the co-operators
A Better Place For You®

# Co-operators General Insurance Company

## Unaudited Condensed Consolidated Interim Financial Statements

For the third quarter ended September 30, 2018

**CO-OPERATORS GENERAL INSURANCE COMPANY**
**CONSOLIDATED BALANCE SHEETS**
(unaudited)

As at

| (in thousands of Canadian dollars) | **September 30, 2018 $** | December 31, 2017 $ |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents | **91,647** | 84,382 |
| Invested assets including securities on loan (note 4) | **4,601,850** | 4,298,938 |
| Premiums due | **1,104,997** | 938,128 |
| Income taxes recoverable | **44,206** | 4,245 |
| Reinsurance ceded contracts (note 6) | **175,413** | 112,177 |
| Deferred acquisition expenses | **288,723** | 224,504 |
| Deferred income taxes | **113,077** | 106,121 |
| Intangible assets (note 8) | **78,419** | 73,308 |
| Other assets (note 9) | **69,667** | 80,261 |
| | **6,567,999** | 5,922,064 |
| **Liabilities** | | |
| Accounts payable and accrued charges | **233,631** | 248,819 |
| Income taxes payable | **8** | 239 |
| Insurance contracts (note 5) | **4,453,004** | 3,875,709 |
| Retirement benefit obligations | **130,698** | 126,686 |
| Deferred income taxes | **3,787** | 4,186 |
| Provisions and other liabilities (note 10) | **139,726** | 135,397 |
| | **4,960,854** | 4,391,036 |
| **Shareholders' equity** | | |
| Share capital | **412,442** | 227,840 |
| Contributed capital | **874** | 10,132 |
| Retained earnings | **1,067,400** | 1,169,323 |
| Accumulated other comprehensive income | **126,429** | 123,733 |
| | **1,607,145** | 1,531,028 |
| | **6,567,999** | 5,922,064 |

See accompanying notes to condensed consolidated interim financial statements.

**CO-OPERATORS GENERAL INSURANCE COMPANY**
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**
(unaudited)

| **9 months ended September 30, 2018**<br>**(in thousands of Canadian dollars)** | **Share capital**<br>**$** | **Contributed capital**<br>**$** | **Retained earnings**<br>**$** | **Accumulated other comprehensive income**<br>**$** | **Total shareholders' equity**<br>**$** |
|---|---|---|---|---|---|
| Balance, beginning of period | **227,840** | **10,132** | **1,169,323** | **123,733** | **1,531,028** |
| Net loss | **-** | **-** | **(18,870)** | **-** | **(18,870)** |
| Other comprehensive loss | **-** | **-** | **-** | **(340)** | **(340)** |
| Total comprehensive loss | **-** | **-** | **(18,870)** | **(340)** | **(19,210)** |
| Staff share loan plan | **(82)** | **-** | **-** | **-** | **(82)** |
| Preference shares issued | **7,823** | **-** | **-** | **-** | **7,823** |
| Preference shares redeemed | **(4,839)** | **-** | **(531)** | **-** | **(5,370)** |
| Common shares issued | **181,700** | **-** | **-** | **-** | **181,700** |
| Dividends declared (note 12) | **-** | **-** | **(6,390)** | **-** | **(6,390)** |
| Acquisition of subsidiary from a related party (note 3) | **-** | **(9,258)** | **(76,132)** | **3,036** | **(82,354)** |
| **Balance, end of period** | **412,442** | **874** | **1,067,400** | **126,429** | **1,607,145** |

| 9 months ended September 30, 2017<br>(in thousands of Canadian dollars) | Share capital<br>$ | Contributed capital<br>$ | Retained earnings<br>$ | Accumulated other comprehensive income<br>$ | Total shareholders' equity<br>$ |
|---|---|---|---|---|---|
| Balance, beginning of period | 222,720 | 10,132 | 1,218,439 | 127,591 | 1,578,882 |
| Net income | - | - | 56,246 | - | 56,246 |
| Other comprehensive loss | - | - | - | (8,705) | (8,705) |
| Total comprehensive income (loss) | - | - | 56,246 | (8,705) | 47,541 |
| Staff share loan plan | 54 | - | - | - | 54 |
| Preference shares issued | 8,140 | - | - | - | 8,140 |
| Preference shares redeemed | (3,975) | - | (78) | - | (4,053) |
| Dividends declared (note 12) | - | - | (106,295) | - | (106,295) |
| Balance, end of period | 226,939 | 10,132 | 1,168,312 | 118,886 | 1,524,269 |

See accompanying notes to condensed consolidated interim financial statements.

# CO-OPERATORS GENERAL INSURANCE COMPANY
# CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

| (in thousands of Canadian dollars except for earnings per share and weighted average number of common shares) | **3 months ended September 30, 2018 $** | 3 months ended September 30, 2017 $ | **9 months ended September 30, 2018 $** | 9 months ended September 30, 2017 $ |
|---|---|---|---|---|
| Income | | | | |
| Net earned premium (note 11) | **750,617** | 656,312 | **2,126,123** | 1,894,291 |
| Net investment income and gains (note 4) | **36,004** | 38,359 | **82,157** | 136,663 |
| Fees and other income | **2,189** | 1,767 | **6,363** | 6,116 |
| | **788,810** | 696,438 | **2,214,643** | 2,037,070 |
| Expenses | | | | |
| Claims and benefits | **538,674** | 469,911 | **1,625,530** | 1,294,021 |
| Ceded claims and benefits | **5,055** | 28,549 | **(53,697)** | 44,762 |
| Premium and other taxes | **25,953** | 24,591 | **73,687** | 67,127 |
| Commissions and advisor compensation | **151,017** | 108,770 | **417,122** | 325,294 |
| Ceded commission | **(28,656)** | (1,088) | **(56,893)** | (3,204) |
| General expenses | **82,286** | 78,202 | **244,142** | 240,217 |
| | **774,329** | 708,935 | **2,249,891** | 1,968,217 |
| Income (loss) before income taxes | **14,481** | (12,497) | **(35,248)** | 68,853 |
| Income tax expense (recovery) (note 7) | **1,611** | (5,128) | **(16,378)** | 12,607 |
| **Net income (loss)** | **12,870** | (7,369) | **(18,870)** | 56,246 |
| Earnings (loss) per share | **0.48** | (0.40) | **(1.08)** | 2.33 |
| Weighted average number of common shares | **24,413** | 21,458 | **23,307** | 21,458 |

# CO-OPERATORS GENERAL INSURANCE COMPANY
# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

| (in thousands of Canadian dollars) | **3 months ended September 30, 2018 $** | 3 months ended September 30, 2017 $ | **9 months ended September 30, 2018 $** | 9 months ended September 30, 2017 $ |
|---|---|---|---|---|
| Net income (loss) | **12,870** | (7,369) | **(18,870)** | 56,246 |
| Other comprehensive income (loss) | | | | |
| Items that may be reclassified subsequently to the statement of income: | | | | |
| Net unrealized gains (losses) on available-for-sale financial assets | **(18,618)** | (25,498) | **1,994** | 8,510 |
| Net reclassification adjustment for (gains) losses included in net income | **(1,362)** | (6,440) | **(4,206)** | (20,305) |
| Items that may be reclassified before income taxes | **(19,980)** | (31,938) | **(2,212)** | (11,795) |
| Income tax expense (recovery) relating to items that may be reclassified | **(5,879)** | (8,273) | **(1,872)** | (3,090) |
| Other comprehensive loss | **(14,101)** | (23,665) | **(340)** | (8,705) |
| **Comprehensive income (loss)** | **(1,231)** | (31,034) | **(19,210)** | 47,541 |

See accompanying notes to condensed consolidated interim financial statements.

# CO-OPERATORS GENERAL INSURANCE COMPANY
# CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

| (in thousands of Canadian dollars) | **9 months ended September 30, 2018 $** | 9 months ended September 30, 2017 $ |
|---|---|---|
| **Operating activities** | | |
| Net income (loss) | **(18,870)** | 56,246 |
| Items not requiring the use of cash (note 13) | **29,369** | (27,673) |
| Changes in non-cash operating components (note 13) | **127,088** | 94,039 |
| Cash provided by operating activities | **137,587** | 122,612 |
| **Investing activities** | | |
| Purchases and advances of: | | |
| Invested assets | **(2,530,062)** | (1,783,430) |
| Intangible assets | **(45)** | (5,786) |
| Property and equipment | **(1,975)** | (2,024) |
| Acquisition of subsidiary from related party, net of cash acquired | **(176,803)** | - |
| Sale and redemption of: | | |
| Invested assets | **2,425,374** | 1,830,602 |
| Assets held for sale | **-** | 738 |
| Cash provided by (used in) investing activities | **(283,511)** | 40,100 |
| **Financing activities** | | |
| Share capital - preference shares issued | **7,823** | 8,140 |
| Share capital - preference shares redeemed | **(5,370)** | (4,053) |
| Share capital - common shares issued | **181,700** | - |
| Dividends paid (note 12) | **(8,997)** | (108,761) |
| Cash provided by (used in) financing activities | **175,156** | (104,674) |
| Net increase in cash and cash equivalents, net of payments in transit | **29,232** | 58,038 |
| Cash and cash equivalents, net of payments in transit, beginning of period | **34,996** | 26,588 |
| **Cash and cash equivalents, net of payments in transit, end of period** | **64,228** | 84,626 |

| | | |
|---|---|---|
| Cash | **51,807** | 27,043 |
| Cash equivalents | **39,840** | 62,455 |
| Net payments in transit, included in accounts payable and accrued charges | **(27,419)** | (4,872) |
| **Cash and cash equivalents, net of payments in transit, end of period** | **64,228** | 84,626 |

See accompanying notes to condensed consolidated interim financial statements.

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

## 1. Nature of operations

Unless otherwise noted or the context otherwise indicates, in these notes “Company” refers to the Consolidated Co-operators General Insurance Company. CGIC refers to the Non-Consolidated Co-operators General Insurance Company.

The Company is comprised of CGIC and its wholly owned subsidiaries: The Sovereign General Insurance Company (Sovereign), COSECO Insurance Company (COSECO), CUMIS General Insurance Company (CUMIS General), Co-operators Investment Limited Partnership (CILP), Co-operators Strategic Growth Corporation (CSGC) and Co-operators Insurance Agencies Limited (CIAL). 100% of the voting rights attached to all the outstanding voting shares or partnership interests of each of Sovereign, COSECO, CUMIS General, CILP, CSGC and CIAL are held by the Company.

The registered office of the Company is 130 Macdonell Street, Guelph, Ontario. The Company is domiciled in Canada and is incorporated under the Insurance Companies Act (Canada). These condensed consolidated interim financial statements of the Company for the nine months ended September 30, 2018 were authorized for issue in accordance with a resolution of the Audit Committee of the Board of Directors on October 25, 2018.

CGIC and certain of its subsidiaries are licensed to write insurance in all provinces and territories in Canada. With the exception of CUMIS General, CGIC and certain of its subsidiaries are licensed to write all classes of insurance, other than life. CUMIS General is licensed to write property, casualty and accident and sickness insurance. AZGA Service Canada Inc. (AZGA Canada), an associate of Co-operators Life Insurance Company (CLIC), a company under common control, acts as Managing General Underwriter (MGU) with respect to travel insurance underwritten by CUMIS General. CGIC and certain of its subsidiaries are regulated by the federal insurance act. The Company must comply with reporting requirements of its regulator the Office of the Superintendent of Financial Institutions, Canada (OSFI).

The Company’s common shares are 100% owned by Co-operators Financial Services Limited (CFSL), which in turn is owned 100% by The Co-operators Group Limited (CGL). The Class E preference shares, Series C are traded on the Toronto Stock Exchange under the symbol CCS.PR.C.

## 2. Summary of significant accounting policies

### Basis of preparation and statement of compliance

These condensed consolidated interim financial statements of the Company have been prepared in accordance with International Accounting Standard (IAS) 34, “Interim Financial Reporting”.

The consolidated balance sheets are presented on a non-classified basis. Assets expected to be realized and liabilities expected to be settled within the Company’s normal operating cycle of one year would typically be considered as current. Certain balances are comprised of both current and non-current amounts.

### Seasonality

The property and casualty (P&C) insurance business is seasonal in nature. Premiums are generally written in annual renewal cycles, often in the second quarter each year. Weather conditions can vary significantly between quarters, with extreme weather conditions historically having an impact on the first and third quarters.

**Segmented information**

The Company's results of operations are reviewed by senior management and the Board of Directors based on one reporting and operating segment, P&C operations.

**Significant accounting policies**

These condensed consolidated interim financial statements should be read in conjunction with the Company's annual consolidated financial statements for the year ended December 31, 2017, which have been prepared in accordance with IFRS as issued by the IASB. The accounting policies followed in these condensed consolidated interim financial statements are consistent as those applied in the Company's audited consolidated financial statements for the year ended December 31, 2017, except where two new policies have been introduced in relation to the acquisition of CUMIS General.

IFRS 3 "Business Combinations" excludes from its scope the combination of entities or businesses under common control. Therefore, in accordance with IAS 8 "Accounting policies, changes in accounting estimates and errors", the Company has considered various other sources of guidance and has elected to record the acquisition of businesses under common control using the pre-acquisition date book values for their assets and liabilities and will not apply the measurement principles of IFRS 3; the difference between fair value and book value has been recorded through equity. Consistent with IFRS 3, the results of the Company prior to the acquisition date will not be restated.

Furthermore, as part of the Company's acquisition of CUMIS General (note 3), the Company has an experienced rated refund pool established as part of its fidelity program. This program provides a mechanism for the accumulation and redistribution of funds if favourable experience exists within the program over a period of years. Refunds are determined based on the adequacy of the pool and the results of the fidelity program. The provision is evaluated regularly and recorded within insurance contracts in the Company's consolidated balance sheet.

The significant estimates and judgments made by management in applying accounting policies and the key sources of estimation uncertainty are the same as those that applied to the consolidated financial statements of the Company for the year ended December 31, 2017.

The Company has the following updates to information provided in the consolidated financial statements ended December 31, 2017 about the standards issued but not yet effective.

*IFRS 9 "Financial Instruments"*

IFRS 9 was issued in July 2014 and is intended to replace IAS 39 "Financial Instruments: Recognition and Measurement". IFRS 9 is a three-part standard aimed at reducing complexity in reporting financial instruments. The project has been divided into three phases: Phase 1 Classification and measurement, Phase 2 Impairment and Phase 3 Hedge accounting. Phase 1 was issued in November 2009 and amended in October 2010. It requires financial assets to be recorded at amortized cost or fair value depending on the entity's business model for managing the assets and their associated cash flow characteristics. All financial assets are to be measured at fair value on the balance sheet if they are not measured at amortized cost. At initial recognition, an entity may irrevocably designate a financial asset as measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases. Phase 2 was completed in July 2014 and introduced a new expected loss impairment methodology that will result in more timely recognition of impairment losses. Phase 3 was completed in November 2013. This phase replaces the rule-based hedge accounting requirements in IAS 39 to more closely align the accounting with risk management activities.

The standard is effective for annual periods beginning on or after January 1, 2018; however, in September 2016, IFRS 4 was amended to provide an option of a temporary exemption from applying IFRS 9 for entities whose predominate activity is issuing insurance contracts within the scope of IFRS 4. Therefore, qualifying entities will have the option to adopt IFRS 9 upon the adoption of IFRS 17. The Company has assessed the qualification criteria and determined that this temporary exemption does apply; thus, IFRS 9 will be effective for annual periods beginning on or after January 1, 2021.

The Company has concluded that it qualifies for the temporary exemption from IFRS 9 based on the following reasons: (1) The Company has not previously applied any version of IFRS 9 for any of the entities and (2) The Company entities are predominantly considered insurance. To be considered predominantly insurance, the carrying amount of liabilities arising from contracts within the scope of IFRS 4 (which includes any deposit components or embedded derivatives unbundled from insurance contracts) must be significant compared to the total carrying amount of all liabilities. The standard goes on to detail that significant is defined as greater than 90 per cent, or less than or equal to 90 per cent but greater than 80 per cent and the insurer does not engage in a significant activity unconnected with insurance.

The Company has assessed the criteria detailed above. Management completed an assessment of the entities that fall within the 80 per cent to 90 per cent range and concluded that significant activities are connected with insurance. This assessment was performed using primarily publicly available information.

Management is evaluating the annual disclosure requirement for the temporary exemption of IFRS 9 and it will be disclosed in the December 31, 2018 financial statements.

*IFRS 15 “Revenue from Contracts with Customers”*

The IFRS 15 scope exemptions for insurance contract revenue and financial instrument revenue apply to the Company’s significant revenue streams (net earned premiums and net investment gains and income, respectively). As a result, this standard does not impact net earned premium or net investment gains and income.

The Company has assessed the other revenue amounts under the new standard and concluded that no change in the revenue recognition policies of the Company is required.

## 3. Acquisition of subsidiary from a related party

On April 1, 2018, CGIC entered into an agreement with a company under common control, CUMIS Services Incorporated, to acquire 100% of the common shares of CUMIS General, a P&C insurance company. Both parties to the agreement are owned 100% by CFSL. The Company has applied the predecessor accounting method and has recorded the acquisition at the carrying value of CUMIS General. As of the date of the acquisition, the results of the operations of CUMIS General are included in these consolidated financial statements. The difference between the carrying value and the consideration exchanged was recorded through shareholders’ equity in the Company’s consolidated financial statements.

The fair value of consideration exchanged of $179,160 was paid in cash. CGIC funded this transaction through the issuance of common shares to its parent, CFSL. The internal reorganization simplifies the overall structure of CGL by aligning the P&C operations under a common legal entity.

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

The table below summarizes the consideration paid for CUMIS General and the amounts recognized for the assets acquired, liabilities assumed, and through equity as at the acquisition date.

| | As at April 1, 2018 $ |
|---|---|
| **Carrying value of assets acquired** | |
| Cash and cash equivalents | 2,357 |
| Invested assets including securities on loan | 219,741 |
| Premiums due | 30,938 |
| Reinsurance ceded contracts | 82,713 |
| Deferred acquisition expenses | 39,225 |
| Deferred income taxes | 4,961 |
| Income taxes recoverable | 481 |
| Intangible assets | 7,528 |
| Other assets | 2,985 |
| | 390,929 |
| **Carrying value of liabilities acquired** | |
| Accounts payable and accrued charges | 6,747 |
| Insurance contracts | 287,274 |
| Provisions and other liabilities | 102 |
| | 294,123 |
| **Net assets acquired** | 96,806 |
| **Fair value of consideration exchanged** | 179,160 |
| **Difference allocated through equity** | (82,354) |
| | |
| **Allocated to:** | |
| Contributed capital | (9,258) |
| Retained earnings | (76,132) |
| Accumulated other comprehensive income | 3,036 |
| Difference allocated through equity | (82,354) |

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

## 4. Invested assets and net investment income and gains

### *a) Invested assets*

| | Fair value | | | Amortized cost | Carrying value |
|---|---|---|---|---|---|
| | | Classified | Designated | Loans and | |
| | AFS | FVTPL | FVTPL | receivables | Total |
| **September 30, 2018** | $ | $ | $ | $ | $ |
| **Bonds** | | | | | |
| Federal | 531,081 | - | 39,219 | - | 570,300 |
| Provincial | 829,689 | - | 38,896 | - | 868,585 |
| Municipal | 32,570 | - | - | - | 32,570 |
| Corporate | 861,469 | - | 46,251 | 894 | 908,614 |
| Asset-backed securities | 74,970 | - | 8,930 | - | 83,900 |
| International | 83,082 | - | - | - | 83,082 |
| | 2,412,861 | - | 133,296 | 894 | 2,547,051 |
| **Stocks** | | | | | |
| Canadian common | 619,825 | - | - | - | 619,825 |
| Canadian preferred | 6,365 | - | 427,935 | - | 434,300 |
| U.S. equities | 167,695 | - | - | - | 167,695 |
| Foreign equities | 89,003 | - | - | - | 89,003 |
| | 882,888 | - | 427,935 | - | 1,310,823 |
| Short-term investments | 130,241 | - | - | 4,783 | 135,024 |
| Limited partnerships | 127,241 | - | - | - | 127,241 |
| Foreign currency forward contracts | - | 2,468 | - | - | 2,468 |
| Mortgages | - | - | - | 444,351 | 444,351 |
| Other investments | - | - | - | 11,000 | 11,000 |
| Investment income due and accrued | - | - | - | 23,892 | 23,892 |
| **Total invested assets** | 3,553,231 | 2,468 | 561,231 | 484,920 | 4,601,850 |

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

| | Fair Value | | | Amortized Cost | Carrying Value |
|---|---|---|---|---|---|
| | | Classified | Designated | Loans and | |
| | AFS | FVTPL | FVTPL | receivables | Total |
| December 31, 2017 | $ | $ | $ | $ | $ |
| Bonds | | | | | |
| Federal | 500,639 | - | 28,871 | - | 529,510 |
| Provincial | 685,693 | - | 38,737 | - | 724,430 |
| Municipal | 40,884 | - | - | - | 40,884 |
| Corporate | 927,015 | - | 48,391 | - | 975,406 |
| Asset-backed securities | 55,133 | - | 5,323 | - | 60,456 |
| International | 48,140 | - | - | - | 48,140 |
| | 2,257,504 | - | 121,322 | - | 2,378,826 |
| Stocks | | | | | |
| Canadian common | 592,439 | - | - | - | 592,439 |
| Canadian preferred | 6,244 | - | 394,375 | - | 400,619 |
| U.S. equities | 149,735 | - | - | - | 149,735 |
| Foreign equities | 86,418 | - | - | - | 86,418 |
| | 834,836 | - | 394,375 | - | 1,229,211 |
| Short-term investments | 143,577 | - | - | - | 143,577 |
| Limited partnerships | 93,800 | - | - | - | 93,800 |
| Foreign currency forward contracts | - | 1,928 | - | - | 1,928 |
| Mortgages | - | - | - | 421,673 | 421,673 |
| Other investments | - | - | - | 10,231 | 10,231 |
| Investment income due and accrued | - | - | - | 19,692 | 19,692 |
| Total invested assets | 3,329,717 | 1,928 | 515,697 | 451,596 | 4,298,938 |

The value of the securities on loan included in invested assets above consists of $64,101 (2017 - $52,056) in stocks and $396,966 (2017 - $580,206) in bonds.

***b) Investments - measured at fair value***

The Company is responsible for determining the fair value of its investment portfolio by utilizing market-driven measurements obtained from active markets where available, by considering other observable and unobservable inputs and by employing valuation techniques that make use of current market data. Assets and liabilities recorded at fair value in the consolidated balance sheets are measured and classified in a hierarchy consisting of three levels for disclosure purposes. The three levels are based on the significance and reliability of the inputs to the respective valuation techniques. The input levels are defined as follows:

*Level 1 - Quoted prices*

Represents unadjusted quoted prices for identical instruments exchanged in active markets. The fair value is determined based on quoted prices in active markets obtained from external pricing sources.

*Level 2 - Significant other observable inputs*

Includes directly or indirectly observable inputs other than quoted prices for identical instruments exchanged in active markets. These inputs include quoted prices for similar instruments exchanged in active markets and quoted prices for identical or similar instruments exchanged in inactive markets. For financial instruments that do not have directly observable inputs, the fair value is calculated as the present value of the future cash flows considering inputs other than quoted prices that are observable for the instruments, such as interest rates and yield curves, volatilities, prepayment spreads, credit risks and default rates where available; and inputs that are derived principally from or corroborated by observable market data by correlation or other means. Consistent with market participants, the Company determines the fair values of foreign exchange forward contracts by using a discounted cash flow valuation technique using observable market data.

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

*Level 3 - Significant unobservable inputs*

Includes inputs that are not based on observable market data. Management is required to use its own assumptions regarding unobservable inputs as there is little, if any, market activity in these assets or liabilities or related observable inputs that can be corroborated at the measurement date. Unobservable inputs require significant management judgement or estimation to make certain projections and assumptions about the information that would be used by market participants in pricing assets or liabilities. To verify pricing, the Company assesses the reasonability of the fair values by comparing to industry accepted valuation models, to movements in credit spreads and to recent transaction prices for similar assets where available.

The following summarizes how fair values were determined for recurring measurements as at:

| September 30, 2018 | Level 1 - Quoted prices $ | Level 2 - Significant other observable inputs $ | Level 3 - Significant unobservable inputs $ | Total fair value $ |
|---|---|---|---|---|
| **AFS** | | | | |
| Bonds | - | 2,412,861 | - | 2,412,861 |
| Stocks | 874,180 | 6,365 | - | 880,545 |
| Short-term investments | - | 130,241 | - | 130,241 |
| Limited partnerships | - | - | 127,241 | 127,241 |
| | 874,180 | 2,549,467 | 127,241 | 3,550,888 |
| **FVTPL** | | | | |
| Bonds | - | 133,296 | - | 133,296 |
| Stocks | 427,935 | - | - | 427,935 |
| Foreign currency forward contracts | - | 2,468 | - | 2,468 |
| | 427,935 | 135,764 | - | 563,699 |
| **Total invested assets at fair value** | 1,302,115 | 2,685,231 | 127,241 | 4,114,587 |
| **FVTPL** | | | | |
| Foreign currency forward contracts (note 10) | - | 122 | - | 122 |
| **Total financial liabilities at fair value** | - | 122 | - | 122 |

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

| December 31, 2017 | Level 1 - Quoted prices $ | Level 2 - Significant other observable inputs $ | Level 3 - Significant unobservable inputs $ | Total fair value $ |
|---|---|---|---|---|
| AFS | | | | |
| Bonds | - | 2,257,504 | - | 2,257,504 |
| Stocks | 826,883 | 6,244 | - | 833,127 |
| Short-term investments | - | 143,577 | - | 143,577 |
| Limited partnerships | - | - | 93,800 | 93,800 |
| | 826,883 | 2,407,325 | 93,800 | 3,328,008 |
| FVTPL | | | | |
| Bonds | - | 121,322 | - | 121,322 |
| Stocks | 394,375 | - | - | 394,375 |
| Foreign currency forward contracts | - | 1,928 | - | 1,928 |
| | 394,375 | 123,250 | - | 517,625 |
| Total invested assets at fair value | 1,221,258 | 2,530,575 | 93,800 | 3,845,633 |
| FVTPL | | | | |
| Foreign currency forward contracts (note 10) | - | 2,855 | - | 2,855 |
| Total financial liabilities at fair value | - | 2,855 | - | 2,855 |

Excluded from these totals are AFS investments of $2,343 (2017 - $1,709) in shares of other co-operative entities which are carried at cost as they do not have quoted market prices in active markets.

The following table is a reconciliation of the Level 3 fair value measurements.

| **9 months ended September 30, 2018** | **Limited partnerships $** |
|---|---|
| Balance, beginning of period | **93,800** |
| Purchases | **18,044** |
| Sales and redemptions | **(1,254)** |
| Acquisition of subsidiary | **4,720** |
| Gains | |
| Unrealized included in OCI | **11,931** |
| **Balance, end of period** | **127,241** |

No investments were transferred between levels during the period (2017 - $nil).

The investments measured at fair value and classified as Level 3 as at September 30, 2018 are limited partnerships, which represent units of third-party managed private equity funds (Funds). The fair values of limited partnership investments are based on the net asset value (NAV) from each of the individual Funds most recent quarterly or annual financial statements. Limited partnership NAV's are derived by valuation techniques employed by each Funds' management using unobservable inputs. The Company assesses the NAV disclosed in each Funds most recent financial statement using independent analytical procedures to ensure the amount is a reasonable representation of fair value. The Company does not assess the sensitivity of the fair value of limited partnerships because the inputs used by each fund manager to determine the NAV are unobservable and not readily available.

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

The fair value of mortgages at September 30, 2018 is $444,213 (December 31, 2017 - $424,440). Mortgages measured at fair value, for disclosure purposes only, are classified as Level 3. The fair value of the mortgages has been calculated by discounting the expected cash flows of each instrument. The discount rate is determined using the Government of Canada benchmark bond yield for instruments of similar maturity adjusted for specific credit risk. In determining the adjustment for credit risk, the Company considers market conditions, the value of the properties that the mortgage is secured by and other indicators of creditworthiness.

### *c) Net investment income and gains*

| | **3 months ended September 30, 2018 $** | 3 months ended September 30, 2017 $ | **9 months ended September 30, 2018 $** | 9 months ended September 30, 2017 $ |
|---|---|---|---|---|
| Interest income | **22,078** | 18,533 | **62,896** | 57,535 |
| Dividend and other income | **10,199** | 9,400 | **31,211** | 28,241 |
| Investment expense | **(1,736)** | (1,546) | **(4,916)** | (4,686) |
| Net investment income | **30,541** | 26,387 | **89,191** | 81,090 |
| Net realized gains | **4,320** | 9,248 | **10,286** | 21,918 |
| Net foreign exchange gains (losses) | **3,759** | 6,834 | **(139)** | 20,291 |
| Change in fair value (note 13) | **(669)** | (2,886) | **(9,724)** | 18,886 |
| Impairment losses (note 13) | **(1,947)** | (1,224) | **(7,457)** | (5,522) |
| Net investment gains (losses) | **5,463** | 11,972 | **(7,034)** | 55,573 |
| **Net investment income and gains** | **36,004** | 38,359 | **82,157** | 136,663 |

## 5. Insurance contracts

Insurance contracts are comprised of the following balances:

| | **As at September 30, 2018 $** | As at December 31, 2017 $ |
|---|---|---|
| Undiscounted unpaid claims and adjustment expenses | **2,658,748** | 2,370,384 |
| Effect of time value of money | **(109,855)** | (121,040) |
| Provisions for adverse deviation (PFADs) | **208,890** | 226,608 |
| Effect of discounting | **99,035** | 105,568 |
| Discounted unpaid claims and adjustment expenses | **2,757,783** | 2,475,952 |
| Unearned premiums | **1,679,206** | 1,399,757 |
| Experience rated refund pool | **16,015** | - |
| | **4,453,004** | 3,875,709 |

The most recent set of annual consolidated financial statements provides a summary of the Company's unpaid claims and adjustment expense provision and unearned premiums by type of insurance contract both before and after reinsurance, prior to the April 1, 2018 acquisition of CUMIS General. The CUMIS General insurance contract liabilities are shown in note 3.

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

## 6. Reinsurance contracts

The Company follows the policy of underwriting and reinsuring contracts of insurance which limits the liability of the Company to a maximum amount on any one loss. In addition, the Company has obtained reinsurance which limits the Company's liability in the event of a series of claims arising out of a single occurrence, with the exception of travel insurance which is described in further detail below.

The Company's net retentions are as follows:

| | **As at September 30, 2018 $** | As at December 31, 2017 $ |
|---|---|---|
| Individual loss | | |
| Property | **7,500** | 7,500 |
| General liability | **5,000** | 5,000 |
| Automobile | **5,000** | 5,000 |
| Fidelity and director's liability | **3,000** | - |
| Catastrophe | | |
| Maximum limit | **1,300,000** | 1,450,000 |
| Company retention | **70,000** | 70,000 |

For certain special classes of business or types of risk, the retention for single risk events may be lower through specific treaties or the use of facultative reinsurance. The maximum limit for catastrophe reinsurance is applied to all P&C insurance operations ultimately owned by CGL. After application of the catastrophe program, the Company's retention is $70,000 in incurred claims.

CUMIS General's accident and sickness travel insurance, underwritten by the MGU, is fully ceded; 45% to CLIC and 55% to an external reinsurer. In addition, 55% of the property travel insurance is ceded to an external reinsurer; the amounts retained are reinsured in excess of $56 per claim, with a catastrophe maximum limit of $1,800 and the company's retention is $450.

The amounts presented under reinsurance ceded contracts in the consolidated balance sheets represent the Company's net contractual rights under reinsurance contracts and consist of the following:

| | **As at September 30, 2018 $** | As at December 31, 2017 $ |
|---|---|---|
| Reinsurance ceded assets | | |
| Reinsurers' share of unearned premiums | **60,952** | 6,475 |
| Reinsurers' share of unpaid claims and adjustment expenses | **165,573** | 135,236 |
| Reinsurer receivables | **11,934** | 7,758 |
| | **238,459** | 149,469 |
| Reinsurance ceded liabilities | | |
| Unearned reinsurance commissions | **32,005** | 1,954 |
| Payable to reinsurers | **3,095** | 2,218 |
| Unlicensed reinsurer deposits | **27,946** | 33,120 |
| | **63,046** | 37,292 |
| Reinsurance ceded contracts | **175,413** | 112,177 |

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

## 7. Income taxes

### *Reconciliation to statutory income tax rate*

In the consolidated statements of income, the income taxes reflect an effective tax rate which differs from the statutory tax rate for the following reasons:

| | **9 months ended September 30, 2018** | | 9 months ended September 30, 2017 | |
|---|---|---|---|---|
| | **$** | **%** | $ | % |
| Income (loss) before income taxes | **(35,248)** | | 68,853 | |
| Income tax expense (recovery) at statutory rates | **(9,517)** | **27.0** | 18,590 | 27.0 |
| Effects of: | | | | |
| Non-taxable investment income | **(7,133)** | **20.2** | (5,988) | (8.7) |
| Non-deductible expenses | **598** | **(1.7)** | 362 | 0.5 |
| Change in income tax rates | **(48)** | **0.1** | 175 | 0.3 |
| Difference in effective tax rate of subsidiaries | **(11)** | **-** | (4) | - |
| Adjustment to tax expense in respect of prior years | **(195)** | **0.6** | (728) | (1.1) |
| Other | **(72)** | **0.2** | 200 | 0.3 |
| Income tax expense (recovery) | **(16,378)** | **46.4** | 12,607 | 18.3 |

## 8. Intangible assets

| | **Goodwill** | Licenses | **Brand** | **Software** | **Broker Customer Lists** | **Total** |
|---|---|---|---|---|---|---|
| | **$** | $ | **$** | **$** | **$** | **$** |
| **Cost** | | | | | | |
| January 1, 2017 | 1,076 | 50,000 | - | 18,395 | 24,359 | 93,830 |
| Additions | - | 3,750 | - | - | 2,035 | 5,785 |
| December 31, 2017 | 1,076 | 53,750 | - | 18,395 | 26,394 | 99,615 |
| Additions | - | - | - | - | 45 | 45 |
| Acquisition of subsidiary | 5,730 | - | 800 | - | 5,700 | 12,230 |
| **September 30, 2018** | **6,806** | **53,750** | **800** | **18,395** | **32,139** | **111,890** |
| **Accumulated amortization** | | | | | | |
| January 1, 2017 | - | - | - | 17,897 | 5,431 | 23,328 |
| Amortization | - | - | - | 230 | 2,749 | 2,979 |
| December 31, 2017 | - | - | - | 18,127 | 8,180 | 26,307 |
| Amortization | - | - | - | 119 | 2,342 | 2,461 |
| Acquisition of subsidiary | - | - | - | - | 4,703 | 4,703 |
| **September 30, 2018** | **-** | - | - | **18,246** | **15,225** | **33,471** |
| **Net carrying value** | | | | | | |
| December 31, 2017 | 1,076 | 53,750 | - | 268 | 18,214 | 73,308 |
| **September 30, 2018** | **6,806** | **53,750** | **800** | **149** | **16,914** | **78,419** |

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

## 9. Other assets

| | **As at September 30, 2018** | As at December 31, 2017 |
|---|---|---|
| | **$** | $ |
| Due from related parties | **30,951** | 39,494 |
| Loans to related parties | **300** | 300 |
| Reinsurance assumed receivables | **1,323** | 1,085 |
| Property and equipment | **19,194** | 23,518 |
| Due from risk sharing pools | **2,813** | 1,008 |
| Investments in associates and joint ventures | **7,785** | 8,405 |
| Prepaid expenses | **1,214** | 1,874 |
| Other | **6,087** | 4,577 |
| | **69,667** | 80,261 |

## 10. Provisions and other liabilities

| | **As at September 30, 2018** | As at December 31, 2017 |
|---|---|---|
| | **$** | $ |
| Provision for advisor transition commissions | **119,884** | 109,610 |
| Advisor transition commission payable | **12,279** | 15,369 |
| Other provisions | **4,600** | 4,599 |
| Foreign currency forward contracts (note 4) | **122** | 2,855 |
| Other liabilities | **2,841** | 2,964 |
| | **139,726** | 135,397 |

## 11. Net earned premium

| | **3 months ended September 30, 2018** | 3 months ended September 30, 2017 | **9 months ended September 30, 2018** | 9 months ended September 30, 2017 |
|---|---|---|---|---|
| | **$** | $ | **$** | $ |
| Direct written premium | **909,125** | 746,244 | **2,450,518** | 2,055,192 |
| Assumed written premium | **5,654** | 2,125 | **13,100** | 5,624 |
| Gross written premium | **914,779** | 748,369 | **2,463,618** | 2,060,816 |
| Ceded written premium | **(74,309)** | (18,358) | **(170,829)** | (57,860) |
| Net written premium | **840,470** | 730,011 | **2,292,789** | 2,002,956 |
| Change in gross unearned premium | **(91,779)** | (73,455) | **(170,933)** | (109,393) |
| Change in ceded unearned premium | **1,926** | (244) | **4,267** | 728 |
| Net earned premium | **750,617** | 656,312 | **2,126,123** | 1,894,291 |

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

## 12. Share capital

The number of shares and the amounts per share are not in thousands.

For the nine months ended September 30, 2018, the Company issued 78,228 (2017 - 81,402) Class A preference shares, series B for $7,823 (2017 - $8,140) and redeemed 37,754 shares (2017 – 38,163) for $3,775 (2017 - $3,816). In addition, the Company issued 2,908,891 (2017 - nil) common shares to its parent for $181,700 (2017 - $nil). The Company redeemed 42,559 (2017 – 6,341) Class A preference shares, series A for $1,063 (2017 - $158).

Dividends are as follows:

| | **9 months ended September 30, 2018** | | | | 9 months ended September 30, 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Declared** | **Declared per share** | **Paid** | **Paid per share** | Declared | Declared per share | Paid | Paid per share |
| | **$** | **$** | **$** | **$** | $ | $ | $ | $ |
| Class A, series A | **119** | **0.94** | **274** | **1.88** | 157 | 0.94 | 320 | 1.88 |
| Class A, series B | **1,794** | **2.50** | **3,521** | **5.00** | 1,661 | 2.50 | 3,239 | 5.00 |
| Class B | **1** | **1.25** | **1** | **2.50** | 1 | 1.25 | 1 | 2.50 |
| Class D, series A | **35** | **2.50** | **69** | **5.00** | 35 | 2.50 | 69 | 5.00 |
| Class D, series B | **106** | **2.50** | **213** | **5.00** | 106 | 2.50 | 213 | 5.00 |
| Class D, series C | **108** | **2.50** | **216** | **5.00** | 108 | 2.50 | 216 | 5.00 |
| Class E, series C | **3,750** | **0.94** | **3,750** | **0.94** | 3,750 | 0.94 | 3,750 | 0.94 |
| Class F, series A | **458** | **0.94** | **916** | **1.88** | 458 | 0.94 | 916 | 1.88 |
| Class G, series A | **19** | **1.25** | **37** | **2.50** | 19 | 1.25 | 37 | 2.50 |
| Common shares | **-** | **-** | **-** | **-** | 100,000 | 4.66 | 100,000 | 4.66 |
| | **6,390** | | **8,997** | | 106,295 | | 108,761 | |

During the nine months ended September 30, 2018, the Company declared and paid common dividends to its parent for $nil (2017 - $100,000).

(Amounts in thousands of Canadian dollars, except for per share amounts and where otherwise noted)

## 13. Statement of cash flows - other non-cash items

| | **9 months ended September 30, 2018** | 9 months ended September 30, 2017 |
|---|---|---|
| | **$** | $ |
| **i) Items not requiring the use of cash** | | |
| Investing activities gains | **(10,147)** | (41,943) |
| Amortization and depreciation of: | | |
| Bond premium/discount | **12,157** | 14,243 |
| Mortgage accretion | **331** | 1,286 |
| Intangible assets | **2,461** | 2,258 |
| Property and equipment | **6,298** | 5,943 |
| Change in fair value of FVTPL invested assets (note 4) | **9,724** | (18,886) |
| Impairment losses (note 4) | **7,457** | 5,522 |
| Deferred income taxes | **(3,544)** | 392 |
| Retirement benefit obligations | **4,012** | 3,508 |
| Loss from investments in joint ventures | **620** | 270 |
| | **29,369** | (27,673) |
| **ii) Changes in non-cash operating components** | | |
| Other | | |
| Insurance contracts | **290,021** | 94,931 |
| Reinsurance ceded contracts | **19,477** | 114,555 |
| Premiums due | **(135,931)** | (99,668) |
| Deferred acquisition expenses | **(24,994)** | (15,686) |
| Staff share loan plan | **(82)** | 54 |
| Accounts receivable and other assets | **5,584** | 2,876 |
| Accounts payable and accrued charges | **2,640** | 7,669 |
| Income taxes payable/recoverable | **(36,689)** | (15,676) |
| Provisions and other liabilities | **7,062** | 4,984 |
| | **127,088** | 94,039 |