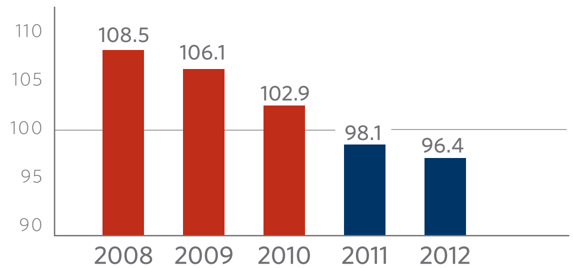
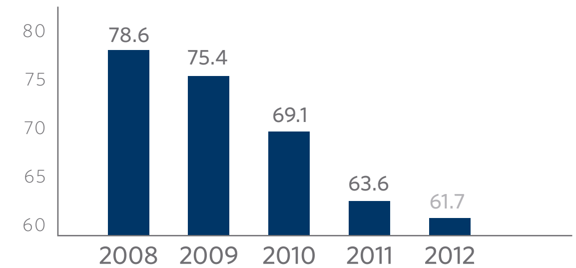
economical® | 2012 ANNUAL REPORT

2012 performance at a glance

COMBINED RATIO*: Economical's combined ratio continuously improved from a high in 2008 of 108.5% to a much stronger current position of 96.4%. This has resulted in an underwriting income in each of the last two years from better risk selection, improved Ontario personal auto results, enhanced claims management and fraud detection activities.

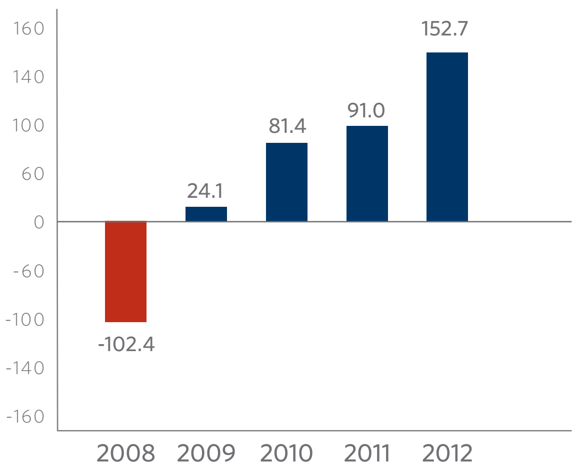


CLAIMS RATIO*: Our claims ratio of 61.7% for 2012, down 16.9% since 2008, clearly demonstrates the high quality of our book of business, disciplined underwriting and our effective adjudication and management of claims.



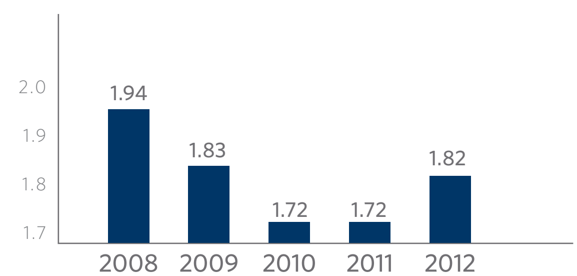
NET INCOME: In 2012, Economical registered its highest net income since 2005, a significant turnaround from the difficult years of 2008 and 2009.

(millions)



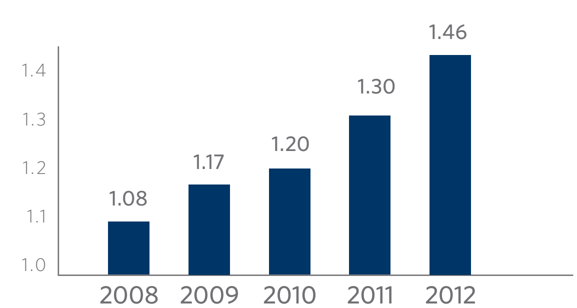
GROSS WRITTEN PREMIUMS: Economical's GWP declined steadily from 2008 through 2010, reflecting specific actions the company took to focus on profitable underwriting. Economical emerged from this pattern in 2011 and recorded GWP growth in 2012.

(billions)



MUTUAL POLICYHOLDERS' EQUITY: Our capital position is the strongest in Economical's 141-year history.

(billions)



* See definitions on page 41

“We achieved net income growth for the fourth consecutive year, and registered the highest net income and most profitable underwriting results for the company since 2005. This translated into the strongest capital position in Economical’s 141-year history.”

Gerry Hooper
Chairman of the Board of Directors

a message from Gerry Hooper, chairman of the board

Profitable growth was the hallmark of Economical's success in 2012. We achieved net income growth for the fourth consecutive year, and registered the highest net income and most profitable underwriting results for the company since 2005. This translated into the strongest capital position in Economical's 141-year history.

This extraordinary achievement is the product of strategic decisions and actions taken to improve the quality and profitability of our book of business with better assessment of risk, underwriting discipline, broker management and adjudication of claims. We are now seeing that vision bearing fruit.

Ours is a complex industry and it takes experience, insight and expertise to succeed. Over the past several years, the board of directors has challenged management to outperform our competitors and I'm proud of how they have met that challenge. Their leadership and the dedication and expertise of our employees delivered a combined operating ratio and a claims ratio that are among the best in the Canadian property and casualty insurance industry.

Overall, our results were aided by the absence of weather-related catastrophes, but were hindered by low investment returns stemming from historically low interest rates and the continued volatility in global markets.

Economical continues to invest in risk management for the long-term financial security and stability of the organization. More than ever before, we are able to see risk and actively manage it, not only to avoid loss but to discover opportunity. Over time, this will come to benefit all our stakeholders, particularly our mutual policyholders, customers and our broker partners.

We see demutualization as the key strategy to sustain the future success and growth of Economical. The board and the executive team are committed to this strategy. Although we do not yet have the demutualization regulations, we have made progress with the federal Department of Finance in furthering the interests of our mutual policyholders and combating the many arguments by others against demutualization as we have proposed.

We are demutualizing because it is the right thing to do at this point in our history. Economical has grown far beyond its local mutual company beginnings in 1871. Our industry is undergoing rapid consolidation and is becoming increasingly competitive. We have our sights set firmly on becoming a dominant player in the property and casualty insurance industry and, to achieve that objective, we need access to the capital that will allow us to participate as an industry consolidator. We will either grow or risk becoming marginalized.

Demutualization will allow us to make the strategic acquisitions at a scale necessary to place Economical among the five largest property and casualty insurance providers in Canada. That will be good for our independent broker partners and our policyholders who will have a financially stronger insurance provider that is able to offer them more choice. Demutualization will deliver greater strength and stability for our industry, and that's good for all of us.

The leadership team under President and CEO Karen Gavan has demonstrated the strength and conviction to make the tough but right decisions to build for the future. It is focused on strengthening its core Canadian operations through a major transformation process to improve productivity and reduce costs in order to foster future growth and sustainable competitive advantage. This has placed an added workload on many employees that will lead to greater profitability in future years, and I am extremely proud that they have embraced this challenge.

On behalf of the company and the board of directors, I want to acknowledge David MacIntosh's retirement after nearly 11 years of dedicated service to the board and the company. David brought a high level of professionalism and expertise as chairman of both our pension committee and investment committee, and as a member of the special committee on demutualization. His clear thinking and steady guidance will be missed in all our deliberations.

I am delighted that Elizabeth (Betty) DelBianco has joined Economical's board of directors. We are looking forward to benefitting from her expertise in legal, human resources, compliance and governance matters in a public company environment as we continue to prepare to be the first Canadian property and casualty insurance company to demutualize.

It is a privilege to work with such a dedicated board and hard-working executive team. I am grateful to all our board members for their leadership and active engagement in the achievements of Economical, to our leadership team for their vision and commitment, and to all of our employees who worked diligently to deliver a very successful year.

I want to close by acknowledging the trust, loyalty and confidence that our broker partners continue to express in Economical. To be recognized as their preferred business partner, we are committed to building a financially strong and stable carrier that provides them with competitive products and increasingly efficient ways of doing business with us.

Sincerely,

GERRY HOOPER
Chairman of the Board

“With a focus on demutualization, building sustainable profitable growth and improving our productivity, we have the right strategy and leadership team to deliver value to our policyholders, employees, broker partners and communities for years to come.”

Karen Gavan
President and CEO

a message from Karen Gavan, president and ceo

Economical Insurance achieved excellent results in 2012, building towards our vision to be a dominant player in the property and casualty insurance industry. Our strategy to deliver profitable growth is the result of the professionalism, dedication and resilience of our employees, and the commitment we've earned from our independent broker partners.

Net income in 2012 was $152.7 million, an increase of $61.7 million or 68% over 2011, reflecting an 11.3% return on equity. Gross written premiums rose nearly 6% over 2011 to $1.82 billion due to organic growth and a modest level of increase in rate in the property lines of business.

The company's strategy of leveraging the powerful combination of predictive analytics, disciplined underwriting and effective claims management contributed to an underwriting profit of $60.7 million, nearly double that of 2011. We completed the year with a combined ratio of 96.4%, an improvement of 1.7 points over 2011. Our capital position is at the highest level in the company's 141-year history at more than $1.46 billion.

In 2012, we launched a refreshed brand and a distinctive new look and feel. It is uncomplicated and clean, and shows why we are truly good to know.

In the fall of 2012, Economical sold the principal operating assets of Seattle-based Mattei Insurance Services, Inc. to Alteris Insurance Services, Inc. of Boston as part of our ongoing efforts to streamline our focus on our core operations.

I also realigned my executive team in 2012 to position our best leaders to execute our strategic plan and focus on running our business operations more efficiently.

We are continuing to derive benefits from the application of predictive analytics to monitor and manage the quality of our book of business, and in many of our pricing models. These applications have enabled us to achieve better risk selection, more accurate pricing and more effective claims management.

To sustain our prosperity in an increasingly competitive and consolidating industry, we are taking one of the most important initiatives in our history to improve the efficiency and effectiveness of our operations. During 2012, we began a multi-year journey to streamline and simplify how we do business to improve service delivery, increase productivity and reduce operating costs. This is a long-term initiative with long-term benefits. The significant investments we will be making in 2013 and 2014 will pay off with improved operating efficiency that will be sustainable in the longer-term.

As we continue to evolve, the strength of our commitment to the independent broker channel is unchanged. Our broker partners count on Economical to be a strong, independent market to do business with for the long term. We are proud of the relationships we have fostered with our broker partners over our 141-year history, and have always been there to collaborate and respond with creative solutions. That is why I was incredibly gratified by the Insurance Brokers Association of Ontario's 2012 broker survey results. In addition to achieving the most significant improvement of all companies in the survey, Economical ranked particularly well in broker management and broker administration, reinforcing the value of our partnership with our independent brokers.

As Gerry mentioned, we need a level playing field with our competitors to achieve our vision of Economical becoming the leading property and casualty insurance company in Canada. Demutualization will unlock that potential. With access to capital we will be able to participate in industry consolidation and achieve scale — both in operating efficiency but also in access to data — which is key to being a market leader in our industry.

At Economical, we place a great deal of emphasis on learning and personal growth. Our world-class training and development programs continue to garner international recognition that highlights our commitment to the success and development of our people.

We are continuing our long and proud history of building healthy and vibrant communities by giving back and making a difference in cities and towns where we, our broker partners and our policyholders work and live. The company bestowed nearly $1 million in charitable donations and sponsorships in 2012 to deserving organizations including United Way, Junior Achievement, Crime Stoppers and many others. Our employees are also active volunteers in their communities.

As always, our employees and our independent broker partners are at the foundation of our success. With a focus on demutualization, building sustainable profitable growth and improving our productivity, we have the right strategy and leadership team to deliver value to our policyholders, employees, broker partners and communities for years to come.

Sincerely,

KAREN GAVAN
President and CEO

management discussion and analysis

introduction

MAY 15, 2013

The following Management Discussion and Analysis (“MD&A”), is intended to enable the reader to assess our results of operations, financial condition and future prospects as at and for the years ended December 31, 2012 and 2011. It should be read in conjunction with the consolidated financial statements and accompanying notes for the financial year ended December 31, 2012. Unless otherwise noted in this MD&A, all information is given as at May 15, 2013.

As used in this discussion, references to “Economical”, “we”, “us”, and “our” refer to Economical Mutual Insurance Company, and, unless the context otherwise requires or as otherwise expressly stated, its subsidiaries.

We use both generally accepted accounting principles (“GAAP”) and certain non-GAAP measures to assess performance. Non-GAAP measures do not have any standardized meaning prescribed by GAAP and may not to be comparable to any similar measures presented by other companies. We analyze performance based on underwriting ratios such as combined, expense and claims ratios. These measures are outlined in the definitions included at the end of this MD&A.

In addition, the preparation of our consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions about future events which affect certain amounts reported in our consolidated financial statements and amounts derived there from, including amounts presented in this discussion. Those critical accounting estimates and assumptions principally relate to the valuation of policy liabilities, valuation and impairment of financial instruments, impairment of goodwill and intangible assets, valuation of post-employment benefits and measurement of income taxes. As more information becomes known, these estimates and assumptions could change and impact future results. For a more complete discussion of critical accounting judgments, estimates and assumptions, please see pages 29 to 30 of this report.

This discussion includes product names, trade names, trademarks, service marks and registered trademarks and service marks of Economical, our subsidiaries and other companies, each of which is the property of its respective owner.

All dollar amounts are in Canadian dollars unless otherwise indicated. Certain totals, subtotals and percentages may not reconcile due to rounding. An increase/decrease column has been provided showing the variation between 2012 and 2011 for certain financial analyses.

This document contains forward-looking statements that involve risks and uncertainties. The company’s actual results could differ materially from these forward-looking statements as a result of various factors, including those discussed later in the document. Please read the cautionary note at the end of this document.

section 1 - overview

ABOUT ECONOMICAL INSURANCE

Founded in 1871, Economical is one of the largest property and casualty ("P&C") insurance companies in Canada, providing security and support to customers and broker partners from coast to coast.

A Canadian owned and operated mutual company, Economical provides a wide range of personal, commercial and farm insurance products to customers in all provinces and territories across Canada. Economical competes against Canadian and foreign owned stock and mutual companies. Economical's head office is located in Waterloo, Ontario, with 17 branches and services offices across the country providing service to policyholders and broker partners. In Canada, Economical partners with approximately 900 independent insurance brokers who work with customers to assess their insurance needs and choose the right products and coverage.

The financial stability of Economical is demonstrated by assets of over $4.8 billion and mutual policyholders' equity in excess of $1.4 billion reflecting the combined strength of its member companies. Economical is committed to providing its broker partners and policyholders with the products and services that today's market demands.

Economical has announced its decision to become the first federally-regulated mutual P&C insurance company in Canada to demutualize, pending the implementation of enabling regulations governing the demutualization of P&C insurance companies.

CORPORATE STRATEGY

Economical's mission, vision and values are the foundation of our strategy. They drive alignment throughout the company to ensure our people are working together collectively to achieve our desired results.

Economical's mission is to provide security and support for our customers and distribution partners and to be there when our customers need us most. Our values are engrained in our culture and are unchanged. We focus on our customers, maintain an unwavering commitment to integrity in everything we do, focus on achievement and value an environment that fosters learning and collaboration.

Economical's vision is to be the leading P&C insurance provider through the delivery of high quality insurance products and superior service, built upon a foundation of innovation and financial strength. Our strategy to achieve this vision is to:

- deliver a customer experience and overall value proposition that is superior to our competitors, as measured by our customers,
- be recognized by our distribution partners as their preferred business partner,
- build and execute industry leading capabilities in pricing, underwriting, claims and risk management,
- be a great place to work with an emphasis on learning, personal growth, diversity and commitment to our communities and our environment, and
- maintain the trust and confidence of our customers, employees, brokers and regulators through consistent top quartile operating performance.

In the near term, we are focused on implementing best practices to prepare for demutualization, building profitable growth by increasing penetration in target market segments, and improving productivity to deliver our products and services in a competitive and efficient manner.

section 2 - 2013 industry outlook

2012 has been a highly successful year for Economical, with the P&C industry also likely to record improved results. Set out below is an overview of the company's expectations for the P&C industry over the next 12 months, together with our current strategies intended to further enhance our industry standing. These expectations are subject to risks and uncertainties, and the company's actual results could differ materially as a result of various factors, including those discussed later in the document. Please read the cautionary note at the end of this document.

	Canadian P&C insurance industry	Our response
PRICING AND UNDERWRITING PROFITABILITY	• We expect sluggish economic conditions and depressed investment returns will continue, likely resulting in a greater industry focus on underwriting profitability. However, overall industry premiums are likely to continue to grow at only a low to mid single digit pace in both personal and commercial lines as competition for business continues. • We do not anticipate the profitability of Ontario automobile to continue to improve at the same rate seen in the last two years. There remain a number of factors that could have a negative impact on future profitability. • Environmental changes continue to have significant impacts on property claims, both personal and commercial. There continues to be more frequent and severe storms across the country which have resulted in significant impacts on underwriting profitability. We expect that price increases will continue as companies look to offset these losses. • We expect commercial lines will continue to remain in a highly competitive soft market in the near term, although there are signs that this may begin to moderate over time.	• Expanding our use of predictive analytics and individual rating tools throughout the company, particularly in relation to pricing, distribution management, risk selection and fraud detection, should enable us to sustain our competitive advantage. • We plan to continue our focus on risk management, disciplined underwriting, claims leakage, and productivity and efficiency levels. • We intend to increase penetration in targeted commercial market segments, in order to attract more profitable business, while reducing exposure to less profitable segments.

	Canadian P&C insurance industry	Our response
ECONOMIC CONDITIONS	• Global investment market conditions are expected to continue to be volatile and depressed. • Economic growth remains slow in the G20, with high unemployment and very high government debt levels persisting. • The current low interest rate environment is expected to continue for the foreseeable future, which may result in firmer industry pricing conditions. • The Office of the Superintendant of Financial Institutions ("OSFI") continues to monitor global capital requirements. Published 2013 minimum capital test ("MCT") changes are likely to somewhat reduce the P&C industry's capital ratios.	• We plan to maintain a stable investment strategy. • Our $3.9 billion cash and investment portfolio is largely comprised of high quality, actively traded securities, Canadian fixed income investments issued or guaranteed by domestic governments, investment-grade bonds, and Canadian and foreign equities. • We intend to further enhance our current strong and stable financial position, as demonstrated by our MCT ratio of 295.1% at December 31, 2012. • MCT changes implemented in 2012 were capital neutral. However, we expect the 2013 changes to be slightly negative based on our current investment portfolio and strategy.

	Canadian P&C insurance industry	Our response
OVERALL	• Given the factors outlined above, we do not expect overall industry underwriting and investment performance to improve significantly in 2013 over 2012.	• As a result of our planned strategies, we believe we will be able to sustain our position as an industry leader in respect of our overall loss ratio performance over the next 12 months. • We initiated a business transformation program in the second half of 2012 in order to improve the effectiveness and efficiency of our business. The program is expected to be completed in multiple phases over the next two years. The planned investments to be made during 2013 and 2014 should lead to sustainable efficiency improvements in the longer term.

section 3 - the year in review

FINANCIAL HIGHLIGHTS FOR THE YEAR INCLUDE:

Gross written premiums	Premium growth of $96.5 million or 5.6%
Underwriting income	Improved underwriting income by $28.3 million
Combined ratio[1]	Improved combined ratio by 1.7 percentage points, ending 2012 with a 96.4% combined ratio
Net income	Increased net income by $61.7 million, resulting in an 11.3% return on equity ("ROE")[1]
Mutual policyholders' equity	Increased total mutual policyholders' equity by $164.1 million during the year, a 12.6% increase

RESULTS FROM OPERATIONS

FIGURE 1 (in millions of dollars, except as otherwise noted)	Year ended December 31 2012	 2011	Increase (Decrease)
Gross written premiums	**1,819.7**	1,723.2	96.5
Net premiums written	**1,723.7**	1,630.8	92.9
Net premiums earned	**1,666.0**	1,615.1	50.9
Claims and adjustment expenses (undiscounted)	**1,027.8**	1,026.5	1.3
Other underwriting expenses	**577.5**	556.2	21.3
Underwriting income (undiscounted)	**60.7**	32.4	28.3
Interest and dividend income	**105.1**	109.3	(4.2)
Recognized gains on investments	**21.7**	38.7	(17.0)
Impact of discounting	**9.3**	(40.5)	49.8
Other income (expense)	**14.8**	(12.4)	27.2
Restructuring expenses	**(11.6)**	-	(11.6)
Income before income taxes	**200.0**	127.5	72.5
Income tax expense	**47.3**	36.5	10.8
Net income	**152.7**	91.0	61.7
Claims ratio (undiscounted)[1]	**61.7%**	63.6%	(1.9 pts)
Expense ratio[1]	**34.7%**	34.5%	0.2 pts
Combined ratio (undiscounted)[1]	**96.4%**	98.1%	(1.7 pts)
Return on equity[1]	**11.3%**	7.3%	4.0 pts
Policies in force *(in thousands)*	**1,130.1**	1,079.0	51.1

[1] The claims, expense and combined ratios and ROE are all non-GAAP measures, which do not have standardized meanings prescribed by GAAP and therefore may not be comparable to any similar measures presented by other companies. These measures are defined in the Definitions section at the end of this MD&A (page 41).

GROSS WRITTEN PREMIUMS

Gross written premiums ("GWP") grew significantly throughout 2012 by $96.5 million or 5.6%. Policies in force ("PIF") grew by over 51,000 policies, or 4.7% and the company had in excess of 1.1 million active policies at December 31, 2012. All lines of business achieved GWP growth primarily by volume increases, mix changes and rate increases in personal property. Regionally, personal automobile and commercial lines in Ontario and all business lines in the Western region accounted for most of the premium growth in 2012. Further details by line of business are provided in section 4.

CLAIMS AND ADJUSTMENT EXPENSES

FIGURE 2 (in millions of dollars, except as otherwise noted)	Year ended December 31 2012	 2011	Increase (Decrease)
Net incurred losses			
Current year claims	**1,085.2**	1,155.4	(70.2)
Prior year favourable claim development	**(57.4)**	(128.9)	71.5
Total	**1,027.8**	1,026.5	1.3

Our enhanced risk selection and claims management combined with moderate rate increases in personal lines have improved our current year claims performance. Milder weather conditions and, in particular the decline in weather-related catastrophic losses, also contributed to Economical's current year results, although the industry as a whole continued to experience significant levels of catastrophic losses. Economical's net weather-related catastrophic losses were $21.9 million compared to $61.9 million in the prior year. The August 2011 Goderich tornado alone represented $25.0 million of the net catastrophic losses for 2011.

Prior year favourable claim development returned to historical levels in 2012. The unusually high favourable development in 2011 was a result of Economical's actions in 2009 and 2010 to actively manage the profitability of its Ontario automobile book of business, combined with regulatory reform of the Ontario automobile product.

Expanded analytic expertise allowed Economical to maintain underwriting discipline and hold claim and adjustment expenses flat while growing the top line in excess of 5.6%. This commitment to disciplined underwriting and effective claims management resulted in a 1.9 percentage point improvement in the claims ratio for 2012.

COMMISSION AND OTHER EXPENSES

FIGURE 3 (in millions of dollars, except as otherwise noted)	Year ended December 31 2012		2011		Increase (Decrease)	
	$	Ratio	$	Ratio	$	Ratio
Commissions	**356.0**	**21.4%**	338.2	21.0%	17.8	0.4 %
Operating expenses	**162.0**	**9.7%**	161.4	10.0%	0.6	(0.3 %)
Premium taxes	**59.5**	**3.6%**	56.6	3.5%	2.9	0.1 %
Total	**577.5**	**34.7%**	556.2	34.5%	21.3	0.2 %

The commission ratio has increased 0.4 percentage points over the prior year driven primarily by increased profit commissions resulting from improved underwriting results and a change in the mix of business. While operating expenses increased marginally during 2012 in dollar terms, the operating expense ratio declined 0.3 percentage points during the year as Economical began to realize run-rate savings from its business transformation program combined with an increase in the earned premium base in the second half of 2012. Premium taxes increased, consistent with the growth in premiums earned during the year.

INVESTMENT INCOME

FIGURE 4

(in millions of dollars, except as otherwise noted)	Year ended December 31 2012	2011	Increase (Decrease)
Interest and dividend income	**105.1**	109.3	(4.2)
Recognized gains on investments	**21.7**	38.7	(17.0)
Total	**126.8**	148.0	(21.2)

Economical generated $105.1 million of interest and dividend income, a marginal decline of $4.2 million over 2011, resulting primarily from the continuing low interest rate environment. Net gains of $21.7 million were recognized in 2012, a decline of $17.0 million from 2011 as a result of a marginal rise in market yields in 2012, causing the fair value of the bond portfolio to decline. This compares to 2011 when market yields dropped creating significant unrealized gains in the portfolio. Also included in recognized gains on investments are impairment losses, which fell significantly to $9.3 million compared to $36.3 million in 2011. Further details on investment performance can be found in section 6.

OTHER INCOME (EXPENSE) AND RESTRUCTURING EXPENSES

During the year, Economical undertook a business transformation program to improve the effectiveness and efficiency of its operations. The program is expected to be completed in multiple phases over the next two years. The 2012 financial results include $13.7 million of costs related to this restructuring that reflect actions taken and plans communicated as of December 31, 2012, of which $2.1 million are included in operating expenses in the consolidated statement of comprehensive income. As part of this program, Economical modified the eligibility criteria for the other post-employment benefit plan that reduced the number of current employees eligible for post-employment benefits under the plan. Included in other income (expense) is a net, one-time benefit of $16.5 million primarily related to this modification. This change has no impact on benefits supplied to current retirees.

INCOME TAX EXPENSE

Economical's effective tax rate for 2012 was 23.6%, compared to 28.6% in 2011 and a statutory rate of 26.3%. The year-over-year reduction in the effective tax rate is due to a 1.7% reduction in the statutory tax rate for 2012 combined with a reduction in non-tax deductible expenses.

NET INCOME

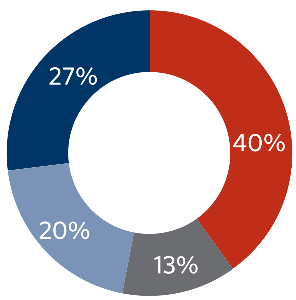
Economical generated net income of $152.7 million in 2012, compared to $91.0 million in 2011, representing the highest net income produced by the company since 2005 and the third highest in its history. While milder weather conditions and the lack of a major catastrophic loss to the company aided the 2012 results, the near record profit was achieved while producing strong GWP growth of 5.6% and improving underwriting profitability by $28.3 million.

CAPITAL STRENGTH

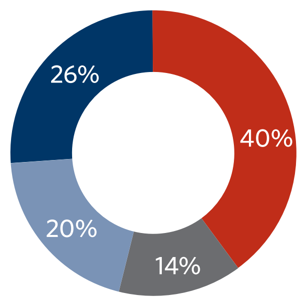
In 2012, Economical demonstrated its commitment to profitable growth and continued to strengthen its capital base with total mutual policyholders' equity and MCT reaching all-time highs. Total mutual policyholders' equity increased $164.1 million, or 12.6%, to $1,464.2 million and MCT reached 295.1% at December 31, 2012.

section 4 - results by line of business

Economical provides a wide range of P&C insurance products throughout Canada in two broad lines of business: personal insurance and commercial insurance. Each line is further subdivided between automobile, property, and — in the case of commercial — property and liability lines of business. The following charts illustrate Economical's GWP mix on this basis:

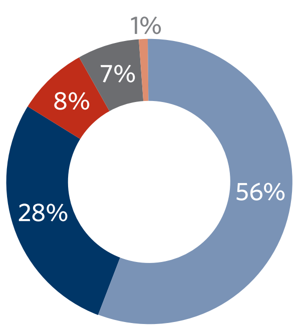


2012 GWP BY LINE OF BUSINESS

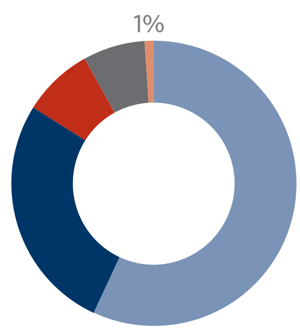


2011 GWP BY LINE OF BUSINESS

PERSONAL AUTO
COMMERCIAL AUTO
PERSONAL PROPERTY
COMMERCIAL PROPERTY & LIABILITY



2012 GWP BY REGION



2011 GWP BY REGION

ONTARIO
WEST
ATLANTIC
QUEBEC
OTHER

Economical's business mix remained stable and well diversified in 2012. The company experienced premium growth across all lines of business. Personal automobile GWP grew by 4.6% reflecting growth in the Western Region and Ontario. Personal property GWP grew by 5.4% driven primarily by growth in the Western Region. Commercial automobile GWP increased 5.0% in 2012 supported by strong growth in the Western Region and Ontario while remaining relatively stable in other regions. Commercial property and liability GWP grew by 7.7% driven again by growth in the Western Region and Ontario. Strong growth in the Western Region outpaced the remainder of the country across all lines of business and it now represents 28% of Economical's total business, an increase of one percentage point year-over-year. Economical continues to be largely concentrated in Ontario, given the company's roots in Southwestern Ontario. However, the company is looking to grow, particularly in the West.

UNDERWRITING - PERSONAL LINES

FIGURE 5 (in millions of dollars, except as otherwise noted)	Year ended December 31 2012	2011	Increase (Decrease)	%
Policies in force (thousands)				
Automobile	**522.9**	488.6	34.3	7.0
Property	**420.6**	410.3	10.3	2.5
Total	**943.5**	898.9	44.6	5.0
Gross written premiums				
Automobile	**725.5**	693.9	31.6	4.6
Property	**368.0**	349.1	18.9	5.4
Total	**1,093.5**	1,043.0	50.5	4.8
Net premiums earned				
Automobile	**690.4**	677.8	12.6	1.9
Property	**336.4**	326.3	10.1	3.1
Total	**1,026.8**	1,004.1	22.7	2.3
Underwriting income (loss)				
Automobile	**65.4**	77.3	(11.9)	(15.4)
Property	**32.0**	(8.0)	40.0	500.0
Total	**97.4**	69.3	28.1	40.5

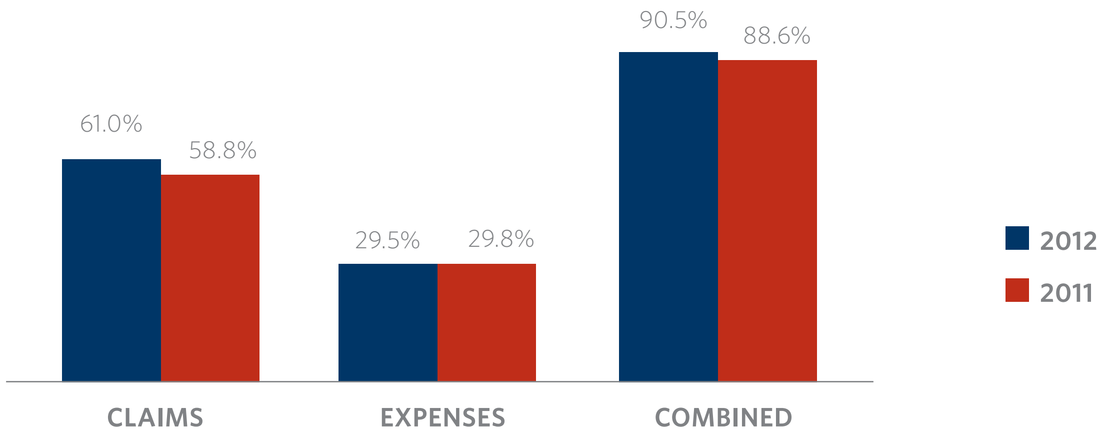
PERSONAL LINES

Personal automobile GWP grew by 4.6% reflecting a strong 7.0% growth in policy volumes which was offset by rate decreases in most regions. This growth was achieved while maintaining underwriting profitability of $65.4 million in 2012 (2011: $77.3 million). Ontario personal automobile continues to contribute positively as a result of enhanced claims management, improved risk selection and, to a lesser degree, the favourable impact of regulatory reforms. The decline in underwriting profitability from 2011 was driven by a return of prior year reserve development to more historic levels. Favourable development during 2011 was significantly higher than usual.

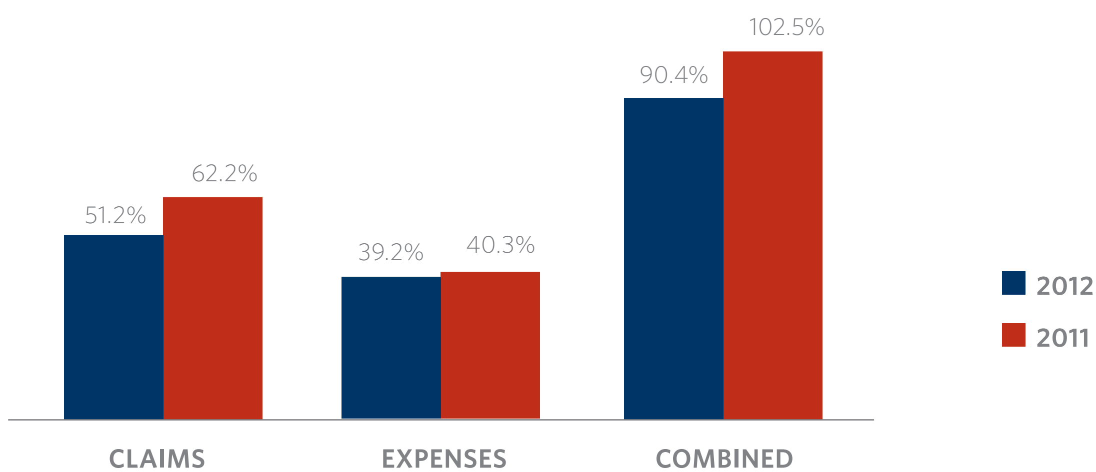
Personal property GWP grew by 5.4% as a 2.5% increase in policy volumes was further supported by rate increases across the country. Personal property produced an underwriting income of $32.0 million compared to an underwriting loss of $8.0 million in 2011. The 2012 results reflect the significant decline in weather-related losses experienced by the company compared to 2011, although the industry overall continued to experience significant catastrophic losses during 2012. In 2011, Economical's personal property results were heavily affected by $27.0 million of weather-related catastrophic losses, compared to $8.8 million in 2012. Adjusting for the impact of weather-related catastrophic losses, the 2012 combined ratio for personal property was 87.9% compared to 94.2% in 2011, an improvement driven mainly by a decline in the frequency of losses in 2012 compared to 2011.

Overall, the personal lines business produced a combined ratio of 90.5%, a 2.6 percentage point improvement over 2011. While aided by a decline in weather-related catastrophic losses, adjusting for these events still shows an overall improvement in the already strong personal lines profitability of one percentage point. Economical's increased focus on profitable growth, and the continued roll out of multi-variant pricing capabilities for personal automobile business in Ontario and Alberta, has resulted in overall growth of 4.8% in personal lines while maintaining profitability.

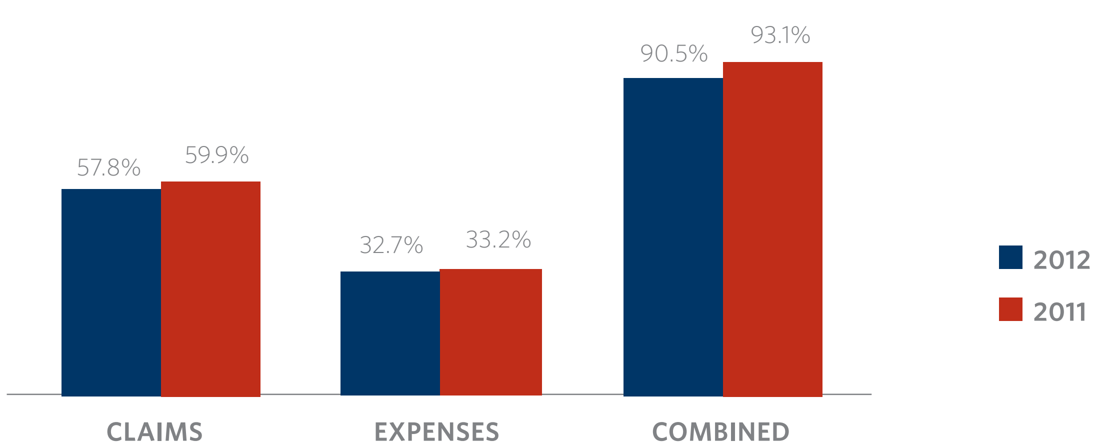
PERSONAL AUTOMOBILE RATIOS



PERSONAL PROPERTY RATIOS



TOTAL PERSONAL LINES RATIOS



UNDERWRITING - COMMERCIAL LINES

FIGURE 6 (in millions of dollars, except as otherwise noted)	Year ended December 31 2012	2011	Increase (Decrease)	%
Policies in force (thousands)				
Automobile	**53.8**	52.7	1.1	2.1
Property & Liability	**132.8**	127.4	5.4	4.2
Total	**186.6**	180.1	6.5	3.6
Gross written premiums				
Automobile	**241.1**	229.7	11.4	5.0
Property & Liability	**485.1**	450.5	34.6	7.7
Total	**726.2**	680.2	46.0	6.8
Net premiums earned				
Automobile	**213.2**	206.2	7.0	3.4
Property & Liability	**425.9**	404.8	21.1	5.2
Total	**639.1**	611.0	28.1	4.6
Underwriting income (loss)				
Automobile	**(6.5)**	1.0	(7.5)	(750.0)
Property & Liability	**(30.3)**	(37.9)	7.6	20.1
Total	**(36.8)**	(36.9)	0.1	0.3

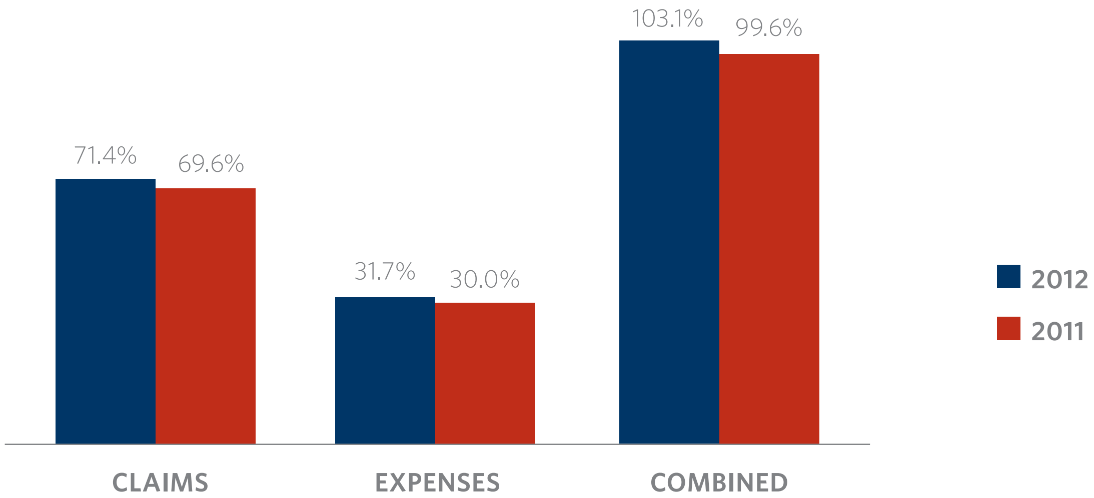
COMMERCIAL LINES

Commercial automobile GWP increased 5.0% supported by policy volume growth of 2.1% and a change in mix of business, particularly in the Western Region and Ontario. An increase in the severity of losses in 2012 resulted in commercial automobile producing an underwriting loss of $6.5 million compared to an underwriting income of $1.0 million in 2011.

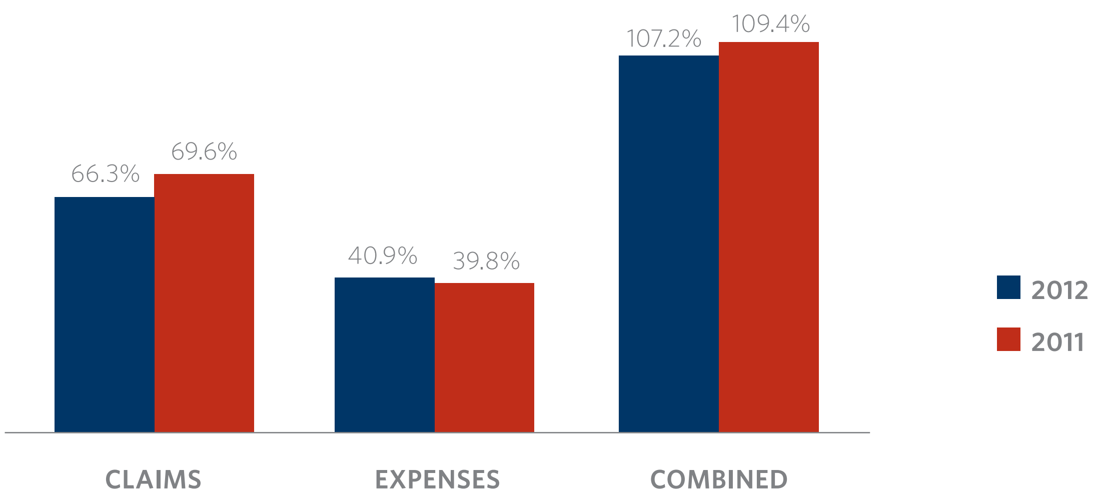
Commercial property and liability GWP grew by 7.7% due to a combination of rate increases and policy volume growth, of 4.2%. Commercial property and liability produced an underwriting loss of $30.3 million which, although disappointing, resulted in a $7.6 million improvement over 2011. As with personal property, Economical's commercial property and liability results were heavily impacted by weather-related catastrophic losses in 2011. Weather-related catastrophic losses contributed $30.7 million of losses in 2011 compared to $5.9 million in 2012. An increase in non-weather-related large loss activity in 2012 largely offset the decline in catastrophic losses.

Due to the continuation of soft market conditions in 2012, overall commercial lines GWP growth was primarily a result of an increase in policy volumes and changes in business mix rather than being rate driven. Economical intends to increase its penetration in targeted commercial market segments in the future to attract more profitable business, while reducing exposure to less profitable segments through the increased use of analytical tools and underwriting expertise.

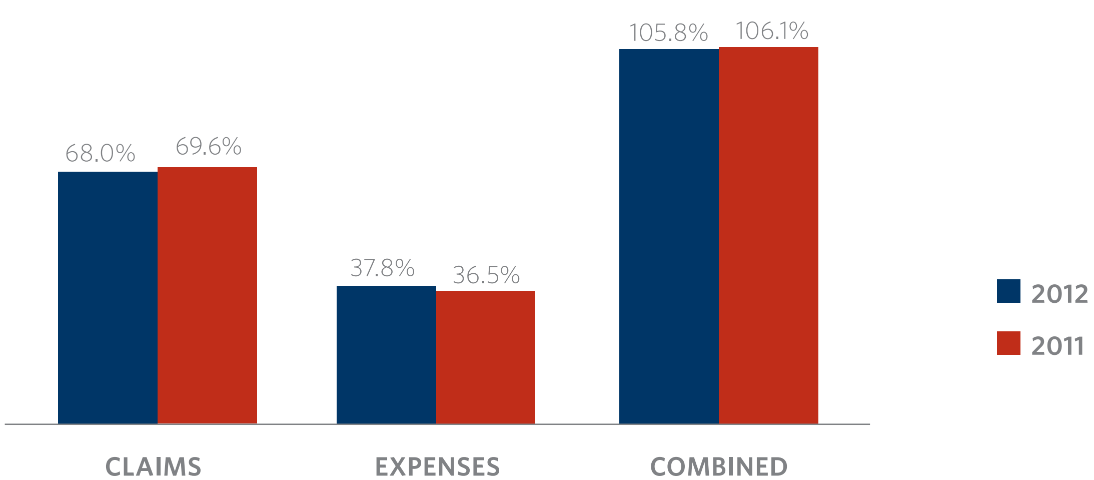
COMMERCIAL AUTOMOBILE RATIOS



COMMERCIAL PROPERTY AND LIABILITY RATIOS



TOTAL COMMERCIAL LINES RATIOS



section 5 – key performance indicators

2010 – 2012 under International Financial Reporting Standards ("IFRS"), 2008 and 2009 under Canadian GAAP

FIGURE 7	Year ended December 31				
(in millions of dollars, except as otherwise noted)	2012	2011	2010*	2009	2008
Policies in force (thousands)	**1,130.1**	1,079.0	1,074.8	1,188.0	1,341.5
Gross written premiums	**1,819.7**	1,723.2	1,722.0	1,826.3	1,939.7
Claims ratio	**61.7%**	63.6%	69.1%	75.4%	78.6%
Expense ratio	**34.7%**	34.5%	33.8%	30.7%	29.9%
Combined ratio	**96.4%**	98.1%	102.9%	106.1%	108.5%
Underwriting income (loss)	**60.7**	32.4	(48.5)	(111.5)	(156.7)
Net income (loss)	**152.7**	91.0	81.4	24.1	(102.4)
Return on equity	**11.3%**	7.3%	7.0%	2.0%	(8.4%)
Retained earnings	**1,418.3**	1,271.9	1,195.0	1,191.5	1,167.4
Mutual policyholders' equity	**1,464.2**	1,300.1	1,202.7	1,170.7	1,079.0
Total assets	**4,826.2**	4,669.8	4,592.2	4,603.8	4,441.2

**The transition to IFRS resulted in minor adjustments to the company's opening 2010 retained earnings*

The information below provides further detail on the movement in key performance indicators and trends experienced between 2008 and 2012.

GWP and PIF levels declined steadily from 2008 through 2010, reflecting specific actions taken by the company to refocus on profitable underwriting. Economical emerged from this pattern during 2011 and recorded growth in both GWP and PIF in 2012. Economical's focus remains one of profitable growth and, as such, the company is disciplined in its underwriting approach to ensure that underwriting performance is not sacrificed to achieve top-line growth.

The claims ratio has improved significantly and continuously from a historical high in 2008 of 78.6% to a much stronger current position, resulting in an underwriting income in each of the last two years. This improvement is a result of management's concerted efforts to restore and maintain underwriting profitability through a combination of better risk selection, improved Ontario personal automobile results, enhanced claims management and fraud detection activities.

The expense ratio has increased over this time as a result of several factors, including the impact of a smaller earned premium base, an increase in the commission ratio due to change in business mix and increased profitability, and continued systems and infrastructure investments, to ensure the successful delivery of the organization's strategy. In 2012, Economical initiated a business transformation program to improve the effectiveness and efficiency of its operations. The company expects to execute this program in phases over the next two years. The 2012 results include $13.7 million of costs related to this program, offset by a one-time net benefit of $16.5 million as a result of changes to the eligibility requirements for current employees to the company's other post-employment benefit plan.

The 2012 net income is the highest reported by the company since 2005, illustrating a significant turnaround from the difficult years of 2008 and 2009. This is further evidenced by the significant improvement in ROE to 11.3% in 2012 compared to a loss of 8.4% in 2008. This improvement in performance has resulted in the highest levels of mutual policyholders' equity and assets in Economical's history.

section 6 – investments

CASH AND INVESTMENTS

FIGURE 8 (in millions of dollars, except as otherwise noted)	As at December 31, 2012 Fair value	 % at fair value	As at December 31, 2011 Fair value	 % at fair value
Cash and cash equivalents	**90.5**	**2.3**	248.9	6.7
Short-term investments	**59.8**	**1.5**	-	-
Bonds				
Government	**2,180.2**	**56.6**	2,152.6	58.1
Corporate	**881.7**	**22.9**	828.8	22.4
Total	**3,061.9**	**79.5**	2,981.4	80.5
Canadian preferred stocks	**206.9**	**5.4**	136.5	3.7
Common stocks and pooled funds				
Canadian	**234.1**	**6.1**	203.1	5.5
Foreign	**154.8**	**4.0**	74.1	2.0
Total	**595.8**	**15.5**	413.7	11.2
Commercial loans	**45.1**	**1.2**	59.6	1.6
Total	**3,853.1**	**100.0**	3,703.6	100.0

Economical has maintained a stable investment strategy, which seeks to generate sufficient income while preserving capital. The strategy focuses on maximizing the long-term capital strength of Economical, while seeking to optimize risk-adjusted returns. The company has an established investment policy and strategy that is based upon its risk appetite, the prudent-person approach, regulatory guidelines, and reflects the expected settlement pattern of claim liabilities in regard to the matched portfolio.

The proportionate share of investments in fixed-income securities, including cash and cash equivalents, has declined slightly to 83.3% of the total portfolio compared with 87.2% in 2011. This decline was primarily the result of the company redeploying surplus cash into its actively managed foreign equity investments early in 2012 and preferred share holdings throughout the year.

Commercial loans decreased $14.5 million year-over-year, as loan repayments were higher than new loans issued during the year.

INTEREST AND DIVIDEND INCOME

FIGURE 9

(in millions of dollars, except as otherwise noted)	Year ended December 31 2012	2011	Increase (Decrease)
Interest income	**85.3**	92.8	(7.5)
Dividend income	**19.8**	16.5	3.3
Total	**105.1**	109.3	(4.2)

Interest income decreased $7.5 million year-over-year due to a decline in the book yield of the bond portfolio. The decline in book yield was a result of investing new money and the reinvestment of maturing or sold bonds into lower yielding bonds as a result of the continued low interest rate environment. The decline in interest income was partly offset during 2012 by an increase in realized gains on the sale of bonds designated as Fair Value Through Profit or Loss ("FVTPL"). Dividend income increased by $3.3 million due to an increase in average equity holdings during 2012.

RECOGNIZED GAINS ON INVESTMENTS

FIGURE 10

(in millions of dollars, except as otherwise noted)	Year ended December 31 2012	2011	Increase (Decrease)
Realized gains on AFS portfolio	**34.8**	11.5	23.3
Realized gains on FVTPL bonds	**22.5**	19.4	3.1
Unrealized gains (losses) on FVTPL bonds	**(26.3)**	44.1	(70.4)
Impairment loss	**(9.3)**	(36.3)	27.0
Total	**21.7**	38.7	(17.0)

A subset of the bond portfolio, which is matched in quantum and duration to the claim reserves, is designated as FVTPL. Changes in the fair value of FVTPL instruments are included in recognized gains in the consolidated statement of comprehensive income. The balance of the bond portfolio, along with the company's short-term investments and equity portfolio, is designated as Available for Sale ("AFS"). Changes in the fair value of AFS instruments are included in other comprehensive income ("OCI") until the instrument is disposed of or considered to be impaired.

Realized gains on the AFS portfolio increased by $23.3 million primarily due to the sale of foreign index funds, which were reinvested during the year into actively managed foreign equity holdings, and an increase in bond valuations.

The net realized and unrealized losses on the FVTPL bond portfolio of $3.8 million (2011: $63.5 million in net gains) offset the recovery on the discounting of claim liabilities of $9.3 million (2011: $40.5 million expense). Significant unrealized gains were created during 2011 due to the decline in market yields during the year. In 2012, market yields rose marginally, resulting in the small, unrealized loss on the FVTPL bond portfolio at December 31, 2012.

While overall investment income is down $21.1 million compared to 2011, all areas of the investment portfolio outperformed against the relevant benchmarks used by the company during the year.

Economical has maintained a high-quality and diversified portfolio during the very challenging capital market conditions over the past couple of years. Impairment charges in 2012 decreased $27.0 million from the prior year.

INVESTMENT CREDIT QUALITY

The company continuously monitors the credit ratings of investments within the portfolio and takes the necessary actions to ensure that a high level of quality is maintained. This resulted in 93.6% (2011: 96.9%) of the company's bonds being rated "A-" or better and 99.5% (2011: 99.3%) of the preferred stocks being rated "P2" or better.

The following tables illustrate the excellent credit quality of the company's fixed income securities and preferred shares portfolios.

FIGURE 11	As at December 31, 2012		As at December 31, 2011	
(in millions of dollars, except as otherwise noted)	Fair value	% at fair value	Fair value	% at fair value
AAA	**1,956.2**	**63.9**	1,908.1	64.0
AA	**302.8**	**9.9**	405.5	13.6
A	**605.8**	**19.8**	575.4	19.3
BBB	**176.5**	**5.8**	75.6	2.5
BB or not rated	**20.6**	**0.6**	16.8	0.6
Total	**3,061.9**	**100.0**	2,981.4	100.0

FIGURE 12	As at December 31, 2012		As at December 31, 2011	
(in millions of dollars, except as otherwise noted)	Fair value	% at fair value	Fair value	% at fair value
P1	**48.6**	**23.5**	40.3	29.5
P2	**157.3**	**76.0**	95.2	69.8
P3 or not rated	**1.0**	**0.5**	1.0	0.7
Total	**206.9**	**100.0**	136.5	100.0

The company focuses on high quality and highly liquid investments which are supported by quoted market prices or other observable inputs.

The company has reviewed its portfolio to identify investments determined to be impaired either due to the significance of a decrease in market value or the length of time that the investment has had a market value below its original cost. The company believes it has recorded appropriate impairment charges.

The company has determined that there is no evidence of impairment, as at December 31, 2012, of any individual commercial loan because all balances are current and a review of the financial condition of the debtors and pledged collateral indicates that there is reasonable assurance of timely collection of the full amount of principal and interest.

section 7 - financial strength

FINANCIAL HIGHLIGHTS FOR THE YEAR INCLUDE:

Total assets	Total assets increased by $156.4 million compared to the prior year.
Premium-related balances	Premium-related assets and liabilities increased as expected in line with the premium growth experienced during 2012.
Claim liabilities	Claim liabilities declined $84.9 million, due to improved underwriting performance and enhanced claim management activities.
Mutual policyholders' equity	Total mutual policyholders' equity increased by $164.1 million, or 12.6%, to a historical high of $1,464.2 million, demonstrating Economical's excellent financial strength.

The table below shows the significant balance sheet line items.

FIGURE 13	Year ended December 31		Increase
(in millions of dollars, except as otherwise noted)	2012	2011	(Decrease)
Cash and cash equivalents	**90.5**	248.9	(158.4)
Investments	**3,766.4**	3,457.3	309.1
Premiums receivable	**525.3**	494.6	30.7
Reinsurance receivable and recoverable	**71.0**	96.5	(25.5)
Deferred policy acquisition expenses	**190.9**	179.2	11.7
Goodwill and intangible assets	**73.9**	77.2	(3.3)
Other assets	**108.2**	116.1	(7.9)
Total assets	**4,826.2**	4,669.8	156.4
Claim liabilities	**2,221.3**	2,306.2	(84.9)
Unearned premiums	**933.0**	877.0	56.0
Other liabilities	**207.7**	186.5	21.2
Total liabilities	**3,362.0**	3,369.7	(7.7)
Retained earnings	**1,418.3**	1,271.9	146.4
Accumulated other comprehensive income	**45.9**	28.2	17.7
Mutual policyholders' equity	**1,464.2**	1,300.1	164.1
Total liabilities and mutual policyholders' equity	**4,826.2**	4,669.8	156.4

CLAIM LIABILITIES AND ADJUSTMENT EXPENSES

Claim liabilities represent an estimate of the amount required to settle all outstanding claims and any unreported claims incurred on or before year end. They are measured using accepted actuarial practice and take into account the time value of money and provisions for adverse deviation. The assumptions made in establishing claim liabilities are best estimates that are subject to variability, which could be material.

The discount rate used to determine the actuarial value of claim liabilities is based on the fair value yield of the company's FVTPL bond portfolio, which at December 31, 2012 was 1.70% (2011: 1.65%).

Figure 14 shows the change in the company's claim liabilities for the past two years.

FIGURE 14

(in millions of dollars, except as otherwise noted)	Year ended December 31 2012	2011
Net unpaid claim liabilities, beginning of year	**2,237.8**	2,294.7
Current year claims incurred	**1,085.2**	1,155.4
Prior year favourable claims development (undiscounted)	**(57.4)**	(128.9)
Claims and adjustment expenses	**1,027.8**	1,026.5
Impact of discounting	**(9.3)**	40.5
Claims paid during the year	**(1,098.3)**	(1,123.9)
Net unpaid claim liabilities, end of the year	**2,158.0**	2,237.8

Figure 15 shows the level of prior year favourable claims development over the past five years.

2010 – 2012 under IFRS, 2008 and 2009 under Canadian GAAP

FIGURE 15

(in millions of dollars, except as otherwise noted)	2012	2011	2010	2009	2008
Net unpaid claim liabilities, beginning of the year, undiscounted	**2,122.6**	2,220.0	2,200.1	2,155.0	1,932.9
Favourable development on prior year claims, undiscounted	**57.4**	128.9	71.8	55.7	43.7
Favourable development on prior year closing claims, undiscounted (percentage)	**(2.7%)**	(5.8%)	(3.3%)	(2.6%)	(2.3%)

These favourable trends demonstrate Economical's continued prudent approach to its claim reserving, and further support the excellent financial strength of the organization and its capacity to meet its future claim obligations. In all years, Economical's closing claim liabilities have been conservative when compared to actual development. The significantly higher than usual level of favourable development in 2011 was driven by Ontario personal automobile.

CAPITAL RESOURCES

MUTUAL POLICYHOLDERS' EQUITY

Figure 16 illustrates the change in Economical's mutual policyholders' equity over the last five years.

2010 – 2012 under IFRS, 2008 and 2009 under Canadian GAAP

FIGURE 16

(in millions of dollars, except as otherwise noted)	2012	2011	2010	2009	2008
Retained earnings	**1,418.3**	1,271.9	1,195.0	1,191.5	1,167.4
Accumulated other comprehensive income (loss)	**45.9**	28.2	7.7	(20.8)	(88.4)
Mutual policyholders' equity	**1,464.2**	1,300.1	1,202.7	1,170.7	1,079.0

The company's retained earnings increased by $146.4 million during the year, and mutual policyholders' equity increased $164.1 million, or 12.6% year-over-year, reflecting both strong earnings and increases in the fair value of investments held by the company. Mutual policyholders' equity ended the year at the highest level in the history of Economical with the company having increased mutual policyholders' equity by $261.5 million in the past two years alone, an increase of 21.7% from December 31, 2010.

CAPITAL MANAGEMENT

As a mutual company with limited access to external sources of capital, the company has adopted a capital management policy to ensure sufficient capital is available to protect the company and its policyholders from adverse events. As a federally-regulated P&C insurance company, the company's capital position, along with its insurance subsidiaries, is monitored by OSFI. OSFI evaluates the company's financial strength primarily through MCT, which measures available capital against required risk-weighted capital. Available capital comprises total mutual policyholders' equity subject to adjustments prescribed by OSFI. Capital required is calculated by applying risk factors to certain assets and liabilities. As of December 31, 2012, Economical's available capital significantly exceeded the MCT requirement of 150% required by OSFI, as well as a higher and more stringent internal target established in the company's capital management policy.

Management actively monitors the capital needs of the company and the effect that external and internal forces and actions may have on the capital base of the company. In particular, management determines the effect on capital before entering into any significant transactions, to ensure that policyholders are not put at undue risk through the depletion of capital to unacceptable levels. The Risk Review Committee and the Board of Directors review the capital levels of the company on at least a quarterly basis.

The following table shows the MCT for the company over the past five years.

2010 and 2012 under IFRS, 2008 – 2009 under Canadian GAAP

FIGURE 17	2012	2011	2010	2009	2008
MCT	**295.1%**	269.4%	234.2%	222.6%	200.2%

The MCT has increased significantly in both 2011 and 2012, and Economical continues to be in the strongest position from a solvency standpoint in its history. The company regularly monitors its MCT ratio, the results of its annual dynamic capital adequacy stress testing, and periodic stress testing, and seeks to ensure that the company maintains a strong regulatory capital position and takes corrective actions as necessary.

Reinsurance is also used to protect the company's capital from large losses, including those of a catastrophic nature, which could have a detrimental impact on available capital. The company has formal policies that specify tolerance for financial risk retention. Once the retention limits are reached, reinsurance is utilized to cover the excess risk.

NET RISK RATIO

Another ratio commonly used to measure the stability of insurers is the Net Risk Ratio ("NRR"). The NRR measures the level of risk relative to capital employed by the company, expressing net written premiums for a 12-month period as a ratio to mutual policyholders' equity. The OSFI guideline for NRR is 3:1 or less. The following table shows the company's NRR for the past five years.

2010 – 2012 under IFRS, 2008 and 2009 under Canadian GAAP

FIGURE 18	2012	2011	2010	2009	2008
NRR	**1.2**	1.3	1.4	1.5	1.7

As at December 31, 2012, the company had significantly more capital than that required to support the volume of business underwritten by its operating companies. The NRR has been trending down from 1.7 in 2008 to 1.2 in 2012 primarily due to strong growth in mutual policyholders' equity combined with a decline in net premiums written from 2008. The company is well positioned from a capital standpoint to support its planned growth in premium levels moving forward.

LIQUIDITY

The liquidity requirements of the company's business are met primarily by funds generated by operations, asset maturities and investment returns. Cash provided from these sources normally exceeds cash requirements to meet claim payments and operating expenses.

The company had $90.5 million of cash and cash equivalents at December 31, 2012. The company also has a highly liquid investment portfolio comprised of actively traded securities including: Canadian fixed-income investments issued or guaranteed by domestic governments, investment-grade corporate bonds, publicly traded Canadian and foreign equities, and a foreign equity pooled fund with a combined fair value of $3,636.1 million. The company believes its internal resources will provide sufficient funds to fulfill cash requirements during the 2013 financial year and to satisfy all regulatory capital requirements.

The company has intercompany reinsurance agreements (the "Agreements") in place which result in each company reporting the same underwriting results (i.e., combined ratio). The Agreements are supported by documented agreements between each of the operating companies and the cash flows resulting from the arrangement are settled on a monthly basis. The Agreements allow the impact of any insurance losses to be spread across each company, enabling each company to maintain a strong capital position without the need to move capital via dividends or capital injections. Further supporting the Agreements, the insurance companies have pooled all of their invested assets into a partnership, The Economical Insurance Group Investment Partnership ("TEIGIP"). The vast majority of invested assets of the companies are held in TEIGIP with each company owning a share of the partnership generally equivalent to its participation in the Agreements described above.

OFF-BALANCE SHEET LIABILITIES AND CONTINGENCIES

Like most companies in the insurance industry, Economical is subject to litigation arising in the normal course of conducting its insurance business. The company is of the opinion that this litigation does not and will not have a significant impact on the financial position, results from operations or the cash flows of the company.

The company participates in a securities lending program managed by a major Canadian financial institution whereby Economical lends securities it owns to other financial institutions in order to allow them to meet delivery commitments. The Canadian financial institution involved must provide sufficient collateral to support the value of the securities loaned. At December 31, 2012, securities with an estimated fair value of $578.1 million have been loaned and securities with an estimated fair value of $598.2 million have been received as collateral from the Canadian financial institution. The securities loaned under this program have not been removed from "Investments" on the consolidated balance sheet because the company retains the risks and rewards of ownership. The financial compensation the company receives in exchange for securities lending is reflected in the consolidated statement of comprehensive income in "Interest".

RELATED PARTY TRANSACTIONS

From time to time, the company enters into transactions in the normal course of business, which are measured at the exchange amounts, with certain directors, senior officers and companies with which it is related. Management has established procedures to review and approve transactions with related parties and reports annually to the Corporate Governance Committee of the Board of Directors on the procedures followed and the results of the review.

Directors

One of the company's directors was employed during a portion of the year by a publicly traded entity in which the company owns common stock with a fair value of $7.2 million as at December 31, 2012 (2011: $5.8 million). This entity also provides certain services on an arms-length basis totalling $0.8 million in 2012 (2011: $0.6 million). The company purchases annuities from life insurers to provide for fixed and recurring payments to claimants. The original purchase price of outstanding annuities purchased from this entity is $59.8 million (2011: $53.2 million).

Employment benefit plans

The company makes contributions to employment benefit plans on behalf of its employees, including both defined contribution and defined benefit plans. During the year, the company contributed $9.2 million (2011: $9.0 million) to the defined contribution plan and $9.8 million (2011: $4.1 million) to the defined benefit plans.

Associates

At the reporting date, commercial loans of $2.3 million (2011: $6.3 million) are due from companies subject to significant influence.

The company participates in a quota share reinsurance treaty with a company subject to significant influence under terms consistent with the other reinsurers. The company's share of reinsurance assumed from the associate is as follows:

FIGURE 19

(in millions of dollars, except as otherwise noted)	Year ended December 31 **2012**	**2011**
Premiums assumed	**3.5**	3.0
Premiums earned	**3.4**	3.2
Claims and adjustment expenses	**2.3**	1.3
Commissions	**1.6**	1.4
Deferred policy acquisition expenses	**0.6**	0.7
Reinsurance assumed receivables	**0.4**	0.4

COMMITMENTS

Economical operates throughout Canada in order to serve its customers and support its broker distribution partners in an effective manner. As a result, the company has committed to leasing premises, automobiles and equipment in support of these operations, as well as making certain other non-cancellable commitments. Annual commitments are as follows:

Less than 1 year	$23.9 million
Between 1 and 5 years	$47.2 million
Thereafter	$29.6 million

section 8 – accounting and internal controls

INTERNAL CONTROLS AND PROCEDURES

The company has designed and validated key internal controls and procedures to ensure that accurate financial information is available internally to the Board of Directors and senior management, and externally to regulators and policyholders in a timely and appropriate manner. Inherent limitations exist in all control systems and, as such, an evaluation of those control systems can provide only reasonable assurance that issues, fraud or errors are detected. The company continues to monitor, assess and improve its system of internal controls and procedures.

FUTURE ACCOUNTING AND REPORTING CHANGES

The following IFRS standards have been issued but are not yet effective. The company is currently analyzing the impact these standards will have on its consolidated financial statements, unless otherwise stated.

(a) Financial Instruments: Classification and Measurement

The International Accounting Standards Board ("IASB") issued IFRS 9 ("IFRS 9") – *Financial Instruments* in November 2009 and published amendments in October 2010 and December 2011. This is the first phase of a three-phase project to replace IAS 39 ("IAS 39") - *Financial Instruments: Recognition and Measurement*. This standard addresses classification and measurement of financial instruments and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and FVTPL. IFRS 9 also replaces the models for measuring equity instruments as such instruments are either recognized at FVTPL or at fair value through OCI. Where such equity instruments are measured at fair value through OCI, the dividends that do not clearly represent a return on investment are recognized in net income as investment income; however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive income ("AOCI") and are never reclassified to net income. The amended standard is currently expected to be effective for fiscal years beginning on or after January 1, 2015.

(b) Offsetting Financial Assets and Financial Liabilities

Amendments to IAS 32 ("IAS 32") – *Offsetting Financial Assets and Financial Liabilities* and IFRS 7 ("IFRS 7") – *Disclosures – Offsetting Financial Assets and Financial Liabilities* were issued in December 2011. The amendments to IAS 32 do not modify the offsetting model but simply clarify that an entity currently has a legally enforceable right to set-off if that right is: (i) not contingent on a future event; and (ii) enforceable both in the normal course of business and in the event of a default, insolvency or bankruptcy of the entity and all counterparties. The amendments to IFRS 7 contain new disclosure requirements for financial assets and liabilities that are offset in the balance sheet or are subject to master netting arrangements or similar arrangements. The amendments to IAS 32 and IFRS 7 are not expected to have a significant impact on the presentation or disclosure of the company's financial assets and financial liabilities. The effective date for the amendments to IAS 32 is January 1, 2014. The effective date for the amendments to IFRS 7 is January 1, 2013.

(c) Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10 ("IFRS 10") – *Consolidated Financial Statements*, IFRS 11 ("IFRS 11") – Joint Arrangements and IFRS 12 ("IFRS 12") – *Disclosure of Interests in Other Entities*. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities and replaces the requirements of the original IAS 27 ("IAS 27") – *Consolidated and Separate Financial Statements* and SIC-12 – *Consolidation – Special Purpose Entities*. As a consequence of these changes, the IASB also issued an amended and retitled IAS 27 – *Separate Financial Statements* and IAS 28 ("IAS 28") – *Investments in Associates and Joint Ventures*. These standards set out the principles of control as being power over the investee, exposure or rights to variable returns from involvement with the investee and the ability to use power over the investee to affect the amount of the investor's returns. When preparing consolidated financial statements, an entity must use uniform accounting policies for reporting like transactions and other events in similar circumstances. Intragroup balances and transactions must be eliminated. Non-controlling interests in subsidiaries must be presented in the consolidated balance sheet within equity separately from the equity of the owners of the parent. Currently, the company does not anticipate any significant changes to the recognition of subsidiaries or associates as a result of adopting these standards. These standards are effective for fiscal years beginning on or after January 1, 2013.

(d) Disclosure of Other Interests in Other Entities

IFRS 12 was issued in conjunction with IFRS 10 and IFRS 11 and replaces the disclosure requirements of IAS 27, IAS 28 and IAS 31 – *Interests in Joint Ventures*. IFRS 12 establishes requirements for disclosing information regarding consolidated entities, associates, joint arrangements, unconsolidated structured entities and non-controlling interests. The requirements of IFRS 12 are not anticipated to have a significant impact on the company's financial statement disclosure. The standard is effective for fiscal years beginning on or after January 1, 2013.

(e) Fair Value Measurement

IFRS 13 ("IFRS 13") – *Fair Value Measurement* defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. This standard applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements, except in specified circumstances. The requirements of IFRS 13 are not anticipated to have a significant impact on the company's financial statement measurement or disclosure. The standard is effective for fiscal years beginning on or after January 1, 2013.

(f) Employee Benefits

IAS 19 ("IAS 19") – *Employee Benefits* was amended in June 2011 eliminating the option to defer the recognition of actuarial gains and losses, known as the "corridor method", and instead requires all pension remeasurement impacts to be recognized in OCI as they occur. Upon adopting IFRS, the company had selected the option to recognize all actuarial gains and losses in OCI as they occur, thereby eliminating the impact of this amendment on the company. The new standard permits an entity to accumulate actuarial gains and losses in either retained earnings, consistent with the current IAS 19 standard, or in AOCI. The company has elected to continue accumulating actuarial gains and losses in retained earnings.

The new IAS 19 standard replaces the separate calculation of return on net assets and interest cost with a net interest amount calculated by applying a discount rate to the net defined benefit obligation. The impact of applying this requirement for 2012 would have been to increase pension expense and to reduce actuarial losses by approximately $2.3 million. For 2013, the impact is estimated to be an increase in pension expense and a reduction of actuarial losses of $3.1 million. The new IAS 19 requirement to immediately recognize past service costs and the changes to the treatment of termination benefits are not expected to impact the company. The amendments to IAS 19 also introduced enhanced disclosures around defined benefit plans. The standard is effective for fiscal years beginning on or after January 1, 2013.

(g) Presentation of Financial Statements

IAS 1 ("IAS 1") – *Presentation of Financial Statements* was amended to require profit or loss and OCI to be presented together as either a single statement of comprehensive income or separate income statement and statement of comprehensive income. The amendments also require presentation of OCI based on whether or not the balance may subsequently be reclassified to net income, with the tax associated with each type of OCI balance to be presented separately. Effective for the company's fiscal year beginning January 1, 2013, the company will present the classification of OCI as required by the IAS 1 amendments.

CRITICAL ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and contingent liabilities as at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the year. Actual results could differ significantly from these estimates. Although some variability is inherent in these estimates, management believes that the amounts provided in the company's consolidated financial statements are reasonable.

The most complex and significant accounting judgments, estimates and assumptions used in preparing the company's consolidated financial statements are discussed below.

Judgments

In the process of applying the company's accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements.

The company has applied judgment in its assessment of the identification of objective evidence of impairments for financial instruments, the recognition of tax losses, the determination of cash-generating units ("CGUs"), the evaluation of current obligations requiring provisions, and the identification of the indicators of impairment for property and equipment, goodwill and intangible assets.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

VALUATION OF CLAIM LIABILITIES

The company is required by applicable insurance laws, regulations and IFRS to establish liabilities for payment of claims and claims adjustment expenses that arise from the company's insurance products. These liabilities represent the expected ultimate cost to settle claims occurring prior to, but still outstanding as of, the reporting date. The company establishes its claim liabilities by geographic region, product line, type and extent of coverage and year of occurrence.

Claim liabilities fall into two categories: individual case reserves for reported claims and provision for incurred but not reported ("IBNR") losses. Additionally, liabilities are held for claims adjustment expenses, including the estimated legal and other expenses expected to be incurred to finalize the settlement of the losses.

Claim liabilities do not represent an exact calculation of liability but instead represent estimates developed using projection techniques in accordance with accepted actuarial practice. Case reserves for reported claims are set by claims adjusters based on information currently available to them. Determining the provisions for IBNR and claims adjustment expenses involves an assessment of the future development of claims reported and yet to be reported. The estimates are principally based on the company's historical experience. Methods of estimation have been used that the company believes produce reasonable results given current information. This process takes into account the consistency of the company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises, and the delays in reporting claims.

Claim liabilities include estimates subject to variability, which could be material. Changes to the estimates could result from future events such as receiving additional claim information, changes in judicial interpretation of contracts or significant changes in severity or frequency of claims from past trends. In general, the longer the term required for the settlement of a group of claims, the greater the potential for variability in the estimate. Any future changes in estimates would be reflected in net claims and adjustment expenses in the consolidated statement of comprehensive income in the year in which the change occurred.

Claim liabilities have been discounted to reflect future investment income in accordance with Canadian accepted actuarial practice. The principal assumptions made in establishing claim liabilities are best estimates. To allow for possible deterioration from historical experience, and to increase the likelihood that the claim liabilities are adequate to pay future benefits, actuaries are required to include margins in some assumptions. A range of allowable margins is prescribed by the Canadian Institute of Actuaries relating to claim development, reinsurance recoveries and investment income variables. The effect of the margins produces the provision for adverse deviation ("PfAD").

Reinsurance recoverables include amounts for expected recoveries from reinsurers related to claim liabilities. Amounts recoverable from reinsurers are evaluated in a manner consistent with the provisions of the reinsurance contracts. The failure of reinsurers to honour their obligations could result in losses to the company, as the ceding of insurance does not relieve the company of its primary liability to its insured parties.

IMPAIRMENT OF GOODWILL AND INTANGIBLE ASSETS

The company determines whether goodwill and intangible assets under development, which are not subject to amortization, are impaired on an annual basis or more frequently if there are potential indicators of impairment. Impairment testing of goodwill and intangible assets requires an estimation of the recoverable amount of the CGUs to which assets are allocated.

VALUATION OF POST-EMPLOYMENT BENEFITS

The company provides certain pension and other non-pension post-employment benefits through both defined benefit and defined contribution pension plans, and a non-pension post-employment benefit plan. The projected cost of defined benefit pension plans and other non-pension post-employment benefits is determined using valuations performed by the company's external pension actuaries. No estimation is required for the defined contribution pension plan. The actuarial valuation involves making assumptions about long-term discount rates, expected rates of return on assets, future salary increases, mortality rate, expected health care costs, inflation and future pension increases. All assumptions are determined by management and are reviewed regularly, in conjunction with the company's external actuarial advisors. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Actual experience that differs from the assumptions will affect the amounts of the benefit obligation recognized on the consolidated balance sheet, the expense recognized in net income and actuarial gains or losses recognized in OCI in the consolidated statement of comprehensive income.

PROVISIONS

Provisions, including restructuring provisions, are recognized when the company determines that there is a present legal or constructive obligation as a result of a past event or decision, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are recorded at the present value of the expenditures expected to be required to settle the obligation. In estimating provisions, the company must make assumptions regarding the timing and amount of the expenditures and determine an appropriate discount rate reflective of the current market assessment of the time value of money and the risks specific to the obligations.

MEASUREMENT OF INCOME TAXES

The company is subject to income tax laws in various federal and provincial jurisdictions where it operates. Various tax laws are potentially subject to different interpretations by the taxpayer and the relevant tax authority. To the extent that the company's interpretations differ from those of tax authorities or the timing of realization is not as expected, the provision for income taxes may increase or decrease in future periods to reflect actual experience

section 9 – risk management

OBJECTIVES

Our risk management framework is designed to ensure that the outcomes of activities involving risk are consistent with our governing objective, risk management capabilities, risk-taking capacity and risk appetite, and that we maintain an appropriate risk and reward balance to protect us from events that have the potential to materially impair our financial strength. Our enterprise risk management framework is rooted in the understanding that we are in the business of taking risk for an appropriate return. Balancing risk and reward is achieved through aligning risk appetite with business strategy, diversifying risk, pricing appropriately for risk, mitigating risk through preventive controls and transferring risk to third parties.

ALIGNMENT

We align our risk tolerance with the company's overall vision, mission and business goals by considering whether risks are core, non-core or collateral in nature.

Core risks are those risks that we are willing to accept in order to achieve return expectations and successfully achieve our business objectives. These include insurance-related risks, credit risk and investment-related risks. Non-core risks are those associated with activities outside of our risk appetite and approved business strategies and are therefore generally avoided, regardless of expected returns. Collateral risks are those that are incurred as a by-product of pursuing the risk and return optimization of core risks. Operational risks often fall into this category. We endeavour to mitigate collateral risks to the extent that the benefit of risk reduction aligns with or exceeds the cost of mitigation.

Our risk appetite is also aligned with our risk management capabilities. We actively seek profitable risk-taking opportunities in those areas where we have established risk management capabilities, and seek to avoid risks that are beyond those capabilities.

ACCOUNTABILITY

Our enterprise-wide risk management framework defines responsibility and authority for risk-taking, governance and control.

Risk management occurs at all levels of the organization and is the responsibility of every employee. However, our Board of Directors is ultimately responsible for ensuring that risk management policies and practices are in place and operating effectively. The Board of Directors, through the Risk Review Committee, oversees the development, approval and maintenance of risk management policies, the identification of major areas of risk facing the company, the development of risk management strategies, and compliance with the risk management policies we implement. To assist in fulfilling the responsibility for ensuring that the principal risks facing the company are appropriately identified and managed, the Board of Directors has delegated certain risk management functions to the following standing board committees:

- Our Risk Review Committee, which is comprised of a majority of non-management directors, is responsible for the oversight of the enterprise-wide risk management framework. This includes the development and implementation of the company's enterprise risk management policy, its governing objective and articulation of risk appetite, together with monitoring key and emerging risks of the company.
- Our Investment Committee, which is comprised of a majority of non-management directors, is responsible for the oversight of investment policies, practices, procedures and controls related to the management of the investment portfolio, the performance of the investment portfolio and monitoring the investment performance of our pension plans.
- Our Corporate Governance Committee, which is comprised entirely of non-management directors, is responsible for developing effective corporate governance guidelines and processes, reviewing policies and processes to sustain ethical behaviour, reviewing reports related to compliance with legal and regulatory matters, assessing the effectiveness of the Board of Directors and its committees as well as the contributions of individual directors, and identifying and recommending for election as directors those individuals with appropriate competencies, skills and experience.
- Our Audit Committee, which is comprised entirely of non-management directors, is responsible for overseeing: the integrity of our financial statements and related public disclosure; the qualifications, independence and appointment of our external auditor; the design, implementation and evaluation of our internal controls over financial reporting and our disclosure controls; and the work of our internal and external auditors.

Economical is currently in the process of implementing a "three-level of defence" risk governance model – consisting of the frontline risk taking through business operations (first line), the risk management and compliance functions (second line) and internal audit (third line). Primary accountability for risk management resides with our president and chief executive officer, who further delegates responsibilities throughout the company under a framework of management authorities and responsibilities. Key components of that framework include:

First level of defense: Line of business management provide day-to-day management and risk control

- Employees within each functional and business area identify, take and manage risk on a day-to-day basis, adhering to board-approved risk appetite and supporting policies and practices.
- Accountable executives within each functional and business area establish and perform ongoing monitoring and oversight of functions and controls to review employee compliance with Economical's risk management policies and practices. They are supported by corporate legal, compliance and risk management resources.
  - Our corporate office functional heads, namely our chief financial officer, chief actuary and chief legal officer, who collaborate with the chief risk officer and the Management Risk Committee in the development, communication and implementation of the company's enterprise risk management framework;
  - Our vice-president personal lines and vice-president commercial lines who establish, oversee and implement the company's underwriting policies and guidelines;
  - Our vice-president claims who establishes, oversees and implements the company's claims handling policies and guidelines; and
  - Our vice-president sales and distribution and underwriting operations who has overall front line accountability for managing the risks in the operations in accordance with our risk management framework and how we distribute our products.

Second level of defense: Risk and compliance functions provide risk policies, tools, methodologies and oversight

- The risk management function headed by the chief risk officer establishes enterprise risk policies and provides direction, processes, methodologies, models and tools. It performs independent monitoring and analysis of risk-taking by the first level of defense and its risk management activities. The compliance function communicates internal and external compliance requirements to the first line of defense and provides support to help it comply with those requirements.
- The risk management and compliance functions' own quality assurance and validation practices are applied to ensure that policies, methodologies, practices, models, frameworks and other capabilities developed by risk management comply with requirements and quality standards and are suitable for use within Economical.
- Our Management Risk Committee is a cross-functional management committee composed of the president and chief executive officer and members of senior management. It is led by our chief risk officer and oversees the management of major enterprise risk and control activities with a view to understanding existing and emerging risks, their impact on the organization's risk profile and ensuring that the magnitude of those risks remains within board-approved risk parameters.
- Our chief risk officer, whose responsibilities include providing independent functional oversight of our enterprise-wide risk management programs by ensuring that effective risk management processes are in place for risk identification, risk measurement and assessment, risk response development, risk monitoring and control, and reporting of risks inherent in our activities.

Third level of defense: Internal Audit provides periodic independent assurance

- Internal audit provides periodic independent assurance on the adequacy and effectiveness of enterprise risk management (ERM) policy, supporting framework and related processes and practices, as well as compliance with policies, standards and required practices.
- Internal audit has its own quality assurance and validation practices and applies them to ensure that internal audits are carried out in compliance with established audit policies, standards and methodologies and that audit findings and conclusions are objective and appropriately supported.

MANAGEMENT OF CORE RISKS

The core risks we manage include insurance-related risks, credit risk, investment-related risks, and operational and other risks, which are explained in greater detail below.

INSURANCE-RELATED RISKS

Business cycle and competitive risk

The P&C insurance industry is cyclical, and the company expects to experience periods where the market has excess underwriting capacity and which results in soft pricing and inadequate returns. The financial performance of the industry has historically tended to fluctuate in cyclical patterns of soft markets characterized generally by increased competition resulting in lower premium rates, followed by hard markets characterized by reduced competition and increasing premium rates. The risk exists that these fluctuations in industry conditions could produce an underwriting environment that has negative impacts on our underwriting results, premium levels and financial condition.

When there is intense competition in the industry for any product line, the company's competitors may price their products at rates that appear to be below the level required to make a reasonable return in an effort to gain or retain market share. If we are unable to realize superior risk selection or sufficient expense efficiencies, our ability to establish or maintain competitive pricing could be adversely affected. Given our disciplined approach to underwriting, there may be market conditions or competitive actions which restrict our ability to grow or maintain our written premium levels.

Product and pricing risk

Product and pricing risk is the risk of financial loss from entering into insurance contracts when the liabilities assumed exceed the expectation reflected in the pricing of the insurance product. Economical prices its products by taking into account several factors including product design and features, claim frequency, severity trends, product line expense ratios, special risk factors, capital requirements, regulatory requirements and investment income. These factors are reviewed and adjusted as needed to ensure they are reflective of current trends and market conditions. Economical endeavours to maintain pricing levels that produce an acceptable return by appropriately measuring and incorporating these factors into its pricing decisions.

New products are subject to a detailed review by management, including our actuarial specialists, prior to their launch, in order to mitigate the risk that they are priced at an inadequate level. The performance and pricing of such new products are regularly monitored and corrective action is taken as considered necessary, including re-pricing of the products and the use of reinsurance.

New or potential legislative or industry developments could affect the company's ability to price some of its products at an adequate level and restrict the ability to make a reasonable return.

Underwriting risk

Underwriting risk is the risk of financial loss resulting from the selection of risks to be insured and the management of contract clauses. To minimize underwriting risk, the company has underwriting policies that set out the underwriting risk appetite and criteria of the organization, as well as specifying tolerances for maximum financial risk retention. Once the retention limits are reached, reinsurance is utilized to cover the excess risk.

The company has established quality review processes to ensure that its underwriting activities fall within established guidelines, risk appetites and pricing structures. The review process includes branch and regional self-reviews, and Head Office reviews conducted on a pre-determined schedule. The results of these quality reviews are distributed to senior management and the appropriate field management staff to ensure any issues identified are remedied.

The company's underwriting results may also be adversely impacted by its mandatory participation in the Facility Association of Canada's ("FA") automobile insurance pools. When certain automobile owners are unable to obtain insurance via the voluntary insurance market, they are insured by the FA. In addition, insurance entities can choose to cede certain risks to FA-administered risk sharing pools ("RSP"). The related risks associated with FA insurance policies and policies ceded by companies to the RSP are aggregated and shared by the entities in the P&C insurance industry, generally in proportion to market share and volume of business ceded to the RSP.

Claims reserving risk

A key objective of the company is to ensure that sufficient claim liabilities are established to cover future insurance claim payments. The company's underwriting profitability depends upon the ability to accurately assess the risk associated with the insurance contracts underwritten by the company. The company establishes claim liabilities to cover the estimated liability for payment of all claims and claim adjustment expenses incurred with respect to insurance contracts underwritten by the company. Claim liabilities do not represent an exact calculation of the liability. Rather, claim liabilities are the company's best estimates of its expected ultimate cost of resolution and administration of claims. The process of calculating claim liabilities involves the use of models, which exposes the company to model risk in the event that actual results differ from those modelled, due to model limitations, data issues or other factors. Expected inflation is taken into account when estimating claim liabilities, thereby mitigating inflation risk.

Claim liabilities include an estimate for reported claims as established by the company's claims adjusters based upon the details of reported claims plus a provision for IBNR.

Individual claims estimates are determined by claims adjusters on a case-by-case basis in accordance with documented policies and procedures. These specialists apply their knowledge and expertise, after taking available information regarding the circumstances of the claim into account, to set individual case reserve estimates. The IBNR provision is intended to cover future development on both reported claims and claims that have occurred but have not yet been reported. Uncertainty exists on reported claims in that all information may not be available at the valuation date. Claims that have occurred may not be reported to the company immediately; therefore, estimates are made to provide for unreported claims.

The valuation of claim liabilities is based on estimates derived by geographical region and line of business using generally accepted actuarial techniques. Numerous individual assumptions that impact average claim costs or frequency of late reported claims are made for each line of business. The principal assumption in the majority of actuarial techniques employed is that future claim development will follow a similar pattern to recent historical experience. However, there are times where historical experience is deemed inappropriate for evaluating future development due to recent judicial decisions, changes to government legislation or major shifts in a book of business. Such instances can require significant actuarial judgment, often supported by industry benchmarks, in establishing an adequate provision for claim liabilities.

Establishing an appropriate level of claim liabilities is an inherently uncertain process and is closely monitored by the company's appointed actuary. The sheer volume and diversity of considerations makes it impracticable to measure the impact on the company's insurance contracts resulting from a change in a particular assumption or group of assumptions. The impact of changing assumptions for all lines of business and geographical regions in such a way that the average claim severity is altered by 5% would result in a change in net claim liabilities of $107.9 million at December 31, 2012 (2011: $111.9 million). Similarly, the impact within the average claims severity of a 5% change solely in claims and adjustment expenses would result in a change in net claims expenses of $6.4 million at December 31, 2012 (2011: $6.6 million).

The outstanding claim liabilities represent payments that will be made in the future; therefore, they are discounted to reflect the time value of money. The discount rate used to determine the discounted value of claim liabilities is based on the fair value yield of the company's matched bond portfolio. The impact of an immediate hypothetical 1% increase in the discount rate, with all other variables held constant, would reduce net claim liabilities at December 31, 2012 by $61.4 million (2011: $63.4 million). The impact of an immediate hypothetical 1% decrease in the discount rate, with all other variables held constant, would increase net claim liabilities at December 31, 2012 by $65.9 million (2011: $67.8 million). See "Interest rate risk" under "Investment-related risks" section for a discussion on the sensitivity on the matched bond portfolio.

Assumptions and methods of estimation have been used that the company believes produce reasonable results given current information. As additional experience and other data become available, the estimates could be revised. Any future changes in estimates would be reflected in the consolidated statement of comprehensive income in the year in which the change occurred.

Catastrophic events risk

Catastrophe risk arises because P&C insurance companies experience large losses due to man-made or natural catastrophes that can result in significant impacts on claims costs. Catastrophes can cause losses in a variety of different lines of business and may have continuing effects which, by their nature, could delay or impede efforts to accurately assess the full extent of the damage they cause on a timely basis. The company evaluates catastrophic events and assesses the probability of occurrence and magnitude of impact through various commonly used, industry-wide modelling techniques and through the aggregation of limits exposed in each geographical territory in which we operate. The company manages its catastrophic events exposure by managing the reinsurance deductibles charged to policyholders, the geographic concentration of its policies, considering levels of reinsurance, capital position and overall risk tolerances. We currently purchase reinsurance to provide coverage for catastrophic events, both on an aggregated and individual basis.

Reinsurance coverage risk

Economical utilizes reinsurance in order to manage its exposure to insured risks. Reinsurance coverage risk arises because reinsurance terms, conditions, availability and/or pricing may change on renewal, particularly during times of high levels of catastrophic events, either in Canada or globally, or as a result of higher than expected claims activity on the non-catastrophe reinsurance treaties. In addition, reinsurers may seek to impose terms that are inconsistent with corresponding terms in the policies written by the company. Ceding risk to reinsurers does not relieve the company of the obligation to its policyholders for claims. The company works only with well-established and financially secure reinsurers that have extensive experience in this industry as well as a strong understanding of the company's business and the Canadian environment. Senior management reviews the company's reinsurance program to ensure its cost effectiveness and that adequate coverage is obtained, reflective of the company's risk tolerances and financial strength, and in compliance with the company's reinsurance risk management policy.

CREDIT RISK

Credit risk is the risk of financial loss as the result of the company's counterparties not being able to meet payment obligations as they become due. The company's credit risk is concentrated in the bond, preferred stock and commercial loan portfolios, the securities lending program, premiums receivable, amounts owing from reinsurers and structured settlements. Unless otherwise stated, the company's credit exposure is limited to the carrying amount of these assets.

Economical's investment policies require the company to invest in bonds and preferred stocks of high credit quality and to limit exposure with respect to any one issuer. No more than 10% of the market value of the bond portfolio may be in any one issuer, except for federal or provincial government issuers, and at least 90% of the bonds in the portfolio must have a credit rating of at least an "A-" or higher by independent rating agencies at the time of purchase. For preferred stocks, no single issue can represent more than 25% of the preferred stock portfolio and at least 90% of the preferred stocks must be rated "P2" or higher by independent rating agencies at the time of purchase. "A-" and "P2" represent the ratings provided by two recognized rating services for high-grade bonds and preferred stocks, respectively, where both asset and earnings protection are well assured. On a continuous basis, the company also monitors publicly available information related to the investments held in the investment portfolio to determine whether there are investments which require closer monitoring of their credit risk. Of the bonds held at December 31, 2012, 93.6% (2011: 96.9%) were rated "A-" or better and 99.5% (2011: 99.3%) of the preferred stocks were rated "P2" or better. Of the corporate bonds held at December 31, 2012, 84.9% (2011: 86.4%) are concentrated in the financial services industry.

The company also participates in a securities lending program. The company minimizes credit risk associated with this program by only dealing with one counterparty that is a Canadian financial institution rated "AA-" by independent rating agencies and by obtaining collateral with a fair value in excess of the value of the securities loaned under the program. As at December 31, 2012, collateral held was 103.5% (2011: 104.1%) of securities loaned, of which 98.9% (2011: 94.5%) was held in cash and government-backed securities with the balance held in high-quality publicly traded corporate securities.

The company's credit exposure to any one individual policyholder or broker included in premiums receivable is not significant. The company regularly monitors amounts due from policyholders and follows up on all overdue accounts. As permitted by regulation, when premiums are overdue for a certain period of time, the company cancels the insurance coverage under the applicable policy. The company's broker appointment process ensures a financial review of each broker before they are granted a contract. This review includes an assessment of the ability of the broker to meet payment obligations as they become due. Periodic broker reviews are conducted to ensure continued profitability and solvency. The allowance for doubtful accounts in the current and comparative periods is insignificant as overdue receivables are negligible. Delinquent accounts are regularly monitored and the company takes action as considered necessary.

The company periodically makes commercial loans to its brokers. Sufficient collateral, including the form of an assignment over the ownership interest in the brokerage and other security, is held to protect the company against default on these loans. Annual financial reviews are undertaken to determine if the broker will be able to make the required payments when due. The company's gross credit exposure on these loans is limited to the carrying value of commercial loans, which amounted to $48.8 million at December 31, 2012 (2011: $62.2 million). There is currently no evidence of impairment of any individual commercial loan.

Credit exposures on the company's reinsurance recoverable and receivable balances exist to the extent that any reinsurer may or may not be willing or able to reimburse the company under the terms of the relevant reinsurance arrangements. The company has policies which limits the exposure to individual reinsurers and a regular review process to assess the creditworthiness of reinsurers from whom the company purchases coverage. The company's reinsurance risk management policy generally limits the use of reinsurers with credit ratings less than "A-". Currently all reinsurers have a credit rating of "A-" or better as determined by independent credit agencies. Where appropriate, the company obtains collateral for outstanding balances in the form of cash, letters of credit, offsetting balances payable, guarantees or assets held under reinsurance security agreements.

The company has purchased annuities from life insurers to provide for fixed and recurring payments to claimants. As a result of these arrangements, the company is exposed to credit risk to the extent to which any of the life insurers fail to fulfill their obligations. This risk is managed by acquiring annuities from life insurers with proven financial stability, all of which are rated "A-" or better by independent rating agencies. As at December 31, 2012, no information has come to the company's attention that would suggest any weakness or failure in life insurers from which it has purchased annuities. Consequently, no provision for credit risk is required. The original purchase price of the outstanding annuities is $269.0 million (2011: $251.6 million), although our ultimate exposure to the creditworthiness of any individual life insurer is significantly less than this.

INVESTMENT-RELATED RISKS

The company's investments holdings are exposed to interest rate risk, equity market price risk, credit risk (as previously discussed) and foreign exchange risk.

Economical has established detailed investment policy statements which are subject to regular review and approval, for both the matched and non-matched investment portfolios. These policy statements set out Economical's philosophy to its investment management, which is to generate sufficient income while preserving capital. The philosophy focuses on maximizing the long-term capital strength of Economical, while seeking to maximize risk-adjusted returns. The policy statements include specific guidelines over such items as asset mix, concentration levels in specific investments, required quality of the underlying investments, the use of derivatives and exposure to foreign currencies. Compliance with these guidelines, and the requirements of the Insurance Companies Act is routinely monitored by and reported upon to the Investment Committee.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Typically, interest income will be reduced during sustained periods of declining interest rates, but this will also generally increase the fair value of the bond portfolio. The reverse is true during a sustained period of increasing interest rates. The company manages its exposure to interest rate risk by matching a portion of the company's bond portfolio against the quantum and duration of the company's claim liabilities.

Duration is a measure used to estimate the extent fair values of fixed-income investments move with changes in interest rates. Using this measure, the impact of an immediate hypothetical 1% change in interest rates with all other variables held constant is as follows: the change in fair value of bonds in the matched portfolio impacting net income before tax at December 31, 2012 is $65.1 million (2011: $67.7 million); the change in the fair value of bonds in the non-matched portfolio impacting OCI before tax at December 31, 2012 is $63.0 million (2011: $51.3 million).

Equity market risk

As part of its investment portfolio, a portion of the company's investments are held in equity investments in Canadian and global stocks. Economic trends, the political environment and other factors can positively or adversely impact the equity markets and, consequently, the value of equity investments the company holds.

The impact of a 10% change in the value of Economical's equity portfolio, with all other variables held constant, to the extent the company does not dispose of any of these stocks during the year, is $54.6 million based upon holdings at December 31, 2012 (2011: $37.3 million). This change would impact OCI before tax, to the extent that no losses were realized or required to be considered for impairments in value.

Foreign exchange risk

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Economical's foreign exchange risk relates primarily to its foreign common stock and pooled fund holdings in the investment portfolio denominated in various foreign currencies.

The impact to the company of a 1% change in the value of the foreign currencies relative to the Canadian dollar is $0.9 million based upon holdings at December 31, 2012 (2011: $0.7 million).

Use of derivatives risk

Generally, Economical's investment policies limit the use of derivative instruments, without prior Investment Committee approval. Economical's current use of derivative instruments is negligible. In addition, the company conducts a search for embedded derivatives on at least an annual basis and found no significant embedded derivatives in 2012.

STRATEGIC RISK

Strategic risk is the potential for loss or under-performance arising from ineffective business strategies, the inability to implement business strategies and/or the inability to adapt strategies to changes in the business environment. The company's strategy, and its ability to implement the strategy is influenced by, amongst other things, industry competition, changes in the regulatory environment or requirements, general economic conditions and legal matters. The company closely monitors the environment in which it operates and risks that impact the execution of its strategy are regularly assessed, managed and addressed by the senior executive team, with oversight from the Board of Directors. Each year the senior management team reassesses the company's strategy in light of industry, general economic, regulatory, technological and other conditions and develops a detailed business plan which is reflective of this strategy. The business plan is presented to and approved by the Board of Directors annually or more frequently, if required.

Successful implementation of the company's strategy depends, among other matters, on the company's ability to attract, develop and retain key employees. The loss of services of key employees could adversely impact the company's financial performance. In 2012, the company made a number of key appointments, strengthening its Board of Directors and senior management team, and continues to focus on the delivery of critical talent management and performance enhancement programs.

OPERATIONAL AND OTHER RELATED RISKS

Liquidity risk

Liquidity risk is the risk that the company will encounter difficulty in raising funds to meet obligations associated with financial liabilities, particularly those related to claim payments. To manage this risk, an appropriate portion of invested assets is maintained in short-term (less than one year) highly liquid money market securities, which are used to manage Economical's operational requirements. A large portion of invested assets are held in highly liquid federal and provincial government debt to protect against any unanticipated large cash requirements.

Operational risk

Operational risk is the risk of financial loss from inadequate or failed processes, people and systems, or due to external events. Economical is continually enhancing its enterprise-wide risk management framework to include current risk assessments for all significant business and functional areas. There is also ongoing monitoring and follow-up on risks and associated controls through regular reporting by the Management Risk Committee, under the stewardship of the company's chief risk officer, to the Risk Review Committee and other relevant board committees.

Internal audit creates an annual risk-based internal audit plan. The plan is developed with the key inherent risks of Economical's operations in mind and is approved by the Audit Committee of the Board of Directors.

Regulatory and legal risk

Regulatory risk refers to the impact of penalties, fines and restrictions on the ability to carry on business as a result of non-compliance with regulatory requirements. It also includes the risk that modifications to regulations will threaten the company's ability and capacity to conduct business in the future in the manner it does today.

As a participant in the P&C insurance industry, Economical is subject to significant regulation by the federal and provincial governments. The company has established procedures and controls to gain reasonable assurance that it is in compliance with all relevant laws, rules and regulations. The personal automobile insurance product is subject to significant regulation in each province, and it is possible that future regulatory changes may prevent the company from taking actions, such as raising rates, to affect operating results. In addition, court decisions on individual claims could drastically change the business environment in which Economical operates. Changes to capital and solvency standards, restrictions on certain types of investments and periodic market conduct and financial examinations by regulators could impact the ability of the company to successfully implement its strategy. The company actively participates in discussions with regulators, governments and industry groups to ensure that significant concerns are understood.

Reputational risk

Reputational risk is the risk that negative publicity regarding the P&C insurance industry generally or Economical's conduct or business practices, whether true or not, will adversely affect Economical's performance, operations, broker relationships or customer base, or require costly litigation or other defensive measures.

Reputational risk assessments involve a broad array of factors, including the extent and outcome of relevant legal and regulatory due diligence, the economic intent of particular transactions, the need for customer or public disclosure, conflicts of interest, fairness issues and public perception.

Economical manages reputational risk by the implementation of its Code of Conduct, governance practices, risk management programs, policies, procedures, and staff and broker partner training. All directors, officers, employees and key business partners of Economical have a responsibility to conduct their activities in accordance with the company's Code of Business Conduct.

Under our ethics reporting program, employees are able to contact an independent service provider on a confidential and anonymous basis to communicate any concerns regarding compliance with our Code of Conduct, including questionable accounting or auditing matters, internal controls over financial reporting, and our disclosure controls and procedures. All concerns raised are forwarded to designated independent company individuals for investigation and follow-up.

section 10 – other matters

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain of the statements in this MD&A and elsewhere in our Annual Report regarding our current and future plans, expectations and intentions, results, levels of activity, performance, goals or achievements, or any other future events or developments constitute forward-looking statements. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other similar or comparable words or phrases, are intended to identify forward-looking statements.

Forward-looking statements are based on estimates and assumptions made by management based on management's experience and perception of historical trends, current conditions and expected future developments, as well as other factors that management believes are appropriate in the circumstances. Many factors could cause Economical's actual results, performance, achievements, future events or developments to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the following factors: Economical's ability to implement its strategy or operate its business as management currently expects; its ability to accurately assess the risks associated with the insurance policies that it writes; unfavourable capital market developments or other factors which may affect Economical's investments and funding obligations under its pension plans; the cyclical nature of the P&C industry; management's ability to accurately predict future claims frequency or severity; government regulations; litigation and regulatory actions; periodic negative publicity regarding the insurance industry; intense competition; Economical's reliance on information technology and telecommunications systems; Economical's dependence on key employees; and general economic, financial and political conditions.

All of the forward-looking statements included in this MD&A are qualified by these cautionary statements and those made in the "Risk Management" section of the MD&A for the year ended December 31, 2012. These factors are not intended to represent a complete list of the factors that could impact Economical; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements we make. We are under no obligation and have no intention to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

definitions

Claims ratio	Claim and adjustment expenses excluding discounting during a defined period, expressed as a percentage of net premiums earned for the same period.
Combined ratio	The sum of the claims ratio and the expense ratio.
Discounting	To reflect the time value of money, claims liabilities are discounted using the market yield rate of the investments held to support those liabilities (matched investments). Actuarially determined provisions for adverse deviation are also included when determining the discounted value.
Expense ratio	Underwriting expenses including commissions, operating expenses and premium taxes during a defined period, expressed as a percentage of net premiums earned for the same period.
Gross written premiums ("GWP")	The total premiums from the sale of insurance during a specified period.
Minimum capital test ("MCT")	A regulatory formula defined by the Office of the Superintendent of Financial Institutions ("OSFI") that is a risk-based test of capital available relative to capital required.
Net earned premiums ("NEP")	The portion of NPW equal to the expired period of time an insurance policy is in effect.
Net premiums written ("NPW")	GWP less the cost of reinsurance coverage.
Policies in force ("PIF")	The number of insurance policies for which the company is on risk at a specified date.
Provision for adverse deviation ("PfAD")	An amount that is added to the discounted claims and adjustment expenses to reduce the potential adverse effect of the uncertainty that is inherent in the assumptions and data used to estimate such liabilities.
Return on equity ("ROE")	Net income after tax for the 12 months ended at a specified date divided by the average retained earnings over the same 12-month period.
Underwriting income	The excess of NEP over the sum of claim and adjustment expenses, excluding discounting, commissions, operating expenses and premium taxes.

good to know®

you have reached the end of the management discussion and analysis…

...and the beginning of the consolidated financial statements.

economical mutual insurance company
audited consolidated financial statements

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report of management's accountability

The accompanying consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards and have been approved by the Board of Directors.

Management is responsible for ensuring that these statements, which include amounts based on estimates and judgment, are consistent with other information and operating data contained in the Annual Report, and reflect the company's business transactions and financial position. The integrity and reliability of Economical Mutual Insurance Company's reporting systems are achieved through the use of formal policies and procedures, the careful selection of employees, and appropriate delegation of authority and division of responsibilities. Deloitte & Touche LLP has been retained to act as the company's internal auditor. The responsibility of the internal auditor is to monitor and assess the integrity of the internal controls within key business processes. Economical's Code of Business Conduct, which is communicated to all levels in the organization, requires employees to maintain high standards in their conduct of the company's affairs.

The external auditor, Ernst & Young LLP, whose report on their audit of the consolidated financial statements follows, also reviews our systems of internal accounting control in accordance with Canadian generally accepted auditing standards for the purpose of expressing their opinion on the consolidated financial statements.

The actuary is appointed by the Board of Directors pursuant to the Insurance Companies Act (Canada). The actuary is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, and applicable legislation and associated regulations or directives. The actuary is also required to provide an opinion regarding the appropriateness of the policy liabilities at the balance sheet date to meet all policyholder obligations of the company. Examination of supporting data for accuracy and completeness is an important element of the work required to form this opinion.

The Board of Directors annually appoints an Audit Committee comprising of directors who are not employees of the company. This committee meets regularly with management, the internal auditor and the external auditor to review significant accounting, reporting and internal control matters. Both the internal and external auditors and the actuary have unrestricted access to the Audit Committee. Following its review of the consolidated financial statements and the report of the external auditor, the Audit Committee submits its report to the Board of Directors for formal approval of the consolidated financial statements.

Karen Gavan
President and chief executive officer

Philip Mather
Senior vice-president and chief financial officer

Waterloo, ON, Canada
February 20, 2013

appointed actuary's report

To the Members of Economical Mutual Insurance Company:

I have valued the policy liabilities of Economical Mutual Insurance Company for its consolidated balance sheet at December 31, 2012, and their change in the consolidated statement of comprehensive income for the year then ended in accordance with accepted actuarial practice in Canada, including selection of appropriate assumptions and methods.

In my opinion, the amount of policy liabilities makes appropriate provision for all policyholder obligations and the consolidated financial statements fairly present the results of the valuation.

Linda M. Goss
Fellow, Canadian Institute of Actuaries

Waterloo, ON, Canada
February 20, 2013

independent auditors' report

To the Members of Economical Mutual Insurance Company:

We have audited the accompanying consolidated financial statements of Economical Mutual Insurance Company, which comprise the consolidated balance sheet as at December 31, 2012 and the consolidated statements of comprehensive income, changes in mutual policyholders' equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITORS' RESPONSIBILITY

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

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

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

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Economical Mutual Insurance Company as at December 31, 2012 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Chartered Accountants
Licensed Public Accountants

Kitchener, Canada
February 20, 2013

ECONOMICAL MUTUAL INSURANCE COMPANY
CONSOLIDATED BALANCE SHEET
AS AT DECEMBER 31

(in thousands of dollars)	Notes	2012	2011
ASSETS			
Cash and cash equivalents		$ 90,523	$ 248,910
Investments	5	3,766,384	3,457,332
Accrued investment income		13,155	15,256
Premiums receivable		525,342	494,607
Income taxes receivable		-	742
Reinsurance receivable and recoverable	7,9	70,979	96,464
Deferred policy acquisition expenses	7	190,938	179,189
Property and equipment	10	22,978	23,021
Deferred income tax assets	11	52,848	53,375
Goodwill and intangible assets	12	73,912	77,246
Other assets	13	19,108	23,617
		$ 4,826,167	$ 4,669,759
LIABILITIES AND MUTUAL POLICYHOLDERS' EQUITY			
Unearned premiums	8	$ 933,013	$ 876,975
Claim liabilities	7,8	2,221,284	2,306,162
Accounts payable and other liabilities	14	195,603	186,538
Income taxes payable		12,054	-
		3,361,954	3,369,675
MUTUAL POLICYHOLDERS' EQUITY			
Retained earnings		1,418,287	1,271,857
Accumulated other comprehensive income		45,926	28,227
Total mutual policyholders' equity	17	1,464,213	1,300,084
		$ 4,826,167	$ 4,669,759
Commitments and contingencies	19		

See accompanying notes.

On behalf of the Board:

G.A. Hooper, Director

K.L. Gavan, Director

ECONOMICAL MUTUAL INSURANCE COMPANY
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED DECEMBER 31

(in thousands of dollars)	Notes		2012		2011
Gross premiums written	15	$	1,819,703	$	1,723,239
Net premiums written	15	$	1,723,656	$	1,630,836
Net premiums earned	15	$	1,666,018	$	1,615,100
Underwriting expenses:					
Net claims and adjustment expenses (undiscounted)	7,9		1,027,777		1,026,517
Net commissions	9		356,071		338,156
Operating expenses			161,964		161,446
Premium taxes			59,552		56,624
			1,605,364		1,582,743
			60,654		32,357
Impact of discounting	7		9,329		(40,499)
Underwriting income (loss)			69,983		(8,142)
Investment income:	5				
Interest			85,284		92,800
Dividends			19,831		16,452
Recognized gains on investments			21,746		38,709
			126,861		147,961
Other income (expense)	16		14,756		(12,352)
Restructuring expenses	21		(11,588)		-
Income before income taxes			200,012		127,467
Income tax expense	11		47,292		36,468
Net income		$	152,720	$	90,999
Net unrealized gains on AFS investments			49,151		2,694
Reclassification to net income of net recognized losses (gains)	5		(25,512)		24,835
Post-employment benefit obligation loss	16		(8,548)		(19,091)
Foreign exchange gain on investments in subsidiaries			7		179
Income tax expense	11		3,689		2,278
Other comprehensive income			11,409		6,339
Comprehensive income		$	164,129	$	97,338

See accompanying notes.

ECONOMICAL MUTUAL INSURANCE COMPANY
CONSOLIDATED STATEMENT OF CHANGES IN MUTUAL POLICYHOLDERS' EQUITY

FOR THE YEAR ENDED DECEMBER 31

(in thousands of dollars)	2012			2011		
	Retained earnings	**Accumulated other comprehensive income**	**Total mutual policyholders' equity**	Retained earnings	Accumulated other comprehensive income	Total mutual policyholders' equity
Balance, beginning of the year	$ 1,271,857	$ 28,227	$ 1,300,084	$ 1,194,991	$ 7,755	$ 1,202,746
Net income	152,720	-	152,720	90,999	-	90,999
Other comprehensive income (loss)	(6,290)[1]	17,699	11,409	(14,133)[1]	20,472	6,339
Total comprehensive income	146,430	17,699	164,129	76,866	20,472	97,338
Balance, end of the year	$ 1,418,287	$ 45,926[2]	$ 1,464,213	$ 1,271,857	$ 28,227[2]	$ 1,300,084

[1] Actuarial losses for the defined benefit plan recognized in retained earnings (net of income tax of $2,258 (2011: $4,958)).

[2] Included in AOCI is $419 (2011: $412) related to the cumulative foreign exchange gain on investments in subsidiaries.

See accompanying notes.

ECONOMICAL MUTUAL INSURANCE COMPANY
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31

(in thousands of dollars)	Notes	2012	2011
Operating activities:			
Receipts:			
Premiums collected		$ 1,697,093	$ 1,618,713
Interest received		105,104	115,972
Dividends received		19,796	16,198
		1,821,993	1,750,883
Payments:			
Claims paid	7	1,098,276	1,123,878
Commissions and expenses paid		493,691	509,392
Premium taxes paid		57,225	53,617
Income taxes paid		42,101	43,451
Restructuring expenses paid	21	6,416	-
		1,697,709	1,730,338
Net cash provided by operating activities		124,284	20,545
Investing activities:			
Investments purchased		(2,185,272)	(2,047,799)
Investments sold, redeemed or matured		1,893,405	2,202,353
Commercial loans advanced		(2,328)	(22,917)
Commercial loans repaid		16,734	14,460
Other assets purchased		(8,130)	(12,628)
Business dispositions		2,920	-
Net cash (used in) provided by investing activities		(282,671)	133,469
Cash and cash equivalents:			
Net (decrease) increase during the year		(158,387)	154,014
Balance, beginning of the year		248,910	94,896
Balance, end of the year		$ 90,523	$ 248,910
Cash		$ 90,523	$ 206,414
Cash equivalents		-	42,496
Total cash and cash equivalents		$ 90,523	$ 248,910

See accompanying notes.

1. NATURE OF OPERATIONS

Economical Mutual Insurance Company (collectively the "Company") is a mutual insurance company which, along with its wholly owned subsidiaries, offers property and casualty ("P&C") insurance primarily in Canada. The Company is incorporated and domiciled in Canada. Its registered office and principal place of business is 111 Westmount Road South, Waterloo, Ontario, Canada. On December 14, 2010, the Company announced its intention to demutualize subject to approval by the mutual policyholders and regulators.

These consolidated financial statements were approved by the Company's Board of Directors on February 20, 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and Canadian accepted actuarial practice and reflect the requirements of the Office of the Superintendent of Financial Institutions Canada ("OSFI").

These consolidated financial statements have been prepared on a historical cost basis, except for those financial instruments that have been measured at fair value and claim liabilities which are on a discounted basis in accordance with accepted actuarial practice.

The financial statements of the subsidiaries and associates are prepared for the same reporting period as the Company. Where necessary, adjustments are made to bring the accounting policies of subsidiaries and associates in line with the Company. The consolidated financial statements include the accounts of Economical Mutual Insurance Company and its wholly owned subsidiaries, Federation Insurance Company of Canada, The Missisquoi Insurance Company, Perth Insurance Company, Waterloo Insurance Company and Westmount Financial Inc. The consolidated financial statements of the Company also include the TEIG Investment Partnership, which manages the investment portfolio for all insurance companies in the group.

The Company's non-controlling interest investments in companies subject to significant influence are accounted for using the equity method and are included in "Other assets". Under the equity method, the original cost of the investments is increased by the comprehensive income of the non-controlling interest since acquisition and reduced by any dividends received. All significant inter-company transactions and balances have been eliminated on consolidation to the extent of the interest in the associate.

All amounts in the notes are shown in thousands of Canadian dollars, unless otherwise stated.

(b) Insurance contracts

Insurance contracts are those contracts which transfer significant insurance risk at inception. The Company (the insurer) has accepted significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified event (the insured event) with uncertain timing or amount adversely affects the policyholder. Similarly, by purchasing reinsurance, the Company transfers significant insurance risk to the reinsurers. As a general guideline, the Company determines whether significant insurance risk has been transferred for insurance and reinsurance contracts by comparing whether significantly more would be paid or received if the insured event occurs, versus if the insured event did not occur.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire.

Premiums and unearned premiums

Premiums are recognized in net income in the consolidated statement of comprehensive income on a pro-rata basis over the contract period. Premiums on policies written with monthly payment terms are accounted for in full in the year written. Premiums receivable includes the premiums due for the remaining months of the contracts. Written premiums on multi-year policies are recognized in gross written premiums in the year written and are recognized in net income on a pro-rata basis over the contract period. Unearned premiums ("UPR") represent the portion of premiums written relating to periods of insurance coverage subsequent to the reporting date and are presented as a liability gross of amounts ceded to reinsurers. UPR ceded to reinsurers is included in "Reinsurance receivable and recoverable".

Claim liabilities

Claim liabilities are calculated based on Canadian accepted actuarial practice. The claim liabilities consist of reserves for reported claims as determined on a case-by-case basis by claims adjusters and an actuarially-determined provision for incurred but not reported claims ("IBNR"). The estimates include related investigation, settlement and adjustment expenses. Measurement uncertainty in these estimates exists due to internal and external factors that can substantially impact the ultimate settlement costs. Consequently, the Company reviews and re-evaluates claims and reserves on a regular basis and any resulting adjustments are included in "Net claims and adjustment expenses" in the consolidated statement of comprehensive income in the period the adjustment is made. Claims and adjustment expenses are reported net of reinsurance. The claim liabilities are valued on a discounted basis using a rate that reflects the estimated fair value yield of the financial instruments that have been matched with the claim liabilities. The effect of discounting is included in "Impact of discounting" in the consolidated statement of comprehensive income. The claim liabilities are extinguished when the obligation to pay a claim expires, is discharged or is cancelled.

Deferred policy acquisition expenses

The amount of deferred policy acquisition expenses ("DPAE") represents the brokers' commission and premium taxes associated with the unearned portion of the premiums written during the year to the extent they are considered recoverable. The costs are expensed in the year in which the related premiums are recognized as income. To the extent deferred commissions and premium taxes are considered non-recoverable, they are expensed as incurred in the consolidated statement of comprehensive income. The maximum deferrable amount is calculated as the difference between the UPR less the estimated claim liabilities and DPAE; however, DPAE is written down if the resulting expected future net policy costs are greater than the net UPR.

Liability adequacy test

At each reporting date, an assessment is made of whether the policy liabilities are adequate, which includes both claim liabilities and premium liabilities. Claim liabilities are assessed using current estimates of future cash flows of unpaid claims and adjustment expenses. If that assessment shows that the carrying amount of the claim liabilities is insufficient in light of the current future cash flows, the deficiency is recognized in the consolidated statement of comprehensive income. Premium liabilities are assessed using current estimates of future claims and expenses associated with the unexpired portion of written insurance policies. A premium deficiency would be recognized immediately as a reduction of DPAE to the extent that the unearned premiums plus anticipated investment income are not considered adequate to cover DPAE and premium liabilities. If the premium deficiency is greater than DPAE, a liability is accrued for the excess deficiency.

Industry pools

When certain automobile owners are unable to obtain insurance via the voluntary insurance market, they are insured by the Facility Association ("FA"). In addition, entities can choose to cede certain risks to FA administered risk sharing pools ("RSP"). The related risks associated with FA insurance policies and policies ceded by companies to the RSP are aggregated and shared by the entities in the P&C insurance industry, generally in proportion to market share and volume of business ceded to the RSP. The Company applies the same accounting policies to FA and RSP insurance it assumes as it does to insurance policies issued by the Company directly to policyholders and thus the Company's share of RSP premiums and claims are included in the relevant financial statement line items. The Company's share of the RSP assets backing policy liabilities is included in "Reinsurance receivable and recoverable".

Reinsurance

Reinsurance receivable and recoverable includes reinsurers' share of UPR and claim liabilities. The Company presents third party reinsurance balances in the consolidated balance sheet on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders. The estimates for the reinsurers' share of claim liabilities are determined on a basis consistent with the related claim liabilities. Reinsurance assets are reviewed at least annually for impairment.

Structured settlements

In the normal course of claims settlement, the Company enters into annuity agreements with various Canadian life insurance companies, that have credit ratings of at least "A-" or higher, to provide for fixed and recurring payments to claimants in full satisfaction of the claim liability. Under such arrangements, the Company removes the liability from its consolidated balance sheet as the liability to its claimants is substantially discharged and legal release has also been obtained from the claimant, although the Company remains exposed to the credit risk that life insurers will fail to fulfill their obligations. See note 6 for further discussion of credit risk.

(c) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances on deposit with banks and term deposits having original maturities of ninety days or less. Fair values approximate carrying values for term deposits. The amount of cash not readily available for use by the Company is insignificant.

(d) Financial instruments including investments

All of the Company's financial instruments are classified into one of the following four categories as defined below:

- available for sale ("AFS")
- financial assets and liabilities at fair value through profit or loss ("FVTPL")
- loans and receivables
- other financial liabilities

All financial instruments are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Instruments voluntarily designated as FVTPL to back the claim liabilities may never be reclassified and, except in very limited circumstances, the reclassification of other financial instruments is not permitted subsequent to initial recognition. Financial assets purchased and sold, where the contract requires the asset to be delivered within an established timeframe, are recognized on a settlement-date basis. Transaction costs are expensed as incurred for FVTPL financial instruments. For other financial instruments, transaction costs are capitalized on initial recognition. The effective interest rate method of amortization is used to account for any transaction costs capitalized on initial recognition and purchased premiums or discounts earned on bonds.

The fair value of a financial instrument on initial recognition is normally the transaction price, i.e. the fair value of the consideration given or received. Subsequent to initial recognition, the fair values are determined based on available information. The fair values of investments, excluding commercial loans, are based on quoted bid market prices or observable market inputs. The fair values of commercial loans and other financial instruments are obtained using discounted cash flow analysis at the current market interest rate for comparable financial instruments with similar terms and risks.

Financial instruments are no longer recognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

Available for sale

All short-term investments, equities (including preferred and common stocks and pooled funds) and bonds, except those voluntarily designated as FVTPL, are designated as AFS. Short-term investments consist of term deposits having original maturities of greater than ninety days and less than one year. AFS financial instruments are carried at fair value. Changes in fair value are recorded, net of income taxes, in "Other comprehensive income (loss)" ("OCI") in the consolidated statement of comprehensive income until the disposal of the financial instrument, or when an impairment loss is recognized. When the financial instrument is disposed of, the gain or loss is reclassified from "Accumulated other comprehensive income" ("AOCI") to "Recognized gains on investments" in the consolidated statement of comprehensive income. Gains and losses on the sale of AFS financial instruments are calculated on an average cost basis.

The Company assesses its AFS financial instruments for objective evidence of impairment at each reporting date. Objective evidence of impairment exists for individual equities (including common stocks and pooled funds) when there has been a significant or prolonged decline in fair value or net asset value below cost. Objective evidence of impairment exists for individual bonds when a loss event that has a reliably estimable impact on the future cash flows of the financial instrument has occurred. Factors that are considered, include but are not limited to, a decline in current financial position; defaults on debt obligations; failure to meet debt covenants; significant downgrades in credit status, and severity and/or duration of the decline in value. For individual preferred stocks, the key features of the preferred stock are assessed to determine if the instrument is more characteristic of an equity instrument or a debt instrument and objective evidence of impairment is evaluated accordingly.

When objective evidence of impairment exists for a financial instrument, the impairment loss is measured as the difference between carrying value and fair value. Impairment losses on AFS financial instruments are reclassified from AOCI to "Recognized gains on investments" in the consolidated statement of comprehensive income in the year such criteria are met. Subsequent fair value increases on previously impaired individual equities and pooled funds are recognized directly in OCI and not reversed through net income, while subsequent fair value decreases are recognized directly in net income. For individual bonds, subsequent fair value increases that can be attributed to an observable positive development are recognized directly in net income, but otherwise, are recognized directly in OCI. Any subsequent reversal of an impairment loss on a bond is recognized in net income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

Fair value through profit or loss

The Company has voluntarily designated a portion of its bonds that are backing its claim liabilities as FVTPL. This designation aims to reduce the accounting mismatch in net income that would otherwise be generated by the fluctuations in fair values of underlying claim liabilities due to changes in interest rates. In compliance with OSFI guidelines, the Company ensures that the quantum and duration of the bond portfolio designated as FVTPL reasonably approximates the quantum and duration of the claim liabilities. The Company has no other significant FVTPL financial assets. Changes in fair values of FVTPL financial instruments are recorded in "Recognized gains on investments" in the consolidated statement of comprehensive income with the related tax impact included in "Income tax expense". As changes in the fair value of the FVTPL financial instruments are reflected within net income in the consolidated statement of comprehensive income, it is not necessary to record an impairment loss when there has been a significant or prolonged decline in the fair value of FVTPL financial instruments.

Loans and receivables/Other financial liabilities

Financial instruments classified as loans and receivables, including commercial loans, and other financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest rate method. When there is evidence of impairment, the value of these financial instruments is written down to the estimated net realizable value through "Recognized gains on investments" in the consolidated statement of comprehensive income.

Evidence of impairment exists for individual loans when there is a deterioration in financial performance to the extent that the Company no longer has reasonable assurance of timely collection of the full amount of principal and interest.

Investment income recognition

Interest income is recognized on bonds and commercial loans on the accrual basis and includes the amortization of premiums and discounts over the life of the investment using the effective interest rate method.

Dividend income is recognized on the ex-dividend date.

(e) Property and equipment

Property and equipment are recorded at historical cost less accumulated depreciation and accumulated impairment losses, if any.

Cost includes amounts directly attributable to the acquisition of the items of property and equipment. Subsequent costs are added to the cost of the asset only when it is probable that economic benefits will flow to the Company in the future and the cost can be reliably measured.

Depreciation is provided on a straight-line or declining balance basis to write down the cost of such assets to their residual value over their expected useful lives. Each component of property and equipment with a cost that is significant in relation to the total cost of the asset is depreciated separately. Residual values, depreciation rates and useful lives are reviewed at least annually and adjusted, if appropriate, at the reporting date. Land is not subject to depreciation and is carried at cost.

Property and equipment are depreciated as follows:

	Basis	Rates
Buildings - structure	Straight-line	50 years
Buildings - infrastructure	Straight-line	25 years
Buildings - fixtures	Straight-line	15 years
Computer equipment	Straight-line	4 years
Furniture and equipment	Declining balance	20%

Property and equipment are derecognized upon disposal or when no further future economic benefits are expected from their use or disposal. Gains and losses on disposal are calculated as the difference between proceeds and net carrying value and are recognized in "Other expense" in the consolidated statement of comprehensive income. Fully depreciated property and equipment are retained in cost and accumulated depreciation accounts until such assets are removed from service.

(f) Leases

Leases of property and equipment where the Company is not exposed to substantially all of the risks and rewards of ownership are classified as operating leases. Incentives received from the lessor on such leases are deferred and amortized on a straight-line basis over the term of the lease in the consolidated statement of comprehensive income. Where substantially all of the risks and rewards have been transferred to the Company, the lease is classified as a finance lease. In these cases, an obligation and an asset are recognized based on the present value of the future minimum lease payments and balances are amortized over the shorter of the lease term or useful life of the asset, as applicable.

(g) Business combinations and consolidation

Business combinations are accounted for using the acquisition method. The acquisition method requires that the acquirer recognize, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree, at the acquisition date. Acquisition costs directly attributable to the acquisition are expensed in the year. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at fair value at the date of acquisition, irrespective of the extent of any non-controlling interest. Contingent consideration is also measured at fair value.

The Company measures goodwill as the fair value of the consideration transferred, including the recognized amount of any non-controlling interest in the acquiree, less the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

(h) Intangible assets

Intangible assets are comprised of capitalized software costs, where the software is not integral to the hardware on which it operates. Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Costs that are directly attributable to the development and testing of identifiable and unique software products controlled by the Company are recognized as intangible assets when the criteria specified in IAS 38 ("IAS 38") – *Intangible Assets* are met. Capitalized costs include employee costs for staff directly involved in software development and other direct expenditures related to the project. Other development expenditures that do not meet the capitalization criteria under IAS 38 are recognized as an expense as incurred. Following the initial recognition, intangible assets are carried at cost less accumulated amortization and accumulated impairment losses, if any.

Intangible assets with finite useful lives are amortized over the useful economic life to a maximum of seven years for non-software items, and a maximum of twenty years for software. Amortization is recorded in "Operating expenses" in the consolidated statement of comprehensive income. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least annually. Intangible assets which are under development, are not amortized, but are tested at least annually for impairment. The Company does not currently hold any indefinite life intangible assets.

Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. Impairment indicators include significant strategic or operational changes in how the intangible assets are used, evidence of obsolescence or damage and worse than expected performance.

(i) Impairment of assets

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company compares the asset's recoverable amount to the asset's carrying value. An asset's recoverable amount is calculated based on the value-in use ("VIU") using a discounted cash flow model. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets and therefore, must be assessed as part of a cash-generating unit ("CGU").

For assets, excluding goodwill and certain financial instruments, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such an indication exists, the Company compares the recoverable amount to the carrying value of the asset. If the recoverable amount exceeds the carrying value of the asset, the carrying value is increased to the lesser of the recoverable amount and the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of comprehensive income.

The following criteria are also applied in assessing impairment of specific assets:

Goodwill

Goodwill is tested for impairment in accordance with IAS 36 – *Impairment of Assets*, which requires goodwill impairment to be assessed at a CGU level. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Company's CGUs, or groups of CGUs, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Company are assigned to those units or groups of units. The Company has defined the CGUs to be each insurance company and each broker or managing general agent subsidiary.

Goodwill relating to an associate is included in the carrying amount of the investment and is not tested separately for impairment.

The Company performs a goodwill impairment review at least annually and whenever there is an indication that goodwill is impaired. The fair value of each CGU has been determined based on the VIU using a discounted cash flow model. Impairment occurs when the carrying amount of the CGU exceeds the recoverable amount, in which case goodwill impairment is recognized prior to impairing other assets. Any impairment of goodwill or other assets is recorded in "Other income (expense)" in the year that such an impairment becomes evident. Previously recorded impairment losses for goodwill are not reversed in future years if the recoverable amount increases.

Investments in associates

After application of the equity method, the Company determines whether it is necessary to recognize an additional impairment loss of the Company's investments in associates. The Company determines at each balance sheet date whether there is any objective evidence that the investments in associates are impaired. If this is the case, the Company calculates the amount of impairment as being the difference between the fair value of the associate and the carrying value, and recognizes this amount in the consolidated statement of comprehensive income in "Other income (expense)."

(j) Income taxes

Income tax expense is comprised of current and deferred income tax. Income tax is recognized in net income except to the extent that it relates to items recognized in OCI or directly to retained earnings.

Current income tax is based on the results of operations in the current year, adjusted for items that are not taxable or not deductible. Current income tax is calculated based on income tax laws and rates enacted or substantively enacted as at the reporting date. Interest income or expenses arising on tax assessments are also included in "Income tax expense" in the consolidated statement of comprehensive income.

Deferred income tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their respective carrying amounts for financial reporting purposes at the reporting date. Deferred income tax is calculated using income tax laws and rates enacted or substantively enacted as at the reporting date, which are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered.

(k) Pensions and other post-employment benefits

The Company provides certain pension and other post-employment benefits to eligible participants upon retirement.

Pension benefits

The Company operates a defined benefit pension plan for certain employees hired prior to January 1, 2002, which requires contributions to be made to a separately administered fund. The defined benefit plan is based on the employee's length of service and final average pensionable earnings. The cost of the defined benefits is actuarially determined and accrued using the projected unit credit valuation method pro-rated on service. This method involves the use of the market interest rate at the measurement date on high-quality debt instruments for the discount rate, and management's best estimates concerning such factors as expected plan investment performance, salary escalation and retirement ages of employees. The expected long-term return on plan assets is calculated using the fair value of plan assets. Costs recognized in the consolidated statement of comprehensive income include the cost of pension benefits provided in exchange for employees' services rendered during the year, the interest cost of the obligations and the expected long-term return on the fair value of plan assets. Actuarial gains and losses are recognized in full in OCI in the year in which they occur and then immediately in retained earnings. They are not reclassified to net income in subsequent years.

The defined benefit asset or liability comprises the fair value of plan assets less the defined benefit obligation out of which the obligations are to be settled directly. Plan assets are held by a long-term employee benefit fund and are not available to creditors of the Company, nor can they be paid directly to the Company. Fair value is based on market price information, and in the case of quoted securities it is the published closing price. The value of any defined benefit asset is restricted to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan plus unamortized actuarial losses and past service costs.

The accumulated value for pension benefits is recorded in the consolidated balance sheet in "Other assets" if the balance is in an asset position and is recorded in "Accounts payable and other liabilities" if in a liability position. The Company also has a defined contribution plan for certain employees, for which contributions are expensed in the year.

Non-pension benefits

The Company provides other post-employment benefits for eligible employees hired prior to July 3, 2012. The Company accounts for the cost of all non-pension post-employment benefits, including medical benefits, dental care and life insurance for eligible retirees, their spouses and qualified dependents, on an accrual basis. These costs are recognized in "Operating expenses" in the consolidated statement of comprehensive income in the year during which services are rendered and are actuarially determined using the projected unit credit valuation method pro-rated on service. This method involves the use of the market interest rate at the measurement date on high-quality debt instruments for the discount rate, and management's best estimates concerning such factors as salary escalation, retirement ages of employees and expected health care costs. The impact of a plan curtailment is recognized in "Other income (expense)" in the consolidated statement of comprehensive income when an event giving rise to a curtailment has occurred. Actuarial gains and losses are recognized in full in OCI in the year in which they occur and then immediately in retained earnings. They are not reclassified to net income in subsequent years.

The accumulated value for non-pension post-employment benefits is recorded in the consolidated balance sheet in "Accounts payable and other liabilities".

(l) Provisions

Provisions, including restructuring provisions, are recognized when the Company determines that there is a present legal or constructive obligation as a result of a past event or decision, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

(m) Foreign currency translation

Functional and presentation currency

The consolidated financial statements are presented in thousands of Canadian dollars, which is also the functional currency of the Company. Each entity within the consolidated group determines its own functional currency based upon the currency used in the entity's primary operating environment, and measures financial results based on that functional currency.

Translation of foreign subsidiaries' accounts

Assets and liabilities of the Company's foreign subsidiaries are translated from their functional currencies into Canadian dollars at the exchange rate in effect at the reporting date for all assets and liabilities, except goodwill acquired prior to the IFRS transition date of January 1, 2010 ("transition date").

Any goodwill arising on the acquisition of a foreign operation subsequent to the transition date and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the closing rate.

Revenues and expenses are translated at the monthly weighted average rate prevailing during the year. On consolidation, exchange differences arising from the translation of the net investment in foreign entities are recorded in OCI. On the disposal of a foreign operation, the cumulative amount of exchange differences relating to that operation are recognized in net income.

Translation of foreign currency transactions

Transactions incurred in currencies other than the functional currency of the reporting entity are converted to the functional currency at the rate in effect on the transaction date. Monetary assets and liabilities denominated in a currency other than the functional currency are converted to the functional currency at the exchange rate in effect at the reporting date. Unrealized foreign currency transaction gains and losses on AFS equity instruments have been included in OCI. All other foreign currency transaction gains and losses have been included in net income.

(n) Comparative figures

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the current year's consolidated financial statements.

3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the Company's consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, and the disclosure of contingent assets and liabilities as at the reporting date and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates. Although some variability is inherent in these estimates, management believes that the amounts provided are appropriate.

The most complex and significant judgments, estimates and assumptions used in preparing the Company's consolidated financial statements are discussed below.

Judgments

In the process of applying the Company's accounting policies, management has made the following judgments, which have the most significant effect on the amounts recognized in the consolidated financial statements.

The Company has applied judgment in its assessment of the identification of objective evidence of impairments for financial instruments, the recognition of tax losses, the determination of CGUs, the evaluation of current obligations requiring provisions and identification of the indicators of impairment for property and equipment, goodwill and intangible assets.

Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

(a) Valuation of claim liabilities

The Company is required by applicable insurance laws, regulations and IFRS to establish liabilities for payment of claims and claims adjustment expenses that arise from the Company's insurance products. These liabilities represent the expected ultimate cost to settle claims occurring prior to, but still outstanding as of, the reporting date. The Company establishes its claim liabilities by geographic region, product line, type and extent of coverage and year of occurrence.

Claim liabilities fall into two categories: reserves for reported claims and provision for IBNR losses. Additionally, liabilities are held for claims adjustment expenses, which contain the estimated legal and other expenses expected to be incurred to finalize the settlement of the losses.

Determining the provision for unpaid claims and adjustment expenses and the related reinsurers' share involves an assessment of the future development of claims. The estimates are principally based on the Company's historical experience. Methods of estimation have been used that the Company believes produce reasonable results given current information. This process takes into account the consistency of the Company's claim handling procedures, the amount of information available, the characteristics of the line of business from which the claim arises, and the delays in reporting claims. Claim liabilities include estimates subject to variability, which could be material.

Changes to the estimates could result from future events such as receiving additional claim information, changes in judicial interpretation of contracts or significant changes in severity or frequency of claims from past trends. In general, the longer the term required for the settlement of a group of claims, the greater the potential for variability in the estimate. Any future changes in estimates would be reflected in the consolidated statement of comprehensive income in the year in which the change occurred. Note 8 contains additional analysis of the impact of the key assumptions on claim liabilities.

Claim liabilities have been discounted to reflect future investment income in accordance with Canadian accepted actuarial practice. The principle assumptions made in establishing claim liabilities are best estimates. To allow for possible deterioration in experience, and to increase the likelihood that the claim liabilities are adequate to pay future benefits, actuaries are required to include margins in some assumptions. A range of allowable margins is prescribed by the Canadian Institute of Actuaries relating to claim development, reinsurance recoveries and investment income variables. The effect of the margins produces the provision for adverse deviation ("PfAD").

Reinsurance recoverables include amounts for expected recoveries from reinsurers related to claim liabilities. Amounts recoverable from reinsurers are evaluated in a manner consistent with the provisions of the reinsurance contracts. The failure of reinsurers to honour their obligations could result in losses to the Company, as the ceding of insurance does not relieve the Company of its primary liability to its insured parties.

(b) Impairment of goodwill and intangible assets

The Company determines whether goodwill and intangible assets are impaired on an annual basis or more frequently if there are potential indicators of impairment. Impairment testing of goodwill and intangible assets requires an estimation of the recoverable amount of the CGUs to which assets are allocated.

(c) Valuation of post-employment benefits obligation

The cost of defined benefit pension plans and other non-pension benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on plan assets, future salary increases, mortality rate, expected health care costs, inflation and future pension increases. The details of the assumptions are disclosed in note 16. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Actual experience that differs from assumptions will affect the amounts of the benefit obligation recognized on the consolidated balance sheet, the expense recognized in net income and actuarial gains or losses recognized in OCI in the consolidated statement of comprehensive income.

(d) Provisions

Provisions, including restructuring provisions, are recognized when the Company determines that there is a present legal or constructive obligation as a result of a past event or decision, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are recorded at the present value of the expenditures expected to be required to settle the obligation. In estimating provisions, the Company must make assumptions regarding the timing and amount of the expenditures and determine an appropriate discount rate reflective of the current market assessment of the time value of money and the risks specific to the obligations.

(e) Measurement of income taxes

The Company is subject to income tax laws in various federal and provincial jurisdictions where it operates. Various tax laws are potentially subject to different interpretations by the taxpayer and the relevant tax authority. To the extent that the Company's interpretations differ from those of tax authorities or the timing of realization is not as expected, the provision for income taxes may increase or decrease in future periods to reflect actual experience.

4. STANDARDS ISSUED BUT NOT YET EFFECTIVE

The following IFRS standards have been issued but are not yet effective. The Company is currently analyzing the impact these standards will have on its consolidated financial statements, unless otherwise stated.

(a) Financial Instruments: Classification and Measurement

The IASB issued IFRS 9 ("IFRS 9") – *Financial Instruments* in November 2009 and published amendments in October 2010 and December 2011. This is the first phase of a three-phase project to replace IAS 39. This standard addresses classification and measurement of financial instruments and replaces the multiple category and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and FVTPL. IFRS 9 also replaces the models for measuring equity instruments as such instruments are either recognized at FVTPL or at fair value through OCI. Where such equity instruments are measured at fair value through OCI, the dividends that do not clearly represent a return of investment are recognized in net income as investment income; however, other gains and losses (including impairments) associated with such instruments remain in AOCI and are never reclassified to net income. The amended standard is currently expected to be effective for fiscal years beginning on or after January 1, 2015.

(b) Offsetting Financial Assets and Financial Liabilities

Amendments to IAS 32 ("IAS 32") – *Offsetting Financial Assets and Financial Liabilities* and IFRS 7 ("IFRS 7") – *Disclosures – Offsetting Financial Assets and Financial Liabilities* were issued in December 2011. The amendments to IAS 32 do not modify the offsetting model but simply clarify that an entity currently has a legally enforceable right to set-off if that right is: (i) not contingent on a future event; and (ii) enforceable both in the normal course of business and in the event of a default, insolvency or bankruptcy of the entity and all counterparties. The amendments to IFRS 7 contain new disclosure requirements for financial assets and liabilities that are offset in the balance sheet or are subject to master netting arrangements or similar arrangements. The amendments to IAS 32 and IFRS 7 are not expected to have a significant impact on the presentation or disclosure of the Company's financial assets and financial liabilities. The effective date for the amendments to IAS 32 is January 1, 2014. The effective date for the amendments to IFRS 7 is January 1, 2013.

(c) Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10 ("IFRS 10") – *Consolidated Financial Statements*, IFRS 11 ("IFRS 11") – *Joint Arrangements* and IFRS 12 ("IFRS 12") – *Disclosure of Interests in Other Entities*. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities and replaces the requirements of the original IAS 27 ("IAS 27") – *Consolidated and Separate Financial Statements* and SIC-12 – *Consolidation – Special Purpose Entities.* As a consequence of these changes, the IASB also issued an amended and retitled IAS 27 – *Separate Financial Statements* and IAS 28 ("IAS 28") – *Investments in Associates and Joint Ventures*. These standards set out the principles of control as being power over the investee, exposure or rights to variable returns from involvement with the investee and the ability to use power over the investee to affect the amount of the investor's returns. When preparing consolidated financial statements, an entity must use uniform accounting policies for reporting like transactions and other events in similar circumstances. Intragroup balances and transactions must be eliminated. Non-controlling interests in subsidiaries must be presented in the consolidated balance sheet within equity separately from the equity of the owners of the parent. Currently, the Company does not anticipate any significant changes to the recognition of subsidiaries or associates as a result of adopting these standards. These standards are effective for fiscal years beginning on or after January 1, 2013.

(d) Disclosure of Interests in Other Entities

IFRS 12 was issued in conjunction with IFRS 10 and IFRS 11 and replaces the disclosure requirements of IAS 27, IAS 28 and IAS 31 – *Interests in Joint Ventures*. IFRS 12 establishes requirements for disclosing information regarding consolidated entities, associates, joint arrangements, unconsolidated structured entities and non-controlling interests. The requirements of IFRS 12 are not anticipated to have a significant impact on the Company's financial statement disclosure. The standard is effective for fiscal years beginning on or after January 1, 2013.

(e) Fair Value Measurement

IFRS 13 ("IFRS 13") – *Fair Value Measurement* defines fair value, sets out a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. This standard applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements, except in specified circumstances. The requirements of IFRS 13 are not anticipated to have a significant impact on the Company's financial statement measurement or disclosure. The standard is effective for fiscal years beginning on or after January 1, 2013.

(f) Employee Benefits

IAS 19 ("IAS 19") – *Employee Benefits* was amended in June 2011 eliminating the option to defer the recognition of actuarial gains and losses, known as the "corridor method" and instead requires all pension remeasurement impacts to be recognized in OCI as they occur. Upon adopting IFRS, the Company had selected the option to recognize all actuarial gains and losses in OCI as they occur, thereby eliminating the impact of this amendment on the Company. The new standard permits an entity to accumulate actuarial gains and losses in either retained earnings, consistent with the current IAS 19 standard, or in AOCI. The Company has elected to continue accumulating actuarial gains and losses in retained earnings.

The new IAS 19 standard replaces the separate calculation of return on net assets and interest cost with a net interest amount calculated by applying a discount rate to the net defined benefit obligation. The impact of applying this requirement for 2012 would have been to increase pension expense and reduce actuarial losses by approximately $2.3 million. For 2013, the impact is estimated to be an increase in pension expense and a reduction of actuarial losses of $3.1 million. The new IAS 19 requirement to immediately recognize past service costs and the changes to the treatment of termination benefits are not expected to impact the Company. The amendments to IAS 19 also introduced enhanced disclosures around defined benefit plans. The standard is effective for fiscal years beginning on or after January 1, 2013.

(g) Presentation of Financial Statements

IAS 1 ("IAS 1") – *Presentation of Financial Statements* was amended to require profit or loss and OCI to be presented together as either a single statement of comprehensive income or separate statement of income and statement of comprehensive income. The amendments also require presentation of OCI based on whether or not the balance may subsequently be reclassified to net income, with the tax associated with each type of OCI balance to be presented separately. Effective for the Company's fiscal year beginning January 1, 2013, the Company will present the classification of OCI as required by the IAS 1 amendments.

5. INVESTMENTS

(a) Investment income and balances

Investment income by financial instrument classification is as follows:

			2012		
(in thousands of dollars)	Notes	FVTPL	AFS	Loans and receivables	Total
Interest		$ 50,708	$ 33,056	$ 1,520	$ 85,284
Dividends		-	19,831	-	19,831
Realized gains on sale of investments		22,517	34,842	-	57,359
Net impairment losses on AFS investments	5 (c)	-	(9,330)	-	(9,330)
Unrealized losses on FVTPL financial instruments		(26,283)	-	-	(26,283)
Recognized gains (losses) on investments		(3,766)	25,512	-	21,746
		$ 46,942	$ 78,399	$ 1,520	$ 126,861

			2011		
(in thousands of dollars)	Notes	FVTPL	AFS	Loans and receivables	Total
Interest		$ 58,864	$ 31,346	$ 2,590	$ 92,800
Dividends		-	16,452	-	16,452
Realized gains on sale of investments		19,403	11,449	-	30,852
Net impairment losses on AFS investments	5 (c)	-	(36,284)	-	(36,284)
Unrealized gains on FVTPL financial instruments		44,141	-	-	44,141
Recognized gains (losses) on investments		63,544	(24,835)	-	38,709
		$ 122,408	$ 22,963	$ 2,590	$ 147,961

The fair value yield at December 31, 2012 for the FVTPL bond portfolio was 1.70% (2011: 1.65%) and for the AFS bond portfolio was 2.66% (2011: 3.31%).

Investment carrying values by financial instrument classification are as follows:

	2012			
(in thousands of dollars)	FVTPL	AFS	Loans and receivables	Total
Short-term investments	$ -	$ 59,848	$ -	$ 59,848
Bonds	2,030,638	1,031,263	-	3,061,901
Preferred stocks	-	206,948	-	206,948
Common stocks	-	309,449	-	309,449
Pooled fund	-	79,404	-	79,404
Commercial loans	-	-	48,834	48,834
	$ 2,030,638	$ 1,686,912	$ 48,834	$ 3,766,384

	2011			
(in thousands of dollars)	FVTPL	AFS	Loans and receivables	Total
Bonds	$ 2,121,228	$ 860,170	$ -	$ 2,981,398
Preferred stocks	-	136,547	-	136,547
Common stocks	-	277,166	-	277,166
Commercial loans	-	-	62,221	62,221
	$ 2,121,228	$ 1,273,883	$ 62,221	$ 3,457,332

The commercial loans have an amortized cost of $48.8 million (2011: $62.2 million) and fair value of $45.1 million (2011: $59.6 million).

The unrealized gains (losses) on AFS investments are detailed below. The cost of all AFS investments, except AFS bonds, is the purchase price less impairment losses, if applicable. The cost of all AFS bonds is the amortized cost adjusted for cumulative impairment losses.

	2012			
(in thousands of dollars)	Cost/amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Short-term investments	$ 59,848	$ -	$ -	$ 59,848
Bonds:				
Government	637,850	16,610	(501)	653,959
Corporate	364,913	13,133	(742)	377,304
	1,002,763	29,743	(1,243)	1,031,263
Canadian preferred stocks	204,854	5,091	(2,997)	206,948
Common stocks:				
Canadian	209,261	26,362	(1,567)	234,056
Foreign	70,201	6,174	(982)	75,393
Foreign pooled fund	77,467	1,937	-	79,404
	356,929	34,473	(2,549)	388,853
	$ 1,624,394	$ 69,307	$ (6,789)	$ 1,686,912

	2011			
(in thousands of dollars)	Cost/amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Bonds:				
Government	$ 470,237	$ 20,154	$ (7)	$ 490,384
Corporate	365,207	13,661	(9,082)	369,786
	835,444	33,815	(9,089)	860,170
Canadian preferred stocks	135,574	3,914	(2,941)	136,547
Common stocks:				
Canadian	196,005	11,838	(4,757)	203,086
Foreign	67,982	6,098	-	74,080
	263,987	17,936	(4,757)	277,166
	$ 1,235,005	$ 55,665	$ (16,787)	$ 1,273,883

(b) Financial instruments measured at fair value

The Company categorizes its fair value measurements according to a three-level hierarchy, which prioritizes the inputs used by the Company's valuation techniques. A level is assigned to each fair value measurement based on the lowest level input significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are defined as follows:

(i) Level 1 fair value measurements reflect unadjusted, quoted prices in active markets for identical assets and liabilities that the Company has the ability to access at the measurement date. If an instrument classified as Level 1 subsequently ceases to be actively traded, it is transferred out of Level 1 and into Level 2 or Level 3 as appropriate. Included in the Level 1 category are all stocks, except the pooled fund, with a fair value of $516.4 million (2011: $411.8 million).

(ii) Level 2 fair value measurements use inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in inactive markets, inputs that are observable but are not prices such as interest rates and credit risks and inputs that are derived from or corroborated by observable market data. Included in the Level 2 category are all bonds with a fair value of $3,061.9 million (2011: $2,981.3 million), the pooled fund with a fair value of $79.4 million (2011: nil) and short-term investments with a fair value of $59.8 million (2011: nil).

(iii) Level 3 fair value measurements use significant non-market observable inputs, including assumptions about risk or liquidity. As at December 31, 2012, the Company has no financial instruments in this category (2011: nil).

There were no transfers of financial instruments between levels during the year.

(c) Impairment review

Impairment reclassification of unrealized losses (recoveries) from AOCI to net income is as follows:

(in thousands of dollars)		2012		2011
Common stocks:				
Canadian	$	9,631	$	24,215
Foreign		2,343		8,675
Bonds:				
Corporate		(2,644)		3,394
	$	9,330	$	36,284

Interest income of $1.3 million (2011: $1.3 million) was earned during the year on the impaired bond.

The remaining gross unrealized losses of $6.8 million (2011: $16.8 million) on the AFS investments have not been recognized in net income as the Company does not believe there is currently objective evidence of impairment.

The Company has determined that there is no evidence of significant impairment of any individual commercial loan because all balances are current and a review of the financial condition of the debtor and pledged collateral indicates that there is reasonable assurance of timely collection of the full amount of principal and interest.

(d) Securities lending

The Company participates in a securities lending program managed by a major Canadian financial institution whereby the Company lends securities it owns to other financial institutions to allow them to meet delivery commitments. The Canadian financial institution assumes all the risk associated with the lending activity. At December 31, 2012, securities with an estimated fair value of $578.1 million (2011: $340.5 million) have been loaned and securities with an estimated fair value of $598.2 million (2011: $354.3 million) have been received as collateral from the Canadian financial institution. Lending collateral at December 31, 2012 was 98.9% (2011: 94.5%) held in cash and government-backed securities with the balance held in high-quality publicly traded corporate securities. The securities loaned under this program have not been removed from "Investments" on the consolidated balance sheet because the Company retains the risks and rewards of ownership.

The financial compensation the Company receives in exchange for securities lending is reflected in the consolidated statement of comprehensive income in "Interest".

(e) Embedded derivatives

At least annually, the Company conducts a search for embedded derivatives within its significant contracts. No significant embedded derivatives were identified that required bifurcation.

6. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

The Company's financial instruments, including investments, are exposed to interest rate risk, equity market price risk, credit risk, foreign exchange risk and liquidity risk. The Company's Statement of Investment Policies and Procedures ("SIP&P") establishes asset mix parameters and risk limits which minimize undue exposure to these risks in the investment portfolio. The SIP&P is reviewed annually by the Investment Committee of the Board of Directors. Compliance with the SIP&P is monitored quarterly by the Investment Committee.

(a) Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments. Typically, interest income will be reduced during sustained periods of declining interest rates, but this will also generally increase the fair value of the bond portfolio. The reverse is true during a sustained period of increasing interest rates. As interest rate risk is a significant risk to the Company due to the nature of its investments and claim liabilities, a portion of the Company's bond portfolio has been voluntarily designated as FVTPL financial assets and is managed to match the Company's claim liabilities. The effect of interest rate risk associated with discounting claim liabilities is disclosed in note 8.

Duration is a measure used to estimate the extent fair values of fixed income investments move with changes in interest rates. Using this measure, the impact of an immediate hypothetical 1% change in interest rates with all other variables held constant is as follows:

(in thousands of dollars)	2012		2011	
Impact on:	+ 1%	- 1%	+ 1%	- 1%
Fair value of FVTPL bonds and net income before tax	$ (65,102)	$ 65,102	$ (67,731)	$ 67,731
Fair value of AFS bonds and OCI before tax	$ (62,978)	$ 62,978	$ (51,306)	$ 51,306

The estimated impact on taxes would be calculated at the statutory rate of 26.3% (2011: 28.0%).

(b) Equity market price risk

Economic trends, the political environment and other factors can positively or adversely impact the equity markets and consequently the value of equity investments the Company holds. The Company's AFS portfolio includes Canadian stocks with fair value movements that are benchmarked against movements in the Toronto Stock Exchange Composite Index, and foreign stocks and a pooled fund with fair values that are benchmarked against movements in the Morgan Stanley Capital International Index.

The impact of a 10% change in the value of the Company's equity portfolio, with all other variables held constant, to the extent the Company does not dispose of any of these equities during the year, is as follows:

(in thousands of dollars)	2012		2011	
Impact on:	+ 10%	- 10%	+ 10%	- 10%
Fair value of Canadian stocks and OCI before tax	$ 38,971	$ (38,971)	$ 29,923	$ (29,923)
Fair value of foreign stocks, pooled fund and OCI before tax	$ 15,630	$ (15,630)	$ 7,408	$ (7,408)

The estimated impact on taxes would be calculated at the statutory rate of 26.3% (2011: 28.0%).

(c) Credit risk

Credit risk is the risk of financial loss as the result of the Company's counterparties not being able to meet payment obligations as they become due. The Company's credit risk is concentrated in the bond, preferred stock and commercial loan portfolios, the securities lending program, premiums receivable, amounts owing from reinsurers and structured settlements. Unless otherwise stated, the Company's credit exposure is limited to the carrying amount of these assets.

The Company's SIP&P requires the Company to invest in bonds and preferred stocks of high credit quality and to limit exposure with respect to any one issuer. No more than 10% of the market value of the bond portfolio may be in any one issuer, except for government issuers, and at least 90% of the bonds in the portfolio must have a credit rating of at least an "A-" or higher by independent rating agencies at the time of purchase. For preferred stocks, no single issue can represent more than 25% of the preferred stock portfolio and at least 90% of the preferred stocks must be rated "P2" or higher by independent rating agencies at the time of purchase. "A-" and "P2" represent the ratings provided by two recognized rating services for high-grade bonds and preferred stocks, respectively, where both asset and earnings protection are well assured. On a regular basis, the Company also monitors publicly available information referencing the investments held in the investment portfolio to determine whether there are investments which require closer monitoring of the credit risk. Of the bonds held at December 31, 2012, 93.6% (2011: 96.9%) were rated "A-" or better and 99.5% (2011: 99.3%) of the preferred stocks were rated "P2" or better. Of the corporate bonds held, 84.9% (2011: 86.4%) are concentrated in the financial services industry.

As disclosed in note 5, the Company participates in a securities lending program. The Company minimizes credit risk associated with this program by only dealing with one counterparty who is a Canadian financial institution rated "AA-" by independent rating agencies and by obtaining collateral with a fair value in excess of the value of the securities loaned under the program. The ratio of fair value of collateral obtained in excess of the fair value of the securities loaned at December 31, 2012 is 103.5% (2011: 104.1%).

The Company's credit exposure to any one individual policyholder or broker included in premiums receivable is not significant. The Company regularly monitors amounts due from policyholders and follows up on all overdue accounts. As permitted by regulation, when premiums are overdue for an extended period of time the Company cancels the insurance coverage under the applicable policy. The Company's broker appointment process ensures a financial review of each broker before they are granted a contract. This review includes an assessment of the ability of the broker to meet payment obligations as they become due. Periodic broker reviews are conducted to ensure continued profitability and solvency. The allowance for doubtful accounts in the current and comparative periods is insignificant as overdue receivables are negligible. Delinquent accounts are regularly monitored and the Company takes action against non-payment.

The Company periodically issues commercial loans to brokers. Sufficient collateral, in the form of an assignment over the ownership interest in the brokerage, is held to protect the Company against default on these loans. Annual financial reviews are undertaken to determine if the broker will be able to make the required payments when due. The Company's gross credit exposure on these loans is limited to the carrying value of commercial loans as disclosed in note 5. There is currently no evidence of significant impairment of any individual commercial loan.

Credit exposures on the Company's reinsurance receivable and recoverable balances exist to the extent that any reinsurer may or may not be willing or able to reimburse the Company under the terms of the relevant reinsurance arrangements. The Company has policies which limits the exposure to individual reinsurers and a regular review process to assess the creditworthiness of reinsurers with whom the Company purchases coverage. The Company's reinsurance risk management policy generally precludes the use of reinsurers with credit ratings less than "A-". Currently, all reinsurers have a credit rating of "A-" or better as determined by independent rating agencies. Where appropriate, the Company obtains collateral for outstanding balances in the form of cash, letters of credit, offsetting balances payable, guarantees or assets held under reinsurance security agreements. The Company has recorded an allowance for losses on reinsurance receivable and recoverable of $0.5 million (2011: $1.0 million).

The Company has purchased annuities from life insurers to provide for fixed and recurring payments to claimants. As a result of these arrangements, the Company is exposed to credit risk to the extent to which any of the life insurers fail to fulfill their obligations. This risk is managed by acquiring annuities from life insurers with proven financial stability, all of which are rated "A-" or better by independent rating agencies. As at December 31, 2012, no information has come to the Company's attention that would suggest any weakness or failure in life insurers from which it has purchased annuities. Consequently, no provision for credit risk is required. The original purchase price of the outstanding annuities is $269.0 million (2011: $251.6 million).

(d) Foreign exchange risk

Foreign exchange risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Company's foreign exchange risk relates primarily to its foreign common stock and pooled fund holdings in the AFS portfolio which are denominated in numerous foreign currencies.

The impact on the Company of a 1% change in the value of the foreign currencies relative to the Canadian dollar is as follows:

(in thousands of dollars)	2012		2011	
Impact on:	+ 1%	- 1%	+ 1%	- 1%
Fair value of foreign stocks, pooled and OCI before tax	$ 865	$ (865)	$ 741	$ (741)

The estimated impact on taxes would be calculated at the statutory rate of 26.3% (2011: 28.0%).

(e) Liquidity risk

Liquidity risk is the risk of having insufficient cash resources to meet current financial obligations. Liquidity risk arises from the Company's general business activities and in the course of managing its assets and liabilities. The liquidity requirements of the Company's business are met primarily by funds generated by operations, asset maturities and investment returns. Cash provided from these sources normally exceeds cash requirements to meet claim payments and operating expenses.

As at December 31, 2012, the Company has $90.5 million (2011: $248.9 million) of cash and cash equivalents and short-term investments of $59.8 million (2011: nil). The Company also has a highly liquid investment portfolio. As at December 31, 2012, Canadian fixed-income investments issued or guaranteed by domestic governments, investment-grade corporate bonds, publicly traded Canadian and foreign equities and the pooled fund have a fair value of $3,636.1 million (2011: $3,379.4 million).

The table below summarizes the maturity profile of the financial assets and financial liabilities of the Company.

For claim liabilities and reinsurance receivable and recoverable, maturity profiles are determined based on estimated timing of net cash flows on an undiscounted basis. DPAE, UPR and the reinsurer's share of UPR have been excluded from the analysis as they are not of themselves contractual obligations.

	2012				
(in thousands of dollars)	Less than 1 year	1-5 years	6-10 years	10 years +	Total
Assets:					
Cash and cash equivalents	$ 90,523	$ -	$ -	$ -	$ 90,523
Short-term investments	59,848	-	-	-	59,848
FVTPL bonds	65,063	1,923,162	42,413	-	2,030,638
AFS bonds	39,465	263,004	643,506	85,288	1,031,263
Preferred stocks	75,146	111,741	20,061	-	206,948
Commercial loans	6,086	30,653	12,095	-	48,834
Accrued investment income	13,155	-	-	-	13,155
Premiums receivable	522,429	2,913	-	-	525,342
Reinsurance receivable and recoverable	12,705	40,501	5,063	-	58,269
	$ 884,420	$ 2,371,974	$ 723,138	$ 85,288	$ 4,064,820
Liabilities:					
Claim liabilities	$ 665,912	$ 1,072,266	$ 345,963	$ 34,110	$ 2,118,251
Accounts payable and other liabilities	144,779	7,029	8,276	35,519	195,603
Income taxes payable	12,054	-	-	-	12,054
	$ 822,745	$ 1,079,295	$ 354,239	$ 69,629	$ 2,325,908

	2011				
(in thousands of dollars)	Less than 1 year	1-5 years	6-10 years	10 years +	Total
Assets:					
Cash and cash equivalents	$ 248,910	$ -	$ -	$ -	$ 248,910
FVTPL bonds	75,504	2,011,222	34,502	-	2,121,228
AFS bonds	60	223,332	598,555	38,223	860,170
Preferred stocks	39,709	81,554	15,284	-	136,547
Commercial loans	7,501	41,929	12,791	-	62,221
Accrued investment income	15,256	-	-	-	15,256
Premiums receivable	490,154	4,453	-	-	494,607
Income taxes receivable	742	-	-	-	742
Reinsurance receivable and recoverable	33,578	43,996	5,467	-	83,041
	$ 911,414	$ 2,406,486	$ 666,599	$ 38,223	$ 4,022,722
Liabilities:					
Claim liabilities	$ 697,412	$ 1,093,505	$ 352,473	$ 43,071	$ 2,186,461
Accounts payable and other liabilities	128,955	4,785	5,270	47,528	186,538
	$ 826,367	$ 1,098,290	$ 357,743	$ 90,599	$ 2,372,999

The Company believes that it has the flexibility to obtain, from internal sources, the funds needed to meet cash and regulatory requirements on an ongoing basis.

7. POLICY LIABILITIES

These consolidated financial statements contain an actuarial estimate of the policy liabilities of the Company. Policy liabilities represent the amount of the obligation of the Company on account of policies effective on or before the reporting date and consist of premium and claim liabilities.

(a) Premium liabilities

Premium liabilities are represented by the amount of net UPR less the amount of net DPAE. Generally, the commissions and premium taxes corresponding to the net UPR are deferrable; however, this amount is written down if the resulting expected future net policy costs are greater than the net UPR. No write-down to DPAE is required for the year ended December 31, 2012 (2011: nil).

The following changes have occurred in UPR during the year:

(in thousands of dollars)	2012			2011		
	Gross	Ceded	Net	Gross	Ceded	Net
UPR, beginning of year	$ 876,975	$ 17,532	$ 859,443	$ 858,248	$ 14,541	$ 843,707
Premiums written during year	1,819,703	96,047	1,723,656	1,723,239	92,403	1,630,836
Premiums earned during year	(1,763,665)	(97,647)	(1,666,018)	(1,704,512)	(89,412)	(1,615,100)
UPR, end of year	$ 933,013	$ 15,932	$ 917,081	$ 876,975	$ 17,532	$ 859,443

The following changes have occurred in the DPAE during the year:

(in thousands of dollars)	2012	2011
DPAE, beginning of year	$ 179,189	$ 173,256
Acquisition costs deferred	365,548	342,852
Amortization of acquisition costs	(353,799)	(336,919)
DPAE, end of year	$ 190,938	$ 179,189

(b) Claim liabilities

Claim liabilities are established to reflect the estimate of the full amount of all liabilities associated with the insurance contracts at the end of the year, including IBNR. The ultimate cost of these liabilities will vary from the best estimate made for a variety of reasons, including additional information with respect to the facts and circumstances of the claims incurred. Note 3 contains additional information on the judgments, estimates and assumptions used in determining claim liabilities. Note 5(a) contains details of the fair value yields for the FVTPL bond portfolio used in determining the discount rate.

The following table presents the movement of the Company's claim liabilities during the year.

	2012		
(in thousands of dollars)	Gross claim liabilities	Ceded claim liabilities	Net claim liabilities
Claim liabilities, beginning of year	$ 2,306,162	$ 68,333	$ 2,237,829
Current year claims incurred	1,098,095	12,893	1,085,202
Prior year favourable claims development	(50,610)	6,815	(57,425)
	1,047,485	19,708	1,027,777
Decrease due to changes in discounting	(10,425)	(1,096)	(9,329)
Claims and adjustment expenses	1,037,060	18,612	1,018,448
Claims paid during the year	1,121,938	23,662	1,098,276
Claim liabilities, end of year	$ 2,221,284	$ 63,283	$ 2,158,001

	2011		
(in thousands of dollars)	Gross claim liabilities	Ceded claim liabilities	Net claim liabilities
Claim liabilities, beginning of year	$ 2,372,682	$ 77,991	$ 2,294,691
Current year claims incurred	1,171,178	15,730	1,155,448
Prior year favourable claims development	(130,478)	(1,547)	(128,931)
	1,040,700	14,183	1,026,517
Increase due to changes in discounting	40,739	240	40,499
Claims and adjustment expenses	1,081,439	14,423	1,067,016
Claims paid during the year	1,147,959	24,081	1,123,878
Claim liabilities, end of year	$ 2,306,162	$ 68,333	$ 2,237,829

8. NATURE AND EXTENT OF RISKS ARISING FROM INSURANCE CONTRACTS

(a) Insurance risk management

By the very nature of an insurance contract, there is uncertainty as to whether an insured event will occur and the amount of loss that would arise in such an event. In the course of these insurance activities, there are several risks the Company must address by applying appropriate underwriting and claims policies and processes.

The Company's exposure to concentrations of insurance risk, in terms of type of risk and level of insured benefits, is mitigated by the use of predictive analytics, underwriting policies and individual limits. The Company carefully assesses individual risk attributes and characteristics in building an insurance portfolio with appropriate risk levels.

Written premiums were derived from personal automobile 39.9% (2011: 40.3%), personal property 20.2% (2011: 20.3%), commercial automobile 13.2% (2011: 13.3%) and commercial property and liability 26.7% (2011: 26.1%). The regional split of written premiums was Ontario 56.3% (2011: 56.7%), Western 28.3% (2011: 26.8%), Atlantic 8.1% (2011: 8.3%), Quebec 6.8% (2011: 7.4%) and Out of Canada 0.5% (2011: 0.8%).

The following discussion outlines the most significant insurance risks and the practices employed to mitigate these risks.

(i) Product and pricing risk

Product and pricing risk is the risk of financial loss from entering into insurance contracts when the liabilities assumed exceed the expectation reflected in the pricing of the insurance product. The Company prices its products by taking into account several factors including product design and features, claim frequency and severity trends, product line expense ratios, special risk factors, capital requirements, regulatory requirements and investment income. These factors are reviewed and adjusted as needed to ensure they are reflective of current trends and market conditions. The Company endeavours to maintain pricing levels that produce an acceptable return.

(ii) Underwriting risk

Underwriting risk is the risk of financial loss resulting from the selection of risks to be insured and the management of contract clauses. To minimize underwriting risk, the Company has adopted underwriting policies that set out the underwriting risk appetite and criteria, as well as specified tolerances for maximum financial risk retention. Once the retention limits are reached, reinsurance is utilized to cover the excess risk. The Company annually reviews the adequacy of its reinsurance programs to ensure sufficient reinsurance protection and financial return.

The Company has established quality review processes to ensure that the underwriting activities fall within established guidelines and pricing structures. The results of these quality reviews are distributed to senior management and the appropriate field management staff to ensure any issues identified are remedied.

(iii) Claims risk

Claims risk is the risk that inappropriate claims payments are made as a result of inadequate adjudication, settlement or payment of claims.

Strict claim review policies are in place to assess all new and ongoing claims. In addition, regular detailed review of claims handling procedures and frequent investigation of possible fraudulent claims reduce the risk exposure of the Company. Further, the Company enforces a policy of actively managing and promptly pursuing claims in order to reduce its exposure to unpredictable future developments that could negatively impact the business.

The Company has also limited its exposure by imposing maximum claim amounts on certain contracts as well as the use of reinsurance arrangements in order to limit exposure to large losses and catastrophic events. The placement of ceded reinsurance is almost exclusively on an excess-of-loss basis (per event or per risk). Under such programs, management considers that in order for a contract to reduce exposure to risk, it must be structured to ensure that the reinsurer assumes significant insurance risk related to the underlying reinsured contracts and it is reasonably possible that the reinsurer may realize a significant loss from reinsurance.

(iv) Interest rate risk

As the outstanding claim liabilities represent payments that will be made in the future, they are discounted to reflect the time value of money, effectively recognizing that the FVTPL bonds held to back insurance liabilities will earn a return during that period. The discount rate used to determine the actuarial discounted value of claim liabilities is based on the fair value yield of the Company's FVTPL bond portfolio (see note 5). In assessing the risks associated with investment income and therefore the discount rate, the Company considers the nature of the FVTPL bond portfolio and the timing of claim payments and their matching to investment cash flows. Future changes in the FVTPL bond portfolio could change the value of claim liabilities by impacting the fair value yield.

The following table presents the interest rate sensitivity analysis for a 1% change in interest rates on the net claim liabilities:

(in thousands of dollars)	2012		2011	
Impact on:	+ 1%	- 1%	+ 1%	- 1%
Net claim liabilities	$ (61,439)	$ 65,925	$ (63,419)	$ 67,842

(v) Regulatory risk

The P&C industry is subject to significant government regulation. As a result it is possible that future regulatory changes or changes in interpretations may limit the Company's ability to adjust prices, adjudicate claims or take other actions that would enhance operating results. The Company seeks to mitigate this risk through regular discussions with regulators and P&C industry groups to ensure the Company is aware of proposed changes and by providing feedback to regulators on proposed changes. The Company monitors compliance with relevant regulations and considers the implications of potential changes in regulation or interpretation on future results. Note 17 provides information on regulatory capital requirements. Note 18 provides additional details on rate regulation.

(b) Uncertainty and assumptions related to insurance contracts

A key objective of the Company is to ensure that sufficient claim liabilities are established to cover future insurance claim payments. The Company's underwriting profitability depends upon the ability to accurately assess the risk associated with the insurance contracts underwritten by the Company. The Company establishes claim liabilities to cover the estimated liability for payment of all claims and claim adjustment expenses incurred with respect to insurance contracts underwritten by the Company. Claim liabilities do not represent an exact calculation of the liability. Rather, claim liabilities are the Company's best estimates of its expected ultimate cost of resolution and administration of claims. Expected inflation is taken into account when estimating claim liabilities, thereby mitigating inflation risk.

Claim liabilities include an estimate for reported claims as established by the Company's claims adjusters based upon the details of reported claims plus a provision for IBNR.

Individual claims estimates are determined by claims adjusters on a case-by-case basis in accordance with documented policies and procedures. These specialists apply their knowledge and expertise, after taking available information regarding the circumstances of the claim into account, to set individual case reserve estimates. The claims reserving strategy and monitoring of their application and effectiveness falls under the accountability of the claims department.

The IBNR provision is intended to cover future development on both reported claims and claims that have occurred but have not yet been reported. Uncertainty exists on reported claims in that all information may not be available at the valuation date. Claims that have occurred may not be reported to the Company immediately; therefore, estimates are made to provide for unreported claims.

The valuation of claim liabilities is based on estimates derived by geographical region and line of business using generally accepted actuarial techniques. Numerous individual assumptions that impact average claim costs or frequency of late reported claims are made for each line of business. The principal assumption in the majority of actuarial techniques employed is that future claim development will follow a similar pattern to recent historical experience. However, there are times where historical experience is deemed inappropriate for evaluating future development due to recent judicial decisions, changes to government legislation or major shifts in a book of business. Such instances can require significant actuarial judgment, often supported by industry benchmarks, in establishing an adequate provision for claim liabilities.

Establishing an appropriate level of claim liabilities is an inherently uncertain process and is closely monitored by the Company's actuarial department. The sheer volume and diversity of considerations makes it impracticable to measure the impact on the Company's insurance contracts resulting from a change in a particular assumption or group of assumptions. The analysis below demonstrates the impact of changing assumptions for all lines of business and geographical regions in such a way that the average claim severity is altered materially. The analysis below also isolates the impact within the average claims severity of a change in claims and adjustment expenses on claim liabilities.

(in thousands of dollars)		2012				2011		
Impact of change in net claim liabilities due to:		+5%		-5%		+5%		-5%
Change in average claims severity	$	107,900	$	(107,900)	$	111,891	$	(111,891)
Change in claims and adjustment expenses	$	6,356	$	(6,356)	$	6,557	$	(6,557)

Assumptions and methods of estimation have been used that the Company believes produce reasonable results given current information. As additional experience and other data become available, the estimates could be revised. Any future changes in estimates would be reflected in the consolidated statement of comprehensive income in the year in which the change occurred.

The following tables show the development of claims over a period of time. The first table reflects development for gross claims, which excludes any reductions for reinsurance recoveries. The second table reflects development for net claims, which is gross claims less reinsurance recoveries. The triangle in each table ("Estimate of ultimate claims") shows how the ultimate estimates of total claims for each accident year develop over time as more information becomes known regarding individual claims and overall claims frequency and severity. Each column tracks the claims relating to a particular "accident year" which is the year in which such loss event occurred, regardless of when they were reported. The rows reflect the estimates in subsequent years for each accident year's claims. Claims are presented on an undiscounted basis in the triangle. "Cumulative claims paid" in each table presents the cumulative amounts paid for claims for each accident year as at December 31, 2012.

The claims development tables exclude FA, assumed RSP and the effect of discounting (including PfAD), which are shown as separate reconciling items below the tables.

Claims development table, gross of reinsurance:

	Accident Year							
(in thousands of dollars)	2006 and prior	2007	2008	2009	2010	2011	2012	Total
Estimate of ultimate claims								
At end of accident year	$ 2,729,630	$ 1,288,512	$ 1,456,644	$ 1,390,668	$ 1,182,512	$ 1,125,527	$ 1,057,765	
1 year later	2,698,362	1,267,471	1,416,109	1,338,880	1,072,306	1,044,459		
2 years later	2,671,020	1,254,042	1,407,710	1,337,790	1,072,615			
3 years later	2,671,619	1,252,232	1,396,826	1,359,769				
4 years later	2,669,927	1,250,487	1,412,092					
5 years later	2,670,851	1,248,037						
6 years later	2,679,406							
Favourable (unfavourable) development recognized in the year, undiscounted	(8,555)	2,450	(15,266)	(21,979)	(309)	81,068		$ 37,409
Favourable development recognized from FA and RSP assumed in the year								13,201
Total favourable development recognized in the year								$ 50,610
Reconciliation to the consolidated balance sheet								
Current estimate of ultimate claims	$ 2,679,406	$ 1,248,037	$ 1,412,092	$ 1,359,769	$ 1,072,615	$ 1,044,459	$ 1,057,765	$ 9,874,143
Cumulative claims paid	2,396,871	1,119,887	1,209,475	1,064,350	810,842	760,114	518,539	7,880,078
Current unpaid and unreported claims before discounting	282,535	128,150	202,617	295,419	261,773	284,345	539,226	1,994,065
Impact of discounting (including PfAD)								109,277
FA and RSP assumed from the pool unpaid and unreported								117,942
Unpaid and unreported claims, gross of reinsurance								$ 2,221,284

Claims development table, net of reinsurance:

	Accident Year							
(in thousands of dollars)	2006 and prior	2007	2008	2009	2010	2011	2012	Total
Estimate of ultimate claims								
At end of accident year	$ 2,585,750	$ 1,268,247	$ 1,442,344	$ 1,367,707	$ 1,169,299	$ 1,109,166	$ 1,044,872	
1 year later	2,553,296	1,245,843	1,400,621	1,313,573	1,059,823	1,018,243		
2 years later	2,525,665	1,232,228	1,390,981	1,309,097	1,059,723			
3 years later	2,525,792	1,232,587	1,380,116	1,327,402				
4 years later	2,529,660	1,231,499	1,395,101					
5 years later	2,534,743	1,229,267						
6 years later	2,550,484							
Favourable (unfavourable) development recognized in the year, undiscounted	(15,741)	2,232	(14,985)	(18,305)	100	90,923		$ 44,224
Favourable development recognized from FA and RSP assumed in the year								13,201
Total favourable development recognized in the year								$ 57,425
Reconciliation to the consolidated balance sheet								
Current estimate of ultimate claims	$ 2,550,484	$ 1,229,267	$ 1,395,101	$ 1,327,402	$ 1,059,723	$ 1,018,243	$ 1,044,872	$ 9,625,092
Cumulative claims paid	2,299,301	1,105,524	1,194,911	1,036,610	799,770	740,911	513,872	7,690,899
Current unpaid and unreported claims before discounting	251,183	123,743	200,190	290,792	259,953	277,332	531,000	1,934,193
Impact of discounting (including PfAD)								105,866
FA and RSP assumed from the pool unpaid and unreported								117,942
Unpaid and unreported claims, gross of reinsurance								$ 2,158,001

9. REINSURANCE CONTRACTS

The Company follows the policy of underwriting and reinsuring contracts of insurance which, in the main, limits the liability of the Company for individual large losses and in the event of a series of claims arising out of a single occurrence. These limits are as follows:

(in thousands of dollars)	2012	2011
Individual loss		
Property	$ 3,000	$ 2,000
General liability	4,000	4,000
Catastrophe - primary		
Company retention	30,000	25,000
Maximum limit	1,600,000	1,400,000
Catastrophe – aggregate		
Company retention[1]	50,000	50,000
Maximum limit	75,000	75,000

[1] Subject to losses of $5.0 million per event

(a) Underwriting impact of reinsurance contracts

The following amounts relate to reinsurance ceded recorded in the consolidated statement of comprehensive income:

(in thousands of dollars)	Notes	2012	2011
Premiums ceded	15	$ 96,047	$ 92,403
Premiums earned	7	97,647	89,412
Claims and adjustment expenses	7,8	18,612	14,423
Commissions		7,099	8,018

The following amounts relate to reinsurance assumed recorded in the consolidated statement of comprehensive income:

(in thousands of dollars)	Notes	2012	2011
Premiums assumed	15	$ 9,896	$ 13,205
Premiums earned	7	10,501	15,739
Claims and adjustment expenses	7,8	8,846	10,558
Commissions		4,095	5,475

(b) Reinsurance receivable and recoverable

The amounts presented under reinsurance receivable and recoverable in the consolidated balance sheet represents the Company's contractual rights under reinsurance contracts and are evaluated in a manner consistent with the gross liabilities.

(in thousands of dollars)	Notes	2012	2011
Reinsurers' share of UPR	7	$ 15,932	$ 17,532
Reinsurers' share of claim liabilities	7,8	63,283	68,333
Reinsurer receivables		8,808	29,225
Reinsurer payables		(13,822)	(14,517)
Unearned reinsurance commissions		(3,222)	(4,109)
		$ 70,979	$ 96,464

(c) Reinsurance assumed contracts

The Company presents balances related to reinsurance assumed contracts in the same manner as it presents direct insurance business with the exception of reinsurance assumed receivables and payables which are presented in "Reinsurance receivable and recoverable". The portion of assets and liabilities related to assumed contracts is as follows:

Reinsurance assumed assets:

(in thousands of dollars)	2012	2011
DPAE	$ 1,864	$ 1,974
Reinsurance assumed receivables	1,750	1,573
	$ 3,614	$ 3,547

Reinsurance assumed liabilities:

(in thousands of dollars)	2012	2011
UPR	$ 4,972	$ 5,577
Claim liabilities	19,055	21,119
Reinsurance assumed payables	3,412	742
	$ 27,439	$ 27,438

10. PROPERTY AND EQUIPMENT

Property and equipment, as presented on the consolidated balance sheets, is composed of the following:

	2012					
(in thousands of dollars)	Land and building structure	Building fixtures	Building infrastructure	Furniture and equipment	Computer equipment	Total
Cost:						
Balance, beginning of year	$ 18,377	$ 9,851	$ 9,253	$ 19,174	$ 7,890	$ 64,545
Additions	2,376	6	-	975	1,307	4,664
Disposals	(2,701)	-	-	(102)	(821)	(3,624)
Balance, end of year	$ 18,052	$ 9,857	$ 9,253	$ 20,047	$ 8,376	$ 65,585
Accumulated depreciation:						
Balance, beginning of year	$ 8,311	$ 7,314	$ 5,615	$ 15,835	$ 4,449	$ 41,524
Depreciation charge	936	392	370	762	1,857	4,317
Depreciation on disposals	(2,558)	-	-	(34)	(642)	(3,234)
Balance, end of year	$ 6,689	$ 7,706	$ 5,985	$ 16,563	$ 5,664	$ 42,607
Net book value, end of year	$ 11,363	$ 2,151	$ 3,268	$ 3,484	$ 2,712	$ 22,978

	2011					
(in thousands of dollars)	Land and building structure	Building fixtures	Building infrastructure	Furniture and equipment	Computer equipment	Total
Cost:						
Balance, beginning of year	$ 18,313	$ 9,776	$ 9,253	$ 19,123	$ 7,314	$ 63,779
Additions	152	75	-	408	899	1,534
Disposals	(88)	-	-	(357)	(323)	(768)
Balance, end of year	$ 18,377	$ 9,851	$ 9,253	$ 19,174	$ 7,890	$ 64,545
Accumulated depreciation:						
Balance, beginning of year	$ 6,494	$ 6,882	$ 5,245	$ 15,381	$ 3,025	$ 37,027
Depreciation charge	1,904	432	370	752	1,729	5,187
Depreciation on disposals	(87)	-	-	(298)	(305)	(690)
Balance, end of year	$ 8,311	$ 7,314	$ 5,615	$ 15,835	$ 4,449	$ 41,524
Net book value, end of year	$ 10,066	$ 2,537	$ 3,638	$ 3,339	$ 3,441	$ 23,021

Depreciation charged to operating expenses amounted to $4.3 million (2011: $5.2 million).

11. INCOME TAXES

(a) Income tax expense

The reconciliation of income tax calculated at the Canadian statutory tax rate to the income tax expense at the effective tax rate recorded in net income in the consolidated statement of comprehensive income is provided in the table below:

	2012		2011	
(in thousands of dollars)	%	$	%	$
Income tax expense calculated based on statutory tax rates	26.3%	$ 52,603	28.0%	$ 35,691
Canadian dividend income not subject to tax	(2.1%)	(4,173)	(3.0%)	(3,865)
Effect of change in tax rates	(0.4%)	(780)	1.8%	2,315
Non-deductible expenses	0.2%	480	0.9%	1,158
Rate differential on recognized gains on AFS equity instruments	0.2%	283	0.4%	481
Other	(0.6%)	(1,121)	0.5%	688
Income tax expense recorded in net income	23.6%	$ 47,292	28.6%	$ 36,468
Current income taxes		$ 44,507		$ 32,829
Deferred income taxes		2,785		3,639
Income tax expense		$ 47,292		$ 36,468

In fiscal 2012, the statutory tax rate decreased to 26.3% due to decreases in the general federal and provincial tax rates for corporations.

The major components of the current income tax expense (recovery) are as follows:

(in thousands of dollars)	2012	2011
Income taxes related to current year	$ 45,642	$ 34,609
Income taxes related to prior years	(1,135)	(1,780)
	$ 44,507	$ 32,829

Income taxes included in OCI are as follows:

(in thousands of dollars)	2012	2011
Net unrealized gains on AFS investments	$ 12,927	$ 754
Reclassification to net income of net recognized losses (gains) on AFS investments	(6,980)	6,482
Post-employment benefit obligations	(2,258)	(4,958)
Income tax expense	$ 3,689	$ 2,278

(b) Deferred income taxes

The deferred income tax expense (recovery) is as follows:

(in thousands of dollars)		2012		2011
Relating to origination and reversal of temporary differences	$	3,565	$	1,324
Changes in tax rates, tax regulations and assessments		(780)		2,315
	$	2,785	$	3,639

The components comprising deferred income tax assets are as follows:

(in thousands of dollars)		2012		2011
Net claim liabilities	$	28,498	$	28,980
Post-employment benefit plans		18,656		19,530
DPAE		8,377		8,585
Property and equipment		(4,672)		(5,243)
Investments		(124)		(344)
Other		2,113		1,867
	$	52,848	$	53,375

The components comprising deferred income tax expense (recovery) are as follows:

(in thousands of dollars)		2012		2011
Net claim liabilities	$	482	$	1,900
Post-employment benefit plans		3,132		(1,002)
DPAE		208		514
Property and equipment		(571)		3,462
Investments		(220)		281
Other		(246)		(1,516)
	$	2,785	$	3,639

12. GOODWILL AND INTANGIBLE ASSETS

Goodwill and intangible assets, as presented on the consolidated balance sheet, is composed of the following items:

(in thousands of dollars)		2012		2011
Goodwill	$	26,925	$	28,949
Intangible assets		46,987		48,297
	$	73,912	$	77,246

(a) Goodwill

(in thousands of dollars)		2012		2011
Cost:				
Balance, beginning of year	$	67,314	$	67,314
Disposals		(2,024)		-
Balance, end of year		65,290		67,314
Accumulated impairment:				
Balance, beginning of year		38,365		37,777
Impairment charge		-		588
Balance, end of year		38,365		38,365
Net book value, end of year	$	26,925	$	28,949

Goodwill has been allocated to two individual CGUs. The carrying amount of goodwill allocated to each of the CGUs is shown below.

(in thousands of dollars)		2012		2011
Economical Mutual Insurance Company	$	24,526	$	24,526
Westmount Financial Inc.		2,399		4,423
	$	26,925	$	28,949

Goodwill is subject to an impairment test that is performed at least annually. When testing for impairment, the recoverable amount of the CGU is determined based on VIU calculations using a discounted cash flow model based on financial forecasts approved by management covering a five-year period and an estimate of the terminal values for the period beyond the five-year forecast.

The key assumptions used for the impairment calculations are as follows:

- Growth rates represent the rates used to extrapolate new business contributions beyond the business plan period. The growth rate is based on historic performance adjusted for management expectations. The growth rate used for current year impairment calculations of 2.0% (2011: 2.0%) does not exceed the historic long-term average growth rate.
- A pre-tax, market adjusted discount rate of 13.8% (2011: 13.8%) is used to discount expected profits from future new business.

Management does not believe that a reasonable change in these assumptions would result in the carrying value of the CGUs exceeding the recoverable amounts.

The goodwill impairment testing for the current year determined that there was no evidence of impairment (2011: $0.6 million).

(b) Intangible assets

	2012					
(in thousands of dollars)		Software		Other intangible assets		Total
Cost:						
Balance, beginning of year	$	62,578	$	1,032	$	63,610
Additions		4,716		-		4,716
Disposals		(2,492)		(1,032)		(3,524)
Impairment charge		(292)		-		(292)
Balance, end of year	$	64,510	$	-	$	64,510
Accumulated amortization:						
Balance, beginning of the year	$	14,719	$	594	$	15,313
Amortization expense		4,043		58		4,101
Amortization on disposals		(1,239)		(652)		(1,891)
Balance, end of year	$	17,523	$	-	$	17,523
Net book value, end of year	$	46,987	$	-	$	46,987

	2011					
(in thousands of dollars)		Software		Other intangible assets		Total
Cost:						
Balance, beginning of year	$	50,997	$	1,075	$	52,072
Additions		11,651		-		11,651
Disposals		(70)		(43)		(113)
Balance, end of year	$	62,578	$	1,032	$	63,610
Accumulated amortization:						
Balance, beginning of year	$	11,297	$	444	$	11,741
Amortization expense		3,422		150		3,572
Balance, end of year	$	14,719	$	594	$	15,313
Net book value, end of year	$	47,859	$	438	$	48,297

Included in software is $3.0 million (2011: $15.6 million) that has not yet commenced amortization as it is still under development.

13. OTHER ASSETS

Other assets, as presented on the consolidated balance sheets, are composed of the following items:

(in thousands of dollars)		2012		2011
Investments in associates	$	14,848	$	16,309
Prepaid expenses		2,487		5,674
Other		1,773		1,634
	$	19,108	$	23,617

Impairment testing for the Company's investments in associates determined that an impairment loss was not required (2011: $1.6 million).

Key financial information about the Company's investments in associates is shown below, in aggregate:

(in thousands of dollars)		2012		2011
Total assets	$	208,846	$	215,534
Total liabilities		157,683		166,051
Total revenue		25,222		148,476
Total net income		2,262		910

The Company's share of these financial items is as follows:

(in thousands of dollars)		2012		2011
Total assets	$	42,422	$	43,037
Total liabilities		31,885		32,801
Total revenue		6,326		31,038
Total net income		558		215
Carrying amount of investments in associates		14,848		16,309

All of the Company's investments in associates are private entities that are not traded on a public exchange. Therefore, there are no published price quotations for the fair value of these investments.

14. ACCOUNTS PAYABLE AND OTHER LIABILITIES

Accounts payable and other liabilities, as presented on the consolidated balance sheet, is composed of the following:

(in thousands of dollars)	Notes		2012		2011
Pension and non-pension benefit obligations	16	$	68,512	$	76,590
Commissions payable			61,801		59,415
Premium taxes and other taxes payable			13,765		11,493
Accounts payable and other liabilities			46,353		39,040
Restructuring provision	21		5,172		-
		$	195,603	$	186,538

15. PREMIUMS

Net premiums written, as presented on the consolidated statement of comprehensive income, is composed of the following:

(in thousands of dollars)	2012	2011
Direct premiums written	$ 1,809,807	$ 1,710,034
Premiums assumed from other companies	9,896	13,205
Gross premiums written	1,819,703	1,723,239
Premiums ceded to other companies	(96,047)	(92,403)
Net premiums written	$ 1,723,656	$ 1,630,836

Net premiums earned, as presented on the consolidated statement of comprehensive income, is composed of the following:

(in thousands of dollars)	2012	2011
Net premiums written	$ 1,723,656	$ 1,630,836
Change in gross unearned premiums	(56,038)	(18,727)
Change in ceded unearned premiums	(1,600)	2,991
Net premiums earned	$ 1,666,018	$ 1,615,100

16. POST-EMPLOYMENT BENEFITS

The Company provides certain pension and other post-employment benefits through defined benefit, defined contribution and other post-employment benefit plans to eligible participants upon retirement.

During the year, the Company modified the eligibility criteria for the other post-employment benefit plan and reduced the number of current employees eligible for post-employment benefits under the plan. This change has no impact on benefits supplied to current retirees or for the remaining eligible employees. The effect of the curtailment is a reduction to the benefit obligation and the net period cost of $16.5 million (2011: nil).

The contributory defined benefit pension plans provide pension benefits based on length of service and final average pensionable earnings. The most recent actuarial valuation was prepared as of January 1, 2012. The contribution to be paid by the Company is determined each year by the Company's actuaries. Based on the latest actuarial valuations of all its plans, the total contributions by the Company to the pension plans are expected to be approximately $9.7 million in 2013. All contributions are expected to be in the form of cash.

Under the defined contribution pension plan, the Company contributes a fixed percentage of an employee's pensionable earnings to the plan. Contributions under the defined contribution pension plan totalled $9.2 million (2011: $9.0 million).

(a) Plan movements

The following table presents the movement of the Company's pension plan and other benefit plan obligations and plan assets during the year.

2012					
	Amounts recognized in net income	(Gains) losses recognized in OCI	Present value of benefit plan obligation		Fair value of plan assets
(in thousands of dollars)			Other benefit plans	Pension plans	Pension plans
Balance, beginning of year			$ 58,693	$ 176,049	$ 158,152
Total service cost	$ 7,979	$ -	3,358	4,621	-
Interest cost	12,180	-	3,258	8,922	-
Curtailment	(16,456)	-	(16,456)	-	-
Return on plan assets	(9,751)	(1,802)	-	-	11,553
Actuarial losses	-	10,350	4,162	6,188	-
Contributions by employer	-	-	-	-	9,774
Contributions by plan participants	-	-	-	510	510
Benefits paid	-	-	(804)	(6,931)	(6,931)
Balance, end of year	$ (6,048)	$ 8,548	$ 52,211	$ 189,359	$ 173,058

2011					
	Amounts recognized in net income	Losses recognized in OCI	Present value of benefit plan obligation		Fair value of plan assets
(in thousands of dollars)			Other benefit plans	Pension plans	Pension plans
Balance, beginning of year			$ 51,442	$ 158,017	$ 155,510
Total service cost	$ 7,248	$ -	3,012	4,236	-
Interest cost	11,774	-	2,966	8,808	-
Return on plan assets	(10,312)	7,003	-	-	3,309
Actuarial losses	-	12,088	2,322	9,766	-
Contributions by employer	-	-	-	-	4,111
Contributions by plan participants	-	-	-	643	643
Benefits paid	-	-	(1,049)	(5,421)	(5,421)
Balance, end of year	$ 8,710	$ 19,091	$ 58,693	$ 176,049	$ 158,152

Of the amounts recognized in net income, $10.4 million (2011: $8.7 million) in expenses were recorded in "Operating expenses" and a curtailment gain of $16.5 million (2011: nil) was recorded in "Other income (expense)".

The actual return on plan assets was $11.6 million (2011: $3.3 million).

(b) Funding status of defined benefit plans

The amounts recognized in the consolidated balance sheet in "Accounts payable and other liabilities" at the reporting date are as follows:

	2012			
(in thousands of dollars)	Other benefit plans			Pension plans
Defined benefit obligation	$	(52,211)	$	(189,359)
Fair value of plan assets		-		173,058
Net defined benefit obligation	$	(52,211)	$	(16,301)
Actuarial gains on plan assets	$	-	$	(1,802)
Actuarial losses on plan liabilities	$	4,162	$	6,188

	2011			
(in thousands of dollars)	Other benefit plans			Pension plans
Defined benefit obligation	$	(58,693)	$	(176,049)
Fair value of plan assets		-		158,152
Net defined benefit obligation	$	(58,693)	$	(17,897)
Actuarial losses on plan assets	$	-	$	7,003
Actuarial losses on plan liabilities	$	2,322	$	9,766

	2010			
(in thousands of dollars)	Other benefit plans			Pension plans
Defined benefit obligation	$	(51,442)	$	(158,017)
Fair value of plan assets	$	-		155,510
Net defined benefit obligation	$	(51,442)	$	(2,507)
Actuarial gains on plan assets	$	-	$	(1,553)
Actuarial losses on plan liabilities	$	10,149	$	24,043

(c) Pension plan asset allocation

The table below shows the allocation of defined benefit pension plan assets:

	% of plan assets	
	2012	2011
Cash	4.1 %	1.4 %
Canadian fixed income securities	39.0	44.6
Equity securities		
Canadian	27.0	26.0
Foreign	26.1	24.0
Other	3.8	4.0
	100.0 %	100.0 %

(d) Assumptions applied

The principal actuarial assumptions used in determining the defined benefit obligation for the Company's pension plans are follows:

	Other benefit plans		Pension plans	
	2012	2011	2012	2011
To determine benefit obligation, end of year:				
Discount rate	4.6%	5.3%	4.5%	5.0%
Expected long-term return on plan assets	-	-	6.3%	6.5%
Future salary increases	-	-	3.0%	3.3%
Future pension increases	-	-	1.0%	1.1%
Inflation assumption	-	-	2.0%	2.3%
Prescription drug cost increase	9.0%	8.0%	-	-
Medical claims cost increase	4.5%	8.0%	-	-
To determine benefit expense for the year:				
Discount rate	5.3%	5.5%	5.0%	5.5%
Expected long-term return on plan assets	-	-	6.5%	7.0%
Future salary increases	-	-	3.3%	3.5%
Future pension increases	-	-	1.1%	1.1%
Inflation assumption	-	-	2.3%	2.3%
Prescription drug cost increase	9.0%	8.0%	-	-
Medical claims cost increase	4.5%	8.0%	-	-

The mortality assumptions used to assess the Company's defined benefit obligations for the pension and other post-employment benefit plans as of December 31, 2012 are based on the 1994 UP mortality tables as established by the Canadian Institute of Actuaries.

The discount rate is the assumption that has the largest impact on the value of these obligations. A 1% change in this rate would impact the present value of the defined benefit obligation by $26.1 million (2011: $23.4 million). A 1% change in this rate would impact the present value of the other post-employment benefit plan obligation by $7.6 million (2011: $10.4 million).

The Company must make assumptions about the expected long-term rate of return on plan assets, but there is no assurance that a plan will be able to earn the assumed rate of return. The overall expected rate of return on assets is determined based on market expectations prevailing on that date, applicable to the year over which the obligation is to be settled

The impact of a 1% change in the health care cost assumption is as follows:.

(in thousands of dollars)	2012		2011	
	+1%	-1%	+1%	-1%
Impact on the defined benefit obligation	$ 8,578	$ (6,827)	$ 14,662	$ (10,983)
Impact on the aggregate of total service cost and interest cost	$ 762	$ (599)	$ 1,767	$ (1,289)

17. CAPITAL MANAGEMENT

Management develops the capital strategy for the Company and supervises the capital management processes. The Board of Directors is responsible for overseeing management's compliance with the capital management policies. As a federally regulated property and casualty insurance company, the Company's capital position is monitored by OSFI. OSFI evaluates the Company's capital adequacy through the Minimum Capital Test ("MCT"), which measures available capital against required risk-weighted capital. Available capital comprises total mutual policyholders' equity plus or minus adjustments prescribed by OSFI. Capital required is calculated by applying risk factors to the assets and liabilities of the Company. As at the reporting date, the Company's MCT ratio of 295.1% exceeds the minimum capital ratio of 150% required by OSFI.

Management actively monitors the MCT and the effect that external and internal actions have on the capital base of the Company. In particular, management determines the effect on capital before entering into any significant transactions to ensure that policyholders are not put at risk through the depletion of capital to unacceptable levels. The Board of Directors reviews the MCT on a quarterly basis. In accordance with regulatory requirements and the Company's capital management policies, the Board of Directors has set internal targets at levels higher and more stringent than OSFI's minimum requirements.

Reinsurance is also used to protect the Company's capital level from large losses, including those of a catastrophic nature, which could have a detrimental impact on capital. The Company has adopted policies that specify tolerance for financial risk retention. Once the retention limits are reached, as disclosed in note 9, reinsurance is utilized to cover the excess risk.

On an annual basis, the Company performs Dynamic Capital Adequacy Testing on the MCT to ensure that the Company has sufficient capital to withstand a number of significant adverse scenarios.

18. RATE REGULATION

In common with the P&C insurance industry in general, the Company is subject to regulation in certain jurisdictions whereby rates charged to customers for certain automobile insurance policies must be approved by the applicable regulatory body. This type of business comprises 43.2% (2011: 43.8%) of the Company's total direct premiums written during the year.

The following table outlines the jurisdictions, regulatory authorities and regulatory processes that the Company is subject to:

Jurisdiction	Regulatory authority	Regulatory process
Alberta	Alberta Automobile Insurance Rate Board	File and use rate regulation for physical damage coverages and prior approval rate regulation for mandatory coverages on individually rated vehicles.
Newfoundland and Labrador	Public Utilities Board	File and use rate regulation for instances where there is no increase in rate for any coverage for any insured; any filing not meeting these requirements will be subject to prior approval rate regulation.
New Brunswick	New Brunswick Insurance Board	Prior approval rate regulation on individually rated vehicles.
Nova Scotia	Nova Scotia Utility and Review Board	File and use rate regulation for instances where there is no increase greater than 2% in rate for any insured per year; any filing not meeting these requirements will be subject to prior approval rate regulation.
Ontario	Financial Services Commission of Ontario	File and use rate regulation on individually rated miscellaneous and commercial vehicles and prior approval rate regulation on individually rated private passenger vehicles.
Prince Edward Island	Island Regulatory and Appeals Commission	File and use rate regulation on individually rated vehicles.
Quebec	Autorité des Marchés Financiers	Use and file rate regulation on individually rated private passenger, miscellaneous and commercial vehicles.

19. COMMITMENTS AND CONTINGENCIES

Commitments

The Company's commitments include operating lease commitments and certain non-cancellable contractual commitments. The Company's motor vehicles, computers and office equipment are supplied through operating leases. The future contractual aggregate minimum lease payments under non-cancellable operating leases and other commitments are as follows:

(in thousands of dollars)		2012		2011
Within 1 year	$	23,861	$	18,616
Later than 1 year but not later than 5 years		47,214		52,606
Later than 5 years		29,590		28,754

Operating lease payments included in "Operating expenses" in the consolidated statement of comprehensive income during 2012 were $19.4 million (2011: $19.3 million).

Total future minimum sublease income under non-cancellable subleases amounted to $2.3 million (2011: $1.5 million).

Contingencies

In common with the insurance industry in general, the Company is subject to litigation arising in the normal course of conducting its insurance business. The Company is of the opinion that this litigation will not have a significant effect on its financial position, results of operations, or cash flows.

20. DEMUTUALIZATION

On December 14, 2010, the Company announced its intention to demutualize. This involves converting from its current mutual form of ownership to a stock company. At this time, there are a number of future decisions to be made with respect to the demutualization, including determining the structure of the demutualization transaction, and approval of the transaction by mutual policyholders and government regulators. Regulation will also need to be enacted to permit the demutualization of a property and casualty insurance company.

21. RESTRUCTURING EXPENSES

During the year, the Company initiated a business transformation program to improve the effectiveness and efficiency of its operations. The Company expects to execute this program in phases over the next two years. Due to the phased approach, additional provisions will be recognized and payments will be made in future periods as restructuring plans are finalized. The provisions made to date reflect decisions and plans communicated as of December 31, 2012 and include employee-related expenses and professional fees for the restructuring element of the program. The restructuring provision is presented in "Accounts payable and other liabilities" on the consolidated balance sheet, and the corresponding expense is presented in "Restructuring expenses" on the consolidated statement of comprehensive income.

A reconciliation of the restructuring provision is provided below:

(in thousands of dollars)		2012		2011
Balance, beginning of year	$	-	$	-
Provisions made during the year		11,588		-
Payments made during the year		6,416		-
Balance, end of year	$	5,172	$	-

In addition to the above amounts, $2.1 million (2011: nil) of expenses related to the business transformation program are included in "Operating expenses", as the criteria for classification as restructuring expenses was not met.

22. SUPPLEMENTAL EXPENSE INFORMATION

Included in operating expenses and net claims and adjustment expenses are the following:

(in thousands of dollars)	Notes		2012		2011
Salary and benefit expenses		$	206,306	$	205,261
Post-employment expenses	16		10,408		8,710
Occupancy expenses			18,765		17,339
		$	235,479	$	231,310

23. RELATED PARTY TRANSACTIONS

From time to time, the Company enters into transactions in the normal course of business, which are measured at the exchange amounts, with certain directors, senior officers and companies with which it is related. Management has established procedures to review and approve transactions with related parties and reports annually to the Corporate Governance Committee of the Board of Directors, on the procedures followed and the results of the review.

The compensation of key management personnel, defined as the Company's directors, president and chief executive officer and senior vice-presidents, is as follows:

(in thousands of dollars)		2012		2011
Salaries	$	2,682	$	2,162
Short-term and long-term incentive plans		4,973		2,356
Post-employment pension benefits		318		332
Other short-term employment benefits		154		189
Directors fees		863		876
Termination benefits		181		322
	$	9,171	$	6,237

Directors

One of the Company's directors was employed by a publicly traded entity during a portion of the year, in which the Company owns common stock with a fair value of $7.2 million (2011: $5.8 million). This entity also provides certain services on an arm's-length basis totalling $0.8 million (2011: $0.6 million). As disclosed in note 6, the Company purchases annuities from life insurers. The original purchase price of outstanding annuities purchased from this entity is $59.8 million (2011: $53.2 million).

Employment benefit plans

The Company makes contributions to employment benefit plans on behalf of its employees, including both defined contribution and defined benefit plans. Information regarding transactions with the plans is included in note 16.

Associates

At the reporting date, commercial loans of $2.3 million (2011: $6.3 million) are due from companies subject to significant influence. The loans are included in "Investments" in the consolidated balance sheet and are initially measured at the exchange amount. The loans are subsequently measured in accordance with the accounting policy for loans and receivables (note 2).

The Company participates in a quota share reinsurance treaty of a company subject to significant influence under terms consistent with the other reinsurers. The Company's share of reinsurance assumed from the associate, including reinsurance assumed contracts (note 9), is as follows:

(in thousands of dollars)	Notes		2012		2011
Premiums assumed	15	$	3,544	$	2,953
Premiums earned	7,9		3,397		3,185
Claims and adjustment expenses	7,8,9		2,343		1,302
Commissions	9		1,581		1,388

Reinsurance assumed assets:

(in thousands of dollars)	Notes		2012		2011
DPAE	9	$	588	$	676
Reinsurance assumed receivables	8,9		370		440
		$	958	$	1,116

Reinsurance assumed liabilities:

(in thousands of dollars)	Notes		2012		2011
UPR	9	$	1,693	$	1,778
Claim liabilities	9		2,687		1,627
		$	4,380	$	3,405

24. OPERATING SEGMENTS

The Company's management and directors review the results of operations based on two reportable segments, the P&C insurance segment and the broker operations segment. More than 99% of assets are contained in the insurance segment, with the balance in the broker operations segment.

ec·o·nom·i·cal (ekəˈnämikəl)

ADJECTIVE:

1. Giving good value or service in relation to the amount of money, time, or effort spent.

2. Careful not to waste money or resources.

3. Good to know.

OUR BRANDS

BOARD OF DIRECTORS*

John H. Bowey (1, 3, 6)

A. Scott Carson (2, 5)

Richard M. Freeborough (1, 2, 6)

Karen L. Gavan (4, 5)

Gerald A. Hooper, Chairman (1, 2, 3, 6)

David A. MacIntosh (4) (retired as of March 2013)

Charles M.W. Ormston (2, 3, 6)

Michael P. Stramaglia (1, 4, 5)

W. David Wilson (4, 5, 6)

Elizabeth L. DelBianco (2, 3) (as of March 2013)

COMMITTEES*

1. Audit
2. Corporate Governance
3. Human Resources and Compensation
4. Investment
5. Risk Review
6. Special

* as of December 31, 2012, except as noted.

EXECUTIVE MANAGEMENT TEAM

Karen Gavan, FCPA, FCA, ICD.D
President and chief executive officer

Jennifer Allan, BBA, MA, MHRM, CHRP, CCP
Vice-president, HR programs and corporate communications

Jorge Arruda, B.Comm.
Senior vice-president and chief transformation officer

Dean Bulloch, MBA, CHRP
Senior vice-president and chief human resources officer

Scott Campbell, BBA, CIP
Vice-president , Ontario region

Innes Dey, B.Sc. (Hons), LL.B
Senior vice-president, chief legal officer
and corporate secretary

Pamela Derksen, BA, FCIP
Vice-president, commercial insurance

Wayne Edwards, FCAS
Vice-president, corporate actuarial

Dianna Fioravanti, BA, CIP
Vice-president, sales, distribution
and underwriting operations

David Fitzpatrick, BA
Vice-president, Economical Financial™

Michael Gagnier, B.Comm.
Senior vice-president and chief information officer

Linda Goss, B.Sc. (Hons), FCIA, FCAS
Senior vice-president and chief actuary

Robert Gow, CCLA, CFE
Vice-president, Western region

Bharat Kannan, B.Math., CA, CFA
Vice-president, finance and controller

Pamela Marson, FCIP
Vice-president, personal insurance

Philip Mather, CA, B.Sc. (Hons)
Senior vice-president and chief financial officer,
president of Economical Financial™

Rocco Neglia, BA (Hons), CIP
Vice-president, claims

Michael O'Neill, BA, MBA, CFA
Vice-president, investments

Mayssa Rifaï, BA, CIP
Vice-president, Quebec Region

Dan Spears, FCIP
Vice-president, Atlantic Region

Chris Van Kooten, FCIA, FCAS
Vice-president, pricing

Chris Weber, BA (Hons), MA
Vice-president, analytics

Tom Mallozzi, BA, FCIP
Division vice-president, Perth Insurance®

The combined environmental certifications associated with the paper used in this report (Enviro 100 and Supreme Matte) are as follows:

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