

ANNUAL REPORT 2010



Empire Life®



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VISION

Our vision is to be the leading, independently-owned, Canadian financial services company known for simplicity, being easy to do business with and having a personal touch.





MISSION

Our mission is to help you build wealth and protect your financial security.

VALUES

Integrity

We are honest, fair and respectful, honour our commitments, and take pride in being a good corporate citizen.

Know our customer

We listen to our customers to provide products and services that meet their needs.

Can-do attitude

We are positive, creative and always search for better ways to do things.

High-performance team

We are focused on our priorities, have high expectations and standards and celebrate effort and achievement.

“While my tenure as Chairman has not been as long as my father’s, I am equally passionate about and impressed by the ability of Empire Life to anticipate and respond to the significant changes we have seen in the financial services marketplace.”

– **Duncan N.R. Jackman**
Chairman of the Board



Message from the Chairman of the Board

At our Board of Directors meeting last June, my father, and former Chairman of the Board of Empire Life, Henry (Hal) N. R. Jackman, gave an impassioned speech about the history of this company. He talked about how Empire Life has adapted and thrived in this ever-changing and often challenging industry.

While my tenure as Chairman has not been as long as my father's, I am equally passionate about and impressed by the ability of Empire Life to anticipate and respond to the significant changes we have seen in the financial services marketplace. Each year it seems the impact of increased regulation, changing capital rules, market volatility, complex products and a shifting competitive landscape becomes greater, creating new challenges.

I believe this company's leadership has done an exemplary job of navigating these challenges. The team has taken a thoughtful, detailed and thorough approach to mapping out a new strategic direction and has successfully galvanized the energy and commitment of its employees to make it happen.

As a Board, we recognize the importance of making strategic investments to continue to move Empire Life forward. The Board of Directors fully supports the vision of the company and the direction its leadership is taking to ensure sustainable prosperity for our shareholders and all our stakeholders.

In closing, I would like to express my appreciation and good wishes to Robert Long, who has been a member of the Empire Life Board of Directors for the past nine years. Bob will not be standing for re-election at the upcoming Annual General Meeting. His support, counsel, expertise and commitment have been greatly appreciated.



Duncan N.R. Jackman
Chairman of the Board
Toronto, Ontario
February 24, 2011

“I am pleased with our results and the progress we made as a company in 2010 to clearly define our role and future in the financial services industry in Canada.”

– **Les Herr**, President and Chief Executive Officer



Message from the President and Chief Executive Officer

If I had to describe the past year in a few simple words, focus and commitment come to mind.

While markets improved in 2010, they were still volatile. Globally, we saw economic instability continue, with the US struggling to recover and avoid a double-dip recession. The global financial crisis, the slower than anticipated economic recovery, low interest rates, and changing capital and regulatory requirements all made it more challenging to manage business growth and expenses.

In this economic climate, Canadians deserve and demand to do business with a strong, reliable company with a healthy balance sheet, strong capital position and good expense management. While other companies have expanded their operations globally, we have remained focused on the Canadian market and stayed true to our conservative, disciplined approach in the best interests of our customers. This focus and commitment on Canada has helped us maintain and build on our position of strength in these uncertain times.

I am pleased with our results and the progress we made as a company in 2010 to clearly define our role and future in the financial services industry in Canada. I believe we made good progress on our strategic initiatives at a pace that is consistent with managing the company during very complex and uncertain conditions. We focused on delivering results while making strategic changes that will differentiate us in the Canadian marketplace, enable us to better meet the needs of our customers, and achieve sustained profitable growth to benefit all our stakeholders.

Our results

From an income perspective, we ended 2010 with shareholders' net income of \$30.2 million, compared to \$53.8 million in 2009. This was primarily due to the strengthening of policy liabilities in response to the low interest rate environment and its impact on the profitability of our Individual Insurance line, and the fact that our net income in 2009 was positively affected by a favourable non-recurring tax item.

This long-term trend toward lower interest rates has affected the entire industry. In 2011, we will increase rates on some of our insurance products to ensure the long-term viability of this line of business.

Sales in all product lines were higher than the previous year, with particularly strong sales in our Individual Insurance and Employee Benefits product lines. Individual Insurance sales ended the year at \$68.1 million, a 12% increase from 2009, and our Employee Benefits product line had an exceptional year, recording the second highest sales year in its history of \$43.0 million, which was an increase of 20% from 2009. Positive results for retention and claims experience all contributed to a very strong year for this line of business. Segregated fund sales of \$778.4 million were up 12% from 2009. Continued volatility in the markets caused many investors to choose more conservative fixed interest deferred annuities rather than segregated funds. As a result, our overall Wealth Management sales finished the year strong at \$1.0 billion compared to \$996.1 million in 2009.

We saw a positive contribution of \$21.5 million from our Capital and Surplus account, and I am happy to report our assets under management increased by 10% from 2009 to \$9.6 billion.

We continue to do a good job of managing our day-to-day operating expenses, spending \$116.5 million in 2010, while still making significant investments in our future growth.

Our 2010 results reflect our steady commitment to growing and supporting our three lines of business. As we've seen again this past year, this diversified, balanced approach helps us generate consistent revenue and premium income in all economic and market conditions, resulting in a stronger company.

Throughout our 88-year history of providing financial services to Canadians, Empire Life has been a well-run company with a strong capital position. Our Minimum Continuing Capital and Surplus Requirements Ratio was 243% as at December 31, 2010, well above minimum requirements. Our continued strong capital and surplus ratio means that we can meet our future obligations and gives our customers and distribution partners confidence that we are there when they need us. This strength and stability is consistently recognized by rating agencies A.M. Best and DBRS.

In 2011, new International Financial Reporting Standards (IFRS) will replace Canadian generally accepted accounting principles (GAAP). We are prepared for the Phase I changes being implemented in 2011 and have not identified any significant impact on the company's information systems,

business processes or other business activities as a result of our transition to IFRS. Although the net impact on the company's transition balance sheet is minimal, we may see income statement and earnings volatility in future periods as a result of current and proposed IFRS accounting standards such as financial instruments, impairment of financial instruments, employee benefits and insurance contracts.

You can read in more detail the impact of this change in the Management's Discussion and Analysis. I would like to acknowledge the tremendous amount of work and effort our team has made to ensure we are prepared for IFRS and compliant with the new standards.

Planning for the future

If 2009 was a year of charting a new strategic direction for our company, 2010 was a year of planning and starting to execute on key activities that will help us realize our vision of being the leading, independently-owned, Canadian financial services company known for simplicity, being easy to do business with and having a personal touch.

We made excellent progress on our eight major initiatives that support our new strategic direction. In 2011, we'll be launching a new Web site, restructuring our sales teams to position us for future growth, and continuing progress to enhancing our systems so that we can better know and serve our customers and grow our business.

I am very proud of our accomplishments this past year. I have always said one of our greatest strengths is our people. We focus on what we do best and work well as a team. We seek out and retain the best talent in the industry and we celebrate our successes. Relationships matter to us. Our culture, with a focus on having a personal touch in everything we do, is what makes us a strong, competitive player in the financial services industry today.

Having a voice and making a difference

Our focus on relationships is evident in our role as a community leader. Empire Life and its employees have always been committed to investing in the communities where we live and work. Through partnerships with organizations like Pathways to Education, a community program that provides tutoring, mentoring, and other support to kids in need, Students in Free Enterprise at St. Lawrence College, and through scholarships such as the Queen's University Fellowship in Community Health & Epidemiology, we are making a difference. I was especially pleased and honoured to chair the Kingston, Frontenac, Lennox and Addington United Way campaign this past fall and to see Empire Life once again exceed its campaign goal, raising an astounding \$245,781 for United Way agencies across the country.

We have also made significant efforts to enhance our profile and influence within the industry at large and in particular among regulators. Our senior leaders are actively involved both at provincial and federal levels with organizations like the Office of the Superintendent of Financial Institutions (OSFI), providing input on the new segregated fund capital rules, and other key organizations such as the Canadian Life and Health Insurance Association (CLHIA) and LLGlobal (LIMRA and LOMA).

Our promise

Author and entrepreneur Seth Godin has said, "Making promises and keeping them is a great way to build a brand."

As a financial services company, we are in the business of making and keeping promises. Our customers rely on us to pay claims, invest their money wisely, and help them build their wealth and protect their financial security. Our reputation depends on it.

The world of financial services has become a very complex place. We need to simplify this world for our customers and help them understand their options, so they can make smart, informed financial decisions. This focus on our customers and making complex choices easier to navigate has become a guiding principle for everything we do. I would like to thank our customers for their loyalty and confidence in our company and for entrusting us with one of their most valuable assets—their financial security.

From a personal perspective, this is an exciting time to lead Empire Life. I would like to thank my senior management team for their vision and leadership and all our employees for their commitment this past year. I would also like to express my appreciation to our Board of Directors for their continued guidance and confidence, and thank Robert Long, who is stepping down from the Board, for his commitment to Empire Life over the past nine years.

Our new strategic direction has infused a fresh energy and focus into our organization and we are all excited at what the future will bring. I am confident that by continuing to meet the needs of our customers, distribution partners, and employees—we will create sustained profitable growth and deliver an acceptable return on equity for our shareholders in 2011 and beyond.



Leslie C. Herr
President and Chief Executive Officer
Kingston, Ontario
February 24, 2011

Source of Earnings

Source of earnings is a methodology for identifying and quantifying the various sources of Canadian generally accepted accounting principles (GAAP) income of a life insurance company. It presents shareholders' net income in a different format from the traditional income statement form and provides a better understanding of the Company's sources of profit for each major product line.

Expected Profit from In-Force Business

This source of earnings represents the profit the Company expects to generate on in-force business if experience is in line with the Company's best estimate assumptions for mortality, morbidity, persistency, investment returns, expenses and taxes.

Impact of New Business

Writing new business typically adds economic value to a life insurance company. However, as of the point of sale, new business may have a positive or negative impact on earnings. A negative impact (new business strain) will result when the provision for adverse deviation included in the actuarial liabilities at the point of sale exceeds the expected profit margin in the product pricing. The impact of new business also includes any excess acquisition expenses not covered by product pricing at the point of issue.

Experience Gains and Losses

This item represents gains or losses due to the difference between actual experience and the best estimate assumptions.

Management Actions and Changes in Assumptions

This component includes earnings generated by management actions during the year (e.g. acquisition or sale of a block of business, changes to product price, fees or asset mix, etc.) or the impact of changes in assumptions or methodology used for the calculation of actuarial liabilities for in-force business.

Other

This item includes any source of earnings from operations not included above.

Earnings on Surplus

This component represents the pre-tax earnings on the shareholders' capital and surplus funds.

Source of Earnings by Line of Business

For the year ended December 31

(in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital & Surplus		Total	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Expected profit on in-force business	\$ 22.9	\$ 13.4	\$ 13.5	\$ 13.5	\$ 38.0	\$ 37.4			\$ 74.4	\$ 64.3
Impact of new business	(15.3)	(10.9)	(9.4)	(5.4)	(41.3)	(27.4)			(66.0)	(43.7)
Experience gains & losses	(3.4)	(2.9)	14.4	5.6	0.3	(26.9)			11.3	(24.2)
Management actions and changes in assumptions	2.8	25.2	(0.4)	1.8	(18.0)	23.1			(15.6)	50.1
Other	–	2.2	–	–	(0.8)	9.8			(0.8)	12.0
Earnings on operations before income taxes	7.0	27.0	18.1	15.5	(21.8)	16.0	–	–	3.3	58.5
Earnings on surplus	–	–	–	–	–	–	29.3	(3.1)	29.3	(3.1)
Income before income tax	\$ 7.0	\$ 27.0	\$ 18.1	\$ 15.5	\$ (21.8)	\$ 16.0	\$ 29.3	\$ (3.1)	\$ 32.6	\$ 55.4
Income taxes	(2.8)	4.6	5.3	5.2	(7.9)	0.7	7.8	(8.9)	2.4	1.6
Shareholders' net income	\$ 9.8	\$ 22.4	\$ 12.8	\$ 10.3	\$ (13.9)	\$ 15.3	\$ 21.5	\$ 5.8	\$ 30.2	\$ 53.8

Wealth Management

Wealth Management's 2010 earnings on operations were lower than the level achieved in 2009. Most of the decrease related to a reduction in income from management actions and changes to assumptions. 2009 had unusually large gains resulting from achievement of improved investment spreads. 2009 also had more favourable earnings than 2010 resulting from the annual update of actuarial assumptions for both annuitant mortality and segregated fund guarantees. In addition earnings declined due to an increase in new business strain. This was primarily due to higher segregated fund sales in 2010 relative to 2009. Experience losses were similar to 2009, and Other earnings were reduced to zero from the small gain from policy liability releases related to tax law changes in 2009. These items were partly offset by an increase in expected profit on in-force business. This increase was due to the increase in average segregated funds under management in 2010 versus 2009 resulting from the continued improvement in stock market conditions during 2010.

Employee Benefits

Employee Benefits' earnings on operations were higher than the level achieved in 2009. Most of the increase was due to very favourable claims experience during 2010. This was partially offset by an increase in new business strain resulting from higher sales in 2010 relative to 2009, and a reduction in earnings from management actions due to a non-recurring gain from a reinsurance transaction in 2009.

Individual Insurance

The decrease in Individual Insurance earnings on operations was primarily due to a significant strengthening of policy liabilities from the annual assumption update during 2010 relative to 2009. This is reported in the management actions and changes in assumptions line. This strengthening was primarily related to the strengthening of reinvestment assumptions, driven by the persisting low interest rate environment. This strengthening was partly offset by releases related to ongoing mortality improvement in this product line.

2010 earnings were also depressed by the increase in new business strain. This was primarily due to higher sales in 2010 relative to 2009, and higher strain rates arising from the low interest rate environment.

There was also a decrease in Other earnings in 2010 relative to last year due to a mildly unfavourable impact on policy liabilities from tax changes in 2010, compared against a favourable impact on policy liabilities from the 2009 tax law update related to Financial Instrument Accounting rules.

Experience gains were close to zero in 2010, and much improved from 2009 when experience losses occurred. This was due to improved mortality experience and improved investment experience. Investment experience in 2009 included the impact of a significant write-down of impaired equity assets.

Expected profit on in-force business increased due to growth of the insurance block of business.

Management's Discussion and Analysis

This document has been prepared for the purpose of providing Management's Discussion and Analysis (MD&A) of the operating results and financial condition of The Empire Life Insurance Company ("Empire Life" or the "Company") for the years ended December 31, 2010 and 2009. This MD&A should be read in conjunction with the Company's December 31, 2010 financial statements, which form part of The Empire Life Insurance Company 2010 Annual Report dated February 24, 2011. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and unless otherwise noted, the reporting currency for the Company is the Canadian dollar, and all amounts in the financial statements and this MD&A are expressed in Canadian dollars.

MD&A may contain certain forward-looking statements that are subject to risks and uncertainties that may cause the results or events mentioned in this discussion to differ materially from actual results or events. No assurance can be given that results, performance or achievement expressed in, or implied by, any forward-looking statements within this discussion will occur, or if they do, that any benefits may be derived from them.

Use of Non-GAAP Measures

MD&A contains references to annualized premium sales. This term does not have any standardized meaning according to GAAP and therefore may not be comparable to similar measures presented by other companies. The Company believes that this measure provides information useful to its shareholders and policyholders in evaluating the Company's underlying financial results.

Financial Analysis

Overview

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Shareholders' net income	\$ 5.9	\$ 4.0	\$ 30.2	\$ 53.8

Empire Life reported full year shareholders' net income of \$30.2 million for 2010, compared to \$53.8 million in 2009.

The primary contributors to the overall decrease in 2010 full year earnings were the low long-term interest rate environment and its impact on Individual Insurance line profitability and last year's favourable impact of amendments to the Income Tax Act related to Financial Instruments (described below) that mainly benefited the Individual Insurance line in 2009. These decreases were partly offset by increased net income in 2010 from sale of investments and lower impairments primarily resulting from write-downs of certain available for sale equity investments in 2009.

For the fourth quarter net income was higher relative to last year primarily due to higher Capital and Surplus net income. This improvement resulted from lower impairment write-downs in 2010.

Empire Life has three major product lines (Wealth Management, Employee Benefits and Individual Insurance) and maintains distinct accounts for Capital and Surplus. A discussion of each product line's 2010 net income compared to 2009 is shown in the Product Line Results sections later in this report.

Last year, on March 4, 2009, the above mentioned amendments to the Income Tax Act related to Financial Instruments passed fourth reading and became substantively enacted. The impact of these amendments, which were recorded in the first quarter of 2009, was a non-recurring after-tax gain of \$22.2 million for shareholders, and a non-recurring after-tax gain of \$13.6 million for policyholders.

Management's Discussion and Analysis

The following tables provide a summary of Empire Life results by major product line:

For the year ended December 31

(in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital & Surplus		Total	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Revenue										
Premium income	\$ 240	\$ 300	\$ 262	\$ 242	\$ 317	\$ 297	\$ –	\$ –	\$ 819	\$ 839
Fee and other income	105	87	6	6	1	1	1	1	113	95
Investment income	58	55	6	7	104	93	37	29	205	184
Realized gain on held for trading investments	4	4	–	3	4	23	–	1	8	31
Realized gain (loss) on available for sale investments including impairment write-downs	(1)	–	–	–	6	(12)	10	(22)	15	(34)
Fair value change in assets	10	43	8	–	180	64	–	–	198	107
	416	489	282	258	612	466	48	9	1,358	1,222
Expenses										
Benefits and expenses	409	463	258	237	638	429	15	12	1,320	1,141
Income and other taxes	(3)	4	11	11	(4)	11	9	(10)	13	16
	406	467	269	248	634	440	24	2	1,333	1,157
Net income (loss) after tax	\$ 10	\$ 22	\$ 13	\$ 10	\$ (22)	\$ 26	\$ 24	\$ 7	\$ 25	\$ 65
Policyholders' portion									(5)	11
Shareholders' net income									\$ 30	\$ 54
Assets under management										
General fund assets	\$ 1,141	\$ 1,060							\$ 4,900	\$ 4,402
Segregated fund assets	\$ 4,707	\$ 4,310							\$ 4,707	\$ 4,310
Annualized premium sales			\$ 43	\$ 36	\$ 68	\$ 61				

Total Revenue

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Revenue				
Premium income	\$ 199	\$ 193	\$ 819	\$ 839
Fee and other income	30	27	113	95
Investment income	55	49	205	184
Fair value change in HFT investments including realized amounts	(45)	(56)	206	138
Realized gain (loss) on available for sale investments including impairment write-downs	2	(15)	15	(34)
Total	\$ 241	\$ 198	\$ 1,358	\$ 1,222

For the year, total revenue at Empire Life increased by 11% to \$1.4 billion compared to \$1.2 billion in 2009. Major revenue items are discussed below.

Premium income for the year decreased in 2010 relative to 2009. The decrease primarily related to fixed interest annuity premiums which declined from 2009's exceptionally strong levels.

Management's Discussion and Analysis

Fee and other income grew strongly in 2010 relative to 2009 as management fees earned on segregated funds recovered strongly due to the impact of rising stock markets and positive net segregated fund sales on average assets under management during 2010.

Fair value change in held for trading (HFT) investments including realized amounts often causes large revenue volatility. On a full year basis, these assets experienced a net gain in both 2010 and 2009. The gains in both 2010 and 2009 resulted primarily from an increase in bond prices (due to a decrease in market interest rates) and an increase in common share prices. The impact of this on net income is largely reduced due to a corresponding change in policy liabilities (discussed in the Total Benefits and Expenses section below).

Realized gain (loss) on available for sale investments was a gain for the year in 2010 versus a loss in 2009. These gains and losses impact net income and are considered in the net income investment experience comments for each of the impacted product lines (see Product Line Results sections later in this report). The gains and losses in 2010 primarily resulted from the sale of certain available for sale equity investments. The losses in 2009 primarily related to impairment write-downs of certain available for sale equity investments. Most of the assets sold or written down backed capital and surplus, while the balance sold or written down primarily matched Individual Insurance long duration liabilities.

Total Benefits and Expenses

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Benefits and expenses				
Insurance benefits	\$ 75	\$ 67	\$ 307	\$ 279
Policy dividends	5	5	19	18
Annuity benefits	66	60	230	199
Increase in policy liabilities	11	(6)	476	385
Operating expenses	33	28	117	104
Commissions	42	40	157	145
Interest expense	3	3	14	11
Total	\$ 235	\$ 197	\$ 1,320	\$ 1,141

Total benefits and expenses at Empire Life for the year increased by 16% to \$1.3 billion compared to \$1.1 billion in 2009. Major benefit and expense items are discussed below.

Insurance benefits experience variability is dependent on the claims incurred. Generally, claims rise year-over-year due to growth of the insurance blocks. Variability in claims amounts does not, in isolation, impact net income as policy liabilities are released when claims occur. The policy liabilities released can be larger or smaller than the claims incurred depending on whether claims experience has been favourable or unfavourable. Claims experience is the combination of claims incurred compared to claims expected in product pricing and in policy liabilities. Year-over-year claims experience is discussed in each of the impacted product lines (see Product Line Results sections later in this report).

Policy dividends increased year-over-year due to business in-force growth.

Annuity benefits increased as the annuity block has grown over recent years resulting in larger annuity benefit payments. Variability in annuity benefit amounts does not, in isolation, impact net income as policy liabilities are released when annuity payments occur. The policy liabilities released can be larger or smaller than the annuity payments depending on whether the annuity block investment and mortality experience has been favourable or unfavourable.

Management's Discussion and Analysis

Increase in policy liabilities varies with many factors including new business sold, claims incurred, surrender and lapse experience, assumptions about the future, and changes in the market value of assets matching policy liabilities. The main reason for the large change from 2009 for this item was the change in policy liabilities resulting from the fair value change in matching assets (described above in the Total Revenue section). Variability in the increase in policy liabilities amounts does not, in isolation, impact net income as it must be looked at in concert with other lines of the income statement.

Operating expenses and commission expenses increased year-over-year due to growth in annualized premium sales and business in-force growth.

Interest expense increased from 2009 levels due to the May 2009 subordinated debt issue that fully impacted 2010 interest expense.

Product Line Results - Wealth Management

(in millions of dollars)	As at Dec. 31			
	2010		2009	
Assets under management				
General fund annuities	\$	1,141	\$	1,060
Segregated funds		4,707		4,310

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Selected financial information				
Fixed interest annuity premiums	\$	51	\$	70
Segregated fund gross sales		226		204
Segregated fund net sales		14		55
Segregated fund fee income		28		24
Net income after tax fixed income annuity portion	\$	3	\$	4
Net income after tax segregated fund portion		3		6
Net income after tax	\$	6	\$	10

Assets in Empire Life general fund annuities and segregated funds increased by 8% and 9% respectively during the last twelve months. The increase for general fund annuities was primarily due to fixed interest annuity premium income received during the last twelve months. The increase for segregated funds was attributable to positive investment returns, due to the stock market recovery that began in the fourth quarter of 2009, and positive net sales (gross sales net of withdrawals) described below.

Premium income for the Wealth Management product line is comprised solely of new deposits on fixed interest annuities and excludes deposits on the segregated fund products. For the year, fixed interest annuity premiums were down 20% compared to 2009 due to decreased sales of fixed interest deferred annuities. However, 2009 was an exceptionally strong year for fixed interest annuity sales. 2010 fixed interest annuity premiums, while lower than 2009, continued to be strong as many customers continued to select fixed interest products over segregated funds due to continuing stock market uncertainty.

For the year, segregated fund gross sales were up 12% from 2009 despite continuing stock market volatility. However, net sales, while positive in three of the last four quarters, were lower than 2009 due to increased withdrawals.

For the year, segregated fund fee income increased by 20% in 2010 relative to 2009 as management fees earned on segregated funds recovered strongly. This recovery was due to growth in average assets under management resulting from the favourable impact of rising stock markets and positive net segregated fund sales. During the fourth quarter of 2010 a significant milestone was reached as segregated fund fee income for the quarter returned to pre-financial crisis levels by surpassing the level of fee income earned in the second quarter of 2008 (just before the financial crisis severely depressed markets).

Management's Discussion and Analysis

During the fourth quarter and for the year, earnings from this product line decreased relative to 2009. The following table provides a breakdown of the components of this year-over-year change in net income.

(in millions of dollars)	Q4		Year	
Wealth Management Net Income Analysis				
Net income after tax 2010	\$	6	\$	10
Net income after tax 2009		10		22
Increase (decrease) net income after tax	\$	(4)	\$	(12)
Components of increase (decrease)				
Non-recurring 2009 gain from tax law changes	\$	–	\$	(2)
Higher (reduced) investment experience gains		1		(10)
Release of segregated fund guarantee policy liabilities in 2009		–		(4)
Higher new business strain		–		(1)
Increase in in-force profit margins		–		6
Improved segregated fund death benefit guarantee and mortality results		–		4
Update of policy liability assumptions		(5)		(5)
Total	\$	(4)	\$	(12)

The 2009 non-recurring tax law change resulted from amendments to the Income Tax Act primarily related to Financial Instruments. Investment experience gains were exceptionally strong in 2009 due to the favourable impact 2009 fixed interest investing activities had on policy liabilities. This 2009 investing activity locked in favourable future investment returns resulting in a release of policy liabilities in 2009. Fixed interest investing opportunities diminished in 2010 as corporate bond and preferred share market yields have dropped significantly. The release of segregated fund guarantee policy liabilities in 2009 was primarily due to the rise in stock markets in the second quarter of 2009. Higher new business strain resulted from rising sales and differing product mix. Higher net income on in-force business in 2010 was due to the increase in segregated funds under management relative to 2009. Improved segregated fund death benefit guarantee and mortality results compared to 2009 was primarily due to the recovery of stock markets. The update of policy liability assumptions was unfavourable in 2010 relative to 2009. The updates for general fund annuities primarily related to the unfavourable impact of annuitant mortality assumptions. In addition, the 2010 update of policy liabilities related to segregated funds was less favourable than 2009.

Product Line Results - Employee Benefits

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Selected financial information				
Annualized premium sales	\$ 10	\$ 13	\$ 43	\$ 36
Premium income	66	43	262	242
Net income after tax	\$ 1	\$ 2	\$ 13	\$ 10

For the year, sales in this product line increased by 20% relative to 2009. The sales result is a strong recovery from recessionary lows and may signal a return to more typical sales levels. This product line's quarterly and annual premium income increased significantly in 2010, however 2009 premiums were depressed by a non-recurring transaction that terminated a reinsurance assumed agreement. After removing the impact of this non-recurring item, premium levels were flat compared to the corresponding period of 2009. This slow premium income growth resulted from this product line's in-force block of business being negatively impacted by the severity of the economic downturn, particularly in Ontario.

Management's Discussion and Analysis

During the fourth quarter earnings from this product line decreased relative to 2009. However, for the year, 2010 earnings from this product line increased compared to 2009. The following table provides a breakdown of the components of this year-over-year change in net income.

(in millions of dollars)	Q4		Year	
Employee Benefits Net Income Analysis				
Net income after tax 2010	\$	1	\$	13
Net income after tax 2009		2		10
Increase (decrease) net income after tax	\$	(1)	\$	3
Components of increase (decrease)				
Improved (worsened) claims experience	\$	(1)	\$	5
Decrease in in-force profit margins		-		(2)
Total	\$	(1)	\$	3

Improved claims experience related to group life, group long-term disability and group health claims results. The decrease in profit margins resulted from the in-force block of business being negatively impacted by the severity of the economic downturn.

Product Line Results - Individual Insurance

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Selected financial information				
Annualized premium sales	\$ 19	\$ 18	\$ 68	\$ 61
Premium income	84	79	317	297
Net income (loss) after tax				
Net income (loss) after tax shareholders' portion	\$ (6)	\$ (5)	\$ (14)	\$ 15
Net income (loss) after tax policyholders' portion	(2)	(6)	(8)	11
Net income (loss) after tax	\$ (8)	\$ (11)	\$ (22)	\$ 26

For the year, annualized premium sales in this product line increased by 12% compared to 2009, and premium income increased by 6% compared to 2009.

During the fourth quarter earnings from this product line increased relative to 2009. However, for the year, earnings from this product line decreased compared to 2009. The following table provides a breakdown of the components of this year-over-year change in net income.

Management's Discussion and Analysis

(in millions of dollars)	Q4		Year	
Individual Insurance Net Income Analysis				
Net income (loss) after tax 2010	\$	(8)	\$	(22)
Net income (loss) after tax 2009		(11)		26
Increase (decrease) net income after tax	\$	3	\$	(48)
Components of increase (decrease)				
Non-recurring 2009 gain from tax law changes	\$	–	\$	(26)
Reduced loss from tax rate changes		2		2
Improved (reduced) investment experience		8		(9)
Higher new business strain		(2)		(13)
Change in mortality and surrender experience		(2)		(1)
Increase in in-force profit margins		–		2
Update of policy liability assumptions		(3)		(3)
Total	\$	3	\$	(48)

The 2009 non-recurring tax law change resulted from amendments to the Income Tax Act primarily related to Financial Instruments. Investment experience gains were exceptionally strong in 2009 due to the favourable impact 2009 fixed interest investing activities had on policy liabilities. This 2009 investing activity locked in favourable future investment returns resulting in a release of policy liabilities in 2009. Fixed interest investing opportunities diminished in 2010 as corporate bond and preferred share market yields have dropped significantly. Higher new business strain resulted from the rise in sales and lower long-term interest rates. The update of policy liability assumptions was unfavourable in 2010 relative to 2009. The updates primarily related to the unfavourable impact of decreases in investment return assumptions, partly offset by the favourable impact of improving mortality assumptions and updates to policyholder dividend assumptions.

Results - Capital and Surplus

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Net income (loss) after tax				
Net income (loss) after tax shareholders' portion	\$ 5	\$ (1)	\$ 21	\$ 6
Net income after tax policyholders' portion	1	–	3	1
Net income (loss) after tax	\$ 6	\$ (1)	\$ 24	\$ 7

In addition to the three major lines of business, Empire Life maintains distinct accounts for the investment income attributable to Shareholders' Capital and Surplus and to Policyholders' Surplus. During the fourth quarter and the full year Capital and Surplus earnings increased relative to 2009. The following table provides a breakdown of the components of this year-over-year change in net income.

Management's Discussion and Analysis

(in millions of dollars)	Q4		Year	
Capital and Surplus Net Income Analysis				
Net income after tax 2010	\$	6	\$	24
Net income (loss) after tax 2009		(1)		7
Increase (decrease) net income after tax	\$	7	\$	17
Components of increase (decrease)				
Non-recurring 2009 gain from tax law changes	\$	–	\$	(7)
Reduced loss from tax rate changes		1		–
Increased net income from sale of investments and lower impairments		5		20
Increased investment income		1		6
Increased interest expense on subordinated debt		–		(2)
Total	\$	7	\$	17

The 2009 non-recurring tax law change resulted from amendments to the Income Tax Act primarily related to Financial Instruments. Increased net income from sale of investments and lower impairments primarily resulted from write-downs of certain available for sale equity investments in the third and fourth quarters of 2009 and gains from the sale of certain available for sale equity investments in the first quarter of 2010. The increase in investment income resulted from a larger fixed interest portfolio due to asset mix changes and investment of the proceeds from the May 2009 subordinated debt issue. Increased interest expense primarily resulted from a larger amount of subordinated debt during 2010 relative to 2009.

Total Cash Flow

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Cash Flow provided from (used for)				
Operating Activities	\$ 36	\$ 66	\$ 170	\$ 328
Investing Activities	(25)	(70)	(153)	(425)
Financing Activities	\$ –	\$ –	\$ (15)	\$ 74
Net change in cash and cash equivalents	\$ 11	\$ (4)	\$ 2	\$ (23)

The decrease in cash provided by operating activities during the year in 2010 relative to 2009 was primarily due to decreased cash inflows related to annuity business, the payment of income taxes, and increased commission expenses due to higher life insurance, employee benefits and segregated fund sales.

The decrease in cash used for investment activities during the year in 2010 relative to 2009 was primarily due to investment of the higher amount of cash provided by operations in 2009 and the investment of proceeds of the net increase of \$74 million of subordinated debt in 2009 described below. In addition, there were higher net investment purchases in 2009 to take advantage of favourable investment yields, and reduced sales of portfolio investments in 2009 due to stock market conditions.

The cash used for financing activities during the full year 2010 was due to Empire Life's decision to pay a dividend to common shareholders in the first quarter of 2010. The cash provided during the full year 2009 of \$74 million was the issuance of \$200 million principal amount of subordinated debt in the second quarter of 2009 and the repayment in 2009 of \$125 million of subordinated debt issued to E-L Financial Corporation Limited.

Management's Discussion and Analysis

Capital Resources

	Dec 31 2010	Sept 30 2010	June 30 2010	Mar 31 2010	Dec 31 2009
MCCSR Ratio	243%	244%	251%	258%	266%

Empire Life continues to maintain a strong balance sheet and capital position. Empire Life's risk-based capital ratio, as measured by Minimum Continuing Capital and Surplus Requirements (MCCSR), at 243% as of December 31, 2010 continued to be well above requirements and above minimum internal targets. The A (Excellent) rating given to Empire Life by A.M. Best Company provides third party confirmation of this strength.

Other Comprehensive Income

(in millions of dollars)	Quarterly results		Year	
	Q4 2010	Q4 2009	2010	2009
Other comprehensive income (OCI)				
Shareholders' OCI	\$ 18	\$ 21	\$ 25	\$ 94
Policyholders' OCI	2	1	2	8

Unrealized gains and losses on Capital and Surplus financial assets and on certain financial assets matching policy liabilities are recorded as Other Comprehensive Income (OCI) or Other Comprehensive Loss (OCL). When these assets are sold or written down the resulting gain or loss is reclassified from OCI to net income. A gain reclassified to net income lowers OCI. A loss reclassified to net income increases OCI.

During the full year 2010 OCI decreased relative to 2009 due to a stronger rise in Canadian stock markets in 2009 and the reclassification to net income of a realized gain in 2010 versus a realized loss in 2009.

Industry Dynamics and Management's Strategy

Empire Life's operations are organized by product line with each line of business having responsibility for product development, marketing, distribution and customer service within their particular markets. This structure recognizes that there are distinct marketplace dynamics in each of the three major product lines. Management believes this structure enables each line of business to develop strategies to achieve the enterprise-wide objectives of business growth and expense management while recognizing the unique business environment in which each operates. The lines of business are supported by corporate units that provide product pricing, administrative and technology services to the lines of business, manage invested assets, and oversee enterprise risk management policies.

Based on general fund and segregated fund assets, Empire Life is among the ten largest life insurance companies in Canada. Empire Life has less than six per cent market share in all three of its product lines. To be priced competitively in the marketplace while simultaneously providing acceptable long-term financial contribution to shareholders, Empire Life, as a mid-sized company, must find a way to be cost competitive with the larger companies that have some natural economy of scale advantages. In order to improve its unit expenses, management's enterprise-wide strategic focus has been on achieving profitable growth in its selected markets and on expense management. Empire Life has focused exclusively on the Canadian marketplace and within it, on particular market segments where management feels there are opportunities to build solid, long-term relationships with independent distribution partners by offering competitive products and more personal service. By focusing on particular market segments and by being seen by these independent advisors as a viable alternative to broadly focused competitors, management believes these solid relationships will enable profitable growth.

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The Wealth Management product line at Empire Life is comprised of segregated fund products and guaranteed interest products. These products compete against products offered by a variety of financial institutions. A key element of any competitive strategy in this market is providing a competitive rate of return to clients. The value-oriented equity investment strategy used by Empire Life has focused on developing long-term performance in the fund marketplace. Management is expecting to grow market share through this long-term performance along with broadened distribution reach and the addition of new funds and fund products such as mutual funds.

Within the broader employee benefits marketplace in Canada, Empire Life continues to focus on the small group market comprised of employers with fewer than 200 employees. This niche strategy coupled with an ongoing focus on balancing growth and profit has enabled Empire Life to be cost competitive within this market segment and is expected to enable this product line to continue to grow its market share while generating acceptable returns.

Individual Insurance products are very long-term in nature and consequently can be subject to significant levels of new business strain. New business strain occurs when the provision for adverse deviation included in the actuarial policy liabilities exceeds the profit margin in the product pricing. Unless a company opts for increased levels of reinsurance, current price levels in the Canadian marketplace create significant new business strain that has a negative impact on short-term earnings. Sales strain has been particularly high in 2010 due to the low long-term interest rate environment that followed the financial crisis. This has impacted the entire industry resulting in price increases in 2011 for individual insurance products by Empire Life and many of our competitors. Rather than give up the future earnings that would emerge if the trend in mortality improvement witnessed in recent decades continues, Empire Life continues to utilize lower than average levels of reinsurance with the resultant negative impact on short-term earnings. Because of the reasonable long-term returns of this product line, management continues to focus on steady growth, technology development and process improvement in order to continue to improve this product line's unit expenses and maintain a competitive market position while generating acceptable long-term financial contribution.

Risk Management

Empire Life's MCCR ratio is sensitive to stock market volatility, primarily due to liability and capital requirements related to segregated fund guarantees. As of December 31, 2010 Empire Life had \$4.7 billion of segregated fund assets. Of this amount, approximately \$4.4 billion have guarantees. The following table provides a percentage breakdown by type of guarantee:

	Dec 31 2010	Dec 31 2009
Percentage of segregated fund assets with:		
75% maturity guarantee and a 100% death benefit guarantee	83.2%	88.6%
100% maturity and death benefit guarantees (with a minimum of 15 years between deposit and maturity date)	5.5%	5.0%
100% maturity and death benefit guarantees (guaranteed minimum withdrawal benefit (GMWB))	11.3%	6.4%

All Empire Life segregated fund guarantees are policy-based (not deposit-based), thereby lowering Empire Life's stock market sensitivity. For segregated fund guarantee policy liabilities the level of sensitivity is highly dependent on the level of the stock market at the time of performing the estimate. If period end stock markets are high relative to market levels at the time that segregated fund policies were issued, the sensitivity is reduced. If period end stock markets are low relative to market levels at the time that segregated fund policies were issued, the sensitivity is increased. Based on stock market levels on December 31 for 2010 and December 31 for 2009, the sensitivity of Empire Life's shareholders' net income to changes in segregated fund guarantee policy liabilities resulting from stock market increases and decreases is as follows:

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(in millions of dollars)	10% Increase	10% Decrease	20% Increase	20% Decrease
Sensitivity To Segregated Fund Guarantees:				
2010 Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
2009 Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ nil

Based on stock market levels on the dates indicated below the sensitivity of Empire Life's MCCSR ratio to stock market increases and decreases for all Empire Life stock market exposures, including segregated fund guarantees is as follows:

(in millions of dollars)	10% Increase	10% Decrease	20% Increase	20% Decrease
Sensitivity To Stock Markets:				
December 31, 2010 MCCSR Ratio	3.7%	-3.8%	7.2%	-8.5%
December 31, 2009 MCCSR Ratio	2.5%	-7.4%	4.9%	-36.5%

Empire Life has not historically hedged or reinsured its segregated fund guarantee risk. Given the current segregated fund product mix and level of sensitivity to stock markets, Empire Life has not hedged or reinsured its segregated fund guarantee risk as of December 31, 2010. In addition, Empire Life does not reinsure any other insurer's segregated fund products.

The amount at risk related to segregated fund maturity guarantees and segregated fund death benefit guarantees and the resulting actuarial liabilities and MCCSR required capital for Empire Life segregated funds is as follows:

Segregated Funds (in millions of dollars)	Guarantee > Fund Value		Death Benefit > Fund Value		Actuarial Liabilities	MCCSR Required Capital
	Fund Value	Amount At Risk	Fund Value	Amount At Risk		
December 31, 2010	\$ 113	\$ 12	\$ 1,422	\$ 137	\$ nil	\$ nil
December 31, 2009	\$ 186	\$ 22	\$ 2,046	\$ 316	\$ nil	\$ nil

The amount at risk represents the excess of the future maturity guarantee or future death benefit guarantee amount over the fund value on all segregated fund policies where the future maturity guarantee or future death benefit guarantee is greater than the fund value. The amount at risk is not currently payable. Payment is contingent on future outcomes including fund performance, deaths, deposits, withdrawals and maturity dates. The level of actuarial liabilities and required capital is calculated based on the probability that Empire Life will ultimately have to make payment to the segregated fund policyholders for any fund value deficiency that may exist upon either future maturity of the segregated fund policies, or upon future death of the segregated fund policyholders. The amounts at risk decreased in December 2010 from December 2009 levels primarily due to the rise of global stock markets.

In addition to the discussion of risks included in this MD&A, a comprehensive discussion of the material risks that impact Empire Life is included in the Annual Information Form of Empire Life's parent company, E-L Financial Corporation Limited, which is available at www.sedar.com. Additional disclosures of Empire Life's sensitivity to risks are included in Note 22 to the financial statements.

Critical Accounting Estimates

The Company's significant accounting policies are described in Note 2 to the Financial Statements. Certain of these policies require management to make estimates and assumptions about matters that are inherently uncertain. The most critical of these accounting estimates for Empire Life are the valuation of policy liabilities and the determination of allowances for impaired investments.

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Policy Liabilities

The determination of policy liabilities requires best estimate assumptions that cover the remaining life of the policies for mortality, morbidity, investment returns, persistency, expenses, inflation and taxes and include consideration of related reinsurance effects. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviation from best estimates is included in each assumption. These margins allow for possible deterioration in future experience and provide for greater confidence that policy liabilities are adequate to pay future benefits. The resulting provisions for adverse deviations have the effect of increasing policy liabilities and decreasing the income that otherwise would have been recognized at policy inception. A range of allowable margins is prescribed by the Canadian Institute of Actuaries. Assumptions are reviewed and updated at least annually and the impact of changes in those assumptions is reflected in earnings in the year of the change. Empire Life's sensitivity to risks related to policy liabilities are included in Note 22 to the Financial Statements.

Provision for Impaired Investments

Empire Life maintains a prudent policy in setting the provision for impaired investments. When there is no longer reasonable assurance of full collection of loan principal and loan interest related to a mortgage or policy contract loan, management establishes a specific provision for loan impairment and charges the corresponding reduction in carrying value to income in the period the impairment is identified. In determining the estimated realizable value of the investment, management considers a number of events and conditions. These include the value of the security underlying the loan, geographic location, industry classification of the borrower, an assessment of the financial stability of the borrower, repayment history and an assessment of the impact of current economic conditions. Changes in these circumstances may cause subsequent changes in the estimated realizable amount of the investment and changes in the specific provision for impairment.

Available for sale securities are subject to a regular review for losses that are other than temporary. If a security is assessed to have a loss that is other than temporary, the security is written down to fair value in the statement of general fund operations. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been below cost, the financial conditions and near-term prospects of the issuer and the ability and intent to hold the investment for a period of time sufficient to allow for recovery.

Quarterly Results

The following table summarizes various financial results on a quarterly basis for the most recent eight quarters:

	Dec 31	Sept 30	June 30	Mar 31	Dec 31	Sept 30	June 30	Mar 31
(in millions of dollars)	2010	2010	2010	2010	2009	2009	2009	2009
Revenue	\$ 241	\$ 409	\$ 341	\$ 367	\$ 197	\$ 390	\$ 396	\$ 239
Shareholders' net income (loss)	\$ 6	\$ 5	\$ 4	\$ 15	\$ 4	\$ (1)	\$ 14	\$ 37

Revenue for the three months ended December 31, 2010 increased to \$241 million (2009 \$197 million) primarily due to losses in 2009 related to impairment write-downs of certain available for sale equity investments (see Total Revenue section earlier in this report).

For the fourth quarter net income was higher relative to last year primarily due to higher Capital and Surplus net income. This improvement resulted from lower impairment write-downs in 2010. See Product Line Results sections earlier in this report for further information on quarterly results.

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Conversion to International Financial Reporting Standards (IFRS)

All amounts are expressed in thousands of dollars in this section. IFRS will replace Canadian GAAP for publicly accountable enterprises for fiscal years beginning on or after January 1, 2011. Empire Life, as a federally regulated financial institution, is considered a publicly accountable enterprise. Empire Life will begin to report its financial results, including comparative information, in accordance with IFRS in its quarterly regulatory filing starting with the March 31, 2011 quarter end. Empire Life's first annual financial results on an IFRS basis will be for the December 31, 2011 reporting year.

A steering committee comprised of senior management has overseen the IFRS conversion project. Over the course of the last two years, both steering committee members and project staff have developed an in-depth technical understanding of IFRS and its application to the Company's financial reporting. In addition, Audit Committee members have gained sufficient knowledge about the impact of the conversion to IFRS on the Company through quarterly status reporting from the steering committee and the review of key IFRS project deliverables throughout the transition period. Training sessions for staff, where appropriate, and the distribution of educational materials will continue throughout the first quarter of 2011.

The accounting standards to be in effect for the 2011 financial reporting year have stabilized. Regulatory and capital requirements have been amended to reflect the adoption of IFRS-based financial reporting. The project team has assessed the impact of the changes to regulatory and capital requirements and there are no material impacts on the Company's regulatory and capital requirements as a result of the accounting policy choices and transition elections currently selected by Empire Life.

At this time, draft financial statement presentation and note disclosures have been prepared on an IFRS basis, and based on the results, no significant impacts have been identified from the transition to IFRS on Empire Life's information systems, business processes and other business activities, including debt covenants, treasury activities and executive compensation. Additionally, Empire Life has not identified any significant impacts on internal controls over financial reporting and disclosure controls and procedures.

At this time, the International Accounting Standards Board (IASB) is planning to complete a number of projects during 2011 that will impact Empire Life (including Phase 2 of IFRS 4 Insurance Contracts and IFRS 9 Financial Instruments), which will have implementation dates of 2013 or later. Empire Life plans to assess the impact of these new standards beginning in 2011.

Empire Life has completed its draft IFRS opening statement of financial position as at January 1, 2010, as well as detailed reconciliations of its 2010 comparative financial statements from a Canadian GAAP basis to an IFRS basis. These reconciliations will be used for the preparation of Empire Life's interim financial information and annual financial reporting under IFRS in 2011. IFRS 1 "First-Time Adoption of International Financial Reporting Standards" provides a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement for full retrospective application of IFRSs. Details of Empire Life's planned elections under IFRS 1 and relevant mandatory exceptions are provided below.

IFRS Exemption Options

- 1. Business combinations** - IFRS 1 provides the option not to apply IFRS 3 "Business Combinations", retrospectively. The Company plans to take this election with respect to business combinations that occurred prior to its transition date and therefore such business combinations will not be restated.
- 2. Employee benefits** - IFRS 1 provides the option to retrospectively apply the corridor approach under IAS 19 "Employee Benefits" for the recognition of actuarial gains and losses or recognize all cumulative gains and losses deferred under Canadian GAAP in opening Retained earnings at the date of transition. The Company plans to elect to recognize all cumulative unamortized actuarial gains and losses that existed at the transition date in opening Retained earnings for all defined benefit pension and other post-employment benefit plans, as it would be impracticable to restate each plan from its inception date under IAS 19. The Company also intends to elect under IFRS 1 to disclose the present value of its defined benefit obligations, fair value of plan assets, surplus or deficit positions and experience adjustments prospectively from the date of transition.
- 3. Fair value or revaluation as deemed cost** - IFRS 1 allows an entity to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to IFRS as deemed cost if, at the date of the revaluation, the revaluation was broadly comparable to fair value, cost or depreciated cost in accordance with IFRS. The Company plans to elect to use a previous GAAP revaluation as deemed cost at the transition date for land and building since this value is expected to be broadly comparable to fair value at the date of the revaluation. The property, which was presented as a

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real estate investment under Canadian GAAP, was last valued as of September 22, 2009. The Company will not apply this election to any other items of property and equipment in its opening statement of financial position.

4. Designation of previously recognized Financial instruments - IFRS I permits the redesignation of previously recognized financial assets at the date of transition as available for sale (AFS) or, provided the asset meets the criteria specified in IAS 39 "Financial Instruments: Recognition and Measurement", fair value through profit or loss (FVTPL). The Company plans to elect to redesignate \$151,047 of financial assets held in support of insurance operations as FVTPL and maintain financial assets held in support of shareholders' equity as AFS. The assets to be redesignated are currently classified as AFS and are valued at fair value under both designations.

IFRS Mandatory Exceptions

- 1. Estimates** - IFRS I requires that an entity's estimates under IFRS at the date of transition be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's estimates under IFRS at January 1, 2010 will be consistent with the estimates made under Canadian GAAP.
- 2. Hedge accounting** - Hedge accounting can only be applied prospectively from the transition date to transactions that satisfy the hedge accounting criteria in IAS 39 "Financial Instruments: Recognition and Measurement" at that date. Hedging relationships cannot be designated retrospectively and the supporting documentation cannot be created retrospectively. As a result, only hedging relationships that satisfy the hedge accounting criteria as of the Company's transition date will be reflected as hedges in the Company's results under IFRS. At January 1, 2010 the Company will reclassify amounts from Accumulated other comprehensive income to Retained earnings relating to hedging relationships under Canadian GAAP that will no longer be designated as hedging relationships under IFRS.

IFRS Reconciliations

The following reconciliations provide details of the quantitative impact that the transition to IFRS is expected to have on the Company's opening statement of financial position at January 1, 2010, including the above-noted elections that the Company plans to make under IFRS I and other transitional adjustments resulting from accounting policy differences between Canadian GAAP and IFRS. The first reconciliation shows the estimated impact to each component of equity and the second reconciliation provides the Company's fully reconciled Canadian GAAP balance sheet to an IFRS basis at January 1, 2010. Explanations for each transitional adjustment are provided below.

These estimates and current policy choices may be subject to change until the issuance of our 2011 annual financial statements.

Draft Reconciliation of Shareholders' equity at January 1, 2010

(in thousands of dollars)	Reference	Share capital	Contributed surplus	Retained earnings	AOCI	Shareholders' equity
As reported under Canadian GAAP - December 31, 2009		\$ 985	\$ 19,387	\$ 697,212	\$ 33,470	\$ 751,054
Differences increasing (decreasing) reported amount:						
1. Financial instruments	a	—	—	8,976	(8,940)	36
2. Employee benefits	b	—	—	3,430	—	3,430
3. Impairment of financial assets	f	—	—	(647)	647	—
4. Contract classification	c	—	—	1,190	—	1,190
5. Investment property	d	—	—	18	—	18
6. Income taxes	e	—	—	(461)	461	—
Total equity under IFRS - as at January 1, 2010		\$ 985	\$ 19,387	\$ 709,718	\$ 25,638	\$ 755,728

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Draft opening Statement of financial position at January 1, 2010

Canadian GAAP Accounts	Reference	Canadian GAAP	Effects of Transition to IFRS	IFRS	IFRS Accounts
Assets					
General Funds					
Cash and cash equivalents		\$ 149,141	\$ –	\$ 149,141	Cash and cash equivalents
–					Investments
Short-term investments		37,080	–	37,080	Short-term investments
Bonds		2,795,896	–	2,795,896	Bonds
Common and preferred shares	a	949,742	36	949,778	Common and preferred shares
Mortgages		223,642	–	223,642	Mortgages
Real Estate	d	15,601	(15,601)	–	–
Loans on policies		38,728	–	38,728	Loans on policies
Policy contract loans		137,764	–	137,764	Policy contract loans
–	i	–	2,493	2,493	Derivative Assets
–		4,198,453	(13,072)	4,185,381	Total investments
Accrued investment income		17,827	–	17,827	Accrued investment income
Premiums receivable	i	3,914	13,746	17,660	Insurance receivables
Current income taxes receivable		–	–	–	Current income taxes receivable
–	a,h	–	32,693	32,693	Reinsurance asset
Other assets	b,i	29,315	(12,260)	17,055	Other assets
–	d,i	–	19,973	19,973	Property and equipment
–	i	–	3,688	3,688	Intangible Assets
–	g	–	4,186,585	4,186,585	Segregated fund assets
Total General Fund Assets		\$ 4,398,650	\$ 4,231,353	\$ 8,630,003	Total Assets
Total Segregated Fund Assets		\$ 4,310,401	\$ (4,310,401)	\$ –	–
Liabilities					
General Funds					
Accounts payable and other liabilities	b,d,j	\$ 82,769	\$ (37,626)	\$ 45,143	Accounts payable and other liabilities
–	ij	–	52,648	52,648	Insurance payables
–	h,j	–	5,260	5,260	Due to reinsurance companies
Current income taxes payable		30,065	–	30,065	Current income taxes payable
Policy liabilities	a,c,h	3,192,988	33,157	3,226,145	Insurance contract liabilities
–	c	–	17,566	17,566	Investment contract liabilities
Policyholders' funds on deposit		29,702	–	29,702	Policyholders' funds on deposit
Provision for unpaid and unreported claims	h	32,606	(32,606)	–	–
Provision for profits to policyholders		18,558	–	18,558	Provision for profits to policyholders
Future income taxes	a,b	1,116	1,695	2,811	Deferred income taxes
Subordinated debt		198,980	–	198,980	Subordinated debt
–	g	–	4,186,585	4,186,585	Segregated fund policy liabilities
		3,586,784	4,226,679	7,813,463	
Shareholders' & Policyholders' Equity					
<u>Shareholders' equity</u>					
Capital stock		985	–	985	Capital stock
Contributed surplus		19,387	–	19,387	Contributed surplus
Retained earnings	a,b,c,d,e,f	697,212	12,506	709,718	Retained earnings
Accumulated other comprehensive income	a,e,f	33,470	(7,832)	25,638	Accumulated other comprehensive income
		751,054	4,674	755,728	
<u>Policyholders' equity</u>					
Retained earnings	a,e	57,839	(196)	57,643	Retained earnings
Accumulated other comprehensive income	a,e	2,973	196	3,169	Accumulated other comprehensive income
		60,812	–	60,812	
		811,866	4,674	816,540	
Total General Fund Liabilities and Equity		\$ 4,398,650	\$ 4,231,353	\$ 8,630,003	Total Liabilities and Equity
Segregated Fund Liabilities	g	\$ 4,310,401	\$ (4,310,401)	\$ –	–

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Notes to the IFRS reconciliations

The following narratives explain the significant differences between Canadian GAAP and IFRS impacting the Company's draft IFRS opening statement of financial position. The letter references correspond to the adjustments in the above reconciliations.

Transitional adjustments

a. Financial Instruments

As noted in the "IFRS Exemption Options" section, \$151,047 of financial assets supporting insurance liabilities previously designated as AFS under Canadian GAAP will be re-designated as fair value through profit or loss (FVTPL) under IFRS. Any accumulated unrealized gains and losses on the redesignated investments currently recorded at fair value on the Balance Sheet will be reclassified from Accumulated other comprehensive income to opening Retained earnings as at January 1, 2010. Subsequent unrealized gains and losses will be recorded in the Statement of Operations.

The effect of this re-designation and a change in the accounting treatment of certain derivative investments previously accounted for using hedge accounting, will be an increase in Retained earnings of \$8,976 and a decrease in Accumulated other comprehensive income (AOCI) of \$8,940. In addition, Common and preferred shares will increase by \$36. The impact on Policyholders' equity will be a decrease to Retained earnings and an increase to Accumulated other comprehensive income of \$133.

b. Employee Benefits

As noted in the "IFRS Exemption Options" section, the Company plans to elect under IFRS 1 to recognize all cumulative unamortized actuarial gains and losses related to its defined benefit plans in opening Retained earnings at the date of transition. The Company will also recognize unamortized transitional amounts that exist at the date of transition. The recognition of these two unamortized amounts will result in the following adjustments to the Company's draft statement of financial position at January 1, 2010: a decrease in Other liabilities of \$348, an increase in Other assets of \$4,263, an increase in Deferred income taxes of \$1,181, and an increase in Retained earnings of \$3,430.

The Company plans to apply the corridor method available under IAS 19 to recognize actuarial gains and losses on defined benefit plans subsequent to the date of transition to IFRS.

c. Contract Classification

Under Canadian GAAP all policy contracts were presented as a single item on the face of the financial statements. Under IFRS, investment contracts without a significant insurance element are presented as investment contract liabilities. Certain of the Company's insurance contracts do not meet the significant insurance element requirement under IFRS and as a result will be reclassified to investment contracts. Deposits and withdrawals on these contracts will be recorded in a liability account rather than revenue and benefit accounts. Contract liabilities of \$19,270 will be removed from insurance contract liabilities on transition. These contracts have been measured as investment contracts under IAS 39 using the effective interest rate method and valued at \$17,566. Deferred income tax liabilities of \$514 will arise on the difference in measurement. Retained earnings will increase by \$1,190.

Management's Discussion and Analysis

d. Property and Equipment

The Company's office properties that were classified as real estate investments under Canadian GAAP do not meet the definition of investment property under IFRS. As a result, they will be accounted for as property and equipment under IAS 16 "Property, Plant and Equipment" and will be reclassified accordingly on the Company's draft statement of financial position. The effect on the Company's draft opening statement of financial position will be a decrease in Real estate investments of \$15,601 and an increase of the same amount to Property and equipment, a decrease in other liabilities of \$18, and an increase of \$18 to Retained earnings.

The Company plans to elect to use a previous GAAP revaluation as deemed cost at the transition date for land and buildings and to apply the cost model available under IAS 16 for the measurement of all Property and equipment subsequent to the date of transition to IFRS.

e. Income Taxes

Under Canadian GAAP the full impact of the March 4, 2009 amendments to the Income Tax Act (Canada) was recorded in Net income. Under IAS 12 "Income Taxes", the impact of any substantively enacted amendments relating to items in OCI would have been reported in OCI. The unrealized tax recovery at January 1, 2010 will be reclassified from Retained earnings to AOCI on transition (Shareholders \$461, Policyholders \$63).

f. Impairment of AFS Assets

IAS 39 "Financial Instruments: Recognition and Measurement" requires the recognition of an impairment loss on a financial asset or group of financial assets when there is objective evidence that the financial assets are impaired. Under Canadian GAAP, an impairment loss is recognized when there is objective evidence of impairment and the decline in fair value is other than temporary. The Company plans to recognize additional impairment on certain preferred share equity investments at January 1, 2010 as a result of the impairment review conducted in accordance with IAS 39. The impact of this adjustment on the Company's draft statement of financial position at January 1, 2010 will be a decrease in Retained earnings of \$647 and an increase to Accumulated other comprehensive income of \$647.

Presentation reclassifications

Certain amounts on the statement of financial position will be reclassified to conform to the presentation adopted under IFRS. The following presentation differences between Canadian GAAP and IFRS have been reflected in the draft opening statement of financial position and have no impact on total equity.

g. Segregated Funds

Under Canadian GAAP, segregated fund assets and liabilities were presented separately from general funds on the face of the statement of financial position. Under IFRS total segregated fund assets will be presented as a separate line item and included in total assets. Segregated fund policy liabilities will also be presented as a separate line item and included in total liabilities. Segregated fund assets and Segregated fund liabilities will decrease by \$123,816 to eliminate Empire Life's investment in Segregated Funds.

h. Presentation of Reinsurance

Under Canadian GAAP reinsurance ceded to third parties was netted against insurance contract liabilities, insurance premiums, annuity premiums, insurance benefits and annuity benefits. IFRS will require these items to be presented on a gross basis with no effect on comprehensive income or equity.

Management's Discussion and Analysis

i. Disaggregation of Other Assets

IFRS requires that insurance related assets, intangible assets and property and equipment be presented separately on the face of the statement of financial position. These line items will be reclassified from Other Assets and Real Estate Investments, where they were presented under Canadian GAAP.

j. Disaggregation of Other Liabilities

IFRS requires that insurance related liabilities and amounts due to reinsurers be presented separately on the face of the statement of financial position. These line items will be reclassified from Accounts payable and other liabilities, where they were presented under Canadian GAAP.

Impact on 2010

The redesignation of assets held in support of insurance operations from AFS to FVTPL is an accounting policy change which is recognized in the transitional statement of financial position. In the first quarter of 2010 Empire Life has updated the method for setting the investment return on policy liability valuations to be consistent with the new accounting policy for assets. This change in policy liability estimate results in an initial reduction to Shareholders' net income of \$6,086 in the first quarter of 2010.

The preparation of Empire Life's Canadian GAAP to IFRS reconciliations for the comparative year ended December 31, 2010 has confirmed that the two most significant changes that impact equity are: a decrease in Shareholders' net income resulting from the initial change in policy liability valuations described above; and a decrease in Shareholders' OCI resulting from the redesignation of \$151,047 of financial assets held in support of insurance operations from AFS to FVTPL. Other adjustments do not have a significant impact on equity.

IFRS prescribes certain presentation changes. The most significant presentation changes include the grossing up of reinsurance balances and the inclusion of Segregated fund assets and liabilities with General fund assets and liabilities. While these changes are significant to particular line items in the financial statements, they do not have an impact on income or equity.

Management's Responsibility for Financial Reporting

The financial statements in this annual report have been prepared by management, who is responsible for their integrity, objectivity and reliability. This responsibility includes selecting and applying appropriate accounting policies, making judgements and estimates and ensuring information contained throughout the annual report is consistent with these statements. These financial statements are prepared in accordance with the *Insurance Companies Act (Canada)* which states that, except as otherwise specified by the Office of the Superintendent of Financial Institutions Canada (OSFI), the financial statements are to be prepared in accordance with Canadian generally accepted accounting principles (GAAP).

The Company maintains a system of internal control over financial reporting which is designed to provide reasonable assurance that assets are safeguarded, expenditures are made in accordance with authorizations of management and directors, transactions are properly recorded and the financial records are reliable for preparing the financial statements in accordance with Canadian generally accepted accounting principles. Under the supervision of management, an evaluation of the effectiveness of the Company's internal control over financial reporting was carried out as at December 31, 2010. Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2010.

The Board of Directors, acting through the Audit Committee which is comprised of directors who are not officers or employees of the Company, oversees management's responsibility for financial reporting and for internal control systems. The Audit Committee is responsible for reviewing the financial statements and annual report and recommending them to the Board of Directors for approval. The Audit Committee meets with management, internal audit and the external auditors to discuss audit plans, internal controls over accounting and financial reporting processes, auditing matters, and financial reporting issues.

The Appointed Actuary is appointed by the Board of Directors and is responsible for ensuring that the assumptions and methods used in the valuation of the policy liabilities are in accordance with accepted actuarial practice and regulatory requirements. The Appointed Actuary is required to provide an opinion regarding the appropriateness of the policy liabilities at the balance sheet date to meet all policyholder obligations of the Company. Examination of supporting data for accuracy and completeness and analysis of Company assets for their ability to support the amount of policy liabilities are important elements of the work required to form this opinion. The Appointed Actuary is also required each year to analyze the financial condition of the Company and prepare a report for the Board of Directors. The analysis tests the capital adequacy of the Company under adverse economic and business conditions for the current year and the next four years.

Deloitte & Touche's responsibility as external auditors is to report to the policyholders, shareholders and OSFI regarding the fairness of presentation of the Company's annual financial statements. The external auditors have full and free access to, and meet periodically with, the Audit Committee to discuss their audit. The Auditors' Report outlines the scope of their examination and their opinion.



Leslie C. Herr
President and Chief Executive Officer
Kingston, Ontario
February 24, 2011



Gary J. McCabe
Senior Vice-President and Chief Financial Officer
Kingston, Ontario
February 24, 2011

Independent Auditor's Report

To the Policyholders and Shareholders of The Empire Life Insurance Company

We have audited the accompanying financial statements of The Empire Life Insurance Company, which comprise the balance sheet including the balance sheet of its segregated funds as at December 31, 2010, and the statements of general fund operations, comprehensive income, shareholders' equity, policyholders' equity, general fund cash flows and changes in segregated funds for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of The Empire Life Insurance Company and its segregated funds as at December 31, 2010 and the results of its operations, its cash flows and changes in segregated funds for the year then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

Licensed Public Accountants

Toronto, Ontario

February 24, 2011

Appointed Actuary's Report

To the Policyholders and Shareholders of The Empire Life Insurance Company

I have valued the policy liabilities of The Empire Life Insurance Company for its balance sheet as at December 31, 2010 and their change in the statement of operations for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

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



J. Edward Gibson, F.S.A., F.C.I.A.

Fellow, Canadian Institute of Actuaries

Kingston, Ontario

February 24, 2011

Balance Sheet

As at December 31

(in thousands of dollars)

	2010	2009
Assets		
General Funds		
Cash and cash equivalents	\$ 151,332	\$ 149,141
Short-term investments (note 3)	50,914	37,080
Bonds (note 3)	3,221,908	2,795,896
Common and preferred shares (note 3)	1,002,238	949,742
Mortgages (note 3)	226,887	223,642
Real estate (note 3)	15,656	15,601
Loans on policies (note 3)	40,242	38,728
Policy contract loans (note 3)	119,896	137,764
Accrued investment income	18,411	17,827
Premiums receivable	3,108	3,914
Current income taxes receivable (notes 7 and 9)	11,054	–
Other assets (note 15)	38,281	32,718
TOTAL GENERAL FUND ASSETS	\$ 4,899,927	\$ 4,402,053
Segregated Funds		
Cash and cash equivalents	\$ 233,078	\$ 142,279
Short-term investments	109,150	230,409
Bonds	768,350	627,045
Common and preferred shares	3,576,969	3,294,346
Other assets	19,111	16,322
TOTAL SEGREGATED FUND ASSETS	\$ 4,706,658	\$ 4,310,401

On Behalf of the Board of Directors:



Duncan N.R. Jackman
Chairman of the Board



Leslie C. Herr
President and Chief Executive Officer

Balance Sheet

As at December 31

(in thousands of dollars)

	2010	2009
Liabilities		
General Funds		
Policy liabilities (notes 5 and 6)	\$ 3,669,504	\$ 3,192,988
Policyholders' funds on deposit	30,037	29,702
Provision for unpaid and unreported claims	42,977	32,606
Provision for profits to policyholders	20,104	18,558
Accounts payable and other liabilities (note 19)	81,654	86,172
Current income taxes payable (notes 7 and 9)	—	30,065
Future income taxes (note 7)	7,343	1,116
Subordinated debt (note 16)	199,185	198,980
	4,050,804	3,590,187
Shareholders' and Policyholders' Equity		
Shareholders' equity (note 11)		
Capital stock (note 10)	985	985
Contributed surplus	19,387	19,387
Retained earnings	712,402	697,212
Accumulated other comprehensive income	58,744	33,470
	791,518	751,054
Policyholders' equity (note 11)		
Retained earnings	52,968	57,839
Accumulated other comprehensive income	4,637	2,973
	57,605	60,812
	849,123	811,866
TOTAL GENERAL FUND LIABILITIES AND EQUITY	\$ 4,899,927	\$ 4,402,053
Segregated Funds		
Policy liabilities	\$ 4,706,658	\$ 4,310,401

Statement of General Fund Operations

Year ended December 31

(in thousands of dollars)

	2010	2009
Revenue		
Insurance premiums	\$ 577,847	\$ 539,570
Annuity premiums	239,864	300,306
Investment income (note 3)	205,360	183,964
Fair value change in held for trading assets	198,111	106,699
Realized gain on held for trading assets	8,248	30,641
Realized gain (loss) on available for sale assets including impairment write-downs (note 3)	15,463	(34,409)
Fee income	113,151	95,453
	1,358,044	1,222,224
Benefits and Expenses		
Insurance benefits	306,847	279,362
Annuity benefits	230,048	199,213
Policy dividends	19,079	17,629
Increase in policy liabilities (notes 5 and 6)	476,516	385,242
Operating expenses	116,527	103,765
Commissions	157,081	144,530
Interest expense	13,665	11,399
	1,319,763	1,141,140
NET INCOME BEFORE TAXES	38,281	81,084
Taxes – premium	12,198	11,436
– investment and capital	3,300	3,300
– income (note 7)	(2,536)	1,422
	12,962	16,158
NET INCOME	25,319	64,926
Participating policyholders	(4,871)	11,124
Shareholders' Net Income	\$ 30,190	\$ 53,802

Statements of Comprehensive Income

Year ended December 31

(in thousands of dollars)

	2010	2009
Shareholders'		
Net income	\$ 30,190	\$ 53,802
Other comprehensive income (loss), net of income taxes:		
Unrealized fair value change on available for sale investments (note 9)	33,690	67,009
Less realized fair value change on available for sale investments including impairment write-downs reclassified to net income (notes 3 and 9)	9,063	(24,518)
Net unrealized fair value increase	24,627	91,527
Gain on derivative investments designated as cash flow hedges (notes 3 and 9)	—	912
Less loss on derivative investments designated as cash flow hedges reclassified to net income (notes 3 and 9)	(462)	(268)
Net gain on derivatives designated as cash flow hedges	462	1,180
Shareholder portion of policyholder other comprehensive income	185	841
Total other comprehensive income	25,274	93,548
COMPREHENSIVE INCOME	\$ 55,464	\$ 147,350
Policyholders'		
Net income (loss)	\$ (4,871)	\$ 11,124
Other comprehensive income (loss), net of income taxes:		
Unrealized fair value change on available for sale investments (note 9)	2,388	6,757
Less realized fair value change on available for sale investments including impairment write-downs reclassified to net income (notes 3 and 9)	539	(1,650)
Net unrealized fair value increase	1,849	8,407
Shareholder portion of policyholder other comprehensive income (loss)	(185)	(841)
Total other comprehensive income	1,664	7,566
COMPREHENSIVE INCOME (LOSS)	\$ (3,207)	\$ 18,690

Statement of Shareholders' Equity

Year ended December 31

(in thousands of dollars)

	2010	2009
Capital stock	\$ 985	\$ 985
Contributed surplus	19,387	19,387
Retained earnings – beginning of year	697,212	643,410
Net income	30,190	53,802
Dividends to common shareholders	(15,000)	–
Retained earnings – end of year	712,402	697,212
Accumulated other comprehensive income (loss) – beginning of year	33,470	(60,078)
Other comprehensive income	25,274	93,548
Accumulated other comprehensive income – end of year <i>(note 12)</i>	58,744	33,470
TOTAL SHAREHOLDERS' EQUITY	\$ 791,518	\$ 751,054

Statement of Policyholders' Equity

Year ended December 31

(in thousands of dollars)

	2010	2009
Retained earnings – beginning of year	\$ 57,839	\$ 46,715
Share of net income (loss)	(4,871)	11,124
Retained earnings – end of year	52,968	57,839
Accumulated other comprehensive income (loss) – beginning of year	2,973	(4,593)
Other comprehensive income	1,664	7,566
Accumulated other comprehensive income – end of year <i>(note 12)</i>	4,637	2,973
TOTAL POLICYHOLDERS' EQUITY	\$ 57,605	\$ 60,812

Statement of General Fund Cash Flows

Year ended December 31

(in thousands of dollars)

	2010	2009
Operating Activities		
Net income	\$ 25,319	\$ 64,926
Non-cash items affecting net income		
Increase in policy liabilities	476,516	385,242
Fair value change in held for trading assets	(198,111)	(106,699)
Realized (gain) loss on assets including impairment write-downs	(23,711)	3,768
Amortization related to invested assets	(68,419)	(68,325)
Future income taxes	6,227	(8,389)
Other items	(47,981)	57,235
CASH PROVIDED FROM OPERATING ACTIVITIES	169,840	327,758
Investment Activities		
Portfolio investments		
Purchases and advances	(1,375,230)	(1,046,238)
Sales and maturities	1,223,373	579,985
Loans on policies		
Advances	(7,800)	(8,073)
Repayments	24,791	12,202
Decrease (increase) in short-term investments	(13,834)	38,815
Other	(3,949)	(1,893)
CASH USED FOR INVESTMENT ACTIVITIES	(152,649)	(425,202)
Financing Activities		
Dividends to common shareholders	(15,000)	–
Debt issue (note 16)	–	198,861
Debt repayment (note 18)	–	(125,000)
CASH PROVIDED FROM (USED FOR) FINANCING ACTIVITIES	(15,000)	73,861
Net change in cash and cash equivalents	2,191	(23,583)
Cash and cash equivalents – beginning of year	149,141	172,724
CASH AND CASH EQUIVALENTS – END OF YEAR (note 21)	\$ 151,332	\$ 149,141
Supplementary information:		
Cash disbursements made for:		
Interest on subordinated debt	\$ 13,460	\$ 11,618
Income taxes, net of (refunds)	\$ 42,129	\$ (42,866)

Statement of Changes in Segregated Funds

Year ended December 31

(in thousands of dollars)

	2010	2009
Segregated funds – beginning of year	\$ 4,310,401	\$ 3,348,827
Additions to segregated funds:		
Amounts received from policyholders	1,081,289	1,024,694
Interest	36,230	33,024
Dividends	95,929	81,790
Net realized gains on sale of investments	–	167,652
Net unrealized increase in market value of investments	354,406	572,517
	5,878,255	5,228,504
Deductions from segregated funds:		
Amounts withdrawn or transferred by policyholders	1,049,679	830,800
Net realized losses on sale of investments	16,109	–
Management fees and other operating costs	105,809	87,303
SEGREGATED FUNDS – END OF YEAR	\$ 4,706,658	\$ 4,310,401

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

1. Nature of the Business

The Empire Life Insurance Company (the Company) underwrites life and health insurance policies and annuity contracts for individuals and groups across Canada. The Company is a subsidiary of E-L Financial Corporation Limited. As at December 31, 2010 the Company has no separate subsidiaries.

2. Significant Accounting Policies

These financial statements have been prepared in accordance with the *Insurance Companies Act (Canada)* which states that, except as otherwise specified by the Office of the Superintendent of Financial Institutions Canada (OSFI), the financial statements are to be prepared in accordance with Canadian generally accepted accounting principles (GAAP).

The Company's financial statements report general fund and segregated fund results separately. The significant accounting policies, which follow, relate to the general fund unless they are specifically identified as segregated fund related:

(a) Change in Accounting Policies

There were no accounting policy changes in 2010.

(i) Future Accounting Changes

International Financial Reporting Standards (IFRS)

In accordance with the requirements of the Canadian Accounting Standards Board, all publicly accountable enterprises will adopt IFRS as of January 1, 2011 with comparatives for the prior year. The Company's first annual consolidated financial statements in accordance with IFRS will be for the year ending December 31, 2011.

(b) Financial Instruments

Most financial assets supporting policy liabilities are classified as held for trading (HFT). These assets may be comprised of cash, short-term investments, bonds and debentures, common and preferred shares, futures, forwards and options. Changes in the fair value of these financial assets are recorded in fair value change in HFT assets in the statement of general fund operations in the period in which they occur.

Most financial assets supporting capital and surplus and certain financial assets supporting policy liabilities are classified as available for sale (AFS). These assets may be comprised of cash, short-term investments, bonds and debentures, or common and preferred shares. AFS assets with a quoted price in an active market are carried at fair value in the balance sheet. Any changes in the fair values are recorded, net of income taxes, in other comprehensive income (OCI). Gains and losses realized on disposal of AFS assets are reclassified from other comprehensive income to realized gain (loss) on AFS assets in the statement of general fund operations.

AFS assets are subject to periodic impairment reviews. Upon recognition of an impairment that management has deemed other than temporarily impaired (OTTI), the write-down is reclassified from other comprehensive income if applicable and recorded in the statement of general fund operations. Impairment write-downs on debt instruments classified as AFS are required to be reversed if objective evidence exists that they are no longer impaired.

Loans and receivables may include mortgage loans, loans on policies, policy contract loans, and premiums receivable. These assets are recorded at amortized cost, using the effective interest method, net of provisions for impairment losses, if any.

Interest income and dividend income are included in investment income in the statement of general fund operations for all financial assets, regardless of classification.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

Related Transaction Costs:

All transactions are recorded on the trade date. Transaction costs are expensed for HFT instruments and capitalized for all others.

(c) Fair Value of Financial Instruments

Fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. When a financial instrument is initially recognized, its fair value is generally the value of the consideration paid or received. Subsequent to initial recognition, the fair value of a financial asset quoted in an active market or based on observable market inputs, is generally the bid price and, for a financial liability quoted in an active market or based on observable market inputs, the fair value is generally the ask price. Due to the short-term nature of accrued investment income and premiums receivable, the carrying value of these instruments approximates fair value.

Fair value measurements used in these financial statements have been classified by using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The three levels of the hierarchy are:

Level 1 – Fair value is based on quoted market prices in active markets for identical assets or liabilities;

Level 2 – Fair value is based on observable inputs other than Level 1 prices, such as quoted market prices for similar (but not identical) assets or liabilities in active markets, quoted market prices for identical assets or liabilities in markets that are not active, and other inputs that are observable;

Level 3 – Fair value is based on non-observable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 financial instruments are initially fair valued at their transaction price. After initial measurement, the fair value of Level 3 assets and liabilities is determined using valuation models, discounted cash flow methodologies, or similar techniques.

All of the Company's financial instruments requiring fair value measurements meet the requirements of Level 1 or Level 2 of the fair value hierarchy.

(d) Impairment

All investments other than HFT instruments are assessed for objective evidence of impairment at each balance sheet date. Impairment is recognized in the statement of general fund operations when it is considered to be other than temporary (OTT).

AFS debt instruments

An AFS debt security would be identified as impaired when there is objective observable evidence that suggests that timely collection of the contractual principal or interest is no longer reasonably assured. An impairment charge equal to the cumulative loss recorded in AOCI is recognized in the statement of general fund operations when impairment is considered OTT. In assessing whether an impairment is OTT, the Company considers its intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery.

AFS equity instruments

Objective evidence of impairment exists if there has been a significant or prolonged decline in the fair value of the investment below its cost, if there is a significant adverse change in the technological, market, economic or legal environment in which the issuer operates or if the issuer is experiencing financial difficulties. In assessing whether an impairment is OTT, the Company considers its intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

Loans

To the extent there is no longer reasonable assurance of full collection of loan principal and loan interest related to a mortgage or policy contract loan, the Company establishes a specific allowance for loan impairment which reduces the carrying value of that loan to its estimated realizable amount and charges the reduction directly to income in the period in which the impairment in value is identified.

Any change in the estimated realizable amount subsequent to the initial recognition of impairment is included in income in the period in which the change occurs as a charge or credit for loan impairment.

Events and conditions considered in determining the charge to income during the period include the value of the security underlying the loan, geographic location, industry classification of the borrower, an assessment of the financial stability of the borrower, repayment history and an assessment of the impact of current economic conditions.

The Company ceases to accrue interest on non-performing loans which are 90 days or more in arrears, as well as those which are less than 90 days in arrears but are deemed by management to be impaired. Once loans are classified as non-performing, any accrued but uncollected interest is reversed.

Subsequent payments are recorded in interest income after any prior write-off has been recovered and if management has determined that a specific provision is not required; otherwise, they are recorded as a reduction in carrying value of the loan.

Provisions are also made for anticipated future losses of principal and interest on invested assets. These provisions are included as a component of policy liabilities.

(e) Restructured Loans

If a loan is restructured, its carrying value is reduced as at the date of restructure to an amount, which does not exceed the estimated realizable value under the modified loan terms. The reduction in carrying value is recognized immediately as a charge for loan impairment. When collection of the scheduled future cash flows in accordance with the modified loan terms is reasonably assured, interest income is recognized at the effective interest rate inherent in the loan at the time it was initially recognized as being impaired.

(f) Assets Acquired on Foreclosure

Assets acquired on foreclosure of a mortgage and held for resale are initially measured at fair value less cost to sell. Subsequent to foreclosure, assets held for resale are measured at the lower of their carrying amount or the fair value less cost to sell. Any write-offs or recoveries are recognized immediately as a charge or credit for loan impairment in income in the period.

Assets acquired on foreclosure to be held and used are initially measured at fair value and thereafter are accounted for in the same manner as similar assets acquired in the normal course of business.

(g) Real Estate

Real estate is carried at cost plus unrealized gains and losses amortized to income as described below. Realized gains and losses on real estate are deferred and amortized to income at 3% each quarter. The unamortized realized gains and losses are included in accounts payable and other liabilities in the balance sheet.

Market values for each property are established periodically by qualified independent appraisers and the unrealized appraisal gains and losses are amortized to income at 3% each quarter. The accumulated unrealized gains and losses amortized to income are included in real estate in the balance sheet.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(h) Segregated Funds

Certain policy contracts allow the policyholder to invest in segregated investment funds managed by the Company for the benefit of these policyholders. The assets of these funds are carried at their period-end fair values, which also represents the segregated fund policy liability. The financial results of the segregated funds are presented separately from the financial results of the general fund. The Company's statement of general fund operations includes fee income earned for management of the segregated funds.

(i) Income Taxes

Future income tax assets and liabilities are recorded for the expected future income tax consequences of events that have been included in the financial statements or income tax returns. Future income taxes are provided for using the asset and liability method. Under the asset and liability method, future income taxes are recognized for all significant temporary differences between the tax and financial statement bases of assets and liabilities and for certain carry-forward items.

Future income tax assets are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates, on the date of the enactment or substantive enactment.

(j) Policy Liabilities

The Company's policy liabilities have been prepared in accordance with GAAP. The Company's policy liabilities were determined using accepted actuarial practices according to the standards established by the Canadian Institute of Actuaries (CIA). The provisions for policy liabilities are recorded net of amounts ceded to reinsurers. Policy liabilities represent an estimate of the amount, which together with estimated future premiums and investment income, will be sufficient to pay future benefits, dividends, expenses and taxes on policies in force.

The liabilities incorporate management's best estimate assumptions regarding such factors as mortality and morbidity, investment returns, rates of policy terminations (lapses), level of operating expenses, inflation, policyholder dividends and taxes. Due to the long-term risks and uncertainties inherent in the life insurance business, a margin for adverse deviations from best estimates is evaluated separately for each variable and included in policy liabilities.

(k) Reinsurance Ceded

Reinsurance is ceded to other insurers in order to limit exposure to significant losses. Reinsurance ceded does not relieve the original insurer of its primary liability. Premiums, policy expenses and operating expenses are recorded net of amounts ceded to and recoverable from reinsurers.

Amounts recoverable from reinsurers are estimated in a manner consistent with the policy liability associated with the reinsured policy.

(l) Employee Future Defined Benefit Plans

The Company accrues its obligations for its employee defined benefit plans, net of plan assets. The cost of defined benefit pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method pro-rated on services and using management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs. For the purpose of calculating the expected return on plan assets, those assets are valued at fair value. Actuarial gains (losses) arise from the difference between actual long-term rate of return on plan assets for a period and expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net accumulated actuarial gain (loss) over 10% of the greater of the accrued benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(m) Foreign Currency Translation

Assets and liabilities measured at fair value are translated at period-end exchange rates. Otherwise, assets and liabilities are translated at exchange rates prevailing at the transaction dates. Revenue and expense items are translated at actual rates prevailing during the period.

(n) Deferral of Acquisition Costs

Distribution costs of segregated funds having a deferred sales charge are deferred and amortized over the term of the related deposits or the applicable period of such sales charges, as appropriate. These deferred costs form part of policy liabilities on the balance sheet and the related amortization forms part of the increase in policy liabilities on the statement of general fund operations.

(o) Capital Assets

Capital assets (furniture, equipment, and leasehold improvements) are carried at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the useful life of the capital assets, which varies from two to five years.

(p) Intangible Assets

Intangible assets include computer software, related licences and software development costs, which are carried at cost less accumulated depreciation and any impairment losses. Depreciation of intangible assets is calculated using the straight line method to allocate costs over their estimated useful lives, which are generally between three and seven years.

(q) Revenue Recognition

Insurance premiums net of reinsurance and annuity premiums, as well as reinsurance assumed premiums, are generally recorded as revenue when due. Annuity premiums are comprised solely of new deposits on general fund products with a guaranteed rate of return or guaranteed income and exclude deposits on segregated fund products.

Fee income earned for investment management and administration of the segregated funds is generally calculated and recorded as revenue daily based on closing segregated funds asset market values.

Dividend income is recognized on the ex-dividend date. Interest income is recognized in the income statement as it accrues and is calculated using the effective interest rate method.

(r) Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (OCI). OCI includes unrealized gains or losses on available for sale financial assets, net of amounts reclassified to the statement of general fund operations, and the effective portion of the change in the fair value of cash flow hedging instruments, net of amounts reclassified to the statement of general fund operations all net of taxes. The balance of shareholders' accumulated other comprehensive income (AOCI) is shown as a separate component of shareholders' equity. The balance of policyholders' AOCI is shown as a separate component of policyholders' equity.

(s) Hedge Accounting

From time to time, the Company enters into hedging arrangements. Where the Company has elected to use hedge accounting, a hedge relationship is designated and documented at inception. The Company evaluates hedge effectiveness at the inception of the relationship and at least on a quarterly basis using a variety of techniques including the cumulative dollar offset method. Both at inception and throughout the term of the hedge, the

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

Company expects that each hedging instrument will be highly effective in offsetting the risk being hedged. When it is determined that the hedging relationship is no longer effective, or the hedged item has been sold or terminated, the Company discontinues hedge accounting prospectively. In such cases, if the derivative hedging instrument is not sold or terminated, any subsequent changes in fair value of the derivative is recognized in investment income.

In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging instrument is recorded in OCI while the ineffective portion is recognized in investment income. Gains and losses accumulated in AOCI are reclassified and recognized in investment income during the periods when the variability in the cash flows hedged or the hedged forecasted transactions are recognized in income. Gains and losses on cash flow hedges accumulated in AOCI are reclassified immediately to investment income when either the hedged item is sold or the forecasted transaction is no longer expected to occur. When hedge accounting is discontinued, and the hedged forecasted transaction remains probable of occurring, then the amounts previously recognized in AOCI are reclassified and recognized in investment income in the periods during which variability in the cash flows hedged or the hedged forecasted transaction is recognized in income.

The Company may enter into fair value hedging relationships associated with currency risk in available for sale assets. Changes in the fair value of the derivatives used for fair value hedges are recorded in investment income. The change in fair value of these available for sale investments related to the hedged risk is recorded in investment income. As a result, ineffectiveness, if any, is recognized in investment income.

(t) Participating Policyholders' Interest

Certain life, health, and annuity policies are defined as participating policies by contractual provisions, and are eligible for periodic dividends. The distribution of dividends is made from the earnings attributed to the performance of the participating business.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

3. Portfolio Investments

(a) Summary of Invested Assets

The carrying values and fair values of portfolio investments are as follows:

	2010					
Asset category	Required to be Held for Trading	Designated as Held for Trading	Available for Sale	Loans & Receivables and Real Estate	Total Carrying Value	Total Fair Value
Short-term investments						
Canadian federal government	\$ 1,990	\$ 1,997	\$ 34,954	\$ –	\$ 38,941	\$ 38,941
Canadian provincial governments	–	–	11,973	–	11,973	11,973
Corporate	–	–	–	–	–	–
TOTAL SHORT-TERM INVESTMENTS	1,990	1,997	46,927	–	50,914	50,914
Bonds						
Bonds issued or guaranteed by:						
Canadian federal government	7,148	46,536	107,870	–	161,554	161,554
Canadian provincial and municipal government	4,410	1,847,287	150,735	–	2,002,432	2,002,432
Total government bonds issued or guaranteed	11,558	1,893,823	258,605	–	2,163,986	2,163,986
Canadian corporate bonds by industry sector:						
Financial services	9,052	479,173	158,274	–	646,499	646,499
Infrastructure	2,370	143,065	26,656	–	172,091	172,091
Utilities	1,541	119,347	17,221	–	138,109	138,109
Energy	480	19,782	4,937	–	25,199	25,199
Consumer staples	206	37,981	3,152	–	41,339	41,339
Industrials	189	24,869	2,695	–	27,753	27,753
Health care	–	6,932	–	–	6,932	6,932
Total Canadian corporate bonds	13,838	831,149	212,935	–	1,057,922	1,057,922
TOTAL BONDS	25,396	2,724,972	471,540	–	3,221,908	3,221,908
Preferred shares						
Canadian	–	250,187	121,143	–	371,330	371,330
TOTAL PREFERRED SHARES	–	250,187	121,143	–	371,330	371,330
Common shares						
Canadian	127,351	–	484,970	–	612,321	612,476
U.S.	16,934	–	–	–	16,934	16,934
Other	1,653	–	–	–	1,653	1,653
TOTAL COMMON SHARES	145,938	–	484,970	–	630,908	631,063
Mortgages	–	–	–	226,887	226,887	236,824
Real estate	–	–	–	15,656	15,656	16,079
Loans on policies	–	–	–	40,242	40,242	40,242
Policy contract loans	–	–	–	119,896	119,896	119,896
TOTAL	\$ 173,324	\$ 2,977,156	\$ 1,124,580	\$ 402,681	\$ 4,677,741	\$ 4,688,256

Common shares Canadian in the above table include AFS at cost assets with a carrying value of \$2,280 (2009 \$2,280) and a fair value of \$2,435 (2009 \$2,316).

The Company has financial liabilities comprised of subordinated debentures with a carrying value of \$199,185 (2009 \$198,980) and a fair value of \$218,858 (2009 \$213,420) as of December 31, 2010.

Due to the nature of loans on policies and policy contract loans, the carrying value of these instruments approximates fair value.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

2009

Asset category	Required to be Held for Trading	Designated as Held for Trading	Available for Sale	Loans & Receivables and Real Estate	Total Carrying Value	Total Fair Value
Short-term investments						
Canadian federal government	\$ 1,100	\$ 2,999	\$ 12,986	\$ –	\$ 17,085	\$ 17,085
Corporate	–	–	19,995	–	19,995	19,995
TOTAL SHORT-TERM INVESTMENTS	1,100	2,999	32,981	–	37,080	37,080
Bonds						
Bonds issued or guaranteed by:						
Canadian federal government	8,353	118,406	191,664	–	318,423	318,423
Canadian provincial and municipal government	2,952	1,423,457	149,427	–	1,575,836	1,575,836
Other foreign government	153	–	1,418	–	1,571	1,571
Total government bonds issued or guaranteed	11,458	1,541,863	342,509	–	1,895,830	1,895,830
Canadian corporate bonds by industry sector:						
Financial services	6,551	458,469	122,544	–	587,564	587,564
Infrastructure	2,211	85,261	19,109	–	106,581	106,581
Utilities	2,250	116,047	20,108	–	138,405	138,405
Energy	475	9,013	5,252	–	14,740	14,740
Consumer staples	394	38,050	4,176	–	42,620	42,620
Industrials	165	8,664	1,327	–	10,156	10,156
Total Canadian corporate bonds	12,046	715,504	172,516	–	900,066	900,066
TOTAL BONDS	23,504	2,257,367	515,025	–	2,795,896	2,795,896
Preferred shares						
Canadian	–	275,640	124,985	–	400,625	400,625
TOTAL PREFERRED SHARES	–	275,640	124,985	–	400,625	400,625
Common shares						
Canadian	111,548	–	362,133	–	473,681	473,717
U.S.	17,989	–	27,609	–	45,598	45,598
Other	2,065	–	27,773	–	29,838	29,838
TOTAL COMMON SHARES	131,602	–	417,515	–	549,117	549,153
Mortgages	–	–	–	223,642	223,642	225,160
Real estate	–	–	–	15,601	15,601	16,079
Loans on policies	–	–	–	38,728	38,728	38,728
Policy contract loans	–	–	–	137,764	137,764	137,764
TOTAL	\$ 156,206	\$ 2,536,006	\$ 1,090,506	\$ 415,735	\$ 4,198,453	\$ 4,200,485

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(b) Impairments

The Company's financial assets are subject to a regular review for impairment. Except as provided below, no additional impairments have been recorded in these financial statements.

Investments in individual assets have been reduced by the following specific allowances for impairment:

	2010		
Impaired Loans	Recorded Investment	Allowance for Impairment	Carrying Amount
Mortgages	\$ 10,649	\$ 2,421	\$ 8,228
Policy contract loans	813	565	248
TOTAL	\$ 11,462	\$ 2,986	\$ 8,476

	2009		
Impaired Loans	Recorded Investment	Allowance for Impairment	Carrying Amount
Mortgages	\$ 10,214	\$ 2,061	\$ 8,153
Policy contract loans	813	578	235
TOTAL	\$ 11,027	\$ 2,639	\$ 8,388

The Company holds collateral of \$8,268 in respect of these mortgages and \$247 in respect of these policy contract loans. Policy contract loans are secured by life insurance policies.

Continuity of Allowance for Loan Impairment	2010		2009
Allowance – beginning of year	\$	2,639	\$ 2,940
Provision for loan impairment		925	258
Write-off of loans		(578)	(559)
ALLOWANCE – END OF YEAR	\$	2,986	\$ 2,639

The Company has recorded interest income of \$1,046 on these assets.

Provisions made for anticipated future losses of principal and interest on investments and included as a component of policy liabilities are \$86,900 (2009 \$65,100).

As at December 31, 2010, financial assets past due, but not impaired are \$nil (2009 \$9,270). The 2009 amount was comprised entirely of mortgages past due less than 90 days.

Management regularly reviews securities classified as available for sale for evidence of impairment. The following table summarizes available for sale assets with unrealized losses recognized in AOCI as at December 31. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been below cost, the financial conditions and near-term prospects of the issuer, and the ability and intent to hold the investment for a period of time sufficient to allow for recovery. Management has conducted an evaluation of the portfolio and concluded that the unrealized losses on these securities are temporary.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

	2010		2009	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Bonds	\$ 47,394	\$ 490	\$ 186,873	\$ 3,059
Preferred shares	7,141	309	20,093	1,803
Common shares	14,706	1,043	—	—
TOTAL	\$ 69,241	\$ 1,842	\$ 206,966	\$ 4,862

Changes in the fair value of available for sale assets are recorded in unrealized fair value change on available for sale investments in other comprehensive income (OCI). Where there is objective evidence that a decline in fair value is other than temporary, the loss accumulated in AOCI is reclassified to realized gain (loss) on available for sale assets including impairment write-downs on the statement of general fund operations. The Company reclassified a pre-tax loss of \$3,447 due to write-downs of impaired available for sale common and preferred shares (2009 \$34,970). Management considers the impairment of these assets to be other than temporary due to the length of time that the fair value was less than the cost and the extent and nature of the loss.

An impairment review has been performed on all AFS investments carried at cost where there was an unrealized loss at year end. Based on the results of this review, the Company recorded a pre-tax loss of \$nil (2009 \$140) directly to the statement of general fund operations, due to the write-downs of impaired AFS common shares that were carried at cost. Management considers the impairment of these assets to be other than temporary due to the length of time that the fair value was less than cost and the extent and nature of the loss.

(c) Investment Income

Investment income is comprised of the following:

	2010	2009
Interest income	\$ 169,423	\$ 155,330
Dividend income	35,713	29,147
Real estate net income	1,056	1,300
Other	93	(1,555)
Impaired asset recovery (write-down)	(925)	(258)
INVESTMENT INCOME	\$ 205,360	\$ 183,964

Interest income includes \$49,257 (2009 \$46,262) relating to assets not classified as held for trading.

(d) Composition of Held for Trading Income

The following amounts have been recognized in the statement of general fund operations:

	2010	2009
Change in fair value of instruments required to be classified as held for trading	\$ 13,167	\$ 28,576
Change in fair value of instruments designated as held for trading	\$ 184,944	\$ 78,123

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(e) Securities Lending

During 2010, the Company continued its securities lending agreement with its custodian, RBC Dexia Investor Services Trust ("RBC Dexia"). Under this agreement, the custodian may lend securities from the Company's portfolio to other institutions for periods of time. In addition to a fee, the Company receives collateral which exceeds the market value of the loaned securities, which is retained by the Company until the underlying security has been returned to the Company. In the event that any of the loaned securities are not returned to RBC Dexia, RBC Dexia at its option, may either restore to the Company securities identical to the loaned securities or it will pay to the Company the value of the collateral up to but not exceeding the market value of the loaned securities on the date on which the loaned securities were to have been returned ("Valuation date") to RBC Dexia. If the collateral is not sufficient to allow RBC Dexia to pay such market value to the Company, RBC Dexia shall indemnify the Company only for the difference between the market value of the securities and the value of such collateral on the Valuation date.

As at December 31, 2010, the Company had loaned securities (which are included in invested assets) with a carrying value of \$159,500. Income from securities lending activities of \$31 is included in other in the table of investment income.

(f) Unrealized Investment Gains

Net unrealized investment gains of \$2,080 (2009 \$2,025) relating to real estate are included in real estate in the balance sheet.

(g) Hedge Accounting

In conjunction with the issuance of unsecured subordinated debentures (note 16), the Company entered into a bond forward derivative with a notional amount of \$75,000 which matured on May 13, 2009. This derivative has been accounted for as a hedging item in a cash flow hedging relationship.

On a year-to-date basis, the Company recognized a loss of \$nil (2009 \$1,265) related to the ineffective portion of its cash flow hedge in investment income on the statement of general fund operations. The Company expects to reclassify a loss of \$735 from AOCI to investment income on the statement of general fund operations in the next 12 months.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(h) Fair Value of Financial Instruments

The following table presents the financial instruments measured at fair value classified by the fair value hierarchy:

2010					
	Level 1	Level 2	Level 3	Total Fair Value	
Cash and cash equivalents	\$ (15,979)	\$ 167,311	\$ –	\$	151,332
Held for trading:					
Bonds	–	2,750,368	–		2,750,368
Common shares	145,938	–	–		145,938
Preferred shares	250,187	–	–		250,187
Short-term investments	–	3,987	–		3,987
Available for sale:					
Bonds	–	471,540	–		471,540
Common shares	482,690	–	–		482,690
Preferred shares	121,143	–	–		121,143
Short-term investments	–	46,927	–		46,927
Derivative assests	–	767	–		767
Derivative liabilities	–	(720)	–		(720)
TOTAL	\$ 983,979	\$ 3,440,180	\$ –	\$	4,424,159
2009					
	Level 1	Level 2	Level 3	Total Fair Value	
Cash and cash equivalents	\$ (12,445)	\$ 161,586	\$ –	\$	149,141
Held for trading:					
Bonds	–	2,280,871	–		2,280,871
Common shares	131,602	–	–		131,602
Preferred shares	275,640	–	–		275,640
Short-term investments	–	4,099	–		4,099
Available for sale:					
Bonds	–	515,025	–		515,025
Common shares	415,235	–	–		415,235
Preferred shares	124,985	–	–		124,985
Short-term investments	–	32,981	–		32,981
Derivative assests	–	2,493	–		2,493
Derivative liabilities	–	(247)	–		(247)
TOTAL	\$ 935,017	\$ 2,996,808	\$ –	\$	3,931,825

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

All of the Level 1 fair value instruments have been priced using exchange listed prices or broker quotes representing actual transactions in an active market. Level 2 fair value instruments are priced through a vendor supplied evaluated price which is based on observable market information (matrix pricing).

The classification of a financial instrument into a level is based on the lowest level of input that is significant to the determination of the fair value. There were no transfers between Level 1 and Level 2 during the year ended December 31, 2010.

For additional information on the composition of the Company's invested assets, and analysis of the Company's risks arising from financial instruments refer to note 22.

4. Derivative Financial Instruments

In the ordinary course of business, the Company has policy obligations which have a savings component that varies with a variety of indices and currencies. The financial instruments used for matching this liability include various futures contracts and foreign currency forward contracts. In addition, the Company may use futures contracts and foreign currency forward contracts in its shareholders' and policyholders' equity accounts. The Company may also use other equity derivative contracts as part of a portfolio of assets to match policy liabilities as to duration and amounts. The Company periodically uses bond contracts for cash flow hedging purposes (see Hedge Accounting, note 3(g)).

The notional amounts of these financial instruments are not recognized on the balance sheet. Notional amounts are the contract amounts used to calculate the cash flows to be exchanged. They are a common measure of volume of outstanding transactions, but do not represent credit or market risk exposures.

Current replacement cost represents the estimated cost of replacing all contracts with a positive value, at current quoted market prices. For over-the-counter contracts, the current replacement cost represents the estimated current fair value.

Credit equivalent amount is the current replacement cost plus an amount for future credit exposure associated with the potential future changes in currency and interest rates. The future credit exposure is calculated using a formula prescribed by OSFI in its capital adequacy guidelines.

Risk-weighted balance represents the regulatory capital required to support the Company's derivative activities. The credit equivalent amounts are weighted according to the creditworthiness of the counterparty using factors prescribed by OSFI in its capital adequacy guidelines.

2010

	Notional Principal	Current Replacement Cost	Fair Value Positive	Fair Value Negative	Credit Equivalent Amount	Risk Weighted Balance
Exchange-traded						
Equity index futures	\$ 9,424	\$ 25	\$ 25	\$ 154	\$ —	\$ —
Equity options	—	—	—	—	—	—
Over-the-counter						
Foreign currency forwards	6,571	12	12	40	78	1
Other equity contracts	11,545	730	730	526	1,422	23
TOTAL	\$ 27,540	\$ 767	\$ 767	\$ 720	\$ 1,500	\$ 24

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

2009

	Notional Principal	Current Replacement Cost	Fair Value		Credit Equivalent Amount	Risk Weighted Balance
			Positive	Negative		
Exchange-traded						
Equity index futures	\$ 10,128	\$ 66	\$ 66	\$ –	\$ –	–
Equity options	7	3	3	–	3	–
Over-the-counter						
Foreign currency forwards	22,425	124	124	247	349	5
Other equity contracts	15,515	2,300	2,300	–	3,407	55
TOTAL	\$ 48,075	\$ 2,493	\$ 2,493	\$ 247	\$ 3,759	\$ 60

All contracts mature in less than one year. Fair value positive amounts and fair value negative amounts are reported on the balance sheet as other assets.

5. Nature and Composition of Policy Liabilities

Policy liabilities represent the amounts which, together with estimated future premiums and investment income, will be sufficient to pay estimated future benefits, dividends, expenses, and taxes on policies in force. Policy liabilities are determined using accepted actuarial practice according to standards established by the CIA.

The Company is active in most life insurance and annuity product lines across Canada and does not operate in foreign markets. The composition of the policy liabilities is as follows:

		2010	2009
Participating	– Individual Life	\$ 391,884	\$ 344,725
	– Other	480	483
Non-participating Individual	– Life	2,033,286	1,708,422
	– Annuity	1,067,736	988,086
	– Health	51,185	35,186
Non-participating Group	– Life	18,933	17,343
	– Health	89,829	82,097
	– Annuity	74,691	75,581
Segregated fund deferred acquisition costs		(58,520)	(58,935)
Segregated fund guarantee liability		–	–
POLICY LIABILITIES		\$ 3,669,504	\$ 3,192,988

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

6. The Valuation of Policy Liabilities

The Company is in the business of measuring and managing risk, as reflected in the valuation of policy liabilities. To the extent that emerging experience is more favourable than assumed in the valuation, income will emerge. If emerging experience is less favourable, losses will result.

The computation of policy liabilities requires "best estimate" assumptions covering the remaining life of the policies. These assumptions are made for mortality, morbidity, investment returns, persistency (lapse), expenses and inflation. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviations from best estimates is calculated separately for each variable and included in policy liabilities. Refer to Note 22 Risk Management for a detailed discussion of assumptions, risks and related sensitivities.

(a) Change in Policy Liabilities

	2010	2009
Policy liabilities – beginning of year	\$ 3,192,988	\$ 2,807,746
Changes in methods and assumptions	7,668	(5,056)
Normal changes – new business	250,302	310,975
– in-force business	218,546	79,323
POLICY LIABILITIES – END OF YEAR	\$ 3,669,504	\$ 3,192,988

Changes in actuarial assumptions are made based on emerging and evolving experience with respect to major factors affecting estimates of future cash flows and consideration of economic forecasts of investment returns, industry studies and requirements of the CIA and OSFI.

The changes in actuarial methods and assumptions in 2010 include a net decrease of \$29,715 (2009 \$28,756) to reflect improving mortality/morbidity experience and a net increase of \$36,987 (2009 \$12,072) to reflect decreases in the investment return assumptions. The net impact of other changes amounted to a net increase of \$396 (2009 \$11,628).

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(b) Mix of Assets Allocated to Policy Liabilities and Shareholders' and Policyholders' Equity

2010					
	Insurance Liabilities		Annuity Liabilities	Equity	Total
Cash & short-term investments	\$ 122,637	\$	22,326	\$ 57,283	\$ 202,246
Bonds	2,082,779		606,762	532,367	3,221,908
Mortgages	–		226,887	–	226,887
Preferred shares	84,928		230,982	55,420	371,330
Common shares	318,235		–	312,673	630,908
Real estate	–		–	15,656	15,656
Loans on policies	40,242		–	–	40,242
Policy contract loans	19,680		49,264	50,952	119,896
Other	6,217		4,935	(46,878)	(35,726)
TOTAL	\$ 2,674,718	\$	1,141,156	\$ 977,473	\$ 4,793,347
2009					
	Insurance Liabilities		Annuity Liabilities	Equity	Total
Cash & short-term investments	\$ 97,645	\$	12,897	\$ 75,679	\$ 186,221
Bonds	1,740,732		505,306	549,858	2,795,896
Mortgages	–		223,642	–	223,642
Preferred shares	90,016		254,624	55,985	400,625
Common shares	282,649		–	266,468	549,117
Real estate	–		–	15,601	15,601
Loans on policies	38,728		–	–	38,728
Policy contract loans	18,921		58,051	60,792	137,764
Other	(6,649)		5,161	(75,379)	(76,867)
TOTAL	\$ 2,262,042	\$	1,059,681	\$ 949,004	\$ 4,270,727

Real estate includes net unrealized investment gains. Other is net of accounts payable and other non-policy liabilities. Specific assets are nominally matched against specific types of liabilities; however all assets are available to pay all liabilities if required.

(c) Fair Value of Policy Liabilities

In the absence of an active market for the sale of policy liabilities, the actuarially determined values provide a reasonable approximation of fair value of policy liabilities.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(d) Liquidity

The Company maintains a high level of liquid assets so that cash demands can be readily met. The Company's liquidity position is as follows:

	2010	2009
Assets:		
Cash and short-term paper	\$ 202,246	\$ 186,221
Canada and provincial bonds	2,140,324	1,880,942
Other readily-marketable bonds and stocks	2,037,552	1,822,602
TOTAL LIQUID ASSETS	\$ 4,380,122	\$ 3,889,765
Liabilities:		
Demand liabilities with fixed values	\$ 438,738	\$ 420,280
Demand liabilities with market value adjustments	978,820	873,268
TOTAL LIQUIDITY NEEDS	\$ 1,417,558	\$ 1,293,548

7. Income Taxes

(a) Income Tax Expense

The Company's income tax expense includes provisions for current and future taxes as follows:

	2010	2009
Current income tax expense	\$ (8,763)	\$ 9,811
Future income tax expense (benefit)		
– relating to the origination and reversal of temporary differences	7,228	(9,372)
– resulting from substantively enacted changes in tax rates	(1,001)	983
INCOME TAX EXPENSE	\$ (2,536)	\$ 1,422

During 2010 the Company paid income tax instalments totalling \$13,004 (2009 \$3,288) and paid (recovered) income taxes in respect of prior years totalling \$29,125 (2009 \$(46,154)).

The Company had unused tax losses of \$69,823 in the province of Ontario related to the harmonization of Ontario and Federal income tax administration that resulted in income tax credits that expire in 2013. The amount of income tax recoverable related to this of \$4,099 is included in future income taxes. These amounts are unchanged from 2009. The company also has an Ontario minimum tax carryforward of \$2,400 which has a life of 20 years. Management considers it more likely than not that these tax losses will be realized before they expire.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(b) Variance from Statutory Provision

Income taxes provided varies from the expected statutory provision as follows:

	2010	2009
Net income before taxes	\$ 38,281	\$ 81,084
Less premium tax	12,198	11,436
Less investment income tax	3,300	3,300
NET INCOME BEFORE INCOME TAXES	22,783	66,348
Income tax provision at statutory rates	6,874	21,065
Increase (decrease) resulting from:		
Substantively enacted changes in income tax rates	(1,001)	983
Tax paid dividends on stocks	(10,026)	(8,439)
Impact of recognizing tax rule changes	-	(12,565)
Miscellaneous	1,617	378
INCOME TAX EXPENSE	\$ (2,536)	\$ 1,422

(c) Future Income Taxes

In certain instances the tax basis of assets and liabilities differs from the carrying amount. These differences will give rise to future income taxes, which are reflected on the balance sheet as follows:

	2010	2009
Policy liabilities	\$ 16,022	\$ 54,334
Portfolio investments	(38,219)	(67,480)
Losses recoverable in future years	13,405	10,052
Other, net	1,449	1,978
FUTURE INCOME TAX ASSET (LIABILITY)	\$ (7,343)	\$ (1,116)

8. Employee Future Benefit Plans

Pension benefit plans include defined benefit plans available to employees. The Company also provides for post-retirement health and dental care coverage and other future benefits to qualifying employees and retirees.

Total cash payments by the Company for employee future benefits for 2010, consisting of cash contributed to its funded pension plans, and cash payments directly to beneficiaries under its unfunded other benefit plans was \$4,475 (2009 \$10,733).

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

The following tables present financial information for the Company's defined benefit plans:

	Pension Benefit Plans		Other Benefit Plans	
	2010	2009	2010	2009
Accrued benefit obligation				
Balance – beginning of year	\$ 118,454	\$ 111,468	\$ 10,509	\$ 12,045
Current service cost	3,144	2,012	106	109
Employee contributions	2,015	1,856	–	–
Interest cost	7,467	7,332	645	667
Benefits paid	(7,170)	(7,480)	(340)	(665)
Actuarial loss (gain)	8,899	3,266	743	(1,647)
BALANCE – END OF YEAR	\$ 132,809	\$ 118,454	\$ 11,663	\$ 10,509
Plan assets				
Fair value – beginning of year	\$ 128,961	\$ 105,878	\$ –	\$ –
Actual return on plan assets	8,797	18,639	–	–
Employer contributions	4,135	10,068	–	–
Employee contributions	2,015	1,856	–	–
Benefits paid	(7,170)	(7,480)	–	–
FAIR VALUE – END OF YEAR	\$ 136,738	\$ 128,961	\$ –	\$ –
Funded status – plan surplus (deficit)	\$ 3,929	\$ 10,507	\$ (11,663)	\$ (10,509)
Unamortized net actuarial loss (gain)	5,545	(2,465)	306	(417)
Unamortized transitional obligation (asset)	(1,438)	(1,798)	56	69
ACCRUED BENEFIT ASSET (LIABILITY)	\$ 8,036	\$ 6,244	\$ (11,301)	\$ (10,857)
Recorded in the balance sheet as:				
Other assets	\$ 8,036	\$ 6,244	\$ –	\$ –
Accounts payable and other liabilities	–	–	(11,301)	(10,857)
ACCRUED BENEFIT ASSET (LIABILITY)	\$ 8,036	\$ 6,244	\$ (11,301)	\$ (10,857)

Included in the previous figures are defined benefit obligations in excess of plan assets as of December 31:

	Pension Benefit Plans		Other Benefit Plans	
	2010	2009	2010	2009
Accrued benefit obligation	\$ –	\$ –	\$ 11,663	\$ 10,509
Plan assets at fair value	\$ –	\$ –	\$ –	\$ –

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

The employee future benefit costs for the Company's defined benefit plans included in the Company's statement of general fund operations is as follows:

	Pension Benefit Plans		Other Benefit Plans	
	2010	2009	2010	2009
Annual net benefit cost (income)				
Current service cost	\$ 3,144	\$ 2,012	\$ 106	\$ 109
Interest cost	7,467	7,332	645	667
Actual return on plan assets	(8,797)	(18,639)	—	—
Actuarial loss (gain)	8,899	3,266	743	(1,647)
Employee future benefit cost (income) prior to adjustments to recognize long-term nature	10,713	(6,029)	1,494	(871)
Adjustments to recognize long-term nature:				
Difference between expected return and actual return on plan assets	815	11,486	—	—
Difference between net actuarial loss (gain) recognized and actual actuarial loss (gain)	(8,824)	(3,293)	(723)	1,574
Amortization of transitional obligation (asset)	(360)	(360)	13	13
NET BENEFIT COST RECOGNIZED FOR THE PERIOD	\$ 2,344	\$ 1,804	\$ 784	\$ 716

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent and next required actuarial valuation of the Company's employee future benefit plans for funding purposes is as follows:

	Recent Valuation Date	Next Valuation Date
Staff Pension Plan	December 31, 2009	December 31, 2012
Supplemental Employee Retirement Benefit Plan	December 31, 2010	December 31, 2011
Retiree Health Benefits	December 31, 2008	December 31, 2011

The average remaining service period of the active employees covered by the pension benefit and other benefit plans as at December 31 is as follows:

	2010	2009
Staff Pension Plan	12 Years	12 Years
Supplemental Employee Retirement Benefit Plan	10 Years	10 Years
Retiree Health Benefits	9 Years	9 Years

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

The following weighted average assumptions were used in actuarial calculations:

	Pension Benefit Plans		Other Benefit Plans	
	2010	2009	2010	2009
Accrued benefit obligation as of December 31:				
Discount rate	5.5%	6.3%	5.5%	6.3%
Rate of compensation increase	3.5%	3.5%	N/A	N/A
Benefit costs for years ended December 31:				
Discount rate	6.3%	7.3%	6.3%	7.3%
Expected long-term rate of return on plan assets	6.2%	6.7%	N/A	N/A
Rate of compensation increase	3.5%	3.5%	N/A	N/A
Assumed health care cost trend rates at December 31:				
Initial health care cost trend rate	N/A	N/A	7.2%	7.3%
Cost trend rate declines to	N/A	N/A	4.5%	4.5%
Year ultimate rate reached	N/A	N/A	2026	2026

A one percentage point change in assumed health care cost trend rates would have the following effects for 2010:

	Increase		Decrease	
Annual total service and interest cost	\$	100	\$	(84)
Accrued benefit obligation	\$	1,541	\$	(1,291)

Plan assets consist of the following asset categories:

	Percentage of Plan Assets	
	2010	2009
Equity securities	54%	55%
Debt securities	36%	35%
Short-term securities	5%	5%
Other	5%	5%

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

9. Income Taxes Included in Other Comprehensive Income (OCI)

Other comprehensive income (loss) is presented net of income taxes. The following income tax amounts are included in each component of shareholders' OCI:

	2010		
	Before Tax	Tax Provision (Recovery)	After Tax
Unrealized fair value change on available for sale investments	\$ 48,137	\$ 14,447	\$ 33,690
Fair value change on available for sale investments reclassified to net income, including impairment write-downs	(14,515)	(5,452)	(9,063)
Gain on derivative investments designated as cash flow hedges	–	–	–
Gain on derivative investments designated as cash flow hedges reclassified to net income	684	222	462
NET OTHER COMPREHENSIVE INCOME	\$ 34,306	\$ 9,217	\$ 25,089

	2009		
	Before Tax	Tax Provision (Recovery)	After Tax
Unrealized fair value change on available for sale investments	\$ 100,548	\$ 33,539	\$ 67,009
Fair value change on available for sale investments reclassified to net income, including impairment write-downs	31,735	7,217	24,518
Gain on derivative investments designated as cash flow hedges	1,336	424	912
Gain on derivative investments designated as cash flow hedges reclassified to net income	397	129	268
NET OTHER COMPREHENSIVE INCOME	\$ 134,016	\$ 41,309	\$ 92,707

The following income tax amounts are included in each component of policyholders' OCI:

	2010		
	Before Tax	Tax Provision (Recovery)	After Tax
Unrealized fair value change on available for sale investments	\$ 3,407	\$ 1,019	\$ 2,388
Fair value change on available for sale investments reclassified to net income, including impairment write-downs	(947)	(408)	(539)
NET OTHER COMPREHENSIVE INCOME	\$ 2,460	\$ 611	\$ 1,849

	2009		
	Before Tax	Tax Provision (Recovery)	After Tax
Unrealized fair value change on available for sale investments	\$ 10,029	\$ 3,272	\$ 6,757
Fair value change on available for sale investments reclassified to net income, including impairment write-downs	2,533	883	1,650
NET OTHER COMPREHENSIVE INCOME	\$ 12,562	\$ 4,155	\$ 8,407

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

10. Capital Stock

(a) Authorized

Common shares: 2,000,000 shares with no par value.

(b) Issued and Fully Paid

	2010	2009
No. of Common shares: 985,076	\$ 985	\$ 985

11. Shareholders' Equity Entitlement

Shareholders' entitlement to \$6,401 (2009 \$6,757) of shareholders' equity is contingent upon future payment of dividends to participating policyholders.

12. Accumulated Other Comprehensive Income (Loss)

Shareholders' accumulated other comprehensive income (loss) is comprised of unrealized gains (losses) net of income tax on available for sale assets of \$60,580 (2009 \$35,769) and unamortized gains (losses) net of income tax on derivatives designated as cash flow hedges of (\$1,836) (2009 (\$2,299)).

Policyholders' accumulated other comprehensive income (loss) is comprised of unrealized gains (losses) net of income tax on available for sale assets of \$4,637 (2009 \$2,973).

13. Operating Lease Commitments

The Company has contractual obligations in respect of rents payable on leased premises and equipment as follows:

	2010	2009
2010	\$ —	\$ 1,976
2011	2,355	1,523
2012	2,069	1,304
2013	1,819	1,019
2014	1,678	874
2015	985	661
Thereafter	3,065	2,614
	\$ 11,971	\$ 9,971

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

14. Segmented Information

The Company operates in the Canadian life insurance industry and follows a product line management approach for internal reporting and decision making. Accordingly, operating results are segmented into three product lines along with the Company's Capital and surplus segment as follows:

	2010					
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total	
Premiums from external customers	\$ 239,864	\$ 261,659	\$ 316,188	\$ –	\$ 817,711	
Investment income	58,280	5,823	104,408	36,849	205,360	
Fair value change in held for trading assets	10,188	7,785	180,138	–	198,111	
Realized gain on held for trading assets	4,475	142	3,631	–	8,248	
Realized gain (loss) on available for sale assets including impairment write-downs	(187)	(188)	5,961	9,877	15,463	
Fee income from external customers	103,829	6,462	1,341	1,519	113,151	
Benefits	230,048	189,972	116,875	–	536,895	
Policy dividends	–	–	19,079	–	19,079	
Increase in policy liabilities	79,185	9,315	388,016	–	476,516	
Income tax expense (recovery)	(2,840)	5,332	(14,134)	9,106	(2,536)	
Segment net income (loss)	9,766	12,778	(21,616)	24,391	25,319	
Segment invested assets	1,141,156	132,477	2,542,241	977,473	4,793,347	

	2009					
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total	
Premiums from external customers	\$ 300,306	\$ 241,916	\$ 297,654	\$ –	\$ 839,876	
Investment income	55,330	6,603	92,890	29,141	183,964	
Fair value change in held for trading assets	43,511	498	62,690	–	106,699	
Realized gain on held for trading assets	3,866	2,886	23,279	610	30,641	
Realized gain (loss) on available for sale assets including impairment write-downs	(47)	(79)	(11,794)	(22,489)	(34,409)	
Fee income from external customers	86,854	5,884	1,423	1,292	95,453	
Benefits	199,213	193,887	85,475	–	478,575	
Policy dividends	–	–	17,629	–	17,629	
Increase (decrease) in policy liabilities	175,367	(11,973)	221,848	–	385,242	
Income tax expense (recovery)	4,561	5,163	1,785	(10,087)	1,422	
Segment net income	22,380	10,335	25,740	6,471	64,926	
Segment invested assets	1,059,681	121,806	2,140,236	949,004	4,270,727	

Invested assets reported by segment are net of certain liability items.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

The following table provides a reconciliation of total Segment invested assets to Total company general fund assets:

	2010	2009
Total invested assets reported for product lines	\$ 4,793,347	\$ 4,270,727
Liability items included above	106,580	131,326
TOTAL COMPANY GENERAL FUND ASSETS	\$ 4,899,927	\$ 4,402,053

A description of the product lines is as follows:

Wealth Management includes both segregated funds and general fund investment products offered primarily to individual policyholders.

Wealth Management's segregated funds are pooled investments beneficially owned by unit holders of the funds. Accordingly, the assets and liabilities of these funds are not included in the Company's assets and liabilities. The Company earns a management fee in consideration of professional investment management and administration of the funds. The segregated fund assets under management are reported on the segregated funds portion of the balance sheet as total segregated fund assets.

Wealth Management's general fund investment products are primarily guaranteed investment policies and annuities providing income for life. The amount of investment product liability owing to policyholders is included in the Company's policy liabilities. Policy liability valuation for annuities providing income for life includes an assumption for annuitant mortality. The Company invests investment product premiums received from the policyholder into matching assets of appropriate quality, term and yield. The Company earns income, after covering expenses and taxes, based on the difference between investment income earned on these assets and interest credited to the policyholder. Emerging mortality experience on annuities providing income for life also affects income.

The **Employee Benefits** product line offers group benefit plans to employers for medical, dental, disability, and life insurance coverage of their employees.

The **Individual Insurance** product line includes both non-participating and participating individual life and health insurance products.

The **Capital and Surplus** segment is made up of assets held in the shareholders' and policyholders' equity accounts. The segment earns investment income on these assets.

While specific general fund assets are nominally matched against specific types of general fund liabilities or held in the shareholders' and policyholders' equity accounts, all general fund assets are available to pay all general fund liabilities if required.

Segment net income was determined by using allocation methods for certain expenses.

15. Other Assets

Other assets consist of the following:

	2010	2009
Capital assets (net of depreciation of \$11,252 (2009 \$11,973))	\$ 6,300	\$ 4,372
Intangible assets (net of depreciation of \$36,656 (2009 \$35,079))	2,244	3,688
Pension asset	8,036	6,244
Accounts receivable from reinsurers	9,550	5,311
Other receivables	12,151	13,103
OTHER ASSETS	\$ 38,281	\$ 32,718

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

16. Subordinated Debt

On May 20, 2009, the Company issued \$200,000 principal amount of unsecured subordinated debentures with a maturity date of May 20, 2019. The interest rate from May 20, 2009 until May 20, 2014 is 6.73%, and the rate from May 20, 2014 until May 20, 2019 will be equal to the 3-month Canadian Deposit Offering Rate plus 5.75%. Interest is payable semi-annually at May 20 and November 20 until May 20, 2014, quarterly thereafter with the first such payment on August 20, 2014. The debenture has been classified as other liabilities and recorded at amortized cost using the effective interest rate method.

The debt is subordinated in right of payment to all policy liabilities of the Company and all other senior indebtedness of the Company. The Company may call for redemption of the issue at any time subject to the approval of the Office of the Superintendent of Financial Institutions. The holder has no right of redemption.

17. Regulatory Capital

The Company aims to manage its capital in order to meet the capital adequacy requirements of the *Insurance Companies Act* (Canada) as established and monitored by the Office of the Superintendent of Financial Institutions (OSFI). Under the guidelines established by OSFI, the Company's capital consists of two tiers. The Company's Tier 1 Capital includes common shares, contributed surplus, retained earnings and participating policyholders' equity. Tier 2 Capital includes the accumulated unrealized gains on AFS equity securities, net of tax, negative reserves on policy liabilities and subordinated debt. OSFI's target Tier 1 and total capital ratios for Canadian life insurance companies are 105% and 150% respectively. As at December 31, 2010, the Company was in compliance with these ratios.

	As at December 31, 2010	As at December 31, 2009
Tier 1 Capital	\$ 710,571	\$ 707,141
Tier 2 Capital	328,862	300,527
TOTAL REGULATORY CAPITAL	\$ 1,039,433	\$ 1,007,668

18. Related Party Transactions

On May 22, 2009 the Company repaid a \$125,000 subordinated debenture issued to its ultimate parent, E-L Financial Corporation Limited. On a year-to-date basis, interest expense on this debenture of \$nil (2009 \$2,946) is included in the statement of general fund operations.

The Company provides investment management services to other companies under common shareholder control. The fees charged for these services are \$1,462 (2009 \$1,337).

19. Accounts Payable and Other Liabilities

Accounts payable and other liabilities consist of:

	2010	2009
Accounts payable	\$ 37,164	\$ 31,423
Employee future benefit accrued obligation	11,301	10,857
Premiums collected in advance	2,314	2,608
Accrued interest on subordinated debt	1,604	1,604
Other	29,271	39,680
ACCOUNTS PAYABLE AND OTHER LIABILITIES	\$ 81,654	\$ 86,172

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

20. Guarantees and Other Contingencies

The Company by-laws provide indemnification to its current and former directors, officers and employees to the extent permitted by law, against liabilities arising from their service to the Company. The broad general nature of these indemnification by-laws does not permit a reasonable estimate of the maximum potential amount of any liability.

In connection with its operations, the Company is from time to time named as defendant in actions for damages and costs allegedly sustained by plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, the Company does not believe that it will incur any material loss or expense in connection with such actions.

In certain cases, the Company would have recourse against third parties with respect to the foregoing items and the Company also maintains insurance policies that may provide coverage against certain of these items.

21. Supplementary Cash Flow Information

Cash and cash equivalents are defined as follows:

	2010	2009
Outstanding cheques	\$ (15,979)	\$ (12,445)
Short-term investments with maturities of three months or less from the date of acquisition	167,311	161,586
CASH AND CASH EQUIVALENTS	\$ 151,332	\$ 149,141

22. Risk Management

The objective of the Company's risk management process is to ensure that the operations of the Company that expose it to risk are consistent with the Company's objectives and risk philosophy, while maintaining an appropriate risk/reward balance. The Company is exposed to financial risks arising from its investing activities and its insurance operations. The risks that management considers to be most significant in terms of likelihood and the potential adverse impact on the Company, are outlined below in order of importance:

1. Investment risk:

- i) **Market risk, including:**
 - a) Market price fluctuations
 - b) Interest rate risk
 - c) Foreign currency risk

- ii) **Liquidity risk**

- iii) **Credit risk**

2. Insurance risk:

- i) **Experience risk**
- ii) **Product design and pricing risk**
- iii) **Underwriting and claims risk**
- iv) **Reinsurance risk**

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

I. Investment Risk

i) Market Risks

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, trading prices of equity and other securities, credit spreads and foreign currency exchange rates. Market risk is directly influenced by the volatility and liquidity in the markets in which the related financial instruments are traded, expectations of future price and yield movements and the composition of the Company's investment portfolio. For the Company, the most significant market risks are market price fluctuations, interest rate risk, and foreign currency risk.

(a) Market Price Fluctuations

The Company's investment portfolio includes primarily bonds and equity securities, and the fair values of its investments vary according to changes in general economic and securities market conditions, including declines and volatility in equity markets. Equity market volatility could occur as a result of general market volatility or as a result of specific social, political or economic events. A decline in securities markets could have an adverse impact on the return on assets backing capital, capital adequacy, the management fees collected on segregated fund contracts and on index funds within universal life contracts, and insurance policy liabilities and capital requirements, particularly in respect of segregated fund guarantees.

The risk of fluctuation of the market value of the Company's segregated funds is generally assumed by the policyholders. Market value variations of such assets will result in variations in the income of the Company to the extent fees are determined in relation to the value of such funds. Moreover, some of the segregated funds provide guarantees upon the death of the policyholder or, after a fixed number of years, upon maturity of the policy. A significant and steady decline of the securities markets may result in net losses on such products which could adversely affect the Company.

Additionally, certain of the Company's segregated fund products contain guarantees upon death, maturity, or withdrawal, where the guarantee may be triggered by the market performance of the underlying funds. If a significant market decline is experienced, the resulting increased cost of providing these guarantees could have an adverse effect on the Company's financial position, Minimum Continuing Capital and Surplus Requirements (MCCSR) position, and results of operations.

The investments of the Company in good quality bonds support, to a very large extent, the liabilities under the insurance and annuity policies of the Company. Cash flows arising from these investments are intended to match the liquidity requirements of the Company's policies, within the limits prescribed by the Company. However, if the Company does not achieve the expected returns underlying the pricing of its products, its operating results may be adversely affected.

A core aspect of the Company's investment strategy is to maintain a higher than industry average level of publicly-listed "large cap" common stocks in its capital and surplus investment portfolio, in pursuit of superior long-term returns. Therefore, the Company has a relatively large common stock portfolio and is exposed to significant loss from declines in its fair value. A decrease in the fair value of the Company's common stock portfolio results in reduced shareholders' equity, reduced policyholders' surplus, and a reduced MCCSR position. Regulatory pressure to increase capital escalates as the MCCSR ratio approaches OSFI's supervisory minimum. Net income would also be reduced if the declines in value are realized through dispositions or recognized in provisions for impairment.

The Company manages this risk exposure mainly through investment limits and Investment Committee oversight of its in-house investment managers and external investment firms. The Investment Committee actively monitors the portfolio size and asset mix. The Company is fully exposed to the portfolio's fair value changes and does not hedge this exposure.

The Company's general fund investments are subject to limits established by the *Insurance Companies Act* and to investment guidelines established by the Investment Committee of its Board. The investment guidelines are designed to limit overall investment risk by defining investment objectives, eligible investments, diversification criteria, exposure,

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

concentration and asset quality limits for eligible investments by segment. The Investment Committee receives monthly reporting on general fund asset mix and performance by segment, derivatives matching, segregated fund asset mix and performance, and investment transactions for all funds. In addition, on at least a quarterly basis, management and the Company's investment managers report to the Investment Committee, and through the Investment Committee to the Board of Directors, on portfolio content, asset mix, the Company's matched position, the performance of general and segregated funds, and compliance with the investment guidelines.

The Company uses stochastic models to monitor and manage risk associated with segregated fund guarantees, and establishes policyholder liability provisions in accordance with standards set forth by the Canadian Institute of Actuaries (CIA). Product development and pricing policies also require consideration of portfolio risk in the design, development and pricing of the products. The Asset Liability Management Committee (ALM) reports quarterly to the Investment Committee of the Board on the nature and value of the Company's segregated fund guarantee liabilities, including potential top-up exposure and capital requirements.

The Company has established a Capital Management policy, capital management levels that exceed regulatory minimums, and Dynamic Capital Adequacy Testing that takes into account the potential effect of adverse investment-risk scenarios (including adverse market conditions and adverse interest rates) on the Company's capital position. Management monitors its MCCSR position on a regular basis and reports at least quarterly to the Board of Directors on the Company's MCCSR.

The following table summarizes the potential impact on the Company of both a 10% and a 20% change in global equity markets. The Company uses a 10% increase or decrease in equity markets as a reasonably possible change in equity markets. The Company has also disclosed the impact of a 20% increase or decrease in its equity market sensitivity. For segregated fund guarantee policy liabilities the level of sensitivity is highly dependent on the level of the stock market at the time of performing the estimate. If period end stock markets are high relative to market levels at the time that segregated fund policies were issued, the sensitivity is reduced. If period end stock markets are low relative to market levels at the time that segregated fund policies were issued, the sensitivity is increased. The amounts shown below for segregated fund guarantee policy liabilities represent the impact on shareholders' net income.

2010

	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' net income	\$ 7,808	\$ (7,808)	\$ 15,728	\$ (15,728)
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ 31,529	\$ (31,529)	\$ 63,058	\$ (63,058)
Policyholders' other comprehensive income	\$ 2,254	\$ (2,254)	\$ 4,508	\$ (4,508)
Segregated fund guarantee policy liabilities	\$ nil	\$ nil	\$ nil	\$ nil

2009

	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' net income	\$ 7,047	\$ (7,047)	\$ 14,161	\$ (14,161)
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ 26,204	\$ (26,204)	\$ 52,408	\$ (52,408)
Policyholders' other comprehensive income	\$ 2,204	\$ (2,204)	\$ 4,408	\$ (4,408)
Segregated fund guarantee policy liabilities	\$ nil	\$ nil	\$ nil	\$ nil

As of December 31, 2010, common equity holdings in the 10 issuers to which the Company had the greatest exposure were \$245,668 (2009 \$200,399), which was approximately 5.1% (2009 4.6%) of total cash and investments. The exposure to the largest single issuer of common equities held as of December 31, 2010 was \$46,192 (2009 \$42,430), which was approximately 1.0% (2009 1.0%) of total cash and investments.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(b) Interest Rate Risk

Interest rate risk is the risk of economic loss due to the need to reinvest or divest during periods of changing interest rates. Changes in interest rates, as a result of the general market volatility or as a result of specific social, political or economic events, could have an adverse effect on the Company's business and profitability in several ways. Certain of the Company's product offerings contain guarantees and, if long-term interest rates fall below those guaranteed rates, the Company may be required to increase reserves against losses, thereby adversely affecting its operating results. Interest rate changes can also cause compression of net spread between interest earned on investments and interest credited, thereby adversely affecting the Company's operating results.

Rapid declines in interest rates may result in, among other things, increased asset calls, and mortgage prepayments and require reinvestment at significantly lower yields, which could adversely affect earnings. Additionally, during periods of declining interest rates, bond redemptions generally increase, resulting in the reinvestment of such funds at lower current rates. Rapid increases in interest rates may result in, among other things, increased surrenders. Fluctuations in interest rates may cause losses to the Company due to the need to reinvest or divest during periods of changing interest rates, which may force the Company to sell investment assets at a loss. In addition, an interest rate sensitivity mismatch between assets and the liabilities that they are designated to support could result in an adverse effect on the Company's financial position and operating results.

The following tables summarize the impact on net income and other comprehensive income of a reasonably possible change in interest rates.

2010

	1% Increase	1% Decrease	2% Increase	2% Decrease
Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ (12,961)	\$ 13,794	\$ (25,125)	\$ 27,602
Policyholders' other comprehensive income	\$ (760)	\$ 801	\$ (1,485)	\$ 1,643

2009

	1% Increase	1% Decrease	2% Increase	2% Decrease
Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ (13,546)	\$ 14,422	\$ (26,278)	\$ 27,478
Policyholders' other comprehensive income	\$ (835)	\$ 875	\$ (1,629)	\$ 1,795

Interest rate risk is managed through Investment Committee established limits and regular reporting by management to the Investment Committee and the Board. The Company's investment guidelines establish investment objectives and eligible interest rate sensitive investments, and establish diversification criteria, exposure, concentration and asset quality limits for these investments. The Asset-Liability Management Committee oversees sensitivity to interest rates. The objective is to maximize investment yields while managing the default, liquidity and reinvestment risks at acceptable and measurable low levels. Product development and pricing policies and practices also require consideration of interest rate risk in the design, development and pricing of the products.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(c) Foreign Currency Risk

Foreign currency risk is the risk that the fair value of cash flows of a financial instrument will fluctuate because of changes in exchange rates and create an adverse effect on earnings and equity when measured on the Company's functional currency.

The Company's primary foreign currency exposure arises from portfolio investments denominated in US dollars. A 10% fluctuation in the US dollar would have an impact of approximately \$nil (2009 \$nil) on net income, \$807 (2009 \$3,573) on shareholders' other comprehensive income and \$nil (2009 \$314) on policyholders' other comprehensive income. The Company has no significant foreign currency exposure in its financial liabilities.

Empire Life uses derivative instruments, including futures contracts and foreign currency forward contracts, to manage foreign exchange risks. Improper use of these instruments could have an adverse impact on earnings. Empire Life manages this risk by applying limits established by the Investment Committee in its investment guidelines, which set out permitted derivatives and permitted uses for derivatives, as well as limits to the use of these instruments. In particular, no leverage is permitted in the use of derivatives and strict counterparty credit restrictions are imposed, with total credit exposure limited to \$25 million.

The Company has a foreign exchange risk management policy which outlines objectives, risk limits and authority associated with any foreign exchange exposure.

ii) Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. The majority of the Company's obligations relate to its policy liabilities, the duration of which varies by line of business and expectations relating to key policyholder actions or events (i.e. cash withdrawal, mortality, and morbidity). The remaining obligations of the Company relate to the subordinated debenture which matures in 2019 (refer to note 16 – Subordinated Debt) and to ongoing operating expenses as they fall due, which are expected to settle in a very short period of time.

The Company's liquidity risk management strategy is to ensure that there will be sufficient cash to meet all financial commitments and obligations as they become due.

The Company's liquidity risk management program is monitored by management and by the Board of the Company through regular reporting to the Investment Committee and the Board. The Company monitors its cash flow obligations and meets its liquidity needs by holding high quality marketable investments that may be easily sold, if necessary, and by maintaining a portion of investments in cash and short-term investments.

The Company maintains a liquidity policy requiring an assessment of the Company's liquidity risk and specific procedures so that liquidity needs are met. Compliance with the policy is monitored and exposures and breaches are reported to the Investment Committee of the Board. The policy and procedures are regularly reviewed for relevance and changes in the risk environment. The Company's current liquidity position as at December 31 is provided in a table at note 6(d).

Based on the Company's historical cash flows and current financial performance, management believes that the cash flows from the Company's operating activities will continue to provide sufficient liquidity for the Company to satisfy debt service obligations and to pay other expenses.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

The following table shows details of the expected maturity profile of the Company's undiscounted obligations with respect to its financial liabilities and estimated cash flows of policy liabilities. Policy liability cash flows include estimates related to the timing and payment of death and disability claims, policy maturities, annuity payments, policyholder dividends, amounts on deposit, commission and premium taxes offset by contractual future premiums and fees on in-force business. Recoveries from reinsurance agreements are also reflected. Segregated fund liabilities are excluded from this analysis. These estimated cash flows are based on the best estimate assumptions, with margins for adverse deviation, used in the determination of policy liabilities. The actuarial and other policy liability amounts included in the Company's 2010 Financial Statements are based on the present value of the estimated cash flows. Due to the use of assumptions, actual cash flows will differ from these estimates.

	2010				
	1 year or less	1 - 5 years	5 - 10 years	Over 10 years	Total
Policy liabilities	\$ 131,018	\$ 415,814	\$ 440,167	\$ 9,562,776	\$ 10,549,775
Subordinated debt	13,460	55,487	249,542	–	318,489
Accounts payable and other liabilities	144,753	5,875	11,300	–	161,928
Total liabilities	289,231	477,176	701,009	9,562,776	11,030,192
Operating lease commitments	2,355	6,551	3,065	–	11,971
TOTAL	\$ 291,586	\$ 483,727	\$ 704,074	\$ 9,562,776	\$ 11,042,163

The Company is able to fund its short-term cash outflows by generating positive cash inflows from operations and from investment income earned on its investment portfolio. The Asset-Liability Management Committee, which meets regularly, monitors the matched position of the Company's investments in relation to its liabilities within the various segments of its operations. The matching process is designed to require that assets supporting policy liabilities closely match, to the extent possible, the timing and amount of policy obligations, and to plan for the appropriate amount of liquidity in order to meet its financial obligations as they fall due. The Company maintains a portion of its investments in short-term investments and cash equivalents to meet its short-term funding requirements. As of December 31, 2010, 4.2% (2009 4.3%) of cash and investments were held in these shorter duration investments.

iii) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company is subject to credit risk which arises from debtors or counterparties who are unable to meet their obligations under debt or derivative instruments. This credit risk is derived primarily from investments in bonds, debentures, preferred shares, short-term investments and mortgages; and amounts recoverable from reinsurers under reinsurance agreements.

The Company manages this risk by applying its investment guidelines and product design and pricing risk management policy established by the Investment Committee and the Board of Directors. The investment guidelines establish minimum credit ratings for issuers of bonds, debentures and preferred share investments, and provide for concentration limits by issuer of such debt instruments. Management and Board committees review credit quality relative to investment purchases and also monitor the credit quality of invested assets over time. Management reports regularly to the Investment Committee of the Company's Board on the credit risk to which the portfolio is exposed. The product design and pricing risk management policy (along with supporting material in the reinsurance policies and practices report) establishes reinsurance objectives and limits, and requires ongoing evaluation of reinsurers for financial soundness. The Company enters into reinsurance agreements only with reinsurance companies that have a credit rating of "A-" or better.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

The Company has the following assets that are exposed to credit risk:

	2010	2009
Cash equivalents and short-term investments	\$ 218,225	\$ 198,666
Bonds	3,221,908	2,795,896
Preferred shares	371,330	400,625
Mortgages	226,887	223,642
Loans on policies	40,242	38,728
Policy contract loans	119,896	137,764
Accrued investment income	18,411	17,827
Premiums receivable	3,108	3,914
Reinsurance ceded	–	29,291
TOTAL	\$ 4,220,007	\$ 3,846,353

Mortgages, Loans on policies, Policy contract loans and Premiums receivable are fully or partially secured.

The Company has made provision in its balance sheet for credit losses. Provisions have been made partly through reduction in the value of the assets and partly through a provision in policy liabilities (see note 3(b)).

Concentration of Credit Risk

Mortgages in the province of Ontario represent the largest concentration with \$218,903 (2009 \$213,885) of the total portfolio.

The Company's preferred share investments are all issued by Canadian companies, with 81% (2009 82%) of these investments rated as P1 as at December 31, 2010 and the remaining 19% (2009 18%) rated as P2.

The concentration of the Company's bond portfolio by investment grade is as follows:

	2010		2009	
	Fair Value	% of Fair Value	Fair Value	% of Fair Value
AAA	\$ 172,028	5%	\$ 323,732	12%
AA	1,025,075	32%	811,887	29%
A	1,858,650	58%	1,523,876	54%
BBB	166,155	5%	130,882	5%
BB	–	0%	5,519	0%
TOTAL	\$ 3,221,908	100%	\$ 2,795,896	100%

As of December 31, 2010, holdings of provincial bonds was \$1,978,770 (2009 \$1,559,947), which was approximately 61% (2009 56%) of total bond holdings.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

The contractual maturities of bonds as at December 31, are shown in the table below.

	2010		2009	
	Fair Value	% of Fair Value	Fair Value	% of Fair Value
1 year or less	\$ 82,431	3%	\$ 146,214	5%
1-5 years	359,701	11%	344,287	12%
5-10 years	297,073	9%	270,540	10%
Over 10 years	2,482,703	77%	2,034,855	73%
Total	\$ 3,221,908	100%	\$ 2,795,896	100%

As of December 31, 2010, holdings of fixed income securities (which includes bonds and debentures, preferred shares and short-term investments) in the 10 issuers (excluding federal governments) to which the Company had the greatest exposure were \$2,539,709 (2009 \$2,174,181), which was approximately 52.6% (2009 50.0%) of total cash and investments. The exposure to the largest single issuer of corporate bonds held as of December 31, 2010 was \$102,940 (2009 \$88,790), which was approximately 2.1% (2009 2.0%) of total cash and investments.

2. Insurance Risk

The Company provides a broad range of life insurance and wealth management products, employee benefit plans, and financial services that are concentrated by product line as follows:

	Wealth Management		Employee Benefits		Individual Insurance	
	2010	2009	2010	2009	2010	2009
Premium income	\$ 239,864	\$ 300,306	\$ 261,659	\$ 241,916	\$ 316,188	\$ 297,654
Fee and other income	103,829	86,854	6,462	5,884	1,341	1,423
TOTAL REVENUES	\$ 343,693	\$ 387,160	\$ 268,121	\$ 247,800	\$ 317,529	\$ 299,077

The Company is in the business of measuring and managing risk, as reflected in the valuation of insurance policy liabilities. The Company is exposed to various insurance risks, and the most important insurance risks in terms of likelihood and potential adverse impact on the Company, include:

- i) **Experience risk, including:**
 - a) Mortality
 - b) Investment Returns
 - c) Persistency
 - d) Expenses
- ii) **Product design and pricing risk**
- iii) **Underwriting and claims risk**
- iv) **Reinsurance risk**

The Company regularly evaluates its exposure to foreseeable risks through Dynamic Capital Adequacy Testing analysis.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

i) Experience Risk

The principal risk the Company faces under insurance contracts is the risk that experience on claims, policy lapses and operating expenses will not emerge as expected. To the extent that emerging experience is more favourable than assumed in the valuation, income will emerge. If emerging experience is less favourable, losses will result. Therefore, the objective of the Company is to establish sufficient insurance liabilities to cover these obligations with reasonable certainty.

The computation of insurance liabilities and related reinsurance recoverable requires "best estimate" assumptions covering the remaining life of the policies. Assumptions in use are based on past experience, current internal data, external market indices and benchmarks which reflect current observable market trends and other published information. These assumptions are made for mortality, morbidity, investment returns, persistency, expenses, inflation and premium taxes. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviations from best estimates is calculated separately for each variable and included in policy liabilities.

The methods for arriving at the most important of these assumptions are outlined below.

(a) Mortality

The Company carries out annual internal studies of its own mortality experience. The valuation mortality assumptions are based on a combination of this experience and recent CIA industry experience. An increase in the rate of mortality will lead to a larger number of claims (and claims could occur sooner than anticipated), which for life insurance, will increase expenditures and reduce profits for the shareholders.

(b) Investment Returns

The computation of policy liabilities takes into account projected investment income net of investment expenses from the assets supporting policy liabilities, and investment income expected to be earned on reinvestments. The assets supporting the policy liabilities are segmented from the assets backing shareholders' and policyholders' equity.

For life and health insurance, the projected cash flows from the matched assets are combined with estimated future reinvestment rates based on both the current economic outlook and the Company's expected future asset mix. The cash flows are subjected to tests under a wide spectrum of possible reinvestment scenarios, and the policy liabilities are then adjusted to provide for credible adverse future scenarios.

In order to match the savings component of policy liabilities that vary with a variety of indices and currencies, the Company maintains certain equity, fixed income and currency financial instruments as part of its general fund assets. Asset-liability mismatch risk for these liabilities is monitored on a daily basis.

For the life insurance business, where the insurance liabilities have a longer term than most available bonds and mortgages, the Company's policy is to cover estimated insurance liability cash flows rigorously only for a rolling 20-year period. In order to provide a margin that recognizes the longer-term mismatch, the cash flows are subjected to tests under a wide spectrum of possible reinvestment scenarios, and the insurance liabilities are then adjusted to provide for credible adverse future scenarios.

For annuity business, where the timing and amount of the benefit obligations can be more readily determined, the matching of the asset and liability cash flows is tightly controlled. A sudden increase or decrease in interest rates would have a negligible effect on future profits from annuity business currently in force.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

(c) Persistency

Lapse and surrender assumptions are based on a combination of the Company's own internal termination studies (conducted annually) and recent CIA industry experience. Separate lapse assumptions are used for permanent cash-value business, for renewable term insurance, and for lapse-supported business (such as term insurance to age 100). In setting lapse rates for renewable term insurance, it is assumed that extra lapses will occur at each renewal point, and that healthy policyholders are more likely to lapse at that time than those who have become uninsurable.

Acquisition costs may not be recovered fully if lapses in the early policy years exceed those in the actuarial assumptions. An increase in lapse rates early in the life of the policy would tend to reduce profits for shareholders. An increase in lapse rates later in the life of the policy would tend to increase profits for shareholders if the product is lapse supported, but decrease shareholder profits for other types of policies.

Unfavourable results in these areas can lead to deviations from the estimates based on the actuarial assumptions, particularly in terms of mortality, morbidity and lapse experience.

(d) Expenses

Policy liabilities provide for the future expense of administering policies in force, renewal commissions, general expenses, and taxes. Expenses associated with policy acquisition and issue are specifically excluded. The future expense assumption is derived from internal cost studies and includes an assumption for inflation.

An increase in the level of expenses would result in an increase in expenditure thereby reducing profits for the shareholders.

Experience Risk Management and Sensitivities

The basic assumptions made in establishing policy liabilities are "best estimates" for a range of possible outcomes. Companies are required to include a margin in each assumption to recognize the uncertainty in establishing these "best estimates", to allow for possible deterioration in experience and to provide greater confidence that policy liabilities are adequate to pay future benefits. A range of allowable margins is prescribed by the CIA.

The Company maintains margins near the middle of the allowable range for those assumptions where the best estimate has been calculated rigorously and with a relatively high degree of credibility, and near the high end of the allowable range for assumptions where the measurement uncertainty is greater.

Policy liability assumptions are reviewed and updated at least annually, and the impact of changes in those assumptions is reflected in earnings in the year of the change.

Based on recent experience, the Company has estimated that a decrease (or increase) in the individual insurance mortality assumption equal to 3% of the CIA8692 mortality table would result in an increase (or decrease) of approximately \$33,900 (2009 \$27,800) in shareholders' net income and \$1,600 (2009 \$700) in policyholders' net income, and that a decrease in reinvestment rate assumptions caused by a decrease of 1% in current market interest rates would result in a decrease of approximately \$34,800 (2009 \$32,300) in shareholders' net income and \$2,100 (2009 \$800) in policyholders' net income, and that net income is not sensitive to short-term swings in expenses.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

ii) Product Design and Pricing Risk

The Company is subject to the risk of financial loss resulting from transacting insurance business where the costs and liabilities assumed in respect of a product exceed the expectations reflected in the pricing of the product. This risk may be due to an inadequate assessment of market needs, a poor estimate of the future experience of several factors, such as mortality, morbidity, lapse experience, future returns on investments, expenses and taxes, as well as the introduction of new products that could adversely impact the future behaviour of policyholders.

For certain types of contracts, all or part of this risk may be shared with or transferred to the policyholder through dividends and experience rating refunds, or through the fact that the Company can adjust the premiums or future benefits if experience turns out to be different than expected. For other types of contracts, the Company assumes the entire risk, and thus must carry out a full valuation of the commitments in this regard.

The Company manages product design and pricing risk through a variety of enterprise-wide programs and controls. The Company has established policy liabilities in accordance with standards set forth by the CIA. Experience studies (both Company-specific and industry level) are factored into ongoing valuation, renewal and new business processes so that policy liabilities, as well as product design and pricing, take into account emerging experience. The Company has established an active capital management process that includes a Capital Management policy and capital management levels that exceed regulatory minimums. As prescribed by regulatory authorities, the Appointed Actuary conducts Dynamic Capital Adequacy Testing and reports annually to the Company's Audit Committee on the Company's financial condition, outlining the impact on capital levels should future experience be adverse. The Company has also developed a product design and pricing policy for each of its major product lines. This policy, which is established by management and approved by the Company's Board of Directors, defines the Company's product design and pricing risk management philosophy. The policy sets out product design and pricing approval authorities, product concentration limits, and required product development and monitoring processes and controls.

iii) Underwriting and Claims Risk

The Company is subject to the risk of financial loss resulting from the selection and underwriting of risks to be insured and from the adjudication and settlement of claims. Many of the Company's individual insurance and group disability products provide benefits over the policyholder's lifetime. Actual claims experience may differ from the mortality and morbidity assumptions used to calculate the related premiums. Catastrophic events such as earthquakes, acts of terrorism or an influenza pandemic in Canada could result in adverse claims experience.

In addition to the risk management controls described above under Product Design and Pricing Risk, the Company also manages underwriting and claims risk through its underwriting and liability management policy for each of its major product lines. This policy is established by management and approved by the Company's Board of Directors. Together, these policies define the Company's underwriting and risk management philosophy. These policies also set out by product line insurance risk tolerances, underwriting criteria, underwriting and liability concentration limits, claims approval requirements, underwriting and claims processes and controls, approval authorities and limits, and ongoing risk monitoring requirements. The Company uses reinsurance to mitigate excessive exposure to adverse mortality and morbidity experience. Management reviews and establishes retention limits for its various product lines in the underwriting and liability management policy and the Board approves changes to these retention limits.

Notes to Financial Statements

Year ended December 31, 2010 (all amounts are expressed in thousands of dollars)

iv) Reinsurance

The Company is subject to the risk of financial loss due to improper reinsurance coverage or a default of a reinsurer. Amounts reinsured per life vary according to the type of protection and the product. The Company also maintains a catastrophe reinsurance program, which provides protection in the event that multiple insured lives perish in a common accident or catastrophic event. Although the Company relies on reinsurance to mitigate excessive exposure to adverse mortality and morbidity experience, reinsurance does not release it from its primary commitments to its policyholders and it is exposed to the credit risk associated with the amounts ceded to reinsurers. The availability and cost of reinsurance are subject to prevailing market conditions, both in terms of price and availability, which can also affect earnings.

As reinsurance does not release a company from its primary commitments to its policyholders, the Company reviews the financial soundness of reinsurers before entering into any reinsurance treaty and thereafter once a treaty is in place. Most of the Company's individual life reinsurance (with the exception of its Term 10 and Term 20 products) is on an excess basis (with a \$500 retention limit), meaning the Company retains 100% of the risk up to \$500 in face amount. With the Company's Term 10 and 20 products, however, all amounts over \$100 are reinsured at an 80% level, meaning that the Company retains only 20% of the risk on coverage over \$100, to a maximum of \$500. In addition the Company also retains a maximum of \$100 on individual accidental death policies. Retention amounts are lower for group business but are in addition to those noted for individual business. As a result of this reinsurance strategy, the Company utilizes lower than average levels of reinsurance and absorbs the resultant negative impact on short-term earnings due to additional sales strain. The Company does not have any material assumed reinsurance annual premium revenue and it does not reinsure segregated fund guaranteed products issued by other insurance companies.

The Company reinsures excess risks with major OSFI regulated reinsurance companies. The Company's retention limit on any one life is \$600 for individual insurance (life and accidental death combined) and \$200 for group insurance (life and accidental death combined). Policy liabilities are reduced (increased) by \$(25,494) (2009 \$29,291) on account of reinsurance ceded. Most of the reinsurance is under yearly renewable term treaties. The Company enters into reinsurance agreements only with reinsurance companies that have an independent credit rating of "A-" or better.

23. Comparative Figures

Certain comparative figures have been reclassified to conform with financial statement presentation adopted in 2010.

Dividend Policy

The Board of Directors of The Empire Life Insurance Company has approved the following policy:

“The dividend policy of the Company is to distribute dividends on participating policies on the basis of the expected margins available for the payments of dividends included in the original product pricing, adjusted periodically to reflect emerging experience.

Dividends must also reflect changing requirements as to long-term levels of required surplus in the participating fund and interest earned on that surplus.

A fundamental objective in the distribution of dividends is the maintenance of reasonable equity between classes of policyholders and between generations of policyholders. It is, therefore, important that the emerging versus the pricing experience be extracted and applied consistently for all policies classified as participating.

All policies defined as participating by contractual provisions including life, disability and annuity plans are credited with dividend payments on a regular basis. Most plans are credited with dividends annually, while a few older plans receive the dividends quinquennially, as per contractual provisions.

The Company’s current practice, so long as the participating account in aggregate remains below \$250 million, is to transfer an amount equal to 1/9 of the dividends credited to participating policyholders, from the participating account to the shareholders’ account.”

Corporate Governance Over Risk Management

The Empire Life Insurance Company (the "Company") is a stock company that has both shareholders and participating policyholders. Pursuant to the *Insurance Companies Act (Canada)* (the Act) each holder of one or more participating policies is entitled to one vote in the election of policyholders' directors, and each shareholder is entitled to one vote per share held in the election of shareholders' directors. At least one-third of directors are elected as policyholder directors and the balance are elected as shareholder directors. The Company is governed by the Act, which contains provisions concerning corporate governance. The Company's governance system is supported by internal audit, corporate compliance, external audit by an independent chartered accountants firm, and examination by the Office of the Superintendent of Financial Institutions Canada (OSFI).

Management is responsible for identifying risks and determining their impact upon the Company. Management is also responsible for establishing appropriate policies, procedures, and controls to mitigate risks. In 2010, the Company established an internal risk management committee, which reports to the Board of Directors. An internal audit function is responsible for assessing the adequacy and adherence to the systems of internal control. The results of internal audit's reviews are reported to management and to the Audit Committee of the Board of Directors regularly throughout the year.

Management is supervised in the completion of these responsibilities by the Board of Directors and its Committees. Senior management of the Company reports regularly to the Board on its risk management policies and procedures.

The **Board of Directors** has plenary power. The Board's responsibility is to oversee the conduct of the business and affairs of the Company including oversight and monitoring of the Company's risk management. The Board discharges these responsibilities directly and through delegation to Board Committees and management. The Board met eight times in 2010 and is scheduled to meet seven times in 2011.

The risk management functions overseen by the Board include those relating to interest rate risk, credit risk, foreign exchange risk, reinsurance risk, liquidity risk, other risks associated with policy liabilities, regulatory risk, and operational risk. Primary responsibility for oversight of some of these risks is delegated to four standing Committees of the Board, whose roles and responsibilities are specifically defined. The following is a brief summary of some of the key responsibilities of the four Committees.

The **Audit Committee** is a committee charged with statutory responsibility under the Act to oversee, on behalf of the Board, the Company's financial reporting, accounting and financial reporting systems and internal controls.

The **Investment Committee** assists the Board in monitoring the Company's investment and lending policies, standards and procedures and in monitoring the Company's investment activities and portfolios. Some of the activities of the Investment Committee are prescribed by the Company's Investment Guidelines, which reflect the requirements of the Act.

The **Human Resources Committee** is responsible for reviewing and monitoring the Company's human resources practices, including employee and executive compensation, manpower and pension and benefit plans.

The **Conduct Review Committee** is responsible for oversight of procedures established to identify material related party transactions pursuant to the Act. The Committee also monitors certain corporate policies, including procedures with respect to conflicts of interest, confidentiality of information and outsourcing.



Corporate Information

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www.empire.ca

The Empire Life Insurance Company is a member of Assuris, the organization that protects Canadian insurance policyholders from loss of benefits due to the financial failure or insolvency of a member company.

Policyholders and prospective policyholders can learn more about Assuris and the protection it provides by visiting www.assuris.ca or calling the Assuris Information Centre at 1 866 878-1225.

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Quebec

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Board of Directors

Shareholders' Directors

Edward M. Iacobucci^{1,4}
Professor of Law
University of Toronto

Duncan N.R. Jackman^{1,2,3,4}
Chairman of the Board
The Empire Life Insurance Company

Robert G. Long, F.C.A.^{1,4}
Corporate Director

Deanna Rosenswig, B.Com., M.B.A.^{1,3}
Corporate Director

Clive P. Rowe²
Partner
Oskie Capital

Stephen J.R. Smith^{2,3}
Chairman and President
First National Financial LP

Mark M. Taylor²
Executive Vice-President and Chief Financial Officer
E-L Financial Corporation Limited

Paul R. Weiss, F.C.A.^{1,4}
Corporate Director

Policyholders' Directors

Mark J. Fuller, LL.B.^{2,3,4}
President and Chief Executive Officer
Ontario Pension Board

Leslie C. Herr²
President and Chief Executive Officer
The Empire Life Insurance Company

Richard E. Rooney, C.A., F.C.A.^{2,3}
President
Burgundy Asset Management

Douglas C. Townsend, F.S.A., F.C.I.A.^{1,3}
President
Townsend Actuarial Consulting Ltd.

Honorary Chairman

The Honourable Henry N.R. Jackman
Honorary Chairman
The Empire Life Insurance Company

Honorary Director

The Right Honourable John N. Turner, P.C., C.C., Q.C.
Partner
Miller Thomson LLP

¹ Member of Audit Committee

² Member of Investment Committee

³ Member of Human Resources Committee

⁴ Member of Conduct Review Committee



Corporate Management

*Back Row: (left to right) Gaelen Morphet, Richard Cleaver, Drew Wallace, Gary McCabe, Edward Gibson, Timo Hytonen
Front Row: (left to right) Les Herr, Anne Butler, Steve Pong*

Leslie C. Herr, M.B.A., C.F.P., C.L.U., Ch.FC., E.P.C.
President and Chief Executive Officer

Drew E. Wallace
Executive Vice-President, Retail

Anne E. Butler, B.A., LL.B.
Senior Vice-President, General Counsel and Corporate Secretary

Richard Cleaver
Senior Vice-President and Chief Technology Officer

J. Edward Gibson, F.S.A., F.C.I.A.
Senior Vice-President and Chief Actuary

Timo J. Hytonen, M.B.A., C.H.R.P., F.C.I.P., C.R.M., C.Dir.
Senior Vice-President, Strategy, Human Resources and Corporate Initiatives

Gary J. McCabe, C.A.
Senior Vice-President and Chief Financial Officer

Gaelen Morphet, C.F.A.
Senior Vice-President and Chief Investment Officer

Steve S. Pong, B.A.Sc.
Senior Vice-President, Group Products

Annual Report 2010

The Empire Life Insurance Company (Empire Life) offers competitive individual and group life and health insurance, investment and retirement products to help you build wealth and protect your financial security. We manage investments and funds for our customers following a conservative, value-oriented philosophy that helps grow and preserve wealth.

Empire Life is among the top 10 life insurance companies in Canada¹ and is rated A (Excellent) by A.M. Best Company². Our vision is to be the leading, independently-owned, Canadian financial services company committed to simplicity, being easy to do business with and having a personal touch.

¹ Financial Post Magazine, June 2010, based on revenue

² As at June 10, 2010

www.empire.ca



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