

# Second Quarter 2015

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Management's Discussion and Analysis  
For the quarter ended June 30, 2015

Intact Financial Corporation

# Intact Financial Corporation

## Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

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### Table of contents

Section 1 – Profile .....	3
Section 2 – Overview of our consolidated performance .....	4
Section 3 – Operating results .....	5
Section 4 – Non-operating results .....	10
Section 5 – Non-IFRS financial measures .....	11
Section 6 – Business developments and operating environment .....	13
Section 7 – Strategy and outlook.....	16
Section 8 – Financial condition .....	17
Section 9 – Liquidity and capital resources.....	22
Section 10 – Capital management.....	23
Section 11 – Risk management.....	25
Section 12 – Off-balance sheet arrangements .....	25
Section 13 – Accounting and disclosure matters .....	26
Section 14 – Investor information .....	27
Section 15 – Selected quarterly information .....	28

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

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July 28, 2015

The following MD&A is the responsibility of management and has been reviewed and approved by the Board of Directors for the quarter ended June 30, 2015. This MD&A is intended to enable the reader to assess our results of operations and financial condition for the three- and six-month periods ended June 30, 2015, compared to the corresponding period in 2014. It should be read in conjunction with our interim Consolidated financial statements, as well as the MD&A and the Consolidated financial statements included in our 2014 Annual Report. All amounts herein are expressed in Canadian dollars.

We use both IFRS and non-IFRS measures to assess performance. Non-IFRS measures do not have any standardized meaning prescribed by IFRS and are unlikely to be comparable to any similar measures presented by other companies. See Section 5 – *Non-IFRS financial measures* for the definition and reconciliation to the most comparable IFRS measures. Management analyzes performance based on underwriting ratios such as combined, expense, loss and claims ratios, MCT, and debt-to-capital, as well as other non-IFRS financial measures, namely DPW (underlying), underlying growth, AEPS, NOIPS, ROE, AROE, OROE, NOI, Non-operating results, Underlying current year loss ratio, Cash flow available for investment activities, and Market-based yield. These measures and other insurance-related terms used in this MD&A are defined in the glossary available in the "Investor Relations" section of our web site at [www.intactfc.com](http://www.intactfc.com). Further information about Intact Financial Corporation, including the Annual Information Form, may be found online on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **Cautionary note regarding forward-looking statements**

Certain of the statements included in this MD&A about 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", "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 the Company'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: the Company'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 the Company writes; unfavourable capital market developments or other factors which may affect the Company's investments and funding obligations under its pension plans; the cyclical nature of the P&C insurance industry; management's ability to accurately predict future claims frequency; government regulations designed to protect policyholders and creditors rather than investors; litigation and regulatory actions; periodic negative publicity regarding the insurance industry; intense competition; the Company's reliance on brokers and third parties to sell its products to clients; the Company's ability to successfully pursue its acquisition strategy; the Company's ability to execute its business strategy; the Company's ability to achieve synergies arising from successful integration plans relating to acquisitions including its acquisition of Canadian Direct Insurance Inc. ("CDI"), as well as management's estimates and expectations in relation to resulting accretion, internal rate of return and debt-to-capital ratio; the Company's participation in the Facility Association (a mandatory pooling arrangement among all industry participants) and similar mandated risk-sharing pools; terrorist attacks and ensuing events; the occurrence of catastrophic events; the Company's ability to maintain its financial strength and issuer credit ratings; access to debt financing and the Company's ability to compete for large commercial business; the Company's ability to alleviate risk through reinsurance; the Company's ability to successfully manage credit risk (including credit risk related to the financial health of reinsurers); the Company's reliance on information technology and telecommunications systems and potential disruption to those systems, including evolving cyber attack risk; the Company's dependence on key employees; changes in laws or regulations; general economic, financial and political conditions; the Company's dependence on the results of operations of its subsidiaries; the volatility of the stock market and other factors affecting the Company's share price; and future sales of a substantial number of its common shares.

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 our MD&A for the year ended December 31, 2014. These factors are not intended to represent a complete list of the factors that could affect the Company. These factors should, however, be considered carefully. Although the forward-looking statements are based upon what management believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. When relying on forward-looking statements to make decisions, investors should ensure the preceding information is carefully considered. Undue reliance should not be placed on forward-looking statements made herein. The Company and management have no intention and undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

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#### Glossary of abbreviations

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

<b>AEPS</b>	Adjusted EPS	<b>MD&amp;A</b>	Management's Discussion and Analysis
<b>AFS</b>	Available-for-sale	<b>MYA</b>	Market yield adjustment
<b>AMF</b>	Autorité des marchés financiers	<b>NOI</b>	Net operating income
<b>AOCI</b>	Accumulated OCI	<b>NOIPS</b>	NOI per share
<b>AROE</b>	Adjusted ROE	<b>OCI</b>	Other comprehensive income
<b>DBRS</b>	Dominion Bond Rating Services	<b>OROE</b>	Operating ROE
<b>DPW</b>	Direct premiums written	<b>OSFI</b>	Office of the Superintendent of Financial Institutions
<b>EPS</b>	Earnings per share to common shareholders	<b>P&amp;C</b>	Property and casualty
<b>FVTPL</b>	Fair value through profit and loss	<b>ROE</b>	Return on equity
<b>IFRS</b>	International financial reporting standards	<b>U.S.</b>	United States
<b>MCT</b>	Minimum capital test		

"Intact", the "Company", "IFC", "we" and "our" are terms used throughout the document to refer to Intact Financial Corporation and its subsidiaries. Certain totals, subtotals and percentages may not agree due to rounding. Certain comparative figures have been reclassified to conform to the presentation adopted in the current year. A change column has been provided for convenience showing the variation between the current period and the prior period. Not meaningful (nm) is used to indicate that the current and prior year figures are not comparable, not meaningful, or if the percentage change exceeds 1,000%.

#### Important notes:

- Unless otherwise noted, DPW refers to DPW as reported under IFRS, excluding industry pools (referred to as "DPW" or "reported DPW" in this MD&A).
- All underwriting results and related ratios exclude the MYA, but include our share of the results of jointly held insurance operations, unless otherwise noted.
- The expense and general expense ratios are presented herein net of other underwriting revenues. As a result, total revenues exclude other underwriting revenues.
- Net investment income includes our share of the results of jointly held insurance operations, unless otherwise noted.
- Catastrophe claims are any one claim, or group of claims, equal to or greater than \$7.5 million, related to a single event.
- All references to "excess capital" in this MD&A include excess capital in the P&C subsidiaries at 170% MCT plus net liquid assets outside of the P&C insurance subsidiaries, unless otherwise noted.

## Section 1 – Profile

We are the largest provider of P&C insurance in Canada with over \$7 billion in annual DPW and an estimated market share of 17%. We insure more than five million individuals and businesses through our insurance subsidiaries and are the largest private sector provider of P&C insurance in British Columbia, Alberta, Ontario, Québec and Nova Scotia. We distribute insurance under the Intact Insurance brand through a wide network of brokers, including our wholly owned subsidiary, BrokerLink, and directly to consumers through belairdirect.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

## Section 2 – Overview of our consolidated performance

### 2.1 Highlights

- Net operating income per share of \$1.56 with a combined ratio of 91.6%
- All business lines contributed to organic growth in DPW of 5%, or 6% including our recent acquisition of Canadian Direct Insurance Inc.
- Strong financial position with \$564 million of excess capital and operating ROE of 16.8% for the last 12 months

### 2.2 Consolidated financial results

Table 1 – Selected highlights

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
DPW	2,346	2,173	8%	3,918	3,676	7%
DPW (underlying) <sup>1</sup>	2,344	2,212	6%	3,919	3,745	5%
Underwriting income (Table 3)	158	128	23%	276	179	54%
Combined ratio	91.6%	92.9%	(1.3) pts	92.5%	95.0%	(2.5) pts
Net investment income (Table 7)	104	105	(1)%	209	210	-
NOI (Table 2) <sup>1</sup>	210	206	2%	396	335	18%
Non-operating gains (losses) (Table 8)	(14)	9	nm	(28)	48	nm
Income before income taxes	254	252	1%	473	448	6%
Income tax expense	55	37	49%	96	73	32%
Effective income tax rate	21.7%	14.7%	7.0 pts	20.3%	16.3%	4.0 pts
<b>Net income</b>	<b>199</b>	<b>215</b>	<b>(7)%</b>	<b>377</b>	<b>375</b>	<b>1%</b>
Preferred share dividends	(5)	(5)	-	(10)	(10)	-
<b>Net income attributable to common shareholders</b>	<b>194</b>	<b>210</b>	<b>(8)%</b>	<b>367</b>	<b>365</b>	<b>1%</b>
<b>Per share measures, basic and diluted (in dollars)</b>						
NOIPS <sup>1</sup>	1.56	1.53	2%	2.93	2.47	19%
EPS	1.47	1.60	(8)%	2.79	2.77	1%
AEPS <sup>1</sup>	1.56	1.65	(5)%	2.94	2.89	2%
ROE for the last 12 months <sup>1</sup>	16.8%	11.6%	5.2 pts			
ROE for the last 12 months	15.4%	11.1%	4.3 pts			
AROE for the last 12 months <sup>1</sup>	16.1%	11.9%	4.2 pts			
Book value per share (in dollars)	39.23	36.29	8%			
MCT <sup>2</sup>	200%	208%	(8.0) pts			
Debt-to-capital ratio	16.8%	17.8%	(1.0) pts			

<sup>1</sup> Refer to Section 5 – *Non-IFRS financial measures*.

<sup>2</sup> Estimated aggregate MCT ratio of our P&C insurance subsidiaries.

### Second quarter 2015

Growth in the quarter was broad based across all lines and all regions, driving underlying DPW higher by 6% compared to Q2-2014. The increase was primarily driven by organic growth initiatives, but also included two months of premiums from recently acquired CDI, which represented 1.2 points of growth.

Our 91.6% combined ratio in Q2-2015 was 1.3 points better than Q2-2014. The success of our profitability initiatives, supported by firmer market conditions and favourable prior year claims development, led to improved underwriting results despite prolonged winter conditions in Atlantic Canada. Our expense ratio of 30.7% was 0.6 points improved from a year ago driven by lower variable commissions, offset in part by investments in growth related initiatives.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

Net investment income of \$104 million in the second quarter of 2015 was \$1 million lower than a year ago, as the benefit of incremental investments was offset by lower yields. Average net investments amounted to \$12.8 billion, up \$0.7 billion from a year ago and down \$0.3 billion from the previous quarter.

Our reported effective income tax rate of 21.7% was 7.0 points higher than a year ago, as Q2-2014 included a 5.1 point benefit from the resolution of specific tax files with the Canada Revenue Agency. Despite the increase in operating income, lower capital markets and a return to a more normal effective tax rate this quarter led to a 7% decline in net income to \$199 million in Q2-2015.

We ended the quarter in a strong financial position despite our all-cash acquisition of CDI, which closed May 1, 2015. Book value per share increased 8% from a year ago to \$39.23, and our estimated MCT remains strong at 200%. Our debt-to-capital ratio at the end of the quarter was 16.8%, lower than our internal target level of 20%. We reported an operating ROE of 16.8% for the last 12 months, despite maintaining significant levels of excess capital (\$564 million at the end of Q2-2015).

#### Year to date 2015

Underlying growth was 5% in the first half of 2015, reflecting organic growth initiatives and the acquisition of CDI, which closed in May 2015, contributing 0.7 points to underlying growth.

Our 92.5% combined ratio for the first half of 2015, was 2.5 points better than the first half of 2014. The improvement reflects the benefits of our profitability initiatives, higher favourable prior year claims development and lower catastrophe losses.

Net investment income of \$209 million in the first half of 2015 was consistent with 2014, as the benefit of incremental investments was offset by lower yields.

## Section 3 – Operating results

### 3.1 Net operating income

The details of NOI and related indicators are as follows:

Table 2 – Components of NOI

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
Underwriting income (Table 3)	158	128	30	276	179	97
Net investment income (Table 7)	104	105	(1)	209	210	(1)
Distribution income, net	34	30	4	54	41	13
Finance costs	(16)	(16)	-	(32)	(32)	-
Corporate and other	(12)	(4)	(8)	(6)	2	(8)
Pre-tax operating income	268	243	25	501	400	101
Tax impact	(58)	(37)	(21)	(105)	(65)	(40)
<b>NOI<sup>1</sup></b>	<b>210</b>	<b>206</b>	<b>4</b>	<b>396</b>	<b>335</b>	<b>61</b>
Preferred share dividends	(5)	(5)	-	(10)	(10)	-
<b>NOI to common shareholders</b>	<b>205</b>	<b>201</b>	<b>4</b>	<b>386</b>	<b>325</b>	<b>61</b>
Weighted-average number of common shares (in millions)	131.5	131.5	-	131.5	131.5	-
<b>NOIPS, basic and diluted (in dollars)<sup>1</sup></b>	<b>1.56</b>	<b>1.53</b>	<b>0.03</b>	<b>2.93</b>	<b>2.47</b>	<b>0.46</b>

<sup>1</sup> Refer to Section 5 – Non-IFRS financial measures.

The change in pre-tax operating income for the quarter was primarily driven by the \$30 million increase in underwriting income (described in Sections 3.2 - 3.4 hereafter). Corporate and other expenses tend to fluctuate from quarter to quarter, and include adjustments that are non-recurring in nature. Net distribution income, which represents income from our wholly owned broker BrokerLink, as well as broker affiliates, increased by \$4 million year-over-year to \$34 million in the quarter due to growth and improved profitability of our distribution operations.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### 3.2 Underwriting results

Table 3 – Components of underwriting results

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
Net premiums earned, before reinstatement premiums	1,862	1,801	61	3,655	3,551	104
Reinstatement premiums recovery (expense)	3	-	3	2	-	2
Net premiums earned, as reported	1,865	1,801	64	3,657	3,551	106
Net claims:						
Current year claims (excluding catastrophe losses)	1,219	1,142	77	2,530	2,386	144
<b>Underlying current year loss ratio<sup>1</sup></b>	<b>65.5%</b>	<b>63.3%</b>	<b>2.2 pts</b>	<b>69.2%</b>	<b>67.1%</b>	<b>2.1 pts</b>
Current year catastrophe losses	22	33	(11)	33	108	(75)
Favourable prior year claims development	(106)	(65)	(41)	(295)	(206)	(89)
<b>Total net claims</b>	<b>1,135</b>	<b>1,110</b>	<b>25</b>	<b>2,268</b>	<b>2,288</b>	<b>(20)</b>
<b>Claims ratio</b>	<b>60.9%</b>	<b>61.6%</b>	<b>(0.7) pts</b>	<b>62.0%</b>	<b>64.4%</b>	<b>(2.4) pts</b>
Commissions, premium taxes and general expenses	572	563	9	1,113	1,084	29
<b>Expense ratio</b>	<b>30.7%</b>	<b>31.3%</b>	<b>(0.6) pts</b>	<b>30.5%</b>	<b>30.6%</b>	<b>(0.1) pts</b>
<b>Underwriting income</b>	<b>158</b>	<b>128</b>	<b>30</b>	<b>276</b>	<b>179</b>	<b>97</b>
<b>Combined ratio</b>	<b>91.6%</b>	<b>92.9%</b>	<b>(1.3) pts</b>	<b>92.5%</b>	<b>95.0%</b>	<b>(2.5) pts</b>

<sup>1</sup> Underlying current year loss ratio is calculated using the Net premiums earned, excluding reinstatement premiums. Refer to Section 5 – *Non-IFRS financial measures*.

#### Second quarter 2015

Underwriting income increased 23% to \$158 million in Q2-2015. The improvement was primarily attributable to firming market conditions in commercial P&C and personal property lines of business, rate actions, and higher favourable prior year claims development, driven by commercial P&C and personal auto. The deterioration in our underlying current year loss ratio largely reflects the lingering impact of a severe winter in Atlantic Canada on our property lines of business and higher claims severity in commercial auto.

Favourable prior year claims development of \$106 million, or 5.5% of opening reserves on an annualized basis, was above the 3.5% recorded in Q2-2014, but more in line with historical Q2 results.

The expense ratio of 30.7% was 0.6 points improved from last year, driven by lower variable commissions, offset in part by investments in growth related initiatives.

#### Year to date 2015

Underwriting income of \$276 million was higher than the \$179 million in the first half of 2014. The increase was primarily attributable to the benefits of our profitability initiatives, an increase in favourable prior year claims development and lower catastrophe losses due to generally better weather this year.

The expense ratio of 30.5% was 0.1 points improved from last year, as lower variable commissions were offset in part by investments in growth related initiatives.

Table 4 – Components of expense ratio

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
Commissions	16.5%	17.3%	(0.8) pts	16.4%	16.8%	(0.4) pts
Premium taxes	3.5%	3.5%	-	3.5%	3.5%	-
General expenses	10.7%	10.5%	0.2 pts	10.6%	10.3%	0.3 pts
<b>Expense ratio</b>	<b>30.7%</b>	<b>31.3%</b>	<b>(0.6) pts</b>	<b>30.5%</b>	<b>30.6%</b>	<b>(0.1) pts</b>

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### 3.3 Underwriting results by lines of business – personal lines

Table 5 – Underwriting results for personal lines

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
<b>Personal auto</b>						
DPW	1,094	1,031	6%	1,797	1,728	4%
DPW (underlying)	1,090	1,029	6%	1,796	1,729	4%
Written insured risks (in thousands)	1,307	1,220	7%	2,125	2,026	5%
Net premiums earned	868	853	2%	1,696	1,683	1%
Underwriting income	85	72	18%	82	97	(15)%
Underlying current year loss ratio <sup>1</sup>	69.0%	66.2%	2.8 pts	77.5%	73.1%	4.4 pts
Catastrophe losses <sup>2</sup>	0.2%	-	0.2 pts	-	-	-
Favourable prior year claims development	(4.1)%	(0.4)%	(3.7) pts	(7.3)%	(3.8)%	(3.5) pts
Claims ratio	65.1%	65.8%	(0.7) pts	70.2%	69.3%	0.9 pts
Combined ratio	90.3%	91.5%	(1.2) pts	95.2%	94.2%	1.0 pts
<b>Personal property</b>						
DPW	541	461	17%	885	762	16%
DPW (underlying)	542	503	8%	885	831	6%
Written insured risks (in thousands)	664	638	4%	1,096	1,067	3%
Net premiums earned	428	403	6%	839	793	6%
Underwriting income	31	26	19%	110	58	90%
Underlying current year loss ratio <sup>1</sup>	60.4%	59.0%	1.4 pts	57.2%	56.9%	0.3 pts
Catastrophe losses <sup>2</sup>	2.3%	5.3%	(3.0) pts	1.3%	8.6%	(7.3) pts
Favourable prior year claims development	(4.4)%	(5.5)%	1.1 pts	(5.9)%	(7.1)%	1.2 pts
Claims ratio	58.3%	58.8%	(0.5) pts	52.6%	58.4%	(5.8) pts
Combined ratio	92.7%	93.5%	(0.8) pts	86.9%	92.6%	(5.7) pts
<b>Personal lines – total</b>						
DPW	1,635	1,492	10%	2,682	2,490	8%
DPW (underlying)	1,632	1,532	7%	2,681	2,560	5%
Underwriting income	116	98	18%	192	155	24%
Combined ratio	91.1%	92.2%	(1.1) pts	92.4%	93.7%	(1.3) pts

<sup>1</sup> Underlying current year loss ratio is calculated using the Net premiums earned, excluding reinstatement premiums. Refer to Section 5 – *Non-IFRS financial measures*.

<sup>2</sup> Catastrophe losses include reinstatement premiums.

#### Second quarter 2015

Personal auto organic growth (excluding CDI) was strong with a 4% increase in premiums and a 5% increase in units. Underlying DPW increased by 6% (Table 5) from Q2-2014 on a 7% increase in units due to investments in our brands and digital strategies, rate actions and the inclusion of two months of CDI premiums. The combined ratio of 90.3% was 1.2 points better than last year's 91.5%, which had an unusually low level of favourable prior year claims development. This was offset in part by a 2.8 point deterioration in underlying current year loss ratio in Q2-2015, reflecting an uptick in claims frequency.

Personal property organic growth (excluding the two-year policy conversion and CDI) of 6%, on a 2% increase in units, reflected continued firm market conditions and new product offerings. Underlying growth of 8% (Table 5) included two months of premium from the CDI acquisition. The ongoing conversion of two-year policies to one-year policies added 9 points for a total reported growth of 17% (Table 5). Our combined ratio of 92.7% in the quarter was 0.8 points better than the same period last year, helped by lower catastrophe losses of \$11 million this quarter compared to \$22 million in Q2-2014. The underlying current year loss ratio deteriorated 1.4 points to 60.4% year-over-year, as the harsh winter in Atlantic Canada continued to be felt in Q2-2015.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### Year to date 2015

Personal auto DPW increased by 4% from the first half of 2014 on a 5% increase in units, including two months of premium from CDI. The combined ratio of 95.2% was 1.0 point worse than last year's 94.2%, reflecting difficult winter conditions in Q1-2015.

Personal property underlying growth of 6% on a 3% increase in units was positively impacted by firming market conditions and two months of premium from the CDI acquisition. The combined ratio of 86.9% was much improved from 92.6% in the first half of 2014, primarily due to our actions to improve profitability and lower catastrophe losses.

### 3.4 Underwriting results by lines of business – commercial lines

Table 6 – Underwriting results for commercial lines

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
<b>Commercial P&amp;C</b>						
DPW	508	489	4%	894	865	3%
DPW (underlying)	508	488	4%	895	864	4%
Written insured risks (in thousands)	126	125	1%	226	227	-
Net premiums earned	407	394	3%	805	776	4%
Underwriting income (loss)	33	(2)	nm	69	(23)	nm
Underlying current year loss ratio <sup>1</sup>	64.1%	65.9%	(1.8) pts	64.7%	67.7%	(3.0) pts
Catastrophe losses <sup>2</sup>	2.0%	2.7%	(0.7) pts	2.5%	5.0%	(2.5) pts
Favourable prior year claims development	(13.6)%	(8.5)%	(5.1) pts	(14.7)%	(9.2)%	(5.5) pts
Claims ratio	52.5%	60.1%	(7.6) pts	52.5%	63.5%	(11.0) pts
Combined ratio	91.8%	100.5%	(8.7) pts	91.4%	103.0%	(11.6) pts
<b>Commercial auto</b>						
DPW	203	192	6%	342	321	7%
DPW (underlying)	204	192	6%	343	321	7%
Written insured risks (in thousands)	162	159	2%	271	266	2%
Net premiums earned	162	151	7%	317	299	6%
Underwriting income	9	32	(72)%	15	47	(68)%
Underlying current year loss ratio <sup>1</sup>	63.2%	53.5%	9.7 pts	68.2%	59.9%	8.3 pts
Catastrophe losses <sup>2</sup>	0.1%	0.1%	-	0.1%	-	0.1 pts
Unfavourable (favourable) prior year claims development	2.5%	(4.1)%	6.6 pts	(1.0)%	(4.7)%	3.7 pts
Claims ratio	65.8%	49.5%	16.3 pts	67.3%	55.2%	12.1 pts
Combined ratio	94.4%	79.5%	14.9 pts	95.4%	84.4%	11.0 pts
<b>Commercial lines – total</b>						
DPW	711	681	4%	1,236	1,186	4%
DPW (underlying)	712	680	5%	1,238	1,185	4%
Underwriting income	42	30	40%	84	24	250%
Combined ratio	92.6%	94.7%	(2.1) pts	92.5%	97.8%	(5.3) pts

<sup>1</sup> Underlying current year loss ratio is calculated using the Net premiums earned, excluding reinstatement premiums. Refer to Section 5 – *Non-IFRS financial measures*.

<sup>2</sup> Catastrophe losses include reinstatement premiums.

#### Second quarter 2015

Underlying DPW in commercial P&C was higher by 4%, benefiting from higher rates. Our improved retention and stronger new business activity continue to support our view that the commercial P&C market is firming. The combined ratio improved 8.7 points to 91.8%. This was helped by both elevated favourable prior year claims development due to the resolution of a number of certain old files and by rate increases under our action plan. We expect that there are approximately 2-3 points of combined ratio improvement remaining to be earned from our action plan which targets a low 90s combined ratio on a sustainable basis.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

Commercial auto underlying DPW was up 6% from a year ago due to growth in regular commercial auto and continued strength in trucking. The combined ratio deteriorated by 14.9 points year-over-year to 94.4%, driven by a 9.7 point increase in the underlying current year loss ratio, largely related to claims severity and unfavourable prior year claims development.

#### Year to date 2015

Commercial P&C underlying DPW increased 4% in the first half of 2015 compared to the same period of 2014 benefiting from higher rates, while underwriting results improved to \$69 million versus a loss of \$23 million in H1-2014. The combined ratio of 91.4% was 11.6 points better than the first half of 2014, due to higher favourable prior year claims development, our profitability improvement initiatives, and lower catastrophe losses.

Commercial auto underlying DPW increased 7% in the first half of 2015 versus H1-2014, while the combined ratio was 95.4%, 11 points worse than H1-2014. The underlying current year loss ratio of 68.2% was 8.3 points worse in H1-2015 than H1-2014 as results were impacted by higher frequency and claims severity due to challenging winter conditions.

### 3.5 Net investment income

Table 7 – Net investment income

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
Interest income	68	71	(4)%	141	139	1%
Dividend income	45	43	5%	86	89	(3)%
Investment income, before expenses	113	114	(1)%	227	228	-
Expenses	(9)	(9)	-	(18)	(18)	-
<b>Net investment income</b>	<b>104</b>	<b>105</b>	<b>(1)%</b>	<b>209</b>	<b>210</b>	<b>-</b>
<b>Average net investments<sup>1</sup></b>	<b>12,805</b>	<b>12,116</b>	<b>5%</b>	<b>12,964</b>	<b>12,041</b>	<b>7%</b>
<b>Market-based yield<sup>2</sup></b>	<b>3.62%</b>	<b>3.69%</b>	<b>(0.07) pts</b>	<b>3.51%</b>	<b>3.72%</b>	<b>(0.21) pts</b>

<sup>1</sup> Defined as the mid-month average fair value of net equity and fixed-income securities held during the reporting period.

<sup>2</sup> Refer to Section 5 – *Non-IFRS financial measures*.

Net investment income of \$104 million in the second quarter of 2015 was essentially flat versus a year ago. The benefit of incremental investments was offset by a low yield environment. Average net investments amounted to \$12.8 billion and were up \$0.7 billion, or 5%, from a year ago, while our market-based yield of 3.62% in Q2-2015 was down 7 basis points from Q2-2014.

Net investment income of \$209 million in the first half of 2015 was essentially unchanged from the \$210 million a year ago as the benefit of a higher level of invested assets was offset by lower yields.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### Section 4 – Non-operating results

Non-operating results, a non-IFRS financial measure, include elements that are not representative of our operating performance because they relate to special items, bear significant volatility from one period to another, or because they are not part of our normal activities. As a result, these elements are excluded from the calculation of NOI and related non-IFRS financial measures.

The details of non-operating results are as follows:

Table 8 – Non-operating results

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
Net investment gains (losses) (Table 9)	(29)	44	(73)	72	147	(75)
Positive (negative) impact of MYA on underwriting (Section 4.2)	38	(19)	57	(59)	(68)	9
Integration and restructuring costs	(3)	(3)	-	(3)	(7)	4
Difference between expected return and discount rate on pension assets (Section 4.3)	(7)	(5)	(2)	(15)	(10)	(5)
Amortization of intangible assets recognized in business combinations	(13)	(8)	(5)	(23)	(14)	(9)
<b>Non-operating gains (losses)</b>	<b>(14)</b>	<b>9</b>	<b>(23)</b>	<b>(28)</b>	<b>48</b>	<b>(76)</b>

#### 4.1 Net investment gains (losses)

Table 9 – Net investment gains (losses)

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
<b>Fixed-income strategies</b>						
Gains (losses) on FVTPL fixed-income securities, net of related derivatives <sup>1</sup>	(52)	13	(65)	25	49	(24)
Gains on AFS securities, net of related derivatives <sup>1</sup>	8	2	6	13	3	10
Gains (losses) on other derivatives	1	(4)	5	(5)	13	(18)
<b>Gains (losses) on fixed-income strategies and related derivatives</b>	<b>(43)</b>	<b>11</b>	<b>(54)</b>	<b>33</b>	<b>65</b>	<b>(32)</b>
<b>Equity strategies</b>						
Gains on AFS securities, net of related derivatives <sup>1</sup>	10	45	(35)	19	118	(99)
Gains (losses) on FVTPL securities, net of related derivatives	(1)	1	(2)	-	(7)	7
Gains (losses) on embedded derivatives and other	12	(12)	24	27	(18)	45
Gains on foreign currency	4	-	4	12	-	12
Impairment losses	(32)	(5)	(27)	(62)	(23)	(39)
<b>Gains (losses) on equity strategies and related derivatives</b>	<b>(7)</b>	<b>29</b>	<b>(36)</b>	<b>(4)</b>	<b>70</b>	<b>(74)</b>
Net gains on investments in associates and joint ventures	21	4	17	43	12	31
<b>Net investment gains (losses)</b>	<b>(29)</b>	<b>44</b>	<b>(73)</b>	<b>72</b>	<b>147</b>	<b>(75)</b>
<b>Net investment gains excluding FVTPL fixed-income securities</b>	<b>23</b>	<b>31</b>	<b>(8)</b>	<b>47</b>	<b>98</b>	<b>(51)</b>

<sup>1</sup> Excluding foreign currency impact.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

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#### Second quarter 2015

Lower bond prices and lower equity markets resulted in a net investment loss of \$29 million, compared to a net investment gain of \$44 million in Q2-2014. Excluding FVTPL fixed-income securities, net investment gains were \$23 million in Q2-2015, compared to \$31 million in Q2-2014, as a result of lower gains from equity strategies and impairments, offset in part by gains from broker transactions.

#### Year to date 2015

Net investment gains of \$72 million for H1-2015 were \$75 million lower than in H1-2014, mainly driven by lower equity markets and higher impairment charges, offset in part by gains on embedded derivatives and broker transactions. Excluding FVTPL fixed-income securities, net investment gains were \$47 million in H1-2015, \$51 million lower than in H1-2014.

#### 4.2 Impact of MYA on underwriting

Claims liabilities are discounted at the estimated market yield of the assets backing these liabilities. The impact of changes in the discount rate used to discount claims liabilities based on the change in the market-based yield of the underlying assets is referred to as MYA. The MYA to claims liabilities is partly offset by gains and losses on FVTPL fixed-income securities with the objective that these items offset each other with a minimal overall impact to net income.

#### 4.3 Difference between expected return and discount rate on pension assets

We continue to manage our pension asset investment portfolio with a target asset return based on a target asset allocation. We continue to measure NOI using a pension expense based on the expected return on plan assets to better reflect our operating performance. Any difference between the expected return on pension assets and the return based on the discount rate determined at the beginning of the year is treated as a non-operating item.

### Section 5 – Non-IFRS financial measures

Non-IFRS financial measures do not have standardized meanings prescribed by IFRS and may not be comparable to similar measures used by other companies in our industry. These non-IFRS financial measures are used by management and financial analysts to assess our performance. Further, they provide users with an enhanced understanding of our results and related trends and increase transparency and clarity into the core results of the business.

- DPW (underlying) represents the amount of premiums for new and renewal policies billed (written) during the reporting period, excluding industry pools and normalized for the effect of multi-year policies. This measure matches DPW to the year in which coverage is provided, whereas under IFRS, the full value of multi-year policies is recognized in the year the policy is written.
- AEPS and AROE exclude the impact of amortization of intangible assets recognized in business combinations and integration and restructuring costs, all on an after tax basis. We believe that these excluded items are not appropriate in assessing our underlying performance.
- NOI, NOIPS and OROE exclude the impact of net investment gains (losses), the positive (negative) effect of MYA on underwriting, the difference between expected return and discount rate on pension assets, the amortization of intangible assets recognized in business combinations, and integration and restructuring costs. Investment gains and losses as well as the effect of MYA on underwriting arise mostly from changes in market conditions, which can be volatile to earnings. We also exclude the difference between expected return and discount rate on pension assets, as we believe the gap in these measures is not reflective of our internal investment management expertise and management of our pension investment asset portfolio.
- The market-based yield represents the annualized total pre-tax investment income (before expenses), divided by the mid-month average fair value of net equity and fixed-income securities held during the reporting period. This calculation provides users with a consistent measure of our relative investment performance.
- The underlying current year loss ratio is our current year claims ratio excluding catastrophe losses, reinstatement premiums, and prior year claims development. Catastrophe events are beyond our control, and as such, excluding them provides clearer insight into our analysis of current year performance. See Section 3.2 – *Underwriting results* for a reconciliation of this non-IFRS financial measure.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

Table 10 – Reconciliation of DPW (underlying) and underlying growth to DPW, as reported under IFRS

	Q2-2015	Q2-2014	YTD 2015	YTD 2014
<b>DPW, as reported under IFRS</b>	<b>2,343</b>	2,165	<b>3,917</b>	3,660
Less impact of industry pools	(13)	(8)	(24)	(8)
Add share of the results of jointly held insurance operations	16	16	25	24
<b>DPW, reported</b>	<b>2,346</b>	2,173	<b>3,918</b>	3,676
Add impact of the normalization for multi-year policies	(2)	39	1	69
<b>DPW, underlying</b>	<b>2,344</b>	2,212	<b>3,919</b>	3,745
<b>Underlying growth</b>	<b>6%</b>	2%	<b>5%</b>	1%

Table 11 – Reconciliation of AEPS and AROE to net income

	Q2-2015	Q2-2014	YTD 2015	YTD 2014
<b>Net income</b>	<b>199</b>	215	<b>377</b>	375
Add amortization of intangible assets recognized in business combinations, net of tax	10	5	18	10
Add integration and restructuring costs, net of tax	1	2	2	5
<b>Adjusted net income</b>	<b>210</b>	222	<b>397</b>	390
Less preferred share dividends	(5)	(5)	(10)	(10)
<b>Adjusted net income attributable to common shareholders</b>	<b>205</b>	217	<b>387</b>	380
Divided by weighted-average number of common shares (in millions)	<b>131.5</b>	131.5	<b>131.5</b>	131.5
<b>AEPS, basic and diluted (in dollars)</b>	<b>1.56</b>	1.65	<b>2.94</b>	2.89
Average common shareholders' equity	<b>4,968</b>	4,575		
<b>AROE for the last 12 months</b>	<b>16.1%</b>	11.9%		

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

Table 12 – Reconciliation of NOIPS and OROE to net income

	Q2-2015	Q2-2014	YTD 2015	YTD 2014
<b>Net income</b>	<b>199</b>	215	<b>377</b>	375
Add income tax expense	<b>55</b>	37	<b>96</b>	73
Deduct net investment gains (losses) (Table 9)	<b>29</b>	(44)	<b>(72)</b>	(147)
Add negative (positive) impact of MYA on underwriting (Section 4.2)	<b>(38)</b>	19	<b>59</b>	68
Add difference between expected return and discount rate on pension assets (Section 4.3)	<b>7</b>	5	<b>15</b>	10
Add amortization of intangible assets recognized in business combinations	<b>13</b>	8	<b>23</b>	14
Add integration and restructuring costs	<b>3</b>	3	<b>3</b>	7
<b>Pre-tax operating income</b>	<b>268</b>	243	<b>501</b>	400
Tax impact	<b>(58)</b>	(37)	<b>(105)</b>	(65)
<b>NOI</b>	<b>210</b>	206	<b>396</b>	335
Less preferred share dividends	<b>(5)</b>	(5)	<b>(10)</b>	(10)
<b>NOI to common shareholders</b>	<b>205</b>	201	<b>386</b>	325
Divided by weighted-average number of common shares (in millions)	<b>131.5</b>	131.5	<b>131.5</b>	131.5
<b>NOIPS, basic and diluted (in dollars)</b>	<b>1.56</b>	1.53	<b>2.93</b>	2.47
Average common shareholders' equity, excluding AOCI	<b>4,807</b>	4,443		
<b>OROE for the last 12 months</b>	<b>16.8%</b>	11.6%		

## Section 6 – Business developments and operating environment

### 6.1 Canadian P&C insurance industry results – Q1-2015 comparison

The Canadian P&C insurance preliminary results for Q1-2015 are available. Highlights are as follows:

Table 13 – Estimated Canadian P&C insurance results

	IFC	Industry benchmark <sup>1</sup>	out(under) performance
DPW growth	<b>2.8%</b>	2.7%	0.1 pts
Combined ratio <sup>2</sup>	<b>99.2%</b>	105.7%	6.5 pts
Return on equity (annualized) <sup>3</sup>	<b>14.3%</b>	7.6%	6.7 pts

Industry data: IFC estimate based on MSA Research Inc.

Note: AMF (Québec) chartered insurance companies are not required to report on Q1 and Q3 results. As such, we have included estimates for non-reporters in our Industry benchmark group, based on publicly available information. Actual results may vary.

<sup>1</sup> Consists of the 19 largest companies, excluding Lloyd's, Genworth, FM Global and IFC.

<sup>2</sup> Combined ratio includes MYA.

<sup>3</sup> IFC's ROE corresponds to the AROE.

We outperformed our P&C insurance industry benchmark from a bottom line perspective and closed the gap on premium growth in Q1-2015, based on data available to date. We estimate that we delivered a combined ratio 6.5 points better than our industry benchmark. The combination of superior underwriting and investment results led to an estimated ROE outperformance in Q1-2015 of 6.7 points versus our industry benchmark.

## **Intact Financial Corporation**

### **Management's Discussion and Analysis for the second quarter of 2015**

(in millions of dollars, except as otherwise noted)

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#### **6.2 Ontario personal auto environment**

In August 2013, the Ontario government introduced a rate and cost reduction mandate to improve the affordability of auto insurance in the province, while also reducing costs in the system. This process has resulted in an average rate reduction of approximately 6.1% for the industry as of Q2-2015. Government cost reduction measures to date include tightening of the Minor Injury Guideline back towards its original intent and licensing of health care clinics to reduce fraud. In addition, Ontario Bill 15, Fighting Fraud and Reducing Automobile Insurance Rates Act, 2014 ("Bill 15") was passed late in 2014 and is becoming effective as regulations are defined in 2015. For example, a recent Ontario Superior Court decision clarified that the mandated reduction in pre-judgment interest to levels closer to current interest rates should be applied retroactively. We therefore reflected in Q1-2015 our initial assessment of the anticipated savings. Other savings from Bill 15 that are in the process of being implemented include a streamlining of the dispute resolution system and protection for consumers against untrustworthy towing and storage providers. In recognition of Bill 15, we elected to take additional rate reductions for a cumulative average of 9.6% since August 2013.

More recently on April 23<sup>rd</sup> 2015, the Ontario government released a budget outlining additional actions to reduce costs. These include updating the catastrophic impairment definition and reducing the standard duration of medical and rehabilitation benefits to be more in line with that of other provinces. The budget also prescribed some measures through which the insurance industry is to translate the cost reductions into premium reductions.

According to industry results, the claims ratio in Ontario personal auto in 2014 was 76.3%, improved significantly from 2010, but still reflective of an industry combined ratio above 100%. This indicates that a number of industry players continue to be in an underwriting loss position, such that rate reductions in excess of reforms would likely lead to availability issues for drivers.

#### **6.3 Acquisition of Canadian Direct Insurance**

On February 10, 2015, we announced that we had entered into a definitive agreement with Canadian Western Bank to acquire CDI, thereby extending our direct-to-consumer operations from coast to coast. The transaction closed on May 1, 2015 and integration efforts are underway. We continue to expect the acquisition to be accretive to NOIPS in 2015. We are targeting annual expense synergies of \$10 million after tax, and expect our run rate to reach this level by mid-2017.

#### **6.4 Capital markets**

The S&P/TSX Composite Index posted a decline of 2.3% in the quarter. The telecommunications and health care sectors were able to end the period higher, while energy stocks remained weak, ending the quarter lower by 5.5%. The preferred share index declined by 5%. Movements in our equity investment values are generally in line with the equity markets' performance, although our exposures to individual sectors may be different (see Table 19 for further details). Our net pre-tax unrealized gain position decreased \$141 million in the quarter due to lower bond and equity prices. Tables 9, 21 and 22 provide detailed information on the net investment gains and unrealized gains (losses) of our investment portfolio.

#### **6.5 Industry pools**

Industry pools consist of the "residual market" (or Facility Association) as well as risk-sharing pools ("RSP") in Alberta, Ontario, Québec, New Brunswick and Nova Scotia. In Q2-2015, the net impact of industry pools on personal auto underwriting income was \$10 million better than Q2-2014. Results for industry risk sharing pools tend to fluctuate between periods.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### 6.6 Weather conditions

Q2-2015 experienced milder temperatures and generally lower precipitation levels across all major cities compared to last year and historical averages. Some exceptions to these favourable conditions include elevated precipitation in Toronto and Québec City, and late winter conditions in Atlantic Canada. Catastrophe losses were relatively low in the quarter at \$22 million.

#### 6.7 Seasonality of the business

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. The underlying seasonality in our combined ratio is best illustrated by excluding the impact of catastrophe losses (see Table 15).

Table 14 – Seasonal indicator, including catastrophe losses

	2014	2013	2012	2011	2010	2009	2008	2007	Eight-year average
<b>Q1</b>	<b>1.05</b>	0.97	0.99	1.00	0.98	1.00	1.03	1.01	1.00
<b>Q2</b>	<b>1.00</b>	1.00	0.99	1.03	0.98	0.97	0.98	0.99	0.99
<b>Q3</b>	<b>1.00</b>	1.05	1.03	0.99	1.01	1.07	0.97	1.02	1.02
<b>Q4</b>	<b>0.95</b>	0.98	0.99	0.98	1.03	0.96	1.02	0.98	0.99

Table 15 – Seasonal indicator, excluding catastrophe losses

	2014	2013	2012	2011	2010	2009	2008	2007	Eight-year average
<b>Q1</b>	<b>1.04</b>	1.04	1.02	1.04	1.00	1.02	1.03	1.02	1.03
<b>Q2</b>	<b>1.02</b>	0.97	0.98	0.96	0.99	0.99	0.97	0.98	0.98
<b>Q3</b>	<b>0.96</b>	0.97	0.97	0.99	0.98	1.00	0.97	1.01	0.98
<b>Q4</b>	<b>0.98</b>	1.02	1.03	1.01	1.03	0.99	1.03	0.99	1.01

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

## Section 7 – Strategy and outlook

### 7.1 Canadian P&C insurance industry 12-month outlook

Our two primary objectives are to outperform the industry ROE by at least 500 basis points every year, and to grow our NOIPS by 10% per year over time. We are well-positioned to continue outperforming the P&C insurance industry in the current environment due to our pricing and underwriting discipline, claims management capabilities, as well as our prudent investment and capital management practices.

	Canadian P&C insurance industry	Our strategy and outlook
<b>Market environment (12-month outlook)</b>	<ul style="list-style-type: none"> <li>Industry premiums are likely to increase at a low single-digit rate, with slightly negative growth in personal auto, mid single-digit growth in commercial lines and upper single-digit growth in personal property expected.</li> <li>We expect future rate reductions in Ontario auto will be commensurate with government cost reduction measures.</li> <li>We expect the current hard market conditions in personal property to continue as the magnitude of catastrophe losses in recent years negatively impacts industry results.</li> <li>We believe the impact of continued low interest rates and limited underwriting profitability at the industry level have translated into firmer conditions in commercial lines.</li> </ul>	<ul style="list-style-type: none"> <li>We maintain our disciplined strategy while capitalizing on our strong position to grow organically in the prevailing market conditions.</li> <li>We are comfortable with the changes taking place in the Ontario auto market and will continue to pursue growth opportunities.</li> <li>The initiatives under our home improvement plan are now fully implemented. We expect this will allow us to continue outperforming the industry in home insurance.</li> <li>In commercial lines, we are targeting a combined ratio sustainably in the low 90s through better segmentation of rate increases and product changes.</li> </ul>
<b>Capital markets</b>	<ul style="list-style-type: none"> <li>Recent economic data and actions from the Bank of Canada lead us to believe that the overnight lending rate may remain low for the foreseeable future. In the current interest rate environment, we estimate that the industry's pre-tax investment yield will decline slightly, given its asset mix and duration.</li> <li>Capital markets remain volatile, as economic data suggest that more time is required for the global recovery to take hold. Industry capital levels could be negatively impacted if volatility results in continued downward pressure on market values.</li> <li>Global capital requirements are continuing to influence the asset decisions of many companies.</li> </ul>	<ul style="list-style-type: none"> <li>We maintain a strong financial position with \$564 million in excess capital and a debt-to-capital ratio of 16.8% as at the end of Q2-2015.</li> <li>Our \$13.4 billion investment portfolio is largely Canadian dollar-denominated.</li> <li>We do not expect growth in our net investment income over the next 12 months.</li> <li>We expect the 2015 MCT guidelines to positively impact our regulatory capital ratios by approximately 2 points per quarter in 2015.</li> </ul>
<b>Overall</b>	<ul style="list-style-type: none"> <li>We expect the industry's combined ratio to continue to improve in 2015 from the recent peak above 100% in 2013, though the level of investment income is unlikely to improve. Overall, we expect the industry's ROE to trend back toward its long-term average of 10% in 2015.</li> </ul>	<ul style="list-style-type: none"> <li>We believe we will outperform the industry's ROE by at least 500 basis points in the next 12 months.</li> </ul>

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

## Section 8 – Financial condition

### 8.1 Condensed balance sheets

The table below shows the significant balance sheet captions.

Table 16 – Condensed balance sheets

<b>As at</b>	<b>Reference</b>	<b>June 30, 2015</b>	<b>December 31, 2014</b>
<b>Assets</b>			
Investments	Section 8.2	13,394	13,440
Premium receivables		2,901	2,711
Reinsurance assets		311	335
Deferred acquisition costs		712	669
Other assets		1,240	1,121
Intangible assets and goodwill		2,426	2,304
<b>Total assets</b>		<b>20,984</b>	<b>20,580</b>
<b>Liabilities</b>			
Claims liabilities	Section 8.3	8,177	8,021
Unearned premiums		4,371	4,110
Financial liabilities related to investments		428	432
Other liabilities		1,215	1,419
Debt outstanding	Section 9.1	1,143	1,143
<b>Total liabilities</b>		<b>15,334</b>	<b>15,125</b>
<b>Shareholders' equity</b>			
Common shares		2,090	2,090
Preferred shares		489	489
Contributed surplus		111	115
Retained earnings		2,863	2,616
AOCI		97	145
<b>Shareholders' equity</b>	Section 14	<b>5,650</b>	<b>5,455</b>
<b>Book value per share (in dollars)</b>		<b>39.23</b>	<b>37.75</b>

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### 8.2 Investments

Our investments totalled \$13.4 billion as at June 30, 2015 and December 31, 2014. Our investment portfolio is mainly comprised of Canadian securities and includes a mix of cash and short-term notes, fixed-income securities, preferred shares and common shares. Most of our investments are denominated in Canadian dollars and currency exposure on our fixed-income portfolio is economically hedged.

Our portfolio is managed in accordance with our investment policy. The overall risk profile of the portfolio is designed to balance the investment return required to back our liabilities while optimizing the investment opportunities available in the marketplace. Management monitors and enforces compliance with our investment policy.

#### Investment mix

The following table provides an overview of the investment mix.

Table 17 – Investment mix

As at	June 30, 2015	As a % of total	December 31, 2014	As a % of total
Short-term notes, including cash and cash equivalents	376	3%	213	2%
Fixed-income securities	8,287	62%	8,560	64%
Preferred shares	1,193	9%	1,268	9%
Common shares	3,053	23%	2,992	22%
	12,909	97%	13,033	97%
Loans	485	3%	407	3%
<b>Total investments</b>	<b>13,394</b>	<b>100%</b>	<b>13,440</b>	<b>100%</b>

As part of our investment strategies, from time to time we take long/short equity positions in order to maximize the value added from active equity portfolio management, or to mitigate overall equity market volatility. We also use strategies where market risk from long equity positions is reduced through the use of swap agreements or other hedging instruments.

The following table illustrates our total investments and asset mix after reflecting the impact of financial liabilities and derivatives related to investments.

Table 18 – Investment mix net of hedging positions and financial liabilities related to investments

As at	June 30, 2015	December 31, 2014
Cash, cash equivalents, and short-term notes	4%	3%
Fixed-income strategies	70%	72%
Preferred shares	9%	9%
Common equity strategies	13%	13%
	96%	97%
Loans	4%	3%
<b>Total investments net of hedging positions and financial liabilities related to investments</b>	<b>100%</b>	<b>100%</b>

The investment mix as at June 30, 2015 is unchanged compared to the mix as at December 31, 2014.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### Net exposure: sector mix by asset class

The following table shows sector exposures by asset class, after reflecting the impact of hedging strategies and financial liabilities related to investments, as a percentage of total investments (excluding cash, short-term notes and loans). This table represents our economic exposure to sector mix by asset class as at June 30, 2015.

Table 19 – Sector mix by asset class (net of hedging positions and financial liabilities related to investments)

	Fixed-income securities	Preferred shares	Common shares		IFC Total
			IFC	S&P/TSX Weighting	
Government	58%	-	-	-	40%
Financials	29%	73%	14%	35%	36%
Energy	2%	15%	24%	20%	6%
Industrials	3%	-	10%	8%	3%
Consumer staples	3%	-	8%	4%	3%
Utilities	-	12%	7%	2%	2%
Information technology	2%	-	7%	2%	3%
Consumer discretionary	1%	-	9%	7%	2%
Materials	1%	-	9%	11%	2%
Health care	1%	-	4%	6%	2%
Telecommunication	-	-	8%	5%	1%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Our fixed-income investment portfolio is concentrated mainly in the government and financial sectors in order to provide liquidity and stability to our balance sheet and our equity portfolio has a focus on dividend-paying Canadian companies.

#### Portfolio credit quality

Our investment portfolio includes high quality government and corporate bonds, as well as equity securities of large, publicly-traded, dividend-paying companies. Approximately 99% of the fixed-income securities are rated 'A' or better and 86% of the preferred shares are highly-rated with at least a 'P2L' credit rating.

As at June 30, 2015, the weighted-average rating of our fixed-income portfolio was 'AA+', unchanged since December 31, 2014 and the average duration of our fixed-income portfolio was 4.12 years (4.09 years including the impact of derivatives used to decrease overall interest rate exposure). The weighted-average rating of our preferred share portfolio was 'P2' as at June 30, 2015, unchanged since December 31, 2014.

We manage our investments prudently to protect capital and generate superior after-tax returns, and we do not invest in leveraged securities.

#### Net exposure: by currency

As a means to provide geographic and sector diversification to our portfolio, which is mainly comprised of Canadian securities, we invest in high quality non-financial U.S. corporate bonds and U.S. equities. Approximately 12% of our fixed-income portfolio and 17% of our common share asset portfolio are comprised of U.S. securities as at June 30, 2015. Foreign currency exposure in U.S. denominated fixed-income securities is hedged using foreign-currency forward contracts.

Table 20 – Currency exposure (net of hedging positions and financial liabilities related to investments)

As at	June 30, 2015	December 31, 2014
Canadian dollar	95%	96%
U.S. dollar	5%	4%
<b>Total</b>	<b>100%</b>	<b>100%</b>

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### Net pre-tax unrealized gains (losses) on AFS securities

In determining the fair value of investments, we rely mainly on quoted market prices. In cases where an active market does not exist, the estimated fair values are based on recent transactions or current market prices for similar securities.

The following table presents the net pre-tax unrealized gains (losses) on AFS securities.

Table 21 – Net pre-tax unrealized gains (losses) on AFS securities

As at	June 30, 2015	March 31, 2015	December 31, 2014	September 30, 2014	June 30, 2014
Fixed-income securities	127	183	94	62	68
Preferred shares	(13)	20	66	59	63
Common shares	36	88	54	83	185
<b>Net pre-tax unrealized gain (loss) position</b>	<b>150</b>	<b>291</b>	<b>214</b>	<b>204</b>	<b>316</b>

During Q2-2015, our pre-tax unrealized gain position decreased by \$141 million compared to Q1-2015, driven by the impact of higher bond prices and weaker equity markets.

During the first half of 2015, our pre-tax unrealized gain position declined by \$64 million, principally on lower equity markets.

Gains and losses in the common share portfolio are generally realized on an ongoing basis under normal capital market conditions, reflecting the investment strategy in the high-dividend common share portfolio.

#### Impairment recognition

Common shares classified as AFS are assessed for impairment if the current market value drops significantly below the book value, and/or if there has been a prolonged decline in the fair value below the book value. Based on our assessment, we recorded impairment losses on AFS common shares amounting to \$15 million in Q2-2015.

Table 22 – Aging of unrealized losses on AFS common shares

As at	June 30, 2015	March 31, 2015	December 31, 2014	September 30, 2014	June 30, 2014
Less than 25% below book value	62	47	36	50	18
More than 25% below book value for less than 6 consecutive months	8	7	57	3	3
More than 25% below book value for 6 consecutive months or more	17	23	2	3	-
<b>Unrealized losses on AFS common shares</b>	<b>87</b>	<b>77</b>	<b>95</b>	<b>56</b>	<b>21</b>

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### 8.3 Claims liabilities

Claims liabilities amounted to \$8.2 billion as at June 30, 2015, a level similar to December 31, 2014. The reserve estimates are evaluated quarterly for redundancy or deficiency. The evaluation is based on actual payments in full or partial settlement of insurance contracts and current estimates of claims liabilities for claims still open or claims still unreported.

#### Prior year claims development

The following table shows the development of claims liabilities for the nine most recent accident years and earlier.

Table 23 – Prior year claims development by accident year

	Total	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005 and earlier
Original reserve		2,571	2,609	2,481	2,417	2,126	1,838	1,654	1,459	1,301	3,760
Favourable development during Q2-2015	(106)	(40)	(15)	(7)	(11)	(12)	(6)	(2)	(1)	(1)	(11)
Favourable development during YTD 2015	(295)	(134)	(32)	(22)	(33)	(27)	(18)	(7)	(5)	(2)	(15)
Cumulative development as a % of original reserve		(5.2)%	(5.8)%	(8.5)%	(14.8)%	(12.7)%	(11.0)%	(9.7)%	(8.2)%	(10.6)%	(16.5)%

The following table shows the historical prior year claims development by line of business, as well as the annualized prior year claims development (as a % of opening reserves).

Table 24 – Prior year claims development

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
<b>By line of business</b>						
Personal auto	(36)	(4)	(32)	(125)	(65)	(60)
Personal property	(19)	(22)	3	(49)	(56)	7
Commercial auto	4	(6)	10	(3)	(14)	11
Commercial P&C	(55)	(33)	(22)	(118)	(71)	(47)
<b>Total unfavourable (favourable) development</b>	<b>(106)</b>	<b>(65)</b>	<b>(41)</b>	<b>(295)</b>	<b>(206)</b>	<b>(89)</b>
<b>Annualized prior year claims development<sup>1</sup></b>	<b>5.5%</b>	<b>3.5%</b>	<b>2.0 pts</b>	<b>7.6%</b>	<b>5.5%</b>	<b>2.1 pts</b>

<sup>1</sup> As a % of opening reserves

Favourable prior year claims development for the second quarter of 2015, at 5.5% of opening reserves on an annualized basis, was above the 3.5% recorded in Q2-2014. Prior year claims development can fluctuate from quarter to quarter and year to year and, therefore, should be evaluated over longer periods of time.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

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## Section 9 – Liquidity and capital resources

### 9.1 Financing and capital structure

We do not generally require financing to support our ongoing operations. We use financing instruments, with a preference for long tenures, to optimize our balance sheet or to support growth initiatives. We believe our optimal capital structure is one where the debt-to-capital ratio is up to 20% and we intend to operate at this level on an ongoing basis. We may exceed this level from time to time to capture market opportunities, but with a goal to return to our target within a reasonable time frame.

As at June 30, 2015, we had a debt-to-capital ratio of 16.8%, compared to 17.3% as at December 31, 2014.

#### Credit facility

We have a \$300-million five-year unsecured revolving term credit facility, which matures on December 5, 2019. This credit facility may be drawn as prime loans or base rate (Canada) advances at the prime rate or base rate plus a margin or as bankers' acceptances or Libor advances at the bankers' acceptance or Libor rate plus a margin. This facility was undrawn as at June 30, 2015 and December 31, 2014.

As part of the covenants of the loans under the credit facilities, we are required to maintain certain financial ratios, which were fully met as at June 30, 2015 and December 31, 2014.

#### Sale and repurchase agreements

We may, from time to time, enter into sale and repurchase agreements consisting of the sale of securities together with an agreement to repurchase them in the short term, at a set price and date, up to a maximum of 1.5% of invested assets. We did not have any securities sold under repurchase agreements as at June 30, 2015 and December 31, 2014.

### 9.2 Credit ratings

On April 20, 2015, Moody's reaffirmed the senior debt rating of Intact Financial Corporation and the insurance financial strength ratings of its principal P&C subsidiaries. The outlook remained stable.

On April 30, 2015, A.M. Best reaffirmed the financial strength ratings and issuer credit ratings of Intact Financial Corporation and its principal P&C subsidiaries. The outlook remained stable.

DBRS maintains its long-term issuer credit rating for Intact Financial Corporation.

Table 25 – Credit ratings

	A. M. Best	Moody's	DBRS
Long-term issuer credit ratings of IFC	a-	Baa1	A (low)
Financial strength ratings of IFC's principal insurance subsidiaries	A+	A1	n/a

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### 9.3 Cash flows

Table 26 – Selected cash inflows (outflows)

	Q2-2015	Q2-2014	Change	YTD 2015	YTD 2014	Change
<b>Operating activities</b>						
Net cash flows used in operating activities	281	486	(205)	230	465	(235)
<b>Financing activities</b>						
Dividends paid on common shares and preferred shares	(75)	(69)	(6)	(150)	(137)	(13)
Common shares repurchased for share-based payments	(12)	(17)	5	(17)	(23)	6
<b>Other activities</b>						
Business combination	(188)	-	(188)	(188)	(13)	(175)
Purchases of brokerages and books of business, net of sales	(22)	(91)	69	(58)	(125)	67
Purchases of intangibles, property and equipment, net of sales	(18)	(27)	9	(40)	(51)	11
<b>Cash flow available for investment activities<sup>1</sup></b>	<b>(34)</b>	<b>282</b>	<b>(316)</b>	<b>(223)</b>	<b>116</b>	<b>(339)</b>
Purchase of investments, net of proceeds from sales	9	(215)	224	295	(16)	311
<b>Net increase in cash and cash equivalents</b>	<b>(25)</b>	<b>67</b>	<b>(92)</b>	<b>72</b>	<b>100</b>	<b>(28)</b>

<sup>1</sup> A non-IFRS financial measure which includes net cash flows from cash and cash equivalents and the investment portfolio.

Cash flow available for investment activities decreased by \$316 million and \$339 million for the three- and six-month periods compared to the same periods last year. The decrease mainly reflects higher tax instalment payments made in 2015.

We consider that we have sufficient capital resources, cash flows from operating activities and borrowing capacity to support our current and anticipated activities, scheduled principal and interest payments on our outstanding debt, the payment of dividends and other expected financial requirements in the near term.

## Section 10 – Capital management

### 10.1 Capital management objectives

Our objectives when managing capital consist of balancing the need to:

- support claims liabilities and ensure the confidence of policyholders;
- support competitive pricing strategies;
- meet regulatory capital requirements;
- provide adequate returns for our shareholders; and
- maintain our strong position in the Canadian P&C insurance industry.

Our capital is managed on an aggregate basis, as well as individually for each regulated subsidiary. Our federally chartered P&C insurance subsidiaries are subject to the regulatory capital requirements defined by OSFI and the *Insurance Companies Act*. Québec provincially chartered subsidiaries are subject to the requirements of the AMF and the *Act respecting insurance*. OSFI and the AMF have established MCT guidelines, which set out 100% as the minimum. OSFI has also set out 150% as the supervisory target MCT standard for Canadian P&C insurance companies. To ensure that there is minimal risk of breaching the supervisory target, we have established a higher internal threshold for our principal insurance subsidiaries, in excess of which, under normal circumstances, we will maintain our capital.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

Our goal is to maintain adequate excess capital levels to ensure the probability of breaching the regulatory minimum requirements is very low. Such levels may vary over time depending on our evaluation of risks and the potential impact on capital. For example, during periods of high volatility in capital markets, we intend to maintain capital levels well above our minimum internal threshold to absorb fluctuations in equity markets or interest rates. Our intent is also to keep higher levels of excess capital if we foresee growth or actionable opportunities in the near term. Finally, we intend to return excess capital to shareholders first through annual dividend increases and then through share buy-backs when excess capital levels permit.

#### MCT Guidelines

MCT guidelines change from time to time and may impact our capital levels. We carefully monitor all changes, actual or proposed. On September 24, 2014, OSFI released the final MCT guidelines outlining changes to the MCT framework. The new guidelines came into effect on January 1, 2015. Its positive impact will be phased in over three years.

#### 10.2 Capital position

The following table presents the estimated aggregate capital position of our P&C insurance subsidiaries.

Table 27 – Aggregate MCT

As at	June 30, 2015	December 31, 2014
Total capital available	3,819	3,933
Total capital required	1,912	1,878
MCT %	200%	209%
Excess capital at 100%	1,907	2,055
Excess capital at 150%	951	1,116
Excess capital at 170%	569	740

Our aggregate MCT level as at June 30, 2015 was strong at an estimated 200%, down by nine points from December 31, 2014. The decrease is primarily due to the funding of our CDI acquisition with excess capital and investment market changes. The decrease was partially offset by the positive impact of the 2015 MCT guidelines phase-in, which as expected, benefited MCT by approximately four points in the first six months of 2015.

Including net liquid assets outside of the P&C insurance subsidiaries, we had an estimated total of \$564 million in excess capital at an MCT of 170% as at June 30, 2015, compared to total excess capital of \$681 million as at December 31, 2014.

Total capital available and total capital required represent amounts applicable to our P&C insurance subsidiaries and are determined in accordance with prescribed OSFI and AMF rules. Total capital available mostly represents total shareholders' equity less specific deductions for disallowed assets including goodwill and intangible assets, net of related deferred tax liabilities. Total capital required is calculated by classifying assets and liabilities into categories and applying prescribed risk factors to each category. It is further increased by an operational risk margin, based on the overall riskiness of a P&C insurer (its capital required) and its premium volume. Capital required is then reduced by a credit for diversification between investment risk and insurance risk. As at June 30, 2015, our P&C insurance subsidiaries remained well capitalized on an individual basis and were in compliance with regulatory requirements, as well as above internal thresholds.

#### 10.3 MCT sensitivity

The MCT is impacted by many factors including changes in equity market performance, interest rates and underwriting profitability. Based on our estimated aggregate MCT of 200% as at June 30, 2015, the following table sets out the estimated immediate impact or sensitivity of our MCT ratio to certain sudden but independent changes in interest rates and equity markets. Actual results can differ materially from these estimates for a variety of reasons and therefore, these sensitivities should be considered as directional estimates.

Table 28 – Sensitivity to interest rates and equity markets

	Interest rates 1% increase <sup>1</sup>	Equity markets decline <sup>2</sup>
MCT <sup>3</sup>	(3) pts	(3) pts

<sup>1</sup> The yield curve experiences an instantaneous parallel shift.

<sup>2</sup> A shock of 10% is applied to all common shareholdings, net of any equity hedges that we may have. In addition, a shock of approximately 5% is applied to all preferred shares.

<sup>3</sup> Capital sensitivities are calculated independently for each risk factor and assume that all other risk variables remain constant. No management action is considered.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

## Section 11 – Risk management

### 11.1 Risk management structure

We have not significantly changed our risk management strategy as presented in our 2014 annual MD&A.

### 11.2 Estimated impact of changes in interest rates and equity prices

The result of the mark to market of the written call option liabilities embedded in our redeemable preferred shares and the marking to market of our AFS fixed-income securities is impacted by many factors including changes in interest rates and equity markets. The following tables set out the estimated immediate impact or sensitivity of net income and OCI to certain sudden but independent changes in interest rates and equity markets. Actual results can differ materially from these estimates for a variety of reasons and, therefore, these sensitivities should be considered as directional estimates.

Table 29 – Sensitivity to interest rates and equity markets

	Interest rates 100 basis-point increase	Interest rates 100 basis-point decrease	Equity markets increase <sup>1</sup>	Equity markets decline <sup>1</sup>
Net income	8	(8)	(14)	10
OCI	(157)	157	170	(165)

<sup>1</sup> A shock of 10% is applied to all common shareholdings, net of any equity hedges that we may have. In addition, a shock of approximately 5% is applied to all preferred shares.

The above-mentioned impacts are approximately linearly related to the change in interest rates and equity markets. These sensitivity analyses were prepared using key assumptions as described below:

- securities in our portfolio are not impaired;
- interest rates and equity prices move independently;
- shifts in the yield curve are parallel;
- credit, liquidity and basis risks have not been considered;
- impact on our pension plans is not included;
- for our FVTPL fixed-income securities, the estimated impact on net income is assumed to be offset by the impact on MYA on underwriting. In addition, it is important to note that unrealized gain and loss position on AFS securities recorded in AOCI may at some point in the future be realized either through a sale or impairment; and
- risk reduction measures perform as expected, with no material basis risk and no counterparty defaults.

## Section 12 – Off-balance sheet arrangements

### 12.1 Securities lending

We participate in a securities lending program to generate fee income. This program is managed by our custodian, a major Canadian financial institution, whereby we lend securities we own to other financial institutions to allow them to meet their delivery commitments. We loaned securities with a fair value of \$1.8 billion as at June 30, 2015 (\$1.6 billion as at December 31, 2014), which are reported as Investments in the accompanying interim Consolidated financial statements.

Collateral, mainly consisting of government securities, is provided by the counterparty and held in trust by the custodian for our benefit until the underlying security has been returned to us. The collateral cannot be sold or re-pledged externally by us, unless the counterparty defaults on its financial obligations. Additional collateral is obtained or refunded on a daily basis as the market value of the underlying loaned securities fluctuates. The collateral amounted to \$1.8 billion as at June 30, 2015 (\$1.7 billion as at December 31, 2014), approximately 105% of the fair value of loaned securities as at June 30, 2015 and December 31, 2014.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

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## Section 13 – Accounting and disclosure matters

### 13.1 Significant accounting estimates and assumptions

The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying value of certain assets and liabilities are described in our MD&A for the year ended December 31, 2014.

### 13.2 Disclosure controls and procedures

We are committed to providing timely, accurate and balanced disclosure of all material information about the Company and to providing fair and equal access to such information. Management is responsible for establishing and maintaining our disclosure controls and procedures to ensure that information used internally and disclosed externally is complete and reliable. Due to the inherent limitations in all control systems, an evaluation of controls can provide only reasonable, not absolute assurance, that all control issues and instances of fraud or error, if any, within the Company have been detected. We continue to evolve and enhance our system of controls and procedures.

Management, at the direction and under the supervision of the Chief Executive Officer and the Chief Financial Officer of the Company, has evaluated the effectiveness of our disclosure controls and procedures. The evaluation was conducted in accordance with the requirements of National Instrument 52-109 – *Certification of Disclosure in Issuer's Annual and Interim Filings* ("National Instrument 52-109") of the Canadian Securities Administrators. This evaluation confirmed, subject to the inherent limitations noted above, the effectiveness of the design of disclosure controls and procedures as at June 30, 2015. Management can therefore provide reasonable assurance that material information relating to the Company and its subsidiaries is reported to it on a timely basis so that it may provide investors with complete and reliable information.

### 13.3 Internal controls over financial reporting

Management has designed and is responsible for maintaining adequate internal controls over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Following the acquisition of CDI on May 1, 2015, management has limited the scope of design of our disclosure controls and procedures and ICFR reporting to exclude the controls, policies and procedures of CDI. CDI's contribution to our Interim Consolidated financial statements for the quarter ended June 30, 2015 was 1% of DPW. Additionally, as at June 30, 2015, CDI's contribution to our consolidated total assets and total liabilities were both approximately 1%. Management is committed to removing this limitation within the timeframe permitted by regulation.

Management has evaluated the design effectiveness of its ICFR (as defined in National Instrument 52-109). The evaluation was based on the criteria established in the "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer of the Company with the assistance of other Company Management and staff to the extent deemed necessary. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the ICFR were appropriately designed as at June 30, 2015.

In spite of its evaluation, Management recognizes that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives.

No significant changes were made to our ongoing ICFR during the second quarter of 2015 that have materially affected, or are reasonably likely to materially affect our ICFR.

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

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## Section 14 – Investor information

### 14.1 Authorized share capital

Our authorized share capital consists of an unlimited number of common shares and Class A shares.

### 14.2 Outstanding share data

The following table presents the outstanding share data as at July 28, 2015.

Table 30 – Outstanding share data  
(number of shares)

Common shares	131,543,134
Class A	
Series 1 Preferred shares	10,000,000
Series 3 Preferred shares	10,000,000

Refer to our Annual Information Form for the year ended December 31, 2014 for more detailed information on the rights of shareholders.

### 14.3 Dividends declared on common shares and preferred shares

The following table presents the total dividends declared on each class of shares for the three-month period ended June 30, 2015.

Table 31 – Dividends declared per share  
(in dollars)

Common shares	0.53
Class A	
Series 1 Preferred shares	0.2625
Series 3 Preferred shares	0.2625

### 14.4 Expected issuance dates of our financial results

The expected issuance dates of our financial results for the next 12 months are as follows:

Third quarter results, for the period ending September 30, 2015	November 4, 2015
Year-end results, for the period ending December 31, 2015	February 10, 2016
First quarter results, for the period ending March 31, 2016	May 4, 2016
Second quarter results, for the period ending June 30, 2016	July 27, 2016

## Intact Financial Corporation

### Management's Discussion and Analysis for the second quarter of 2015

(in millions of dollars, except as otherwise noted)

#### Section 15 – Selected quarterly information

Table 32 – Selected quarterly information

	2015				2014			2013
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Written insured risks (in thousands)	<b>2,259</b>	1,459	1,595	1,881	2,142	1,444	1,589	1,899
DPW	<b>2,346</b>	1,572	1,760	1,913	2,173	1,503	1,702	1,911
DPW (underlying)	<b>2,344</b>	1,575	1,775	1,941	2,212	1,533	1,729	1,916
Total revenues	<b>1,975</b>	2,027	1,964	1,989	1,984	1,978	1,897	1,908
Net premiums earned	<b>1,865</b>	1,792	1,830	1,826	1,801	1,750	1,804	1,784
Current year catastrophe losses	<b>22</b>	11	10	125	33	75	55	270
Favourable prior year claims development	<b>(106)</b>	(189)	(78)	(80)	(65)	(141)	(66)	(103)
Underwriting income (loss)	<b>158</b>	118	216	124	128	51	67	(50)
Combined ratio	<b>91.6%</b>	93.4%	88.2%	93.2%	92.9%	97.1%	96.3%	102.8%
Net investment income	<b>104</b>	105	111	106	105	105	104	104
NOI	<b>210</b>	186	247	185	206	129	143	59
Net income attributable to shareholders	<b>199</b>	178	205	202	215	160	107	47
<b>Per share measures, basic and diluted (in dollars)</b>								
NOIPS	<b>1.56</b>	1.37	1.84	1.37	1.53	0.94	1.05	0.41
EPS	<b>1.47</b>	1.32	1.52	1.49	1.60	1.17	0.77	0.32

See discussion on seasonality of the business in Section 6 – *Business developments and operating environment*.