commissions are based on ceded premiums with a coverage period beyond the current year end. Unearned commissions are recognized as liabilities using principles consistent with the Company's method of determining policy acquisition costs.

PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost less accumulated amortization and impairment. Amortization is provided over the estimated useful lives of the assets using the straight-line method over the following terms:

Furniture and equipment	3 years
Computer hardware	3 years

INTANGIBLE ASSETS

Intangible assets with definite useful lives, comprised primarily of computer software, are recorded at cost less accumulated amortization and impairment. Amortization is provided over the estimated useful life of the asset (2-3 years) using the straight-line method. Intangible assets with indefinite lives are recorded at lower of cost and recoverable amount.

IMPAIRMENT OF NON-FINANCIAL ASSETS

Property, plant and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units – or "CGUs"). Recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU, as determined by management).

The Company evaluates impairment losses, for potential reversals when events or circumstances warrant such consideration.

EMPLOYEE BENEFITS

The Company contributes to a group registered savings plan for employees as services are incurred. Contributions are charged to operating expenses. There are no other post-employment benefit expenses.

INCOME TAXES

Income taxes are recognized in the consolidated statements of income and comprehensive income except to the extent that it relates to items recognized in OCI or directly in equity. In those cases, the related taxes are also recognized in OCI or directly in equity, respectively.

Current income tax is based on the results of the operations, adjusted for items that are not taxable or not deductible, that is payable for the current year. Current income tax is calculated based on income tax laws and rates enacted or substantively enacted as at the balance sheet date.

The Company follows the asset and liability method of accounting for income taxes, whereby deferred income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the carrying values of existing assets and liabilities and their respective income tax bases and taxable losses and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in income tax rates on future income tax assets and liabilities is recognized in income or OCI or equity in the year which includes the date of enactment or substantive enactment. Deferred income tax assets are recognized only to the extent the realization of such assets is probable. Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is intention to settle the balances on a net basis.

STOCK-BASED COMPENSATION

The Company has a stock option plan that provides for the issuance of shares of the Company's common stock not exceeding 10% of the total issued and outstanding shares (on a diluted basis) and shares reserved for issuance under the employee stock option plans, options for services and employee stock purchase plans.

The Company utilizes the fair-value-based method of accounting for stock-based compensation. The fair value of stock-based compensation determined using an option pricing model, is recorded over the vesting period as a charge to net earnings with a corresponding credit to contributed surplus. Awards are equity settled.

Stock options which contain a graded vesting feature (the total options granted vest on a graded basis such as annually over 5 years) are accounted for separately based on the date of vesting. At the time the options are granted, expected forfeiture rates are estimated and used to reduce the amount expensed over the life of the options. The estimated forfeiture rate is adjusted to actual forfeiture experience as information becomes available.

The Company has established a Share Unit Plan, under which the Board of Directors may from time to time determine (i) those eligible employees and directors (a "participant") who shall receive a grant of Restricted Share Units ("RSUs") and/or Performance Share Units ("PSUs") (RSUs and PSUs are collectively referred to as "Share Units"), (ii) the number of such RSUs and/or PSUs, and (iii) the grant date(s) applicable to such RSUs and/or PSUs. Compensation expense and the related liability are recorded equally over the vesting period, taking into account fluctuations in the market price of the Company's share price.

Each Share Unit granted under the Share Unit Plan will entitle the participant, upon satisfying all applicable vesting criteria, to receive one common share or, at the discretion of the Company, a cash payment equal to the market value of such share, calculated based on the weighted average trading price per common share on the Toronto Stock Exchange for the 5 trading days prior to a fixed date. The grant of a Share Unit will not entitle the participant to exercise any voting rights, or exercise any other right which attaches to ownership of common shares.

Grant date fair value of each Share Unit is calculated based on the weighted average trading price per common share on the Toronto Stock Exchange for the 5 trading days prior to a fixed date. The fair value of the Share Unit is re-measured each period for subsequent changes in the market value of common shares.

Certain members of the Board, who are not otherwise an employee of the Company or any affiliate and are not employed by a corporation that holds at least 100,000 Shares of the Corporation, are eligible to participate in a Deferred Share Unit Incentive Plan, which allows them to elect to defer all or a portion of their annual retainer and meeting fees received in the form of deferred share units (DSUs), each of which is equivalent in value to one common share of the Company. The number of DSUs is established by dividing the amount of retainers not paid in cash by the weighted average trading price of the Common Shares for the last 5 trading days preceding the determination. Whenever cash dividends are paid on the common shares, the director's account under the DSU plan is credited with additional DSUs corresponding to the dividend paid on the common shares. The fair value of the DSUs is re-measured each period for subsequent changes in the market value of common shares.

PROVISIONS

Provisions are recognized as liabilities when the Company has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period, and are discounted to present value where the effect is material. The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

SHARE CAPITAL

Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity. The cost method is used to account for the shares purchased under a normal course issuer bid with the average cost of the shares reducing share capital and any excess recorded as a deduction to retained earnings.

DIVIDENDS

Dividends on common shares are recognized in the Company's consolidated financial statements in the period in which the dividends are approved by the Board of Directors.

EARNINGS PER SHARE

Basic earnings per share ("EPS") are calculated by dividing the net income (loss) for the period attributable to shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, and similar instruments is computed using the treasury stock method. The Company's potentially dilutive common shares comprise stock options, DSUs and RSUs granted to employees and directors.

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 set out in the September 2016 amendment to IFRS 4 Insurance Contracts which allows eligible insurers to defer the adoption of IFRS 9 until the new insurance contracts standard is adopted, or 2021 at the latest.

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 JUDGEMENTS

The preparation of the Company's consolidated 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.

VALUATION 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). Provision 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 the Company'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 and comprehensive income for the period in which such estimates are updated.

IMPAIRMENT OF FINANCIAL ASSETS

The Company considers an impairment if there is objective evidence that an AFS financial asset is impaired, including in the case of equity investments classified as AFS, a significant or prolonged decline in the fair value of the security below its carrying value.

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).

VALUATION OF REINSURER'S SHARE OF PROVISION FOR UNPAID CLAIMS

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.

VALUATION OF DEFERRED TAX ASSET

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 and comprehensive 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.

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 December 31, 2016, and December 31, 2015.

	Fair values	
Available-for-sale	**As at Dec. 31, 2016**	As at Dec. 31, 2015
Fixed income		
Canadian		
Federal	**67,826**	45,524
Provincial	**44,147**	55,976
Municipal	**519**	1,386
Corporate	**136,984**	171,789
	249,476	274,675
Fixed income lent through securities lending program		
Federal	**15,390**	14,231
Provincial	**998**	3,800
Municipal	**845**	—
Corporate	**1,885**	4,673
	19,118	22,704
Foreign fixed income		
Government	**—**	17,555
Corporate	**—**	114,399
	—	131,954
Total fixed income	**268,594**	429,333
Commercial mortgages pooled funds	**17,423**	17,017
Money market pooled funds	**200**	403
Short-term fixed income and mortgage pooled funds	**17,229**	16,934
Total pooled funds	**34,852**	34,354
Common shares		
Canadian	**312**	2,656
U.S.	**—**	8,012
Total common shares	**312**	10,668
Total available-for-sale	**303,758**	474,355
Fair value through profit or loss		
Preferred shares	**32,678**	38,400
Preferred shares lent through securities lending program	**99**	344
Total preferred shares	**32,777**	38,744
Total investments	**336,535**	513,099
Cash and short-term deposits	**50,588**	23,373
Total investments including cash and short-term deposits	**387,123**	536,472

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 December 31, 2016, the Company had collateral of $20,580 (December 31, 2015 – $24,507) for the loaned securities or approximately 105% of the fair value of the loaned securities.

(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 funds and 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 December 31, 2016, and December 31, 2015:

Dec. 31, 2016

	Level 1	**Level 2**	**Level 3**	**Total**
Fixed income	**—**	**268,594**	**—**	**268,594**
Commercial mortgages pooled funds	**—**	**17,423**	**—**	**17,423**
Money market pooled funds	**—**	**200**	**—**	**200**
Short-term fixed income and mortgage pooled funds	**—**	**17,229**	**—**	**17,229**
Equities	**312**	**—**	**—**	**312**
Preferred Shares	**32,777**	**—**	**—**	**32,777**
	33,089	**303,446**	**—**	**336,535**

Dec. 31, 2015

	Level 1	Level 2	Level 3	Total
Fixed income	—	429,333	—	429,333
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	463,687	—	513,099

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

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 December 31, 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. During the year ended December 31, 2015, the Company transferred bonds with carrying value of 2,173 from level 3 to level 2 as the Company is now receiving quoted prices for these bonds. There were no level 3 investments in 2016.

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.

The Company has interests in unconsolidated structured entities, through investments in pooled funds, which are included in investments on the balance sheets. These entities are not controlled by the Company. The carrying value of pooled funds as of December 31, 2016 was $34,852 (2015 – $34,354), and the maximum exposure to loss as of December 31, 2016 was $34,852 (2015 – $34,354). Investments in pooled funds consist of units invested in underlying money market and mortgage securities managed by Addenda and other third-party managers. The pooled funds are perpetual private trusts created under trust agreements. Financing and support is only provided to the pooled funds through the purchase of units and is therefore limited to the investment made.

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 records 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 December 31, 2016 (December 31, 2015 – $267). A remaining gross unrealized loss of $1,691 on AFS investments held as at December 31, 2016 (December 31, 2015 – $3,232) is recorded, net of tax, in the amount of $1,231 (December 31, 2015 – $2,506) in Accumulated Other Comprehensive Income.

INVESTMENT INCOME

The table below provides additional details on net investment income:

	2016	2015
Interest income	**10,597**	12,531
Dividend income	**1,771**	2,605
Net realized gains	**280**	6,202
Impairment loss recognized on AFS investment	**—**	(267)
Fair value change on FVTPL investments	**3,870**	(7,315)
Realized and unrealized foreign exchange gains	**855**	(57)
Investment expenses	**(866)**	(1,086)
Investment income	**16,507**	12,613

7 DERIVATIVE FINANCIAL INSTRUMENTS

On January 21, 2016, the Company entered into a three month forward contract to manage the foreign currency risk on its investment in European subsidiary by buying $47.8M (CAD) and selling €30.0 million (EUR). The contract matured on April 22, 2016, with a settled value of $4.3 million recognized in the OCI. This was an effective hedge.

The Company entered into forward contracts for hedging the sales proceeds of its European subsidiary. The gain of $0.4 million has been booked in the investment income in FX gains. The net payable on the outstanding contracts as at December 31, 2016 is $0.3 million. The details of the outstanding contracts for hedging the sales proceeds of European subsidiary is as follows:

Contract Party	Deal Date	Value Date	FX Contract Purchase Amount CAD$	FX Contract Sale Amount DKK	Contract Rate	Rate as at Dec. 31, 2016	Net Settlement Amount at Dec. 31, 2016 CAD$
RBC Royal Bank	8 December 2016	6 February 2017	6M	31.9M	5.3100	5.2386	(0.1) M
RBC Royal Bank	8 December 2016	6 July 2017	12M	63.4M	5.2850	5.2041	(0.2) M

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

8 LINE OF CREDIT

The Company has a $10.0 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 at the bankers' acceptances rate plus a margin. This facility was undrawn as at December 31, 2016. As part of the covenants of the loans under the credit facilities, the Company is required to maintain certain ratios and financial limits. All financial limits and ratios have been met as at December 31, 2016.

For the year ending December 31, 2016, the Company has expensed $0.2 million on the income statement, below income before interest expense and income tax, related to the maintenance of the credit facility.

9 DEFERRED POLICY ACQUISITION COSTS

Reconciliation of deferred policy acquisition costs (DPAC) at December 31:

		2016		2015
	Gross	**Ceded**	Gross	Ceded
Balance at the beginning of the year	**77,456**	**23,689**	49,353	9,459
Acquisition costs during the year	**52,998**	**6,006**	139,920	42,059
Amortization of acquisition costs during the year	**(47,227)**	**(5,682)**	(117,013)	(28,945)
Currency translation	**—**	**—**	5,196	1,116
Discontinued operations (note 26)	**(52,538)**	**(21,725)**	—	—
Acquisition costs deferred at the end of the year	**30,689**	**2,288**	77,456	23,689

10 UNEARNED PREMIUMS

The following table shows unearned premiums by line of business and nature of risk:

		2016		2015
	Gross	**Ceded**	Gross	Ceded
Automobile				
– accident benefits	**15,799**	**929**	23,645	7,785
– liability	**33,942**	**1,082**	95,692	43,571
– other	**22,448**	**555**	52,015	21,486
Property				
– commercial	**5,671**	**553**	5,167	718
– personal	**36,381**	**4,724**	78,334	16,042
Liability	**3,521**	**118**	3,755	222
Accident and sickness	**86**	**—**	5,562	21
Commercial auto	**—**	**—**	—	50
Surety	**1,949**	**890**	—	—
Other	**387**	**124**	414	58
	120,184	**8,975**	264,584	89,953

A reconciliation of unearned premium is shown below:

		2016		2015
	Gross	**Ceded**	Gross	Ceded
Unearned premium at the beginning of the year	**264,584**	**89,953**	168,555	37,528
Premium written and ceded during the year	**217,486**	**17,885**	495,091	156,789
Premium earned in income	**(198,148)**	**(17,088)**	(415,760)	(109,360)
Currency translation	**—**	**—**	16,698	4,996
Discontinued operations (note 26)	**(163,738)**	**(81,775)**	—	—
Unearned premium at the end of the year	**120,184**	**8,975**	264,584	89,953

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

11 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:

Entity	**Dec. 31, 2016**	Dec. 31, 2015
Echelon Insurance	**1.90%**	2.44%
ICPEI	**1.75%**	1.63%

The Company recorded a $17,409 reduction to the net provision for unpaid claims relating to redundancies in prior years' estimates (December 31, 2015 – $18,012).

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 $21,388 as at December 31, 2016 (December 31, 2015 – $21,818).

The provision for unpaid claims on an actuarial present value (APV) gross and ceded basis by line of business is as follows:

		2016		2015
	Gross	**Ceded**	Gross	Ceded
Automobile				
– accident benefits	**95,810**	**16,334**	102,467	23,153
– liability	**113,334**	**7,897**	193,368	43,125
– other	**6,474**	**86**	41,964	17,637
Property				
– commercial	**4,928**	**951**	5,750	1,243
– personal	**9,155**	**989**	17,799	3,308
Liability	**23,063**	**362**	30,720	910
Accident and sickness	**1,858**	**381**	4,636	682
Commercial Auto	**53**	**10**	257	100
Surety	**211**	**—**	—	—
Other	**243**	**13**	253	—
Total unpaid claims	**255,129**	**27,023**	397,214	90,158

CLAIMS DEVELOPMENT

Provision for unpaid claims analysis	**Dec. 31, 2016**	Dec. 31, 2015
Unpaid claims, beginning of year, net	**307,056**	295,955
Favourable prior year claims development	**(17,409)**	(18,012)
Provision for claims occurring in current period	**131,003**	211,248
Paid on claims occurring during		
Current year	**(56,642)**	(79,113)
Prior year	**(62,173)**	(103,022)
Discontinued Operations	**(73,729)**	—
Unpaid claims, end of period, net	**228,106**	307,056
Reinsurers' share	**27,023**	90,158
Gross unpaid claims	**255,129**	397,214

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

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

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.

CLAIMS DEVELOPMENT TABLE, GROSS OF REINSURANCE

The following tables show the estimates of cumulative incurred claims, including IBNR, for the ten most recent accident years, elected in year of adoption as permitted by IFRS 4, with subsequent developments during the periods and together with cumulative payments to date. The original reserve estimates are evaluated quarterly for redundancy or deficiency. The evaluation is based on actual payments in full or partial settlement of claims and current estimates of claims liabilities for claims still unreported.

										Calendar Year
	2007 & prior	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Provision for claims including LAE	169,091	185,255	207,220	239,036	254,519	268,580	296,856	344,692	397,214	255,129
Reserve re-estimate as of:										
1 year later	163,465	186,446	203,920	232,472	246,972	269,499	284,934	326,083	377,570	
2 years later	162,916	189,093	201,044	239,117	245,331	252,279	276,565	295,495		
3 years later	164,290	186,429	206,039	239,338	232,772	250,266	263,289			
4 years later	161,852	190,342	205,646	228,612	230,271	244,385				
5 years later	163,440	189,297	197,841	228,628	229,741					
6 years later	163,069	183,341	199,637	230,487						
7 years later	159,402	187,392	201,049							
8 years later	163,480	189,298								
9 years later	165,003									
Cumulative favourable (unfavourable) development	4,088	(4,043)	6,171	8,549	24,778	24,195	33,567	49,197	19,644	

CLAIMS DEVELOPMENT TABLE, NET OF REINSURANCE

										Calendar Year
	2007 & prior	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Provision for claims including LAE	120,630	143,354	168,484	202,884	221,250	238,297	264,094	295,955	307,055	228,106
Reserve re-estimate as of:										
1 year later	115,530	142,641	164,393	196,517	215,191	233,517	252,748	277,943	289,646	
2 years later	112,960	143,980	162,651	203,632	214,128	225,958	245,568	252,548		
3 years later	112,595	142,924	166,901	203,367	204,365	220,530	234,335			
4 years later	111,267	144,486	166,300	195,502	197,028	215,901				
5 years later	110,883	143,125	160,078	192,120	196,751					
6 years later	110,001	138,578	159,189	193,183						
7 years later	107,439	139,649	160,168							
8 years later	108,297	140,793								
9 years later	109,209									
Cumulative favourable (unfavourable) development	11,421	2,561	8,316	9,701	24,499	22,396	29,759	43,407	17,409	

The provision for unpaid claims relating to the International division, currently held for sale, was treated as paid in the development table above.

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

12 UNDERWRITING POLICY AND REINSURANCE CEDED

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophes or other events that cause unfavourable underwriting results by purchasing reinsurance to share all or part of the insurance risks originally accepted by the Company in writing premiums. This does not relieve the Company of its primary obligation to policyholders.

During 2016, the Company followed the policy of underwriting and reinsuring contracts of insurance, which limits the net exposure of the Company to a maximum amount on any one loss to $2,000 (2015 – $1,500). In addition, the Company obtained catastrophe reinsurance which limits the loss from a series of claims arising from a single occurrence to $2,000 (2015 – $2,000), to a maximum coverage of $58,000 (2015 – $35,000).

The Company places all its Canadian and European automobile reinsurance with registered reinsurers. There are non-registered reinsurers participating in the specialty property and casualty program business. The Company has access to trust funds that, in the Company's judgement, are adequate to secure the liabilities that the Company has ceded to non-registered reinsurers.

Failure of reinsurers to honour their obligations could result in losses to the Company. Consequently, the Company continually evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses. There have been no defaults and no provision made in the accounts for defaults based on management's review of the creditworthiness of its reinsurers.

REINSURANCE RECOVERABLE

The following tables summarize the balances outstanding from reinsurers as at December 31, 2016 and 2015, by risk rating:

Dec. 31, 2016

Credit rating	**Gross reinsurance recoverable**	**Less: Deposits held in trust**	**Net exposure**
A or higher	**36,329**	**—**	**36,329**
Not rated	**1,256**	**1,263**	**—**
	37,585	**1,263**	**36,329**

Dec. 31, 2015

Credit rating	Gross reinsurance recoverable	Less: Deposits held in trust	Net exposure
A or higher	180,011	1,308	178,703
Not rated	1,779	1,417	362
	181,790	2,725	179,065

Included in gross reinsurance recoverable is reinsurers' share of unearned premiums of $8,975 (December 31, 2015 – $89,953), reinsurers' share of provision for unpaid claims of $27,023 (December 31, 2015 – $90,158), and receivables from reinsurers presented as due from insurance companies of $1,587 (December 31, 2015 – $1,821). No balances due from reinsurers are considered past due as at December 31, 2016 and 2015. There is no valuation allowance or amounts written off during the years ended December 31, 2016 and 2015.

13 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.

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.

Direct Written Premium	**Dec. 31, 2016**	Dec. 31, 2015
Lines		
Personal Lines	**71%**	73%
Commercial Lines	**29%**	27%
Regions		
Ontario	**47%**	52%
Atlantic Canada	**22%**	22%
Quebec	**12%**	8%
Western Canada	**19%**	18%

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

SENSITIVITY TO INSURANCE RISK

The table below shows the sensitivity of earnings from operations before income taxes and total equity after giving effect to a one percentage point increase in the loss ratio and claims settlement costs. The loss ratio is regarded as a non-IFRS measure and is calculated by the Company with respect to its ongoing insurance operations as losses on claims incurred (including losses and loss adjustment expenses) expressed as a percentage of net premiums earned. Such an increase could arise from higher frequency of losses, increased severity of losses, or from a combination of both. The sensitivity analysis presented below does not consider the probability of such losses to loss frequency or severity occurring or any non-linear effects of reinsurance and, as a result, each additional percentage point increase in the loss ratio would result in a linear impact on earnings from operations before income taxes and total equity.

	2016		2015	
Sensitivity Factor	**Net income before income taxes**	**Shareholders' equity**	Net income before income taxes	Shareholders' equity
Increase of 1% to loss ratio	**(1,811)**	**(1,322)**	(1,765)	(1,288)
Increase of 1% to claims settlement costs	**(2,281)**	**(1,665)**	(3,071)	(2,242)

PRODUCT AND PRICING

The Company 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. The Company's pricing process is designed to ensure an appropriate return on capital and long-term rate stability avoiding wide fluctuations in rates, unless necessary. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

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

UNDERWRITING AND CLAIMS

The Company is exposed to loss resulting from the underwriting of risks being insured and the exposure to financial loss resulting from greater than anticipated adjudication, settlement and claims costs.

The Company's underwriting objectives are to develop business within target markets on a prudent and diversified basis and to achieve profitable underwriting results. The Company underwrites automobile business after a review of the applicant's driving record and claims experience. Specialty commercial and personal risks are selected by the Company, working with its external brokers, after consideration of various risk factors associated with these lines of business. Despite its best efforts, and consideration of all known risk factors, there can be no assurance that all risks associated with the insurance policies that it writes can be identified and assessed, and the Company may, therefore, experience increased adjudication, settlement and claims costs.

The Company estimates its claims reserves on a quarterly basis and this is supported by quarterly assessments by the independent appointed actuary. Every quarter, for each line of business, the Company compares actual and expected claims development. To the extent that actual results differ from expected development, assumptions are re-evaluated and new estimates are derived. Although the Company believes its overall provision levels to be adequate to satisfy its obligations under existing policies, actual losses may deviate, perhaps substantially, from the amounts reflected in the Company's consolidated financial statements. To the extent provisions prove to be inadequate, the Company would have to re-evaluate such provisions and may incur a charge to earnings in the future.

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 business lines. Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in the Company's financial results and could materially reduce the Company's profitability or harm the Company's financial condition. The Company manages the impact of losses which may result from catastrophic events by purchasing excess of loss and catastrophe reinsurance to share all or part of the insurance risks originally accepted by the Company as well as geographic diversification.

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

The Company's ability to write new business also could be affected. The Company may experience an abrupt interruption of activities caused by unforeseeable and/or catastrophic events. The Company's operations may be subject to losses resulting from such disruptions. Losses can relate to property, financial assets, trading positions and to key personnel. The Company has developed business continuity plans designed to allow the Company to continue operations in case of a catastrophic event; however, if these plans cannot be put into action or do not take such events into account, losses may further increase.

ASSET AND LIABILITY MATCHING

The Company is exposed to:

- changes in the value of its fixed income investments and policy liabilities to the extent that market interest rates change;
- equity price fluctuations, which affect the fair values of equities held by the Company;
- the risk of losses to the extent that the sale of an investment prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows;
- the risk that future inflation of policyholder cash flows exceed returns on long-term investments; and
- foreign exchange risks with respect to investments, derivatives, receivables and policy liabilities denominated in foreign currencies.

The Company's exposures are monitored on a regular basis and actions are taken to balance investment positions when approved risk tolerance limits are exceeded.

Risk management is carried out by the Audit and Risk Committee under policies approved by the Board of Directors.

MARKET RISK

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity market fluctuations, foreign 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 financial assets are traded. Below is a discussion of the Company's primary market risk exposures and how these exposures are currently managed.

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 December 31, 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 Dec. 31, 2016			
200 basis point rise	**252,340**	**(6)%**	**(11,865)**
100 basis point rise	**260,468**	**(3)%**	**(5,932)**
No change	**268,594**	**—**	**—**
100 basis point decline	**276,722**	**3%**	**5,931**
200 basis point decline	**284,850**	**6%**	**11,863**

Change in interest rates	Fair value of fixed income	Hypothetical change on fair value	Effect on OCI net of tax
As at Dec. 31, 2015			
200 basis point rise	404,244	(6)%	(18,315)
100 basis point rise	416,788	(3)%	(9,158)
No change	429,333	—	—
100 basis point decline	441,879	3%	9,159
200 basis point decline	454,425	6%	18,317

As discussed in note 11, the discount rate used in the determination of the provision for unpaid claims is based on the expected return of assets on its investment portfolio with appropriate assumptions for interest rates relating to reinvestment of maturing investments. Fluctuations in market interest rates will therefore have an impact on the discount rate used in the valuation of the net provision for unpaid claims. The table below shows the potential impact of interest rate fluctuations on the net provision for unpaid claims and income statement:

Change in discount rate	**Net provision for unpaid claims**	**Hypothetical change in value**	**Effect on net income net of tax**
As at Dec. 31, 2016			
100 basis point rise	**223,441**	**(2)%**	**(3,405)**
No change	**228,106**	**—%**	**—**
100 basis point decline	**233,024**	**2%**	**3,590**
As at Dec. 31, 2015			
100 basis point rise	300,563	(2)%	(4,740)
No change	307,056	—	—
100 basis point decline	313,755	2%	4,890

(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 December 31, 2016, and December 31, 2015, are as follows:

Dec. 31, 2016	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**	**Greater than 5 years**	**Total**
Bonds	**18,190**	**76,090**	**100,469**	**73,845**	**268,594**
Percentage of total	**7%**	**28%**	**37%**	**28%**	**100%**

Dec. 31, 2015	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Bonds	36,949	121,892	125,709	144,783	429,333
Percentage of total	9%	28%	29%	34%	100%

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

Dec. 31, 2016	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**	**Greater than 5 years**	**Total**
Actuarial liabilities (undiscounted)	**86,700**	**87,875**	**43,864**	**24,008**	**242,447**
Less: Reinsurance recoverable (undiscounted)	**9,251**	**8,928**	**3,608**	**4,660**	**26,447**
Net actuarial liabilities	**77,449**	**78,947**	**40,256**	**19,348**	**216,000**

Dec. 31, 2015	Less than 1 year	1 – 3 years	3 – 5 years	Greater than 5 years	Total
Actuarial liabilities (undiscounted)	157,206	121,333	73,855	26,267	378,661
Less: Reinsurance recoverable (undiscounted)	45,441	24,209	16,700	2,518	88,868
Net actuarial liabilities	111,765	97,124	57,155	23,749	289,793

All other financial liabilities are for duration of one year or less. The contractual maturities for lease commitments are listed in note 20.

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.

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 twelve months ended December 31, 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**	
	Dec. 31, 2016	Dec. 31, 2015	**Dec. 31, 2016**	Dec. 31, 2015
10% rise	**2,393**	2,828	**23**	779
10% decline	**(2,393)**	(2,828)	**(23)**	(779)

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

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's maximum exposure to credit risk, without taking into account amounts held as collateral, is:

	As at Dec. 31, 2016	As at Dec. 31, 2015
Bonds	**268,594**	429,333
Gross reinsurance recoverable	**36,329**	180,011
Accounts receivable	**46,705**	105,300
Structured settlements (note 21)	**32,729**	33,009
Cash	**50,588**	23,373
Total	**434,945**	771,026

Echelon has entered into FX contracts for its European subsidiary sales proceeds hedging. The FX contracts are with Royal Bank of Canada, a Canadian multinational financial services company and the largest bank in Canada.

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

FIXED INCOME PORTFOLIO

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

	As at Dec. 31, 2016		As at Dec. 31, 2015	
	Fair value	**Fair value**	Fair value	Fair value
AAA	**107,267**	**40%**	132,195	31%
AA	**52,728**	**20%**	87,986	21%
A	**67,360**	**25%**	76,398	18%
BBB	**41,239**	**15%**	81,639	19%
BB	**—**	**—%**	25,888	6%
B	**—**	**—%**	14,717	3%
CCC	**—**	**—%**	537	0%
Unrated	**—**	**—%**	9,973	2%
Total	**268,594**	**100%**	429,333	100%

PREFERRED SHARE PORTFOLIO

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

	As at Dec. 31, 2016		As at Dec. 31, 2015	
	Fair value	**Fair value**	Fair value	Fair value
P2	**29,600**	**90%**	30,702	79%
P3	**3,177**	**10%**	8,042	21%
Total	**32,777**	**100%**	38,744	100%

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

CAPITAL MANAGEMENT

Capital is comprised of the Company's total equity. As at December 31, 2016, the Company's equity was $137,414 (December 31, 2015 – $180,935).

The Company's objectives when managing capital consists of:

- maintaining capital to be above minimum regulatory levels,
- ensuring capital is above internally determined risk management levels,
- financial strength and protecting its claims paying abilities, to maintain creditworthiness
- maximizing returns to shareholders over the long term.

FOREIGN EXCHANGE RISK

Foreign exchange risk is the possibility that changes in foreign exchange rates produce an unintended effect on earnings and equity when measured in Canadian dollars (CAD), the Company's functional currency. The Company is exposed to foreign currency risk through transactions conducted in currencies other than CAD, and through its investments in subsidiaries that have a functional currency other than the CAD.

A portion of the Company's premiums are written in Great British Pounds (GBP), Euros (EUR) and Danish Kroner (DKK) and a portion of loss reserves are also in GBP, EUR and DKK. A portion of the Company's cash and investments are also held in DKK, EUR and United States dollars (USD).

In general, the Company attempts to manage foreign exchange risk on liabilities by investing in financial instruments denominated in the same currency as the corresponding financial liabilities. The Company may, nevertheless, from time to time experience losses resulting from fluctuations in the value of the USD, GBP, EUR and DKK, which could adversely affect operating results.

The table below illustrates the expected impact on net income after tax and OCI after tax of a 10% change in CAD compared to the GBP and DKK as at December 31, 2016 and 2015. The impact to changes in USD is not significant. Computations of the prospective effects of hypothetical foreign exchange changes are based on numerous assumptions, including the maintenance of the existing level and composition of financial assets and financial liabilities, and should not be relied on as indicative of actual or future results.

Change in CAD/DKK rate	**Effect on Net Income**		**Effect on OCI**	
	2016	2015	**2016**	2015
10% rise	**(8,808)**	(2,203)	**4,805**	2,078
10% decline	**8,808**	2,203	**(4,805)**	(2,078)
Change in CAD/GBP rate	**Effect on Net Income**		**Effect on OCI**	
	2016	2015	**2016**	2015
10% rise	**(3,065)**	(2,822)	**3,603**	3,124
10% decline	**3,065**	2,822	**(3,603)**	(3,124)

14 INTANGIBLE ASSETS

	Opening cost	Purchases	Sales	End of period cost	Accumulated amortization	Net
Software						
December 31, 2016	**23,014**	**5,698**	**—**	**28,712**	**20,915**	**7,797**
December 31, 2015	19,430	3,584	—	23,014	17,176	5,838
Goodwill						
December 31, 2016	**400**	**—**	**—**	**400**	**—**	**400**
December 31, 2015	400	—	—	400	—	400
Total intangible assets						
December 31, 2016	**23,414**	**5,698**	**—**	**29,112**	**20,915**	**8,197**
December 31, 2015	19,830	3,584	—	23,414	17,176	6,238

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

15 INCOME TAXES

The income tax (recovery) is as follows:

	2016	2015
Current	**1,738**	1,555
Deferred	**(68)**	121
	1,670	1,676

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.

The difference is broken down as follows:

	2016	2015
Income tax expense calculated at statutory rates	**27.0%**	27.0%
Increase (decrease) in income tax rates resulting from:		
Non-taxable dividend income	**(6.1)%**	(3.9)%
Non-taxable (income) loss	**(5.7)%**	(1.4)%
Non-deductible expenses	**2.7%**	0.8%
Tax benefit of losses not previously recognized	**(0.1)%**	(4.2)%
Tax benefit of losses not recognized	**0.8%**	—%
Statutory rate differences	**1.1%**	(0.6)%
Non-taxable portion of capital gains	**(1.8)%**	(3.7)%
Other	**1.1%**	(3.2)%
Effective income tax rate	**19.0%**	10.8%

Deferred income taxes are comprised of the following:

	Losses carried forward	**Reserves**	**Investments**	**Property, equipment and intangible assets**	**Total**
Balance – January 1, 2016	**1,146**	**4,758**	**(32)**	**568**	**6,440**
Amounts recorded in discontinued operations	**7,904**	**(131)**	**—**	**—**	**7,773**
Amounts recorded in the income statement	**(274)**	**62**	**7**	**273**	**68**
Write-off	**(8,421)**	**—**	**—**	**—**	**(8,421)**
Balance – December 31, 2016	**355**	**4,689**	**(25)**	**841**	**5,860**
	Losses carried forward	Reserves	Investments	Property, equipment and intangible assets	Total
Balance – January 1, 2015	956	4,730	(55)	724	6,355
Amounts recorded in the income statement	190	28	23	(156)	85
Balance – December 31, 2015	1,146	4,758	(32)	568	6,440

Management reviews the recoverability of the deferred income tax asset on an ongoing basis and adjusts, as necessary, to reflect its anticipated realization. Management expects that the recorded deferred income tax asset will be realized in the normal course of operations.

The Company has tax losses available resulting from capital losses of $3,499, temporary differences of $26,822 in respect of the discontinued operations and $258 in respect of unrealized losses in foreign exchange forward contracts for which no deferred tax assets have been set up. These capital losses have no expiry date.

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

INCOME TAXES INCLUDED IN OCI

The amounts included in the consolidated statements of comprehensive income for the years ended December 31 are shown net of the following tax benefit:

	2016	2015
Change in unrealized gains	**739**	(208)
Reclassification to net income of (gains) and losses	**(1,030)**	(1,200)
Total income tax expense included in OCI	**(291)**	(1,408)

Income taxes payable are expected to be settled within one year of the financial statement date.

16 SHARE CAPITAL

	As at Dec. 31, 2016	As at Dec. 31, 2015
Authorized		
Unlimited common shares (no par value)		
Unlimited special shares issuable in Series (no par value)		
Issued		
11,747,736 common shares (December 31, 2015 – 11,729,112 common shares)	**70,227**	69,653

In 2016, 52,600 common shares (2015 – 202,125) with a value of $866 (2015 – $3,142) were issued for the exercise of stock options. In 2016, 21,891 common shares (2015 – 21,530) were issued pursuant to the Share Unit Plan for eligible employees. During 2016, 55,867 shares or $676 were repurchased under the normal course issuer bid and subsequently canceled (2015 – 103,600 shares or $1,513).

DIVIDENDS

During the year ended December 31, 2016, the Company has paid $0.24 per share (December 31, 2015 – $0.45 per share).

17 EMPLOYEE STOCK OPTION PLAN

For the year ended December 31, 2016, the Company recorded a compensation recovery of $56 (2015 – expense of $78), with an offsetting credit to contributed surplus in relation to its stock option plan. Stock options granted have varying vesting periods. It also recorded an expense of $344 (2015 – $629) in relation to its Share Unit Plan. No stock options were granted in 2016.

The following is a continuity schedule of stock options outstanding as at December 31, 2016 and 2015.

	Number of options		**Weighted average exercise price per share**	
	2016	2015	**2016**	2015
Outstanding, beginning of year	**309,325**	569,950	**8.15**	8.67
Granted during the year	**—**	—	**—**	—
Exercised during the year	**(52,600)**	(202,125)	**7.71**	9.51
Canceled during the year	**(39,750)**	(58,500)	**8.24**	8.48
Expired during the year	**(14,625)**	—	**7.80**	—
Outstanding, end of the year	**202,350**	309,325	**8.27**	8.15

As at December 31, 2016, the outstanding stock options consist of the following:

Stock Option price per share	**Number**	**Average remaining contractual life**	**Number of options exercisable**
$8.01 – $8.89	128,525	3.25	52,000
$7.18 – $8.00	73,825	1.38	62,825

The fair values of the stock options issued in 2016 were determined using the Black-Scholes option pricing model with the following assumptions: (i) risk-free rate of 1.25%; (ii) life expectancy of 2-5 years; and (iii) estimated volatility of 2.5%. The grant-date fair value of total options granted during the year is estimated at nil (2015 – $nil). The weighted average grant-date fair value per share option to date is $3.20.

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

RESTRICTED SHARE UNIT (RSU) PLAN

The restricted share units are share-settled awards for which the provision recorded as at December 31, 2016 was $360 (2015 – $727). The amount credited to operating expenses for 2016 was $367 (2015 – $9).

18 RELATED PARTY TRANSACTIONS

KEY MANAGEMENT

Key management includes named executive officers and directors. Compensation to these individuals are summarized in the following table:

Compensation	2016	2015
Salaries, directors' fees and other short-term benefits	**1,626**	2,220
Equity-settled and cash-settled compensation benefits	**552**	642
Termination benefits	**2,067**	—
	4,245	2,862

19 OPERATING COSTS BY NATURE

The table below presents operating costs by major category:

	2016	2015
Salaries and benefits	**14,475**	14,510
Systems costs	**7,565**	6,120
Professional fees	**1,760**	1,518
Occupancy	**1,358**	1,322
Severance	**4,266**	—
Other expenses	**3,999**	4,170
	33,423	27,640

Corporate expenses include $0.5 million (2015 – $1.0 million) 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.

20 LEASE COMMITMENTS

The Company is committed under lease agreements for office premises and computer equipment with minimum lease payments of $11,533 as follows:

Lease commitments	
2017	1,622
2018	1,608
2019	1,482
2020	1,209
2021	1,233
2021 and thereafter	4,379
	11,533

21 STRUCTURED SETTLEMENTS

In the normal course of claims adjudication, the Company may settle certain long-term losses through the purchase of annuities (structured settlements) from life insurance companies. The fair estimated value of these annuity contracts amounts to $32,729 (December 31, 2015 – $33,009) using a discount rate of 2.31% (December 31, 2015 – 2.15%). It is the policy of the Company to purchase annuities from life insurers with proven financial stability. The net risk to the Company is the credit risk related to the life insurance companies and this risk is reduced to the extent of coverage provided by Assuris, the life insurance compensation insurance plan. The Company has determined that no credit risk provision is required.

22 CONTINGENCIES

From time to time, in connection with its insurance operations, the Company is named as a defendant in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome, such actions have generally been resolved with minimal damage or expense in excess of amounts provided as policy liabilities. The Company does not believe that it will incur any significant additional loss or expense in connection with such actions.

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

23 RATE REGULATIONS

The Company writes business subject to rate regulation, including non-standard automobile and motorcycle insurance in Canada, which comprises approximately 72% (2015 – 74%) of gross premiums written and assumed. The Company's automobile insurance premiums can be impacted by mandatory rate rollbacks and mandatory rate assessments as legislated by provincial law and by regulation in certain provinces. This could result in lower future premium rates or reductions to premium rates charged by the Company in prior years. In addition, the Company is required, under certain provincial legislation, to participate in risk-sharing pools, which may impact positively or negatively on underwriting results. Certain benefit payments are also subject to provincial government regulation, including automobile accident benefits.

24 ACCUMULATED OTHER COMPREHENSIVE INCOME

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

	As at Dec. 31, 2016	As at Dec. 31, 2015
Gross unrealized gains	**(459)**	4,208
Foreign currency translation adjustments	**(10,776)**	2,151
Foreign exchange forward	**4,314**	—
Tax impact	**1,851**	(299)
Ending balance	**(5,070)**	6,060

25 EARNINGS PER SHARE

	2016	2015
Basic earnings per share on continued operations:		
Net income available to shareholders	**6,606**	12,254
Average number of common shares	**11,738**	11,669
Basic earnings per share on continued operations	**$0.56**	$1.05
Diluted earnings per share:		
Average number of common shares	**11,738**	11,669
Average number of dilutive common shares under employee stock compensation plan	**261**	300
Average number of diluted common shares	**11,999**	11,969
Diluted earnings per share on continued operations	**$0.55**	$1.02

	2016	2015
Basic earnings per share on discontinued operations:		
Net income available to shareholders	**(36,414)**	(5,629)
Average number of common shares	**11,738**	11,669
Basic earnings per share on discontinued operations	**$(3.10)**	$(0.48)
Diluted earnings per share:		
Average number of common shares	**11,738**	11,669
Average number of dilutive common shares under employee stock compensation plan	**261**	300
Average number of diluted common shares	**11,999**	11,969
Diluted earnings per share on discontinued operations	**$(3.10)**	$(0.48)

	2016	2015
Basic earnings per share:		
Net income available to shareholders	**(29,808)**	6,625
Average number of common shares	**11,738**	11,669
Basic earnings (loss) per share	**$(2.54)**	$0.57
Diluted earnings per share:		
Average number of common shares	**11,738**	11,669
Average number of dilutive common shares under employee stock compensation plan	**261**	300
Average number of diluted common shares	**11,999**	11,969
Diluted earnings (loss) per share	**$(2.54)**	$0.55

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

26 HELD FOR SALE CLASSIFICATION AND DISCONTINUED OPERATIONS

During the second quarter, a decision was made to sell the company's European operations and all assets were recorded as "Held for Sale" at the lower of the fair value less cost to sell and the carrying value. This reclassification for the discontinued operations resulted in a $23.4 million impairment, including all transactions costs to dispose of the operations, being recorded against the unearned premiums included within the liabilities of the disposal group held for sale.

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 December 31, 2016 were as follows:

	As at Dec. 31, 2016
Assets of the disposal group held for sale	
Cash and short-term deposits	**87,047**
Investments	**67,174**
Reinsurers' share of unpaid claims	**97,636**
All other assets	**28,185**
Total assets of disposal group held for sale	**280,042**
Liabilities of the disposal group held for sale	
Accounts payable and accrued liabilities	**13,899**
Unearned premiums	**55,198**
Provision for unpaid claims	**190,433**
All other liabilities	**3,664**
Total liabilities of disposal group held for sale	**263,194**

NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS

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

	2016	2015
Revenue		
Gross written and assumed premiums	**247,573**	295,618
Net written premium	**121,052**	157,966
Decrease (increase) in provision for unearned premium	**23,792**	(25,156)
Net earned premiums	**144,844**	132,810
Investment income	**2,643**	1,274
Total revenue	**147,487**	134,084
Expenses		
Net incurred claims	**108,677**	83,817
Impact of change in discount rate on claims	**—**	616
Net acquisition costs	**51,198**	49,365
Operating costs	**6,910**	7,234
Total expenses	**166,785**	141,032
(Loss) income before income taxes	**(19,298)**	(6,948)
Income tax (recovery) expense	**(6,031)**	(1,271)
Net (loss) income on discontinued operations	**(13,267)**	(5,677)
Impairment of the net assets of disposal group held for sale	**(23,379)**	—
Net (loss) income on discontinued operations	**(36,646)**	(5,677)

CORRECTION OF AN ERROR

It was identified during the year that there was an error in the calculation of unearned premiums on select policies in the Company's discontinued operations for the year ended December 31, 2015. The error resulted in an overstatement of earned premiums and an understatement of unearned premiums as at December 31, 2015. The discontinued operations in 2015 had a premium deficiency which decreased DPAC, and it was identified that if unearned premiums were corrected in 2015, no deficiency would have been required. Thus the impact on the December 31, 2015 income statement is an increase in UPR offset by an increase in the DPAC. The company has adjusted the financial statements for the comparative year ended December 31, 2015 in these statements.

The following table presents the amounts previously reported and restated in the consolidated balance sheet and consolidated statement of income and comprehensive income for the year ended December 31, 2015.

Balance as at Dec. 31, 2015	As Reported	Adjustment	As Amended
Unearned premium	260,073	4,511	264,584
Deferred policy acquisition costs	76,710	746	77,456
Opening retained earnings as at January 1, 2015	105,354	(2,132)	103,222
Net income (loss)	8,218	(1,633)	6,585
(Loss) per share discontinued operations – basic	$(0.34)	$(0.14)	$(0.48)
(Loss) per share discontinued – diluted	$(0.34)	$(0.14)	$(0.48)

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

27 NON-CONTROLLING INTEREST

The Company has non-controlling interests attributable to the subsidiary of ICPEI; please refer to note 1.

	2016	2015
Revenue		
Gross written and assumed premiums	**7,409**	6,869
Net earned premiums	**6,482**	6,413
Investment income	**330**	51
Total revenue	**6,812**	6,464
Expenses		
Net incurred claims	**3,427**	4,165
Net acquisition costs	**1,636**	1,479
Operating costs	**1,035**	867
Total expenses	**6,098**	6,511
Income (loss) before income taxes	**714**	(47)
Income tax expense (recovery)	**202**	(55)
Net income (loss) attributable to NCI	**512**	8
OCI attributable to NCI	**(52)**	(11)
Comprehensive income attributable to NCI	**460**	(3)

	As at Dec. 31, 2016	As at Dec. 31, 2015
Assets		
Cash and investments	**9,421**	8,337
Other assets	**4,377**	4,417
Total assets	**13,798**	12,754
Liabilities		
Unearned premium	**3,699**	3,428
Unpaid claims	**5,709**	5,682
Other liabilities	**648**	362
Total liabilities	**10,056**	9,472
Equity		
Share capital	**—**	—
AOCI	**(43)**	9
:Retained earnings	**3,785**	3,273
Total equity	**3,742**	3,282
Total liabilities and equity	**13,798**	12,754

The equity balance above excludes discontinued operations and will therefore differ from the non-controlling interest amount disclosed on the balance sheet of these financial statements.

	As at Dec. 31, 2016	As at Dec. 31, 2015
	ICPEI	ICPEI
Cash flow from operating activities	**1,138**	(581)
Cash flow from investing activities	**(232)**	(201)
Cash flow from financing activities	**—**	250
Net increase (decrease) in cash and short-term deposits	**906**	(532)

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

28 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.

	2016	2015
Revenue		
Earned premiums		
– Personal Lines	**139,616**	134,791
– Commercial Lines	**41,444**	41,677
Total earned premium	**181,060**	176,468
Net claims Incurred		
– Personal Lines	**97,823**	89,620
– Commercial Lines	**12,949**	20,207
Total net claims incurred	**110,772**	109,827
Net expenses		
– Personal Lines	**44,970**	41,862
– Commercial Lines	**18,504**	16,581
Total	**63,474**	58,443
Corporate Expenses	**7,228**	8,645
Total net expenses	**70,702**	67,088
Income (loss) before income taxes		
– Personal Lines	**(3,177)**	3,309
– Commercial Lines	**9,991**	4,889
Total Canada	**6,814**	8,198
Corporate and other	**(7,228)**	(8,645)
Underwriting (loss) income	**(414)**	(447)
Impact of change in net claims discount rate (1)	**(2,822)**	1,024
Other income	**—**	748
Severance expense	**(4,266)**	—
Investment income	**16,507**	12,613
Total income before income taxes	**9,005**	13,938

(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.

Shareholder Information

Echelon Financial Holdings Inc.

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Stock Exchange Listing

Toronto Stock Exchange
Trading Symbol “EFH”

Common Shares Outstanding

11,747,736 (as at December 31, 2016)

Dividends

All dividends paid by the Company are “eligible dividends” for Canadian income tax purposes unless indicated otherwise

General Counsel

Blake, Cassels & Graydon LLP

Appointed Actuary

Willis Towers Watson

Auditors

PricewaterhouseCoopers LLP

Investor Relations

Kathy Shulman,
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