echelon
Insurance

ECHELON FINANCIAL HOLDINGS INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended June 30, 2018

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MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended June 30, 2018

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

Important Note:

The condensed consolidated interim financial statements for the quarters ended June 30, 2018, and 2017 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 policies applied in the condensed consolidated interim financial statements are based on IFRS and have been consistent with those of the previous financial year except for the ones explained in note 3 in the condensed financial statements.

The following discussion should be read in conjunction with EFH's unaudited condensed consolidated interim financial statements for the second quarter of fiscal 2018 and 2017, with the notes to the condensed consolidated interim financial statements, and with management's discussion and analysis (MD&A) and audited annual consolidated financial statements and accompanying notes in the Company's 2017 Annual Report. The financial data in this discussion has been prepared in accordance with IFRS and has been derived from the unaudited consolidated interim financial statements for the six months ended June 30, 2018 and 2017.

The following commentary is current as of August 8, 2018. Additional information relating to EFH is available on SEDAR at www.sedar.com. Certain totals, subtotals and percentages may not reconcile due to rounding.

EFH 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 operating income and underwriting ratios such as combined, expense and loss ratios, which are non-IFRS measures. Underwriting income is defined as net earned premiums less net claims incurred, net acquisition expenses, general expenses, integration costs and excludes any impact of change in discount rate on claims and non-recurring items.

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 of EFH for 2018 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 EFH and its business, and could cause actual results to differ materially from the expectations expressed in any of this forward-looking information.

COMPANY OVERVIEW

EFH operates in the property and casualty (“P&C”) insurance industry 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. The Company underwrites automobile insurance and other specialty insurance products, with a focus on niche under-served markets. It has two lines of insurance business – 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, motor-homes, recreational vehicles and personal property. Commercial Lines designs and underwrites Commercial Property, Commercial Automobile, Surety, Liability, and Specialty Programs.

On March 7, 2017, the Company completed the sale of its European operations. The European operation results are referred to as discontinued operations in this document.

EFH intends to grow its business profitably across Canada by offering a complete and diverse suite of products to its brokers, with an ability to transact efficiently through modern systems. EFH currently intends to use any excess capital in addition to capital generated from its operations to fund its growth.

SECOND QUARTER HIGHLIGHTS

- Net operating income on continued operations of $0.24 per share compared to $0.28 per share in the second quarter of 2017.
- A combined operating ratio of 97% compared to 94% in the second quarter of 2017.
- A 33% increase in direct written premiums over the same period in 2017 to $112.8 million as a result of organic growth in Personal and Commercial Lines nationally.
- A pre-tax gain on invested assets of $2.5 million in the quarter compared to a pre-tax gain of $0.1 million in the prior year quarter, as a result of positive returns from both the Fixed Income and Preferred Share portfolios.
- Closing book value per share of $12.88, an increase of $0.41 or 3% from the first quarter of 2018. This increase was driven by positive underwriting income, and investment returns.

The financial information below compares three and six months ended June 30, 2018 results with the same period in 2017.

	3 months ended June 30		6 months ended June 30	
($ THOUSANDS except per share amounts)	**2018**	**2017**	**2018**	**2017**
Direct written and assumed premiums	112,833	85,035	192,120	139,621
Net written premiums	107,224	78,985	186,466	129,061
Net earned premiums	75,280	53,448	146,802	102,473
Net claims incurred	48,997	31,808	90,737	60,676
Net acquisition costs	17,676	11,934	37,141	23,985
Operating expenses	8,243	8,229	17,313	15,619
Underwriting income	364	1,477	1,611	2,193
Severance recovery / (expense)	15	(89)	(288)	(89)
Investment income	2,759	2,977	4,718	11,464
Impact of discount rate on claims	2,039	—	4,114	—
Net income before interest and income taxes	5,177	4,365	10,155	13,568
Interest expense	—	84	—	155
Income tax expense	1,213	1,088	524	2,754
Net income	3,964	3,193	9,631	10,659
Net income attributable to shareholders	4,020	3,142	9,871	10,597
Net operating income attributable to shareholders	2,935	3,338	6,476	5,654
Earnings per share				
Basic	$0.34	$0.27	$0.83	$0.90
Diluted	$0.33	$0.26	$0.81	$0.88
Net operating income per share – diluted (1)	$0.24	$0.28	$0.53	$0.47
Trailing twelve month return on equity (ROE) - continuing operations (2)	8.9%	9.7%	8.9%	9.7%

(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, and non-recurring items. Net investment income consists of interest income, dividend income and premium financing charges, less investment expense, as per Note 6 of the Company's Consolidated 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 and Net Earned Premiums

In the second quarter of 2018, direct written premiums increased by 33% while net earned premiums increased by 41% compared to the same prior-year period. The increase in premium was driven by organic growth in both Personal and Commercial line products supported by Commercial Line rate increases.

Claims Incurred

For the quarter ended June 30, 2018, net claims expense increased by 54% driven by a reduction in claim redundancies compared to the prior period.

Net favourable development, excluding the impact of discounting, on prior year claims of $4.7 million was recorded in the second quarter of 2018 compared to net favourable development of $7.8 million in the same period in 2017.

Acquisition Costs

Acquisition costs, which consist mainly of commissions, premium taxes and a portion of general expenses related to policy acquisitions, increased by 48%, in the quarter ended June 30, 2018. This increase is slightly higher than the growth in earned premiums due to the change in the Company's business mix.

Operating Expenses

Operating expenses were flat in the second quarter of 2018 compared to the comparative quarter, despite growth in earned premiums. The lower expense ratio reflects the additional efficiencies realized through the deployment of the Company's policy management system, *Passport*.

Underwriting Income

Underwriting income of $0.4 million was recorded in the second quarter of 2018 compared to underwriting income of $1.5 million in the same period in 2017, due to lower underwriting income in Commercial Lines. Including the impact of discounting, underwriting income was $2.6 million for the quarter compared to $3.5 million in the prior year quarter.

Investment Income

Investment income was $2.8 million in the second quarter compared to $3.0 million in the second quarter of 2017.

Net Income before Income Taxes

Net income before taxes increased to $5.2 million in the second quarter compared to income of $4.4 million in the second quarter of 2017, primarily due to a greater impact from the change in discount rate on claims liabilities.

Income Taxes

For the quarter ended June 30, 2018, the provision for income taxes reflects an expense of $1.2 million compared to an expense of $1.1 million for the same period last year.

SEGMENTED FINANCIAL INFORMATION (Continued Operations)

The segmented results below exclude corporate expenses and the impact of change in claims discount rates.

TOTAL OPERATIONS

	3 months ended June 30				6 months ended June 30			
($THOUSANDS)	**2018**	**2017**	**$ Change**	**% Change**	**2018**	**2017**	**$ Change**	**% Change**
Direct written premiums	112,833	85,035	27,798	33	192,120	139,621	52,499	38
Net earned premiums	75,280	53,448	21,832	41	146,802	102,473	44,329	43
Net claims:								
Current year claims	53,661	39,653	14,008	35	99,025	71,802	27,223	38
Current year loss ratio	71.3%	74.2%			67.5%	70.1%		
Favourable prior year claims development	4,664	7,845	(3,181)	(41)	8,288	11,126	(2,838)	(26)
Total net claims	48,997	31,808	17,189	54	90,737	60,676	30,061	50
Loss ratio	65.1%	59.5%			61.8%	59.2%		
Expense ratio	31.4%	34.0%			34.2%	34.6%		
Combined ratio	96.5%	93.5%			96.0%	93.8%		
Underwriting income	2,649	3,469	(820)	(24)	5,875	6,359	(484)	(8)

PERSONAL LINES

	3 months ended June 30				6 months ended June 30			
($THOUSANDS)	**2018**	**2017**	**$ Change**	**% Change**	**2018**	**2017**	**$ Change**	**% Change**
Direct written premiums	73,858	59,099	14,759	25	119,262	96,419	22,843	24
Net earned premiums	48,844	39,317	9,527	24	94,664	76,311	18,353	24
Net claims:								
Current year claims	36,452	32,056	4,396	14	68,072	58,344	9,728	17
Current year loss ratio	74.6%	81.5%			71.9%	76.5%		
Favourable prior year claims development	2,616	6,180	(3,564)	(58)	4,961	9,360	(4,399)	(47)
Total net claims	33,836	25,876	7,960	31	63,111	48,984	14,127	29
Loss ratio	69.3%	65.8%			66.7%	64.2%		
Expense ratio	27.2%	30.8%			29.5%	31.6%		
Combined ratio	96.5%	96.6%			96.2%	95.8%		
Underwriting income	1,641	1,350	291	22	3,620	3,240	380	12

Second quarter 2018

Personal Lines recorded underwriting income of $1.6 million compared to an underwriting income of $1.4 million in the same period last year. Direct written premiums increased by 25% in the quarter due to organic growth in Personal Auto, particularly in Ontario.

This segment’s combined ratio was unchanged at 97% in the quarter with noteable changes in:

1. Improved personal property results nationally due to reduced severity and frequency over the prior year quarter.
2. Stronger motorcycle results nationally due to an improvement in current accident year results over the prior year quarter.
3. The above factors were offset by a reduction in favorable development on prior year claims.

Year-to-date 2018

Personal Lines recorded an underwriting income of $3.6 million compared to an underwriting income of $3.2 million in the same period last year.

This segment’s combined ratio was unchanged at 96% for the year with specific changes in:

1. Strong motorcycle results in all regions due to strong current accident year results.
2. Reduced expense ratio as efficiencies from the new policy system are realized.
3. Offset by reduced favourable development on prior year claims.

COMMERCIAL LINES

	3 months ended June 30				6 months ended June 30			
($THOUSANDS)	**2018**	**2017**	**$ Change**	**% Change**	**2018**	**2017**	**$ Change**	**% Change**
Direct written premiums	38,975	25,936	13,039	50	72,858	43,202	29,656	69
Net earned premiums	26,436	14,131	12,305	87	52,138	26,162	25,976	99
Net claims:								
Current year claims	17,209	7,597	9,612	127	30,953	13,458	17,495	130
Current year loss ratio	65.1%	53.8%			59.4%	51.4%		
Favourable prior year claims development	2,048	1,665	383	23	3,327	1,766	1,561	88
Total net claims	15,161	5,932	9,229	156	27,626	11,692	15,934	136
Loss ratio	57.4%	42.0%			53.0%	44.7%		
Expense ratio	38.8%	43.0%			42.7%	43.4%		
Combined ratio	96.2%	85.0%			95.7%	88.1%		
Underwriting (loss) / income	1,008	2,119	(1,111)	(52)	2,255	3,119	(864)	(28)

Second quarter 2018

Commercial Lines recorded an underwriting income of $1.0 million compared to $2.1 million in the same period last year. Direct written premiums increased by 50% in the quarter primarily due to organic growth in commercial auto and commercial property, supported by rate increases.

This segment's combined ratio deteriorated to 96% from an exceptional 85% in the prior year quarter as a result of the following factors:

1. Weaker Commercial Property and Liability results due to a few large fire-related losses in Western Canada.
2. Weaker results from warranty due to a large loss in the period.
3. Offset by improved Surety results in the period.

Year-to-date 2018

Commercial Lines recorded an underwriting income of $2.3 million, a decrease of $0.9 million. Direct written premiums increased by 69% for the year primarily due to the launch of Commercial Auto and Surety in 2016.

This segment's combined ratio deteriorated to 96% for the year due to:

1. Weaker results from commercial auto compared to the same period in the prior year.
2. Weaker results in warranty compared to the same period in the prior year.
3. Offset by improved performance in Surety line and greater favourable prior year claims development.

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. As part of the sale, 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. The loan interest rate on the principal amount outstanding was six percent (6%) per annum, it commenced on July 6, 2017 and was payable monthly. On December 29, 2017, the Company received 59.4 million DKK as a partial repayment of the principal amount of the loan. The Company extended the maturity date for the outstanding balance of the loan with NNGL from December 31, 2017 to May 27, 2018 and further to July 20, 2018. The loan outstanding amount was repaid on June 29, 2018.

Please refer to Note 7 and Note 18 of the Financial Statements for further details.

SUMMARY OF QUARTERLY RESULTS

A summary of the Company's last eight quarters (after all corporate expenses) is as follows:

	2018		2017				2016	
($ THOUSANDS except per share amounts)	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**
Direct written and assumed premiums	112,833	79,287	68,050	78,047	85,035	54,586	49,403	58,171
Net earned premiums and other revenue	75,280	71,522	64,906	60,017	53,448	49,025	46,013	46,452
Underwriting income (loss)	364	1,247	(11,208)	(3,428)	1,477	716	2,555	(429)
Impact of change in net claims discount rate	2,039	2,050	1,220	2,034	—	—	(1,370)	(1,452)
Investment Income	2,759	1,959	3,316	2,416	2,977	8,487	3,159	4,487
One time recovery (expense)	15	(303)	(87)	(86)	(89)	—	(769)	(984)
Income (loss) before interest expense and income taxes	5,177	4,953	(6,759)	936	4,365	9,203	3,575	1,622
Net income (loss)	3,964	5,642	(4,826)	810	3,193	7,466	2,602	1,402
Net operating income (loss)	2,935	3,541	(6,252)	1,211	3,338	2,316	4,857	1,580
Earnings (loss) per adjusted share								
(a) Basic	$0.34	$0.49	($0.42)	$0.07	$0.27	$0.63	$0.22	$0.10
(b) Diluted	$0.33	$0.48	($0.42)	$0.07	$0.26	$0.62	$0.22	$0.10
Net operating income (loss) per share - diluted	$0.24	$0.29	($0.51)	$0.10	$0.28	$0.19	$0.40	$0.13
Selected financial ratios								
Loss ratio	65.1%	58.4%	81.4%	72.2%	59.5%	58.9%	55.8%	61.5%
Expense ratio	34.4%	39.9%	35.8%	33.5%	37.7%	39.6%	38.6%	39.4%
Combined ratio	99.5%	98.3%	117.2%	105.7%	97.2%	98.5%	94.4%	100.9%
Book value per share	$12.88	$12.47	$12.01	$12.14	$12.25	$12.10	$11.70	$12.90

The quarterly results reflect the seasonality of the Company's business. While net earned premiums are relatively stable from quarter to quarter, underwriting results may vary significantly by quarter as they are affected by seasonality, as described in Note 5 of the Financial Statements.

Net Operating Income

($ THOUSANDS except per share amounts)	3 months ended June 30 2018	3 months ended June 30 2017	6 months ended June 30 2018	6 months ended June 30 2017
Net investment income [1]	3,414	2,456	6,560	4,744
Underwriting income [2]	364	1,477	1,611	2,193
Add: Catastrophe losses	—	548	—	604
Pre-tax operating income	3,778	4,481	8,171	7,541
Income tax	(899)	(1,092)	(1,935)	(1,825)
Net operating income	2,879	3,389	6,236	5,716
Minority interest	56	(51)	240	(62)
Net operating income attributable to shareholders	2,935	3,338	6,476	5,654
Net operating income per share - diluted	$0.24	$0.28	$0.53	$0.47

[1] Net investment income consists of interest income, dividend income and premium financing charges, less investment expense, as per Note 6 of the Company's Financial Statements.

[2] Underwriting income excludes impact of change in claims discount rates, and non-recurring items.

BALANCE SHEET ANALYSIS

The Balance Sheet analysis that follows should be read in conjunction with the condensed consolidated interim financial statements for the second quarter of 2018, and notes therein.

Balance Sheet Highlights

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

($ THOUSANDS except per share amounts)	As at June 30, 2018	As at December 31, 2017
Cash and short-term deposits	55,152	44,459
Investments	371,568	370,933
Total assets	641,055	590,586
Provision for unpaid claims	262,281	262,966
Unearned premiums	201,980	160,577
Total equity attributable to shareholders	153,570	142,822
Book value per share [1]	$12.88	$12.01
MCT Ratio - Echelon Insurance	231%	212%
- ICPEI	315%	355%

[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 in line with its risk appetite and tolerance. 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 accordance with its investment policy. Fair values for most investments are determined by reference to observable market data.

Fair Value of Investments

The following table sets forth EFH's invested assets as at June 30, 2018 and December 31, 2017.

($ Thousands)	**Fair values**			
Available-for-sale	**As at June 30, 2018**	**% of Total**	**As at December 31, 2017**	**% of Total**
Fixed income				
Canadian				
Federal	33,090		39,408	
Provincial	43,413		29,883	
Municipal	895		14	
Corporate	126,332		127,701	
	203,730		197,006	
Fixed income lent through securities lending program				
Federal	62,999		63,864	
Provincial	6,051		17,564	
Municipal	832		1,322	
Corporate	8,564		8,535	
	78,446		91,285	
Foreign fixed income				
Corporate	5,773		2,014	
Foreign fixed income lent through securities lending program				
Corporate	484		—	
Total fixed income	288,433	68%	290,305	70%
Corporate value pooled fund	4,997		—	
Money market pooled funds	488		1,014	
Short-term fixed income and mortgage pooled funds	14,416		19,303	
Specialty pooled fund	9,236		7,385	
Total pooled funds	29,137	7%	28,557	7%
Common shares				
Canadian	1,141		889	
Foreign	1,426		1,043	
Global Equity Pooled Fund	7,590		7,385	
Total common shares	10,157	2%	9,317	2%
Total available for sale	327,727		328,179	
Fair value through profit or loss				
Preferred shares	43,808		42,754	
Preferred shares lent through securities lending program	33		—	
Total preferred shares	43,841	10%	42,754	10%
Total investments	371,568	87%	370,933	89%
Cash and short-term deposits	55,152	13%	44,459	11%
Total investments including cash and short-term deposits	426,720	100%	415,392	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 were no impairments recognized during the six months ended June 30, 2018 and 2017.

A gross unrealized loss of $3.3 million (December 31, 2017 – $3.3 million) on investments held as at June 30, 2018, is recorded, net of tax, in the amount of $2.4 million (December 31, 2017 – $2.4 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.

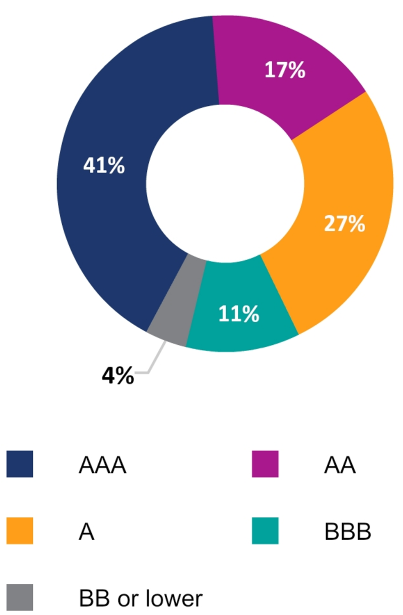
Fixed Income Securities

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.

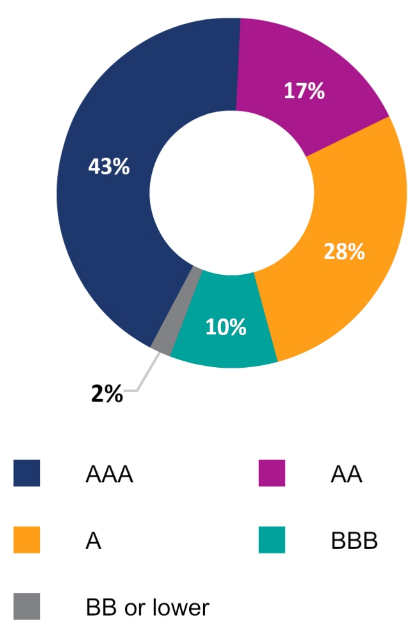
EFH's bond portfolio has a high overall credit quality with an average rating of AA. The preferred shares have an average rating of P2. The duration of the bond portfolio is 2.7 years.

The charts below show EFH's fixed income and preferred share portfolios by credit quality as at June 30, 2018 compared to December 31, 2017.

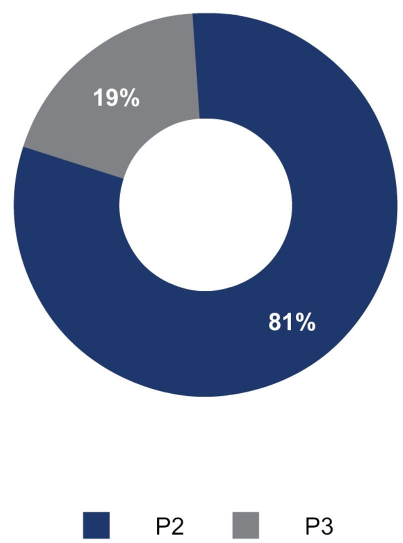
Bond Ratings Q2 2018
As at June 30, 2018



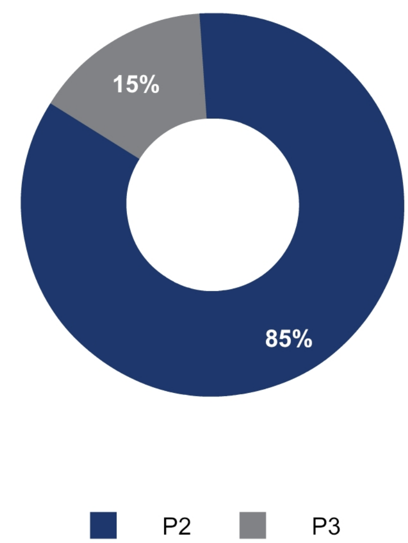
Bond Ratings Q4 2017
As at December 31, 2017



Preferred Shares Q2 2018
As at June 30, 2018



Preferred Shares Q4 2017
As at December 31,2017



Sector Mix by Asset Class

The following table shows sector exposure by asset class as at June 30, 2018:

Sector	Fixed Income Securities & Pooled Funds [1]	Preferred Shares	Common Shares	Total
Government	49%	—	—	42%
Financial Services	26%	51%	12%	27%
Infrastructure	10%	—	—	8%
Industrial Products	4%	13%	17%	6%
Utilities	—	31%	2%	4%
Energy	3%	—	1%	3%
Pipelines	3%	5%	—	3%
Telecommunication	2%	—	5%	2%
Consumer Discretionary	—	—	31%	1%
Technology	—	—	18%	1%
Other	3%	—	14%	3%
Total	100%	100%	100%	100%
Total	$316,412	$43,841	$10,157	$370,410

[1] Fixed income securities and pooled funds do not include any cash being carried by the pooled funds, $1.1 million as at June 30, 2018.

Common Share Portfolio

As at June 30, 2018, 11% of the common share portfolio was invested in Canadian equities.

Recoverable from Reinsurers

($ THOUSANDS)	As at June 30, 2018	As at December 31, 2017
Reinsurers’ share of unpaid claims	24,888	23,471
Reinsurers’ share of unearned premiums	11,693	9,957
Total	36,581	33,428

As at June 30, 2018, the recoverable from reinsurers decreased by $3.2 million, or 9%, to $36.6 million from $33.4 million as at December 31, 2017. The reinsurers share of unearned premium remained unchanged while the decrease in reinsurers share of unpaid claims was due to an increase in discount rates. 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 June 30, 2018	As at December 31, 2017
Premium financing receivables	65,331	53,538
Agents and brokers	34,753	17,215
Other	5,851	4,869
Total	105,935	75,622

Premium financing receivables represent 62% of total receivables as at June 30, 2018. Premium financing receivables increased to $65.3 million at June 30, 2018, from $53.5 million at December 31, 2017, due to the growth in direct bill premiums. Agent and broker receivables increased from $17.2 million in 2017 to $34.8 million in 2018 due to growth in broker billed premiums.

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 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 discount rates used for June 30, 2018 and December 31, 2017 for the following entities are below:

Entity	As at June 30, 2018	As at December 31, 2017
Echelon Insurance	3.48%	2.65%
ICPEI	3.25%	2.80%

Share Capital

As of August 8, 2018, there were 11,923,354 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 $1.1 million is due in less than a year and $11.1 million is due over the next eight 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 June 30, 2018, was $157.2 million compared to $146.7 million at December 31, 2017.

The Minimum Capital Test (MCT) ratio of the Company's subsidiary, Echelon Insurance, as at June 30, 2018, was 231%, which comfortably exceeds the supervisory regulatory capital level required by the Office of the Superintendent of Financial Institutions (OSFI). ICPEI's MCT ratio of 315% was in excess of provincial supervisory targets. As at June 30, 2018, the Company has approximately $27 million of excess deployable capital invested in equities and liquid assets in the holding company.

ACCOUNTING POLICIES

The unaudited condensed consolidated interim financial statements have been prepared in accordance with IFRS and in compliance with IAS 34 "Interim Financial Reporting." Please refer to note 3 of the unaudited condensed consolidated interim financial statements for the quarter ended June 30, 2018.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company's 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 June 30, 2018, 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 June 30, 2018, 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 June 30, 2018, 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.

A new policy management system is being rolled out across the country and management is satisfied that sufficient internal controls over financial reporting are in place during the transition and partial completion of the project.

CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

For a description of EFH's accounting policies, which are on an IFRS basis, refer to note 3 in the unaudited condensed consolidated interim financial statements for the quarter ended June 30, 2018. A description of EFH's critical accounting estimates and assumptions is also detailed in note 4 of the interim financial statements.

GLOSSARY OF SELECTED INSURANCE TERMS

“Acquisition costs” commissions, premium taxes and a portion of general expenses related to policy acquisitions.

“Acquisition Expense ratio” for any period means the sum of the acquisition costs divided by Net earned premiums.

“Broker” an intermediary who negotiates policies of insurance or reinsurance with insurers on behalf of the insured or reinsured, receiving a commission from the insurer or the reinsurer for placement and other services rendered.

"Catastrophe event" or **"CAT event"** refers to a group of claims from a specific event considered to be non-recurring and therefore not reflective of normal operating performance.

“Catastrophe reinsurance” a form of insurance, which subject to specified limits, indemnifies the ceding company for the amount of loss in excess of a specified retention amount with respect to an accumulation of losses resulting from a CAT event.

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

“Ceded earned premiums” means ceded written premium during the period, plus the ceded unearned premiums reserve at the beginning of the period, less the ceded unearned premiums reserve at the end of the period.

“Ceded written premiums” of an insurer for any period means the total insurance premiums written transferred by the insurer to a reinsurer during such period.

“Claim” the amount owed by an insurer or reinsurer pursuant to a policy of insurance or reinsurance arising from the loss relating to an insured event.

“Claims development” a non-IFRS measure representing the change in reserve balance on unpaid claims through the process of adjudication from the initial estimate to the ultimate amount paid. The difference between prior year end estimates of ultimate undiscounted claim costs and the current estimates for the same block of claims. A favourable development represents a reduction in the estimated ultimate claim costs during the period for that block of claims. An unfavourable development represents an increase in the estimated ultimate claims costs during the period.

“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 insurance premiums written by the insurer during such period.

“Expense ratio” for any period means the sum of the acquisition expense ratio and the general expense ratio.

“Frequency of claims” the ratio of the number of claims files opened in a period to the total number of policies in force. A measure of how often a claim is reported as a function of policies in force.

“General Expense ratio” for any period means the sum of all general expenses divided by Net earned premiums.

“Gross earned premiums” means written premium during the period, plus the unearned premiums reserve at the beginning of the period, less the unearned premiums reserve at the end of the period.

“Incurred but not reported (IBNR)” the estimate of claims incurred but not yet reported by policyholders and not enough case reserve.

“Large Loss” is a single claim in excess of $100,000.

“Line of business” the major product groupings offered to the public.

“Market yield adjustment (MYA)” a non-IFRS measure representing the impact of changes in the discount rate on claims liabilities, the provision for adverse deviation (PFADs) and other discounting assumptions based on the change in the market-based yield of the underlying assets.

“Minimum Capital Test” means the regulatory guideline under which a federally regulated insurer is measured for the adequacy of its capital.

“Net earned premiums” of an insurer is the gross earned premiums less the ceded earned premiums.

“Net Operating Income” means net income plus or minus the after tax impact of change in market yield adjustment, 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 for any period means direct written premiums less ceded written premiums.

“Property and casualty (P&C) insurance” all insurance excluding life insurance and governmental insurance. Also known as general insurance.

“Provision for adverse deviation (PFAD)” margins that are added to loss reserves to provide for adverse deviation from claims reserve estimates; this includes provisions covering claims development variability and risks associated with interest rate and reinsurance recoveries.

“Reinsurance” means an arrangement in which an insurance company agrees to indemnify another insurance or reinsurance company against all or a portion of the insurance or reinsurance risks underwritten by the ceding company under one or more policies.

“Retention” has two meanings: (1) in respect of reinsurance, the amount of risk not ceded to reinsurers; (2) in respect to policies in force, the number of policyholders who renew for a subsequent term.

“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.

“Underwriting income or loss” a non-IFRS measure calculating the profit or loss from the activity of taking on insurance risks, excluding the impact of the market yield adjustment.

“Unearned commissions” means the portion of reinsurance commissions within a policy term which have not yet earned.

“Unearned premiums” means the portion of premiums within a policy term which have not yet earned.

“Unearned premiums recoverable” means the portion of ceded written premiums within a policy term which have not yet earned.