

**ECHELON FINANCIAL HOLDINGS INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**For the six months ended June 30, 2019**

## TABLE OF CONTENTS

COMPANY OVERVIEW .....	4
BASIS OF PRESENTATION .....	4
SECOND QUARTER HIGHLIGHTS.....	4
SUBSEQUENT EVENT .....	8
SUMMARY OF QUARTERLY RESULTS (to be updated) .....	8
BALANCE SHEET ANALYSIS .....	9
LIQUIDITY AND CAPITAL MANAGEMENT .....	13
ACCOUNTING POLICIES.....	13
CONTROLS AND PROCEDURES.....	13
CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS.....	14

## MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended June 30, 2019

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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, 2019, and 2018 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 2019 and 2018, 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 for 2018. 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, 2019 and 2018.

The following commentary is current as of August 2, 2019. Additional information relating to EFH is available on SEDAR at [www.sedar.com](http://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 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 corporate expenses.

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 2019 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 The Insurance Company of Prince Edward Island ("ICPEI"), a provincially regulated P&C insurance company.

On November 9, 2018, the Company entered into a definitive agreement to sell Echelon Insurance, its main operating subsidiary, and the unregulated warranty business of Echelon Financial Holdings Inc. ("Discontinued Operations") and the sale was completed on May 31, 2019.

After the sale of Echelon Insurance and the unregulated warranty business of Echelon Financial Holdings Inc., the Company has insurance operations in ICPEI and investments and cash in Echelon Financial Holdings Inc. It also owns CIM Re in Barbados which is dormant and in the process of being wound up.

## BASIS OF PRESENTATION

This MD&A is based on information in the audited consolidated financial statements and accompanying notes thereto for the year ended December 31, 2018 and the unaudited consolidated interim financial statements for the six months ended June 30, 2019.

As a result of the Company's sale of Echelon Insurance and the unregulated warranty business of Echelon Financial Holdings Inc., the results of these operations have been presented as discontinued operations and the Company's operational results have been retroactively restated, as required. See the Discontinued Operations section of this MD&A.

### Adoption of IFRS 16

The company has adopted IFRS 16 from January 1, 2019 using the modified approach, and has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening balance sheet on January 1, 2019.

On adoption of IFRS 16, right-of-use assets are measured at the amount of the initial measurement of the lease liability. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. The Company recognized lease liabilities in relation to leases which had previously been classified as operating leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as of January 1, 2019. The incremental borrowing rate applied to the lease liabilities on January 1, 2019 was based on the prime rate plus a margin of 1.3%. The Company considered the leases as renewable and therefore did not consider short term or low value leases.

The change in accounting policy affected occupancy and printing equipment leases in the balance sheet on January 1, 2019 and the net impact on retained earnings on January 1, 2019 was a decrease of \$4,000.

## SECOND QUARTER HIGHLIGHTS

- The sale of Echelon Insurance and the unregulated warranty business of Echelon Financial Holdings Inc. was completed on May 31, 2019. The gain of sale, net of expenses and taxes was \$56.2 million. The operations of discontinued businesses to the closing of May 31, 2019 lost \$0.8 million in the second quarter. Net income of Discontinued Operations in this quarter was \$55.4 million.
- Net income of \$4.55 per share diluted compared to \$0.33 per share diluted in the second quarter of 2018. Net Income on continued operations of \$0.01 per share diluted compared to a loss of \$0.02 per share diluted in the second quarter of 2018.
- Direct written premiums increased by \$0.5 million over the same period in 2018 to \$11.0 million as the Company is cautious in writing business while it is awaiting implementation of rate increases.

- Investment income in the quarter was comparable to same period last year.
- Closing book value per share of \$7.48, has decreased despite Net Income per share of \$4.55 for the quarter because the Company paid a dividend of \$8.80 per share in this quarter.

The financial information below compares three and six months ended June 30, 2019 results with the same period in 2018, as restated.

(\$ THOUSANDS except per share amounts)	3 months ended		6 months ended	
	June 30		June 30	
	2019	2018	2019	2018
Direct written and assumed premiums	10,972	10,425	17,929	17,184
Net earned premiums	7,921	7,497	15,462	14,668
Net claims incurred	4,853	4,933	9,405	10,698
Net acquisition costs	1,701	1,896	3,364	3,740
Operating expenses	1,239	1,214	2,162	2,187
Corporate expense	201	440	703	955
Underwriting income (loss)	128	(546)	531	(1,957)
Investment income	430	377	985	802
Impact of change in discount rate on claims	(138)	56	(308)	149
Net income before interest and income taxes	219	(553)	505	(1,961)
Income tax expense	22	(294)	105	(605)
Net income on continued operations	197	(259)	400	(1,356)
Net income on discontinued operations	55,405	4,223	46,220	10,987
Net Income	55,602	3,964	46,620	9,631
Net income (loss) attributed to:				
Shareholders of the Company – continued operations	138	(203)	220	(1,116)
Shareholders of the Company – discontinued operations	55,405	4,223	46,220	10,987
Non-controlling interest – continued operations	59	(56)	180	(240)
Earnings per share				
Continued operations				
Basic	\$0.01	\$(0.02)	\$0.02	\$(0.09)
Diluted	\$0.01	\$(0.02)	\$0.02	\$(0.09)
Discontinued operations				
Basic	\$4.62	\$0.35	\$3.86	\$0.92
Diluted	\$4.54	\$0.35	\$3.77	\$0.90

<sup>(1)</sup> Underwriting income excludes impact of change in claims discount rates and corporate expenses. Net investment income consists of interest income, dividend income, less investment expense, as per Note 6 of the Company's Consolidated Financial Statements.

### *Direct Written and Net Earned Premiums*

In the second quarter of 2019, direct written premiums increased by \$0.5 million compared to the same prior-year period. For six months, direct written premium increased by \$0.7 million compared to same period last year. The increase was relatively small as the Company was being strategically cautious in writing business until implementation of rate increases. The Company has implemented rate increases in July for personal auto in PEI and property in all provinces.

### *Claims Incurred*

For the quarter ended June 30, 2019, net claims expense was \$0.1 million lower than same period in the prior year. For six months ended June 30, net claim expense was \$1.3 million lower in 2019 than 2018. The improvement in net claims incurred is a result of the current accident year as the Company experienced fewer large losses and lower frequency in claims.

### *Acquisition Costs*

Acquisition costs, which consist mainly of commissions, premium taxes and a portion of general expenses related to policy acquisitions, decreased by \$0.2 million in the quarter ended June 30, 2019 compared to same period last year. For six months ended June 30, acquisition costs in 2019 decreased by \$0.4 million compared to 2018. The decreases are due to the Company's focus on profitability and decreasing costs.

### *Operating Expenses*

Operating expenses were comparable in the second quarter of 2019 compared to the same quarter in 2018 and similarly for the six months ended in 2019 compared to the same period in 2018.

### *Underwriting Income*

Underwriting income of \$0.1 million was recorded in the second quarter of 2019 compared to underwriting loss of \$0.5 million in the same period in 2018. For six months ended June 30, \$0.5 million underwriting income was recorded in 2019 compared to underwriting loss of \$2.0 million in 2018. The improvement in results is attributed to higher revenue, lower expenses and lower net claims incurred.

### *Impact of Change in Discount Rate on Claims*

The discount rate used to discount future claims payment is based on the expected yield on investments. The discount rate used for Q2 2019 was 2.99% compared to 3.18% for Q1 2019 and 3.67% used for Q4 2018. The changes in discount rates were reflective of the interest yield in investments.

### *Investment Income*

Investment income was slightly higher in the second quarter compared to same period last year. For six months ended June 30, investment income was \$0.2 million higher in 2019 when compared to 2018. The improvement in results was largely due to realized gains recorded in the first six months of 2019 while there was a realized loss in the same period of 2018.

### *Net Income before Income Taxes*

Net income before taxes increased to \$0.2 million in the second quarter compared to a loss of \$0.6 million in the second quarter of 2018. For six months ended June 30, in 2019 net income before taxes improved to \$0.5 million from a loss of \$2.0 in 2018. The improvements were largely the result of improvements in underwriting results.

### Income Taxes

For the quarter ended June 30, 2019, the provision for income taxes was almost zero compared to expense recovery of \$0.3 million for the same period last year. For six months ended June 30, an expense of \$0.1 million was recorded in 2019 compared to a recovery of \$0.6 million in 2018. See effective tax rates note 9 on the financial statements for the six months ended June 30, 2019.

### Discontinued Operations

On November 9, 2018, the Company entered into a definitive agreement to sell Echelon Insurance, its main operating subsidiary, and the unregulated warranty business of Echelon Financial Holdings Inc. ("Discontinued Operations") and the sale was completed on May 31, 2019.

Net earnings of discontinued operations for the three and six months ended June 30, 2019 includes results of Echelon Insurance and the unregulated warranty business of Echelon Financial Holdings Inc. to their disposal date of May 31, 2019.

### Income statement results

\$ Thousands	3 months ended		6 months ended	
	June 30		June 30	
	2019	2018	2019	2018
Revenues				
Net earned premiums	59,044	67,783	133,164	131,134
Investment Income (loss)	1,519	2,382	4,656	3,916
Total Revenue	60,563	70,165	137,820	136,050
Expenses				
Net incurred claims	40,554	42,056	99,889	76,074
Net acquisition costs	13,099	15,761	31,402	33,401
Operating costs	7,778	6,618	16,411	14,459
Total Expenses	61,431	64,435	147,702	123,934
Income (Loss) before income taxes	(868)	5,730	(9,882)	12,116
Income tax expense (recovery)	(46)	1,507	(2,974)	1,129
Net Income (loss) on discontinued operations	(822)	4,223	(6,908)	10,837
Gain on sale, net of expenses	56,227		53,128	--
Net Income on discontinued operations	55,405	4,223	46,220	10,987

The Company received \$165.5 million on May 31, 2019 including \$4.3 million for expenses with \$12 million to be received pending final determination of the Minimum Capital Test ("MCT") ratio. On July 22, 2019, the Company agreed with CAA Club Group that \$4.8 million will be paid to the Company from the \$12 million withheld. The Company recognized a gain of \$56.2 million, which is included in the Net Income of discontinued operations. The gain on disposal is comprised of:

\$ Thousands	2019	3 months ended June 30	6 months ended June 30
Proceed		\$170,241	\$170,241
Net assets disposed		\$112,984	\$112,984
Gain on sale		\$57,257	\$57,257
Expenses relating to the sale		\$1,030	\$4,128
Net gain		\$56,227	\$53,128

## SUBSEQUENT EVENT

As disclosed previously, arbitration proceedings were commenced on September 18, 2018 in Denmark against EFH alleging misrepresentations by the Company at the time EFH sold Qudos Insurance to New Nordic Advisors Limited (“NNAL”). Although the Share Sale Agreement specifically provided that it was not assignable, NNAL purported to assign it to a third party, who commenced the arbitration. The arbitration panel in Denmark has now dismissed entirely the arbitration proceedings, with costs awarded to EFH, on the basis that the third party had no standing to bring them.

A statement of claim naming New Nordic Odin Denmark as plaintiff was filed on August 2, 2019 in the Danish Institute of arbitration. The Company continues to deny all allegations made against it by NNGL and states that there is no merit to NNGL's claim for €45.8 million in damages.

## SUMMARY OF QUARTERLY RESULTS

The following quarterly financial summary has been restated to exclude Discontinued Operations except for investment income, net income, earnings per share, and book value per share information.

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

amounts)	2019			2018			2017	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Direct written and assumed premiums	10,972	6,957	7,469	9,284	10,425	6,759	7,227	8,860
Net earned premiums and other revenue	7,921	7,541	7,660	7,609	7,497	7,171	7,203	7,284
Underwriting income (loss)	128	405	1,809	-997	-547	-1,410	382	-703
Impact of change in net claims discount rate	-138	(171)	142	69	56	93	67	167
Investment Income	430	555	280	380	377	425	708	532
Net Income (Loss)	55,602	(8,984)	(7,426)	170	3,964	5,642	(4,826)	810
Earnings (loss) per share								
(a) Basic	\$4.64	(\$0.76)	(\$0.65)	\$0.02	\$0.34	\$0.49	(\$0.42)	\$0.07
(b) Diluted	\$4.55	(\$0.76)	(\$0.65)	\$0.02	\$0.33	\$0.48	(\$0.42)	\$0.07
Selected financial ratios								
Book value per share <sup>(1)</sup>	\$7.48	\$11.74	\$12.21	\$12.89	\$12.88	\$12.47	\$12.01	\$12.14

<sup>(1)</sup> In Q2 - 2019, the Company paid a dividend of \$8.80 per share to shareholders.

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 4 of the Q2 – 2019 Financial Statements.



## 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 2019, and notes therein.*

### Balance Sheet Highlights

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

(\$ THOUSANDS except per share amount(s))	As at June 30, 2019	As at December 31, 2018
Cash and short-term deposits	70,516	22,785
Investments	46,538	45,576
Total assets	146,068	668,216
Provision for unpaid claims	23,156	24,090
Unearned premiums	18,053	16,848
Total equity attributable to shareholders	89,766	145,667
Book value per share <sup>(1)</sup>	\$7.48	\$12.21

<sup>(1)</sup> 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, 2019 and December 31, 2018.

Available for sale	As at June 30, 2019	% of Total	As at December 31, 2018	% of Total
Fixed income				
Canadian				
Federal	4,928		4,254	
Provincial	3,065		3,047	
Corporate	4,169		4,592	
Total fixed income	12,162	10.4%	11,893	17.4%
Corporate value pooled fund	5,173		4,998	
Money market pooled funds	488		459	
Short-term fixed income and mortgage pooled funds	13,477		14,610	
Total pooled funds	19,138	16.3%	20,067	29.4%
Common shares				
Canadian	1,355		1,138	
Foreign	2,108		1,481	
Global Equity Pooled Fund	8,118		7,417	
Total common shares	11,581	9.9%	10,036	14.7%
Total available-for-sale	42,881		41,996	
<b>Fair value through profit or loss</b>				
Preferred shares	3,657		3,580	
Total preferred shares	3,657	3.1%	3,580	5.2%
Total investments	46,538	39.7%	45,576	66.7%
Cash and short-term deposits	70,516	60.3%	22,785	33.3%
Total investments including cash and short-term deposits	117,054	100%	68,361	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, 2019 and 2018.

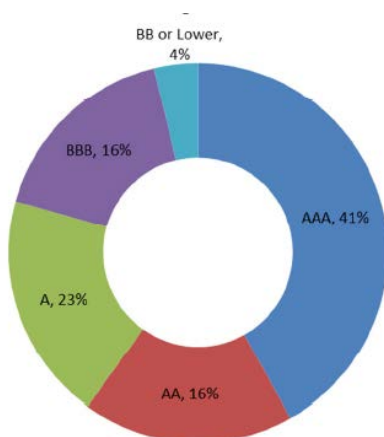
## Fixed Income Securities

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.

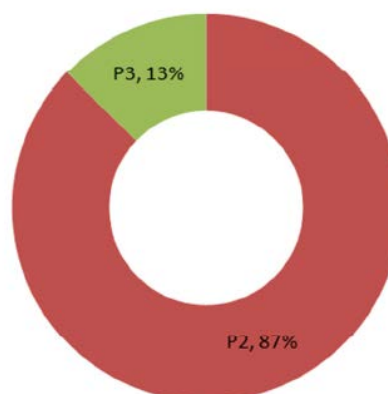
EFH's bond portfolio has a high overall credit quality with an average rating of AA. The preferred shares have an average rating of P2. The duration of the bond portfolio is 2.7 years.

The charts below show EFH's fixed income and preferred share portfolios by credit quality as at June 30, 2019 :

Bond Ratings



Preferred Share Rating



## Common Share Portfolio

The Global Equity Pooled Fund is managed by Burgundy Asset Management and the Canadian and USA common equities are managed by Silver Heights Investment Manager.

### Recoverable from Reinsurers

(\$ THOUSANDS)	As at June 30, 2019	As at December 31, 2018
Reinsurers' share of unpaid claims	3,804	4,889
Reinsurers' share of unearned premiums	1,283	1,522
Total	5,087	6,411

As at June 30, 2019, the amount recoverable from reinsurers decreased by \$1.3 million, down to \$5.1 million from \$6.4 million as at December 3, 2018. Reinsurers' share of unpaid claims decreased by \$1.1 million as there was a large claim settled and provision for claims was lower. The reinsurers share of unearned premium decreased by \$0.2 million as reinsurance premium in 2019 was lower than 2018. All reinsurers, with balances due, have a rating of A- or above as determined by A.M. Best.

### Accounts Receivable

(\$ THOUSANDS)	As at June 30, 2019	As at December 31, 2018
Agents and brokers	12,849	11,738
Other	4,750	-
Total	17,599	11,738

Agent and broker receivables increased from \$11.7 million in 2018 to \$12.8 million in 2019 due to growth in broker billed premiums in the current quarter. Other receivable relates to the amount outstanding from escrow on the sale of Echelon Insurance.

### 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 and provision for adverse development. 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 a decrease in yields compared to December 31, 2018. The discount rates used for June 30, 2019 and December 31, 2018 for the following entities are below:

	As at June 30, 2019	As at December 31, 2018
	2.99%	3.67%

### Share Capital

As of August 2, 2019, there were 12,006,558 common shares issued and outstanding. In the second quarter of 2019, the Company paid a dividend of \$8.80 per share totaling \$105.6 million.

## 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.

Echelon Financial Holdings Inc. is primarily a holding company and, as such, has limited direct operations of its own. Its principal assets are cash, an investment portfolio and ownership of ICPEI. Selected balance sheet items of Echelon Financial Holdings Inc. as at June 30, 2019 are as follows:

<b>(\$) Thousand</b>	
Cash and short-term deposits	\$68,219
Portfolio investments	\$11,234
Investment in Insurance Subsidiary	\$12,306
Other assets	\$676
Accounts receivable	\$4,750
Liabilities	\$7,710

Accordingly, its future cash flows depend on its investment income and the availability of dividends and other statutorily permissible distributions from ICPEI.. 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 subsidiary is domiciled, which subject the insurance subsidiary to significant regulatory restrictions. These laws and regulations require, among other things, that the insurance subsidiary maintain minimum solvency requirements and may also limit the amount of dividends that the insurance subsidiary can pay to its parent.

## 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, 2019.

## 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, 2019, 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, 2019, 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, 2019, 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.

### **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, 2019. A description of EFH's critical accounting estimates and assumptions is also detailed in note 4 of the interim financial statements.