Unaudited Condensed Consolidated Interim Financial Statements of

Echelon Financial Holdings Inc.

For three months ended March 31, 2018 and 2017

The external auditors have not reviewed these unaudited consolidated financial statements.

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

	Note	March 31, 2018	December 31, 2017
Assets			
Cash and short–term deposits	6	30,006	44,459
Accounts receivable		83,630	75,622
Loan receivable	7	6,851	6,553
Investments (including securities on loan)	6	372,774	370,933
Due from insurance companies		780	510
Deferred policy acquisition costs		43,407	40,888
Income taxes recoverable		1,067	1,001
Prepaid expenses and other assets		5,602	2,462
Reinsurers' share – unearned premiums		9,891	9,957
– provision for unpaid claims	10	23,004	23,471
Property and equipment		1,391	859
Intangible assets	12	8,695	8,037
Deferred income taxes		6,484	5,834
Total assets		593,582	590,586
Liabilities			
Accounts payable and accrued liabilities		11,562	18,116
Payable to insurance companies		167	610
Unearned premiums		168,231	160,577
Unearned commission		1,155	1,667
Provision for unpaid claims	10	259,977	262,966
Total liabilities		441,092	443,936
Equity			
Share capital		71,824	71,520
Contributed surplus		259	248
Retained earnings		79,713	73,887
Accumulated other comprehensive income	16	(2,940)	(2,833)
Equity attributed to shareholders of the Company		148,856	142,822
Non-controlling interest	19	3,634	3,828
Total equity		152,490	146,650
Total liabilities and equity		593,582	590,586

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

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

		3 months ended March 31	
	Note	**2018**	**2017**
Revenue			
Gross written and assumed premiums		79,287	54,586
Less: premiums ceded to reinsurers		(45)	(4,510)
Net written and assumed premiums		79,242	50,076
(Increase) in gross unearned premiums		(7,654)	(1,184)
(Decrease) increase in unearned premiums, reinsurers' share		(66)	133
Change in provision for unearned premiums		(7,720)	(1,051)
Net earned premiums		71,522	49,025
Investment income	6	1,959	8,487
Total revenue		73,481	57,512
Expenses			
Gross claims incurred		41,231	30,446
Less: claims recoveries from reinsurers		509	(1,578)
Net incurred claims		41,740	28,868
Gross acquisition costs		17,430	13,598
Less: acquisition cost recoveries from reinsurers		2,054	(1,547)
Net acquisition costs		19,484	12,051
Operating costs	14	9,354	7,390
Total expenses		70,578	48,309
Income before taxes and discount rate impact on claims		2,903	9,203
Impact of change in discount rate on claims(1)		2,050	—
Income before interest expense and income taxes		4,953	9,203
Interest expense	9	—	71
Income tax (recovery) expense	13	(689)	1,666
Net income on continued operations		5,642	7,466
Net (loss) on discontinued operations	18	—	(7,268)
Net income		5,642	198
Attributed to:			
Shareholders of the Company - continued operations		5,826	7,455
Shareholders of the Company - discontinued operations	18	—	(7,268)
Non-controlling interest - continued operations	19	(184)	11
Non-controlling interest - discontinued operations	18	—	—
Net income		5,642	198
Other comprehensive income (loss), net of taxes that may be classified subsequently to net income			
Available-for-sale investments:			
Change in net unrealized gains		(870)	1,509
Reclassification of net realized losses to net income		725	85
(Loss) on foreign exchange forward	6	—	(4,314)
Tax impact		28	139
Other comprehensive (loss) on continued operations		(117)	(2,581)
Other comprehensive income on discontinued operations	18	—	7,268
Other comprehensive income		(117)	4,687

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

		3 months ended March 31	
	Note	**2018**	**2017**
Attributed to:			
Shareholders of the Company - continued operations		(107)	(2,598)
Shareholders of the Company - discontinued operations	18	—	7,268
Non-controlling interest - continued operation	19	(10)	17
Non-controlling interest - discontinued operation	18	—	—
Other comprehensive income		(117)	4,687
Total comprehensive income		5,525	4,885
Attributed to:			
Shareholders of the Company - continued operations		5,719	4,857
Shareholders of the Company - discontinued operations	18	—	—
Non-controlling interest - continued operation	19	(194)	28
Non-controlling interest - discontinued operation	18	—	—
Total comprehensive income		5,525	4,885
Earnings per share attributable to shareholders of the Company	17		
Earnings per share continued operations - basic		$0.49	$0.63
(Loss) per share discontinued operations - basic		$0.00	$(0.62)
Earnings per share - basic		$0.49	$0.02
Earnings per share continued operations - diluted		$0.48	$0.62
(Loss) per share discontinued operations - diluted		$0.00	$(0.62)
Earnings per share - diluted		$0.48	$0.02
Net income		5,642	198

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

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

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

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Shareholders' Equity	Non-controlling Interest	Total Equity
Balance at January 1, 2018	71,520	248	(2,833)	73,887	142,822	3,828	146,650
Net income	—	—	—	5,826	5,826	(184)	5,642
Other comprehensive income	—	—	(107)	—	(107)	(10)	(117)
Total comprehensive income	—	—	(107)	5,826	5,719	(194)	5,525
Common shares issued on stock options exercised	304	(13)	—	—	291	—	291
Stock compensation expense	—	24	—	—	24	—	24
Balance at March 31, 2018	71,824	259	(2,940)	79,713	148,856	3,634	152,490

	Share Capital	Contributed Surplus	Accumulated Other Comprehensive Income	Retained Earnings	Shareholders' Equity	Non-controlling interest	Total Equity
Balance at January 1, 2017	70,227	322	(5,070)	71,935	137,414	3,960	141,374
Net income	—	—	—	187	187	11	198
Other comprehensive income	—	—	4,670	—	4,670	17	4,687
Total comprehensive income	—	—	4,670	187	4,857	28	4,885
Transfer of currency translation adjustment	—	—	(99)	318	219	(219)	—
Common shares issued on stock options exercised	546	(60)	—	—	486	—	486
Stock options expense	—	7	—	—	7	—	7
Balance at March 31, 2017	70,773	269	(499)	72,440	142,983	3,769	146,752

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

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

	3 months ended	
	March 31, 2018	**March 31, 2017**
Cash provided by (used in):		
Operating activities		
Net income from continued operations	5,642	7,466
Net loss from discontinued operations	—	(7,268)
Adjusted for:		
Reinsurers' share of unearned premiums	66	(133)
Reinsurers' share of unpaid claims	467	(265)
Provision for unpaid claims	(2,989)	(1,619)
Unearned premiums	7,654	1,184
Deferred income taxes	(650)	190
Unearned commissions	(512)	(69)
Deferred policy acquisition costs	(2,519)	(494)
Amortization on property plant equipment and intangible assets	1,279	1,477
Amortization of premiums on bonds	320	414
Fair value change on FVTPL investments	558	(2,750)
Options expense	24	7
Foreign exchange forward	—	(4,314)
Prepaid expenses & other assets	(3,140)	(954)
	558	(7,326)
Cash flow from changes in		
Accounts receivable	(8,008)	(2,245)
Loan receivable	(298)	(17,503)
Net realized losses (gains)	765	931
Income taxes payable	(37)	775
Due to insurance companies	(713)	177
Other liabilities	(6,554)	1,141
Cash (used) by continuing operating activities	(8,645)	(16,584)
Cash (used) by discontinued operating activities	—	(137,935)
Cash (outflow) from operating activities	(8,645)	(154,519)
Financing activities		
Proceeds from issuing of common shares for stock options	291	486
Cash provided by continuing financing activities	291	486
Cash inflow from financing activities	291	486
Investing activities		
Purchases of property, equipment and intangible assets	(2,469)	(1,654)
Sale of property and equipment & intangible assets	—	—
Purchases of investments	(102,493)	(56,329)
Sale/maturity of investments	98,863	57,996
Proceeds received from the sale of subsidiary	—	5,117
Cash (used) by continuing investing activities	(6,099)	5,130
Cash provided by discontinued investing activities	—	62,619
Cash (outflow) from investing activities	(6,099)	67,749

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

	3 months ended	
	March 31, 2018	**March 31, 2017**
(Decrease) in cash and short-term deposits	(14,453)	(86,284)
Cash and short-term deposits, beginning of period	44,459	137,635
Cash and short-term deposits, end of period	30,006	51,351
Supplementary information		
Operating activities		
Income taxes paid	—	813

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

1 Nature of operations

Echelon Financial Holdings Inc. ("the Company") was incorporated in Canada on August 18, 1997, under the Business Corporations Act (Ontario). The Company is domiciled in Canada and principally engaged, through its subsidiaries, in property and casualty insurance in Canada. 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").

The Company completed the sale of Qudos Insurance A/S ("Qudos") March 7, 2017. Please refer to note 18.

2 Basis of preparation

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting. The condensed consolidated interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2017, which have been prepared in accordance with IFRS.

These consolidated financial statements have been authorized for issue by the Board of Directors on May 3, 2018.

3 Summary of significant accounting policies

The accounting policies adopted are consistent with those of the previous financial year end except as described below.

Discontinued Operations

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

Standards, amendments and interpretations not yet adopted or effective

IFRS 9, Financial Instruments

In July 2014, the IASB published the complete version of IFRS 9 which is effective for annual periods beginning on or after January 1, 2018, with retrospective application. The new standard includes requirements on the classification and measurement of financial assets and liabilities, an expected credit loss model that replaces the existing incurred loss impairment model and new hedge accounting guidance. The Company has evaluated and meets the requirements to defer the adoption of IFRS 9 since the percentage of liabilities connected with insurance contracts over total liabilities is above the 80% threshold. The company has deferred adoption, until the new insurance contracts standard is adopted effective January 1, 2021.

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. 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. Revenue arising from insurance contracts and from financial instruments is outside the scope of IFRS 15. There are no other revenues arising from other sources of income.

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 has evaluated the impact of IFRS 16 on its Consolidated Financial Statements and the impact will be minimal.

IFRS 17, Insurance Contracts

In May 2017, the IASB published IFRS 17 which is effective January 1, 2021, with retrospective application. The standard replaces IFRS 4. The standard is comprehensive in scope and addresses recognition, measurement, presentation and disclosure for insurance contracts. The standard requires the entity to recognize a group of insurance contracts it issues from the earliest of the following: (a) the beginning of the coverage period of the group of contracts; (b) the date when the first payment from a policyholder in the group becomes due; and (c) for a group of onerous contracts, when the group becomes onerous. The measurement approach is based on the following building blocks: (i) a current, unbiased probability-weighted estimate of future cash flows expected to arise as the insurer fulfills the contract; (ii) the effect of the time value of money; (iii) a risk adjustment that measures the effects of uncertainty about the amount and timing of future cash flows; and (iv) a contractual service margin which represents the unearned profit in a contract (that is recognized in net earnings as the insurer fulfills its performance obligations under the contract). Estimates are required to be re-measured each reporting period. In addition, a simplified measurement approach is permitted for short-duration contracts in which the coverage period is approximately one year or less. The Company is currently evaluating the impacts of IFRS 17 on its consolidated financial statements.

4 Critical accounting estimates and assumptions

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

In preparing these condensed consolidated interim financial statements, the significant judgements made by management in applying accounting policies and the key sources of estimation uncertainty were the same as those applied to the annual 2017 consolidated financial statements.

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

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.

6 Investments

The following table provides a breakdown of the investment portfolio as at March 31, 2018 and December 31, 2017:

	Fair values	
Available-for-sale	**As at March 31, 2018**	**As at December 31, 2017**
Fixed income		
Canadian		
Federal	35,625	39,408
Provincial	38,863	29,883
Municipal	417	14
Corporate	121,557	127,701
	196,462	197,006
Fixed income lent through securities lending program		
Federal	67,663	63,864
Provincial	9,049	17,564
Municipal	1,317	1,322
Corporate	13,519	8,535
	91,548	91,285
Foreign fixed income		
Corporate	4,401	2,014
	4,401	2,014
Foreign lent through securities lending program		
Corporate	470	—
Total fixed income	292,881	290,305
Money market pooled funds	312	1,014
Short-term fixed income and mortgage pooled funds	19,356	19,303
Specialty pooled fund	8,286	8,240
Total pooled funds	27,954	28,557
Common shares		
Canadian	1,020	889
Foreign	1,175	1,043
Global Equity Pooled Fund	7,465	7,385
Total common shares	9,660	9,317
Total available-for-sale	330,495	328,179
Fair value through profit or loss		
Preferred shares	42,279	42,754
Total preferred shares	42,279	42,754
Total investments	372,774	370,933
Cash and short-term deposits	30,006	44,459
Total investments including cash and short-term deposits	402,780	415,392

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 March 31, 2018, the Company had collateral of $101,011

(December 31, 2017 – $98,798) for the loaned securities or approximately 108% of the fair value of the loaned securities.

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 technique employed has remained the same from December 31, 2017. 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 rationality 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.

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

The following table provides the classification of the Company's investments within the fair value hierarchy, as outlined above, as at March 31, 2018 and December 31, 2017:

March 31, 2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Fixed income	—	292,881	—	292,881
Money market pooled funds	—	312	—	312
Short-term fixed income and mortgage pooled funds	—	19,356	—	19,356
Specialty pooled fund	—	—	8,286	8,286
Common Shares	2,195	7,465	—	9,660
Preferred Shares	42,279	—	—	42,279
	44,474	320,014	8,286	372,774

December 31, 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Fixed income	—	290,305	—	290,305
Money market pooled funds	—	1,014	—	1,014
Short-term fixed income and mortgage pooled funds	—	19,303	—	19,303
Specialty pooled fund	—	—	8,240	8,240
Common Shares	1,932	7,385	—	9,317
Preferred Shares	42,754	—	—	42,754
	44,686	318,007	8,240	370,933

The Company's policy is to recognize transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. There were no transfers from the existing portfolio for the quarter ended March 31, 2018 or 2017.

A new specialty pooled fund was added in the portfolio year ended December 31, 2017 which includes Level 3 private debt securities assets. The fund provides special situation financing solutions, generally in the form of senior or subordinated loans to both public and private companies. The fair value of the limited partnership investments is based on the net asset value ("NAV") provided by management of the limited partnership investments. For securities in the fund that are publicly traded, the fund uses the current available market prices provided the market price is reasonable taking into consideration both value and liquidity. Private securities in the fund are valued based upon the value of the underlying components. The loan component is valued by a discounted cash flow method taking into account current market interest rate spreads. The discount rate is determined to be the sum of the following components:

a) Benchmark yield - for Canadian loans, this is the on-the-run Government of Canada bond with equivalent duration to the loan. For U.S. loans, this is the on-the-run U.S. Treasury with equivalent duration to the loan.
b) Credit spread - this is the BBB index for equivalent duration to the loan.
c) Excess credit spread and Excess illiquidity spread -The excess credit spread and excess illiquidity spread are included so as to account for the additional risk and illiquidity of the loan compared to a comparable publicly traded bond.

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

Warrants and Gifted Equity make up a small proportion of the fund's valuation. Warrants are valued using a Black-Scholes model, with the implicit volatility of the warrants used in the calculation. This calculated implicit volatility is used for future warrant pricing. The gifted equity component is calculated using a combination of a modified discounted cash flow model and a normalized earnings based enterprise value model.

Based on the unobservable nature of these NAVs, Echelon does not assess whether applying reasonably possible alternative assumptions would have an impact on the fair value of the limited partnership investments. The total unrealized gain on the fund for year ended March 31, 2018 was $146 (March 31, 2017 - nil). The following table summarizes the changes in the fair value measurement for financial instruments in level 3 amount of the fair value hierarchy as at March 31, 2018 and December 31, 2017:

	As at	**As at**
	March 31, 2018	**December 31, 2017**
Opening Balance, January 1	8,240	—
Purchases	—	8,139
Sales	—	—
Realized gain (loss)	—	—
Change in unrealized gain in value of investment	46	101
Principal repayment	—	—
Closing Balance	8,286	8,240

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 and maximum exposure to loss as of March 31, 2018 was $27,954 (December 31, 2017 – $28,557). Investments in pooled funds consist of units invested in underlying money market and mortgage securities managed by third-party managers in addition to units invested in a Specialty Pooled Fund that provides special situation financing solutions, generally in the form of senior or subordinated loans to both public and private companies. The pooled funds are perpetual private trusts created under trust agreements. Financing 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

A gross unrealized loss of $3,382 on AFS investments at March 31, 2018 (December 31, 2017 – $3,326) is recorded, net of tax, in the amount of $2,471 (December 31, 2017 – $2,415) in Accumulated Other Comprehensive Income primarily due to the impact of higher government bond yields on the Company's fixed income portfolio.

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.

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

No impairments on AFS investments were recognized for the period ended March 31, 2018 and 2017.

Investment income

The table below provides additional details on net investment income:

	3 months ended March 31	
	2018	**2017**
Interest income	2,877	2,102
Dividend income	502	370
Net realized (losses)	(765)	(931)
Fair value change on FVTPL investments	(558)	2,750
Realized and unrealized foreign exchange gains	136	4,380
Investment expenses	(233)	(184)
Investment income	1,959	8,487

7 Loan receivable

As part of the sale of its European operations, the Company entered into a loan agreement with New Nordic Odin Guernsey Limited (NNGL) on March 7, 2017 to lend the principal amount of 91.5 million Danish Krone (DKK) payable on December 31, 2017.

On December 29, 2017, the Company received 59.4 million DKK as partial repayment of the principal amount of the loan. The Company has extended the maturity date for the outstanding balance of the loan with NNGL to May 27, 2018.

The loan bears interest on the principal amount outstanding at the rate of six percent (6%) per annum that commenced on July 6, 2017 and is payable monthly. The Company has received all interest payments due to date.

Please refer to Note 18 for further details.

8 Derivative financial instruments

The Company has entered into derivative contract to hedge the principal repayment from the loan receivable from New Nordic Odin Guernsey Limited. The total notional value of the derivative contracts at March 31, 2018 is $6.8 million (December 31, 2017 - $6.6 million). Contracts are classified as Level 2 under the fair value hierarchy.

9 Line of credit

The Company had a $10.0 million two-year secured revolving term credit facility effective June 30, 2015, which matured on July 1, 2017. The facility expired and has not been renewed.

For the period ended March 31, 2018, the Company has expensed nil on the income statement, related to the maintenance of the credit facility (March 31, 2017 – $0.1 million).

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

10 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 investment portfolio has experienced an increase in yields compared to December 31, 2017. The Company discounts its best estimate as follows for each entity, which is for all lines of business within the reporting entity:

Entity	March 31, 2018	December 31, 2017
Echelon Insurance	3.10%	2.65%
ICPEI	3.10%	2.80%

The Company recorded a $5,758 reduction to the net provision for unpaid claims relating to redundancies in prior years' estimates (March 31, 2017 – $3,280).

To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience, and to provide greater comfort that the actuarial liabilities are adequate to pay future claims, the Company includes provisions for adverse deviations (PFADs) in some assumptions relating to claims development, reinsurance recoveries and future investment income. The PFADs selected are in the mid-range of those recommended by the Canadian Institute of Actuaries. The aggregate impact of the provision for adverse deviation is to increase the provision for unpaid claims on a net basis by $19,240 as at March 31, 2018 (December 31, 2017 – $19,349).

Claims development

Provision for unpaid claims analysis	March 31, 2018	March 31, 2017
Unpaid claims, beginning of year, net	239,495	228,106
Favourable prior year claims development	(5,758)	(3,280)
Net claims incurred in current period	45,448	32,148
Paid on claims occurring during		
Current year	(13,235)	(9,549)
Prior year	(28,977)	(21,203)
Unpaid claims, end of period, net	236,973	226,222
Reinsurers' share	23,004	27,288
Gross unpaid claims	259,977	253,510

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

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

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

11 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.

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

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 other comprehensive income ("OCI") relating to the fixed income investment portfolio as at March 31, 2018, and December 31, 2017, based on parallel 200 basis point shifts in interest rates up and down in 100 basis point increments.

Change in interest rates ***As at March 31, 2018***	**Fair value of fixed income**	**Hypothetical change on fair value**	**Effect on OCI net of tax**
200 basis point rise	303,279	(5)%	(12,816)
100 basis point rise	312,057	(3)%	(6,408)
No change	320,835	—	—
100 basis point decline	329,612	3 %	6,407
200 basis point decline	338,390	5 %	12,818

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

Change in interest rates ***As at December 31, 2017***	**Fair value of fixed income**	**Hypothetical change on fair value**	**Effect on OCI net of tax**
200 basis point rise	301,610	(5)%	(12,594)
100 basis point rise	310,085	(3)%	(6,407)
No change	318,862	—	—
100 basis point decline	327,639	3 %	6,406
200 basis point decline	336,114	5 %	12,596

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 are as follows, as at March 31, 2018 and December 31, 2017:

March 31, 2018	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**	**Greater than 5 years**	**Total**
Bonds	19,184	115,907	97,878	59,912	292,881
Percentage of total	7%	40%	33%	20%	100%

December 31, 2017	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**	**Greater than 5 years**	**Total**
Bonds	24,001	117,230	84,152	64,922	290,305
Percentage of total	8%	41%	29%	22%	100%

The following tables summarize the expected timing of cash flows arising from insurance obligations, on an undiscounted basis, as at March 31, 2018 and December 31, 2017:

March 31, 2018	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**	**Greater than 5 years**	**Total**
Gross claim liabilities (undiscounted)	89,511	90,370	45,486	29,782	255,149
Less: Reinsurance recoverable (undiscounted)	5,386	4,855	3,159	9,454	22,854
Net actuarial liabilities	84,125	85,515	42,327	20,328	232,295

December 31, 2017	**Less than 1 year**	**1 – 3 years**	**3 – 5 years**	**Greater than 5 years**	**Total**
Gross claim liabilities (undiscounted)	93,874	89,302	46,779	25,803	255,758
Less: Reinsurance recoverable (undiscounted)	10,877	7,758	2,661	1,464	22,760
Net actuarial liabilities	82,997	81,544	44,118	24,339	232,998

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

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

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 three months ended March 31, 2018, and the year ended December 31, 2017. 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**	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
10% rise	3,086	3,121	705	680
10% decline	(3,086)	(3,121)	(705)	(680)

Credit risk

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

The Company is exposed to risk from reinsurers' inability to cover balances. 98.9% of the Company's reinsurance balances are from registered reinsurers. The Company holds sufficient collateral to cover the 1.1% of reinsurance balances from unregistered reinsurers.

The following table sets forth the Company's fixed income securities portfolio by credit quality as at March 31, 2018, and December 31, 2017.

Fixed income portfolio

A breakdown of the fixed income portfolio by credit rating is shown below as at March 31, 2018 and December 31, 2017:

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

	As at March 31, 2018		As at December 31, 2017	
	Fair value	**%**	**Fair value**	**%**
AAA	126,636	43%	125,595	43%
AA	47,817	16%	50,040	17%
A	80,662	28%	81,816	28%
BBB	30,131	10%	28,156	10%
BB	2,098	1%	1,420	1%
B	2,370	1%	1,741	1%
CCC	1,948	1%	184	—%
Unrated	1,219	—%	1,353	—%
Total	292,881	100%	290,305	100%

Preferred share portfolio

A breakdown of the preferred shares portfolio by credit rating is shown below as at March 31, 2018 and December 31, 2017:

	As at March 31, 2018		As at December 31, 2017	
	Fair value	**%**	**Fair value**	**%**
P2	35,879	85%	36,335	85%
P3	6,400	15%	6,419	15%
Total	42,279	100%	42,754	100%

12 Intangible assets

A reconciliation of the movement in Intangible Assets is shown below, as at March 31, 2018 and December 31, 2017:

	Opening cost	Additions	Disposals	End of period cost	Accumulated amortization	Net
Software						
March 31, 2018	33,210	1,775	—	34,985	26,690	8,295
December 31, 2017	28,712	4,498	—	33,210	25,573	7,637
Goodwill						
March 31, 2018	400	—	—	400	—	400
December 31, 2017	400	—	—	400	—	400
Total intangible assets						
March 31, 2018	33,610	1,775	—	35,385	26,690	8,695
December 31, 2017	29,112	4,498	—	33,610	25,573	8,037

13 Income taxes

The income tax is as follows:

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

	3 months ended March 31	
	2018	**2017**
Current	(51)	1,476
Deferred	(638)	190
	(689)	1,666

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 company's effective tax rate in the first quarter of 2018, reflects the recognition of a deferred tax asset from the utilization of capital losses though the transfer of information technology assets. The capital losses arose from the sale of the company's European and US subsidiaries.

The difference is broken down as follows:

	3 months ended March 31	
	2018	**2017**
Income tax expense calculated at statutory rates	27.0 %	27.0 %
Increase (decrease) in income tax rates resulting from:		
Non-taxable dividend income	(2.6)%	(1.1)%
Non-deductible expenses	(0.2)%	0.3 %
Tax benefit of losses not previously recognized	(43.7)%	— %
Tax benefit of losses recognized	— %	(1.5)%
Statutory rate differences	(0.7)%	(0.1)%
Non-taxable portion of capital gains	1.4 %	(6.5)%
Other	4.4 %	0.1 %
Effective income tax rate	(14.4)%	18.2 %

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

14 Operating Costs by nature

The table below presents operating costs by major category:

	3 months ended March 31	
	2018	**2017**
Salaries and benefits	5,318	4,077
Systems costs	1,967	2,124
Professional fees	831	816
Occupancy	495	388
Severance	303	—
Other expenses	440	(15)
	9,354	7,390

15 Operating lease commitments

The Company is committed under lease agreements for office and property operating leases with minimum lease payments of $10,429 as at March 31, 2018:

Lease commitments	
2018	1,334
2019	1,696
2020	1,417
2021	1,417
2022	1,364
2023 and thereafter	3,201
	10,429

16 Accumulated other comprehensive income

A breakdown of the accumulated other comprehensive income is shown below as at March 31, 2018 and December 31, 2017:

	As at March 31, 2018	**As at December 31, 2017**
Gross unrealized losses	(4,097)	(3,966)
Foreign currency translation adjustments	499	499
Tax impact	658	634
Ending balance	(2,940)	(2,833)

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

17 Earnings per share

Earnings per share is calculated in the following table:

	3 months ended March 31	
Earnings Per Share on Continued Operations	**2018**	**2017**
Basic earnings per share on continued operations:		
Net income available to shareholders	5,826	7,455
Average number of common shares	11,907	11,783
Basic earnings per share on continued operations	$0.49	$0.63
Diluted earnings per share:		
Average number of common shares	11,907	11,783
Average number of dilutive common shares under employee stock compensation plan	278	235
Average number of diluted common shares	12,185	12,018
Diluted earnings per share on continued operations	$0.48	$0.62

	3 months ended March 31	
Earnings Per Share on Discontinued Operations	**2018**	**2017**
Basic (loss) per share on discontinued operations:		
Net (loss) available to shareholders	—	(7,268)
Average number of common shares	11,907	11,783
Basic (loss) per share on discontinued operations	$0.00	$(0.62)
Diluted earnings per share:		
Average number of common shares	11,907	11,783
Average number of dilutive common shares under employee stock compensation plan	278	235
Average number of diluted common shares	12,185	12,018
Diluted (loss) per share on discontinued operations	$0.00	$(0.62)

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

	3 months ended March 31	
Total Earnings Per Share	**2018**	**2017**
Basic earnings per share:		
Net income available to shareholders	5,826	187
Average number of common shares	11,907	11,783
Basic earnings per share	$0.49	$0.02
Diluted earnings per share:		
Average number of common shares	11,907	11,783
Average number of dilutive common shares under employee stock compensation plan	278	235
Average number of diluted common shares	12,185	12,018
Diluted earnings per share	$0.48	$0.02

18 Discontinued operations

On August 4, 2016, Echelon entered into a definitive stock purchase agreement to sell its European insurance subsidiary, subject to regulatory approval. On February 28, 2017, regulatory approval was received from the Danish Financial Supervisory Authority, which completed the necessary approvals required for the sale. The Company completed the sale on March 7, 2017, and has retained no residual insurance risk or other financial risk other than credit risk associated with the loan receivable from the sale.

	3 months ended March 31	
	2018	**2017**
Revenue		
Gross written and assumed premiums	—	15,896
Net written premium	—	12,784
Decrease in provision for unearned premium	—	6,173
Net earned premiums	—	18,957
Investment (loss)	—	(10,562)
Total revenue	—	8,395
Expenses		
Net incurred claims	—	10,392
Net acquisition costs	—	6,254
Operating costs	—	1,067
Total expenses	—	17,713
(Loss) before income taxes	—	(9,318)
Income tax (recovery)	—	(2,050)
Net (loss) on discontinued operations	—	(7,268)
Other comprehensive income on discontinued operations	—	7,268
Comprehensive income on discontinued operations	—	—

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

19 Non-controlling interest

The Company has non-controlling interests attributable to the subsidiary of ICPEI, please refer to Note 1. The following tables summarize the comprehensive income attributable to the non-controlling shareholders:

	3 months ended March 31	
	2018	**2017**
Revenue		
Gross written and assumed premiums	1,690	1,641
Net earned premiums	1,793	1,630
Investment income	58	131
Total revenue	1,851	1,761
Expenses		
Net incurred claims	1,418	1,118
Net acquisition costs	461	428
Operating costs	243	205
Total expenses	2,122	1,751
(Loss) income before income taxes	(271)	10
Income tax (recovery)	(87)	(1)
Net (loss) income attributable to NCI	(184)	11
Other comprehensive (loss) income attributable to NCI	(10)	17
Comprehensive (loss) income attributable to NCI	(194)	28

The following tables are the net assets of the non-controlling shareholders as at March 31, 2018 and December 31, 2017:

	March 31, 2018	**December 31, 2017**
Assets		
Cash and investments	9,131	9,430
Other assets	4,956	5,018
Total assets	14,087	14,448
Liabilities		
Unearned premium	3,745	4,048
Unpaid claims	6,308	6,062
Other liabilities	400	508
Total liabilities	10,453	10,618
Equity		
Share capital	—	—
AOCI	(119)	(109)
Retained earnings	3,753	3,939
Total equity	3,634	3,830
Total liabilities and equity	14,087	14,448

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

The prior year 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 March 31, 2018	**As at December 31, 2017**
Cash flow from operating activities	(251)	70
Cash flow from investing activities	(80)	(720)
Net increase (decrease) in cash and short-term deposits	(331)	(650)

20 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 non-standard automobile insurance and insurance for motorcycles, antique and classic vehicles, trailers, motor-homes, recreational vehicles and personal property.

Through its Commercial Lines, the Company designs and underwrites specialized insurance programs, such as commercial property, commercial automobile, long-haul trucking, surety, liability, creditor insurance, and extended warranty.

The European operations are discontinued. Please refer to note 18.

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.

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

The following tables summarize the net income before interest and income taxes by Personal and Commercial Lines:

	3 months ended March 31	
	2018	**2017**
Revenue		
Net earned premiums		
– Personal Lines	45,820	36,994
– Commercial Lines	25,702	12,031
Total net earned premium	71,522	49,025
Net claims incurred		
– Personal Lines	29,275	23,108
– Commercial Lines	12,465	5,760
Total net claims incurred	41,740	28,868
Net expenses		
– Personal Lines	14,566	11,996
– Commercial Lines	11,990	5,271
Total	26,556	17,267
Corporate Expenses	1,979	2,174
Total net expenses	28,535	19,441
(Loss) income before income taxes		
– Personal Lines	1,979	1,890
– Commercial Lines	1,247	1,000
Total	3,226	2,890
Corporate and other	(1,979)	(2,174)
Underwriting income	1,247	716
Impact of change in net claims discount rate	2,050	—
Severance expense	(303)	—
Investment income	1,959	8,487
Total income before interest expense and income taxes	4,953	9,203