

First Quarter

2018

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Interim Consolidated Financial Statements (unaudited)
For the quarter ended March 31, 2018

Intact Financial Corporation



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INTACT FINANCIAL CORPORATION
Interim Consolidated balance sheets (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

As at	Note	March 31, 2018	December 31, 2017
Assets			
Investments	5		
Cash and cash equivalents		\$ 240	\$ 163
Debt securities		11,041	11,229
Preferred shares		1,325	1,409
Common shares		3,479	3,659
Loans		339	393
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Investments		16,424	16,853
Premium receivables		3,095	3,351
Reinsurance assets	10	813	822
Income taxes receivable		75	24
Deferred tax assets		115	112
Deferred acquisition costs		839	881
Other assets	11	824	782
Investments in associates and joint ventures		556	550
Property and equipment		149	150
Intangible assets		2,170	2,161
Goodwill		2,270	2,242
<hr/>			
Total assets		\$ 27,330	\$ 27,928
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Liabilities			
Claims liabilities	9	\$ 10,567	\$ 10,475
Unearned premiums		5,064	5,365
Financial liabilities related to investments	6	370	246
Income taxes payable		7	262
Deferred tax liabilities		247	257
Other liabilities	11	1,457	1,619
Debt outstanding	12	2,248	2,241
<hr/>			
Total liabilities		19,960	20,465
<hr/>			
Shareholders' equity			
Common shares		2,816	2,816
Preferred shares		783	783
Contributed surplus		131	128
Retained earnings		3,516	3,520
Accumulated other comprehensive income (loss)			
Available-for-sale securities		75	224
Translation of foreign operations, net of hedges		54	(2)
Other		(5)	(6)
<hr/>			
Total liabilities and shareholders' equity		\$ 27,330	\$ 27,928

See accompanying notes to the interim Consolidated financial statements.

INTACT FINANCIAL CORPORATION

Interim Consolidated statements of income (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

For the three-month periods ended March 31,	Note	2018	2017
Direct premiums written		\$ 2,124	\$ 1,731
Premiums ceded		(101)	(49)
Net premiums written		2,023	1,682
Change in unearned premiums		331	315
Net earned premiums		2,354	1,997
Other underwriting revenues		27	28
Investment income	14		
Interest income		83	64
Dividend income		48	50
Other revenues		31	35
Total revenues		2,543	2,174
Net claims incurred	9	(1,599)	(1,399)
Underwriting expenses		(738)	(615)
Investment expenses	14	(9)	(9)
Net gains (losses)	15	5	75
Finance costs		(25)	(19)
Integration and restructuring costs	4	(25)	(4)
Other expenses		(32)	(22)
Income before income taxes		120	181
Income tax expense	16	(17)	(35)
Net income attributable to shareholders		\$ 103	\$ 146
Weighted-average number of common shares outstanding (in millions)	17	139.2	131.0
Earnings per common share, basic and diluted (in dollars)	17	\$ 0.68	\$ 1.08
Dividends paid per common share (in dollars)		\$ 0.70	\$ 0.64

See accompanying notes to the interim Consolidated financial statements.

INTACT FINANCIAL CORPORATION

Interim Consolidated statements of comprehensive income (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

For the three-month periods ended March 31,	Note	2018	2017
Net income attributable to shareholders		\$ 103	\$ 146
Other comprehensive income (loss)			
Available-for-sale securities:			
net changes in unrealized gains (losses)		(141)	143
income tax benefit (expense)		35	(39)
reclassification of net losses (gains)		(53)	(98)
income tax benefit (expense)		10	24
		(149)	30
Foreign exchange gains (losses) on:			
translation of foreign operations		126	-
net investment hedges		(70)	-
		56	-
Other		1	-
Items that may be reclassified subsequently to net income		(92)	30
Net actuarial gains (losses) on employee future benefits	19	-	(21)
income tax benefit (expense)		-	5
Items that will not be reclassified subsequently to net income		-	(16)
Other comprehensive income (loss)		(92)	14
Total comprehensive income attributable to shareholders		\$ 11	\$ 160

See accompanying notes to the interim Consolidated financial statements.

INTACT FINANCIAL CORPORATION
Interim Consolidated statements of changes in shareholders' equity (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

	Common shares	Preferred shares	Contributed surplus	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance as at January 1, 2018	\$ 2,816	\$ 783	\$ 128	\$ 3,520	\$ 216	\$ 7,463
Net income attributable to shareholders	-	-	-	103	-	103
Other comprehensive income (loss)	-	-	-	-	(92)	(92)
Total comprehensive income (loss)	-	-	-	103	(92)	11
Dividends declared on:						
common shares	-	-	-	(98)	-	(98)
preferred shares	-	-	-	(8)	-	(8)
Share-based payments	-	-	3	(1)	-	2
Balance as at March 31, 2018	\$ 2,816	\$ 783	\$ 131	\$ 3,516	\$ 124	\$ 7,370
Balance as at January 1, 2017	\$ 2,082	\$ 489	\$ 129	\$ 3,197	\$ 191	\$ 6,088
Net income attributable to shareholders	-	-	-	146	-	146
Other comprehensive income (loss)	-	-	-	(16)	30	14
Total comprehensive income (loss)	-	-	-	130	30	160
Common shares repurchased for cancellation	(1)	-	-	(4)	-	(5)
Dividends declared on:						
common shares	-	-	-	(84)	-	(84)
preferred shares	-	-	-	(5)	-	(5)
Share-based payments	-	-	(4)	(2)	-	(6)
Acquisition of non-controlling interests	-	-	-	(7)	-	(7)
Balance as at March 31, 2017	\$ 2,081	\$ 489	\$ 125	\$ 3,225	\$ 221	\$ 6,141

See accompanying notes to the interim Consolidated financial statements.

INTACT FINANCIAL CORPORATION
Interim Consolidated statements of cash flows (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

For the three-month periods ended March 31,	Note	2018	2017
Operating activities			
Income before income taxes		\$ 120	\$ 181
Income tax received (paid), net		(291)	4
Contributions to the defined benefit pension plans		(14)	(15)
Share-based payments		(1)	(1)
Net losses (gains)	15	(5)	(75)
Adjustments for non-cash items	21	75	48
Changes in other operating assets and liabilities	21	(204)	(230)
Changes in net claims liabilities	9	73	71
Net cash flows used in operating activities		(247)	(17)
Investing activities			
Proceeds from sale of investments		5,682	2,801
Purchases of investments		(5,221)	(2,701)
Purchases of brokerages and other equity investments, net		(3)	(34)
Purchases of intangibles and property and equipment, net		(22)	(25)
Net cash flows provided by investing activities		436	41
Financing activities			
Amount borrowed (repaid) on the credit facility	12	(2)	-
Common shares repurchased for cancellation		-	(5)
Common shares repurchased for share-based payments		(8)	(10)
Dividends paid on common shares		(98)	(84)
Dividends paid on preferred shares		(8)	(5)
Net cash flows used in financing activities		(116)	(104)
Net increase (decrease) in cash and cash equivalents		73	(80)
Cash and cash equivalents, beginning of period		163	168
Exchange rate differences on cash and cash equivalents		4	-
Cash and cash equivalents, end of period		\$ 240	\$ 88
Composition of cash and cash equivalents			
Cash		132	87
Cash equivalents		108	1
Cash and cash equivalents, end of period		\$ 240	\$ 88
Other relevant cash flow disclosures – operating activities			
Interest paid		22	22
Interest received		66	45
Dividends received		52	53

See accompanying notes to the interim Consolidated financial statements.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Glossary of abbreviations

AFS	Available for sale	LTIP	Long-term incentive plan
AMF	Autorité des marchés financiers	MBS	Mortgage-backed securities
CAD	Canadian Dollar	MCT	Minimum capital test
CALs	Company action levels	MD&A	Management's Discussion and Analysis
DSU	Deferred share unit	MYA	Market yield adjustment
EPS	Earnings per share to common shareholders	NEP	Net earned premiums
ESPP	Employee share purchase plan	OCI	Other comprehensive income
FVTPL	Fair value through profit and loss	OSFI	Office of the Superintendent of Financial Institutions
IASB	International Accounting Standards Board	P&C	Property and casualty
IBNR	Insurance claims incurred but not yet reported by policyholders	RBC	Risk-based capital
IFRS	International Financial Reporting Standards	U.S.	United States
JV	Joint ventures	USD	U.S. Dollar

Note 1 – Status of the Company

Intact Financial Corporation (the “Company”), incorporated under the *Canada Business Corporations Act*, is domiciled in Canada and its shares are publicly traded on the Toronto Stock Exchange (TSX: IFC). The Company has investments in wholly-owned subsidiaries which operate principally in the Canadian P&C insurance market as well as offering specialty insurance products to small and midsize businesses in the United States. The Company, through its operating subsidiaries, principally underwrites automobile, home, as well as commercial P&C contracts to individuals and businesses. On September 28, 2017, the Company acquired all of the issued and outstanding shares of OneBeacon Insurance Group, Ltd. (“OneBeacon”), a leading U.S. specialty insurer. Further details of the acquisition are provided in *Note 4 – Business combination*.

These interim Consolidated Financial Statements include the accounts of the Company and its subsidiaries.

The registered office of the Company is 700 University Avenue, Toronto, Canada.

Note 2 – Basis of presentation

2.1 Statement of compliance

These interim Consolidated financial statements are prepared in accordance with International Accounting Standards 34 – *Interim Financial Reporting*. These interim Consolidated financial statements and the accompanying notes were authorized for issue in accordance with a resolution of the Board of Directors on May 8, 2018.

2.2 Preparation and presentation of financial statements

These interim Consolidated financial statements are condensed financial statements and should be read in conjunction with the Company's Consolidated financial statements for the year ended December 31, 2017.

The Company presents its Consolidated balance sheets broadly in order of liquidity. Certain comparative figures have been reclassified to conform to the presentation adopted in the current year.

2.3 Seasonality

The P&C insurance business is seasonal in nature. While net premiums earned are generally stable from quarter to quarter, underwriting results are driven mainly by weather conditions which may vary significantly between quarters.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

2.4 Foreign currency translation

Table 2.1 – Exchange rates used in the preparation of the interim consolidated financial statements

	As at		Average rate for the three-month periods ended	
	March 31, 2018	December 31, 2017	March 31, 2018	March 31, 2017
USD vs CAD	1.28940	1.25730	1.26485	1.32391

Note 3 – Summary of significant accounting policies

The accounting policies applied during the three-month period ended March 31, 2018, are the same as those described and disclosed in Note 2 – *Summary of significant accounting policies* of the Consolidated financial statements for the year ended December 31, 2017. In addition, on January 1, 2018, the Company has adopted the following new standards and amendments to existing standards:

Amendments to IFRS 4 – *Insurance Contracts* for the application of IFRS 9 – *Financial Instruments*

The Company has adopted the amendments to IFRS 4 – *Insurance Contracts* (“IFRS 4”) that address concerns of insurers about the different effective dates for IFRS 9 – *Financial Instruments* (“IFRS 9”) and IFRS 17, the new insurance contracts standard. The amendments allow insurance entities to elect one of the two following options:

- the deferral approach provides entities whose predominant activities are to issue contracts within the scope of IFRS 4, a temporary exemption to continue using IAS 39, instead of IFRS 9 until January 1, 2021 (the “deferral approach”).
- the overlay approach can be applied to eligible financial assets and provides an option for all issuers of insurance contracts to reclassify from profit or loss to OCI any additional accounting volatility that may arise from applying IFRS 9 before the new insurance contracts standard.

The Company has opted for the deferral approach and performed an assessment as at September 30, 2017, considering OneBeacon’s acquisition (*see Note 4 – Business combinations*). The Company concluded that its activities are predominantly connected with insurance, since the percentage of liabilities connected with insurance contracts over total liabilities is above the 80% threshold.

Therefore, the Company applies the temporary exemption and will continue to apply IAS 39 to its financial assets until January 1, 2021.

IFRS 15 – *Revenue from contracts with customers*

The Company has adopted the new IFRS 15 – *Revenue from Contracts with Customers* (“IFRS 15”). The standard supersedes IAS 18 – *Revenue*, IAS 11 – *Construction Contracts*, and a number of revenue-related interpretations. This new standard specifies how and when to recognize revenue and additional relevant disclosure requirements. IFRS 15 applies to nearly all contracts with customers, except for insurance contracts, financial instruments and leases.

IFRS 15 only applies to the Company’s Other revenues and its adoption had no impact on the interim Consolidated financial statements.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 4 – Business combination

4.1 OneBeacon

On September 28, 2017, the Company completed the acquisition of OneBeacon, a leading U.S. specialty insurer, for a cash consideration of US\$1.7 billion (\$2.3 billion). OneBeacon became a wholly owned subsidiary of the Company and the results of operations are included in the Consolidated financial statements from that date.

The following table summarizes the consideration paid for OneBeacon, and the amounts recognized for the assets acquired and liabilities assumed (determined in accordance with IFRS) as at the acquisition date.

Table 4.1 – Business combination – OneBeacon

As at March 31, 2018	USD	CAD
Purchase price		
Cash consideration paid	1,702	2,128
Purchase price hedge	-	200
Total purchase price	1,702	2,328
Provisional fair value of assets acquired and liabilities assumed		
Investments ¹	2,706	3,383
Premium receivables	275	343
Reinsurance assets	287	358
Distribution networks and other intangibles	626	782
Other assets	379	474
Claims liabilities	(1,630)	(2,038)
Unearned premiums	(650)	(813)
Deferred tax liabilities	(35)	(43)
Debt outstanding	(292)	(364)
Other liabilities	(431)	(538)
Total identifiable net assets	1,235	1,544
Goodwill	467	784
Exchange rate (CAD/USD) as at the acquisition date		1.25030

¹ Included net cash acquired of US\$151 million.

As at March 31, 2018, the fair value of the acquired distribution networks, trade names and other intangible assets are based on a preliminary discounted cash flow analysis. The distribution networks are amortized over a 20 year period. The fair value of the claims liabilities reflected the impact of discounting and risk margin. Goodwill reflects the quality of the acquired business and the synergies expected following the integration of OneBeacon. The goodwill is not deductible for tax purposes. The final determination of the fair value of identifiable assets and liabilities acquired will be completed within the prescribed period of one year following the acquisition.

The integration costs in connection with the acquisition of OneBeacon are reported in Integration and restructuring costs in the interim Consolidated Statements of income.

The Company has hedged the purchase price and book value exposure associated with CAD/USD exchange rate fluctuations.

INTACT FINANCIAL CORPORATION
Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 5 – Investments
5.1 Classification of investments

Table 5.1 – Classification of investments

As at	Fair value			Amortized cost	Total carrying amount
	AFS	Classified as FVTPL	Designated as FVTPL	Cash and cash equivalents, and loans	
March 31, 2018					
Cash and cash equivalents¹	-	-	-	240	240
Short-term notes	109	28	-	-	137
Fixed income					
Investment grade					
Government	1,826	-	3,342	-	5,168
Corporate	1,596	-	2,174	-	3,770
Asset backed ²	375	-	312	-	687
Mortgage backed					
Agency ³	137	-	376	-	513
Non agency	196	-	318	-	514
Below investment grade					
Corporate	2	96	15	-	113
Non rated ⁴	139	-	-	-	139
Debt securities	4,380	124	6,537	-	11,041
Investment grade					
Retractable	24	-	-	-	24
Fixed-rate perpetual	269	-	-	-	269
Other perpetual	1,032	-	-	-	1,032
Preferred shares	1,325	-	-	-	1,325
Common shares	2,375	145	959	-	3,479
Loans	-	-	-	339	339
	8,080	269	7,496	579	16,424
December 31, 2017					
Cash and cash equivalents¹	-	-	-	163	163
Short-term notes	120	97	-	-	217
Fixed income					
Investment grade					
Government	1,775	-	3,432	-	5,207
Corporate	1,505	-	2,368	-	3,873
Asset backed ²	500	-	487	-	987
Mortgage backed					
Agency ³	90	-	250	-	340
Non agency	109	-	218	-	327
Below investment grade					
Corporate	-	99	18	-	117
Mortgage backed – non agency	-	-	7	-	7
Non rated ⁴	122	-	32	-	154
Debt securities	4,221	196	6,812	-	11,229
Investment grade					
Retractable	24	-	-	-	24
Fixed-rate perpetual	285	-	-	-	285
Other perpetual	1,100	-	-	-	1,100
Preferred shares	1,409	-	-	-	1,409
Common shares	2,272	357	1,030	-	3,659
Loans	-	-	-	393	393
	7,902	553	7,842	556	16,853

¹ Cash equivalents consist of treasury bills.

² Consist of credit card receivables and auto loans.

³ Consist of publicly traded MBS, which carry the full faith and credit guarantee of the U.S. government or are guaranteed by a government sponsored entity.

⁴ Included \$40 million of MBS as at December 31, 2017 and nil as at March 31, 2018.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

5.2 Carrying value of investments

Table 5.2 – Carrying value of investments

As at	FVTPL investments	Amortized cost	Unrealized gains	Unrealized losses	Other investments	Total investments
	Carrying value				Carrying value	Carrying value
March 31, 2018						
Cash and cash equivalents	-	240	-	-	240	240
Debt securities	6,661	4,378	32	(30)	4,380	11,041
Preferred shares	-	1,261	84	(20)	1,325	1,325
Common shares	1,104	2,321	136	(82)	2,375	3,479
Loans	-	339	-	-	339	339
	7,765	8,539	252	(132)	8,659	16,424
December 31, 2017						
Cash and cash equivalents	-	163	-	-	163	163
Debt securities	7,008	4,199	43	(21)	4,221	11,229
Preferred shares	-	1,330	95	(16)	1,409	1,409
Common shares	1,387	2,060	263	(51)	2,272	3,659
Loans	-	393	-	-	393	393
	8,395	8,145	401	(88)	8,458	16,853

As at March 31, 2018, approximately 91% of the fixed-income securities were rated 'A-' or better and 80% of the preferred shares were highly-rated with at least a 'P2L' credit rating (December 31, 2017 – 90% and 79% respectively).

5.3 Market neutral equity investment strategy

Table 5.3 – Market neutral equity investment strategy

As at	March 31, 2018		December 31, 2017	
	Fair value	Collateral	Fair value	Collateral
Long positions – common shares	121	-	121	-
Short positions (Table 6.1)	(121)	121	(122)	126

Note 6 – Financial liabilities related to investments

Table 6.1 – Financial liabilities related to investments

As at	March 31, 2018	December 31, 2017
Equities sold short positions (Table 5.3)	121	122
Accounts payable to investment brokers on unsettled trades	112	24
Embedded derivatives	72	79
Derivative financial liabilities (Table 7.1)	65	21
	370	246

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 7 – Derivative financial instruments

7.1 Fair value and notional amount of derivatives

The Company uses derivatives for economic hedging purposes and for the purpose of improving the risk profile of its investment portfolio, as long as the resulting exposures remain within the guidelines of its investment policy. In certain circumstances, these hedges also meet the requirements for hedge accounting. Risk management strategies eligible for hedge accounting have been designated as net investment hedges in foreign operations.

Table 7.1 – Fair value and notional amount of derivatives by nature of risk

As at	March 31, 2018			December 31, 2017		
	Notional amount	Fair value		Notional amount	Fair value	
		Asset	Liability		Asset	Liability
Foreign currency contracts¹						
Forwards	1,779	6	64	1,852	8	13
Interest rate contracts						
Futures and forwards	1,269	-	-	1,317	-	-
Equity contracts						
Swap agreements	952	14	1	1,022	-	8
Futures	169	-	-	247	-	-
Inflation options						
Options	60	-	-	63	-	-
	4,229	20	65	4,501	8	21
Held for risk management purposes	4,141	20	65	4,337	8	21
Held for trading purposes	88	-	-	164	-	-
	4,229	20	65	4,501	8	21
Term to maturity:						
less than one year	4,216			4,279		
from one to five years	13			222		
	4,229			4,501		

¹ Includes net investment hedges of foreign subsidiaries.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 8 – Fair value measurement

8.1 Categorization of fair values

Table 8.1 – Fair value hierarchy of financial assets and financial liabilities measured at fair value

As at	Level 1 Valued using quoted (unadjusted) market prices	Level 2 Valued using models (with observable inputs)	Level 3 Valued using models (without observable inputs)	Total
March 31, 2018				
Short-term notes	131	6	-	137
Fixed income				
Investment grade				
Government	2,841	2,327	-	5,168
Corporate	-	3,770	-	3,770
Asset backed	-	687	-	687
Mortgage backed				
Agency	-	513	-	513
Non agency	-	514	-	514
Below investment grade				
Corporate	-	113	-	113
Non rated	-	-	139	139
Debt securities	2,972	7,930	139	11,041
Preferred shares	1,253	-	72	1,325
Common shares	3,452	-	27	3,479
Derivative financial assets (Table 7.1)	-	20	-	20
Total financial assets measured at fair value	7,677	7,950	238	15,865
Total financial liabilities measured at fair value	121	65	72	258
December 31, 2017				
Short-term notes	217	-	-	217
Fixed income				
Investment grade				
Government	2,902	2,305	-	5,207
Corporate	-	3,873	-	3,873
Asset backed	-	987	-	987
Mortgage backed				
Agency	-	340	-	340
Non agency	-	327	-	327
Below investment grade				
Corporate	-	117	-	117
Mortgage backed – non agency	-	7	-	7
Non rated	-	43	111	154
Debt securities	3,119	7,999	111	11,229
Preferred shares	1,330	-	79	1,409
Common shares	3,595	35	29	3,659
Derivative financial assets (Table 7.1)	-	8	-	8
Total financial assets measured at fair value	8,044	8,042	219	16,305
Total financial liabilities measured at fair value	122	21	79	222

The fair value of loans presented at amortized cost was \$329 million as at March 31, 2018 (December 31, 2017 – \$384 million).

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 9 – Claims liabilities

Claims liabilities are established to reflect the estimate of the full amount of all liabilities associated with the insurance contracts earned at the balance sheet date, including IBNR, that have occurred on or before the balance sheet date. The ultimate amount 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 insurance claims incurred. To recognize the uncertainty in establishing this best estimate, to allow for possible deterioration in experience and to provide greater comfort that the actuarial liabilities are sufficient to pay future benefits, actuaries are required to include margins in some assumptions.

9.1 Movements in claims liabilities

Table 9.1 – Movements in claims liabilities

For the three-month periods ended	Direct	Ceded	Net
March 31, 2018			
Balance, beginning of period	10,475	729	9,746
Current period claims	1,743	26	1,717
Unfavourable (favourable) prior year claims development	(72)	(6)	(66)
Increase (decrease) due to changes in discount rate	(56)	(4)	(52)
Total claims incurred	1,615	16	1,599
Claims paid	(1,575)	(49)	(1,526)
Exchange rate differences	52	11	41
Balance, end of period	10,567	707	9,860
March 31, 2017			
Balance, beginning of period	8,536	465	8,071
Current period claims	1,497	29	1,468
Unfavourable (favourable) prior year claims development	(90)	(7)	(83)
Increase (decrease) due to changes in discount rate	14	-	14
Total claims incurred	1,421	22	1,399
Claims paid	(1,358)	(30)	(1,328)
Balance, end of period	8,599	457	8,142

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 10 – Reinsurance

10.1 Company's reinsurance net retention and coverage limits by nature of risk

In the ordinary course of business, the Company reinsures certain risks with other reinsurers to limit its maximum loss in the event of catastrophic events or other significant losses. The following table shows the Company's reinsurance net retention and coverage limits by nature of risk.

Canadian operations

Table 10.1 – Company's reinsurance net retention and coverage limits by nature of risk

As at	March 31, 2018	December 31, 2017
Single risk events		
Retentions:		
on property policies	7.5	7.5
on liability policies	3 - 10	3 - 10
Multi-risk events and catastrophes		
Retention	100	100
Coverage limits	3,687	3,600

For certain special classes of business or types of risks, the retention for single risk events may be lower through specific treaties or the use of facultative reinsurance. For multi-risk events and catastrophes, the Company retains participations averaging 5.6% as at March 31, 2018 (December 31, 2017 – 5.1%) on reinsurance layers between the retention and coverage limit. The coverage limit prudently exceeds the Company's risk assessment of an earthquake in Western Canada at a 1-in-500 year return period.

U.S. operations

The Company's U.S. operations are covered by their own reinsurance program for single risk events but also for multi-risk events and catastrophes. Under the property catastrophe reinsurance program, the first US\$20 million of losses resulting from any single catastrophe are retained, with the coverage limit for the next US\$110 million of losses being entirely reinsured. In addition to the corporate catastrophe reinsurance protection, the Company also purchases dedicated reinsurance protection for certain lines of business. Among these, the retention for single risk events is US\$3 million on property policies and main liability policies.

In connection with the acquisition of OneBeacon, the Company entered into a reinsurance contract pursuant to which a major reinsurer will assume 80% of negative reserve development with respect to OneBeacon's claims liabilities for accident years 2016 and prior. The maximum amount recoverable under the reinsurance agreement is US\$200 million and is subject to some exclusions and limitations.

10.2 Components of reinsurance assets

Table 10.2 – Components of reinsurance assets

As at	March 31, 2018	December 31, 2017
Reinsurers' share of claims liabilities (<i>Table 9.1</i>)	707	729
Reinsurers' share of unearned premiums	106	93
	813	822

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 11 – Other assets and other liabilities

11.1 Other assets

Table 11.1 – Components of other assets

As at	March 31, 2018	December 31, 2017
Restricted funds	105	111
Industry pools receivable	102	100
Guaranteed loan ¹	100	96
Other receivables and recoverables	98	112
Accrued investment income	91	76
Financial assets related to investments	73	34
Prepays	55	43
Investments, at cost	54	54
Reinsurance receivable	53	60
Premium and sale taxes receivable	41	38
Pension plans in a surplus position	2	5
Other	50	53
	824	782

¹ Recorded at fair value based on a discounted cash flow model using information as of the measurement date and classified in Level 3 of the fair value hierarchy.

During the three-month period ended March 31, 2018, there were no events or changes in circumstances that indicated that the carrying values of Investments at cost may not be recoverable.

11.2 Other liabilities

Table 11.2 – Components of other liabilities

As at	March 31, 2018	December 31, 2017
Deposits received in connection with insurance contracts ¹	244	197
Accrued salaries and other short-term benefits	169	177
Premium and sale taxes payable	147	233
Pension plans in a deficit position and unfunded plans	144	140
Account payables and accrued expenses	130	175
Commissions payable	112	199
Industry pools payable	98	99
Other post-employment benefits and other post-retirement benefits	53	52
Deposits received from reinsurers	20	25
Other payables and other liabilities	340	322
	1,457	1,619

¹ Unrestricted collateral held by the Company primarily in relation with the surety business.

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Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 12 – Debt outstanding

12.1 Summary of debt outstanding

Table 12.1 – Carrying value of debt outstanding

As at	Maturity date	Initial term (years)	Fixed rate	Coupon (payment)	Principal amount	Carrying value (net of fees)	
						March 31, 2018	December 31, 2017
Term notes							
Series 1	Sept. 2019	10	5.41%	Mar. & Sept.	250	250	250
Series 2	Nov. 2039	30	6.40%	May & Nov.	250	248	248
Series 3	July 2061	50	6.20%	Jan. & July	100	99	99
Series 4	Aug. 2021	10	4.70%	Feb. & Aug.	300	299	299
Series 5	June 2042	30	5.16%	June & Dec.	250	249	249
Series 6	Mar. 2026	10	3.77%	Mar. & Sept.	250	249	249
Series 7	June 2027	10	2.85%	June & Dec.	425	422	422
2012 U.S. Senior Notes	Nov. 2022	10	4.60%	May & Nov.	USD 275	374	365
Credit facility						58	60
						2,248	2,241

The term notes are accounted for at amortized cost which equals their carrying value. They may be redeemed at the option of the issuer, in whole or in part at any time, at a redemption price equal to the greater of a value calculated using the yield on Government of Canada bonds at the date of redemption plus a margin or their par value.

Fair value of debt outstanding amounted to \$2,448 million as at March 31, 2018 (December 31, 2017 – \$2,449 million) and was established using valuation data from a benchmark firm. As at March 31, 2018, the Company was in compliance with all debt covenants.

Note 13 – Capital management

13.1 Capital management objectives

The Company's objectives when managing capital consist of:

- maintaining strong regulatory capital levels (see Regulatory capital section below), while ensuring policyholders are well protected; and
- maximizing long-term shareholder value by optimizing capital used to operate and grow the Company.

The Company seeks to maintain adequate capital margin to ensure the probability of breaching the regulatory minimum requirements is very low. Such levels may vary over time depending on the Company's evaluation of risks and their potential impact on capital. The Company also keeps higher levels of capital margin when it foresees growth or actionable opportunities in the near term. Furthermore, the Company may return capital to shareholders through annual dividend increases and, when appropriate, through share buybacks.

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Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Regulatory capital

The amount of capital deployed in any particular company or country is dependent upon local regulatory requirements, as well as the Company's internal assessment of capital requirements in the context of its risk profiles, requirements and strategic plans. The Company's practice is to maintain the capitalization of its regulated operating subsidiaries at a level that will exceed the relevant minimum regulatory capital requirements in the jurisdictions in which they operate (referred to as regulator supervisory minimum levels). Regulatory capital guidelines change from time to time and may impact the Company's capital levels. The Company carefully monitors all changes, actual or proposed.

Canada	The Company's federally chartered Canadian P&C insurance subsidiaries are subject to the regulatory capital requirements defined by OSFI and the Insurance Companies Act, while its Québec provincially chartered subsidiaries are subject to the requirements of the AMF and the Act respecting insurance. Federal and Québec regulated P&C insurers are required, at a minimum, to maintain a MCT ratio of 100%. OSFI and the AMF have also established a regulator supervisory target capital ratio of 150%, which provides a cushion above the minimum requirement.
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U.S.	The Company's U.S. insurance operations are subject to regulation and supervision in each of the states where they are domiciled and licensed to conduct business. State insurance departments have established the insurer solvency laws and regulatory infrastructure to maintain accredited status with the National Association of Insurance Commissioners ("NAIC"). A key solvency-driven NAIC accreditation requirement is a state's adoption of RBC requirements. Dividends from our major U.S. insurance subsidiary are subject to the New York Regulator's prior approval for a two year period ending September 30, 2019.
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13.2 Capital position

As at March 31, 2018, and December 31, 2017, all the Company's regulated P&C insurance subsidiaries were well capitalized on an individual basis with capital levels well in excess of regulator supervisory minimum levels, as well as CALs. CALs represent the thresholds below which regulator notification is required together with a company action plan to restore capital levels.

Table 13.1 – Estimated aggregate capital position

As at	March 31, 2018			December 31, 2017		
	Canada (MCT)	U.S. (RBC)	IFC Capital margin	Canada (MCT)	U.S. (RBC)	IFC Capital margin
Regulatory capital ratios	201%	411%	-	205%	459%	-
Industry-wide supervisory minimum levels	150%	150%	-	150%	150%	-
CALs	170%	200%	-	170%	200%	-
Capital above CALs (capital margin)	537	404	941	618	438	1,056
Other regulated / unregulated entities ¹	-	-	126	-	-	79
Total capital margin			1,067			1,135

¹ Other regulated entities include Split Rock Insurance, Ltd. (Bermuda) and IB Reinsurance Inc. (Barbados).

U.S. capital levels comprise the RBC levels of OneBeacon's U.S. regulated entities consolidated in Atlantic Specialty Insurance.

IFC total capital margin represents the aggregate of capital in excess of CALs in regulated entities.

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Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 14 – Net investment income

Table 14.1 – Net investment income

For the three-month periods ended March 31,	2018	2017
Interest income from:		
debt securities		
designated or classified as FVTPL	50	38
classified as AFS	27	21
loans and cash and cash equivalents	6	5
Interest income	83	64
Dividend income (expense) from:		
common shares, net		
designated or classified as FVTPL	15	15
classified as AFS	20	21
preferred shares		
classified as AFS	14	16
equities sold short positions	(1)	(2)
Dividend income	48	50
Expenses	(9)	(9)
	122	105

Note 15 – Net gains (losses)

Table 15.1 – Net gains (losses)

For the three-month periods ended March 31,	2018			2017		
Strategies	Fixed income	Equity	Total	Fixed income	Equity	Total
Net gains (losses) from:						
financial instruments:						
designated as FVTPL	(52)	(95)	(147)	3	9	12
classified as FVTPL	(4)	(2)	(6)	-	-	-
classified as AFS	(8)	80	72	2	83	85
	(64)	(17)	(81)	5	92	97
derivatives ¹ :						
swap agreements	-	85	85	-	(18)	(18)
futures	1	15	16	-	(3)	(3)
	1	100	101	-	(21)	(21)
Embedded derivatives	-	(2)	(2)	-	(19)	(19)
Net foreign currency gains (losses), net	-	-	-	-	14	14
Impairment losses from common shares	-	(19)	(19)	-	-	-
	(63)	62	(1)	5	66	71
Other gains (losses) ²			6			4
			5			75

¹ Excluding foreign currency contracts, which are reported in Net foreign currency gains (losses) in the interim Consolidated statements of income.

² Including net gains on investments in associates and joint ventures related to a change in ownership interests.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 16 – Income taxes

16.1 Income tax expense recorded in Net income

Table 16.1 – Components of income tax expense recorded in Net income

For the three-month periods ended March 31,	2018	2017
Current income tax expense		
Current year	15	76
Adjustments to prior years	-	1
Deferred income tax expense (benefit)		
Change related to temporary differences	2	(41)
Adjustments to prior years	-	(1)
	17	35

16.2 Effective income tax rate

The effective income tax rates are different from the combined statutory income tax rates. The interim Consolidated statements of comprehensive income contain items that are non-taxable or non-deductible for income tax purposes, which cause the income tax expense to differ from what it would have been if based on statutory tax rates.

The following table presents the reconciliation of the effective income tax rate to the income tax expense calculated at statutory rates.

Table 16.2 – Effective income tax rate reconciliation

For the three-month periods ended March 31,	2018	2017
Income tax expense calculated at statutory tax rates	26.9%	26.9%
Increase (decrease) in income tax rates resulting from:		
non-taxable dividend income	(7.9)%	(5.1)%
foreign income taxed at different rates	(4.5)%	-
non-taxable income	(2.4)%	(0.8)%
non-taxable gains	(0.1)%	(2.0)%
non-deductible expenses	0.6%	0.5%
non-deductible losses (non-taxable income) from subsidiaries	0.1%	(0.3)%
other	1.5%	0.1%
Effective income tax rate	14.2%	19.3%

Note 17 – Earnings per share

EPS was calculated by dividing the Net income attributable to common shareholders of the Company by the weighted-average number of common shares outstanding during the period. Dilution is not applicable and, therefore, diluted EPS is the same as basic EPS.

Table 17.1 – Earnings per share

For the three-month periods ended March 31,	2018	2017
Net income attributable to shareholders	103	146
Less: dividends declared on preferred shares, net of tax	(8)	(5)
Net income attributable to common shareholders	95	141
Weighted-average number of common shares outstanding (in millions)	139.2	131.0
EPS – basic and diluted (in dollars)	0.68	1.08

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Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 18 – Share-based payments

18.1 Long-term incentive plan

Table 18.1 – Movements in LTIP share units

For the three-month periods ended March 31,	2018 (in units)	2017 (in units)
Outstanding, beginning of period	774,783	702,246
Awarded	196,239	192,469
Net change in estimate of units outstanding	27,369	(43,693)
Units settled	(57,294)	(78,384)
Outstanding, end of period	941,097	772,638

The LTIP expense was \$9 million for the three-month period ended March 31, 2018 (March 31, 2017 - \$1 million).

18.2 Employee share purchase plan

Table 18.2 – Movements in restricted common shares

For the three-month periods ended March 31,	2018 (in units)	2017 (in units)
Outstanding, beginning of period	132,491	145,368
Accrued	34,013	34,577
Awarded and vested	(30,323)	(38,811)
Forfeited	(1,952)	(2,129)
Outstanding, end of period	134,229	139,005

The ESPP expense was \$5 million for the three-month periods ended March 31, 2018 and 2017.

18.3 Deferred share unit

The DSU provision amounted to \$10 million as at March 31, 2018 and December 31, 2017.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 19 – Employee future benefits

19.1 Employee future benefit expense recognized in Net income

Table 19.1 – Employee future benefit expense recognized in Net income

For the three-month periods ended March 31,	2018	2017
Current service cost	19	16
Net interest expense		
Interest expense on defined benefit obligation	19	18
Interest income on plan assets	(18)	(17)
Other	1	1
	21	18

19.2 Actuarial gains (losses) recognized in OCI

Table 19.2 – Actuarial gains (losses) recognized in OCI

For the three-month periods ended March 31,	2018	2017
Re-measurements related to:		
change in discount rate used to determine the benefit obligation	29	(44)
actual return on plan assets	(29)	23
	-	(21)

19.3 Discount rates used

Table 19.3 – Discount rates used

For the three-month periods ended March 31,	2018	2017
To determine the defined benefit obligation as at:		
beginning of period	3.5%	3.8%
end of period	3.6%	3.7%
Increase (decrease) in discount rate	0.1%	(0.1)%
To determine the benefit expense for the periods		
Current service cost	3.6%	3.9%
Interest expense	3.3%	3.3%-3.5%

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Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 20 – Segment information

20.1 Reportable segments

The Company has two reportable segments, in line with its management structure and internal financial reporting which is based on country, as well as nature of activities.

Canada Insurance (“Canada”)

- Underwriting of automobile, home and business insurance contracts to individuals and businesses in Canada distributed through a wide network of brokers and directly to consumers.
- Distribution operations, including the results from the Company’s wholly-owned subsidiary (BrokerLink) and broker affiliates.

U.S. Insurance (“U.S.”)

- Underwriting of specialty contracts to small and midsize businesses in the United States. The Company distributes insurance through independent agencies, brokers, wholesalers and managing general agencies.

Corporate and Other (“Corporate”) consists of centralized investing, treasury and capital management activities, as well as other corporate activities.

20.2 Segment operating performance

Table 20.1 – Segment operating performance¹

For the three-month periods ended March 31,	2018				2017			
	Canada	U.S.	Corporate	Total	Canada	U.S.	Corporate	Total
Operating income								
NEP	2,020	314	-	2,334	1,997	-	-	1,997
Investment income	-	-	131	131	-	-	114	114
Other	29	-	2	31	27	-	8	35
Segment operating revenues	2,049	314	133	2,496	2,024	-	122	2,146
Net claims incurred (before MYA)	(1,432)	(181)	-	(1,613)	(1,381)	-	-	(1,381)
Underwriting expenses ²	(584)	(118)	-	(702)	(581)	-	-	(581)
Investment expenses	-	-	(9)	(9)	-	-	(9)	(9)
Gains (losses)	-	-	-	-	-	-	-	-
Share of profit from invest. in associates & JV	9	-	-	9	8	-	-	8
Finance costs	-	-	(25)	(25)	-	-	(19)	(19)
Other	(14)	-	(3)	(17)	(11)	-	(3)	(14)
PTOI³	28	15	96	139	59	-	91	150
Comprised of:								
underwriting income	4	15	-	19	35	-	-	35
net investment income	-	-	122	122	-	-	105	105
net distribution income	24	-	-	24	24	-	-	24
other income (expense)	-	-	(1)	(1)	-	-	5	5
finance costs	-	-	(25)	(25)	-	-	(19)	(19)

¹ See Table 20.2 for the reconciliation to the interim Consolidated statements of income.

² Other underwriting revenues are netted against underwriting expenses when assessing segment performance.

³ See Section 15 – Non IFRS financial measures of the Company’s interim MD&A for the definition of related operating measures.

INTACT FINANCIAL CORPORATION

Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

All segment operating revenues presented in *Table 20.1 – Segment operating performance* are generated from external customers.

Management measures the profitability of the Company's segments based on pre-tax operating income ("PTOI"). PTOI excludes elements that are not representative of the Company's operating performance because they relate to special items, bear significant volatility from one period to another, or because they are not part of the Company's normal activities.

The reconciliation of the segment information to the amounts reported in the interim Consolidated statements of income is presented in the table below. Other underwriting revenues are netted against underwriting expenses when assessing segment performance for MD&A presentation and, as such, are not included in segment operating revenues. Revenues and expenses not allocated to segments mainly represent non-operating items excluded from PTOI.

Table 20.2 – Reconciliation of segment information to amounts reported in the interim Consolidated statements of income

For the three-month periods ended March 31,	2018	2017
Segment operating revenues (<i>Table 20.1</i>)	2,496	2,146
Add: other underwriting revenues	27	28
Add: NEP exited lines ¹	20	-
Revenues, as reported	2,543	2,174
Segment PTOI (<i>Table 20.1</i>)	139	150
Non-operating items:		
net gains (losses)	5	75
positive (negative) impact on MYA on underwriting	52	(13)
integration and restructuring costs	(25)	(4)
amortization of intangible assets recognized in business combinations	(20)	(12)
difference between expected return and discount rate on pension assets	(12)	(11)
underwriting results from OneBeacon exited lines	(15)	-
other non-operating costs	(4)	(4)
Pre-tax income, as reported	120	181

¹ Consist of the U.S. Commercial's business units Programs, and Architects and Engineers.

20.3 Selected segment assets and liabilities

Table 20.3 – Selected segment assets and liabilities

As at	March 31, 2018				December 31, 2017			
	Canada	U.S.	Corporate	Total	Canada	U.S.	Corporate	Total
Investments	-	-	16,424	16,424	-	-	16,853	16,853
Net claims liabilities (<i>Table 9.1</i>)	8,170	1,690	-	9,860	8,098	1,648	-	9,746

20.4 Information by geographic areas

Table 20.4 – Information by geographic areas

	Revenues		Total assets	
	March 31, 2018	March 31, 2017	March 31, 2018	December 31, 2017
Canada	2,189	2,174	21,188	22,093
U.S.	354	-	6,142	5,835
	2,543	2,174	27,330	27,928

Revenues and assets are allocated based on the country where the risks originate.

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Notes to the interim Consolidated financial statements (unaudited)

(in millions of Canadian dollars, except as otherwise noted)

Note 21 – Additional information on the interim Consolidated statements of cash flows

21.1 Adjustments for non-cash items

Table 21.1 – Adjustments for non-cash items

For the three-month periods ended March 31,	2018	2017
Depreciation of property and equipment	9	8
Amortization of intangible assets	27	17
Net premiums on debt securities classified as AFS	5	2
Defined benefit pension expense	21	18
Share-based payments expense	14	6
Share of profit from investments in associates and joint ventures	(2)	(2)
Other	1	(1)
	75	48

21.2 Changes in other operating assets and liabilities

Table 21.2 – Changes in other operating assets and liabilities

For the three-month periods ended March 31,	2018	2017
Unearned premiums, net	(331)	(315)
Premium receivables, net	264	276
Deferred acquisition costs, net	45	46
Other operating assets	4	(29)
Other operating liabilities	(188)	(212)
Dividends received from investments in associates and joint ventures	2	4
	(204)	(230)

Note 22 – Standards issued but not yet effective

There have been no significant updates to Note 32 – *Standards issued but not yet effective* of Consolidated financial statements for the year ended December 31, 2017, except as described below.

22.1 Plan amendment, curtailment or settlement (amendments to IAS 19 – *Employee Benefits*)

In February 2018, the IASB issued amendments to IAS 19 – *Employee Benefits* (“IAS 19”) to specify how companies determine pension expenses when changes to a defined benefit pension plan occur. A company now uses updated assumptions from the remeasurement of the net defined benefit asset (liability) to determine the current service cost and net interest for the period. Previously, it would not have updated its calculation of these costs until year-end.

The amendments are to be applied prospectively, effective for annual periods beginning on or after January 1, 2019, with earlier application permitted. The Company will not early adopt the amendments to IAS 19.

22.2 Conceptual framework for financial reporting

In March 2018, the IASB issued a comprehensive set of concepts for financial reporting: the revised Conceptual Framework for Financial Reporting (“Conceptual Framework”), which replaces its previous version. It assists companies in developing accounting policies when no IFRS Standard applies to a particular transaction and it helps stakeholders more broadly to better understand the Standards.

The revised Conceptual Framework’s effective date is January 1, 2020, with earlier application permitted. The Company does not expect any impact upon its adoption.