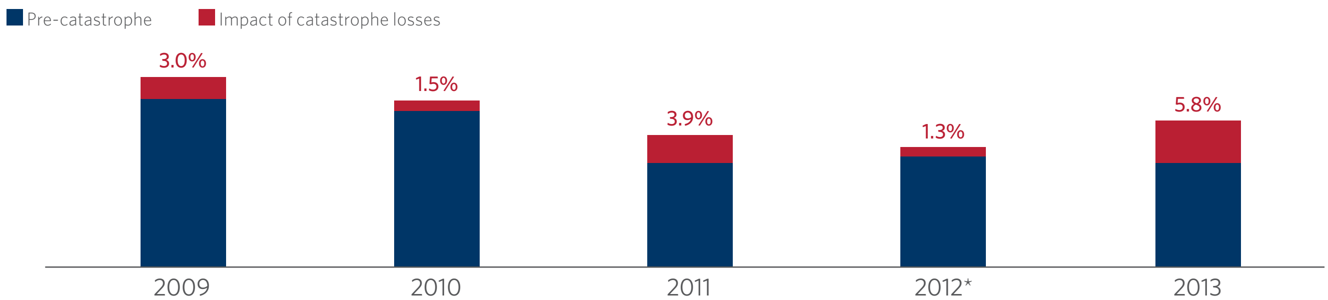
2013 Annual Report

2013 performance at a glance...

COMBINED RATIO (COR)

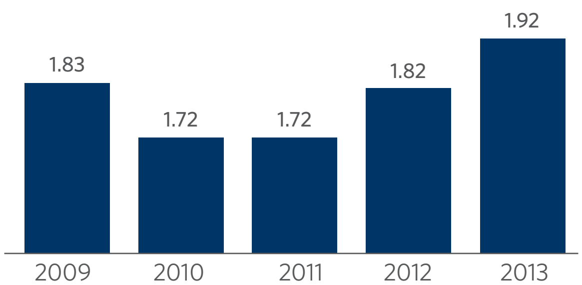
2013 was the worst catastrophe year on record for both the company and Canada's property and casualty insurance industry as a whole. Even so, the company's underlying operating performance was fundamentally strong. When excluding catastrophe costs, the company's COR has steadily improved from a high of 103.1% in 2009 to 94.3% in 2013.



* 2012 restated for Pension Adjustment impact of 0.1 percentage points.

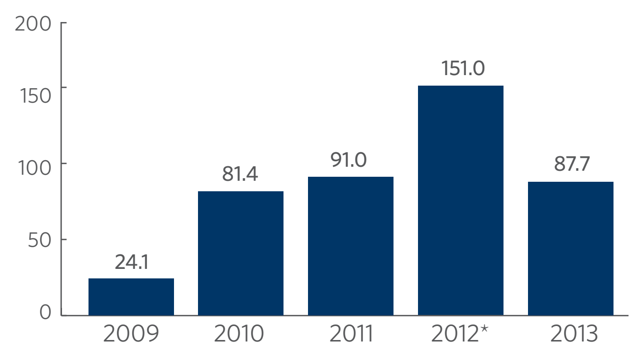
GROSS WRITTEN PREMIUMS (GWP) ($ BILLIONS)

The company has recorded consistent growth in GWP levels since 2011, following targeted actions taken in 2009 through 2010 to refocus the company on profitable underwriting.



NET INCOME ($ MILLIONS)

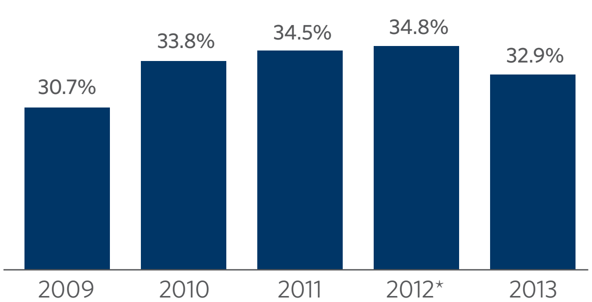
Net income for 2013 remained strong at $87.7 million, despite absorbing $76.1 million in weather-related catastrophe costs, net of reinsurance and tax.



* 2012 restated for Pension Adjustment impact of $1.7 million.

EXPENSE RATIO

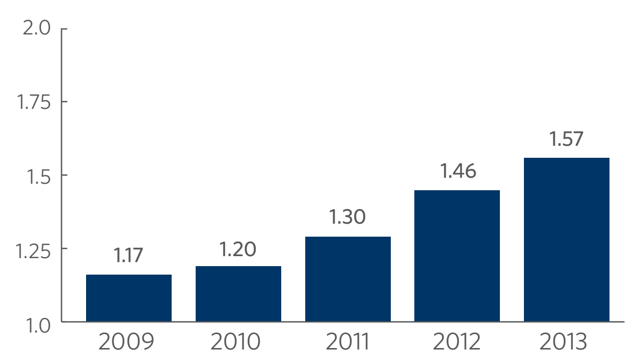
In 2012, the company began a business transformation program to improve operating efficiency. In combination with the increases in net earned premiums and reduced commissions, program benefits contributed to an improved expense ratio, which is now at its lowest level since 2009.



* 2012 restated for Pension Adjustment impact of 0.1 percentage points.

MUTUAL POLICYHOLDERS EQUITY ($ BILLIONS)

The company's focus on profitable underwriting, operating efficiency and its strong investment portfolio has helped offset unprecedented catastrophe losses in 2013, contributing to the highest levels of mutual policyholders' equity in the company's history.



economical® | good to know®

"… since Economical first announced its intention to pursue demutualization…there have been six major transactions involving the Top 10 players in the industry and impacting more than 12% of total industry premiums. … [A]s the pace of industry consolidation increases, so too does our competitive disadvantage and the importance of our demutualization initiative."

Gerry Hooper, Chairman of the Board of Directors

a message from Gerry Hooper, chairman of the board

In 2013, the Canadian P&C industry experienced the worst year of catastrophe losses in its history, suffering an estimated $3.2 billion in losses from severe weather events across Canada. For its part, Economical absorbed weather related catastrophe losses in excess of $103 million, an all-time high for the company, but emerged from the year with only a small underwriting loss, a testament to the strength of our company and the effectiveness of our operating platform.

For more than five years, we have been focused on improving our operating platform and financial performance to make the company stronger and more valuable. We reached many new milestones in 2013, although it was an active year in dealing with claims losses and providing customers with the high level of service they expect from our company. Gross written premiums have grown quarter after quarter, increasing by 5.5% year-over-year to $1.92 billion at the end of 2013. With increased underwriting discipline, we have turned these top-line results into higher overall profitability. Despite record catastrophe losses, we ended the year in a very strong capital position with an MCT ratio of 295% and mutual policyholders' equity of $1.57 billion, its highest level ever.

Economical continues to make significant progress in executing its business transformation program designed to improve productivity, profitability and competitiveness across the company for the long term. Our president and CEO Karen Gavan and her leadership team have demonstrated the strength and willingness to make tough but necessary decisions to enhance the future performance of the company. We have overhauled internal processes in our information technology, underwriting and procurement functions, and strengthened our risk management and corporate capabilities. These are all critical to improving productivity and reducing costs in order to foster future growth and sustainable competitive advantage. This has placed an added workload on many employees and I am impressed by how they have embraced these challenges.

It has been more than three years since Economical first announced its intention to pursue demutualization. Over that period, there have been six major transactions involving the Top 10 players in the industry, impacting more than 12% of total industry premiums. Three significant examples of this consolidation are the 2011 acquisition of AXA Canada by Intact, Canada's largest P&C insurer, the 2013 purchase of The Dominion of Canada General Insurance Company by Travelers, and the recently announced acquisition of State Farm Canada by Desjardins Group. As a mutual company, Economical is restricted in its ability to access capital and, as the pace of industry consolidation increases, so too does our competitive disadvantage and the importance of our demutualization initiative.

The regulations that will govern how we can proceed with demutualization have not been released, yet we do see signs of progress. The 2014 Federal Budget included confirmation that the department of finance is committed to making the legislative and regulatory changes necessary to allow federally regulated P&C mutual insurance companies to demutualize. The first step toward fulfilling that commitment was made in the budget implementation bill, Bill C-31, which includes amendments to the Insurance Companies Act (Canada) that will support the eventual implementation of the demutualization regulations.

The draft regulations are expected to be subject to a public consultation period before coming into force. At that point, Economical's board of directors will be in a position to decide whether demutualization within the final regulatory framework would be in the best interest of the company. In the meantime, we continue to prepare for demutualization and focus on building the long-term value of the company.

Our board of directors continues to diversify and expand its expertise and in December, I had the pleasure of welcoming Barbara Fraser onboard. Barbara brings extensive C-suite executive experience within the financial services industry with American Express and Citibank, as well as a broad range of board experience. We look forward to benefiting from Barbara's innovative thinking and collaborative leadership in marketing, branding and corporate strategy to help Economical sustain profitable growth and build competitive advantage.

Also in December, John Bowey, a member of the board since 2011, was appointed board vice-chair. John's appointment strengthens our board's resilience as part of our succession planning and renewal process, and positions us well for the eventual transition of my board chair responsibilities. For three years, John has ably led the board's special committee on demutualization which has worked diligently with our advisors to advocate for a workable demutualization framework.

Earlier this year, Dr. Scott Carson retired from the board to focus on his academic and leadership responsibilities at Queen's University. On behalf of Economical and the board of directors, I want to thank Scott for his 14 years of dedicated service, which included eight years as chair of our corporate governance committee, as well as roles on our audit, risk review and investment committees. We always valued Scott's active involvement and wise counsel. He will be missed but we wish him well.

By any measure, 2013 was a challenging year. I am particularly grateful to Karen and her leadership team for their vision and commitment, and want to express the board's appreciation to our employees who worked vigorously through the company's ongoing business transformation and for consistently delivering on our promise to be there when our policyholders need us most. I also want to acknowledge the support and dedication of our broker partners. Each day we work hard to earn their trust, loyalty and confidence. 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

“Our A.M. Best A- (Excellent) rating reflects Economical’s excellent financial strength and performance, and reinforces our broker partners’ confidence in recommending Economical to their commercial and group insurance customers.”

Karen Gavan, President and CEO

a message from Karen Gavan, president and ceo

If I had to choose a single phrase to sum up 2013 it would have to be: grace under pressure. In a year that saw not only unprecedented industry catastrophe losses, but also enormous internal change, I am extremely proud of how we, as a company, rose to those challenges to deliver both outstanding service to our policyholders and exceptional results overall.

The devastation caused by the June floods in Alberta, the July rainstorms in the Greater Toronto Area and the December ice storm that hit a large swath of Ontario and parts of Quebec and Atlantic Canada served as poignant reminders of the critical role we play in protecting our policyholders. On their own, each event was massive in scale, severely impacting homes, property and businesses of our insureds; together, they combined to produce the worst catastrophe year on record for the property and casualty insurance industry in Canada. In each case, Economical responded within hours of the event, deploying teams on the ground to meet the needs of our policyholders in ways that many of our competitors simply couldn't match.

Yet despite the devastation caused by record catastrophes, our results remained strong. The sophistication that our industry-leading predictive analytics provide to our products, pricing, broker management and risk selection, allowed Economical to emerge from 2013 with a net income of $87.7 million after absorbing $76.1 million of weather-related catastrophe costs net of reinsurance and tax.

Gross written premiums continued to grow in 2013 by $99.5 million, or 5.5%. We ended the year with a combined ratio of just over 100%, 5.8 percentage points of which was due to weather-related catastrophe losses, and registered a small underwriting loss of $2.3 million. Our capital position is at the highest level in our history at $1,573 million.

Our results also show the early progress we have made in our multi-year business transformation journey. As you know, in 2012 we began to take a fresh look at the way we do business, making changes designed to sustain our prosperity in an increasingly consolidating industry. Many tough decisions have been made since we started and we have seen many early successes, including those outlined below.

- We completed the transformation of our IT department in 2013 with new processes designed to improve cost-effectiveness and productivity, and surpassed our IT run-rate expense reduction targets. Today, our IT organizational structure is streamlined and we are using industry best practices and processes for the delivery of applications and services to the business, based on business value.
- On the underwriting side, we made significant changes to our processes for greater consistency and efficiency. We have eliminated non-value added redundant procedures, and realigned our controls to better protect the profitability of the business we write. We have made fundamental changes to our organizational structure and operating platform to become more consistent, resilient and agile.
- In British Columbia, we created a single point of contact model by integrating the distribution, underwriting and policy administration of all Economical's personal auto and property insurance under Family Insurance Solutions. This eliminates duplication, increases efficiency and simplifies decision-making for brokers and policyholders in the province.
- To offer our broker partners significant time and energy savings, we made eDocs an option across Canada in July, a solution which automatically pushes electronic policy declaration pages to our brokers for a much more efficient and streamlined process. In November, we led the broker market as the first to accept electronic signatures on new business applications for personal and commercial insurance policies, which save brokers time and money, streamlines their workflow processes and improves communication with their clients.

More work is yet to be done to finish what we've started, but along the way we've learned that we simply cannot stand still and expect to win. Change is now a part of the way we do business.

We continued to strengthen our management team, appointing a number of key executives. Ed Berko, who has more than 25 years of experience in enterprise risk management, is our new chief risk officer. Tom Reikman returned to Economical as the new chief operating officer with more than 20 years of senior leadership experience and breadth of expertise in all aspects of the P&C industry. We strengthened our M&A capabilities and public company readiness by hiring Max Weis as vice-president, corporate development, and upped our game with the sales leadership that Javier Ibañez brings to the team as vice-president, sales and distribution.

We were delighted to receive our inaugural financial strength rating from independent rating agency A.M. Best last June and to have it reaffirmed less than one year later. Our A- (Excellent) rating reflects Economical's excellent financial strength and performance, and reinforces our broker partners' confidence in recommending Economical to their commercial and group insurance customers. We were also recognized on a global basis by being named Canada's Best General Insurance Company for 2013 by *World Finance* magazine, an honour which validates the work we are doing at this pivotal point in our history to implement best practices across the company.

Looking forward, we are facing headwinds on several fronts. In Ontario, there is uncertainty associated with the timing, scope and ultimate effectiveness of the proposed cost reduction measures that are meant to offset recent mandated rate reductions. At the same time, regulatory capital requirements continue to intensify in ways which raise questions about the conflicting agendas of federal and provincial regulators and the future efficiency of our industry overall. The prolonged low interest rate environment continues to pressure insurers to generate underwriting profits, yet it is becoming increasingly clear that municipal infrastructure is inadequate to handle the reality of severe, pervasive and irreversible impacts of climate change. Against that backdrop, our industry continues to consolidate, as evidenced by the recently announced acquisition of State Farm Canada by Desjardins Group, further illustrating the importance of pursuing our demutualization.

Despite these challenges, I am very proud of the progress we are making to create value and position Economical for the future. These are exciting times at Economical. Thanks to the dedication of our employees, the loyalty of our broker partners, and the ongoing support of our board of directors, we are building sustainable profitable growth and enhancing our competitiveness for the long term.

Sincerely,

Karen Gavan

KAREN GAVAN
President and CEO

management's discussion and analysis

table of contents

INTRODUCTION 8

SECTION 1 – OVERVIEW 9
About Economical Insurance 9
Corporate strategy 9
Glossary of abbreviations 9

SECTION 2 – 2014 INDUSTRY OUTLOOK 10

SECTION 3 – THE YEAR IN REVIEW 12
Financial highlights 12

SECTION 4 – RESULTS BY LINE OF BUSINESS 15
Personal lines 16
Commercial lines 17

SECTION 5 – KEY PERFORMANCE INDICATORS 18

SECTION 6 – INVESTMENTS 19
Cash and investments 19
Interest and dividend income 19
Recognized gains on investments 20
Investment credit quality 21

SECTION 7 – FINANCIAL STRENGTH 22
Financial highlights 22
Claims liabilities and adjustment expenses 22
Capital resources 23
  Mutual policyholders' equity 23
  Capital management 23
  Net risk ratio 24
  Credit rating 24
  Liquidity 24
  Off balance sheet liabilities and contingencies 24
  Related party transactions 24
Commitments 25

SECTION 8 – ACCOUNTING AND INTERNAL CONTROLS 26
Internal controls and procedures 26
Future accounting and reporting changes 26
Critical accounting judgments, estimates and assumptions 26

SECTION 9 – RISK MANAGEMENT 28
Objectives 28
Alignment 28
Accountability 28
Management of core risks 29
  Insurance-related risks 29
  Credit risk 31
  Investment-related risks 32
  Strategic risks 33
  Operational and other related risks 33

SECTION 10 – OTHER MATTERS 35
Cautionary note regarding forward-looking statements 35
Definitions 35

management's discussion and analysis

introduction

May 16, 2014

The following management's 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, 2013 and 2012. It should be read in conjunction with the consolidated financial statements and accompanying notes for the financial year ended December 31, 2013. Unless otherwise noted in this MD&A, all information is given as at May 16, 2014.

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

We use both generally accepted accounting principles ("GAAP") as defined by International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board, and certain non-GAAP measures to assess performance. Non-GAAP measures do not have any standardized meaning prescribed by GAAP and may not 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 financial statements in accordance with GAAP requires us to make estimates and assumptions about future events which affect certain amounts reported in our financial statements and amounts derived therefrom, 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 26 and 27 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 2013 and 2012 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 regarding forward-looking statements" 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.

Economical provides a wide range of personal and commercial insurance products to customers in most 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 branches and service offices across the country providing service to policyholders and brokers. Economical partners with independent insurance brokers who work with customers to assess their insurance needs and choose the right products and coverage. Economical is committed to providing its broker partners and policyholders with the products and services that today's market demands.

The financial stability of Economical is demonstrated by assets of over $5.0 billion and mutual policyholders' equity in excess of $1.5 billion as at December 31, 2013, reflecting the combined strength of its member companies.

On December 14, 2010, the company announced its intention to pursue demutualization, a process which requires, among other things, approval by its mutual policyholders and regulators.

CORPORATE STRATEGY

Economical's mission, vision and values form the foundation for 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 strongly ingrained in our culture. 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 in Canada 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
- 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 and sustaining public company level practices to prepare for demutualization and improving the productivity and efficiency of our business. We are also focused on sustaining profitable growth over the longer term by increasing penetration in target market segments and leveraging our analytical capabilities, while maintaining our productivity enhancements in order to deliver our products and services in a competitive and efficient manner.

GLOSSARY OF ABBREVIATIONS

This MD&A contains abbreviations which are defined as follows:

AFS	Available for sale
AOCI	Accumulated other comprehensive income
COR	Combined operating ratio
IBNR	Incurred but not reported
FVTPL	Fair value through profit and loss
GWP	Gross written premiums
IASB	International Accounting Standards Board
MCT	Minimum Capital Test
NRR	Net risk ratio
OCI	Other comprehensive income
OSFI	Office of the Superintendent of Financial Institutions Canada
PIF	Policies in force
ROE	Return on equity

section 2 - 2014 industry outlook

In 2013, the Canadian P&C insurance industry experienced the worst catastrophe loss year in its history while continuing to be impacted by a low interest rate environment. This resulted in the industry ROE for 2013 falling below its historical long-term average. 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 regarding forward-looking statements" at the end of this document.

	CANADIAN P&C INSURANCE INDUSTRY	OUR RESPONSE
PRICING AND UNDERWRITING PROFITABILITY	• We expect overall industry premiums to show low- to mid-single digit pace of growth in both personal and commercial lines. • While 2013 was an unprecedented year for catastrophe losses, we believe that an increase in the frequency of catastrophe events will become an ongoing issue for the industry. This will impact underwriting results in both personal and commercial property lines and could translate into firmer pricing conditions in property business over the next year. • The announced target of 15% rate reductions in Ontario auto will impact industry premiums in 2014 and, to a larger extent, in 2015. While we are encouraged that the Ontario government has identified actions intended to mitigate claims costs, we believe that there will be a lag on recognizing the impact of those actions relative to the premium reductions, which may have a negative impact on underwriting performance in the near term.	• Continue to leverage our predictive analytics capabilities to target profitable segments and drive profitable growth. • We intend to focus on increasing penetration in target market segments in commercial lines to attract more profitable business, while seeking rate and enhancing the quality of our book. • We will continue our focus on risk management, disciplined underwriting, containing claims leakage, and on productivity and efficiency levels.

	CANADIAN P&C INSURANCE INDUSTRY	OUR RESPONSE
ECONOMIC CONDITIONS	• Recent Bank of Canada commentary and recent economic reports suggest the historically low interest rate environment will not change significantly in the near term. Given this situation, the pre-tax investment yield for the industry is expected to remain flat during 2014. As a result, reinvestment of maturing investments in the current low-yield environment will likely continue to put pressure on industry levels of interest income. • Economic news reflecting a delay in a solid global recovery has resulted in continued capital market instability. This volatility could depress market values with the potential for an unfavourable impact on levels of available industry capital.	• We will maintain a stable investment strategy that focuses on long-term value creation. • Our $3.9 billion cash and investment portfolio is largely composed of high quality, actively traded securities including: 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 295.2% as at December 31, 2013.
INDUSTRY CONSOLIDATION	• Premium levels are becoming increasingly concentrated within the industry's top 10 companies, and this trend is expected to continue. • The industry is going through a period of active consolidation at both the carrier and distribution level, as scale becomes an increasingly important factor in achieving sustainable profitability.	• We expect the heightened pace of consolidation to continue and will continue preparing for a potential demutualization to gain access to the necessary capital to strengthen our market position. • We will continue to focus on our internal corporate development capabilities and build the efficiency of our operations to more effectively position us for potential acquisition integration.
OVERALL	• Should catastrophe costs revert to more historical levels, underwriting profitability in the industry is expected to improve in 2014, likely resulting in a return to more historical levels of overall industry returns.	• As a result of our planned strategies, we believe that 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, and have made substantial progress to date against our program objectives. The program is expected to be completed by the end of 2014.

section 3 - the year in review

FINANCIAL HIGHLIGHTS FOR THE YEAR INCLUDE

Gross written premiums Increased premium levels by $99.5 million or 5.5%.

Combined ratio[1] Achieved a combined ratio of 100.1%, despite experiencing the worst catastrophe year in the company's history, which added 5.8 percentage points to the 2013 results.

Net income Produced net income of $87.7 million despite absorbing $76.1 million in after-tax catastrophe costs.

Mutual policyholders' equity Increased total mutual policyholders' equity by $108.9 million during the year, a 7.4% increase.

RESULTS FROM OPERATIONS

FIGURE 1 (in millions of dollars, except as otherwise noted)	Year ended December 31		Increase (Decrease)
	2013	2012	
Gross written premiums	**1,919.2**	1,819.7	99.5
Net premiums written	**1,803.6**	1,723.7	79.9
Net premiums earned	**1,769.2**	1,666.0	103.2
Claims and adjustment expenses (undiscounted)	**1,188.5**	1,027.8	160.7
Other underwriting expenses	**583.0**	579.9	3.1
Underwriting income (loss) (undiscounted)	**(2.3)**	58.3	(60.6)
Interest and dividend income	**103.0**	105.1	(2.1)
Recognized gains on investments	**2.0**	21.7	(19.7)
Impact of discounting	**8.4**	9.3	(0.9)
Other income	**23.0**	14.9	8.1
Restructuring expenses	**(23.4)**	(11.6)	(11.8)
Income before income taxes	**110.7**	197.7	(87.0)
Income tax expense	**23.0**	46.7	(23.7)
Net income	**87.7**	151.0	(63.3)
Claims ratio (undiscounted)[1]	**67.2%**	61.7%	5.5 pts
Expense ratio[1]	**32.9%**	34.8%	(1.9) pts
Combined ratio (undiscounted)	**100.1%**	96.5%	3.6 pts
Return on equity	**6.0%**	11.2%	(5.2) pts
Policies in force (in thousands)	**1,135.6**	1,130.1	5.5

GROSS WRITTEN PREMIUMS

Gross written premiums grew at consistent levels throughout 2013 by $99.5 million or 5.5%. Policies in force grew by over 5,500 policies, or 0.5% and the company had in excess of 1.1 million active policies at December 31, 2013. Growth was split evenly between personal and commercial lines, with the Ontario and Western regions accounting for all of the GWP and PIF growth. Further details by line of business are provided in Section 4.

[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" at the end of this MD&A (page 35).

CLAIMS AND ADJUSTMENT EXPENSES

FIGURE 2 (in millions of dollars, except as otherwise noted)	Year ended December 31 2013	2012	Increase (Decrease)
Net incurred losses			
Current year claims	**1,251.5**	1,085.2	166.3
Prior year favourable claims development	**(63.0)**	(57.4)	(5.6)
Total	**1,188.5**	1,027.8	160.7
Combined ratio	**100.1%**	96.5%	3.6 pts

In 2013, the company withstood the worst catastrophe year in its history, with net weather-related catastrophic losses of $103.4 million compared to $21.9 million in the prior year. These losses, which include the associated reinsurance reinstatement premiums, contributed 5.8% to the company's 2013 combined ratio of 100.1%, compared to a 1.3% impact to the combined ratio of 96.5% in 2012.

Prior year favourable claims development remained stable in 2013, at 3.1% of prior year closing claims, compared to 2.7% in 2012. These levels of development reflect the company's continued prudent approach to its claims reserving, and further support the excellent financial strength of the organization and its capacity to meet its future claims obligations.

Figure 3 shows the key components of the company's reported combined ratio, illustrating the impact of both weather-related catastrophes and prior year claims development.

FIGURE 3	Year ended December 31 2013	2012	2011	2010	2009
Accident year loss ratio excluding catastrophes	**64.9%**	63.8%	67.7%	71.9%	75.5%
Expense ratio	**32.9%**	34.8%	34.5%	33.8%	30.7%
Adjusted combined ratio	**97.8%**	98.6%	102.2%	105.7%	106.2%
Impact of prior year claims development	**(3.5)%**	(3.4)%	(8.0)%	(4.3)%	(3.1)%
Impact of weather-related catastrophes	**5.8%**	1.3%	3.9%	1.5%	3.0%
Reported combined ratio	**100.1%**	96.5%	98.1%	102.9%	106.1%

COMMISSION AND OTHER EXPENSES

FIGURE 4 (in millions of dollars, except as otherwise noted)	Year ended December 31 2013		2012		Increase (Decrease)	
	$	Ratio	$	Ratio	$	Ratio
Commissions	**348.7**	**19.7%**	356.0	21.4%	(7.3)	(1.7) pts
Operating expenses	**171.3**	**9.6%**	164.4	9.8%	6.9	(0.2) pts
Premium taxes	**63.0**	**3.6%**	59.5	3.6%	3.5	-
Total	**583.0**	**32.9%**	579.9	34.8%	3.1	(1.9) pts

The commission ratio fell 1.7 percentage points over the prior year, driven by lower base commissions due to shift in business mix and lower profit commissions resulting from weaker underwriting results, combined with the growth in earned premiums. In 2013, the company began to realize benefits from actions commenced in 2012 related to its business transformation program, which helped to offset the program-related costs incurred in operating expenses. While operating expenses increased marginally during 2013 in dollar terms, the operating expense ratio declined 0.2 percentage points during the year due to the company's focus on increasing efficiencies and productivity. Premium taxes increased consistent with the growth in premiums earned during the year.

INVESTMENT INCOME

FIGURE 5 (in millions of dollars, except as otherwise noted)	Year ended December 31		Increase (Decrease)
	2013	2012	
Interest and dividend income	103.0	105.1	(2.1)
Recognized gains on investments	2.0	21.7	(19.7)
Total	105.0	126.8	(21.8)

The company generated $103.0 million of interest and dividend income, a marginal decline of $2.1 million over 2012 resulting primarily from the continuing low interest rate environment. Net gains of $2.0 million were recognized in 2013, a decline of $19.7 million from 2012, primarily due to the sale of foreign index funds in early 2012 and reduced trading activity. Also included in recognized gains on investments are impairment losses recorded for accounting purposes, which remained stable at $10.7 million compared with $9.3 million in 2012. Further details on investment performance can be found in Section 6.

OTHER INCOME AND RESTRUCTURING EXPENSES

In 2012, the company undertook a business transformation program to improve the efficiency and effectiveness of its operations, and expects to complete this program in phases by the end of 2014. The 2013 financial results include $37.7 million (2012: $13.7 million) of costs related to this restructuring that reflect actions taken and plans communicated as of December 31, 2013, of which $14.3 million (2012: $2.1 million) are included in underwriting income (loss).

The company's execution of its business transformation program resulted in employee separations, the cumulative impact of which triggered curtailment accounting in 2013. The effect of the curtailment was a reduction in the defined benefit pension obligation of $4.7 million and a reduction in the other post-employment benefit obligation of $1.4 million. This resulted in a reduction in the net period cost of $6.1 million for 2013, which was recognized within other income.

Historically, the company had, in its sole discretion granted increases to retirees in the defined benefit pension plans. Effective December 31, 2013, no further increases are expected to be granted in the foreseeable future. This change has resulted in a $20.5 million reduction in the calculation of the pension plan and other benefit plan obligations, which was recognized within other income.

In 2012, the company modified the eligibility criteria for the other post-employment benefit plan that reduced the number of current employees eligible for post-retirement benefits under the plan. Included in 2012 other income is a net, one-time benefit of $16.5 million primarily related to this modification.

INCOME TAX EXPENSE

The company's effective tax rate for 2013 was 20.7%, compared to 23.6% in 2012 and a statutory rate of 26.4%. The year-over-year reduction in the effective tax rate is due primarily to an increase in Canadian dividend income not subject to tax, combined with a decrease in underwriting income which is taxed at the full statutory rate, when compared to 2012.

NET INCOME

The company's net income for 2013 was $87.7 million compared to $151.0 million in 2012, and was significantly impacted by weather-related catastrophe costs. The 2013 results incorporate $76.1 million of weather-related catastrophe costs net of reinsurance and tax, a record level in the company's history. This compares to $16.1 million of weather-related catastrophe costs net of reinsurance and tax in 2012.

CAPITAL STRENGTH

In 2013, the company continued to strengthen its capital base with total mutual policyholders' equity exceeding the milestone level of $1.5 billion for the first time in the company's history. Total mutual policyholders' equity increased $108.9 million, or 7.4%, to $1,573.1 million, and the MCT ratio reached 295.2% at December 31, 2013.

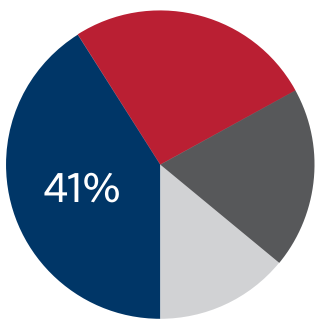
section 4 - results by line of business

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 included in the insurance segment, with the balance in the broker operations segment.

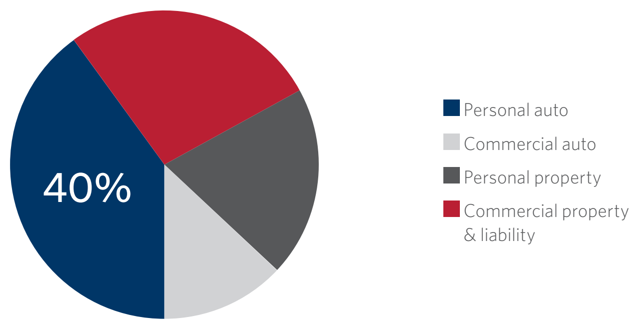
Within the insurance segment, Economical provides a wide range of P&C insurance products throughout Canada in two broad lines of business: personal insurance and commercial insurance. Each line is further subdivided between automobile, property, and – in the case of commercial – property and liability lines of business.

The following charts illustrate the company's GWP mix on this basis:

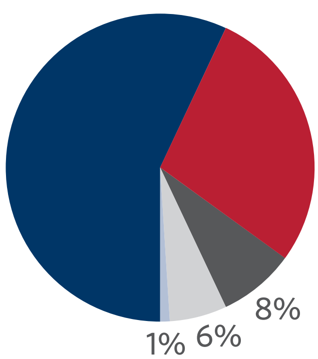
2013 GWP BY LINE OF BUSINESS



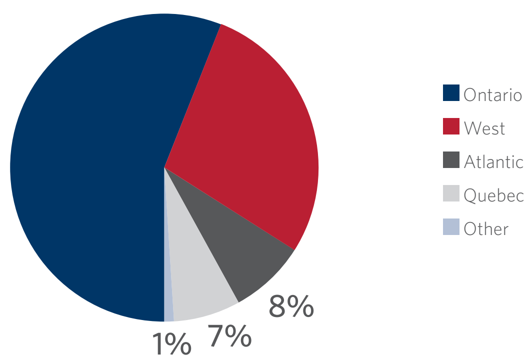
2012 GWP BY LINE OF BUSINESS



2013 GWP BY REGION



2012 GWP BY REGION



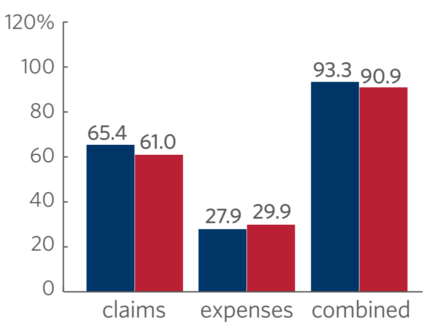
The company's business mix remained stable in 2013, with growth focused in the more profitable automobile lines of business. The company increased gross written premiums by $99.5 million, or 5.5% in 2013 and generated premium growth across all lines of business, with the exception of a slight decline in personal property. In the automobile lines, growth has been driven by an increase in policy volumes combined with a shift in the mix of business toward regions and lines with higher average premiums. Personal automobile GWP grew by 7.8%, reflecting growth in the Western and Ontario regions.

Commercial auto GWP increased 12.5% in 2013, largely due to significant growth in the company's fleet business which has increased average written premium. This shift in mix has been concentrated in the Ontario and Western regions, while individually rated commercial automobile business remained competitive resulting in limited growth for all provinces. Commercial property and liability GWP grew by 4.5% as a result of increased rate taken to improve profitability in the Ontario and Western regions on non-target business and focused growth with target brokers.

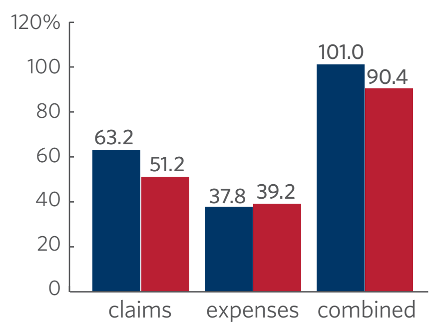
UNDERWRITING – PERSONAL LINES

FIGURE 6 (in millions of dollars, except as otherwise noted)	Year ended December 31 2013	2012	Increase (Decrease)	%
Policies in force (thousands)				
Automobile	**552.5**	522.9	29.6	5.7
Property	**394.3**	420.6	(26.3)	(6.3)
Total	**946.8**	943.5	3.3	0.3
Gross written premiums				
Automobile	**782.1**	725.5	56.6	7.8
Property	**359.0**	368.0	(9.0)	(2.4)
Total	**1,141.1**	1,093.5	47.6	4.4
Net premiums earned				
Automobile	**747.6**	690.4	57.2	8.3
Property	**337.7**	336.4	1.3	0.4
Total	**1,085.3**	1,026.8	58.5	5.7
Underwriting income (loss)				
Automobile	**50.1**	63.1	(13.0)	(20.6)
Property	**(3.5)**	32.0	(35.5)	(110.9)
Total	**46.6**	95.1	(48.5)	(51.0)

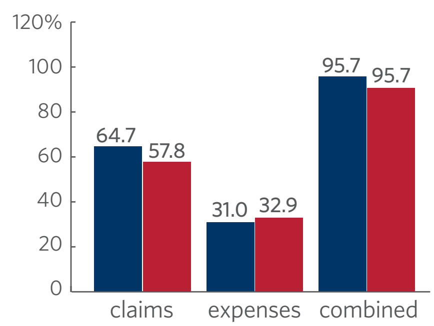
PERSONAL AUTOMOBILE RATIOS



PERSONAL PROPERTY RATIOS



TOTAL PERSONAL LINES RATIOS



2013 2012

PERSONAL LINES

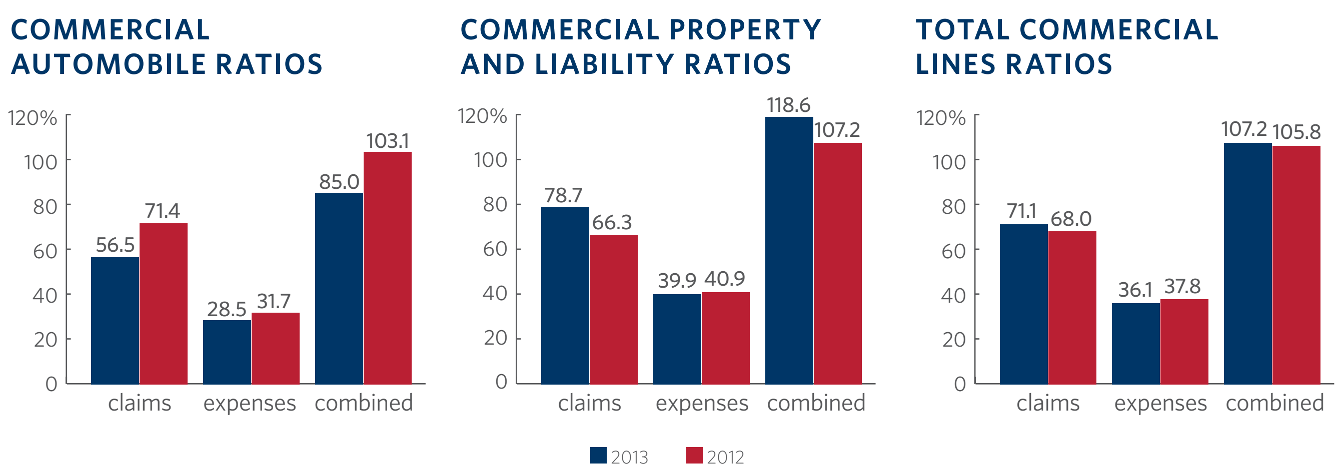
Personal automobile GWP grew by 7.8%, reflecting a strong 5.7% growth in policy volumes and a shift in the mix of business toward regions with higher average premiums. This growth was achieved while maintaining underwriting profitability of $50.1 million in 2013 (2012: $63.1 million). The 2.4 percentage point deterioration in the personal automobile COR in 2013 is attributable to a return to more normal winter driving conditions in the year.

Personal property GWP fell by 2.4%, reflecting lower policy volumes due to the company's targeted rate increases and shifts in the competitive landscape. Personal property produced an underwriting loss of $3.5 million, compared to underwriting income of $32.0 million in 2012. Adjusting for the impact of weather-related catastrophe losses, the 2013 combined ratio for personal property was 86.4% compared to 87.9% in 2012.

Overall, the personal lines business produced a combined ratio of 95.7%, a 5.0 percentage point deterioration from 2012. The deterioration is primarily attributed to the significant catastrophe losses during 2013, which contributed 5.1% (2012: 1.4%) to the personal lines combined ratio. The combined ratio increase was moderated by a 1.9% reduction in the expense ratio.

UNDERWRITING – COMMERCIAL LINES

FIGURE 7 (in millions of dollars, except as otherwise noted)	Year ended December 31 2013	2012	Increase (Decrease)	%
Policies in force (thousands)				
Automobile	**53.4**	53.8	(0.4)	(0.7)
Property and liability	**135.4**	132.8	2.6	2.0
Total	**188.8**	186.6	2.2	1.2
Gross written premiums				
Automobile	**271.2**	241.1	30.1	12.5
Property and liability	**506.9**	485.1	21.8	4.5
Total	**778.1**	726.2	51.9	7.1
Net premiums earned				
Automobile	**233.8**	213.2	20.6	9.7
Property and liability	**450.1**	425.9	24.2	5.7
Total	**683.9**	639.1	44.8	7.0
Underwriting income (loss)				
Automobile	**35.0**	(6.5)	41.5	638.5
Property and liability	**(83.9)**	(30.3)	(53.6)	(176.9)
Total	**(48.9)**	(36.8)	(12.1)	(32.9)



COMMERCIAL LINES

Commercial automobile GWP increased 12.5% compared to a policy volume decline of 0.7%, reflecting the company's focus on fleet business which has a higher average premium. The majority of fleet growth was in the transportation sector due to strategic partnerships with managing general agents and key brokers, as well as the launch of the company's EXPERT Transportation product early in 2013. Commercial automobile returned to a high level of profitability in 2013, producing an underwriting income of $35.0 million compared to an underwriting loss of $6.5 million in 2012.

Commercial property and liability GWP grew by 4.5%, supported both by policy volume growth of 2.0% and rate increases in specific classes of business and territories. 2013 saw a significant increase in both the number and severity of large losses in commercial property and liability, generally driven by a number of severe fire losses, as well as substantial weather-related catastrophe losses, resulting in an underwriting loss of $83.9 million compared to $30.3 million in 2012.

$47 million in net incurred commercial property costs associated with catastrophe losses contributed 10.6 percentage points to the 2013 combined operating ratio, compared to $5.9 million (or 1.4 percentage points of combined ratio) for the prior year.

The severe weather and large loss issues encountered in commercial property and liability during 2013 resulted in a combined ratio of 118.6%. This was offset by strong performance in the commercial automobile business (combined ratio of 85.0%), to produce an overall combined ratio for commercial insurance of 107.2%. This represents a slight deterioration from the 105.8% recorded in 2012.

While 2013 saw unusually high levels of loss activity in commercial property and liability, the company recognizes the need to build resiliency into its commercial results in order to address increased costs associated with shock losses and more frequent weather-related catastrophes. The company's strategy for 2014 will focus action on key perils, segments and territories while also allocating risk management resources to high risk accounts.

section 5 - key performance indicators

2010 – 2013 under IFRS, 2009 under Canadian GAAP

FIGURE 8 (in millions of dollars, except as otherwise noted)	Year ended December 31				
	2013	2012	2011	2010	2009
Policies in force (thousands)	**1,135.6**	1,130.1	1,079.0	1,074.8	1,188.0
Gross written premiums	**1,919.2**	1,819.7	1,723.2	1,722.0	1,826.3
Claims ratio	**67.2%**	61.7%	63.6%	69.1%	75.4%
Expense ratio	**32.9%**	34.8%	34.5%	33.8%	30.7%
Combined ratio	**100.1%**	96.5%	98.1%	102.9%	106.1%
Underwriting income (loss)	**(2.3)**	58.3	32.4	(48.5)	(111.5)
Net income (loss)	**87.7**	151.0	91.0	81.4	24.1
Return on equity	**6.0%**	11.2%	7.3%	7.0%	2.0%
Retained earnings	**1,513.2**	1,418.3	1,271.9	1,195.0	1,191.5
Mutual policyholders' equity	**1,573.1**	1,464.2	1,300.1	1,202.7	1,170.7
Total assets	**5,060.2**	4,826.2	4,669.8	4,592.2	4,603.8

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

GWP and PIF levels declined from 2009 through 2010 reflecting specific actions taken by the company to refocus on profitable underwriting. The company emerged from this pattern during 2011 and has recorded consistent growth in both GWP and PIF since then. The company'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 improved significantly and continuously from 2009 through 2012, before falling back in 2013 due to the company enduring the worst catastrophe loss year in its history. When excluding weather-related catastrophe events, the overall trend of improved underwriting results is due to management's concerted efforts to restore and maintain underwriting profitability through a combination of better risk selection, improved personal automobile results, enhanced claims management and fraud detection activities.

In 2012, the company initiated a business transformation program to improve the efficiency and effectiveness of its operations. In combination with the increases in net earned premiums, the benefits realized from this program contributed to an improvement in the expense ratio to its lowest level since 2009 from a five-year high in 2012. The company expects to complete executing this program by the end of 2014. The 2013 results include $37.7 million (2012: $13.7 million) of costs related to this program.

Net income for 2013 remained strong at $87.7 million, despite absorbing $76.1 million in after-tax weather-related catastrophe costs, net of reinsurance and tax. The company's focus on expense reduction actions have helped protect the company's performance in the face of rising catastrophe losses, contributing to the highest levels of mutual policyholders' equity and assets in the company's history.

section 6 - investments

CASH AND INVESTMENTS

FIGURE 9 (in millions of dollars, except as otherwise noted)	As at December 31, 2013 Carrying value	As at December 31, 2013 Percent at carrying value	As at December 31, 2012 Carrying value	As at December 31, 2012 Percent at carrying value
Cash and cash equivalents	**87.2**	**2.2**	90.5	2.3
Short-term investments	**109.7**	**2.8**	59.8	1.5
Bonds				
Government	**1,898.1**	**48.2**	2,180.2	56.5
Corporate	**1,101.2**	**28.0**	881.7	22.9
	2,999.3	**76.2**	3,061.9	79.4
Canadian preferred stocks	**262.4**	**6.7**	206.9	5.4
Common stocks and pooled funds				
Canadian	**241.2**	**6.1**	234.1	6.1
Foreign	**194.2**	**4.9**	154.8	4.0
	435.4	**11.0**	388.9	10.1
Commercial loans	**45.0**	**1.1**	48.8	1.3
	3,939.0	**100.0**	3,856.8	100.0

Economical has maintained a consistent 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 on its risk appetite, the prudent person approach, regulatory guidelines, and reflects the expected settlement pattern of claims 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 81.2% of the total portfolio compared with 83.2% in 2012. This decline was the result of the company reinvesting dividends and gains within its actively managed foreign equity investments, and moving funds from lower-yielding money market instruments into dividend-paying preferred share holdings throughout the year.

Commercial loans decreased $3.8 million year-over-year as loan repayments outpaced new loans issued during the year.

INTEREST AND DIVIDEND INCOME

FIGURE 10 (in millions of dollars, except as otherwise noted)	Year ended December 31 2013	Year ended December 31 2012	Increase (Decrease)
Interest income	**79.4**	85.3	(5.9)
Dividend income	**23.5**	19.8	3.7
Total	**102.9**	105.1	(2.2)

Interest income decreased $5.9 million year-over-year due to the continued low interest rate environment wherein bonds with high historical book yields were reinvested in new securities purchased at current lower yields. Although long-term interest rates have risen sharply since the middle of the second quarter of 2013, the bond portfolio's market yield was still noticeably below its book yield as at the end of December 2013, which indicates that rates would have to rise further before a discernible increase in interest income can be expected.

Dividend income increased by $3.7 million due to an increase in average preferred equity holdings during 2013.

RECOGNIZED GAINS ON INVESTMENTS

FIGURE 11 (in millions of dollars, except as otherwise noted)	Year ended December 31		Increase (Decrease)
	2013	2012	
Realized gains on AFS portfolio	**17.9**	34.8	(16.9)
Realized gains on FVTPL bonds	**16.8**	22.5	(5.7)
Unrealized losses on FVTPL bonds	**(22.0)**	(26.3)	4.3
Impairment loss	**(10.7)**	(9.3)	(1.4)
Total	**2.0**	21.7	(19.7)

A subset of the bond portfolio, which is matched in quantum and duration to the claims 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 AFS. Changes in the fair value of AFS instruments are included in OCI until the instrument is disposed of or considered to be impaired.

Realized gains on the AFS portfolio were lower by $16.9 million primarily due to the sale of foreign index funds in early 2012, which generated a one-time gain of $13.7 million. Realized gains were further depressed due to reduced trading activity.

The net realized and unrealized losses on the FVTPL bond portfolio of $5.2 million (2012: $3.8 million in net losses) offset the recovery on the discounting of claims liabilities of $8.4 million (2012: $9.3 million recovery). Market yields were volatile in 2013 and were up 13 basis points year-over-year at December 31, 2013, resulting in the $5.2 million net loss on the FVTPL portfolio noted above.

The company has maintained a high-quality and diversified portfolio during the very volatile capital market conditions over the past several years. Impairment charges stabilized in 2013 at only 0.7 percentage points of the carrying value of common stocks and corporate bonds ($10.7 million), compared to 0.7 percentage points ($9.3 million) in 2012.

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 credit quality is maintained. This resulted in 91.8% (2012: 93.6%) of the company's bonds being rated "A-" or better and 99.7% (2012: 99.5%) of the preferred stocks being rated "P2" or better. "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.

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

CREDIT RATING - BONDS

FIGURE 12 (in millions of dollars, except as otherwise noted)	As at December 31, 2013		As at December 31, 2012	
	Fair value	Percent at fair value	Fair value	Percent at fair value
AAA	**2,002.1**	**66.8**	1,956.2	63.9
AA	**246.4**	**8.2**	302.8	9.9
A	**506.5**	**16.9**	605.8	19.8
BBB	**223.2**	**7.4**	176.5	5.8
BB or not rated	**21.1**	**0.7**	20.6	0.6
Total	**2,999.3**	**100.0**	3,061.9	100.0

CREDIT RATING - PREFERRED STOCKS

FIGURE 13 (in millions of dollars, except as otherwise noted)	As at December 31, 2013		As at December 31, 2012	
	Fair value	Percent at fair value	Fair value	Percent at fair value
P1	**18.6**	**7.1**	48.6	23.5
P2	**242.9**	**92.6**	157.3	76.0
P3 or not rated	**0.9**	**0.3**	1.0	0.5
Total	**262.4**	**100.0**	206.9	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 AFS 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, 2013, 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 $234.0 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 2013.
Claims liabilities	Gross claims liabilities increased $120.5 million, as the company absorbed record levels of weather-related catastrophe events in 2013.
Mutual policyholders' equity	Total mutual policyholders' equity increased by $108.9 million, or 7.4%, to a historical high of $1,573.1 million, demonstrating Economical's excellent financial strength.

The figure below shows the significant balance sheet line items.

FIGURE 14 (in millions of dollars, except as otherwise noted)	Year ended December 31		Increase (Decrease)
	2013	2012	
Cash and cash equivalents	**87.2**	90.5	(3.3)
Investments	**3,851.8**	3,766.4	85.4
Premiums receivable	**548.2**	525.3	22.9
Reinsurance receivable and recoverable	**156.9**	71.0	85.9
Deferred policy acquisition expenses	**196.8**	190.9	5.9
Goodwill and intangible assets	**68.0**	73.9	(5.9)
Other assets	**151.3**	108.2	43.1
Total assets	**5,060.2**	4,826.2	234.0
Claims liabilities	**2,341.8**	2,221.3	120.5
Unearned premiums	**971.8**	933.0	38.8
Other liabilities	**173.5**	207.7	(34.2)
Total liabilities	**3,487.1**	3,362.0	125.1
Retained earnings	**1,513.2**	1,418.3	94.9
Accumulated other comprehensive income	**59.9**	45.9	14.0
Total mutual policyholders' equity	**1,573.1**	1,464.2	108.9
Total liabilities and mutual policyholders' equity	**5,060.2**	4,826.2	234.0

CLAIMS LIABILITIES AND ADJUSTMENT EXPENSES

Claims liabilities represent an estimate of the amount required to settle all outstanding claims and any unreported claims incurred on or before the company's 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 claims liabilities are best estimates that are subject to variability, which could be material.

The discount rate used to determine the actuarial value of claims liabilities is based on the fair value yield of the company's FVTPL bond portfolio, which at December 31, 2013 was 1.83% (2012: 1.70%).

Figure 15 shows the change in the company's claims liabilities for the past two years.

FIGURE 15 (in millions of dollars, except as otherwise noted)	Year ended December 31	
	2013	2012
Net unpaid claims liabilities, beginning of the year	**2,158.0**	2,237.8
Current year claims incurred	**1,251.4**	1,085.2
Prior year favourable claims development, undiscounted	**(63.0)**	(57.4)
Claims and adjustment expenses	**1,188.4**	1,027.8
Impact of discounting	**(8.4)**	(9.3)
Claims paid during the year	**(1,132.0)**	(1,098.3)
Net unpaid claims liabilities, end of the year	**2,206.0**	2,158.0

Figure 16 shows the level of prior year favourable claims development over the past five years.

2010 – 2013 under IFRS, 2009 under Canadian GAAP

FIGURE 16 (in millions of dollars, except as otherwise noted)	2013	2012	2011	2010	2009
Net unpaid claims liabilities, beginning of the year, undiscounted	**2,052.1**	2,122.6	2,220.0	2,200.1	2,155.0
Favourable development on prior year claims, undiscounted	**63.0**	57.4	128.9	71.8	55.7
Favourable development on prior year closing claims, undiscounted (percentage)	**3.1%**	2.7%	5.8%	3.3%	2.6%

These favourable trends demonstrate the company's continued prudent approach to its claims reserving, and further support the excellent financial strength of the organization and its capacity to meet its future claims obligations. In all years, the company's closing claims 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 due to the introduction of automobile regulatory reform in late 2010.

CAPITAL RESOURCES

MUTUAL POLICYHOLDERS' EQUITY

Figure 17 illustrates the change in the company's mutual policyholders' equity over the last five years.

2010 – 2013 under IFRS, 2009 under Canadian GAAP

FIGURE 17 (in millions of dollars, except as otherwise noted)	Year ended December 31				
	2013	2012	2011	2010	2009
Retained earnings	**1,513.2**	1,418.3	1,271.9	1,195.0	1,191.5
Accumulated other comprehensive income (loss)	**59.9**	45.9	28.2	7.7	(20.8)
Mutual policyholders' equity	**1,573.1**	1,464.2	1,300.1	1,202.7	1,170.7
Change in total mutual policyholders' equity	**108.9**	164.1	97.4	32.0	91.7

The company's retained earnings increased by $94.9 million during the year, and mutual policyholders' equity increased $108.9 million, or 7.4% 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 $370.4 million in the past three years, an increase of 30.8% 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 the 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, 2013, Economical's regulatory capital significantly exceeded the MCT 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 figure shows the MCT ratio for the company over the past five years.

FIGURE 18	Year ended December 31				
	2013	2012	2011	2010	2009
MCT	**295.2%**	295.1%	269.4%	234.2%	222.6%

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 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 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 – 2013 under IFRS, 2009 under Canadian GAAP

FIGURE 19	Year ended December 31				
	2013	2012	2011	2010	2009
NRR	**1.2**	1.2	1.3	1.4	1.5

As at December 31, 2013, 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 1.5 in 2009 to 1.2 in 2013 primarily due to strong growth in mutual policyholders' equity. The company is well positioned from a capital standpoint to support its planned growth in premium levels moving forward.

CREDIT RATING

On June 21, 2013, Economical received its inaugural financial strength rating and issuer credit rating from independent rating agency A.M. Best. The ratings of A- (Excellent) and "a-" respectively provide a further reinforcement of the company's excellent financial strength and significantly improved financial performance. By extension, Waterloo Insurance Company also received an A- (Excellent) financial strength rating and "a-" issuer credit rating. The outlook for all ratings is stable.

LIQUIDITY

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

The company had $87.2 million (2012: $90.5 million) of cash and cash equivalents at December 31, 2013. The company also had a highly liquid investment portfolio comprising 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 $3,675.1 million (2012: $3,636.1 million). The company believes its internal resources will provide sufficient funds to fulfill cash requirements during the 2014 financial year and to satisfy all regulatory capital requirements.

The company has no credit facilities, aside from bank overdraft operating lines, or outstanding debt other than trade payables.

The company has intercompany reinsurance agreements (the "Agreements") in place, which result in each insurance company subsidiary reporting the same underwriting results (i.e. combined ratio). The Agreements are supported by documented agreements between each of the 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 insurance company subsidiary, enabling each subsidiary 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 approximating 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 not aware of any litigation that does, or will, 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 major Canadian and US financial institutions, whereby the company lends securities it owns to other financial institutions to allow them to meet delivery commitments. The lending agents assume the risk of borrower default associated with the lending activity. At December 31, 2013, securities with an estimated fair value of $227.0 million (2012: $578.1 million) have been loaned and securities with an estimated fair value of $236.1 million (2012: $598.2 million) have been received as collateral from the financial institutions. Lending collateral at December 31, 2013 was 100.0% (2012: 98.9%) held in cash and government-backed 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".

RELATED PARTY TRANSACTIONS

From time to time, the company enters into transactions in the normal course of business, which are measured at the exchanged 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 by a publicly traded entity during a portion of the year ended December 31, 2012, in which the company owned common stock with a fair value of $7.2 million as at December 31, 2012. This entity also provided certain services on an arm's-length basis that totaled $0.8 million during 2012. 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, as at December 31, 2012, was $59.8 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 $9.1 million (2012: $9.2 million) to the defined contribution plan and $9.7 million (2012: $9.8 million) to the defined benefit plans.

Associates: At the reporting date, commercial loans of $2.0 million (2012: $2.3 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 affiliate's other reinsurers. The company's share of reinsurance assumed from the associate is as follows:

FIGURE 20 (in millions of dollars, except as otherwise noted)	Year ended December 31	
	2013	2012
Premiums assumed	**3.5**	3.5
Premiums earned	**3.4**	3.4
Claims and adjustment expenses	**2.1**	2.3
Commissions	**1.5**	1.6
Deferred policy acquisition expenses	**0.6**	0.6
Reinsurance assumed receivables	**0.3**	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.

FIGURE 21	Year ended December 31				
	Total	Less than 1 year	1 3 years	4 5 years	After 5 years
Buildings	**65.1**	11.8	20.0	13.8	19.5
Information Technology	**3.4**	2.0	1.4	-	-
Other obligations	**14.0**	2.4	8.1	1.7	1.8
Total contractual obligations	**82.5**	16.2	29.5	15.5	21.3

section 8 – accounting and internal controls

INTERNAL CONTROLS AND PROCEDURES

The company has designed and evaluated 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

Classification and measurement of financial instruments is the first phase of a three-phase project to replace IAS 39 - *Financial Instruments: Recognition and Measurement*. The classification and measurement portion of IFRS 9 ("IFRS 9") – *Financial Instruments* has been subject to a new exposure draft in December 2012 which modifies the standard which was to be effective for fiscal years beginning on or after January 1, 2015.

As a result, the IASB tentatively decided to defer the mandatory effective date for IFRS 9 and on February 20, 2014 announced that it will be January 1, 2018 at the earliest. Under the exposure draft, debt instruments may be carried at amortized cost, FVTPL or fair value through OCI, depending upon the purpose for which the debt instrument is held. IFRS 9 replaces the current models for classifying equity instruments, permitting equity instruments to be 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.

(b) Offsetting Financial Assets and Financial Liabilities

Amendments to IAS 32 ("IAS 32") – *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 IAS 32 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 was January 1, 2014.

CRITICAL 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 reasonable.

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 control or significant influence over investees, of the identification of objective evidence of impairment for financial instruments, the recoverability and recognition of tax losses, the determination of cash-generating units ("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.

VALUATION OF CLAIMS 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 claims liabilities by geographic region, product line, type and extent of coverage and year of occurrence.

Claims 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 claims 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. Claims liabilities include estimates subject to variability, which could be material. Changes to the estimates could result from future events such as receiving additional claims 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.

Claims liabilities have been discounted to reflect future investment income in accordance with Canadian accepted actuarial practice. The principal assumptions made in establishing claims liabilities are best estimates. To allow for possible deterioration in experience, and to increase the likelihood that the claims 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 claims 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 claims 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 to reinsurers 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 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 the assets are allocated.

CONTROL OR SIGNIFICANT INFLUENCE OVER INVESTEES

The company presumes that control or significant influence over an investee is primarily evidenced by the ownership percentage held of the investee unless there are other factors which indicate the level of control is not aligned with the ownership percentage. Currently there are no investments in investees for which the assessment of control or significant influence is not aligned with the ownership percentage.

VALUATION OF POST-EMPLOYMENT BENEFITS

The company provides certain pension and other non-pension future benefits through both defined benefit and defined contribution pension plans and a non-pension future benefit plan. The projected cost of defined benefit pension plans and other non-pension future benefits is determined using actuarial 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, 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 in the consolidated balance sheet and 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

The company's enterprise risk management framework is designed to ensure that (i) the outcomes of activities involving risk are consistent with its governing objective, risk management capabilities, risk taking capacity and risk appetite, and (ii) the company maintains an appropriate risk and reward balance to protect itself from events that have the potential to materially impair its financial strength. The company's enterprise risk management framework is rooted in the understanding that the company is 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

The company aligns its risk tolerance with its overall vision, mission and business goals by considering whether risks are core, non-core or collateral in nature.

Core risks are those risks that the company is willing to accept in order to achieve return expectations and successfully achieve its business objectives. These include insurance-related risks, credit risk and investment-related risks. Non-core risks are those associated with activities outside of the company's 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. The company endeavours to mitigate collateral risks to the extent that the benefit of risk reduction aligns with or exceeds the cost of mitigation.

The company's risk appetite is also aligned with its risk management capabilities. The company actively seeks profitable risk-taking opportunities in those areas where it has established risk management capabilities, and seeks to avoid risks that are beyond those capabilities.

ACCOUNTABILITY

The company's enterprise 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, the company's board of directors is ultimately responsible for ensuring that enterprise 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 the company implements. 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:

- Risk review committee, which is composed entirely 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.
- Investment committee, which is composed 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 the company's pension plans.
- Corporate governance committee, which is composed 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.
- Audit committee, which is composed entirely of non-management directors, is responsible for overseeing: the integrity of the company's financial statements and related public disclosure; the qualifications, independence and appointment of the company's external auditor; the design, implementation and evaluation of the company's internal controls over financial reporting and the company's disclosure controls; and the work of the company's internal and external auditors.

Economical has implemented a three lines of defence risk governance model, consisting of: front-line risk taking through business operations (first line); the enterprise risk management and compliance functions (second line); and internal audit (third line). Primary accountability for enterprise risk management resides with the company's 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 LINE OF DEFENCE

Business management provides day-to-day management and risk control:

- Employees within each functional and business area identify, take and manage risk on a daily basis, adhering to board-approved risk appetite statements 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. These individuals are supported by corporate legal, compliance and enterprise risk management resources, and include the following roles:
  - Corporate office functional heads, namely the 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.
  - Vice-president, personal insurance, analytics and pricing, and vice-president, commercial insurance, who establish, oversee and implement the company's underwriting and pricing policies and guidelines.
  - Vice-president, claims, who establishes, oversees and implements the company's claims handling policies and guidelines.
  - The chief operating officer has overall front-line accountability for managing the risks in the operations in accordance with the company's enterprise risk management framework and how it distributes its products. Prior to April 2, 2014, the senior vice-president, sales, distribution and underwriting operations was accountable for this function.
  - Vice-president, investments, who establishes, oversees and implements the company's investment policies and guidelines.

SECOND LINE OF DEFENCE

Risk and compliance functions provide risk policies, tools, methodologies and oversight:

- The enterprise risk management function, headed by the chief risk officer, establishes enterprise risk policies and provides direction, processes, methodologies, models and tools to the organization. It performs independent monitoring and analysis of risk-taking by the first line of defence and its risk management activities. The compliance function communicates internal and external compliance requirements to the first line of defence and provides support to help the first line of defence ensure compliance with those requirements.
- The enterprise 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 enterprise risk management comply with requirements and quality standards and are suitable for use within the company.
- The company's management risk committee is a cross-functional management committee composed of the president and CEO and members of senior management. It is led by the 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.
- The chief risk officer, whose responsibilities include providing independent functional oversight of the company's enterprise 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 the company's activities.

THIRD LINE OF DEFENCE

Internal audit provides periodic independent assurance:

- Internal audit provides periodic independent assurance on the adequacy and effectiveness of the enterprise risk management policy, supporting framework and related processes and practices, as well as compliance with policies, standards and required practices, taking into account the relative risk in each area of coverage.
- 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 the company manages include insurance-related risks, credit risk, investment-related risks and operational and the other risks, which are explained in greater detail below.

INSURANCE-RELATED RISKS

Business cycle and competitive risk: The financial performance of the P&C 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 negatively impacts the company's 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 the company is unable to realize superior risk selection or sufficient expense efficiencies, its ability to establish or maintain competitive pricing could be adversely affected. Given the company's disciplined approach to underwriting, there may be market conditions or competitive actions which restrict the company's ability to grow or maintain its 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. The company prices its products by taking into account several factors including product design and features, claims 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. The company 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 the company's 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 its 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 claims liabilities are established to cover future insurance claims 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 claims liabilities to cover the estimated liability for payment of all claims and claims adjustment expenses incurred with respect to insurance contracts underwritten by the company. Claims liabilities do not represent an exact calculation of the liability. Rather, claims liabilities are the company's best estimates of its expected ultimate cost of resolution and administration of claims. The process of calculating claims 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 claims liabilities, thereby mitigating inflation risk.

Claims 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 claims liabilities is based on estimates derived by geographical region and line of business using generally accepted actuarial techniques. Numerous individual assumptions that impact average claims 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 claims 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 claims liabilities.

Establishing an appropriate level of claims 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 claims liabilities of $110.3 million at December 31, 2013 (2012: $107.9 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 $6.6 million at December 31, 2013 (2012: $6.4 million).

The outstanding claims 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 claims 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 claims liabilities at December 31, 2013 by $63.2 million (2012: $61.4 million). The impact of an immediate hypothetical 1% decrease in the discount rate, with all other variables held constant, would increase net claims liabilities at December 31, 2013 by $67.9 million (2012: $65.9 million). Refer to Interest rate risk under the Investment-related risks section for a discussion on the sensitivity of 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.

Catastrophe 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 catastrophe 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 the company operates. The company manages its catastrophe events exposure through the deductibles charged to policyholders, managing the geographic concentration of its policies, purchasing reinsurance, and monitoring the impact on capital position and overall risk tolerances. The company currently purchases reinsurance to provide coverage for catastrophe events, both on an aggregated and individual basis.

Reinsurance coverage risk: The company uses 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 catastrophe 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 the P&C insurance 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.

The company'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 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, 2013, 91.8% (2012: 93.6%) were rated "A-" or better and 99.7% (2012: 99.5%) of the preferred stocks were rated "P2" or better. Of the corporate bonds held, 79.5% (2012: 84.9%) are concentrated in the financial services industry, 6.8% (2012: 7.6%) are concentrated in infrastructure and 13.7% (2012: 7.5%) are concentrated in other industries. Of the preferred stock and bonds held, the country of issuer is concentrated as 94.0% (2012: 95.5%) in Canada, 4.3% (2012: 3.1%) in the US and 1.7% (2012: 1.4%) in other.

The company participates in a securities lending program managed by major Canadian and US financial institutions, whereby the company lends securities it owns to other financial institutions to allow them to meet delivery commitments. The lending agents assume the risk of borrower default associated with the lending activity. At December 31, 2013, securities with an estimated fair value of $227.0 million (2012: $578.1 million) have been loaned and securities with an estimated fair value of $236.1 million (2012: $598.2 million) have been received as collateral from a Canadian financial institution. Lending collateral at December 31, 2013 was 100.0% (2012: 98.9%) held in cash and government-backed 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 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. Delinquent accounts are regularly monitored and the company takes action against non-payment.

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 $45.0 million at December 31, 2013 (2012: $48.8 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, 2013, 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 $270.3 million (December 31, 2012: $269.0 million), although the company's ultimate exposure to the creditworthiness of any individual life insurer is significantly less than this.

INVESTMENT-RELATED RISKS

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

The company has established detailed investment policy statements for both the matched and non-matched investment portfolios, which are subject to regular review and approval. These policy statements set out the company'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 the company, 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 management 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 claims 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% decrease in interest rates with all other variables held constant is as follows: the increase in fair value of bonds in the matched portfolio would increase income before income taxes at December 31, 2013 by $65.1 million (2012: $67.8 million); and the increase in the fair value of bonds in the non-matched portfolio would increase OCI before income taxes at December 31, 2013 by $56.1 million (2012: $68.5 million). The impact of an immediate hypothetical 1% increase in interest rates with all other variables held constant is as follows: the decrease in the fair value of bonds in the matched portfolio would decrease before income taxes at December 31, 2013 by $60.2 million (2012: $62.4 million); and the decrease in the fair value of bonds in the non-matched portfolio would decrease OCI before income taxes at December 31, 2013 by $47.7 million (2012: $57.5 million).

As discussed under claims reserving risk, an immediate hypothetical 1% increase in the discount rate would reduce net claims liabilities, and increase income before income taxes, by $63.2 million (2012: $61.4 million). This would almost entirely be offset by the corresponding decrease in income before income taxes on the matched bond portfolio discussed above of $60.2 million (2012: $62.4 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 the company'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 $64.2 million based upon holdings at December 31, 2013 (2012: $54.6 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. The company'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 majority of the company's foreign exchange exposure is to the US dollar. The impact on the company of a 1% change in the value of the US dollar and other foreign currencies relative to the Canadian dollar is $1.2 million based upon holdings at December 31, 2013 (2012: $0.9 million).

Use of derivatives risk: Generally, the company's investment policies limit the use of derivative instruments, without prior investment committee approval. The company'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 2013.

STRATEGIC RISKS

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 develop and 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 the 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 annually, or more frequently if required, by the board of directors.

Key employee risk: 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 2013, 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.

Distribution risk: In order to meet the company's overall strategy, the company must manage its distribution risk. Distribution risk includes the inherent risk of dealing with independent brokers and new market entrants; as well as the risk that the broker distribution channel would not be viable in a specific market. Changes to customer preferences for different distribution channels, including direct insurers, could lead to a material decline in the company's market share.

The company writes products through a network of select brokers across Canada. The ability of the company's broker network to be competitive against other distributors and the company's ability to maintain a strong relationship with the brokers, is critical for staying competitive in the market. The competitive environment is further complicated by the consolidation of brokers, and the acquisition of brokers by other P&C insurance companies, which may have a direct impact on the company's market share and ability to grow profitably. The company maintains close relationships with brokers through the business development staff, who provide training and guidance to enhance the brokers' understanding and marketing of the company's products. Strong competition exists among insurers for brokers with the proven ability to develop and deliver a profitable book of business. Premium volume and profitability could be negatively affected if there is a material decrease in the number of brokers that choose to sell the company's insurance products. The company periodically issues commercial loans to, or participates in equity investments in, certain profitable brokers to maintain broker loyalty. By doing so, the company could be exposed to financial risk and potential relationship issues. To mitigate these risks, commercial loans and equity investments in brokers are subject to annual financial reviews and are supported by standard agreement terms for oversight and security assignment. The board of directors provides supervision by reviewing the loan portfolio and equity holdings semi-annually.

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 claims 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 the company'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. The company has no credit facilities, aside from bank overdraft operating lines, or outstanding debt other than trade payables.

Operational risk: Operational risk is the risk of financial loss from inadequate or failed processes, people and systems, or their failure to respond adequately to external events. The company is continually enhancing its enterprise risk management framework to include current risk assessments for all significant business and functional areas. There is also on-going 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 which takes into consideration the key inherent risks of the company's operations. The annual internal audit plan 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 considers the risk that modifications to regulations, including increasing complexity and amount, will threaten the company's ability and capacity to conduct profitable business in the future in the manner it does today.

As a participant in the P&C insurance industry, the company 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 the company 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 the company'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.

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

Under the company's 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 the company's Code of Business Conduct, including questionable accounting or auditing matters, internal controls over financial reporting and the company's 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 Economical's Annual Report regarding the company's 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 or achievements or 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, 2013. 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 any of the forward-looking statements that 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

Policies in force (PIF)	The number of insurance policies for which the company is on risk at a specified date.
Gross written premiums (GWP)	The total premiums from the sale of insurance during a specified period.
Net premiums written (NPW)	GWP less the cost of reinsurance coverage.
Net earned premiums (NEP)	The portion of NPW equal to the expired period of time an insurance policy is in effect.
Claims ratio	Claims and adjustment expenses excluding discounting during a defined period, expressed as a percentage of net earned premiums for the same period.
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.
Combined ratio	The sum of the claims ratio and the expense ratio.
Underwriting income	The excess of net earned premiums over the sum of claims and adjustment expenses excluding discounting, commissions, operating expenses and premium taxes.
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.
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.
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.
Minimum capital test (MCT)	A regulatory formula defined by OSFI that is a risk-based test of capital available relative to capital required.

consolidated financial statements

table of contents

Report of management's accountability	38
App ointed actuary's report	39
Independent auditors' report	40
Consolidated Balance Sheet	41
Consolidated Statement of Comprehensive Income	42
Consolidated Statement of Changes in Mutual Policyholders' Equity	43
Consolidated Statement of Cash Flows	44
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	**45**
Note 1 – Nature of Operations	45
Note 2 – Summary of Significant Accounting Policies	45
Note 3 – Change in Accounting Policies	51
Note 4 – Standards Issued But Not Yet Effective	52
Note 5 – Significant Accounting Judgments, Estimates and Assumptions	52
Note 6 – Investments	54
Note 7 – Nature and Extent of Risks Arising From Financial Instruments	57
Note 8 – Policy Liabilities	60
Note 9 – Nature and Extent of Risks Arising From Insurance Contracts	63
Note 10 – Reinsurance Contracts	67
Note 11 – Property and Equipment	68
Note 12 – Income Taxes	69
Note 13 – Goodwill and Intangible Assets	70
Note 14 – Other Assets	72
Note 15 – Investments in Associates	72
Note 16 – Accounts Payable and Other Liabilities	72
Note 17 – Premiums	73
Note 18 – Post-Employment Benefits	73
Note 19 – Capital Management	77
Note 20 – Rate Regulation	77
Note 21 – Commitments and Contingencies	78
Note 22 – Demutualization	78
Note 23 – Restructuring Expenses	78
Note 24 – Supplemental Expense Information	78
Note 25 – Related Party Transactions	78
Note 26 – Operating Segments	79

consolidated financial statements

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 consolidated financial 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 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 chief actuary is appointed by the board of directors pursuant to the Insurance Companies Act (Canada). The chief 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 chief 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 chief 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 21, 2014

appointed actuary's report

To the Members of Economical Mutual Insurance Company:

I have valued the policy liabilities and reinsurance recoverables of Economical Mutual Insurance Company for its consolidated balance sheet at December 31, 2013 and their changes 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 net of reinsurance recoverables makes appropriate provision for all policy 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 21, 2014

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, 2013 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, 2013 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLP

Chartered Accountants
Licensed Public Accountants

Kitchener, Canada
February 21, 2014

CONSOLIDATED BALANCE SHEET

As at December 31 (in thousands of dollars)	Notes	2013	2012
Assets			
Cash and cash equivalents		**87,243**	90,523
Investments	6	**3,851,799**	3,766,384
Accrued investment income		**13,587**	13,155
Premiums receivable		**548,172**	525,342
Income taxes receivable		**26,935**	-
Reinsurance receivable and recoverable	8, 10	**156,875**	70,979
Deferred policy acquisition expenses	8	**196,805**	190,938
Property and equipment	11	**20,619**	22,978
Deferred income tax assets	12	**43,847**	52,848
Goodwill and intangible assets	13	**68,042**	73,912
Other assets	14	**46,318**	19,108
		5,060,242	4,826,167
Liabilities and mutual policyholders' equity			
Unearned premiums	8	**971,762**	933,013
Claims liabilities	8, 9	**2,341,776**	2,221,284
Accounts payable and other liabilities	16	**173,588**	195,603
Income taxes payable		**-**	12,054
		3,487,126	3,361,954
Mutual policyholders' equity			
Retained earnings		**1,513,222**	1,418,287
Accumulated other comprehensive income		**59,894**	45,926
Total mutual policyholders' equity	19	**1,573,116**	1,464,213
		5,060,242	4,826,167
Commitments and contingencies	21		

See accompanying notes.

On behalf of the board:

G.A. Hooper, director

K.L. Gavan, director

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended December 31 (in thousands of dollars)	Notes	2013	2012
Gross premiums written	8, 17	**1,919,186**	1,819,703
Net premiums written	17	**1,803,586**	1,723,656
Net premiums earned	17	**1,769,195**	1,666,018
Underwriting expenses			
Net claims and adjustment expenses, undiscounted	8, 10	**1,188,474**	1,027,777
Net commissions	10	**348,651**	356,071
Operating expenses		**171,425**	164,273
Premium taxes		**62,970**	59,552
		1,771,520	1,607,673
		(2,325)	58,345
Impact of change in net claims discount rate	8	**8,411**	9,329
Underwriting income		**6,086**	67,674
Investment income	6		
Interest		**79,447**	85,284
Dividends		**23,519**	19,831
Recognized gains on investments		**2,023**	21,746
		104,989	126,861
Other income	18	**23,070**	14,756
Restructuring expenses	23	**(23,417)**	(11,588)
Income before income taxes		**110,728**	197,703
Income tax expense	12	**22,981**	46,685
Net income		**87,747**	151,018
Items that may be reclassified subsequently to net income			
Net unrealized gains on AFS investments		**26,485**	49,151
Reclassification to net income of net recognized gains on AFS investments	6	**(7,177)**	(25,512)
Foreign exchange gain on investments in subsidiaries		**503**	7
Income tax expense	12	**5,424**	5,947
		14,387	17,699
Items that will not be reclassified subsequently to net income			
Post-employment benefit obligation gain (loss)	3, 18	**9,763**	(6,239)
Income tax expense (recovery)	12	**2,575**	(1,651)
		7,188	(4,588)
Other comprehensive income		**21,575**	13,111
Comprehensive income		**109,322**	164,129

See accompanying notes.

CONSOLIDATED STATEMENT OF CHANGES IN MUTUAL POLICYHOLDERS' EQUITY

For the year ended December 31 (in thousands of dollars)	2013			2012		
	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	**1,418,287**	**45,926**	**1,464,213**	1,271,857	28,227	1,300,084
Net income	**87,747**	**-**	**87,747**	151,018	-	151,018
Other comprehensive income (loss)	**7,188**[1]	**14,387**	**21,575**	(4,588)[1]	17,699	13,111
Total comprehensive income	**94,935**	**14,387**	**109,322**	146,430	17,699	164,129
Reclassification of foreign exchange gain	**-**	**(419)**	**(419)**	-	-	-
Balance, end of the year	**1,513,222**	**59,894**[2]	**1,573,116**	1,418,287	45,926[2]	1,464,213

[1] Actuarial gains (losses) for the defined benefit plan recognized in retained earnings (net of income tax expense of $2,575 (2012: $1,651 income tax recovery)).

[2] Included in accumulated other comprehensive income is $503 (2012: $419) related to the cumulative foreign exchange gain on investments in associates.

See accompanying notes.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31 (in thousands of dollars)	Notes	2013	2012
Operating activities			
Receipts			
Premiums collected		**1,777,201**	1,697,093
Interest received		**93,783**	105,104
Dividends received		**24,177**	19,796
		1,895,161	1,821,993
Payments			
Claims paid	8	**1,132,033**	1,098,276
Commissions and expenses paid		**542,760**	493,691
Premium taxes paid		**64,253**	57,225
Income taxes paid		**60,698**	42,101
Restructuring expenses paid	23	**17,849**	6,416
		1,817,593	1,697,709
Net cash provided by operating activities		**77,568**	124,284
Investing activities			
Investments purchased		**(1,726,575)**	(2,185,272)
Investments sold, redeemed or matured		**1,643,571**	1,893,405
Commercial loans advanced		**(6,240)**	(2,328)
Commercial loans repaid		**10,095**	16,734
Other assets purchased		**(1,699)**	(8,130)
Business dispositions		**-**	2,920
Net cash used in investing activities		**(80,848)**	(282,671)
Cash and cash equivalents			
Net decrease during the year		**(3,280)**	(158,387)
Balance, beginning of the year		**90,523**	248,910
Balance, end of the year		**87,243**	90,523
Cash		**67,261**	90,523
Cash equivalents		**19,982**	-
Total cash and cash equivalents		**87,243**	90,523

See accompanying notes.

notes to the consolidated financial statements

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 pursue demutualization, a process which requires, among other things, approval by its mutual policyholders and regulators.

These consolidated financial statements were approved by the company's board of directors on February 21, 2014.

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 claims liabilities which are valued on a discounted basis in accordance with accepted actuarial practice.

The financial statements of the subsidiaries and material 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. and the TEIG Investment Partnership, which manages the investment portfolio for all insurance companies in the group. Each of the subsidiaries operate and are incorporated in Canada.

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."

Claims liabilities: Claims liabilities are calculated based on Canadian accepted actuarial practice. The claims 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 claims 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 claims liabilities. The effect of discounting is included in "Impact of change in net claims discount rate" in the consolidated statement of comprehensive income. The claims 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 through the liability adequacy test.

Liability adequacy test: At each reporting date, an assessment is made of whether the policy liabilities are adequate, which includes both claims liabilities and premium liabilities. Claims liabilities are assessed using current estimates of future cash flows of unpaid claims and adjustment expenses, discounted to reflect the time value of money. If that assessment shows that the carrying amount of the claims 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 the discounted 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 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 industry administered risk sharing pools ("RSP") or in Quebec, the Plan de Repartition des Risques ("PRR") or collectively "the pools." The related risks associated with FA insurance policies and policies ceded by companies to the pools 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 pools. The company applies the same accounting policies to FA and pool insurance it assumes as it does to insurance policies issued by the company directly to policyholders and thus the company's share of pool premiums and claims are included in the relevant financial statement line items. The company's share of the pool assets backing policy liabilities is included in "Reinsurance receivable and recoverable."

Reinsurance: Reinsurance receivable and recoverable includes reinsurers' share of UPR and claims 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 claims liabilities are determined on a basis consistent with the related claims 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 claims 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 7 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 claims 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. 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 stocks, 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” (“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 claims 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 claims 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 claims 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 recorded 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 income" 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) Basis of 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 at the acquisition date.

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.

When the company is exposed, or has rights, to variable returns from its involvement with an investee and has the ability to affect those returns through its power over the investee, the investee is considered a subsidiary. Subsidiaries are fully consolidated from the date that control is obtained by the company. Subsidiaries are deconsolidated from the date that control ceases.

When the company has significant influence over an investee, that is the power to participate in the financial and operating decisions of the investee but does not have control or joint control over those decisions, the investee is considered to be an associate. Associates are accounted for under the equity method.

(h) Intangible assets

Intangible assets include 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" 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."

(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, other post-employment benefits and other employee 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 salary escalation, and retirement ages of employees. 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, and the net interest cost calculated by applying a discount rate to the net defined benefit obligation. 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. Past service costs, which are a result of a plan amendment or curtailment, are recognized in "Other income" in the consolidated statement of comprehensive income when the amendment or curtailment has occurred.

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.

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 they are due. The company has no further payment obligations once the contributions and applicable administration fees have been paid.

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" in the consolidated statement of comprehensive income when an event giving rise to a curtailment has occurred.

Actuarial gains and losses, except for long-term disability benefits, 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. Actuarial gains and losses for long-term disability benefits are recognized in "Operating expenses" in the consolidated statement of comprehensive income.

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

Termination benefits: Termination benefits are payable when employment is terminated by the company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The company recognizes termination benefits at the earlier of the following dates: (a) when the company can no longer withdraw the offer of those benefits; and (b) when the company recognizes costs for a restructuring that is within the scope of IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* and involves the payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to their present value.

Incentive plans: The company recognizes a liability and an expense for bonuses based on a formula that takes into consideration various financial metrics. The company recognizes a provision where contractually obliged or where there is a past practice that has created a reasonable expectation of a constructive obligation.

(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 gains and losses on AFS equity instruments have been included in OCI. All other foreign currency 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. CHANGE IN ACCOUNTING POLICIES

The company has adopted the following standards effective January 1, 2013. The standards have been applied retrospectively, unless otherwise stated.

(a) Employee benefits

The company implemented IAS 19 ("IAS 19") – *Employee Benefits* effective January 1, 2013. The revised IAS 19 standard replaces the separate calculations 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 retrospectively has been to increase pension expense included in "Operating expenses" within net income and to correspondingly reduce actuarial losses in OCI by approximately $2.3 million for the year ended December 31, 2012.

The new standard permits an entity to accumulate actuarial gains and losses in either retained earnings or in AOCI. The company has elected to continue accumulating actuarial gains and losses in retained earnings; and as a result, the adjustment to 2012 pension expense in net income and to actuarial losses in OCI noted above have no net impact on retained earnings.

As the retrospective application of the standard did not impact the net defined benefit pension obligation or retained earnings reported on the balance sheet for the year ended December 31, 2012, an opening balance sheet for the year ended December 31, 2012 has not been disclosed.

The reconciliation of the condensed consolidated statement of comprehensive income for the year ended December 31, 2012 is as follows:

(in thousands of dollars)	As reported	IAS 19 adjustments	As restated
Net premiums earned	1,666,018	-	1,666,018
Underwriting expenses			
Operating expenses	161,964	2,309	164,273
Other underwriting expenses	1,434,071	-	1,434,071
Underwriting income	69,983	(2,309)	67,674
Investment and other income	130,029	-	130,029
Income before income taxes	200,012	(2,309)	197,703
Income tax expense	47,292	(607)	46,685
Net income	152,720	(1,702)	151,018
Post-employment benefit obligation loss which will not be reclassified subsequently to net income	(8,548)	2,309	(6,239)
Other comprehensive income items that may be reclassified subsequently to net income	23,646	-	23,646
Income tax expense	3,689	607	4,296
Other comprehensive income	11,409	1,702	13,111
Comprehensive income	164,129	-	164,129

(b) Consolidated financial statements

The company has determined that the adoption of IFRS 10 – *Consolidated Financial Statements*, IFRS 11 – *Joint Arrangements* and IFRS 12 – *Disclosure of Interests in Other Entities* did not result in any change in the consolidation status of any of its subsidiaries.

(c) Presentation of other comprehensive income

Consistent with the requirements of IAS 1 – *Presentation of Financial Statements*, effective January 1, 2013, OCI is presented in two categories based on whether or not the balance may subsequently be reclassified to net income, with the tax associated with each type of OCI balance presented separately.

(d) Other IFRS standards

The implementation of the following standards or amendments had minimal impact on disclosure and did not require opening transition adjustments:

IFRS 7 – *Disclosures – Offsetting Financial Assets and Financial Liabilities*

IFRS 13 – *Fair Value Measurement*

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

Classification and measurement of financial instruments is the first phase of a three-phase project to replace IAS 39 - *Financial Instruments: Recognition and Measurement*. The classification and measurement portion of IFRS 9 ("IFRS 9") – *Financial Instruments* has been subject to a new exposure draft in December 2012 which modifies the standard which was to be effective for fiscal years beginning on or after January 1, 2015. As a result, the IASB tentatively decided to defer the mandatory effective date for IFRS 9 and has noted that it will be January 1, 2017 at the earliest. Under the exposure draft, debt instruments may be carried at amortized cost, FVTPL or fair value through OCI, depending upon the purpose for which the debt instrument is held. IFRS 9 replaces the current models for classifying equity instruments, permitting equity instruments to be 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.

(b) Offsetting Financial Assets and Financial Liabilities

Amendments to IAS 32 ("IAS 32") – *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 IAS 32 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.

5. 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 reasonable.

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 control or significant influence over investees, of the identification of objective evidence of impairment for financial instruments, the recoverability and 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 claims 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 claims liabilities by geographic region, product line, type and extent of coverage and year of occurrence.

Claims 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 claims 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. Claims liabilities include estimates subject to variability, which could be material. Changes to the estimates could result from future events such as receiving additional claims 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 9 contains additional analysis of the impact of the key assumptions on claims liabilities.

Claims liabilities have been discounted to reflect future investment income in accordance with Canadian accepted actuarial practice. The principal assumptions made in establishing claims liabilities are best estimates. To allow for possible deterioration in experience, and to increase the likelihood that the claims 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 claims 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 claims 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 the assets are allocated.

(c) Control or significant influence over investees

The company presumes that control or significant influence over an investee is primarily evidenced by the ownership percentage held of the investee unless there are other factors which indicate the level of control is not aligned with the ownership percentage. Currently there are no investments in investees for which the assessment of control or significant influence is not aligned with the ownership percentage.

(d) 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, future salary increases, mortality rate, expected health care costs, inflation and future pension increases. The details of the assumptions are disclosed in note 18. 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.

(e) 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.

(f) 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.

6. INVESTMENTS

(a) Investment income and balances

Investment income by financial instrument classification is as follows:

(in thousands of dollars)	2013				
	Notes	FVTPL	AFS	Loans and receivables	Total
Interest		44,950	33,058	1,439	**79,447**
Dividends		-	23,519	-	**23,519**
Realized gains on sale of investments		16,872	17,878	-	**34,750**
Net impairment losses on AFS investments	6(c)	-	(10,701)	-	**(10,701)**
Unrealized losses on FVTPL financial instruments		(22,026)	-	-	**(22,026)**
Recognized gains (losses) on investments		(5,154)	7,177	-	**2,023**
		39,796	63,754	1,439	**104,989**

(in thousands of dollars)	2012				
	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	6(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

The fair value yield at December 31, 2013 for the FVTPL bond portfolio was 1.83% (2012: 1.70%) and for the AFS bond portfolio was 3.33% (2012: 2.66%).

Investment carrying values by financial instrument classification are as follows:

(in thousands of dollars)	2013			
	FVTPL	AFS	Loans and receivables	Total
Short-term investments	-	109,702	-	**109,702**
Bonds	2,057,783	941,539	-	**2,999,322**
Preferred stocks	-	262,369	-	**262,369**
Common stocks	-	339,017	-	**339,017**
Pooled fund	-	96,410	-	**96,410**
Commercial loans	-	-	44,979	**44,979**
	2,057,783	1,749,037	44,979	**3,851,799**

(in thousands of dollars)	2012			
	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

The commercial loans have an amortized cost of $45.0 million (2012: $48.8 million) and fair value of $41.0 million (2012: $45.1 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.

(in thousands of dollars)	2013			
	Cost/amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Short-term investments	109,702	-	-	**109,702**
Bonds				
Government	462,299	1,382	(12,269)	**451,412**
Corporate	487,499	7,508	(4,880)	**490,127**
	949,798	8,890	(17,149)	**941,539**
Canadian preferred stocks	267,705	3,486	(8,822)	**262,369**
Common stocks				
Canadian	186,928	54,828	(583)	**241,173**
Foreign	72,393	25,548	(97)	**97,844**
Foreign pooled fund	80,683	15,727	-	**96,410**
	340,004	96,103	(680)	**435,427**
	1,667,209	108,479	(26,651)	**1,749,037**

(in thousands of dollars)	2012			
	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

(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 company recognizes transfers between the levels of the fair value hierarchy at the end of the reporting period during which the change has occurred. 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 $601.4 million (2012: $516.4 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 $2,999.3 million (2012: $3,061.9 million) which are valued on a discounted cash flow basis, the pooled fund with a fair value of $96.4 million (2012: $79.4 million) which is valued based on quoted prices of the underlying securities in an active market and short-term investments with a fair value of $109.7 million (2012: $59.8 million) which are valued on a discounted cash flow basis. The inputs into the discounted cash flow model for the bonds and short-term investments are an estimate of the expected cash flows discounted at a pre-tax risk-free rate plus an appropriate adjustment for credit risk.

(iii) Level 3 fair value measurements use significant non-market observable inputs, including assumptions about risk or liquidity. As at December 31, 2013, the company has no financial instruments in this category (2012: nil). Commercial loans are measured at cost but fair value is disclosed. The fair value is measured on a discounted cash flow basis. The inputs into the discounted cash flow model are an estimate of the expected cash flows discounted at a pre-tax risk-free rate plus an appropriate adjustment for credit risk.

There were no transfers of financial instruments between the 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)	2013	2012
Common stocks		
Canadian	**9,518**	9,631
Foreign	**426**	2,343
Bonds		
Corporate	**757**	(2,644)
	10,701	9,330

Interest income of $1.3 million (2012: $1.3 million) was earned during the year on the impaired bond.

The remaining gross unrealized losses of $26.7 million (2012: $6.8 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 and US financial institution, whereby the company lends securities it owns to other financial institutions to allow them to meet delivery commitments. The lending agents assume the risk of borrower default associated with the lending activity. At December 31, 2013, securities with an estimated fair value of $227.0 million (2012: $578.1 million) have been loaned and securities with an estimated fair value of $236.1 million (2012: $598.2 million) have been received as collateral from the financial institutions. Lending collateral at December 31, 2013 was 100.0% (2012: 98.9%) held in cash and government-backed 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.

7. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

The company's financial instruments, including investments, are exposed to interest rate risk, equity market 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 at least 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 claims 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 claims liabilities. The effect of interest rate risk associated with discounting claims liabilities is disclosed in note 9.

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)	2013		2012	
Impact on	**+ 1%**	**- 1%**	+ 1%	- 1%
Fair value of FVTPL bonds and income before income taxes	**(60,239)**	**65,121**	(62,404)	67,800
Fair value of AFS bonds and OCI before income taxes	**(47,686)**	**56,073**	(57,496)	68,461

The estimated impact on income taxes would be calculated at the statutory rate of 26.4% (2012: 26.3%).

(b) Equity market 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)	2013		2012	
Impact on	**+ 10%**	**- 10%**	+ 10%	- 10%
Fair value of Canadian stocks and OCI before income taxes	**44,728**	**(44,728)**	38,971	(38,971)
Fair value of foreign stocks, pooled fund and OCI before income taxes	**19,425**	**(19,245)**	15,630	(15,630)

The estimated impact on income taxes would be calculated at the statutory rate of 26.4% (2012: 26.3%).

(c) Credit risk

Credit risk is the risk of financial loss as a 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.

Bonds and stocks: 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, 2013, 91.8% (2012: 93.6%) were rated "A-" or better and 99.7% (2012: 99.5%) of the preferred stocks were rated "P2" or better. Of the corporate bonds held, 79.5% (2012: 84.9%) are concentrated in the financial services industry, 6.8% (2012: 7.6%) are concentrated in infrastructure and 13.7% (2012: 7.5%) are concentrated in other industries. Of the preferred stock and bonds held, the country of issuer is concentrated as 94.0% (2012: 95.5%) in Canada, 4.3% (2012: 3.1%) in the US and 1.7% (2012: 1.4%) in other countries.

Securities lending: As disclosed in note 6, the company participates in a securities lending program. The company minimizes credit risk associated with this program by only dealing with counterparties who are rated "A+" or higher 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, 2013 is 104.0% (2012: 103.5%).

Premiums receivable: 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. Delinquent accounts are regularly monitored and the company takes action against non-payment. The allowance for doubtful accounts in the current and comparative periods is insignificant as overdue receivables are negligible.

Commercial loans: 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 6. There is currently no evidence of significant impairment of any individual commercial loan.

Reinsurance receivable and recoverable: 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 (2012: $0.5 million).

Structured settlements: 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, 2013, 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 $270.3 million (2012: $269.0 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 various foreign currencies.

The only significant foreign currency exposure the company has is the US dollar. The impact on the fair value of US dollar foreign stocks, pooled fund and OCI from a 1% change in the US dollar relative to the Canadian dollar is $0.7 million (2012: $0.4 million). The impact on the fair value of non-US dollar foreign stocks, pooled fund and OCI from a 1% change in non-US dollar currencies relative to the Canadian dollar is $0.5 million (2012: $0.4 million). The estimated impact on income taxes would be calculated at the statutory rate of 26.4% (2012: 26.3%).

(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 claims payments and operating expenses.

As at December 31, 2013, the company has $87.2 million (2012: $90.5 million) of cash and cash equivalents and short-term investments of $109.7 million (2012: $59.8 million). The company also has a highly liquid investment portfolio. As at December 31, 2013, 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 $3,675.1 million (2012: $3,636.1 million).

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

For claims 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 reinsurers' share of UPR have been excluded from the analysis as they are not of themselves contractual obligations.

(in thousands of dollars)	2013				
	Less than 1 year	1 5 years	6 10 years	10 years +	Total
Assets					
Cash and cash equivalents	87,243	-	-	-	**87,243**
Short-term investments	109,702	-	-	-	**109,702**
FVTPL bonds	19,001	1,990,351	48,431	-	**2,057,783**
AFS bonds	37,443	301,491	538,821	63,784	**941,539**
Preferred stocks	39,998	173,261	49,110	-	**262,369**
Commercial loans	5,431	26,795	12,753	-	**44,979**
Accrued investment income	13,587	-	-	-	**13,587**
Premiums receivable	546,211	1,961	-	-	**548,172**
Reinsurance receivable and recoverable	42,425	86,877	10,860	-	**140,162**
Income taxes receivable	26,935	-	-	-	**26,935**
	927,976	2,580,736	659,975	63,784	**4,232,471**
Liabilities					
Claims liabilities	700,805	1,052,823	372,053	113,890	**2,239,571**
Accounts payable and other liabilities	120,624	8,021	8,946	35,997	**173,588**
	821,429	1,060,844	380,999	149,887	**2,413,159**

(in thousands of dollars)	2012				
	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					
Claims 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

Note 18(c) contains the maturity profile for other post-employment benefit obligations.

The company believes that it has the flexibility to obtain the funds needed to meet cash and regulatory requirements on an ongoing basis.

8. 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 claims 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, 2013 (2012: nil).

The following changes have occurred in UPR during the year:

(in thousands of dollars)	2013			2012		
	Gross	Ceded	Net	Gross	Ceded	Net
UPR, beginning of year	**933,013**	**15,932**	**917,081**	876,975	17,532	859,443
Premiums written during year	**1,919,186**	**115,600**	**1,803,586**	1,819,703	96,047	1,723,656
Premiums earned during year	**(1,880,437)**	**(111,242)**	**(1,769,195)**	(1,763,665)	(97,647)	(1,666,018)
UPR, end of year	**971,762**	**20,290**	**951,472**	933,013	15,932	917,081

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

(in thousands of dollars)	2013	2012
DPAE, beginning of year	**190,938**	179,189
Acquisition costs deferred	**368,223**	365,548
Amortization of acquisition costs	**(362,356)**	(353,799)
DPAE, end of year	**196,805**	190,938

The following table presents the company's UPR by line of business as at December 31.

(in thousands of dollars)	2013		
	Gross UPR	Ceded UPR	Net UPR
Personal lines			
Automobile	**394,817**	**-**	**394,817**
Property	**185,597**	**-**	**185,597**
	580,414	**-**	**580,414**
Commercial lines			
Automobile	**132,696**	**9,573**	**123,123**
Property and liability	**258,652**	**10,717**	**247,935**
	391,348	**20,290**	**371,058**
	971,762	**20,290**	**951,472**

(in thousands of dollars)	2012		
	Gross UPR	Ceded UPR	Net UPR
Personal lines			
Automobile	373,007	-	373,007
Property	192,056	-	192,056
	565,063	-	565,063
Commercial lines			
Automobile	119,207	5,587	113,620
Property and liability	248,743	10,345	238,398
	367,950	15,932	352,018
	933,013	15,932	917,081

(b) Claims liabilities

Claims 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 5 contains additional information on the judgments, estimates and assumptions used in determining claims liabilities. Note 6(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 claims liabilities during the year.

(in thousands of dollars)	2013		
	Gross claims liabilities	Ceded claims liabilities	Net claims liabilities
Claims liabilities, beginning of year	**2,221,284**	**63,283**	**2,158,001**
Current year claims incurred	**1,343,317**	**91,886**	**1,251,431**
Prior year favourable claims development	**(55,329)**	**7,628**	**(62,957)**
	1,287,988	**99,514**	**1,188,474**
Decrease due to change in net claims discount rate	**(7,072)**	**1,339**	**(8,411)**
Claims and adjustment expenses	**1,280,916**	**100,853**	**1,180,063**
Claims paid during the year	**1,160,424**	**28,391**	**1,132,033**
Claims liabilities, end of year	**2,341,776**	**135,745**	**2,206,031**

(in thousands of dollars)	2012		
	Gross claims liabilities	Ceded claims liabilities	Net claims liabilities
Claims 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 change in net claims discount rate	(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
Claims liabilities, end of year	2,221,284	63,283	2,158,001

The following table presents the company's claims liabilities by line of business as at December 31.

(in thousands of dollars)	2013		
	Gross claims liabilities	**Ceded claims liabilities**	**Net claims liabilities**
Personal lines			
Automobile	**1,369,799**	**15,513**	**1,354,286**
Property	**123,749**	**10,318**	**113,431**
	1,493,548	**25,831**	**1,467,717**
Commercial lines			
Automobile	**325,223**	**15,643**	**309,580**
Property and liability	**523,005**	**94,271**	**428,734**
	848,228	**109,914**	**738,314**
	2,341,776	**135,745**	**2,206,031**

(in thousands of dollars)	2012		
	Gross claims liabilities	**Ceded claims liabilities**	**Net claims liabilities**
Personal lines			
Automobile	1,415,588	23,796	1,391,792
Property	113,125	4,427	108,698
	1,528,713	28,223	1,500,490
Commercial lines			
Automobile	297,481	10,124	287,357
Property and liability	395,090	24,936	370,154
	692,571	35,060	657,511
	2,221,284	63,283	2,158,001

9. 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.

The concentration of written premiums by line of business and geographical region are as follows:

	2013	2012
Personal automobile	**40.8%**	39.9%
Personal property	**18.7%**	20.2%
Commercial automobile	**14.1%**	13.2%
Commercial property and liability	**26.4%**	26.7%
	100.0%	100.0%

	2013	2012
Ontario	**57.0%**	56.3%
Western	**28.5%**	28.3%
Atlantic	**7.6%**	8.1%
Quebec	**6.3%**	6.8%
Out of Canada	**0.6%**	0.5%
	100.0%	100.0%

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, claims 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 claims 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 claims 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 claims liabilities is based on the fair value yield of the company's FVTPL bond portfolio (see note 6). 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 claims payments and their matching to investment cash flows. Future changes in the FVTPL bond portfolio could change the value of claims 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 claims liabilities:

(in thousands of dollars)	2013		2012	
Impact of change in net claims liabilities due to:	**+ 5%**	**- 5%**	+ 5%	- 5%
Net claims liabilities	**(63,168)**	**67,875**	(61,439)	65,925

(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 19 provides information on regulatory capital requirements. Note 20 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 claims liabilities are established to cover future insurance claims 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 claims liabilities to cover the estimated liability for payment of all claims and claims adjustment expenses incurred with respect to insurance contracts underwritten by the company. Claims liabilities do not represent an exact calculation of the liability. Rather, claims 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 claims liabilities, thereby mitigating inflation risk.

Claims 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 claims liabilities is based on estimates derived by geographical region and line of business using generally accepted actuarial techniques. Numerous individual assumptions that impact average claims 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 claims 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 claims liabilities.

Establishing an appropriate level of claims 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 claim severity of a change in claims and adjustment expenses on claims liabilities.

(in thousands of dollars)	2013		2012	
Impact on	**+ 1%**	**- 1%**	+ 1%	- 1%
Change in average claims severity	**110,302**	**(110,302)**	107,900	(107,900)
Change in claims and adjustment expenses	**6,647**	**(6,647)**	6,356	(6,356)

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, 2013.

The company applied the transitional rules of IFRS 4 in 2011 that permit less than ten years of information to be disclosed upon adoption of IFRS. The claims development information disclosed is being increased from five years to ten years over the period 2011 to 2016.

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

Claims development table, gross of reinsurance:

(in thousands of dollars)	Accident year								
	2006 and prior	2007	2008	2009	2010	2011	2012	2013	Total
Estimate of ultimate claims									
At end of accident year	2,802,828	1,315,851	1,487,688	1,424,591	1,211,469	1,145,945	1,071,470	1,316,867	
1 year later	2,773,029	1,302,449	1,447,808	1,377,851	1,098,293	1,064,950	1,022,904		
2 years later	2,745,973	1,286,559	1,439,293	1,377,872	1,099,548	1,059,188			
3 years later	2,745,708	1,285,525	1,427,448	1,400,698	1,100,260				
4 years later	2,746,523	1,283,801	1,444,109	1,400,578					
5 years later	2,747,756	1,292,433	1,445,248						
6 years later	2,746,984	1,296,330							
7 years later	2,746,733								
Favourable (unfavourable) development recognized in the year, undiscounted	251	(3,897)	(1,139)	120	(712)	5,762	48,566		48,951
Favourable development recognized from FA and RSP/PRR ceded and assumed in the year									6,378
Total favourable development recognized in the year									55,329
Reconciliation to the consolidated balance sheet									
Current estimate of ultimate claims	2,746,733	1,296,330	1,445,248	1,400,578	1,100,260	1,059,188	1,022,904	1,316,867	11,388,108
Cumulative claims paid	2,533,841	1,195,278	1,278,691	1,157,466	879,621	821,557	718,192	614,673	9,199,319
Current unpaid and unreported claims before discounting	212,892	101,052	166,557	243,112	220,639	237,631	304,712	702,194	2,188,789
Impact of change in net claims discount rate (including PfAD)									102,205
FA and RSP/PRR ceded and assumed, unpaid and unreported									50,782
Unpaid and unreported claims, gross of reinsurance									2,341,776

Claims development table, net of reinsurance:

(in thousands of dollars)	Accident year								
	2006 and prior	2007	2008	2009	2010	2011	2012	2013	Total
Estimate of ultimate claims									
At end of accident year	2,658,948	1,295,586	1,473,388	1,401,630	1,198,256	1,129,584	1,058,577	1,224,981	
1 year later	2,627,963	1,280,821	1,432,320	1,352,544	1,085,810	1,038,734	1,005,550		
2 years later	2,600,618	1,264,745	1,422,564	1,349,179	1,086,656	1,031,543			
3 years later	2,599,881	1,265,880	1,410,738	1,368,331	1,088,028				
4 years later	2,606,256	1,264,813	1,427,118	1,367,656					
5 years later	2,611,648	1,273,663	1,427,746						
6 years later	2,618,062	1,275,879							
7 years later	2,618,160								
Favourable (unfavourable) development recognized in the year, undiscounted	(98)	(2,216)	(628)	675	(1,372)	7,191	53,027		56,579
Favourable development recognized from FA and RSP/PRR ceded and assumed in the year									6,378
Total favourable development recognized in the year									62,957
Reconciliation to the consolidated balance sheet									
Current estimate of ultimate claims	2,618,160	1,275,879	1,427,746	1,367,656	1,088,028	1,031,543	1,005,550	1,224,981	11,039,543
Cumulative claims paid	2,430,419	1,178,981	1,263,997	1,129,626	868,098	799,181	709,598	601,849	8,981,749
Current unpaid and unreported claims before discounting	187,741	96,898	163,749	238,030	219,930	232,362	295,952	623,132	2,057,794
Impact of change in net claims discount rate (including PfAD)									97,455
FA and RSP/PRR ceded and assumed, unpaid and unreported									50,782
Unpaid and unreported claims, net of reinsurance									2,206,031

10. 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)	2013	2012
Individual loss		
Property		
Net company retention	**3,000**	3,000
Maximum limit	**40,000**	40,000
Auto and general liability		
Net company retention	**4,000**	4,000
Maximum limit	**30,000**	30,000
Catastrophe – primary[1]		
Net company retentions	**30,000**	30,000
Maximum limit	**1,800,000**	1,600,000
Catastrophe – aggregate[2]		
Company retention	**-**	50,000
Maximum limit	**-**	75,000

[1] In addition to $30.0 million (2012: $30.0 million) of base retention, the company has a maximum $77.0 million (2012: nil) participation in higher layers of the treaty

[2] Subject to losses of $5.0 million per event for 2012

(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	2013	2012
Premiums ceded	17	**115,600**	96,047
Premiums earned	8	**111,242**	97,647
Claims and adjustment expenses	8, 9	**100,853**	18,612
Commissions		**6,838**	7,099

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

(in thousands of dollars)	Notes	2013	2012
Premiums assumed	17	**11,921**	9,896
Premiums earned	8	**11,162**	10,501
Claims and adjustment expenses	8, 9	**11,066**	8,846
Commissions		**4,366**	4,095

(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	2013	2012
Reinsurers' share of UPR	8	**20,290**	15,932
Reinsurers' share of claim liabilities	8, 9	**135,745**	63,283
Reinsurer receivables		**21,576**	8,808
Reinsurer payables		**(17,159)**	(13,822)
Unearned reinsurance commissions		**(3,577)**	(3,222)
		156,875	70,979

(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)	Notes	2013	2012
DPAE	8	**2,139**	1,864
Reinsurance assumed receivables		**2,763**	1,750
		4,902	3,614

Reinsurance assumed liabilities:

(in thousands of dollars)	Notes	2013	2012
UPR	8	**5,732**	4,972
Claim liabilities	8	**22,670**	19,055
Reinsurance assumed payables		**514**	3,412
		28,916	27,439

11. PROPERTY AND EQUIPMENT

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

(in thousands of dollars)	2013					
	Land and building structure	Building fixtures	Building infrastructure	Furniture and equipment	Computer equipment	Total
Cost						
Balance, beginning of year	**18,052**	**9,857**	**9,253**	**20,047**	**8,376**	**65,585**
Additions	**376**	**-**	**-**	**616**	**597**	**1,589**
Disposals	**(335)**	**-**	**-**	**(106)**	**(351)**	**(792)**
Balance, end of year	**18,093**	**9,857**	**9,253**	**20,557**	**8,622**	**66,382**
Accumulated depreciation						
Balance, beginning of year	**6,689**	**7,706**	**5,985**	**16,563**	**5,664**	**42,607**
Depreciation charge	**719**	**333**	**370**	**740**	**1,546**	**3,708**
Depreciation on disposals	**(121)**	**-**	**-**	**(103)**	**(328)**	**(552)**
Balance, end of year	**7,287**	**8,039**	**6,355**	**17,200**	**6,882**	**45,763**
Net book value, end of year	**10,806**	**1,818**	**2,898**	**3,357**	**1,740**	**20,619**

(in thousands of dollars)	2012					
	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

Depreciation charged to operating expenses amounted to $3.7 million (2012: $4.3 million).

12. 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:

(in thousands of dollars)	2013		2012	
	%	$	%	$
Income tax expense calculated based on statutory tax rates	**26.4%**	**29,233**	26.3%	51,996
Canadian dividend income not subject to tax	**(4.6%)**	**(5,053)**	(2.1%)	(4,173)
Effect of change in tax rates	**0.0%**	**(28)**	(0.4%)	(780)
Non-deductible expenses	**0.3%**	**358**	0.2%	480
Rate differential on recognized gains on AFS equity instruments	**(0.3%)**	**(331)**	0.2%	283
Other	**(1.1%)**	**(1,198)**	(0.6%)	(1,121)
Income tax expense recorded in net income	**20.7%**	**22,981**	23.6%	46,685

(in thousands of dollars)	2013	2012
Current income taxes	**16,555**	43,900
Deferred income taxes	**6,426**	2,785
Income tax expense	**22,981**	46,685

In fiscal 2013, the statutory tax rate changed to 26.4% due to changes in the provincial tax rates for corporations.

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

(in thousands of dollars)	2013	2012
Income taxes related to current year	**18,945**	45,035
Income taxes related to prior years	**(2,390)**	(1,135)
	16,555	43,900

Income taxes included in OCI are as follows:

(in thousands of dollars)	2013	2012
Items that may be reclassified subsequently to net income		
Net unrealized gains on AFS investments	**6,992**	12,927
Reclassification to net income of net recognized gains on AFS investments	**(1,568)**	(6,980)
	5,424	5,947
Items that will not be reclassified subsequently to net income		
Post-employment benefit obligation gain (loss)	**2,575**	(1,651)
Income tax expense	**7,999**	4,296

(b) Deferred income taxes

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

(in thousands of dollars)	2013	2012
Relating to origination and reversal of temporary differences	**6,454**	3,565
Changes in tax rates, tax regulations and assessments	**(28)**	(780)
	6,426	2,785

The components comprising deferred income tax assets are as follows:

(in thousands of dollars)	2013	2012
Net claim liabilities	**29,164**	28,498
Post-employment benefit plans	**7,886**	18,656
DPAE	**9,225**	8,377
Property and equipment	**(5,768)**	(4,672)
Investments	**(56)**	(124)
Other	**3,396**	2,113
	43,847	52,848

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

(in thousands of dollars)	2013	2012
Net claim liabilities	**(666)**	482
Post-employment benefit plans	**8,195**	3,132
DPAE	**(848)**	208
Property and equipment	**1,096**	(571)
Investments	**(68)**	(220)
Other	**(1,283)**	(246)
	6,426	2,785

13. 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)	2013	2012
Goodwill	**26,925**	26,925
Intangible assets	**41,117**	46,987
	68,042	73,912

(a) Goodwill

(in thousands of dollars)	2013	2012
Cost		
Balance, beginning of year	**65,290**	67,314
Disposals	**-**	(2,024)
Balance, end of year	**65,290**	65,290
Accumulated impairment		
Balance, beginning of year	**38,365**	38,365
Balance, end of year	**38,365**	38,365
Net book value, end of year	**26,925**	26,925

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)	2013	2012
Economical Mutual Insurance Company	**24,526**	24,526
Westmount Financial Inc.	**2,399**	2,399
	26,925	26,925

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% (2012: 2.0%) does not exceed the historic long-term average growth rate.
- A pre-tax, market adjusted discount rate of 11.0% (2012: 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 (2012: nil).

(b) Intangible assets

(in thousands of dollars)	2013		
	Software	Other intangible assets	Total
Cost			
Balance, beginning of year	**64,510**	**-**	**64,510**
Additions	**2,644**	**-**	**2,644**
Disposals	**(141)**	**-**	**(141)**
Impairment charge	**(2,759)**	**-**	**(2,759)**
Balance, end of year	**64,254**	**-**	**64,254**
Accumulated amortization			
Balance, beginning of the year	**17,523**	**-**	**17,523**
Amortization expense	**5,754**	**-**	**5,754**
Amortization on disposals	**(140)**	**-**	**(140)**
Balance, end of year	**23,137**	**-**	**23,137**
Net book value, end of year	**41,117**	**-**	**41,117**

(in thousands of dollars)	2012		
	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

Included in software is $1.4 million (2012: $3.0 million) that has not yet commenced being amortized as it is still under development.

14. OTHER ASSETS

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

(in thousands of dollars)	Notes	2013	2012
Investments in associates	15	**15,429**	14,848
Pension asset	18	**24,497**	-
Prepaid expenses		**4,895**	2,487
Other		**1,497**	1,773
		46,318	19,108

15. INVESTMENTS IN ASSOCIATES

The company has only immaterial associates. Key financial information about the company's investments in immaterial associates is shown below, in aggregate:

(in thousands of dollars)	2013	2012
Total assets	**203,365**	208,846
Total liabilities	**151,298**	157,683
Total revenue	**27,615**	25,222
Total net income	**1,427**	2,262

The company's share of the results of operations of individually immaterial associates is as follows:

(in thousands of dollars)	2013	2012
Total net income	**241**	558
Total other comprehensive income (loss)	**30**	(166)
Total comprehensive income	**271**	392

Impairment testing for the company's investments in associates determined that an impairment loss was not required (2012: nil).

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.

16. 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	2013	2012
Pension and non-pension benefit obligations	18	**54,530**	68,512
Commissions payable		**60,560**	61,801
Premium taxes and other taxes payable		**13,727**	13,765
Accounts payable and other		**34,031**	46,353
Restructuring provision	23	**10,740**	5,172
		173,588	195,603

17. PREMIUMS

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

(in thousands of dollars)	2013	2012
Direct premiums written	**1,907,265**	1,809,807
Premiums assumed from other companies	**11,921**	9,896
Gross premiums written	**1,919,186**	1,819,703
Premiums ceded to other companies	**(115,600)**	(96,047)
Net premiums written	**1,803,586**	1,723,656

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

(in thousands of dollars)	2013	2012
Net premiums written	**1,803,586**	1,723,656
Change in gross unearned premiums	**(38,749)**	(56,038)
Change in ceded unearned premiums	**4,358**	(1,600)
Net premiums earned	**1,769,195**	1,666,018

18. 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.

Previously, ad hoc, discretionary indexation increases were granted to retirees in the defined benefit pension plans. Effective December 31, 2013, no further ad hoc increases are expected to be granted in the foreseeable future. The effect of this change resulted in a negative past service cost being recognized, resulting in a reduction to the benefit obligation and the net period cost of $20.5 million for 2013. The reduction in the net period cost was recognized in "Other income."

During the year, the company continued its business transformation program which resulted in further employee separations, the cumulative impact of which triggered a plan curtailment. The effect of the curtailment was a reduction in the defined benefit pension obligation of $4.7 million and a reduction in the other post-employment benefit obligation of $1.4 million. This resulted in a reduction in the net period cost of $6.1 million for 2013, which was recognized within "Other income."

During 2012, 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 was a reduction to the other post-employment benefit obligation and the net period cost of $16.5 million for 2012.

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 pension actuaries. The company's funding policy is to make contributions in amounts that are required to discharge the benefit obligations over the life of the plan. Discretionary pension contributions for the year ended December 31, 2013 were nil (2012: nil). 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 $9.9 million in 2014. The contributions are expected to be made via a combination of cash and the utilization of available prior year credit balances. The plans are regulated by the Financial Services Commission of Ontario.

Plan assets associated with the pension plans are funded pursuant to a trust agreement through a trust company as selected by the company. Ultimate responsibility for governance of the plan lies with the company's board of directors and specifically with the investment committee, and the human resources and compensation committee. Regular administration duties are delegated to the pension management committee as appropriate.

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 $9.1 million (2012: $9.2 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.

(in thousands of dollars)	2013				
			Present value of benefit plan obligation		Fair value of plan assets
	Amounts recognized in net income	(Gains) losses recognized in OCI	Other benefit plans	Pension plans	Pension plans
Balance, beginning of year			**52,211**	**189,359**	**173,058**
Total service cost	**5,983**	**-**	**1,985**	**3,998**	**-**
Interest cost	**10,585**	**-**	**2,316**	**8,269**	**-**
Interest income	**(2,767)**	**-**	**-**	**-**	**2,767**
Return on plan assets excluding interest income	**(5,188)**	**(11,583)**	**-**	**-**	**16,771**
Past service cost	**(20,529)**	**-**	**-**	**(20,529)**	**-**
Curtailment	**(6,073)**	**-**	**(1,387)**	**(4,686)**	**-**
Actuarial losses (gains)					
Due to changes in demographic assumptions	**(880)**	**12,253**	**1,126**	**10,247**	**-**
Due to changes in financial assumptions	**(187)**	**(10,081)**	**(254)**	**(10,014)**	**-**
Due to experience losses	**-**	**(352)**	**(352)**	**-**	**-**
Settlements	**370**	**-**	**-**	**370**	**-**
Contributions by employer	**-**	**-**	**-**	**-**	**9,746**
Administration cost	**831**	**-**	**-**	**-**	**(831)**
Contributions by plan participants	**-**	**-**	**-**	**541**	**541**
Benefits paid	**-**	**-**	**(1,115)**	**(12,210)**	**(12,210)**
Balance, end of year	**(17,855)**	**(9,763)**	**54,530**	**165,345**	**189,842**

(in thousands of dollars)	2012				
			Present value of benefit plan obligation		Fair value of plan assets
	Amounts recognized in net income	(Gains) losses recognized in OCI	Other benefit plans	Pension plans	Pension plans
Balance, beginning of year			58,693	176,049	158,152
Total service cost	8,422	-	3,536	4,886	-
Interest cost	11,737	-	3,080	8,657	-
Interest income	(2,930)	-	-	-	2,930
Return on plan assets excluding interest income	(4,947)	(4,111)	-	-	9,058
Curtailment	(16,456)	-	(16,456)	-	-
Actuarial losses (gains)					
Due to changes in demographic assumptions	-	(7,233)	(7,233)	-	-
Due to changes in financial assumptions	-	21,579	11,730	9,849	-
Due to experience losses	-	(3,996)	(335)	(3,661)	-
Contributions by employer	-	-	-	-	9,774
Administration cost	435	-	-	-	(435)
Contributions by plan participants	-	-	-	510	510
Benefits paid	-	-	(804)	(6,931)	(6,931)
Balance, end of year	(3,739)	6,239	52,211	189,359	173,058

Of the amounts recognized in net income, $8.7 million (2012: $12.7 million) in expenses were recorded in "Operating expenses" and a curtailment gain of $6.1 million (2012: $16.5 million) and a negative past service cost of $20.5 million (2012: nil) were recorded in "Other income."

The actual return on plan assets was $19.5 million (2012: $11.6 million).

(b) Funding status of defined benefit plans

The amounts recognized for pension plans in the consolidated balance sheet in “Other assets” or “Accounts payable and other liabilities” at the reporting date are as follows:

(in thousands of dollars)	2013	2012	2011	2010
Defined benefit obligation	**(165,345)**	(189,359)	(176,049)	(158,017)
Fair value of plan assets	**189,842**	173,058	158,152	155,510
Net defined benefit asset (obligation)	**24,497**	(16,301)	(17,897)	(2,507)
Actuarial (gains) losses on plan assets	**(11,583)**	(1,802)	7,003	(1,553)
Actuarial losses on plan liabilities	**233**	6,188	9,766	24,043

The amounts recognized for other benefit plans in the consolidated balance sheet in “Accounts payable and other liabilities” at the reporting date are as follows:

(in thousands of dollars)	2013	2012	2011	2010
Defined benefit obligation	**(54,530)**	(52,211)	(58,693)	(51,442)
Actuarial losses on plan liabilities	**520**	4,162	2,322	10,149

The company applied the transitional rules of IFRS 1 permitting comparative information of the amounts recognized for pension plans and other employee benefits to be disclosed prospectively from adoption of IFRS until four comparative periods are presented.

(c) Maturity analysis of defined benefit obligations

The weighted average duration of the pension plan obligation is 15 years (2012: 16 years) and the weighted average duration of the other benefit plans obligation is 17 years (2012: 18 years).

The expected maturity of the defined benefit obligations is as follows:

(in thousands of dollars)	2013				
	Less than 1 year	1 5 years	6 10 years	10 years +	Total
Pension plans	**6,693**	**33,280**	**32,718**	**92,654**	**165,345**
Other benefit plans	**1,566**	**8,021**	**8,946**	**35,997**	**54,530**
	8,259	**41,301**	**41,664**	**128,651**	**219,875**

(in thousands of dollars)	2012				
	Less than 1 year	1 5 years	6 10 years	10 years +	Total
Pension plans	6,111	25,155	33,605	124,488	189,359
Other benefit plans	1,387	7,029	8,276	35,519	52,211
	7,498	32,184	41,881	160,007	241,570

(d) Pension plan asset allocation

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

(in thousands of dollars)	2013		2012	
Cash	**8,160**	**4.3%**	7,037	4.1%
Canadian fixed income securities (investment grade)				
Government of Canada	**24,021**	**12.7**	29,016	16.8
Provincial and municipal	**13,688**	**7.2**	17,888	10.3
Corporate	**26,055**	**13.7**	20,552	11.9
Pooled equity funds				
Canadian	**49,563**	**26.1**	46,779	27.0
Foreign	**61,048**	**32.2**	45,229	26.1
Other	**7,307**	**3.8**	6,557	3.8
	189,842	**100.0%**	173,058	100.0%

The company undertakes an asset-liability study as deemed necessary. The goal of the asset-liability study is to balance the expected long term cost of the plan with the risk tolerance of the company. To achieve this balance, the company’s targeted asset mix is 45% fixed income securities, 30% foreign equities and 25% Canadian equities.

(e) 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	
	2013	**2012**	**2013**	**2012**
To determine benefit obligation, end of year				
Discount rate	**4.9%**	4.6%	**4.8%**	4.5%
Future salary increases	**-**	-	**3.0%**	3.0%
Future pension increases	**-**	-	**0.0%**	1.0%
Inflation assumption	**-**	-	**2.0%**	2.0%
Prescription drug cost increase	**8.8%**	9.0%	**-**	-
Medical claims cost increase	**4.5%**	4.5%	**-**	-
To determine benefit expense for the year				
Discount rate	**4.6%**	5.3%	**4.5%**	5.0%
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%**	9.0%	**-**	-
Medical claims cost increase	**4.5%**	4.5%	**-**	-

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, 2013 are based on 85% (2012: 100%) of the 1994 UP mortality tables as established by the Canadian Institute of Actuaries. The impact of using 85% of the 1994 UP mortality tables resulted in an increase in the obligation and a decrease in the gains recognized in OCI of $10.2 million for the pension plans and $3.4 million for the other benefit plans.

The discount rate is the assumption that has the largest impact on the value of these obligations. The impact of a 1% change in this rate is as follows:

(in thousands of dollars)	2013		2012	
Impact on	**+ 1%**	**- 1%**	+ 1%	- 1%
Defined benefit obligation – pension plans	**(21,843)**	**26,480**	(26,139)	32,878
Defined benefit obligation – other benefit plans	**(7,918)**	**10,052**	(7,587)	9,685

This impact is calculated by performing a calculation of the liabilities as at December 31, 2013 using a discount rate 1% higher or lower than the discount rate used, holding all other assumptions constant.

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

(in thousands of dollars)	2013		2012	
Impact on	**+ 1%**	**- 1%**	+ 1%	- 1%
Defined benefit obligation – other benefit plans	**9,448**	**(7,511)**	8,578	(6,827)
Aggregate of total service cost and interest cost	**821**	**(648)**	762	(599)

This impact is calculated by performing a calculation of the liabilities as at December 31, 2013 using a health care cost 1% higher or lower than the health care cost increase used, holding all other assumptions constant.

(f) Risks arising from post-employment benefits

The key risks to which the company is exposed to as a result of sponsoring the defined benefit pension plans and other post-employment benefit plans are as follows:

(i) Inflation risk – Inflation can increase the cost of benefits provided under post-employment benefits and result in higher benefit obligations. As the return on plan assets is indirectly influenced by inflation, an increase in inflation would not result in a corresponding increase in the value of plan assets.

(ii) Interest rate risk – Changes in interest rates will influence discount rates resulting in an inverse change in benefit obligations. For the defined benefit plan, interest rate changes would also have an inverse change on the fair value fixed income security assets thereby somewhat offsetting the impact of the change in discounting of the benefit obligations.

(iii) Equity market risk – As discussed in note 7, economic trends, the political environment and other factors can positively or adversely impact the equity markets and consequently the value of equity investments held by the defined benefit plan. If equity market returns exceed or lag behind the discount rates, the net defined benefit obligation will be impacted.

(iv) Foreign exchange risk – Changes in foreign exchange rates will impact the fair value of foreign pooled equity funds held by the defined benefit plan. A decrease in the value of foreign currencies relative to the Canadian dollar will decrease the fair value of foreign pooled equity funds, increasing the net defined benefit obligation. An increase in the value of foreign currencies relative to the Canadian dollar will have an inverse effect.

(v) Life expectancy risk – Changes in life expectancy will impact the amount of benefits provided under post-employment benefits resulting in a change in the benefit obligation. An increase in life expectancy will increase the amount of benefits provided under post-employment benefits resulting in an increase in the benefit obligation. A decrease in life expectancy will have an inverse effect.

19. 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 295.2% 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 10, 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.

20. 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 44.0% (2012: 43.2%) 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.

21. 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)	2013	2012
Within 1 year	**16,224**	23,861
Later than 1 year but not later than 5 years	**45,012**	47,214
Later than 5 years	**21,263**	29,590

Operating lease payments included in "Operating expenses" in the consolidated statement of comprehensive income during 2013 were $18.5 million (2012: $21.1 million).

Total future minimum sublease income under non-cancellable subleases amounted to $4.0 million (2012: $2.3 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.

22. DEMUTUALIZATION

On December 14, 2010, the company announced its intention to pursue demutualization, a process which requires, among other things, approval by its mutual policyholders and regulators. 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.

23. RESTRUCTURING EXPENSES

Commencing late in 2012, 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 a two-year period. 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, 2013 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)	2013	2012
Balance, beginning of year	**5,172**	-
Provisions made during the year	**23,417**	11,588
Payments made during the year	**17,849**	6,416
Balance, end of year	**10,740**	5,172

In addition to the above amounts, $14.3 million (2012: $2.1 million) of expenses related to the business transformation program are included in "Operating expenses", as the criteria for classification as restructuring expenses was not met.

24. SUPPLEMENTAL EXPENSE INFORMATION

Included in "Operating expenses" and "Net claims and adjustment expenses" are the following:

(in thousands of dollars)	Notes	2013	2012
Salary and benefit expenses		**184,207**	206,306
Post-employment plan expenses	18	**8,747**	12,717
Occupancy expenses		**16,643**	18,765
		209,597	237,788

25. 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)	2013	2012
Salaries	**3,018**	2,682
Short-term and long-term incentive plans	**5,444**	4,973
Post-employment defined benefit pension benefits	**24**	23
Post-employment defined contribution pension benefits	**260**	251
Other post-employment benefits	**-**	44
Other short-term employment benefits	**113**	154
Directors' fees*	**962**	863
Termination benefits	**-**	181
	9,821	9,171

*Directors' fees disclosed above include fees accrued in respect of all controlled entities in the group.

Directors: One of the company's directors was employed by a publicly traded entity during a portion of the year ended December 31, 2012, in which the company owned common stock with a fair value of $7.2 million as at December 31, 2012. This entity also provided certain services on an arm's-length basis that totalled $0.8 million during 2012. As disclosed in note 7, the company purchases annuities from life insurers. The original purchase price of outstanding annuities purchased as at December 31, 2012 from this entity was $59.8 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 18.

Associates: At the reporting date, commercial loans of $2.0 million (2012: $2.3 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 10), is as follows:

(in thousands of dollars)	Notes	2013	2012
Premiums assumed	17	**3,454**	3,544
Premiums earned	8, 10	**3,396**	3,397
Claims and adjustment expenses	8, 9, 10	**2,054**	2,343
Commissions	10	**1,540**	1,581

Reinsurance assumed assets:

(in thousands of dollars)	Notes	2013	2012
DPAE	10	**643**	588
Reinsurance assumed receivables	9, 10	**303**	370
		946	958

Reinsurance assumed liabilities:

(in thousands of dollars)	Notes	2013	2012
UPR	10	**1,750**	1,693
Claim liabilities	10	**3,296**	2,687
		5,046	4,380

26. 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 included in the insurance segment, with the balance in the broker operations segment.

ec·o·nom·i·cal (ekə'nämikəl)

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

economical®

economical™
SELECT

economical™
FINANCIAL

western general®

perth insurance®
An Economical Insurance Company

FAMILY
INSURANCE SOLUTIONS

BOARD OF DIRECTORS*

John H. Bowey, vice-chair (2, 3, 6)

A. Scott Carson (4, 5) (retired as of January 31, 2014)

Elizabeth L. DelBianco (2, 3)

Barbara H. Fraser (1, 4) (as of December 1, 2013)

Richard M. Freeborough (1, 5, 6)

Karen L. Gavan (4)

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

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

Michael P. Stramaglia (1, 4, 5)

W. David Wilson (4, 5, 6)

COMMITTEES*

1. Audit
2. Corporate governance
3. Human resources and compensation
4. Investment
5. Risk review
6. Special

* as of April 1, 2014, except as noted

EXECUTIVE MANAGEMENT TEAM*

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

Jorge Arruda, B.Comm.
Senior vice-president, sales, distribution and underwriting operations

Ed Berko, B.Sc., MBA
Senior vice-president and chief risk officer

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

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

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

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

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

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

Toomas (Tom) Reikman, B.Sc., MBA, CIP
Senior vice-president and chief operating officer

Chris Van Kooten, FCIA, FCAS
Vice-president, personal insurance, analytics and pricing

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

Aneeta Bains, B.Sc.
Vice-president, information technology

Wayne Edwards, FCAS
Vice-president, corporate actuarial

David Fitzpatrick, BA
Vice-president, Economical Financial™ and division vice-president, Economical Select®

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

Javier Ibañez, BA, M.Ad.Ed
Vice-president, sales and distribution

Pamela Marson, FCIP
Vice-president, underwriting transformation

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

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

Karen Kaminska, FCIP, CRM
Vice-president, Atlantic region

Chris Weber, BA (Hons), MA
Vice-president, Western region

Max Weis, B.Sc., MBA, CFA
Vice-president, corporate development

* as of April 2, 2014