

FINANCIAL STATEMENTS
(excerpted from Annual Report 2010)



Empire Life®

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		Credit Equivalent Amount	Risk Weighted Balance
			Positive	Negative		
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 of 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.

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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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