

The Empire Life Insurance Company

Annual Report 2016



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2016 FINANCIAL HIGHLIGHTS

248%

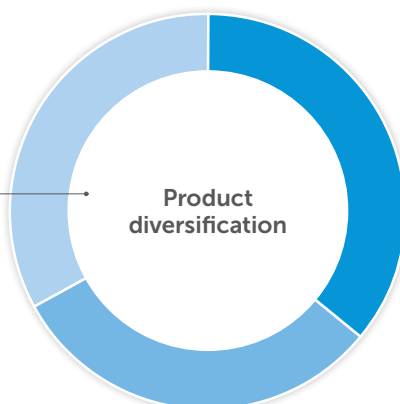
MCCSR ratio
as at December 31, 2016

Strength of our capital base

Our Minimum Continuing Capital and Surplus Requirements (MCCSR) ratio is well above the minimum requirements set by the industry regulator. A high MCCSR ratio demonstrates our long-term ability to pay claims and our prudent capital management.

What is an MCCSR ratio?

An MCCSR ratio of 100% means that a company has adequate capital to meet obligations to its policyholders. The Office of the Superintendent of Financial Institutions of Canada (OSFI) requires life insurance companies to maintain an MCCSR ratio of at least 120% and expects them to have a target ratio of at least 150%.



Product diversification

by premium and fee income for the 12 months ended December 31, 2016

Empire Life is well-diversified across three product lines:

Wealth Management

36%



Employee Benefits

31%



Individual Insurance

33%



Common Shareholders'
Net Income
2016 (in millions)

\$152.7

Common Shareholders'
Net Income
2015 (in millions): \$108.6

Net Premium and Fee Income
2016 (in millions)

\$1,110

Net Premium and Fee Income
2015 (in millions): \$1,052

Total Assets Under Management
2016 (in millions)

\$16,051

Total Assets Under Management
2015 (in millions): \$14,535

Financial ratings

These financial ratings give you an independent opinion of our financial strength as an insurer and our ability to meet policyholder obligations.

A (Excellent)

A.M. Best Company (as at May 27, 2016)

Financial Strength Rating: A

Issuer Rating: A

Subordinated Debt Rating: A (low)

DBRS (as at May 27, 2016)

Note: The selected financial information presented above is derived from the audited financial statements of The Empire Life Insurance Company and Management's Discussion and Analysis included in the Empire Life 2016 Annual Report.

MESSAGE FROM THE CHAIRMAN OF THE BOARD

The Board of Directors is very pleased with the Company's 2016 results and particularly with how its management team is successfully developing the Company's capacity to finance its growth. In 2016, the Company raised \$350 million through a preferred share offering in the first quarter, and a subordinated debt issue in late December. This is a sign of maturity and agility that further strengthens the ability of Empire Life to compete and succeed in the Canadian marketplace.

On March 29, 2016, I had the pleasure of opening the Toronto Stock Exchange with Empire Life President and Chief Executive Officer, Mark Sylvia and colleagues from both E-L Financial and Empire Life. This event recognized the listing of Empire Life preferred shares on the Exchange. That morning, before we rang the opening siren, I remarked that my father, Henry (Hal), had also opened the TSX when E-L Financial was listed in 1968 and how proud I was that our family has been invested in Empire Life for such a long history.

That history continues and over the past year Empire Life has achieved important milestones and growth. Throughout this report, you will find evidence of its strong performance over the past year and how it is successfully preparing for the future.

I am grateful for the contributions of our Board members over the past year and thank them for their dedication and commitment to the Company. This past year, Richard Rooney and Jonathan Yates did not stand for re-election and I wish to thank them both for their work on the Board. Douglas Townsend retired earlier this year and did not stand for re-election in 2016. I commend Mr. Townsend on a long, accomplished career and thank him for his many years of dedicated service to both Empire Life and its Board of Directors.

Once again, it is the people of Empire Life, including our shareholders and policyholders, who make this Company successful. On behalf of the Board of Directors, I sincerely thank all of them for their support, commitment, hard work and dedication.



Duncan N. R. Jackman

Chairman of the Board

February 24, 2017

MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Each year when I write this message, I reflect on the economic environment and how it has impacted our customers and our business. In our 2014 annual report, I noted that despite an uncertain world economy, the Toronto Stock Exchange (TSX) index had increased by 7.4%. Last year at this time, I characterized 2015 as a down year, since equity markets and oil prices had declined and long-term interest rates remained low.

I think most people will agree that 2014 and 2015 were both relatively uneventful compared to 2016. We saw the TSX decline dramatically early in the year, only to finish strong after a series of unexpected international political events that were expected to negatively impact stock markets. We also saw long-term interest rates rise and return to 2015 levels.

Very few people could have predicted the events of the past year. It will be interesting to look back on 2017 at this time next year and see how much of what we experience was expected. I suspect we will continue to be surprised by political and economic events. Uncertainty has become our new normal. We do not believe we can plan for every possible scenario, so rather than speculate on what the future holds, Empire Life stays focused on offering solid products, running an efficient business and investing in high quality assets that have value and persevere through turbulent times.

Empire Life was founded almost 100 years ago in Toronto, but soon after moved its head office to Kingston, Ontario, the base from which we have grown into the sixth largest life insurance company in Canada, based on assets. We only do business in Canada, and that gives us a unique perspective and understanding of our customers - middle income families and small business owners and their employees.

We believe our country's future is bright. We have a strong resource base that has allowed us to build a national infrastructure that includes a strong education system. This focus on education is helping Canada to make the transition to a technology-based economy. We are beginning to see innovation centres develop across the country. This emerging trend will provide opportunities to the next generation of Canadians.

Last year, I mentioned how important technology has become to our business. It provides a service platform that supports the advice our customers receive from the more than 20,000 qualified financial advisors who recommend Empire Life to their clients. All the life insurance, employee benefits and investment products and services we are developing use technology to enhance the customer experience and power our delivery system. Our customers expect product purchases and claims payments to be simple, fast, and easy and we are committed to delivering on this mantra.

Our approach to managing our business has been to concentrate on doing the fundamental things to provide great value in our products and good service to our customers. I can say with certainty that our focus on value in our investment portfolio and careful management style will serve us and our customers well as we continue to embrace the emerging technology age.

Our 2016 financial results

We achieved overall shareholders' net income of \$152.7 million in 2016, up from \$108.6 million in 2015. Improved stock market conditions, good operating results and our capital and asset and liability management strategies helped us achieve this record result.

Insurance sales were buoyed by the introduction of new income tax rules affecting life insurance policies that came into effect January 1, 2017. Many customers purchased insurance protection to take advantage of their last chance to buy a policy under the old rules. Net income for Individual Insurance in 2016 was \$83 million, an increase from a loss of \$2 million the previous year. We have been reducing the risk in our insurance portfolio by focusing on developing simple products that are easy to purchase and understand. These products are also less capital intensive and provide good value to our customers.

MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Despite the headwinds that faced equity markets at the beginning of the year, the TSX Composite Index finished the year strong, delivering an impressive 17.5% return. Strong equity markets and growth in segregated fund guarantee fees, management fees, and lower expenses contributed to a net income of \$62 million in our Wealth Management line of business for 2016 compared to \$59 million in 2015. We continue to manage our investment portfolio carefully to mitigate the impact of the continued low interest rate environment on our long-term returns.

The Employee Benefits market remains very competitive. Despite this challenge, our net income was \$10.0 million for 2016, an increase from \$6 million the previous year. Profit margins increased as the result of a series of profit recovery measures that improved our health insurance product results. In 2016 we entered into a small number of new partnerships with specialty providers and third party administrators in order to expand our distributor opportunities in the small business market.

Risk and capital management

The cornerstone of our capital management strategy is maintaining a strong capital base. Empire Life went to market to raise capital twice in 2016, issuing \$149.5 million of preferred shares in January and completing a \$200 million subordinated debt issue in December. Increasing our access to capital markets was one of our priorities. We were very pleased to sound the opening bell for the Toronto Stock Exchange (TSX) on March 31, 2016 to signal that we had become a reporting issuer.

Empire Life's Minimum Continuing Capital and Surplus Requirements ("MCCSR") ratio was 248% as at December 31, 2016, up from 201% the previous year-end. This strong capital base will ensure we can weather changes in our economic environment.

Capital management is just one element of managing risk. We are continuing to evolve our enterprise risk management framework to ensure we identify, measure and manage risks that could impact our business.

Timeless value

In our fast changing world one thing has not changed—the importance of value. Our customers want competitive prices and expect us to prudently manage their investments and the investments that back our insurance products.

As value investors, we have been following the same disciplined investment philosophy for more than 50 years. It has served us and our customers well. Our investment management team pays attention to detail and focuses on investing in the debt and equity of companies that will increase in value over time.

As at December 31, 2016, Empire Life had \$16.1 billion dollars in assets under management in segregated funds, mutual funds, participating insurance policies and general assets. We are aware of the immense responsibility and trust Canadians have placed in us. We understand that we aren't just managing money or providing insurance. We are helping families to buy their first home, look after medical expenses, ensure their loved ones are cared for, and help them plan for their retirement years. That is the purpose behind what we do and we take that responsibility and trust very seriously.

We believe we have a clear advantage over our competitors, and that is the personal touch and caring of our employees. I'd like to thank all members of the Empire Life team for another successful year, our management group for their vision and leadership, and our Board of Directors for their continued support and guidance.



Mark Sylvia

President and Chief Executive Officer

February 24, 2017

SOURCES OF EARNINGS

Source of earnings is a methodology for identifying and quantifying the various sources of International Financial Reporting Standards (IFRS) income of a life insurance company. It presents shareholders' net income in a different format from the traditional income statement form and provides a better understanding of the Company's sources of profit for each major product line.

Expected Profit from In-Force Business

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

Impact of New Business

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

Experience Gains and Losses

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

Management Actions and Changes in Assumptions

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

Other

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

Earnings on Surplus

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

Source of Earnings by Line of Business

For the year ended December 31 (millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Expected profit on in-force business	\$ 99.9	\$ 94.9	\$ 20.0	\$ 21.1	\$ 39.6	\$ 43.8			\$ 159.5	\$ 159.7
Impact of new business	(6.5)	(17.0)	(7.7)	(9.9)	(1.0)	(6.9)			(15.2)	(33.8)
Experience gains (losses)	8.5	6.2	(5.2)	(3.4)	29.3	(12.4)			32.6	(9.6)
Management actions and changes in assumptions	(19.9)	(5.8)	7.0	0.2	53.2	(19.3)			40.3	(24.9)
Other	—	—	—	—	—	—			—	—
Earnings on operations before income taxes	82.1	78.3	14.1	8.0	121.1	5.2	—	—	217.2	91.4
Earnings on surplus	—	—	—	—	—	—	(2.7)	50.2	(2.7)	50.2
Income before income tax	\$ 82.1	\$ 78.3	\$ 14.1	\$ 8.0	\$ 121.1	\$ 5.2	\$ (2.7)	\$ 50.2	\$ 214.5	\$ 141.6
Income taxes	20.0	19.0	4.1	2.2	30.9	(1.6)	(1.1)	13.4	54.0	33.0
Shareholders' net income	\$ 62.1	\$ 59.3	\$ 10.0	\$ 5.8	\$ 90.2	\$ 6.8	\$ (1.6)	\$ 36.8	\$ 160.6	\$ 108.6

SOURCES OF EARNINGS

Wealth Management

Wealth Management's 2016 earnings on operations were higher than the level achieved in 2015. In 2016 there were higher earnings from lower new business strain primarily due to lower segregated fund product sales in 2016 relative to 2015 and lower expenses.

In 2016 there was an increase in expected profit on in-force business primarily due to the segregated fund business. This was due to growth in segregated fund guarantee fees and management fees and lower expenses.

In addition, there were higher experience gains in 2016 compared to 2015 levels primarily due to improved investment experience resulting from market interest rate movements and improved availability of assets at attractive yields for matching fixed interest annuity contract liabilities.

These items were partly offset by higher 2016 losses resulting from management actions and changes in assumptions compared to 2015 levels. In 2016 the losses primarily related to investment return assumptions and refinements to the modelling of preferred share investment cash flows for deferred and immediate annuity business. In 2015 the losses primarily related to investment return assumptions.

Employee Benefits

Employee Benefit's earnings on operations were higher than the level achieved in 2015. In 2016 there was an increase in earnings from the update of policy liability assumptions which primarily related to group long-term disability products.

Individual Insurance

The increase in Individual Insurance earnings on operations was primarily due to management actions and changes in assumptions. Management actions to improve asset/liability matching resulted in increased profit for 2016. The improved matching position resulted in a gain from updating insurance contract liabilities. Empire Life increased its investment in real estate limited partnership units during 2016. This investment is used to match long term insurance contract liabilities. In addition Empire Life made changes to its bond investments throughout 2016 to tighten matching of investments with insurance contract liabilities.

Assumption updates in 2016 resulted in gains for Individual Insurance compared to losses in 2015. In 2016 gains from assumption updates primarily related to refinements to the modelling of reinsurance treaties and improved mortality assumptions. These were partly offset by losses from the assumption updates related to lapse and reinvestment assumptions. The refinements to lapse rate assumptions for 2016 were primarily related to emerging lapse rate experience for increasing renewal lapse rates on renewable Term 10 business. The update in investment return assumptions for 2016 was primarily due to regular updates to reinvestment rates and credit spreads for the Canadian Asset Liability Method ("CALM") valuation model for future reinvestment assumptions.

This compared to a loss from the net strengthening of reserves in 2015 primarily related to lapse assumption updates to reflect new industry data released in 2015. This was partly offset by gains from updating 2015 reinvestment assumptions primarily related to a refinement of the projected amount of equities backing individual life liabilities.

Individual Insurance earnings on operations also improved due to experience gains, which primarily related to investment experience in 2016 compared to a smaller gain in 2015. In 2016 this experience gain primarily resulted from favourable stock market movements during 2016. In 2015 this experience gain primarily resulted from an increase in interest rate spreads on provincial and corporate bonds.

Capital & Surplus

Earnings from Capital and Surplus in 2016 were lower than 2015 primarily due to a \$28 million after tax loss on Empire Life's hedging program, compared to a \$2 million after tax gain in 2015. The 2016 hedging program loss was primarily due to rising Canadian stock prices.

In addition, there were lower gains from the sale of AFS bonds in 2016 relative to 2015.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This MD&A is dated as of February 24, 2017.

This document has been prepared for the purpose of providing Management's Discussion and Analysis ("MD&A") of the operating results and financial condition of The Empire Life Insurance Company ("Empire Life" or the "Company") for the years ended December 31, 2016 and 2015. This MD&A should be read in conjunction with the Company's December 31, 2016 consolidated financial statements, which form part of The Empire Life Insurance Company 2016 Annual Report dated February 24, 2017. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as set out in the Handbook of the Chartered Professional Accountants of Canada. Unless otherwise noted, both the consolidated financial statements and this MD&A are expressed in Canadian dollars.

MD&A contains forward-looking information and involves numerous risks and uncertainties, including, but not limited to, those described in the "Risk Factors" section of the Annual Information Form which is available at www.sedar.com. No assurance can be given that results, performance or achievement expressed in, or implied by, any of the forward-looking information will occur, or, if they do, that any benefits may be derived from them. Actual results may differ materially from those expressed or implied by such forward-looking information. See Forward-Looking Statements and Information section in this report.

The financial statements of the Company are prepared in compliance with IFRS, which is generally accepted accounting principles ("GAAP") as set out in the Handbook of the Chartered Professional Accountants of Canada. This MD&A makes reference to certain non-GAAP measures. These measures are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS. They are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement IFRS measures by providing further understanding of the Company's results of operations from management's perspective. Accordingly, they should not be considered in isolation nor as a substitute for analysis of the Company's financial information reported under IFRS. See Non-GAAP Measures section in this report.

Financial Analysis Overview

(in millions of dollars except per share amounts)	Fourth quarter		Year	
	2016	2015	2016	2015
Common shareholders' net income	\$ 52.5	\$ 16.2	\$ 152.7	\$ 108.6
Earnings per share - basic and diluted	\$ 53.34	\$ 16.43	\$ 155.03	\$ 110.22
Return on common shareholders' equity (quarters annualized) ("ROE")	17.1%	5.9%	13.1%	10.2%

Empire Life reported fourth quarter common shareholders' net income of \$52.5 million for 2016, compared to \$16.2 million for 2015. Full year common shareholders' net income was \$152.7 million compared to \$108.6 million in 2015.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following table provides a breakdown of the sources of earnings¹ for the fourth quarter and full year.

Sources of Earnings (in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Expected profit on in-force business	\$ 39.9	\$ 40.9	\$ 159.5	\$ 159.7
Impact of new business	(5.5)	(9.5)	(15.2)	(33.8)
Experience gains (losses)	34.5	8.0	32.6	(9.6)
Management actions and changes in assumptions	5.5	(24.9)	40.3	(24.9)
Earnings on operations before income taxes	74.4	14.5	217.2	91.4
Earnings on surplus	(1.1)	7.1	(2.7)	50.2
Income before income tax	73.3	21.7	214.5	141.6
Income taxes	18.6	5.4	54.0	33.0
Shareholders' net income	54.7	16.2	160.6	108.6
Dividends on preferred shares	2.2	—	7.9	—
Common shareholders' net income	\$ 52.5	\$ 16.2	\$ 152.7	\$ 108.6

Fourth quarter and full year common shareholders' net income and ROE were higher relative to 2015 due to higher profit from the Individual Insurance product line primarily from improved stock market conditions in 2016, a favourable update of policy liability assumptions for the Individual Insurance product line in 2016 (compared to an unfavourable update in 2015) and management actions to improve asset/liability matching in 2016. Empire Life improved its matching position throughout 2016 by increasing its investment in real estate limited partnership units and by making changes to its bond investments. The improved matching position resulted in a gain in all four quarters of 2016.

The expected profit on in-force business was slightly lower relative to 2015 primarily due to increased premium taxes on in-force policies. This was partly offset by strong profit on the in-force Wealth Management product line due to growth in segregated fund guarantee fees and management fees and lower expenses. The impact of new business improved relative to 2015 in all quarters of 2016 primarily due to lower new business strain (resulting from lower segregated fund sales) and lower Wealth Management expenses. Earnings on surplus decreased primarily due to hedging costs which resulted from the increase in stock markets in 2016.

During the first quarter of 2016, Empire Life issued \$149.5 million of preferred shares resulting in the payment of preferred share dividends in 2016 which lowered common shareholders' net income relative to 2015. On December 16, 2016, the Company issued \$200 million principal amount of unsecured subordinated debentures with a maturity date of December 16, 2026. The interest rate from December 16, 2016 until December 16, 2021 is 3.383%, and the rate from December 16, 2021 until December 16, 2026 is equal to the 3-month Canadian Bankers' Acceptance Rate plus 1.95%. The issuance of these debentures increased Empire Life's Minimum Continuing Capital and Surplus Requirements ("MCCSR") ratio by 26 percentage points during the fourth quarter of 2016.

Empire Life has three major product lines (Wealth Management, Employee Benefits and Individual Insurance) and maintains distinct accounts for Capital and Surplus. A discussion of each product line's 2016 net income compared to 2015 is shown in the Product Line Results sections later in this report.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Selected Financial Information

Income Statement Financial Information (in millions of dollars)	For the years ended December 31		
	2016	2015	2014
Revenue			
Net premium income	\$ 882	\$ 835	\$ 867
Fees income	228	217	188
Investment income	255	259	246
Realized gain on FVTPL investments	20	42	74
Realized gain on available for sale investments including impairment write downs	12	19	13
Fair value change in FVTPL investments	12	(85)	538
Total Revenue	1,409	1,287	1,926
Expenses			
Benefits and expenses	\$ 1,178	\$ 1,139	\$ 1,770
Income and other taxes	74	46	49
Total Expenses	1,252	1,185	1,819
Net income after tax	157	102	107
Participating policyholders' portion	(4)	(6)	9
Shareholders' net income	\$ 161	\$ 108	\$ 98
Dividends on preferred shares	8.0	—	—
Common shareholders' net income	153	108	98
Return on shareholders' equity	13.1%	10.2%	10.5%

Revenue volatility was primarily driven by the impact of market interest rate movements on fair value change in fair value through profit or loss (“FVTPL”) investments. The impact of this on net income is significantly reduced due to a corresponding change in insurance contract liabilities (included in Benefits and expenses in the above table).

Balance Sheet Financial Information (in millions of dollars)	As at December 31		
	2016	2015	2014
Assets			
Total Cash and Investments	\$ 7,605	\$ 6,859	\$ 6,669
Other assets	175	137	112
Segregated fund assets	8,082	7,368	6,948
Total Assets	\$ 15,862	\$ 14,364	\$ 13,729
Liabilities			
Insurance contract liabilities	\$ 5,003	\$ 4,799	\$ 4,713
Reinsurance liabilities	533	531	491
Subordinated debt	499	299	299
Other liabilities	295	215	216
Segregated fund policy liabilities	8,082	7,368	6,948
Total Liabilities	14,412	13,212	12,667
Total Equity	1,450	1,152	1,062
Total Liabilities & Equity	\$ 15,862	\$ 14,364	\$ 13,729

MANAGEMENT'S DISCUSSION AND ANALYSIS

Other Financial Information (in millions of dollars)	As at December 31		
	2016	2015	2014
Assets under management²			
General fund assets ²	\$ 7,780	\$ 6,996	\$ 6,780
Segregated fund assets ²	8,082	7,368	6,948
Mutual fund assets ²	189	171	109
Subordinated debt	499	299	299
Preferred shares	150	—	—
Available regulatory capital			
Tier 1	\$ 1,206	\$ 918	\$ 872
Tier 2	707	504	452
Total	1,913	1,422	1,324
Required regulatory capital	\$ 771	\$ 708	\$ 671
MCCSR Ratio	248%	201%	197%
	2016	2015	2014
Cash dividends per share			
Preferred shares series 1	\$ 1.3183	\$ —	\$ —
Common shares	\$ —	\$ —	\$ 34.4985

During 2016, Empire Life's MCCSR ratio increased by 26 percentage points from the issuance of \$200 million of subordinated debentures and 20 percentage points from the issuance of \$149.5 million of preferred shares.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following table provides a summary of Empire Life results by major product line (figures in MD&A may differ due to rounding):

For the twelve months ended December 31 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Revenue										
Net premium income	\$ 176	\$ 144	\$ 339	\$ 325	\$ 367	\$ 366	\$ —	\$ —	\$ 882	\$ 835
Fee income	217	207	9	9	2	1	—	—	228	217
Investment income	41	43	4	4	176	171	34	41	255	259
Realized gain (loss) on FVTPL investments	(1)	1	1	1	48	38	(28)	2	20	42
Realized gain on available for sale investments including impairment write downs	—	—	—	—	—	—	12	19	12	19
Fair value change in FVTPL investments	(4)	(28)	—	(2)	22	(56)	(6)	1	12	(85)
Total Revenue	429	367	353	337	615	520	12	63	1,409	1,287
Expenses										
Benefits and expenses	348	289	329	322	491	518	10	10	1,178	1,139
Income and other taxes	19	19	14	9	40	4	—	14	73	46
Total Expenses	367	308	343	331	531	522	10	24	1,251	1,185
Net income (loss) after tax	\$ 62	\$ 59	\$ 10	\$ 6	\$ 83	\$ (2)	\$ 2	\$ 39	\$ 157	\$ 102
Participating policyholders' portion									(4)	(6)
Dividends on preferred shares									8	—
Common shareholders' net income									\$ 153	\$ 108
Assets under management³										
General fund assets ³	\$ 970	\$ 959							\$ 7,780	\$ 6,996
Segregated fund assets ³	\$ 8,061	\$ 7,347			\$ 21	\$ 20			\$ 8,082	\$ 7,367
Mutual fund assets ³	\$ 189	\$ 171							\$ 189	\$ 171
Annualized premium sales³			\$ 44	\$ 44	\$ 42	\$ 51				

Total Revenue

(in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Revenue				
Net premium revenue	\$ 222	\$ 206	\$ 882	\$ 835
Investment income	69	67	255	259
Fair value change in FVTPL investments including realized amounts	(371)	62	32	(43)
Realized gain (loss) on AFS investments including impairment write downs	(3)	—	12	19
Fee and other income	58	56	228	217
Total Revenue	\$ (25)	\$ 391	\$ 1,409	\$ 1,287

For the quarter, total revenue at Empire Life decreased by \$416 million to negative \$25 million in 2016. On a full year basis, total revenue increased by 9% to \$1,409 million compared to \$1,287 million in 2015. Revenue volatility was primarily driven by the impact of market interest rate and stock market movements on Fair value change in fair value through profit and loss (“FVTPL”) investments. Major revenue items are discussed below.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Net premium revenue for the quarter and year increased by 7.9% and 5.5% respectively, relative to 2015. The increase related primarily to the fixed interest immediate annuities portion of the Wealth Management product line, which experienced stronger demand due to improved interest rates offered by Empire Life and customer caution resulting from stock market volatility.

Fair value change in FVTPL investments including realized amounts often causes large revenue volatility. These assets experienced a loss for the fourth quarter and a net gain for the year in 2016 compared to an opposite pattern for the same periods in 2015. In 2016, the fourth quarter loss was from a decrease in bond prices (due to an increase in market interest rates). In 2015, the fourth quarter gain was primarily from an increase in bond prices (due to a decrease in market interest rates) and an increase in US stock prices. In 2016, the full year gain was primarily from an increase in stock prices and for 2015, the full year loss was from a decrease in stock prices and bond prices (due to an increase in market interest rates). For the fourth quarter and year, the impact of this on net income is significantly reduced due to a corresponding change in insurance contract liabilities (discussed in the Total Benefits and Expenses section below).

Realized gain (loss) on available for sale investments ("AFS") including impairment write downs was a gain for the year in both 2016 and 2015. The gain for both years was primarily due to the sale of AFS bonds. These gains and losses impact net income and are considered in the net income investment experience comments for each of the impacted product lines (see Product Line Results sections later in this report). The assets sold primarily backed capital and surplus.

Fee income for the quarter and year increased by 3.9% and 5.3% respectively in 2016 relative to 2015 primarily due to growth in segregated fund guarantee fees and management fees (see the Product Line Results - Wealth Management section later in this report).

Total Benefits and Expenses

(in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Benefits and expenses				
Net benefits and claims	\$ 151	\$ 162	\$ 593	\$ 642
Net change in insurance contract liabilities	(357)	109	207	126
Change in investment contracts provision	(1)	(1)	—	—
Policy dividends	8	7	29	26
Operating expenses	40	39	145	147
Net commissions	56	49	195	189
Interest expense	3	2	9	9
Total benefits and expenses	\$ (100)	\$ 367	\$ 1,178	\$ 1,139

Total benefits and expenses at Empire Life for the quarter decreased by \$467 million to negative \$100 million in 2016. On a full year basis, total benefits and expenses decreased by 3.5% to \$1,178 million compared to \$1,139 million in 2015. Expense volatility was primarily driven by the impact of market interest rate and stock market movements on net change in insurance contract liabilities. Major benefit and expense items are discussed below.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Net benefits and claims variability is dependent on the claims incurred. Generally, claims rise year over year due to growth of the insurance blocks, which was the case for the quarter and full year for the Employee Benefits line of business. Otherwise net benefits and claims for the quarter and full year were lower than last year primarily due to Wealth Management, which declined due to lower fixed interest deferred annuity withdrawals. Variability in claims amounts does not, in isolation, impact net income as insurance contract liabilities are released when claims occur. The insurance contract liabilities released may be larger or smaller than the claims incurred depending on whether claims experience has been favourable or unfavourable. Claims experience is the combination of claims incurred compared to claims expected in product pricing and in insurance contract liabilities. Year over year claims experience is discussed in each of the impacted product lines (see Product Line Results sections later in this report).

Net change in insurance contract liabilities varies with many factors including new business sold, claims incurred, surrender and lapse experience, assumptions about the future, and changes in the market value of assets matching insurance contract liabilities. For the quarter and full year, the main reason for the large change from 2015 for this item was the change in insurance contract liabilities resulting from the fair value change in matching assets (described above in the Total Revenue section). Variability in the net change in insurance contract liabilities amounts does not, in isolation, impact net income as it must be looked at in concert with other lines of the statement of operations.

For the quarter and full year net commissions increased year over year primarily due to the increase in Individual Insurance participating product sales.

Product Line Results - Wealth Management

(in millions of dollars)	As at December 31			
	2016		2015	
Assets under management⁴				
General fund annuities ⁴	\$	970	\$	959
Segregated fund assets ⁴		8,061		7,347
Mutual funds ⁴		189		171
(in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Selected financial information				
Net fixed interest annuity premiums	\$	39	\$	32
Segregated fund gross sales ⁴		326		279
Segregated fund net sales ⁴		92		65
Segregated fund fee income		54		52
Mutual fund gross sales ⁴		6		13
Mutual fund net sales ⁴		(1)		7
Mutual fund fee income		1		1
Net income after tax	\$	8	\$	10
			\$	62
				59

Assets in Empire Life general fund annuities increased by less than 1%, while segregated fund assets increased by 10% during the last 12 months. The increase in the last 12 months for general fund annuities is related primarily to improving demand for fixed interest immediate annuities. The increase over the last 12 months for segregated funds was attributable to increased stock markets and positive net sales.

Premium revenue for the Wealth Management product line is composed solely of new deposits on fixed interest annuities and excludes deposits on the segregated fund and mutual fund products. For the fourth quarter and full year, net fixed interest annuity premiums were up 21% and 22% respectively compared to 2015 due to improved interest rates offered by Empire Life. Management also believes that customers have chosen more conservative fixed interest products due to concerns with stock market volatility.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the fourth quarter and full year, segregated fund gross sales were up 17% and down 8% respectively compared to 2015, primarily due to 75% maturity guarantee product sales which increased by \$34 million in the fourth quarter but decreased by \$56 million for the year. In the fourth quarter of 2014, Empire Life closed its existing segregated funds products to new policies effective October 31, 2014 and on November 3, 2014 launched a new suite of investment products including a new segregated funds family and a new version of its Guaranteed Minimum Withdrawal Benefit ("GMWB") product. Fees charged to the customer on the new product line are higher than those for the former product line. The new product line's pricing and features are Empire Life's response to the economic, regulatory and competitive landscape in the segregated fund product marketplace. While 2016 sales were down from last year, the launch of these new segregated fund products has gone well, achieving gross sales of \$281 million (2015 \$227 million) and \$840 million (2015 \$844 million) for the fourth quarter and full year respectively, which represented 86% (2015 81%) and 82% (2015 75%) respectively of total segregated fund gross sales.

Segregated fund net sales for the quarter and full year were up 41% and down 42% respectively compared to 2015 primarily due to the above mentioned gross sales result.

Mutual fund gross sales were very weak and are still a small component of our Wealth Management assets under management. Management believes that customers have chosen more conservative fixed interest products given stock market volatility, which hurt mutual fund sales as these products offer no guarantees to customers. Empire Life continues to explore various strategic alternatives with respect to its mutual fund business.

For the quarter and full year, segregated fund fee income increased by 4% and 5% respectively in 2016 relative to 2015. The increase was primarily due to growth in segregated fund guarantee fees and management fees. Improved stock markets in the second half of 2016 resulted in higher average assets under management and management fees earned relative to 2015.

During the fourth quarter earnings from this product line decreased, while full year earnings increased relative to 2015. The following table provides a breakdown of the components of this year over year change in net income.

(in millions of dollars)	Fourth quarter	Year
Components of increase (decrease)		
2015 loss from update of policy liability assumptions	\$ 4	\$ 4
2016 loss from update of policy liability assumptions	(14)	(14)
Lower new business strain	2	7
Increase in inforce profit margins	—	4
Improved annuitant mortality experience	1	—
Improved investment experience	5	2
Total	\$ (2)	\$ 3

In both 2015 and 2016, the update of policy liability assumptions was unfavourable. In both years there were unfavourable updates for general fund annuities. In 2015, this primarily related to investment return assumptions. In 2016, this primarily related to investment return assumptions and refinements to the modelling of preferred share investment cash flows for deferred and immediate annuity business.

Higher net income from lower new business strain for the year was primarily due to the decrease in segregated fund gross sales (and the resulting sales strain) and lower expenses.

Higher net income on in-force business in 2016 was primarily due to lower expenses and improved stock markets.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Product Line Results - Employee Benefits

(in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Selected financial information				
Annualized premium sales ⁵	\$ 9	\$ 12	\$ 44	44
Net premium revenue	85	82	339	325
Net (loss) income after tax	\$ 9	\$ (2)	\$ 10	6

For the quarter, annualized premium sales in this product line decreased by 25% and for the full year annualized premium sales were flat relative to 2015. In-force premium revenue grew 4% for the quarter and for the full year relative to the same periods in 2015. While down slightly, the 2016 level of sales is a strong achievement particularly given the weak economic conditions in Canada.

During the fourth quarter and full year, earnings from this product line increased relative to 2015. The following table provides a breakdown of the components of this year over year change in net income.

(in millions of dollars)	Fourth quarter	Year
Components of increase		
2016 gain from update of policy liability assumptions	\$ 5	5
Improved (worsened) claims experience	6	(1)
Total	\$ 11	4

In 2016, there was a favourable assumption update for the group long-term disability policy liability in the fourth quarter.

For the full year, claims experience was unfavourable in both years primarily due to health claims partly offset by group life insurance and long-term disability claims results.

Product Line Results - Individual Insurance

(in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Selected financial information				
Annualized premium sales ⁶	\$ 14	\$ 11	\$ 42	51
Net premium revenue	98	92	367	366
Net income (loss) after tax				
Net income after tax shareholders' portion	\$ 38	\$ 2	\$ 90	6
Net loss after tax policyholders' portion	(3)	(1)	(7)	(8)
Net income (loss) after tax	\$ 35	\$ 1	\$ 83	(2)

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the fourth quarter and full year, annualized premium sales in this product line increased by 18% and decreased by 19% respectively compared to 2015. This product line's fourth quarter sales result was attributable primarily to increased sales of participating products. Management believes this is due in part to the January 1, 2017 effective date of less favourable tax rules that deal with the exemption status of certain life insurance policies. The full year decrease in sales was due to lower universal life insurance product sales partly offset by increased sales of participating products and term products. Empire Life's recently launched EstateMax[®] participating product contributed to this increase in participating product sales. EstateMax[®] is distributed through professional financial advisors aimed at providing simple estate planning solutions to Canadian baby boomers. In recent years Empire Life has been shifting its product mix toward shorter-term products such as term life, while increasing prices on long-term products, due to the low long-term interest rate environment. During the fourth quarter of 2016 Empire Life decided to stop selling universal life insurance products but will continue to administer its in-force block of universal life insurance products.

During the fourth quarter and full year earnings from this product line increased relative to 2015. The following table provides a breakdown of the components of this year over year change in net income.

(in millions of dollars)	Fourth quarter	Year
Components of increase		
2015 loss from update of policy liability assumptions	\$ 15	\$ 15
2016 gain from update of policy liability assumptions	4	4
Management actions to improve asset/liability matching	1	27
Improved investment experience	7	31
Improved mortality, surrender and other experience	8	11
Decrease in inforce profit margins	(1)	(3)
Total	\$ 34	\$ 85

In 2015, the update of policy liability assumptions was unfavourable by \$15 million.

In 2016, the update of policy liability assumptions was favourable by \$4 million. The following table provides a breakdown of the components of this amount:

(in millions of dollars)	Year
Components of income increase from update of policy liability assumptions	
Lapse	\$ (19)
Net re-investment assumptions	(12)
Mortality	7
Other	28
Total 2016 gain from update of policy liability assumptions	\$ 4

The refinements to lapse rate assumptions for 2016 were primarily related to emerging lapse rate experience for increasing renewal lapse rates on renewable Term 10 business.

The update in investment return assumptions for 2016 was primarily due to regular updates to reinvestment rates and credit spreads for the Canadian Asset Liability Method ("CALM") valuation model for future reinvestment assumptions.

Other policy liability assumption updates for 2016 were primarily related to refinements to the modelling of reinsurance treaties.

Management actions to improve asset/liability matching resulted in increased profit for the fourth quarter and the full year in 2016. The improved matching position resulted in a gain from updating insurance contract liabilities. Empire Life increased its investment in real estate limited partnership units during the first nine months of 2016. This investment is used to match long-term insurance contract liabilities. In addition Empire Life made changes to its bond investments throughout 2016 to tighten matching of investments with insurance contract liabilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS

There was a gain from investment experience for the fourth quarter and full year of 2016 compared to a smaller gain for the comparable period in 2015. In 2016, the experience gain primarily resulted from favourable stock market movements during the fourth quarter and full year in 2016. In 2015, the experience gain primarily resulted from an increase in interest rate spreads on provincial and corporate bonds.

Long-term interest rate movements are demonstrated in the following table.

	Fourth quarter		Year	
	2016	2015	2016	2015
Interest rate movement				
30 year Canadian federal government bond yield				
End of period	2.31 %	2.16 %	2.31 %	2.16 %
Beginning of period	1.67 %	2.20 %	2.16 %	2.36 %
Change during period	0.64 %	(0.04)%	0.15 %	(0.20)%
30 year Province of Ontario spread				
End of period	0.90 %	1.05 %	0.90 %	1.05 %
Beginning of period	1.00 %	1.00 %	1.05 %	0.95 %
Change during period	(0.10)%	0.05 %	(0.15)%	0.10 %
30 year A rated corporate spread (including financials)				
End of period	1.60 %	1.92 %	1.60 %	1.92 %
Beginning of period	1.73 %	1.85 %	1.92 %	1.52 %
Change during period	(0.13)%	0.07 %	(0.32)%	0.40 %
30 year A rated financials spread				
End of period	2.01 %	2.19 %	2.01 %	2.19 %
Beginning of period	2.26 %	2.05 %	2.19 %	1.87 %
Change during period	(0.25)%	0.14 %	(0.18)%	0.32 %

Interest rate movements impact both bond asset fair values and insurance contract liabilities. In the fourth quarter and full year of 2016, the increase in interest rates (including spreads described above) caused lower bond prices, which resulted in mark to market fair value bond adjustments. These fair value adjustments are offset by changes in insurance contract liabilities.

Stock market movements are demonstrated in the following table.

	Fourth quarter		Year	
	2016	2015	2016	2015
Stock market movement				
S&P/TSX Composite Index				
End of period	15,288	13,010	15,288	13,010
Beginning of period	14,726	13,307	13,010	14,632
Percentage change during period	3.80%	(2.20)%	17.50%	(11.10)%
S&P 500 Index				
End of period	2,239	2,044	2,239	2,044
Beginning of period	2,168	1,920	2,044	2,059
Percentage change during period	3.30%	6.50 %	9.50%	(0.70)%

In the fourth quarter and full year of 2016 the strong increase in stock markets caused common share asset fair value gains. These gains are partially offset by increases in insurance contract liabilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Results - Capital and Surplus

(in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Net income (loss) after tax				
Net income (loss) after tax shareholders' portion	\$ (1)	\$ 5	\$ (2)	\$ 37
Net income after tax policyholders' portion	—	—	4	2
Net income (loss) after tax	\$ (1)	\$ 5	\$ 2	\$ 39

In addition to the three major lines of business, Empire Life maintains distinct accounts for the investment income attributable to Shareholders' Capital and Surplus and to Policyholders' Surplus.

During the fourth quarter and year, earnings from Capital and Surplus decreased relative to 2015. The following table provides a breakdown of the components of this year over year change in net income.

(in millions of dollars)	Fourth quarter	Year
Components of decrease		
Increased net loss on hedging instruments	\$ (4)	\$ (30)
Decreased net income from investments	(2)	(7)
Total	\$ (6)	\$ (37)

During the fourth quarter and full year of 2016, Empire Life experienced a loss of \$5 million and \$28 million after tax respectively on its hedging program primarily due to rising Canadian stock prices compared to a loss of \$1 million and a gain of \$2 million respectively for the comparable period in 2015 (discussed in the Risk Management section later in this report).

Decreased net income from investments was primarily due to lower gains from the sale of AFS bonds in 2016 relative to 2015.

Total Cash Flow

(in millions of dollars)	Year	
	2016	2015
Cash Flow provided from (used for)		
Operating activities	\$ 292	\$ 149
Investing activities	(454)	(179)
Financing activities	331	(9)
Net change in cash and cash equivalents	\$ 169	\$ (39)

Cash provided from operating activities in 2015 was close to 2014 levels.

Cash provided from operating activities in 2016 increased from 2015 levels primarily due to increased net cash flows from increases in working capital levels.

The increase in cash used for investing activities during 2016 relative to 2015 was primarily due to the investment of the proceeds from its first quarter 2016 issuance of \$149.5 million of preferred shares, the investment of the increased cash flows from fixed interest annuity products into matching assets and the partial investment of the proceeds from Empire Life's fourth quarter 2016 issuance of \$200 million of subordinated debt.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The increase in cash provided by financing activities during 2016 relative to 2015 was primarily due to Empire Life's issuance \$200 million of subordinated debt during the fourth quarter of 2016 and its issuance of \$149.5 million of preferred shares during the first quarter of 2016.

For an analysis of liquidity for Empire Life, see note 10(e) and note 28(b) to the 2016 consolidated financial statements.

Financial Instruments

Empire Life buys investment quality bonds to support, to a very large extent, the liabilities under the insurance and annuity policies of Empire Life. Empire Life's investment strategy also includes the use of publicly-listed "large cap" common stocks to support the liabilities under its insurance policies. Cash flows arising from these financial instruments are intended to match the liquidity requirements of Empire Life's policies, within the limits prescribed by Empire Life. Empire Life is subject to market risk on these financial instruments.

Empire Life is also subject to credit risk on these financial instruments which could result in a financial loss should the other party fail to discharge an obligation. This credit risk is derived primarily from investments in bonds, debentures, preferred shares, short-term investments and mortgages. Empire Life manages market risk exposure mainly through investment limits and oversight of its in-house investment managers and external investment firms by the Chief Investment Officer, Asset Management Committee and Investment Committee of the Board. The Investment Committee actively monitors the portfolio size and asset mix. Empire Life has a semi-static hedging program as part of its approach to managing this risk. Empire Life manages credit risk by applying its investment guidelines established by the Investment Committee of 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 Empire Life's Board on the credit risk to which the portfolio is exposed.

Empire Life manages credit risk with respect to derivatives by applying limits and credit rating restrictions 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 \$100 million. Additional information regarding financial instruments is included in notes 2(d), 3, 10(c), and 28 to the audited consolidated financial statements for the year ended December 31, 2016.

Capital Resources

	Dec 31 2016	Sep 30 2016	Jun 30 2016	Mar 31 2016	Dec 31 2015
MCCSR Ratio	248%	213%	213%	219%	201%

Empire Life continues to maintain a strong balance sheet and capital position. Empire Life's debentures and preferred shares are rated by DBRS Limited ("DBRS") and A.M. Best Company, Inc. ("A.M. Best"). On May 27, 2016, DBRS confirmed its ratings of Empire Life including its issuer rating of "A" (sixth highest of 20 categories), its subordinated debt rating of "A (low)" (seventh highest of 20 categories), its financial strength rating of "A" (sixth highest of 22 categories) and its Preferred Share rating of Pfd-2 (fifth highest of 18 categories). All ratings have a stable trend. According to DBRS, the assigned ratings reflect Empire Life's smaller scale, full suite of products, participation in niche markets that reward company strengths and improved and consistent levels of profitability and fixed charge coverage. On December 16, 2016, Empire Life issued \$200 million principal amount of unsecured subordinated debentures due December 16, 2026 by way of private placement in Canada. On December 15, 2016 DBRS assigned a subordinated debt rating of "A (low)" with a stable trend to these debentures.

MANAGEMENT'S DISCUSSION AND ANALYSIS

On May 27, 2016, A.M. Best confirmed its ratings of Empire Life including its issuer rating of “a” (sixth highest of 21 categories), its subordinated debt rating of “bbb+” (eighth highest of 21 categories), its financial strength rating of “A (Excellent)” (third highest of 16 categories) and its Preferred Share rating of “bbb” (ninth highest of 21 categories). All ratings have a stable trend. According to A.M. Best, the ratings reflect Empire Life’s favourable risk-adjusted capital position, continued earnings growth and sustainable market presence in Canada with multiple lines of business. On December 16, 2016, A.M. Best assigned a subordinated debt rating of “bbb+” with a stable trend to Empire’s December 16, 2016 subordinated debenture issue.

Empire Life’s risk-based regulatory capital ratio, as measured by MCCR, of 248% as at December 31, 2016 continued to be above the requirements set by the Office of the Superintendent of Financial Institutions Canada (“OSFI”) as well as Empire Life’s minimum internal targets.

The MCCR ratio increased 35 percentage points from the previous quarter and increased by 47 percentage points for the full year. The increase for the fourth quarter and full year was primarily due to increases in available regulatory capital. For the year this was partly offset by increases in required regulatory capital, as shown in the table below. The increase for the fourth quarter and full year 2016 was primarily due to Empire Life’s issuance of \$200 million principal amount of unsecured subordinated debentures on December 16, 2016 (as described below) which increased Empire Life’s MCCR ratio by 26 percentage points. The increase for the full year was also due to Empire Life’s issuance of \$149.5 million of preferred shares in the first quarter of 2016 (as described below) which increased Empire Life’s MCCR ratio by 20 percentage points.

(millions of dollars)	Dec 31 2016	Sep 30 2016	Jun 30 2016	Mar 31 2016	Dec 31 2015
Available regulatory capital					
Tier 1	\$ 1,206	\$ 1,123	\$ 1,089	\$ 1,078	918
Tier 2	707	541	535	528	504
Total	\$ 1,913	\$ 1,664	\$ 1,624	\$ 1,606	1,422
Required regulatory capital	\$ 771	\$ 781	\$ 762	\$ 734	708

The increase in Tier 1 available regulatory capital from the previous quarter was primarily due to net income. The increase in Tier 1 available regulatory capital for the year was primarily due to net income and Empire Life’s issuance of \$149.5 million of Preferred Shares in the first quarter of 2016.

Tier 2 available regulatory capital increased from the previous quarter and for the full year primarily due to Empire Life’s issuance of \$200 million principal amount of unsecured subordinated.

Regulatory capital requirements decreased from the previous quarter but increased for the full year. The decrease for the quarter was primarily due to decreased requirements related to lapses and interest rate risk, both of which benefited from rising long-term interest rates during the fourth quarter. The increase for the full year was primarily due to increased requirements related to asset default and segregated fund guarantees.

During the first quarter of 2016, Empire Life completed a Canadian public offering of \$149.5 million of Preferred Shares. Empire Life is using the net proceeds from the offering for regulatory capital and general corporate purposes. The offering closed during the first quarter and commenced trading on the Toronto Stock Exchange under the ticker symbol EML.PR.A. Holders of the Preferred Shares will be entitled to receive fixed non-cumulative quarterly dividends yielding 5.75% annually, as and when declared by the Board of Directors of Empire Life, for the initial period ending on and including April 17, 2021. Thereafter, the dividend rate will be reset every five years at a rate equal to the 5-year Government of Canada bond yield plus 4.99%.

On December 16, 2016, the Company issued \$200 million principal amount of unsecured subordinated debentures with a maturity date of December 16, 2026. The interest rate from December 16, 2016 until December 16, 2021 is 3.383%, and the rate from December 16, 2021 until December 16, 2026 is equal to the 3-month Canadian Bankers’ Acceptance Rate plus 1.95%.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Other Comprehensive Income

(in millions of dollars)	Fourth quarter		Year	
	2016	2015	2016	2015
Other comprehensive income (loss)	\$ (16)	\$ 3	\$ 3	(13)
Less: Participating Policyholders	—	(1)	(2)	1
Other comprehensive income (loss), attributable to shareholders	\$ (16)	\$ 3	\$ 1	(12)

Other comprehensive income (OCI) decreased in the fourth quarter but increased for the full year of 2016 relative to the comparable periods of 2015. For the fourth quarter, this was primarily due to unrealized fair value decreases relating to AFS bonds in 2016, primarily due to interest rate movements (interest rates increased during the fourth quarter of 2016). This was partly offset by a large gain in the fourth quarter on the re-measurement of the liability component of post-employment defined benefit (“DB”) plans resulting from increased interest rates. For the full year 2016, the increase in OCI was primarily due to re-measurement of the asset component of post-employment defined benefit (“DB”) plans (described below) and lower realized gains reclassified to net income relating to AFS bonds.

OCI includes the re-measurement of DB plans which had a gain for the full year in 2016 compared to a loss in 2015. The 2016 result for DB plans was primarily due to stock market increases in 2016, compared to stock market decreases in 2015.

Unrealized fair value increases and decreases on AFS bonds in OCI do not impact MCCSR. Re-measurement of DB plans does not immediately impact MCCSR as each quarter’s re-measurement gain or loss is amortized over 12 quarters for MCCSR purposes.

Industry Dynamics and Management’s Strategy

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

Based on general fund and segregated fund assets, Empire Life is among the 10 largest life insurance companies in Canada. Empire Life has approximately six per cent or less market share in all three of its product lines. To be priced competitively in the marketplace while simultaneously providing acceptable long-term financial contribution to shareholders, Empire Life, as a mid-sized company, must find a way to continue to be cost competitive with the larger companies that have some natural economy of scale advantages. In order to improve its unit expenses, management’s enterprise-wide strategic focus has been on achieving profitable growth in its selected markets and on expense management. Empire Life has focused exclusively on the Canadian marketplace and, within it, on particular market segments where management feels there are opportunities to build solid, long-term relationships with independent distribution partners by offering competitive products and more personal service. By focusing on particular market segments and by being seen by these independent advisors as a viable alternative to broadly focused competitors, management believes these solid relationships will enable profitable growth.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Wealth Management product line at Empire Life is comprised of segregated fund products, guaranteed interest products and mutual funds. These products compete against products offered by a variety of financial institutions. A key element of any competitive strategy in this market is providing a competitive rate of return to clients. The value-oriented equity investment strategy used by Empire Life has focused on developing long-term performance in the fund marketplace. Management will continue to improve competitiveness by focusing on long-term performance, providing low cost products to customers along with broadened distribution reach. Although industry sales and Empire Life sales were down in 2016, Empire Life achieved strong growth in assets under management from its segregated fund business as a result of equity market appreciation. Empire Life is continuing to monitor and manage GMWB risk exposure and the competitive landscape for this product. The fourth quarter 2014 product launch by Empire Life included a new version of its GMWB product which commands a higher price and reduces the amount of risk to Empire Life while still offering a competitive guaranteed income solution to customers.

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

Individual Insurance products are very long-term in nature and consequently can be subject to new business strain. New business strain occurs when the provision for adverse deviation included in the actuarial policy liabilities exceeds the profit margin in the product pricing. At current reinsurance price levels in the Canadian market place, a company may reduce new business strain and improve profitability in the short term by opting to increase the amount of insurance risk reinsured to third parties. Mortality trends continue to be favourable for life insurance products. Rather than give up the future earnings that would emerge if the trend in mortality improvement witnessed in recent decades continues, Empire Life continues to utilize lower than average levels of reinsurance with the resultant negative impact on short-term earnings. Low long-term interest rates continue to have an unfavourable impact on this product line. In the past few years, industry prices for longer term life insurance products have increased. Empire Life has also increased prices for these products and has focused its growth efforts on shorter term products, such as 10 year renewable term life insurance. Because of the reasonable long-term returns of this product line, management continues to focus on steady growth, technology development and process improvement in order to continue to have a cost structure that allows us to compete while generating an acceptable long-term financial contribution. Empire Life is continuously reviewing its Individual Insurance product mix to improve profitability, reduce interest rate risk, reduce required regulatory capital, develop web-based products and processes, and improve the customer and advisor experience.

Risk Management

Empire Life is a financial institution offering Wealth Management, Employee Benefits and Individual Insurance products. The Company is exposed to a number of risks as a result of its business activities. The goal of the Company's risk management process is to ensure that the operations that expose it to risk are consistent with the Company's strategy, business objectives and risk philosophy while maintaining an appropriate risk/reward balance and enhancing stakeholder value. When making decisions about risk taking and risk management, Empire Life considers:

- The need to meet the expectations of its customers, shareholders and creditors and to protect the commitments that have been made to them;
- The need to be adequately compensated for the capital deployed to support business activities and strategic objectives;
- The need to protect its brand; and
- The need to maintain its targeted financial strength rating.

Empire Life's risk appetite defines the aggregate level of risk the Company is willing to take to achieve its business strategies. The risk appetite supports the pursuit of shareholder value but does not compromise the Company's ability to pay claims and fulfil policyholder commitments.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Empire Life's risk management framework is structured based on a number of guiding principles:

- Due to the long term nature of the majority of its commitments, the Company accepts capital market risk provided it is managed within specific risk tolerances and limits. The Company takes a low risk, value-oriented approach to managing its investments - it accepts credit and alternative asset risk provided it is rewarded through appropriately enhanced returns;
- The Company manages liquidity across the business to provide a high level of confidence that all obligations (to customers, creditors and shareholders) will be met when they fall due;
- The Company accepts insurance risks provided they are properly priced and managed in order to deliver value to its customers and shareholders;
- The Company is forward-looking in its business planning and takes a prudent approach to capital management. It strives to have a high level of confidence that capital is sufficient to support planned activities into the future;
- Management is active in industry committees and, through a network of oversight functions, monitors the landscape so that the Company is appropriately positioned to manage regulatory, tax, accounting and actuarial changes;
- The Company accepts that operational risks are a part of doing business and knows that risk management is a key part of decision-making. It protects its business and customers by engaging in cost effective risk mitigation; and
- The Company expects ethical conduct by all of its employees and acts with integrity at all times.

The Board of Directors oversees and monitors the Company's risk management framework, processes and practices and reviews and approves the Company's Enterprise Risk Management Framework and overall risk appetite. Senior management shares responsibility and accountability for risk management across the organization. This enables a cross-functional perspective on risk management, enhanced by the frequency of contact across the management team. The Company has an Asset Management Committee with responsibility for overseeing the management of corporate policies established by both the Investment Committee and Risk and Capital Committee of the Board. More information related to governance can be found under the Corporate Governance over Risk Management section of Empire Life's 2016 annual report. Risk management policy development is centralized under the leadership of the Chief Risk Officer and applies to all business units. The Chief Risk Officer is a member of the Asset Management Committee and has Board reporting responsibility with respect to risk and capital management. All risk management policies and procedures are regularly reviewed for relevance and changes in the risk environment. Accountability, application, day-to-day management and procedural elements are the responsibility of area management, supported by business unit compliance officers and the risk management department. There is senior management representation and oversight on various interdisciplinary risk control committees. The Company formally establishes and documents its values and risk tolerances through several company-wide policies including a Code of Business Conduct, Corporate Disclosure principles, enterprise risk management, capital management and whistleblower policies. The Company's strategic risk management policies (including those related to product design and pricing, investment policies and capital management) are also approved by its Board, or a Board committee.

Caution Related to Sensitivities

In the sections that follow, the Company provides sensitivities and risk exposure measures for certain risks. These include sensitivities due to specific changes in market prices and interest rates, based on market prices, interest rates, assets, liabilities and business mix in place as at the calculation dates. The sensitivities are calculated independently for each risk factor, assuming that all other risk variables remain constant. Actual results can differ materially from these estimates for a variety of reasons, including the interaction among these factors when more than one factor changes; changes in actuarial and investment return and future investment activity assumptions; actual experience differing from the assumptions; changes in business mix, effective tax rates and other market factors; and the general limitations of the Company's internal models used for purposes of these calculations. Changes due to new sales or maturities, asset purchases/sales, or other management actions could also result in material changes to these reported sensitivities. For these reasons, the sensitivities should only be viewed as directional estimates of the underlying sensitivities for the respective factors based on the assumptions outlined, and should not be viewed as predictors for the Company's future net income, OCI, and capital sensitivities. Changes in risk variables in excess of the ranges illustrated may result in other than proportionate impacts.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Market Risk

Empire Life has equity market risk related to its segregated fund products and from equity assets backing life insurance liabilities. Empire Life has a semi-static hedging program. The objective of the hedging program is to partially protect Empire Life from possible future MCCR ratio declines that might result from adverse stock market price changes. The hedging program currently employs put options and short positions on key equity indices. The extent of options used is monitored and managed on an ongoing basis, giving consideration to equity risk and the level of available capital.

There is income statement volatility from this hedging program. Based on current equity market levels, Empire Life has required capital for MCCR purposes related to segregated fund guarantees, but does not have policy liabilities related to these guarantees on its balance sheet. Therefore a by-product of hedging MCCR exposure is income statement volatility, as the gains or losses from hedging instruments are not offset by changes in policy liabilities related to segregated fund guarantees on the income statement. During the fourth quarter and full year of 2016 Empire Life experienced a loss of \$5 million and \$28 million after tax respectively on its hedging program primarily due to rising Canadian stock prices compared to a loss of \$1 million and a gain of \$2 million respectively for the comparable period in 2015.

Empire Life's MCCR ratio is also sensitive to stock market volatility, due primarily to liability and capital requirements related to segregated fund guarantees. As of December 31, 2016, Empire Life had \$8.1 billion of segregated fund assets and liabilities. Of this amount, approximately \$7.8 billion have guarantees. The following table provides a percentage breakdown by type of guarantee:

	Dec 31 2016	Dec 31 2015
Percentage of segregated fund liabilities with:		
75% maturity guarantee and a 75% death benefit guarantee	1.2%	0.4%
75% maturity guarantee and a 100% death benefit guarantee	49.7%	51.5%
100% maturity and death benefit guarantees (with a minimum of 15 years between deposit and maturity date)	6.1%	5.9%
100% maturity and death benefit guarantees (guaranteed minimum withdrawal benefit (GMWB))	43.0%	42.2%

All Empire Life segregated fund guarantees are policy-based (not deposit-based), thereby generally lowering Empire Life's stock market sensitivity relative to products with deposit-based guarantees. Policy-based guarantees consider all of the deposits in the customer's policy (whether the fund value is below or above the guaranteed amount) to arrive at an overall net guarantee payment, whereas deposit-based guarantees consider only the deposits where the fund value is below the guaranteed amount and ignores all the deposits in the customer's policy where the fund value is above the guaranteed amount. Therefore, generally policy-based guarantees pay less than deposit-based guarantees. For segregated fund guarantee insurance contract 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The segregated fund regulatory capital and liability framework includes the use of "zero floors" (i.e. negative amounts are not permitted so zero is used instead, as described below) and other regulatory constraints, and this often makes the sensitivity impacts non-linear. Generally as stock markets and interest rates rise the magnitude of the negative liabilities will also rise. In the first table below, Empire Life discloses the sensitivity of net income to changes in segregated fund guarantee insurance contract liabilities. There is a net loss resulting from a 20% and a 30% decrease at December 31 for 2016 and 2015, but otherwise the amounts shown in the table are nil. These liabilities (present value of future benefits and expenses minus the present value of future fee revenue) are calculated using stochastic modeling techniques based on a range of future economic scenarios. The liabilities are the greater of: (i) the average of the amounts determined in the worst 20% of the scenarios; and (ii) zero. For the nil amounts shown in this table, the liability for Empire Life was negative. Therefore, the alternative level of zero is applied in these tests (zero floor) resulting in a net income impact of nil. Based on stock market levels at December 31 for 2016 and 2015, the sensitivity of Empire Life shareholders' net income to changes in segregated fund guarantee insurance contract liabilities resulting from stock market increases and decreases is as follows:

Sensitivity to segregated fund guarantees: (in millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
December 31, 2016 Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ (10)	\$ (117)
December 31, 2015 Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ (10)	\$ (109)

As per the sensitivity table, the impact of stock market changes on the segregated fund guarantee liabilities is not linear. As noted earlier, Empire Life also has equity market risk related to its equity assets backing life insurance liabilities. Based on stock market levels as at December 31, 2016 and 2015, the sensitivity of Empire Life shareholders' net income (including changes in segregated fund guarantee insurance contract liabilities) resulting from stock market increases and decreases is as follows (excluding the effect of Empire Life's equity risk hedging program):

Sensitivity excluding equity risk hedge (in millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
December 31, 2016 Shareholders' net income	\$ 51	\$ 25	\$ (25)	\$ (60)	\$ (196)
December 31, 2015 Shareholders' net income	\$ 44	\$ 22	\$ (22)	\$ (54)	\$ (207)

The equity risk hedging program provides relief in adverse scenarios, but incurs losses in positive scenarios.

The December 31, 2016 and 2015 amounts in the following table include the effect of Empire Life's equity risk hedging program (described above):

Sensitivity including equity risk hedge (in millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
December 31, 2016 Shareholders' net income	\$ 36	\$ 18	\$ (16)	\$ (36)	\$ (148)
December 31, 2015 Shareholders' net income	\$ 27	\$ 12	\$ (7)	\$ (19)	\$ (149)

Empire Life also has a reinsurance agreement to cede a portion of Empire Life's segregated fund death benefit exposure. All Empire Life segregated fund policyholders with death benefit guarantees of at least \$2 million are included in this agreement. Empire Life does not reinsure any other insurer's segregated fund products.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Based on stock market levels on the dates indicated below the sensitivity of Empire Life's MCCR ratio to stock market increases and decreases for all Empire Life stock market exposures, including segregated fund guarantees, is as follows (excluding the effect of Empire Life's equity risk hedging program):

Excluding Equity Risk Hedge MCCR	Increase		Decrease		
	20%	10%	10%	20%	30%
Sensitivity to stock markets					
December 31, 2016 MCCR Ratio	(0.7)	(0.2)	(12.1)	(35.3)	(40.1)
December 31, 2015 MCCR Ratio	1.2	0.7	(13.9)	(31.6)	(50.0)

The December 31, 2016 and 2015 amounts in the following table include the effect of Empire Life's equity risk hedging program (described below):

Including Equity Risk Hedge MCCR	Increase		Decrease		
	20%	10%	10%	20%	30%
Sensitivity to stock markets					
December 31, 2016 MCCR Ratio	(5.4)	(2.6)	(9.7)	(30.4)	(30.2)
December 31, 2015 MCCR Ratio	(3.0)	(1.8)	(10.6)	(24.8)	(40.0)

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

Segregated Funds (in millions of dollars)	Withdrawal Benefit > Fund Value		Maturity Guarantee > Fund Value		Death Benefit > Fund Value		Actuarial Liabilities	MCCR Required Capital
	Fund Value	Amount At Risk	Fund Value	Amount At Risk	Fund Value	Amount At Risk		
December 31, 2016	\$ 2,530	\$ 627	\$ 37	\$ 1	\$ 324	\$ 4	nil	150
December 31, 2015	\$ 2,343	\$ 593	\$ 124	\$ 4	\$ 1,415	\$ 17	nil	130

The first six columns of the above table show all segregated fund policies where the future withdrawal benefit, future maturity guarantee, or future death benefit guarantee is greater than the fund value. The amount at risk represents the excess of the future withdrawal benefit, future maturity guarantee or future death benefit guarantee amount over the fund value for these policies. The withdrawal benefit amounts in the above table relate to GMWB products. The GMWB withdrawal benefit amount at risk represents the amount that could be paid by Empire Life to GMWB policyholders if the net return on each GMWB policyholder's assets is zero for the remainder of each GMWB policyholder's life, based on life expectancy. As at December 31, 2016, the aggregate amount at risk for these three categories of risk (reported in the above table) was \$632 million, an increase from the aggregate amount at risk of \$614 million as at December 31, 2015.

For these three categories of risk, the amount at risk is not currently payable. Payment is contingent on future outcomes including fund performance, deaths, deposits, withdrawals and maturity dates.

The level of actuarial liabilities and required regulatory capital in the above table is calculated based on the probability that Empire Life will ultimately have to make payment to the segregated fund policyholders for any fund value deficiency that may exist on future payments to GMWB policyholders, or upon future maturity of the segregated fund policies, or upon future death of the segregated fund policyholders. The amounts at risk in December 2016 decreased from the December 2015 levels for GMWB withdrawal benefit exposure primarily due to GMWB sales volume in 2016. The quarterly update of segregated fund policy data on our stochastic model resulted in an increase in required regulatory capital.

MANAGEMENT'S DISCUSSION AND ANALYSIS

In addition, Empire Life's MCCSR ratio is sensitive to changes in market interest rates. The impact of an immediate 50 basis point decrease in interest rates, and a 50 basis point decrease in assumed initial reinvestment rate ("IRR") for nonparticipating insurance business and segregated fund guarantees, is shown in the table below. This assumes no change in the ultimate reinvestment rate ("URR"). The first column below excludes the impact of market value changes in AFS bonds. The AFS bonds provide a natural economic offset to the interest rate risk arising from our product liabilities. The second column below shows the impact if the AFS bonds were sold to realize the gains from a 50 basis point decrease in interest rates.

	Before The Sale of AFS Assets	After The Sale of AFS Assets
	50 bps Decrease	50 bps Decrease
Sensitivity To Market Interest Rates:		
December 31, 2016 MCCSR Ratio	(20)%	(15)%
December 31, 2015 MCCSR Ratio	(17)%	(13)%

Operational Risk

Operational risk relates to the uncertainty arising from larger than expected losses or damages as a result of inadequate or failed internal processes, people and systems, or from external events. Operational risk is naturally present in all of the Company's business activities and encompasses a broad range of risks, including legal disputes, regulatory compliance failures, technology failures, business interruption, information security and privacy breaches, human resources management failures, processing errors, modelling errors, theft and fraud, and damage to physical assets. The following is a further description of key operational risks and their associated risk management strategies.

(1) Legal and Regulatory Risk

The Company is governed by the Insurance Companies Act ("ICA") and supervised by OSFI and is also subject to various requirements imposed by legislation and regulation in each of the provinces and territories of Canada applicable to insurance companies and companies providing other financial services. Material changes in the regulatory framework could have an adverse effect on the Company. Failure to comply with regulatory requirements or public expectations could adversely impact the Company's reputation and ability to conduct business. The Company is subject to litigation from time to time, in the normal course of business, and currently has a number of outstanding lawsuits. There can be no assurance that the present or any future litigation will not have a material adverse effect on the Company.

The Company's corporate compliance department, headed by the Chief Compliance Officer, oversees the regulatory compliance framework. This framework promotes risk-based management of compliance and regulatory risk and includes Company-wide policies, operating guidelines, programs to promote awareness of laws and regulations impacting the Company, ongoing monitoring of emerging legal issues and regulatory changes and employee education programs that include anti-money laundering and anti-terrorist financing, privacy and information security risk management as well as reporting breaches and the Company's code of business conduct. The framework is supported by a network of business unit compliance officers as well as the corporate legal services department. The Chief Compliance Officer reports regularly to the Conduct Review Committee of the Board on the state of compliance, key compliance risks and emerging regulatory trends. General Counsel reports regularly to the Audit Committee of the Board on litigation activity.

(2) Model Risk

The Company uses models to support many business functions including investment analysis, product development and pricing, valuation of policy liabilities, planning, asset/liability management, capital management, project management and risk management. The risk of inappropriate use or interpretation of the Company's models or their output, or the use of deficient models, data or assumptions could result in financial losses or inappropriate decision making. The Company has developed management and mitigation processes related to model use and oversight of models to limit financial, operational and strategic impacts from an error or misinterpretation of model results. Senior management has overall responsibility and accountability for models in use to support activities within their business area.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(3) Human Resources Risk

Competition for qualified employees, including executives, is intense both in the financial services industry and non-financial industries. If the Company is unable to retain and attract qualified employees and executives, the results of its operations and financial condition, including its competitive position, could be adversely affected. To mitigate this risk, the Company has a number of human resources policies, processes and practices in place. Management reports regularly to the Human Resources Committee of the Board on succession planning and employee development programs as well as compensation practices and programs, all of which are designed to attract, motivate and retain high-performing and high-potential employees.

(4) Third-party Risk

The Company obtains many different types of services from a number of third-party services providers and has outsourced certain business functions or processes to third parties. Should these third parties fail to deliver services in compliance with contractual or other service arrangements, the Company's business may be adversely impacted. To mitigate this risk, the Company has established a Company-wide outsourcing policy that provides guidance when considering, entering into or managing existing outsourcing arrangements commensurate with the risks associated with the service provider and the nature of the arrangement. Annually, management reports to the Conduct Review Committee of the Board on outsourcing activities including details on those arrangements deemed to be most material to the Company.

(5) Technology, Information Security and Business Continuity Risk

The Company relies on technology in virtually all aspects of its business and operations including the creation and support of new products and services, and the nature of life insurance business necessitates a substantial investment in technology. Operational integrity, data integrity and security of information and systems infrastructure are all relied upon for normal business operations. Disruptions due to system failure, information security breaches, privacy breaches, cyber-attacks, human errors, natural disasters, criminal activity, fraud or the loss of certain software licensing agreements could have a material adverse impact on the Company.

The Company has an enterprise-wide business continuity and disaster recovery program overseen by the Business Continuity Planning Team and the Chief Technology Officer. The program includes policies, plans and procedures designed so that, to the extent practically possible, key business functions can continue and normal operations can resume effectively and efficiently should a major disruption occur. Each business unit is accountable for preparing and maintaining detailed business continuity plans and processes. The Company establishes and regularly tests business continuity and disaster recovery plans and maintains off-site backup facilities and failover capability designed to minimize downtime and accelerate system recovery.

Information security breaches, including various forms of cyber-attack, could occur and may result in inappropriate disclosure or use of personal or confidential information. To mitigate this risk, the Company has an information security program overseen by the Chief Technology Officer. This program consists of a number of standards, procedures and guidelines focused on protecting information and computer systems. An incident management process is in place for monitoring and managing security events.

Privacy breaches could occur and may result in unauthorized disclosure or use of private and confidential information. To manage this risk, the Company has a privacy program overseen by the Chief Privacy Officer. The program includes policies and standards, ongoing monitoring of emerging privacy legislation and a network of business unit privacy officers. Processes have been established to provide guidance to employees on the handling of personal information and the reporting of privacy incidents and issues to appropriate management for response and resolution.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Business and Strategic Risk

Business and strategic risk relates to the uncertainty in future earnings and capital related to the potential inability to implement appropriate business plans and strategies, make decisions, allocate resources, manage distribution or adapt to changes in business environment, such as the competitive landscape, regulatory and tax changes or changes in accounting and actuarial standards. The Company regularly reviews and adapts its business strategies and plans in consideration of changes in the external business environment, economic, political and regulatory environment. The Company's financial performance is dependent upon its ability to implement and execute business strategies and plans for growth.

The Company's business strategies and plans are designed to align with risk appetite, capital position and financial performance objectives. The Company periodically reassesses risk appetite taking into consideration the economic, regulatory and competitive environments in which it operates. The current environment requires the Company to adapt rapidly to new opportunities and challenges and to refine its strategies accordingly. If the Company fails to revise its strategies on a timely basis or adapt to the changing environment, it may not be able to achieve its growth objectives.

The Company's business strategies and plans are dependent on the successful execution of organizational and strategic initiatives designed to support the growth of its business. The ability to effectively manage these changes and prioritize initiatives directly affects the Company's ability to execute these strategies. Identifying and implementing the right set of initiatives is critical to achieving the Company's business plan targets. Failure to implement these initiatives could also lead to cost structure challenges.

Successful execution of the Company's business strategies and plans depends on a number of factors including its ability to (i) generate sufficient earnings to maintain an adequate level of capital; (ii) generate sustained investment performance; (iii) meet regulatory requirements; (iv) manage risk exposures effectively; (v) attract and retain customers and distributors; (vi) have the right set of products; and (vii) reduce operating expenses while maintaining the ability to hire, retain and motivate key personnel. The Company's business and strategic plans are reviewed and discussed by its senior management team and are subject to approval by the Board of Directors, which also receives regular updates on implementation progress against key business plan objectives. The Board and its subcommittees receive regular updates on key risks.

In addition to the discussion of risks included in this MD&A, a comprehensive discussion of the material risks that impact Empire Life is included in Empire Life's Annual Information Form available at www.sedar.com. Additional disclosures of Empire Life's sensitivity to risks are included in note 28 to the 2016 consolidated financial statements.

Disclosure Controls and Procedures

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company under Canadian securities laws is recorded, processed, summarized and reported within the specified time periods, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management on a timely basis to allow appropriate decisions regarding public disclosure. Under the supervision of management, an evaluation was carried out on the effectiveness of the Company's disclosure controls and procedures as of December 31, 2016. Based on that evaluation, management concluded that the Company's disclosure controls and procedures were effective as at December 31, 2016.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS. Under the supervision of management, an evaluation of the Company's internal control over financial reporting was carried out as at December 31, 2016. Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2016. No changes were made in the Company's internal control over financial reporting during the year ended December 31, 2016, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Critical Accounting Estimates

Empire Life's significant accounting policies are described in note 2 to the consolidated financial statements. Certain of these policies require management to make estimates and assumptions about matters that are inherently uncertain. The most critical of these accounting estimates for Empire Life are the valuation of policy liabilities, financial instrument classification, pension and other employee future benefits and the determination of allowances for impaired investments.

Policy Liabilities

The determination of policy liabilities requires best estimate assumptions that cover the remaining life of the policies for mortality, morbidity, investment returns, persistency, expenses, inflation and taxes and include consideration of related reinsurance effects. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviation from best estimates is included in each assumption. These margins allow for possible deterioration in future experience and provide for greater confidence that policy liabilities are adequate to pay future benefits. The resulting provisions for adverse deviations have the effect of increasing policy liabilities and decreasing the income that otherwise would have been recognized at policy inception. A range of allowable margins is prescribed by the Canadian Institute of Actuaries. Assumptions are reviewed and updated at least annually and the impact of changes in those assumptions is reflected in earnings in the year of the change. Empire Life's sensitivity to risks related to policy liabilities are included in note 28 to the consolidated financial statements.

Financial Instrument Classification

Management judgment is used to classify financial instruments as fair value through profit or loss (FVTPL), available for sale (AFS) or loans and receivables. Most financial assets supporting insurance contract liabilities and investment contract liabilities are designated as FVTPL. Most financial assets supporting capital and surplus and participating accounts are classified as AFS. Loans and receivables support both contract liabilities and capital and surplus. The designation of a financial instrument as FVTPL or AFS dictates whether unrealized fair value changes are reported in net income or other comprehensive income. Additional information regarding financial instrument classification is included in notes 2(d), 3(a), 3(b), and 10(c).

Pension and Other Employee Future Benefits

Pension and other employee future benefits expense is calculated by independent actuaries using assumptions determined by management. The assumptions made affect the pension and other employee future benefits expense included in net income. If actual experience differs from the assumptions used, the resulting experience gain or loss is recorded in OCI. Additional information regarding pension and other employee future benefits is included in notes 2(j), and 12.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Provision for Impaired Investments

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

Available for sale securities are subject to a regular review for losses that are significant or prolonged. Objective evidence of impairment exists if there has been a significant or prolonged decline in the fair value of the investment below its cost or if there is a significant adverse change in the technological, market, economic or legal environment in which the issuer operates or the issuer is experiencing financial difficulties.

Outlook

The Canadian economy continued to experience slow growth in 2016. Much of the weakness came from low investments in the oil industry and disruption in the output in Alberta oil sands. Unemployment hovered near 7% for most of the year. The sluggishness in Canada reflected the uncertainty in the Global economy. The momentum in the US in 2015 didn't spill over into 2016 as expected. Growth in China for most of 2016 was sluggish compared to prior years while the economy shifts to a more market driven consumer based economy. Business confidence in the UK and the Euro zone was damaged by the potential impact from the Brexit referendum. The headwinds from the global economy was partially offset by increased consumer spending, an increase in infrastructure spending, and continued growth in the residential housing market in Canada. The Canadian economy picked up momentum in the second half of 2016. The Canadian long-term interest rates increased from 1.72% at the end of the second quarter to 2.31% at the end of fourth quarter 2016. While corporate and provincial bond spreads decrease slightly during this period, the increase in yields brought some relief after a significant decrease in interest rates that occurred in 2014. Interest rates have generally been lower than typical levels for several years. 2016 Global stock markets rallied in 2016. Stock market conditions mainly impact in-force profit margin results and new business growth for the segregated fund and mutual fund portions of Empire Life's Wealth Management product line. The Canadian resource heavy stock market rose by 17.5% in 2016 compared to a decrease of 11.1% in 2015. The U.S. S&P 500 stock index rose by 9.5% in 2016 compared to a decrease of 0.7% in 2015. The increase in the Canadian and U.S. stock markets has a positive impact on Empire Life's fees from the segregated funds in the wealth management business. The strengthening of the Canadian dollar resulted in a slightly weaker performance for assets denominated in U.S. dollars which contributed to the performance of many of Empire Life's segregated funds. Looking forward, consumers continue to be cautious about stock market exposure and Empire Life is well positioned with segregated fund, mutual fund and fixed interest annuity product offerings to satisfy demand for lower risk investments.

While Canada fared well during the 2008 financial crisis compared to many other countries, Canada's economy has experienced modest growth in the past few years and there continues to be uncertainty resulting in mixed economic indicators. Consumers are the primary stimulus for growth and home sales continue to rise particularly in central Canada and the far western regions of Canada. The recession in parts of western Canada caused by the drop in the oil price appears to have run its course. With recent stability in oil prices and progress in the approval of key pipelines, Alberta's economy is expected to expand in 2017. Overall the Canadian economy is expected to grow by 2% depending on the contribution the federal fiscal stimulus will provide to growth. With the new administration in the U.S., the uncertainty surrounding Canada's trade with its largest trading partner could have a material impact on growth in Canada in 2017. This could ultimately have a negative impact on all of Empire's lines of business.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Individual Insurance product line has been challenged by a persistent low long-term interest rate environment that followed the financial crisis. This has impacted the entire industry resulting in price increases for individual insurance products by Empire Life and many of our competitors. While market long-term interest rates recovered somewhat in 2015 and 2016, interest rate volatility continued in 2016. Empire Life has decreased its emphasis on long-term life insurance products in favor of shorter term products, such as 10 year renewable term life insurance. Long-term interest rates, product mix and product pricing are expected to continue to be issues for Empire Life's Individual Insurance product line in 2017.

Regulatory changes related to segregated fund guarantees continues to evolve. OSFI is reviewing the overall approach for determining capital requirements for segregated fund guarantee risks. Changes to the capital required for products with guaranteed income may ultimately impact the industry's ability to offer these products at reasonable prices to the consumer.

On September 12, 2016, OSFI released its final version of 2018 guideline - Life Insurance Capital Adequacy Test. This new Guideline, effective January 1, 2018, will establish a new regulatory capital framework for life insurance companies, which will replace the current MCCSR Guideline. This new Guideline was developed in consultation with the Life Insurance industry and OSFI does not expect that it will have a material impact on the capital required by the industry as a whole, in comparison to MCCSR. Empire life is assessing the impact of the new framework and will provide further information once the assessment is completed and OSFI concurs with Empire's application of the new Guidelines.

The IASB has set January 1, 2021 for the adoption of IFRS 17 Accounting for Insurance Contracts. IFRS 17 will include fundamental differences from the CALM method (equivalent to IFRS 4 Insurance Contracts) that Empire Life currently applies for the valuation of insurance contracts and revenue recognition. The IASB has also granted a temporary exemption from the application of IFRS 9 Financial Instruments to allow insurance companies the option of implementing both IFRS 17 and IFRS 9 effective 2021. IFRS 9 applies to the measurement of financial assets, the expected credit loss model and hedge accounting. For Insurance Contracts and Financial Instruments accounting the goal is global consistency under IFRS as opposed to the differing approaches in each country that exist today. In 2014 OSFI issued the Capital Adequacy Guidelines for Banks in Canada based on the Basel III capital standards for Banks worldwide. The Guidelines include requirements that ensure that investors in non-common regulatory capital instruments will bear the loss in the event that the bank may become non-viable as a going concern. These new financial instruments issued by banks must comply with new regulations in order to be included in the banks' capital ratios. OSFI has indicated that they are exploring the applicability of these rules for insurance companies. Empire Life is not aware of any immediate plans by OSFI to make similar changes for life insurance companies.

For capital adequacy standards the goal is consistent treatment of risk within insurance companies from a capital adequacy perspective regardless of the type of business. These two items could have a material impact on the measurement of Empire Life's net income in the future and capital ratios.

The Canadian Securities Administrators ("CSA") has increased disclosure requirements for mutual fund companies, including point of sale requirements and customer relationship model initiatives. Mutual fund fees continue to be an area of interest for Canadian securities regulators. The CSA commissioned independent third-party research that will assess the impact of commissions and embedded (trailer) fees on mutual fund flows. This research will support CSA policy decisions concerning Canada's current mutual fund fee structure. Empire Life continues to monitor these developments and assess the possible impact to the insurance industry at some future date.

Regulatory change is also occurring for Managing General Agents ("MGAs"). Life insurance companies, including Empire Life, commonly contract with MGAs as a key component of the distribution chain for insurance and wealth management products. In 2013, the Canadian Life and Health Insurance Association ("CLHIA") developed a new Insurer-MGA Relationship guideline (effective January 1, 2015). The Guideline describes desired outcomes and related practices in five general areas, stating that insurers should: perform due diligence prior to entering into a contract with an MGA, clearly set out roles and responsibilities in the contract, commit to a culture of treating customers fairly, monitor the performance of the MGA and retain ultimate responsibility.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Government pension reform including the Federal Pooled Registration Pension Plan program and the proposed Ontario Registered Pension Plan are expected to reduce future demand for private sector retirement savings products, having an adverse impact on banks, mutual fund companies, life insurance companies and advisors.

In 2016 changes to tax rules that deal with the exemption status of certain life insurance policies effective on January 1, 2017. The exemption test aims to distinguish between (and tax differently) policies that are designed as protection versus those that are primarily investments. The new exempt test represent a significant change to the tax regime that has existed over the past 30 years. These changes required all life insurance companies to review the design and the pricing of their life insurance product offerings. Empire Life has either modified or withdrawn certain product offerings to comply with the new tax rules.

Quarterly Results

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

	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
(in millions of dollars, except earnings per share)	2016	2016	2016	2016	2015	2015	2015	2015
Revenue	\$ (25)	\$ 453	\$ 564	\$ 416	\$ 391	\$ 212	\$ 41	\$ 643
Common shareholders' net income	\$ 53	\$ 38	\$ 25	\$ 37	\$ 16	\$ 22	\$ 44	\$ 26
Earnings per share - basic and diluted	\$ 53.34	\$ 38.67	\$ 25.21	\$ 37.81	\$ 16.43	\$ 22.49	\$ 45.34	\$ 25.97

For the fourth quarter of 2016, total revenue at Empire Life decreased to negative \$25 million compared to \$391 million in the fourth quarter of 2015. The decrease was primarily due to a large loss in the fourth quarter on FVTPL investments in 2016 compared to a net gain for the same period in 2015. In 2016, the loss was from a decrease in bond prices (due to an increase in market interest rates). In 2015, the net gain was primarily from an increase in bond prices (due to a decrease in market interest rates) and an increase in US stock prices (see Total Revenue section earlier in this report). Revenue volatility during the most recent eight quarters was primarily driven by the impact of market interest rate movements and stock market movements on Fair value change in FVTPL investments. The impact of this on net income is significantly reduced due to a corresponding change in insurance contract liabilities.

For the fourth quarter of 2016, net income was higher relative to 2015 due to higher profit from the Individual Insurance product line primarily attributable to improved stock market conditions in 2016, a favourable update of policy liability assumptions for the Individual Insurance product line in 2016 (compared to an unfavourable update in 2015) and management actions to improve asset/liability matching in 2016. See Product Line Results sections earlier in this report for further information on quarterly results.

Empire Life improved its matching position throughout 2016 by increasing its investment in real estate limited partnership units during the first nine months of 2016 and by making changes to its bond investments. The improved matching position resulted in a gain in all four quarters of 2016 from updating insurance contract liabilities.

Net income variability during the most recent eight quarters was often driven by long-term interest rate movements. Long-term interest rates decreased resulting in unfavourable net income in the individual insurance product line during the quarters ending June 30, 2016, March 31, 2015 and December 31, 2014 quarters. Long-term interest rates increased, resulting in favourable net income in the individual insurance product line during the second, third and fourth quarters of 2015. In addition, unfavourable Individual Insurance mortality, surrender and lapse experience lowered net income in the first, second and third quarters of 2016 and the third quarter of 2015. The annual update of Individual Insurance policy liability assumptions lowered net income in the fourth quarter of 2015. During the first and third quarters of 2016, the first three quarters of 2015 and the fourth quarter of 2014, Empire Life achieved strong year over year growth in the Wealth Management product line net income. This product line's strong result was primarily due to the growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products. Strong fee income was primarily due to the positive impact of favourable stock market conditions on management fees earned, strong segregated fund sales and higher GMWB prices.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Forward-looking Statements and Information

Certain statements in this MD&A about the Company's current and future plans, expectations and intentions, results, market share growth and profitability, strategic objectives or any other future events or developments constitute forward-looking statements and information within the meaning of applicable securities laws. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other comparable words or phrases, are intended to identify forward-looking statements and information. Although management believes that the expectations and assumptions on which such forward-looking statements and information are based are reasonable, undue reliance should not be placed on the forward-looking statements and information because there can be no assurance that they will prove to be correct. By their nature, such forward-looking statements and information are subject to various risks and uncertainties, which could cause the actual results and expectations to differ materially from the anticipated results or expectations expressed. These risks and uncertainties include, but are not limited to, market risks including equity risks, hedging risks, interest rate risks, foreign exchange rate risks; liquidity risks; credit risks including counterparty risks; insurance risks including mortality risks, policyholder behaviour risks, expense risks, morbidity risks, product design and pricing risks, underwriting and claims risks, reinsurance risks; operational risks, including legal and regulatory risks, model risks, human resources risks, third-party risks, technology, information security and business continuity risks; and business risks, including risks with respect to competition, risks with respect to financial strength, capital adequacy risks, risks with respect to distribution channels, risks with respect to changes to applicable income tax legislation, risks with respect to litigation, risks with respect to reputation, risks with respect to risk management policies, risks with respect to intellectual property, risks with respect to significant ownership of common shares. Please see the section titled "Risk Factors" in Empire Life's Annual Information Form available at www.sedar.com for more details on these risks.

Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements and information include that the general economy remains stable; assumptions on interest rates, mortality rates and policy liabilities; and capital markets continue to provide access to capital. These factors are not intended to represent a complete list of the factors that could affect the Company; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein or in the documents reproduced herein.

To the extent any forward-looking information in this MD&A constitutes future-oriented financial information or financial outlooks within the meaning of securities laws, such information is being provided to demonstrate potential benefits and readers are cautioned that this information may not be appropriate for any other purpose. Future-oriented financial information and financial outlooks are, without limitation, based on the assumptions and subject to the risks set out above.

The forward-looking information contained herein is expressly qualified in its entirety by this cautionary statement. When relying on the Company's forward-looking statements and information to make decisions, investors and others should carefully consider the foregoing factors, assumptions and other uncertainties and potential events. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date hereof or the date indicated, and to not use such forward-looking information for anything other than its intended purpose. The Company undertakes no obligation to update publicly or revise any forward-looking statements and information, whether as a result of new information, future events or otherwise after the date of this document, except as required by law.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Non-GAAP Measures

The Company uses non-GAAP measures including source of earnings, annualized premium sales, assets under management, mutual fund gross and net sales and segregated fund gross and net sales to provide investors with supplemental measures of its operating performance and to highlight trends in its core business that may not otherwise be apparent when relying solely on IFRS financial measures. The Company also believes that securities analysts, investors and other interested parties frequently use non-GAAP measures in the evaluation of issuers. The Company's management also uses non-GAAP measures in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and to determine components of management compensation.

Sources of earnings breaks down Empire Life earnings into several categories which are useful to assess the performance of the business. These categories include expected profit from in-force business, impact of new business, experience gains and losses, management actions and changes in assumptions, and earnings on surplus. The sources of earnings components are reconciled to net income, see Overview section earlier in this report.

Annualized premium sales is used as a method of measuring sales volume. It is equal to the premium expected to be received in the first twelve months for all new individual insurance and employee benefit policies sold during the period. Mutual fund gross and net sales and segregated fund gross and net sales are also used as measures of sales volume. Empire Life believes that these measures provide information useful to its shareholders and policyholders in evaluating Empire Life's underlying financial results.

Assets under management is a non-GAAP measure of the assets managed by Empire Life, which includes general fund assets, mutual fund assets and segregated fund assets. They represent the total assets of Empire Life and the assets its customers invest in. Empire Life believes that these measures provide information useful to its shareholders and policyholders in evaluating Empire Life's underlying financial results.

The following table provides a reconciliation of assets under management to total assets in Empire Life's financial statements.

Reconciliation of Assets Under Management

(in millions of dollars)	As at December 31	
	2016	2015
Assets under management		
General fund assets	\$ 7,780	\$ 6,996
Segregated fund assets	8,082	7,368
Total assets per financial statements	15,862	14,364
Mutual fund assets	189	171
Assets under management	\$ 16,051	\$ 14,535

The above table includes the following amounts held by Empire Life's DB plans.

(in millions of dollars)	As at December 31	
	2016	2015
DB Plan Assets		
Segregated fund assets	\$ 195	\$ 183
Mutual fund assets	13	11

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated 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. The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and the accounting requirements of the Office of the Superintendent of Financial Institutions, Canada (OSFI).

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 consolidated financial statements in accordance with (IFRS). 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, 2016. Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2016.

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 consolidated 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 consolidated statement of financial position 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.

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



Mark Sylvia

President and Chief Executive Officer
Kingston, Ontario
February 24, 2017



Ron Friesen

Senior Vice-President and Chief Financial Officer
Kingston, Ontario
February 24, 2017

INDEPENDENT AUDITOR'S REPORT

To the Policyholders and Shareholders of The Empire Life Insurance Company

We have audited the accompanying consolidated financial statements of The Empire Life Insurance Company and its subsidiary, which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015 and the consolidated statements of operations, comprehensive income, changes in equity, and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on our audits. We conducted our audits 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of The Empire Life Insurance Company and its subsidiary as at December 31, 2016 and December 31, 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Ontario

February 24, 2017

APPOINTED ACTUARY'S REPORT

To the Policyholders and Shareholders of The Empire Life Insurance Company

I have valued the policy liabilities and reinsurance liabilities of The Empire Life Insurance Company for its Consolidated statements of financial position at December 31, 2016 and their change in the Consolidated statements of operations for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods.

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



Leonard Pressey, F.S.A., F.C.I.A.

Fellow, Canadian Institute of Actuaries

Kingston, Ontario

February 24, 2017

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands of Canadian dollars)

As at December 31	2016	2015
Assets		
Cash and cash equivalents (Note 3)	\$ 368,873	\$ 199,770
Investments		
Short-term investments (Note 3)	102,874	33,652
Bonds (Note 3)	5,521,172	5,193,439
Preferred shares (Note 3)	285,184	194,680
Common shares (Note 3)	929,611	801,778
Derivative assets (Note 3)	3,855	14,649
Mortgages (Note 3)	264,309	289,221
Loans on policies (Note 3)	47,969	46,925
Policy contract loans (Note 3)	80,944	84,921
Total cash and cash equivalents and investments	7,604,791	6,859,035
Accrued investment income	40,551	26,023
Insurance receivables (Note 4)	53,097	47,909
Current income taxes	—	3,361
Other assets (Note 5)	39,680	26,257
Property and equipment (Note 6)	27,683	23,911
Intangible assets (Note 7)	14,341	9,225
Segregated fund assets (Note 8)	8,082,033	7,367,823
Total assets	\$ 15,862,176	\$ 14,363,544
Liabilities		
Accounts payable and other liabilities (Note 11)	\$ 79,600	\$ 59,145
Insurance payables (Note 9)	97,135	77,337
Current income taxes payable	32,536	—
Reinsurance liabilities (Note 10)	533,357	530,826
Insurance contract liabilities (Note 10)	5,003,450	4,798,683
Investment contract liabilities	13,903	11,241
Policyholders' funds on deposit	32,957	32,599
Provision for profits to policyholders	29,555	26,951
Deferred income taxes (Note 18)	8,989	7,910
Subordinated debt (Note 13)	498,603	299,112
Segregated fund policy liabilities	8,082,033	7,367,823
Total liabilities	14,412,118	13,211,627
Equity		
Preferred shares (Note 20)	149,500	—
Common shares (Note 20)	985	985
Contributed surplus	19,387	19,387
Retained earnings	1,267,049	1,121,542
Accumulated other comprehensive income	13,137	10,003
Total equity	1,450,058	1,151,917
Total liabilities and equity	\$ 15,862,176	\$ 14,363,544



Duncan N. R. Jackman
Chairman of the Board



Mark Sylvia
President and Chief Executive Officer

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands of Canadian dollars except per share amounts and shares authorized and outstanding)

For the year ended December 31	2016	2015
Revenue		
Gross premiums (Note 14)	\$ 1,002,252	\$ 947,037
Premiums ceded to reinsurers (Note 14)	(120,752)	(111,821)
Net premiums (Note 14)	881,500	835,216
Investment income (Note 3)	254,913	259,210
Fair value change in fair value through profit or loss assets	11,873	(85,677)
Realized gain (loss) on fair value through profit or loss assets sold	20,114	42,233
Realized gain (loss) on available for sale assets including impairment write downs (Note 3)	11,739	19,128
Fee income (Note 15)	228,369	216,818
Total revenue	1,408,508	1,286,928
Benefits and expenses		
Gross benefits and claims paid (Note 16)	665,420	727,319
Claims recovery from reinsurers (Note 16)	(72,670)	(84,988)
Gross change in insurance contract liabilities (Note 16)	204,767	85,221
Change in insurance contract liabilities ceded (Note 16)	2,531	40,251
Change in investment contracts provision	40	426
Policy dividends	28,564	25,991
Operating expenses (Note 17)	145,004	147,165
Commissions	197,651	190,769
Commission recovery from reinsurers	(2,492)	(2,361)
Interest expense	9,297	8,959
Total benefits and expenses	1,178,112	1,138,752
Premium tax	19,529	14,226
Investment and capital tax	3,996	4,000
Net income before income taxes	206,871	129,950
Income taxes (Note 18)	49,705	27,492
Net income	\$ 157,166	\$ 102,458
Less: net income (loss) attributable to participating policyholders	(3,439)	(6,119)
Shareholders' net income (loss)	160,605	108,577
Less: preferred share dividends declared (Note 21)	7,884	—
Common shareholders' net income	\$ 152,721	\$ 108,577
Earnings per share - basic and diluted (Note 19)	\$ 155.03	\$ 110.22
(2,000,000 shares authorized; 985,076 shares outstanding)		

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands of Canadian dollars)

For the year ended December 31	2016	2015
Net income	\$ 157,166	\$ 102,458
Other comprehensive income (loss), net of income taxes:		
Items that may be reclassified subsequently to net income:		
Unrealized fair value change on available for sale investments (Note 18)	6,287	4,118
Fair value change on available for sale investments reclassified to net income, including impairment write downs (Note 18)	(8,553)	(13,922)
Net unrealized fair value increase (decrease)	(2,266)	(9,804)
Items that will not be reclassified to net income:		
Remeasurements of post-employment benefit liabilities (Note 18)	5,400	(3,016)
Total other comprehensive income (loss)	3,134	(12,820)
Comprehensive income (loss)	\$ 160,300	\$ 89,638
Comprehensive income (loss) attributable to:		
Participating policyholders	\$ (1,710)	\$ (7,203)
Shareholders	162,010	96,841
Total	\$ 160,300	\$ 89,638

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(in thousands of Canadian dollars)

For the year ended December 31	2016			2015		
	Shareholders'	Policyholders'	Total	Shareholders'	Policyholders'	Total
Preferred shares (Note 20)	\$ 149,500	\$ —	\$ 149,500	\$ —	\$ —	\$ —
Common shares (Note 20)	985	—	985	985	—	985
Contributed surplus	19,387	—	19,387	19,387	—	19,387
Retained earnings						
Retained earnings - beginning of year	1,075,120	46,422	1,121,542	966,543	52,541	1,019,084
Net income (loss)	160,605	(3,439)	157,166	108,577	(6,119)	102,458
Preferred share dividends declared	(7,884)	—	(7,884)	—	—	—
Preferred share issue costs net of income tax (Note 20)	(3,775)	—	(3,775)	—	—	—
Common share dividends declared	—	—	—	—	—	—
Retained earnings - end of period	1,224,066	42,983	1,267,049	1,075,120	46,422	1,121,542
Accumulated other comprehensive income (loss)						
Accumulated other comprehensive income (loss) - beginning of year	3,588	6,415	10,003	15,324	7,499	22,823
Other comprehensive income (loss)	1,405	1,729	3,134	(11,736)	(1,084)	(12,820)
Accumulated other comprehensive income (loss) - end of period	4,993	8,144	13,137	3,588	6,415	10,003
Total equity	\$ 1,398,931	\$ 51,127	\$ 1,450,058	\$ 1,099,080	\$ 52,837	\$ 1,151,917
Composition of accumulated other comprehensive income (loss) - end of period						
Unrealized gain (loss) on available for sale financial assets	\$ 11,287	\$ 9,239	\$ 20,526	\$ 15,148	\$ 7,644	\$ 22,792
Remeasurements of post-employment benefit liabilities	(7,014)	(375)	(7,389)	(12,163)	(626)	(12,789)
Shareholder portion of policyholders' accumulated other comprehensive income	720	(720)	—	603	(603)	—
Total accumulated other comprehensive income (loss)	\$ 4,993	\$ 8,144	\$ 13,137	\$ 3,588	\$ 6,415	\$ 10,003

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of Canadian dollars)

For the year ended December 31	2016	2015
Operating activities		
Net income	\$ 157,166	\$ 102,458
Non-cash items affecting net income:		
Change in contract liabilities	204,807	85,647
Change in reinsurance liability	2,531	40,251
Fair value change in fair value through profit or loss assets	(11,873)	85,677
Realized (gain) loss on assets including impairment write downs on available for sale assets	(31,853)	(61,361)
Amortization related to discount on debt instruments	(77,215)	(73,515)
Amortization related to property and equipment and intangible assets (Notes 6 & 7)	5,065	4,369
Deferred income taxes (Note 18)	(639)	761
Other items	44,273	(35,723)
Cash provided from (used for) operating activities	292,262	148,564
Investing activities		
Portfolio investments		
Purchases and advances	(2,319,608)	(2,081,180)
Sales and maturities	1,946,146	1,918,878
Loans on policies		
Advances	(8,177)	(7,333)
Repayments	11,151	8,657
(Increase) decrease in short-term investments	(69,222)	(6,760)
Purchase of property and equipment and intangible assets (Notes 6 & 7)	(13,953)	(11,548)
Cash provided from (used for) investing activities	(453,663)	(179,286)
Financing activities		
Dividends paid to preferred shareholders (Note 21)	(5,735)	—
Interest paid on subordinated debt	(8,610)	(8,610)
Preferred share issue (Note 20)	149,500	—
Preferred share issue costs net of income tax (Note 20)	(3,775)	—
Debt Issue (Note 13)	199,124	—
Cash provided from (used for) financing activities	330,504	(8,610)
Net change in cash and cash equivalents	169,103	(39,332)
Cash and cash equivalents - beginning of period (Note 3)	199,770	239,102
Cash and cash equivalents - end of period (Note 3)	\$ 368,873	\$ 199,770
Supplementary cash flow information related to operating activities:		
Income taxes paid, net of (refunds)	\$ 12,370	\$ 34,185
Interest income received	139,405	149,988
Dividend income received	35,150	37,764

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

1. Description of Company and Summary of Operations

The Empire Life Insurance Company (the "Company" or "Empire Life") was founded in 1923 when it was organized under a provincial charter in Toronto. Authorization to continue as a federal corporation was obtained in 1987. The Company underwrites life and health insurance policies and provides segregated funds, mutual funds and annuity products for individuals and groups across Canada. The Company is a subsidiary of E-L Financial Corporation Limited (the "Parent" or "E-L"). The head office, principal address and registered office of the Company are located at 259 King Street East, Kingston, Ontario, K7L 3A8. Empire Life is a Federally Regulated Financial Institution, regulated by the Office of the Superintendent of Financial Institutions, Canada (OSFI). Empire Life became a public company on August 5, 2015 and registered as a public issuer with the Ontario Securities Commission. The Company established a mutual fund subsidiary in 2011, Empire Life Investments Inc. (ELII). ELII became a registered Investment Funds Manager on January 5, 2012. The head office for ELII is located at 165 University Avenue, 9th Floor, Toronto, Ontario, M5H 3B8.

These consolidated financial statements were approved by the Company's Board of Directors (the Board) on February 24, 2017.

2. Significant Accounting Policies

(a) Basis of preparation

The annual Consolidated Financial Statements of the Company for the year ended December 31, 2016 have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

These Consolidated Financial Statements have been prepared on a fair value measurement basis, with the exception of certain assets and liabilities. Insurance contract liabilities and Reinsurance assets/liabilities are measured on a discounted basis in accordance with accepted actuarial practice. Investment contract liabilities, Mortgages, Policy contract loans and Loans on policies are carried at amortized cost. Certain other assets and liabilities are measured on a historical cost basis, as explained throughout this note. All amounts included in the Consolidated Financial Statements are presented in thousands of Canadian dollars except for per share amounts and where otherwise stated. These Consolidated Financial Statements also comply with the accounting requirements of OSFI, none of which are an exception to IFRS.

(b) Basis of consolidation

The Company's Consolidated Financial Statements include the assets, liabilities, results of operations and cash flows of the Company and its wholly-owned and controlled subsidiary, ELII. The Company owns 100% of the voting shares and maintains control of its subsidiary. The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date that control ceases. The financial statements of ELII are prepared for the same reporting period as the Company, using consistent accounting policies. All significant inter-company transactions, balances, income and expenses are eliminated in full on consolidation.

(c) Critical accounting estimates and judgements

The preparation of the Consolidated Financial Statements, in accordance with IFRS, requires management to make judgements and estimates and form assumptions that affect the reported amounts of assets and liabilities as at the date of the Consolidated Financial Statements, and the reported amounts of revenue and expenses during the year. On an ongoing basis, management evaluates its judgements, estimates and critical assumptions in relation to assets, liabilities, revenues and expenses. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The Company considers the following items to be particularly susceptible to changes in estimates and judgements:

(i) Insurance-related liabilities

Liabilities for insurance contracts are determined using the Canadian Asset Liability Method (CALM), which incorporates best-estimate assumptions for mortality, morbidity, policy lapses, surrenders, future investment yields, policy dividends, administration costs and margins for adverse deviation. These assumptions are reviewed at least annually and are updated to reflect actual experience and market conditions. Changes in the assumptions and margins for adverse deviation can have a significant impact on the valuation of insurance related liabilities.

Additional information regarding insurance-related liabilities is included in Notes 2(e), 2(k), 10 and 28.

(ii) Financial instruments classification

Management judgement is used to classify financial instruments as fair value through profit or loss (FVTPL), available for sale (AFS) or loans and receivables. Most financial assets supporting insurance contract liabilities and investment contract liabilities are designated as FVTPL. Most financial assets supporting capital and surplus and participating accounts are classified as AFS. Loans and receivables support both contract liabilities and capital and surplus. The designation of a financial instrument as FVTPL or AFS dictates whether unrealized fair value changes are reported in Net income or Other comprehensive income (OCI).

Additional information regarding financial instrument classification is included in Notes 2(d), 3(a), 3(b) and 10(c).

(iii) Pension and other post-employment benefits

Pension and other employee future benefits expense is calculated by independent actuaries using assumptions determined by management. The assumptions made affect the pension and other employee future benefits expense included in Net income. If actual experience differs from the assumptions used, the resulting experience gain or loss is recorded in OCI.

Additional information regarding pension and other post-employment benefits is included in Notes 2(j) and 12.

(iv) Impairment

AFS securities and loans and receivables are reviewed at each quarter-end reporting period to identify and evaluate investments that show indications of possible impairment. For AFS securities and loans and receivables, impairment losses are recognized if there is objective evidence of impairment as a result of an event that reduces the estimated future cash flows of the instrument and the impact can be reliably estimated. Objective evidence of impairment includes, but is not limited to, bankruptcy or default, delinquency by a debtor, and specific adverse conditions affecting an industry or a region. In addition, for equity securities, a significant or prolonged decline in the fair value of a security below its cost is objective evidence of impairment. For these purposes management considers a significant decline to be 20% or greater and a prolonged period to be 12 months or greater. The decision to record a write-down, its amount and the period in which it is recorded could change if management's assessment of those factors were different. Impairment write-downs on debt securities are not recorded when impairment is due to changes in market interest rates, if future contractual cash flows associated with the debt security are still expected to be recovered.

Additional information regarding impairment is included in Notes 2(d), 3(b), 10(c) and 28(c).

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(d) Financial instruments

(i) Fair value

Fair value 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 or liability quoted in an active market is generally the closing price. For financial instruments such as cash equivalents and short-term investments that have a short duration, the carrying value of these instruments approximates fair value.

Fair value measurements used in these Consolidated Financial Statements have been classified by using a fair value hierarchy based upon the transparency of the inputs used in making the measurements. The three levels of the hierarchy are:

Level 1 - Fair value is based on unadjusted quoted prices for identical assets or liabilities in an active market. The types of financial instruments classified as level 1 generally include cash and exchange traded common and preferred shares and derivatives.

Level 2 - Fair value is based on quoted prices for similar assets or liabilities in active markets, valuation that is based on significant observable inputs, or inputs that are derived principally from or corroborated with observable market data through correlation or other means. The types of financial instruments classified as level 2 generally include cash equivalents, government bonds, certain corporate and private bonds, short-term investments, certain common shares (real estate limited partnership units) and over the counter derivatives.

Level 3 - Fair value is based on valuation techniques that require one or more significant inputs that are not based on observable market inputs. These unobservable inputs reflect the Company's expectations about the assumptions market participants would use in pricing the asset or liability.

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

(ii) Cash and cash equivalents and investments

Cash and cash equivalents are short-term, highly liquid investments that are subject to insignificant changes in value and are readily convertible into known amounts of cash. Cash equivalents comprise financial assets with maturities of three months or less from the date of acquisition.

Short-term investments comprise financial assets with maturities of greater than three months and less than one year when acquired.

Most financial assets supporting insurance contract liabilities and investment contract liabilities are designated as FVTPL. These assets may be comprised of cash and cash equivalents, 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 FVTPL assets in the Consolidated Statements of Operations in the period in which they occur.

Most financial assets supporting capital and surplus and participating accounts are classified as AFS. These assets may be comprised of short-term investments, bonds and debentures or common and preferred shares. AFS assets are carried at fair value in the Consolidated Statements of Financial Position. Except for foreign currency gains/losses on monetary AFS assets and impairment losses, any changes in the fair value are recorded, net of income taxes, in OCI. Gains and losses realized on sale or maturity of AFS assets are reclassified from OCI to Realized gain (loss) on AFS assets in the Consolidated Statements of Operations.

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Loans and receivables may include mortgage loans, loans on policies and policy contract loans. These assets are recorded at amortized cost, using the effective interest rate method, net of provisions for impairment losses, if any. Mortgage loans are secured by real estate. Loans on policies and policy contract loans are secured by policy values. Loans and receivables are defined as non-derivative financial assets with fixed or determinable payments that are not quoted in active markets.

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

(iii) Derivative financial instruments

The Company uses derivative financial instruments to manage exposure to foreign currency, equity and other market risks associated with certain assets and liabilities. Derivative financial assets and liabilities are classified as FVTPL. Therefore, they are initially recorded at fair value on the acquisition date and subsequently revalued at their fair value as at each reporting date. Derivative financial instruments with a positive fair value are disclosed as derivative assets while derivative financial instruments with a negative fair value are disclosed as other liabilities. Changes in fair value are recorded, in Fair value change in FVTPL assets, in the Consolidated Statements of Operations.

(iv) Impairment

All investments other than FVTPL instruments are assessed for impairment at each reporting date. Impairment is recognized in net income (loss), when there is objective evidence that a loss event has occurred which has impaired the estimated future cash flows of an asset.

(1) AFS debt instruments

An AFS debt instrument would be identified as impaired when there is objective evidence suggesting that timely collection of the contractual principal or interest is no longer reasonably assured. This may result from a breach of contract by the issuer, such as a default or delinquency in interest or principal payments, or evidence that the issuer is in significant financial difficulty. Impairment is recognized through Net income (loss). Impairment losses previously recorded through Net income (loss) are reversed if the fair value subsequently increases and the increases can be objectively related to an event occurring after the impairment loss was recognized.

(2) 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 or if there is a significant adverse change in the technological, market, economic or legal environment in which the issuer operates or the issuer is experiencing financial difficulties.

The accounting for an impairment that is recognized in Net income (loss) is the same as described for AFS debt instruments above with the exception that impairment losses previously recognized in net income (loss) cannot be subsequently reversed through Net income (loss). Any subsequent increase in value is recorded in OCI.

(3) Loans and receivables

Mortgages and loans are individually evaluated for impairment in establishing the allowance for impairment.

Objective evidence of impairment exists if there is no longer reasonable assurance of full collection of loan principal or loan interest related to a mortgage, policy contract loan or a loan on a policy. Events and conditions considered in determining if there is objective evidence of impairment include the value of the security underlying the loan, geographic location, industry classification of the borrower, an assessment of the financial stability and credit worthiness of the borrower, repayment history and an assessment of the impact of current economic conditions. If objective evidence of impairment is found, allowances for credit losses are established to adjust the carrying value of these assets to their net recoverable amount and the impairment loss is

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recorded in Net income (loss). If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment was recognized, the impairment loss is reversed by adjusting the allowance account and the reversal is recognized in Net income (loss).

(v) **Derecognition**

A financial asset is derecognized when the contractual rights to its cash flows expire or the Company has transferred its economic rights to the asset and substantially all risks and rewards. In instances where substantially all risks and rewards have not been transferred or retained, the assets are derecognized if the asset is not controlled through rights to sell or pledge the asset.

(vi) **Other**

Insurance receivables and trade accounts receivables have been classified as loans or receivables and are carried at amortized cost. Trade accounts receivables are presented as Other assets. Accounts payable and other liabilities (excluding derivative liabilities) and Insurance payables have been classified as other financial liabilities and are carried at amortized cost. For these financial instruments, carrying value approximates fair value due to their short term nature.

(e) Reinsurance

The Company enters into reinsurance agreements with reinsurers in order to limit its exposure to significant losses. The Company has a Reinsurance Risk Management policy which requires that such arrangements be placed with well-established, highly rated reinsurers. Reinsurance is measured consistently with the amounts associated with the underlying insurance contracts and in accordance with the terms of each reinsurance treaty. Amounts due to or from reinsurers with respect to premiums received or claims paid are included in Insurance receivables and Insurance liabilities in the Consolidated Statement of Financial Position. Premiums for reinsurance ceded are presented as Premiums ceded to reinsurers in the Consolidated Statements of Operations. Reinsurance recoveries on claims incurred are recorded as Claims recovery from reinsurers in the Consolidated Statements of Operations. The reinsurers' share of Insurance contract liabilities is recorded as Reinsurance assets or Reinsurance liabilities in the Consolidated Statements of Financial Position at the same time as the underlying insurance contract liability to which it relates.

Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when objective evidence exists that not all amounts due under the terms of the contract will be received. If a reinsurance asset is determined to be impaired, it would be written down to its recoverable amount and the impairment loss would be recorded in the Consolidated Statements of Operations.

Gains or losses on buying reinsurance are recognized in the Consolidated Statements of Operations immediately at the date of purchase and are not amortized.

(f) Property and equipment

Property and equipment comprises own use land, buildings, leasehold improvements and furniture and equipment. All classes of assets are carried at cost less accumulated amortization including any impairment losses, except for land, which is not subject to amortization. Cost includes all expenditures that are directly attributable to the acquisition of an asset. Subsequent costs are included in the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably.

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Amortization is calculated to write down the cost of property and equipment to their residual values over their estimated useful lives as follows:

Land	No amortization
Building	Five percent (declining balance)
Furniture and equipment	Three to five years (straight-line)
Leasehold improvements	Remaining lease term (straight-line)

Amortization is included in Operating expenses in the Consolidated Statements of Operations.

The estimated useful lives, residual values and amortization methods are reviewed at each year-end, with the effect of any changes in estimate accounted for on a prospective basis. Impairment reviews are performed when there are indicators that the carrying value may not be recoverable. An impairment loss is recognized for the amount by which the carrying value of the asset exceeds its expected recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. Impairment losses are recognized in the Consolidated Statements of Operations.

(g) Intangible assets

Intangible assets include computer software, related licenses and software development costs, which are carried at cost less accumulated amortization and any impairment losses. Amortization of intangible assets is calculated using the straight-line method to allocate the costs over their estimated useful lives, which are generally between three and seven years. Amortization is included in Operating expenses in the Consolidated Statements of Operations. For intangible assets under development, amortization begins when the asset is available for use. The Company does not have intangible assets with indefinite useful lives.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates.

Impairment reviews are performed when there are indicators that the carrying value may not be recoverable. An impairment loss is recognized for the amount by which the carrying value of the asset exceeds its expected recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. Impairment losses are recognized in the Consolidated Statements of Operations.

(h) Segregated funds

Certain insurance contracts allow the policyholder to invest in segregated investment funds managed by the Company for the benefit of these policyholders. Although the underlying assets are registered in the Company's name and the policyholder has no direct access to the specific assets, the contractual arrangements are such that the segregated fund policyholder bears the risk and rewards of the fund's investment performance. Segregated fund assets are not available to pay liabilities of the general fund. The assets of these funds are carried at their period-end fair values. The Company records a segregated fund policy liability equal to the fair value of the assets and any guarantees are recorded as an insurance contract liability. The Company's Consolidated Statements of Operations includes fee income earned for management of the segregated funds, as well as expenses related to the acquisition, investment management, administration and death benefit, maturity benefit and withdrawal guarantees of these funds. See Note 8 for details on segregated fund assets and changes in segregated fund assets.

The Company provides minimum guarantees on certain segregated fund contracts. These include minimum death, maturity and withdrawal benefit guarantees which are accounted for as insurance contracts. The actuarial liabilities associated with these minimum guarantees are recorded within Insurance contract liabilities. Sensitivity of the Company's liability for segregated fund guarantees to market fluctuations is disclosed in Note 28(a)(1).

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(i) Subordinated debt

Subordinated debt is recorded at amortized cost using the effective interest rate method. Interest on subordinated debt is reported as Interest expense in the Consolidated Statements of Operations.

(j) Employee benefits

The Company provides employee pension benefits through either a defined benefit or a defined contribution component of its pension plan. The Company discontinued new enrolments in the defined benefit component effective October 1, 2011 and introduced a defined contribution component effective January 1, 2012 for new enrolments and for any existing employees who chose to transfer from the defined benefit component. The Company also provides other post-employment benefits.

(i) Pension benefits

The defined benefit plan defines an amount of pension benefit that an employee will receive on retirement, dependent on factors such as age, years of service and compensation. The liability recognized in the balance sheet in respect of the defined benefit component is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent qualified actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using current interest rates of high-quality corporate bonds.

Defined benefit expense includes the net interest on the net defined benefit liability (asset) calculated using a discount rate based on market yields on high quality bonds as of prior-year end. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to OCI in the period in which they arise, and remain in accumulated other comprehensive income (AOCI). Past-service costs are recognized immediately in net income.

The defined contribution component of the Plan is a component under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay employees the benefits relating to employee service in the current and prior periods. The contributions are recognized as employee benefit expense when they are due.

(ii) Other post-employment benefits

The Company also provides other post-employment benefits to their retirees. The entitlement to these benefits is conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using the same accounting methodology as used for defined benefit pension plans. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to OCI in the period in which they arise and remain in AOCI. These obligations are valued annually by independent qualified actuaries and are not funded.

(iii) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without realistic possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

(k) Insurance and investment contracts

(i) Product classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the Company agrees to compensate a policyholder if a specified uncertain future event (other than a change in a financial variable) adversely affects the policyholder and the insurance contract has commercial substance. Any contracts not meeting the

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definition of an insurance contract under IFRS are classified as investment contracts or service contracts, as appropriate. Products issued by the Company that transfer significant insurance risk have been classified as insurance contracts in accordance with IFRS 4 *Insurance Contracts*. Otherwise, products issued by the Company are classified as either investment contracts in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* or service contracts in accordance with IAS 18 *Revenue*. The Company defines significant insurance risk as the possibility of paying at least 2% more than the benefits payable if the insured event did not occur. When referring to multiple contract types, the Company uses the terminology policy liabilities.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts, however, can be reclassified as insurance contracts after inception if insurance risk becomes significant.

The Company classifies its insurance and investment contracts into three main categories: short-term insurance contracts, long-term insurance contracts and investment contracts.

(1) Insurance contracts

The Company's insurance contract liabilities are determined using accepted actuarial practices according to standards established by the Canadian Institute of Actuaries (CIA) and the requirements of OSFI. The Company uses CALM for valuation of insurance contracts, which satisfies the IFRS 4 *Insurance Contracts* requirements for eligibility for use under IFRS.

(a) Short-term insurance contracts

These contracts include both annuity products and group benefits.

The annuity products classified as short-term insurance contracts are guaranteed investment options that provide for a fixed rate of return over a fixed period. Contracts include certain guarantees that are initiated upon death of the annuitant. The liabilities are determined using CALM.

The group benefits classified as short-term insurance contracts include short-term disability, health and dental benefits. Benefits are typically paid within one year of being incurred. Liabilities for unpaid claims are estimated using statistical analysis and Company experience for claims incurred but not reported.

(b) Long-term insurance contracts

These contracts include insurance products, annuity products and group benefits. In all cases, liabilities represent an estimate of the amount that, together with estimated future premiums and investment income, will be sufficient to pay future benefits, dividends, expenses and taxes on policies in force.

The insurance products so classified are life insurance and critical illness that provide for benefit payments related to death, survival or the occurrence of a critical illness. Terms extend over a long duration. The annuity products classified as long-term insurance contracts include both annuities that provide for income payments for the life of the annuitant and guarantees associated with the Company's segregated fund products. The group benefits classified as long-term insurance contracts are life benefits which are payable upon death of the insured and disability benefits that provide for income replacement in case of disability.

The determination of long-term insurance contract liabilities requires best estimate assumptions that cover the remaining life of the policies for mortality, morbidity, investment returns, persistency, expenses, inflation and taxes. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviation from best estimates is included in each assumption. These margins allow for

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possible deterioration in future experience and provide for greater confidence that insurance contract liabilities are adequate to pay future benefits. The resulting provisions for adverse deviation have the effect of increasing insurance contract liabilities and decreasing the income that otherwise would have been recognized at policy inception. Assumptions are reviewed and updated at least annually and the impact of changes in those assumptions is reflected in Change in insurance contract liabilities in the Consolidated Statements of Operations in the year of the change.

Annually, the Appointed Actuary determines whether insurance contract liabilities (for both short-term and long-term categories) are sufficient to cover the obligations and deferred acquisition costs that relate to policies in force as at the date of the Consolidated Statements of Financial Position. A number of valuation methods are applied, including CALM, discounted cash flows and stochastic modeling. Aggregation levels and the level of prudence applied in assessing liability adequacy are consistent with requirements of the CIA. Any adjustment is recorded as a Gross change in insurance contract liabilities and/or Change in insurance contract liabilities ceded in the Consolidated Statements of Operations.

(2) Investment contracts

These contracts include annuity products that do not involve the transfer of significant insurance risk, either at inception or during the life of the contract. For the Company, products so classified are limited to term certain annuities that provide for income payments for a specified period of time.

Investment contract liabilities are recognized when contracts are entered into and deposits are received. These liabilities are initially recognized at fair value, and subsequently they are carried at amortized cost based on expected future cash flows using the effective interest rate method. The expected future cash flows are re-estimated at each reporting date and the carrying amount of the financial liability is recalculated as the present value of estimated future cash flows using the financial liability's original effective interest rate. Any adjustment is immediately recognized in the Consolidated Statements of Operations. Deposits and withdrawals are recorded in Investment contract liabilities on the Consolidated Statements of Financial Position.

(ii) Premiums

Gross premiums for all types of insurance contracts are recognized as revenue when due and collection is reasonably assured. When premiums are recognized, actuarial liabilities are computed, with the result that benefits and expenses are matched with such revenue. Annuity premiums are comprised solely of new deposits on general fund products with a guaranteed rate of return and exclude deposits on segregated fund and investment contract products.

(iii) Benefits and claims paid

Benefits are recorded as an expense when they are incurred. Annuity payments are expensed when due for payment. Health insurance claims are accounted for when there is sufficient evidence of their existence and a reasonable assessment can be made of the monetary amount involved. Benefits and claims paid include the direct costs of settlement. Reinsurance recoveries are accounted for in the same period as the related claim.

(iv) Deferred 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 charge, as appropriate. These deferred costs form part of Insurance contract liabilities on the Consolidated Statements of Financial Position. The costs deferred in the period and amortization of deferred costs form part of the Gross change in insurance contract liabilities on the Consolidated Statements of Operations.

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(I) Participating policies

The Company maintains an account in respect of participating policies (“participating account”), separate from those maintained in respect of other policies, in the form and manner determined by OSFI under sections 456-464 of the *Insurance Companies Act*. The participating account includes all policies issued by the Company that entitle its policyholders to participate in the profits of the participating account. The Company has discretion as to the amount and timing of dividend payments which take into consideration the continuing solvency of the participating account. Dividends are paid annually, with a few older plans paying dividends every five years as per contractual provisions. Participating policyholder dividends are recognized as Policy dividends expense in the Consolidated Statements of Operations.

At the end of the reporting period all participating insurance contract liabilities, both guaranteed and discretionary, are held within Insurance contract liabilities, Policyholders’ funds on deposit and Provision for profits to policyholders. All participating policy reinsurance ceded at the end of the reporting period is held within Reinsurance assets or Reinsurance liabilities. Net income (loss) attributable to participating policyholders is shown on the Consolidated Statements of Operations. Comprehensive income (loss) attributable to participating policyholders is shown on the Consolidated Statements of Comprehensive Income. The participating policyholders’ portion of Retained earnings and Accumulated other comprehensive income (AOCI) is reported separately in the Policyholders’ equity section of the Consolidated Statements of Changes in Equity. Supplementary participating policyholder information is reported in Note 23.

(i) Investment policy

The investments in the participating account are subject to limits established by the *Insurance Companies Act* and to investment guidelines established by the Investment Committee of the Board. The investment guidelines are designed to limit overall investment risk by defining investment objectives, eligible investments, diversification criteria, exposure, concentration and asset quality limits for eligible investments. Interest rate risk is managed through Investment Committee established limits and regular reporting by management to the Investment Committee and the Board. The Asset 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.

(ii) Investment income allocation

Investment income is recorded directly to each asset segment. When there is a deficiency of funds over assets, a portion of investment income is allocated to the Shareholders’ Capital and Surplus segment from the participating account’s asset segments in proportion to the deficiency of funds over assets of each segment. When there is an excess of funds over assets, a portion of investment income is allocated from the Shareholders’ Capital and Surplus segment to the participating account’s asset segments in proportion to the excess of funds over assets of each segment.

(iii) Expense allocation

For purposes of allocation of profits to the participating account, expenses associated directly with the participating account will be attributed to the participating account. Expenses arising from or varying directly with various functional activities are charged to the participating account in proportion to statistics appropriate to each cost centre. Expenses incurred by overhead cost centres are charged to the participating account in proportion to expenses directly charged. Investment expenses are allocated monthly to the participating account in proportion to the Company’s total funds at the beginning of each month. Premium taxes are allocated in proportion to taxable premiums. Other taxes, licenses, and fees are allocated to lines of business using cost centre methods.

(iv) Income tax allocation

For the purpose of allocation of profits to the participating account, income taxes are allocated to the participating account in proportion to total taxable income for the Company.

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(m) Fee income

Fee income includes investment management, policy administration and guarantee fees that are recognized on an accrual basis, and surrender charges that are recognized as incurred. Fee income earned for investment management, administration and guarantees of the investment funds is based on the funds' closing net asset values.

(n) Investment income

Interest income is recognized using the effective interest rate method. Fees that are an integral part of the effective yield of the financial asset are recognized as an adjustment to the effective interest rate of the instrument.

Dividend income is recognized when the right to receive payment is established, which is usually the ex-dividend date.

Interest income and dividend income are included in Investment income in the Consolidated Statements of Operations for all financial assets.

(o) Income taxes

Income tax expense for the period is comprised of current and deferred tax. Tax is recognized in the Consolidated Statements of Operations except to the extent that it relates to items recognized in OCI or directly in equity. In these cases, the tax is recognized in OCI or directly in equity, respectively.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the end of each reporting period.

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

Deferred income tax assets are recognized only to the extent that, in the opinion of management, it is probable that the deferred income tax assets will be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates, on the date of their substantive enactment.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets and they relate to income taxes levied by the same tax authority on the same taxable entity.

(p) Foreign currency translation

The Company uses the Canadian dollar as both its functional and presentational currency.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognized in the Consolidated Statements of Operations.

For monetary financial assets designated as AFS, translation differences are recognized in the Consolidated Statements of Operations. Translation differences on non-monetary items, such as foreign denominated AFS common equities, are recognized in OCI and included in the AFS component within AOCI. On derecognition of an AFS non-monetary financial asset, the cumulative exchange gain or loss previously recognized in AOCI is recognized in the Consolidated Statements of Operations.

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(q) Comprehensive income

Comprehensive income consists of Net income and OCI. OCI includes items that may be reclassified subsequently to Net income: Unrealized fair value change on AFS investments, net of amounts reclassified to net income and the Amortization of loss on derivative investments designated as cash flow hedges. OCI also includes items that will not be reclassified to net income: Remeasurements of post-employment benefit liabilities. All OCI amounts are net of taxes.

(r) Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. If the outflow of economic benefits is not probable, a contingent liability is disclosed unless the possibility of an outflow of economic benefits is remote. Any change in estimate of a provision is recorded in Net income. Provisions are not recognized for future operating losses. Provisions are measured as the present value of the expected expenditures to settle the obligation using a discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

(s) Leases

The Company leases certain property and equipment. The Company does not have substantially all of the risks and rewards of ownership and these leases are therefore classified as operating leases. Payments made under operating leases are charged to Net income on a straight-line basis over the term of the lease.

(t) Earnings per share (EPS)

Basic EPS is calculated by dividing the Net income (loss) for the period attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. The Company does not have any potentially dilutive instruments. As a result, diluted EPS are the same as basic EPS.

(u) Accounting changes

(i) New accounting pronouncements adopted in 2016

(1) *Amendment to IAS 1 Presentation of financial statements ("IAS 1")*

The IASB has issued amendments to IAS 1, as part of its major initiative to improve presentation and disclosure in financial reports. The amendments clarify the guidance in IAS 1 on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies. Adoption of the amendment on January 1, 2016 did not have a significant impact on the consolidated financial statements.

(2) *IFRS Annual Improvements 2012-2014*

In September 2014, the IASB issued a limited number of amendments to clarify the requirements of four IFRS standards. Adoption of the 2012-2014 improvements on January 1, 2016 in accordance with their respective transition provisions did not have a significant impact on the consolidated financial statements.

(ii) New accounting pronouncements issued but not yet effective

(1) *IFRS 15 Revenue from Contracts with Customers*

In May 2014, the IASB published IFRS 15 which introduces a single model for recognizing revenue from contracts with customers. IFRS 15 excludes insurance contracts from its scope and is primarily applicable to the Company's non-insurance revenue. In April 2016, IASB issued amendments to IFRS 15 clarifying the guidance on identifying performance obligations, accounting for licences of intellectual property and the principal versus agent assessment, and to provide additional practical expedients on transition. The standard and the amendments are effective for annual periods beginning on or after January 1, 2018, with retrospective application. The Company is evaluating the impact of IFRS 15 on its consolidated financial statements.

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(2) *IFRS 9 Financial Instruments*

In July 2014, the IASB published the complete version of IFRS 9 which is effective for annual periods beginning on or after January 1, 2018, with retrospective application. The new standard includes requirements on the classification and measurement of financial assets and liabilities, an expected credit loss model that replaces the existing incurred loss impairment model and new hedge accounting guidance. The Company is currently evaluating the impact of IFRS 9 on its Consolidated Financial Statements as well as the implementation options for insurers set out in the September 2016 amendment to IFRS 4 Insurance Contracts which allows eligible insurers to defer the adoption of IFRS 9 until the new insurance contracts standard is adopted, or 2021 at the latest.

(3) *IFRS 16 Leases*

In January 2016, the IASB published IFRS 16 which is effective January 1, 2019. The new standard requires the capitalization of all leases by recognizing the present value of the lease payments and showing them as lease assets, and recognizing a financial liability representing an obligation to make future lease payments. The Company is evaluating the impact of IFRS 16 on its consolidated financial statements.

(4) *Amendments to IAS 12 Income Taxes ("IAS 12")*

In January 2016, the IASB issued amendments to clarify the requirements for recognizing deferred tax assets on unrealized losses. The amendments clarify the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. They also clarify certain other aspects of accounting for deferred tax assets. The amendments are effective from January 1, 2017. The Company is evaluating the impact of the amendments to IAS 12 on its consolidated financial statements.

(5) *Amendments to IAS 7 Statement of cash flows ("IAS 7")*

In January 2016, the IASB issued an amendment to IAS 7 introducing an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment is part of the IASB's Disclosure Initiative, which continues to explore how financial statement disclosure can be improved. The amendment is effective from January 1, 2017. The Company is evaluating the impact of the amendments to IAS 7 on its consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

3. Financial Instruments

(a) Summary of Cash and cash equivalents and investments

The carrying values of cash and cash equivalents and investments are as follows:

As at Asset category	December 31, 2016			December 31, 2015		
	Fair value through profit or loss	Available for sale	Total carrying value	Fair value through profit or loss	Available for sale	Total carrying value
Cash and cash equivalents						
Cash	\$ 14,278	\$ —	\$ 14,278	\$ 21,390	\$ —	\$ 21,390
Cash equivalents	354,595	—	354,595	178,380	—	178,380
Total cash and cash equivalents	368,873	—	368,873	199,770	—	199,770
Short-term investments						
Canadian federal government	4,983	69,883	74,866	4,781	4,996	9,777
Canadian provincial governments	—	—	—	5,994	—	5,994
Canadian municipal governments	3,963	—	3,963	—	—	—
Corporate	24,045	—	24,045	17,881	—	17,881
Total short-term investments	32,991	69,883	102,874	28,656	4,996	33,652
Bonds						
Canadian federal government	81,516	288,200	369,716	76,053	214,285	290,338
Canadian provincial governments	2,614,635	310,369	2,925,004	2,523,693	322,456	2,846,149
Canadian municipal governments	78,743	72,819	151,562	52,099	69,687	121,786
Total Canadian government bonds	2,774,894	671,388	3,446,282	2,651,845	606,428	3,258,273
Canadian corporate bonds by industry sector:						
Energy	50,679	43,649	94,328	40,999	53,352	94,351
Materials	10,716	—	10,716	10,789	—	10,789
Industrials	54,162	33,343	87,505	61,790	15,650	77,440
Consumer discretionary	17,037	27,028	44,065	17,190	23,925	41,115
Consumer staples	78,747	65,110	143,857	78,697	52,401	131,098
Health care	69,543	22,084	91,627	70,821	13,001	83,822
Financial services	504,027	343,255	847,282	475,027	386,044	861,071
Communications	45,101	28,148	73,249	1,484	24,444	25,928
Utilities	317,114	42,408	359,522	274,431	33,070	307,501
Real estate	6,726	—	6,726	—	—	—
Infrastructure	278,675	37,338	316,013	279,858	22,193	302,051
Total Canadian corporate bonds	1,432,527	642,363	2,074,890	1,311,086	624,080	1,935,166
Total bonds	4,207,421	1,313,751	5,521,172	3,962,931	1,230,508	5,193,439
Total preferred shares - Canadian	274,871	10,313	285,184	189,645	5,035	194,680
Common shares						
Canadian						
Common shares	582,582	66,969	649,551	505,534	61,831	567,365
Real estate limited partnership units	75,594	—	75,594	60,396	—	60,396
U.S.	181,600	—	181,600	154,482	—	154,482
Other	22,866	—	22,866	19,535	—	19,535
Total common shares	862,642	66,969	929,611	739,947	61,831	801,778
Total derivative assets	3,855	—	3,855	14,649	—	14,649

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(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

As at Asset category (continued)	December 31, 2016			December 31, 2015		
	Fair value through profit or loss	Available for sale	Total carrying value	Fair value through profit or loss	Available for sale	Total carrying value
Loans and receivables						
Mortgages	—	—	264,309	—	—	289,221
Loans on policies	—	—	47,969	—	—	46,925
Policy contract loans	—	—	80,944	—	—	84,921
Total financial instruments	\$ 5,750,653	\$ 1,460,916	\$ 7,604,791	\$ 5,135,598	\$ 1,302,370	\$ 6,859,035

The following table presents the fair value of cash and cash equivalents and investments classified by the fair value hierarchy:

As at	December 31, 2016			December 31, 2015		
	Level 1	Level 2	Total fair value	Level 1	Level 2	Total fair value
Fair value through profit or loss:						
Cash and cash equivalents	\$ 14,278	\$ 354,595	\$ 368,873	\$ 21,390	\$ 178,380	\$ 199,770
Short-term investments	—	32,991	32,991	—	28,656	28,656
Bonds	—	4,207,421	4,207,421	—	3,962,931	3,962,931
Preferred shares	274,871	—	274,871	189,645	—	189,645
Common shares	787,048	75,594	862,642	679,551	60,396	739,947
Derivative assets	3,265	590	3,855	14,482	167	14,649
Available for sale:						
Short-term investments	—	69,883	69,883	—	4,996	4,996
Bonds	—	1,313,751	1,313,751	—	1,230,508	1,230,508
Preferred shares	10,313	—	10,313	5,035	—	5,035
Common shares	66,969	—	66,969	61,831	—	61,831
Loans and Receivables						
Mortgages	—	269,171	269,171	—	300,186	300,186
Loans on policies	—	47,969	47,969	—	46,925	46,925
Policy contract loans	—	80,944	80,944	—	84,921	84,921
Total	\$ 1,156,744	\$ 6,452,909	\$ 7,609,653	\$ 971,934	\$ 5,898,066	\$ 6,870,000

The fair value of mortgages has been calculated by discounting cash flows of each mortgage at a discount rate appropriate to its remaining term to maturity. The discount rates are determined based on regular competitive rate surveys. The fair values of Loans on policies and Policy contract loans approximates their carrying values, due to the life insurance contracts that secure them.

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 and there were no Level 3 investments during the year ended December 31, 2016 or during the year ended December 31, 2015.

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 28 Risk Management.

(b) Impairments

(i) Loans and receivables

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

As at December 31	2016			2015		
	Recorded investment	Allowance for impairment	Carrying value	Recorded investment	Allowance for impairment	Carrying value
Impaired Loans						
Mortgages	\$ 6,649	\$ 3,152	\$ 3,497	\$ 5,963	\$ 2,600	\$ 3,363
Policy contract loans	813	502	311	813	525	288
Total	\$ 7,462	\$ 3,654	\$ 3,808	\$ 6,776	\$ 3,125	\$ 3,651

The Company holds collateral with a fair value of \$3,500 (2015 \$3,370) in respect of these mortgages and \$311 (2015 \$288) in respect of these policy contract loans as at December 31, 2016. Mortgage loans are secured by real estate, and policy contract loans are secured by life insurance.

Continuity of allowance for loan impairment:	2016	2015
Allowance - beginning of year	\$ 3,125	\$ 2,836
Provision for loan impairment	529	545
Write-off of loans	—	(256)
Allowance - end of year	\$ 3,654	\$ 3,125

The Company has recorded interest income of \$789 (2015 \$858) on these assets.

As at December 31, 2016 loans and receivables past due but not impaired are \$ nil (2015 \$ nil).

(ii) Available for sale

For the year-ended December 31, 2016, the Company reclassified a pre-tax loss of \$777 from OCI to Net income due to write downs of impaired AFS common and preferred shares (2015 \$2,379). Management considers these assets to be impaired due to the length of time that the fair value was less than the cost and/or the extent and nature of the loss.

For additional information on the fair values of the Company's AFS investments, refer to Note 3 (a). For analysis of the Company's risks arising from financial instruments, refer to Note 28.

(c) Investment income

Investment income is comprised of the following:

For the year ended December 31	2016	2015
Interest income	\$ 218,589	\$ 220,681
Dividend income	35,970	38,225
Other	883	849
Provision for loan impairment	(529)	(545)
Investment income	\$ 254,913	\$ 259,210

Included in interest income is \$53,134 (2015 \$63,449) relating to assets not classified as FVTPL.

(d) Derivative financial instruments

The values of derivative instruments are set out in the following table. The use of derivatives is measured in terms of notional principal amounts, which serve as the basis for calculating payments and are generally not actual amounts that are exchanged.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

As at December 31	2016			2015		
	Notional principal	Fair value assets	Fair value liabilities	Notional principal	Fair value assets	Fair value liabilities
Exchange-traded						
Equity index futures	\$ 128,708	\$ 1,471	\$ 213	\$ 94,312	\$ 977	\$ 340
Equity options	325,348	1,794	—	299,876	13,505	—
Over-the-counter						
Foreign currency forwards	28,247	590	25	175,368	167	36
Total	\$ 482,303	\$ 3,855	\$ 238	\$ 569,556	\$ 14,649	\$ 376

All contracts mature in less than one year. Fair value asset amounts are reported on the Consolidated Statements of Financial Position as Derivative assets. Fair value liability amounts are reported on the Consolidated Statements of Financial Position as part of Accounts payable and other liabilities. Fair value of exchange traded derivatives is determined based on Level 1 inputs. Foreign currency forward contracts are valued based primarily on the contract notional amount, the difference between the contract rate and the forward market rate for the same currency, interest rates and credit spreads. Contracts for which counterparty credit spreads are observable and reliable, or for which the credit-related inputs are determined not to be significant to fair value, are classified as Level 2.

For analysis of the Company's risks arising from financial instruments, refer to Note 28.

4. Insurance Receivables

As at December 31	2016	2015
Due from policyholders	\$ 4,050	\$ 3,229
Due and accrued from reinsurers	26,461	22,810
Fees receivable	17,844	18,506
Other	4,742	3,364
Insurance receivables	\$ 53,097	\$ 47,909

All amounts are expected to be recovered within one year of the Consolidated Statements of Financial Position date. These financial instruments are short-term in nature and their fair values approximate carrying values.

5. Other Assets

Other assets consist of the following:

As at December 31	2016	2015
Trade accounts receivable	\$ 33,731	\$ 20,803
Prepaid expenses	5,949	5,454
Other assets	\$ 39,680	\$ 26,257

All amounts are expected to be recovered within one year of the Consolidated Statements of Financial Position date. These financial instruments are short-term in nature and their fair values approximate carrying value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

6. Property and Equipment

		Land	Buildings	Furniture and equipment	Leasehold improvements	Total
Cost						
As at January 1, 2015	\$	2,318 \$	12,947 \$	24,907 \$	6,341 \$	46,513
Additions		—	91	5,899	56	6,046
Disposals		—	—	—	—	—
As at December 31, 2015		2,318	13,038	30,806	6,397	52,559
Additions		—	—	6,577	822	7,399
Disposals		—	—	—	—	—
As at December 31, 2016	\$	2,318 \$	13,038 \$	37,383 \$	7,219 \$	59,958
Amortization						
As at January 1, 2015	\$	— \$	(2,912) \$	(17,320) \$	(5,156) \$	(25,388)
Charge for the year		—	(498)	(2,205)	(557)	(3,260)
Disposals		—	—	—	—	—
As at December 31, 2015		—	(3,410)	(19,525)	(5,713)	(28,648)
Charge for the year		—	(476)	(2,712)	(439)	(3,627)
Disposals		—	—	—	—	—
As at December 31, 2016	\$	— \$	(3,886) \$	(22,237) \$	(6,152) \$	(32,275)
Carrying amount						
December 31, 2016	\$	2,318 \$	9,152 \$	15,146 \$	1,067 \$	27,683
December 31, 2015	\$	2,318 \$	9,628 \$	11,281 \$	684 \$	23,911

There were no asset impairments in 2016 or 2015.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

7. Intangible Assets

	Intangible assets	
Cost		
As at January 1, 2015	\$	44,337
Additions		5,502
Disposals		—
As at December 31, 2015		49,839
Additions		6,554
Disposals		—
As at December 31, 2016	\$	56,393
Amortization		
As at January 1, 2015	\$	(39,505)
Charge for the year		(1,109)
Disposals		—
As at December 31, 2015		(40,614)
Charge for the year		(1,438)
Disposals		—
As at December 31, 2016	\$	(42,052)
Carrying amount		
December 31, 2016	\$	14,341
December 31, 2015	\$	9,225

There were no asset impairments during 2016 or 2015.

8. Segregated Funds

(a) The following table identifies segregated fund assets by category of asset:

As at December 31	2016		2015	
Cash and cash equivalents	\$	262,838	\$	301,764
Short-term investments		142,710		151,203
Bonds		1,668,044		1,528,873
Common and preferred shares		5,990,431		5,362,003
Other assets		54,212		59,085
		8,118,235		7,402,928
Less segregated funds held within general fund investments		(36,202)		(35,105)
Total	\$	8,082,033	\$	7,367,823

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

(b) The following table presents the investments of the segregated funds measured on a recurring basis at fair value classified by the fair value hierarchy:

As at December 31	2016			2015		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Cash and cash equivalents	\$ 60,370	\$ 202,468	\$ 262,838	\$ 42,827	\$ 258,937	\$ 301,764
Short-term investments	—	142,710	142,710	—	151,203	151,203
Bonds	—	1,668,044	1,668,044	—	1,528,873	1,528,873
Common and preferred shares	5,990,431	—	5,990,431	5,362,003	—	5,362,003
Total	\$ 6,050,801	\$ 2,013,222	\$ 8,064,023	\$ 5,404,830	\$ 1,939,013	\$ 7,343,843

There were no transfers between Level 1 and Level 2, and there were no Level 3 investments during the year ended December 31, 2016 or during the year ended December 31, 2015.

(c) The following table presents the change in segregated fund assets:

For the year ended December 31	2016	2015
Segregated fund assets - beginning of year	\$ 7,367,823	\$ 6,948,475
Additions to segregated funds:		
Amount received from policyholders	1,349,159	1,521,736
Interest	67,562	63,259
Dividends	125,173	130,732
Other income	29,340	32,306
Net realized gains on sale of investments	277,602	412,110
Net unrealized increase in fair value of investments	286,056	—
	2,134,892	2,160,143
Deductions from segregated funds:		
Amounts withdrawn or transferred by policyholders	1,194,885	1,245,387
Net unrealized decrease in fair value of investments	—	262,012
Management fees and other operating costs	224,700	224,593
	1,419,585	1,731,992
Net change in segregated funds held within general fund investments	(1,097)	(8,803)
Segregated fund assets - end of year	\$ 8,082,033	\$ 7,367,823

(d) Empire Life's exposure to segregated fund guarantee risk
Segregated fund products issued by Empire Life contain death, maturity, and withdrawal benefit guarantees. Market price fluctuations impact Empire Life's estimated liability for those guarantees.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

9. Insurance Payables

As at December 31	2016	2015
Claims due and accrued	\$ 54,625	\$ 38,159
Payable to agents	12,050	11,297
Premiums paid in advance	1,902	2,267
Due to reinsurance companies	12,151	11,707
Other	16,407	13,907
Insurance payables	\$ 97,135	\$ 77,337

Of the above total, \$2,985 (2015 \$1,305) is expected to be settled more than one year after the Consolidated Statements of Financial Position date. Most of these financial instruments are short-term in nature and their fair value approximates carrying values.

10. Insurance Contract Liabilities and Reinsurance Assets/Liabilities

- (a) Nature and composition of insurance contract liabilities and related reinsurance
Insurance contract liabilities include life, health and annuity contracts on a participating and non-participating basis.

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.

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

The Company reinsures excess risks with Canadian regulated reinsurance companies. The reinsurance assets (liabilities) are determined based on both the premiums expected to be paid by the Company under reinsurance agreements over the duration of the insurance contracts that they support and the insurance claims expected to be received by the Company when an insured event occurs under those insurance contracts. The liability position of some of the reinsurance is because of the excess of future premiums payable over the expected benefit of reinsurance. The change in reinsurance liability is primarily related to the Company's revised mortality assumptions, which reduce the present value of insurance claims expected to be recovered from the reinsurance companies. The Company enters into reinsurance agreements only with reinsurance companies that have an independent credit rating of "A-" or better from A.M. Best.

Reinsurance transactions do not relieve the original insurer of its primary obligation to policyholders.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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The Company is active in most life insurance and annuity product lines across Canada and does not operate in foreign markets. The table below shows the concentration of insurance contract liabilities and related reinsurance assets (liabilities) by type of contract:

As at December 31	2016			2015		
	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net
Participating Individual						
Life	\$ 554,486	\$ (406)	\$ 554,080	\$ 547,978	\$ (2,111)	\$ 545,867
Annuity	179	—	179	192	—	192
Non-participating Individual						
Life	3,191,047	625,926	3,816,973	3,011,228	623,305	3,634,533
Annuity	915,889	(11,036)	904,853	908,073	(12,439)	895,634
Health	168,981	(8,800)	160,181	154,455	(9,274)	145,181
Non-participating Group						
Life	23,289	(757)	22,532	21,564	(626)	20,938
Annuity	52,631	—	52,631	56,398	—	56,398
Health	191,582	(71,570)	120,012	194,029	(68,029)	126,000
Segregated fund deferred acquisition costs	(94,634)	—	(94,634)	(95,234)	—	(95,234)
Total	\$ 5,003,450	\$ 533,357	\$ 5,536,807	\$ 4,798,683	\$ 530,826	\$ 5,329,509

The Company expects to pay \$4,933,196 (2015 \$4,710,118) of Insurance contract liabilities and \$531,976 (2015 \$529,604) of Reinsurance liabilities more than one year after the Consolidated Statements of Financial Position date. The remaining balance is expected to be settled within one year.

The following segregated fund deferred acquisition costs are included in Insurance contract liabilities:

	2016	2015
Segregated funds deferred acquisition costs - beginning of year	\$ 95,234	\$ 89,925
Deferred during year	34,171	38,551
Amortized during year	(34,772)	(33,242)
Segregated funds deferred acquisition costs - end of year	\$ 94,633	\$ 95,234

Of the above total, \$37,775 (2015 \$37,876) is expected to be amortized during the next year.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

(b) Change in insurance contract liabilities and reinsurance assets/liabilities

For the year ended December 31	2016			2015		
	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net
Balance - beginning of year	\$ 4,798,683	\$ 530,826	\$ 5,329,509	\$ 4,713,462	\$ 490,575	\$ 5,204,037
Changes in methods and assumptions						
Improvements in mortality/morbidity experience	(15,843)	12,543	(3,300)	(45,126)	36,149	(8,977)
Lapse assumption updates	31,764	(6,356)	25,408	67,282	8,364	75,646
Update of investment return assumptions	32,906	(3,523)	29,383	(37,843)	(10,160)	(48,003)
Model enhancements and other changes	(44,247)	44	(44,203)	8,599	(1,250)	7,349
Normal changes						
New business	79,275	(10,939)	68,336	77,241	(10,535)	66,706
In-force business	120,912	10,762	131,674	15,068	17,683	32,751
Balance - end of year	\$ 5,003,450	\$ 533,357	\$ 5,536,807	\$ 4,798,683	\$ 530,826	\$ 5,329,509

Changes in methods and assumptions summarized in the above tables are further explained as follows:

Improvements for mortality experience for 2016 are primarily related to the individual life business, which was offset by a small deterioration in mortality for immediate annuities.

Improvements for mortality/morbidity experience for 2015 are primarily related to the individual life business.

The lapse rate assumption update for 2016 was primarily related to an increase of lapse experience on renewable term 10 business. The remainder was related to regular experience updates for term to 100 and 20-pay life policies.

The lapse rate assumption update for 2015 was primarily related to Empire Life's term to 100 and Universal Life Level Cost of Insurance (UL LCOI) ultimate lapse rate assumptions to reflect the CIA Research Committee's research papers on Lapse Experience Under Term-to-100 Insurance Policies and Lapse Experience released September 2015. This was partially offset by an update to lapse rate margins to reflect company and industry experience.

The investment return assumption for 2016 was primarily due to regular updates to reinvestment rates and credit spreads for the CALM valuation as well as enhancements to the modeling of preferred shares cash flows for deferred and immediate annuity business.

The investment return assumption for 2015 was primarily related to a refinement of the projected amount of equities backing individual life liabilities. In addition, there were several enhancements to the CALM model for future reinvestment assumptions.

Model enhancements and other changes for 2016 related to enhancements to the modeling of reinsurance treaties and terms for individual life insurance and updates to Group LTD termination rate experience study. In addition, maintenance expense unit costs for individual life business increased slightly as a result of changes in expense allocations related to sales and inforce business.

Model enhancements and other changes for 2015 relate to lower expenses unit costs that were offset by refinements to target fund value mix for universal life policies and other minor changes to assumptions and methodologies.

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(c) Mix of assets allocated to insurance, annuity, investment contract liabilities and equity

	As at December 31, 2016				
	Insurance liabilities	Annuity liabilities	Investment contract liabilities	Equity and other liabilities	Total
Cash and cash equivalents & Short-term investments	\$ 114,547	\$ 15,006	\$ 218	\$ 341,976	\$ 471,747
Bonds	3,628,303	488,382	7,102	1,397,385	5,521,172
Mortgages	45,574	215,600	3,135	—	264,309
Preferred shares	28,043	199,822	2,906	54,413	285,184
Common shares	862,642	—	—	66,969	929,611
Derivative assets	2,061	—	—	1,794	3,855
Loans on policies	47,969	—	—	—	47,969
Policy contract loans	335	30,848	449	49,312	80,944
Other	36,126	6,430	93	132,703	175,352
Total	\$ 4,765,600	\$ 956,088	\$ 13,903	\$ 2,044,552	\$ 7,780,143

	As at December 31, 2015				
	Insurance liabilities	Annuity liabilities	Investment contract liabilities	Equity and other liabilities	Total
Cash and cash equivalents & Short-term investments	\$ 62,748	\$ 20,676	\$ 245	\$ 149,753	\$ 233,422
Bonds	3,518,901	480,695	5,700	1,188,143	5,193,439
Mortgages	46,811	239,569	2,841	—	289,221
Preferred shares	23,853	168,825	2,002	—	194,680
Common shares	739,948	—	—	61,830	801,778
Derivative assets	1,144	—	—	13,505	14,649
Loans on policies	46,925	—	—	—	46,925
Policy contract loans	318	33,444	397	50,762	84,921
Other	23,754	4,731	56	108,145	136,686
Total	\$ 4,464,402	\$ 947,940	\$ 11,241	\$ 1,572,138	\$ 6,995,721

Provisions made for anticipated future losses of principal and interest on investments and included as a component of policy liabilities are \$155,700 (2015 \$163,500).

- (d) Fair value of insurance and investment contract liabilities and reinsurance assets/liabilities
In the absence of an active market for the sale of insurance and investment contract liabilities and reinsurance assets/liabilities, the actuarially determined values provide a reasonable approximation of their fair value. Investment contract liabilities are term certain annuities with a relatively short duration.
- (e) Liquidity
The Company defines liquid assets as high quality marketable investments that may be easily sold, meaning there exists an active market and observable prices for the investments. Liquid asset values are based on fair value as at December 31.

The Company defines cash demands or demand liabilities as those policyholder obligations that may be called on immediately at the discretion of the policyholder. More specifically, demand liabilities include cash surrender values under whole life insurance products as well as current accumulated values of annuity products. Amounts would be gross of any surrender charge or market value adjustment allowed under the terms of the contract. Demand liabilities are determined as though all such policyholders made their call at the same time and as such cannot be readily compared to insurance contract liabilities that are determined based on actuarial assumptions associated with lapse as well as other decrements.

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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:

As at December 31	2016	2015
Assets:		
Cash and cash equivalents & Short-term investments	\$ 471,747	\$ 233,422
Canadian federal and provincial bonds	3,294,720	3,136,487
Other readily-marketable bonds and stocks	2,807,447	2,459,446
Total liquid assets	\$ 6,573,914	\$ 5,829,355
Liabilities:		
Demand liabilities with fixed values	\$ 624,818	\$ 586,695
Demand liabilities with market value adjustments	1,141,199	1,099,332
Total liquidity needs	\$ 1,766,017	\$ 1,686,027

11. Accounts Payable and Other Liabilities

Accounts payable and other liabilities consist of:

As at December 31	2016	2015
Accounts payable	\$ 42,806	\$ 21,905
Post-employment benefit liability (Note 12)	20,505	23,685
Accrued interest on subordinated debt	1,087	767
Derivative liabilities (Note 3d)	238	376
Other	14,964	12,412
Accounts payable and other liabilities	\$ 79,600	\$ 59,145

Of the above total, \$20,505 (2015 \$23,685) is expected to be settled more than one year after the Consolidated Statements of Financial Position date. In the absence of an active market for post-employment benefit liabilities, the actuarially determined value provides a reasonable approximation of fair value. Derivative liabilities are carried at fair value, as disclosed in Note 3(d). All other amounts are short-term in nature and their fair value approximates carrying value.

12. Employee Benefit Plans

Empire Life sponsors pension and other post-employment benefit plans for eligible employees. The Empire Life Insurance Company Staff Pension Plan (the Plan) consists of a defined benefit component and a defined contribution component. The Company discontinued enrolments in the defined benefit component effective October 1, 2011. The Company has supplemental arrangements that provide defined pension benefits in excess of statutory limits. In addition to pension benefits, the Company also provides for post-employment health and dental care coverage and other future benefits to qualifying employees and retirees.

The defined benefit component of the Plan is a final average salary pension plan, which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' age, length of service and their salary in the final years leading up to retirement. Pensions generally do not receive inflationary increases once in payment. In the past, however, the Company has provided ad-hoc pension increases on its defined benefit staff pension plan. Increases take place at the discretion of the Board. The pension benefit payments are from trustee-administered funds.

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The Company's staff pension plan is governed by the *Pension Benefits Act of the Province of Ontario*, as amended, which requires that the plan sponsor fund the defined benefits determined under the plan. The Company's supplemental employee retirement benefit plan is governed by provisions of the plan, which requires that the plan sponsor fund the defined benefits determined under the plan. The amount of funds contributed to these defined benefit pension plans by Empire Life is determined by an actuarial valuation of the Plans.

Under the defined contribution component, contributions are made in accordance with the provisions of the Plan documents.

A pension committee, composed of selected senior members of Empire Life's management and that of its parent, E-L Financial Corporation, oversees the Pension Plan of the Company. The Pension Committee reports to the Human Resources Committee of the Board three times each year. The Audit Committee of the Board approves the audited annual financial statements of the Pension Plan.

The other post-employment benefit plan provides for health, dental care, and other future defined benefits to qualifying employees and retirees. It is unfunded and the Company meets the benefit payment obligation as it falls due.

In the absence of an active market for post-employment benefit obligations, the actuarially determined values provide a reasonable approximation of their fair value. Plan assets are carried at fair value.

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

	Pension benefits		Other post-employment benefits	
	2016	2015	2016	2015
As at December 31				
Present value of obligations	\$ 218,059	\$ 209,311	\$ 9,727	\$ 9,684
Fair value of plan assets	207,281	195,310	—	—
Post-employment benefit asset (liability)	\$ (10,778)	\$ (14,001)	\$ (9,727)	\$ (9,684)

The post-employment benefit asset (liability), net of the cumulative impact of the asset ceiling, is included in the Consolidated Statements of Financial Position in Accounts payables and other liabilities (Note 11).

The movement in the present value of the defined benefit obligations over the year is as follows:

	Pension benefits		Other post-employment benefits	
	2016	2015	2016	2015
As at December 31				
Present value of defined benefit obligation - beginning of year	\$ 209,311	\$ 192,948	\$ 9,684	\$ 10,531
Current service cost	6,233	6,817	13	29
Interest expense	8,635	8,038	367	400
Decrease (increase) in net income before tax	14,868	14,855	380	429
Remeasurements				
(Gain) loss from changes in demographic assumptions	—	—	—	(2,133)
(Gain) loss from changes in financial assumptions	888	(5,873)	154	(177)
Actuarial (gain) loss from member experience	177	12,992	(98)	1,384
Decrease (increase) in OCI before tax	1,065	7,119	56	(926)
Employee contributions	1,707	1,823	—	—
Benefits paid	(8,892)	(7,434)	(393)	(350)
Present value of defined benefit obligation - end of year	\$ 218,059	\$ 209,311	\$ 9,727	\$ 9,684

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The movement in the fair value of the Plan's defined benefit assets over the year is as follows:

As at December 31	Pension benefits	
	2016	2015
Fair value of defined benefit assets - at beginning of year	\$ 195,310	\$ 185,919
Interest income	8,138	7,355
Administrative expense	(780)	(682)
Increase (decrease) in net income before tax	7,358	6,673
Remeasurements		
Return on plan assets, excluding amounts included in interest income	8,487	2,083
Increase (decrease) in OCI before tax	8,487	2,083
Employer contributions	3,311	6,246
Employee contributions	1,707	1,823
Benefits paid	(8,892)	(7,434)
Fair value of defined benefit assets - end of year	\$ 207,281	\$ 195,310

The actual return on defined benefit assets net of administrative expense, for the year ended December 31, 2016 was a gain of \$15,845 (2015 gain of \$8,756).

The following table summarizes income, expense and remeasurement activity for the Company's defined benefit plans:

For the year ended December 31	Pension benefits		Other post-employment benefits	
	2016	2015	2016	2015
Operating expense				
Current service cost	\$ 6,233	\$ 6,817	\$ 13	\$ 29
Interest expense	8,635	8,038	367	400
Interest income on plan assets	(8,138)	(7,355)	—	—
Administrative expense	780	682	—	—
Decrease (increase) in net income before tax	\$ 7,510	\$ 8,182	\$ 380	\$ 429
Remeasurements				
Return on plan assets, excluding amounts included in interest income	\$ (8,487)	\$ (2,083)	\$ —	\$ —
(Gain) loss from changes in demographic assumptions	—	—	—	(2,133)
(Gain) loss from changes in financial assumptions	888	(5,873)	154	(177)
Actuarial (gain) loss from member experience	177	12,992	(98)	1,384
Change in effect of asset limit	—	—	—	—
Decrease (increase) in OCI before tax (Note 18(d))	\$ (7,422)	\$ 5,036	\$ 56	\$ (926)

Defined benefit plan expense is recognized in Operating expenses. Remeasurements in the defined benefit plan are included in OCI. Operating expenses also include \$927 (2015 \$823) of employer contributions related to the defined contribution component of the Plan.

Expected contributions (including both employer and employee amounts) to the Company's defined benefit pension plans for the year ending December 31, 2017 are approximately \$4,607.

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The Plan invests primarily in Empire Life segregated and mutual funds. The fair value of the underlying assets of the funds and other investments are included in the following table:

As at December 31	2016		2015	
Equity				
Canadian				
Consumer discretionary	\$ 3,525	2%	\$ 3,535	2%
Consumer staples	7,763	4%	6,301	3%
Energy	17,421	9%	6,988	3%
Financials	28,284	15%	18,863	9%
Industrials	9,937	5%	7,677	4%
Information technology	7,219	3%	5,876	3%
Materials	2,875	1%	1,057	1%
Telecom services	6,730	3%	5,088	3%
Utilities	2,554	1%	1,399	1%
Total Canadian	86,308	43%	56,784	29%
Foreign	36,805	18%	56,411	29%
Total equity	123,113	61%	113,195	58%
Debt				
Government of Canada	11,038	5%	10,336	5%
Provincial governments	14,662	7%	15,459	8%
Municipal governments	490	—%	1,167	1%
Canadian corporations	33,819	16%	32,778	17%
Total debt	60,009	28%	59,740	31%
Cash, cash equivalent, accruals	6,783	3%	5,512	3%
Mutual funds	8,863	4%	8,177	4%
Other	8,513	4%	8,686	4%
Total fair value of assets	\$ 207,281	100%	\$ 195,310	100%

Fair value is determined based on Level 1 inputs for equities and Level 2 inputs for debt.

The following weighted average assumptions were used in actuarial calculations:

As at December 31	Pension benefits		Other post-employment benefits	
	2016	2015	2016	2015
Defined benefit obligation as at December 31:				
Discount rate - defined benefit obligation	4.0%	4.2%	3.8%	4.0%
Discount rate - net interest	4.2%	4.0%	4.0%	3.9%
Inflation assumption	2.0%	2.0%	n/a	n/a
Rate of compensation increase	3.5%	3.5%	n/a	n/a
Future pension increases	3.0%	3.0%	n/a	n/a
Assumed health care cost trend rates at December 31:				
Initial health care cost trend rate	n/a	n/a	7.3%	7.5%
Cost trend rate declines to	n/a	n/a	4.5%	4.5%
Year ultimate health care cost trend rate is reached	n/a	n/a	2026	2026

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Assumptions (in number of years) relating to future mortality, to determine the defined benefit obligation and the net benefit cost for the defined benefit pension plans are as follows:

As at December 31	2016	2015
Males aged 65 at measurement date	21.64	21.57
Females aged 65 at measurement date	24.08	24.02
Males aged 40 at measurement date	22.98	22.93
Females aged 40 at measurement date	25.27	25.22

The following table provides the sensitivity of the defined benefit pension and other post-employment benefit obligations to changes in significant actuarial assumptions. For each sensitivity test, the impact of a reasonably possible change in a single factor is shown with other assumptions left unchanged. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method has been applied as when calculating the Post-employment benefit liability recognized within the Consolidated Statements of Financial Position.

As at December 31, 2016	Change in assumption	Impact on pension benefits		Impact on other post employment benefits	
		Increase	Decrease	Increase	Decrease
Discount rate	1%	(26,091)	35,166	(964)	1,163
Rate of compensation increase	1%	12,094	(10,577)	n/a	n/a
Health care cost increase	1%	n/a	n/a	1,138	(956)
Claim rate	10%	n/a	n/a	905	(905)
Life expectancy	1 year	5,321	(5,437)	449	(438)

As at December 31, 2015	Change in assumption	Impact on pension benefits		Impact on other post employment benefits	
		Increase	Decrease	Increase	Decrease
Discount rate	1%	(24,832)	33,832	(969)	1,171
Rate of compensation increase	1%	10,444	(9,080)	n/a	n/a
Health care cost increase	1%	n/a	n/a	1,110	(955)
Claim rate	10%	n/a	n/a	894	(895)
Life expectancy	1 year	4,565	(4,690)	414	(407)

The weighted average duration, in number of years, of the defined benefit obligations are:

As at December 31	2016	2015
Staff pension plan	14	14
Supplemental employee retirement plan	10	11
Other post-employment benefits	11	15

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Risks

Through its defined benefit pension plan and the other post-employment benefit plan, the Company is exposed to a number of risks, the most significant of which are detailed below:

Asset volatility

The Plan obligations are calculated using a discount rate set with reference to corporate bond yields; if Plan assets underperform this yield, this will create a deficit. The pension plan holds a significant proportion of equities, which are expected to outperform corporate bonds in the long-term while producing volatility and risk in the short-term.

The following table summarizes the potential impact on OCI of a change in global equity markets regarding assets in Empire Life's pension plan. 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.

As at December 31, 2016				
	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' other comprehensive income	\$ 9,499	\$ (9,499)	\$ 18,998	\$ (18,998)
Policyholders' other comprehensive income	\$ 456	\$ (456)	\$ 912	\$ (912)

As at December 31, 2015				
	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' other comprehensive income	\$ 8,641	\$ (8,641)	\$ 17,281	\$ (17,281)
Policyholders' other comprehensive income	\$ 410	\$ (410)	\$ 820	\$ (820)

The following tables summarize the potential impact on OCI as a result of a change in interest rates on assets in Empire Life's pension plan.

As at December 31, 2016				
	50 bps Increase	50 bps Decrease	100 bps Increase	100 bps Decrease
Shareholders' other comprehensive income	\$ (1,491)	\$ 1,716	\$ (2,757)	\$ 3,657
Policyholders' other comprehensive income	\$ (72)	\$ 83	\$ (133)	\$ 176

As at December 31, 2015				
	50 bps Increase	50 bps Decrease	100 bps Increase	100 bps Decrease
Shareholders' other comprehensive income	\$ (1,576)	\$ 1,731	\$ (2,993)	\$ 3,620
Policyholders' other comprehensive income	\$ (75)	\$ 82	\$ (142)	\$ 172

Changes in bond yields

A decrease in corporate bond yields will increase Plan obligations, although this will be partially offset by an increase in the value of the Plans' bond holdings.

Life expectancy

The majority of the Plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the Plans' liabilities.

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In case of the funded plans, the Pension Committee ensures that the investment positions are managed in accordance with the investment philosophy outlined in the investment policy approved by the Human Resources Committee of the Board. The fundamental philosophy is to achieve acceptably high investment return over the long term without jeopardizing the level of security of the members' benefits and without introducing too much volatility into the Company's future expense. The Company's objective is to match assets to the pension obligations by investing in equities as well as fixed interest securities. The Company monitors how the duration and the expected yield of the investments are matching the expected cash outflows arising from the pension obligations. The Plan has not changed the processes used to manage its risks from previous periods. Investments are well diversified, such that the failure of any single investment would not have a material impact on the overall level of assets. The Plan invests primarily in Canadian Bonds and Equities through its' ownership of units in Empire Life segregated and mutual funds. The Company believes that equities offer the best returns over the long term with an acceptable level of risk.

The last triennial valuation on the Staff Pension Plan was completed in August 2014, as at December 31, 2013. The next triennial valuation will be completed in 2017, as at December 31, 2016.

13. Subordinated Debt

On May 31, 2013, the Company issued \$300,000 principal amount of unsecured subordinated debentures with a maturity date of May 31, 2023. The interest rate from May 31, 2013 until May 31, 2018 is 2.870%, and the rate from May 31, 2018 until May 31, 2023 is equal to the 3-month Canadian Deposit Offering Rate plus 1.05%. Interest is payable semi-annually at May 31 and November 30 until May 31, 2018, quarterly thereafter with the first such payment on August 31, 2018. The Company may call for redemption of the debentures on or after May 31, 2018 subject to the approval of OSFI. The holders have no right of redemption. The fair value of these debentures is \$301,062 as of December 31, 2016 (2015 \$305,244), and is within level 2 of the fair value hierarchy. The fair value is provided by a third party bond pricing service.

On December 16, 2016, the Company issued \$200,000 principal amount of unsecured subordinated debentures with a maturity date of December 16, 2026. The interest rate from December 16, 2016 until December 16, 2021 is 3.383%, and the rate from December 16, 2021 until December 16, 2026 is equal to the 3-month Canadian Deposit Offering Rate plus 1.95%. Interest is payable semi-annually at December 16 and June 16 until December 16, 2021, quarterly thereafter with the first such payment on March 16, 2022. The Company may call for redemption of the debentures on or after December 16, 2021 subject to the approval of OSFI. The holders have no right of redemption. The fair value of these debentures is \$199,870 as of December 31, 2016, and is within level 2 of the fair value hierarchy. The fair value is provided by a third party bond pricing service.

The debentures are subordinated in right of payment to all policy contract liabilities of the Company and all other senior indebtedness of the Company.

14. Insurance Premiums

For the year ended December 31	2016			2015		
	Gross	Reinsurance ceded	Net	Gross	Reinsurance ceded	Net
Life premiums	\$ 470,115	\$ (93,167)	\$ 376,948	\$ 460,324	\$ (85,418)	\$ 374,906
Health premiums	356,057	(27,337)	328,720	342,489	(26,170)	316,319
Total life and health premiums	826,172	(120,504)	705,668	802,813	(111,588)	691,225
Annuity premiums	176,080	(248)	175,832	144,224	(233)	143,991
Total insurance premiums	\$ 1,002,252	\$ (120,752)	\$ 881,500	\$ 947,037	\$ (111,821)	\$ 835,216

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15. Fee Income

For the year ended December 31	2016	2015
Investment management, policyholder administration and guarantee fees	\$ 219,152	\$ 208,085
Surrender charges and other miscellaneous fees	9,217	8,733
Fee income	\$ 228,369	\$ 216,818

16. Benefits and Expenses

(a) Insurance contract benefits and claims paid

For the year ended December 31	2016			2015		
	Gross	Reinsurance ceded	Net	Gross	Reinsurance ceded	Net
Life claims	\$ 185,379	\$ (53,948)	\$ 131,431	\$ 207,352	\$ (67,549)	\$ 139,803
Health claims	267,921	(16,261)	251,660	257,559	(14,528)	243,031
Total life and health claims	453,300	(70,209)	383,091	464,911	(82,077)	382,834
Annuity benefits	212,120	(2,461)	209,659	262,408	(2,911)	259,497
Benefits and claims paid	\$ 665,420	\$ (72,670)	\$ 592,750	\$ 727,319	\$ (84,988)	\$ 642,331

(b) Change in insurance contract liabilities and reinsurance ceded

For the year ended December 31	2016			2015		
	Gross	Reinsurance ceded	Net	Gross	Reinsurance ceded	Net
Life	\$ 188,221	\$ 4,342	\$ 192,563	\$ 193,091	\$ 33,569	\$ 226,660
Health	11,911	(3,215)	8,696	4,340	4,504	8,844
Total life and health	200,132	1,127	201,259	197,431	38,073	235,504
Annuity	4,635	1,404	6,039	(112,210)	2,178	(110,032)
Change in insurance contract liabilities	\$ 204,767	\$ 2,531	\$ 207,298	\$ 85,221	\$ 40,251	\$ 125,472

17. Operating Expenses

Operating expenses include the following:

For the year ended December 31	2016	2015
Salary and benefits expense	\$ 83,428	\$ 83,301
Professional services	16,077	19,658
Rent, leasing and maintenance	12,450	11,290
Amortization of property and equipment and intangibles	5,065	4,369
Other	27,984	28,547
Total	\$ 145,004	\$ 147,165

Significant components of other expenses include travel, advertising, and office supplies and services.

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18. Income Taxes

(a) Income tax expense

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

For the year ended December 31	2016	2015
Current income tax expense	\$ 50,344	\$ 26,731
Deferred income tax expense (benefit)		
Relating to the origination and reversal of temporary differences	(639)	761
Income tax expense	\$ 49,705	\$ 27,492

During 2016 the Company paid income tax installments totaling \$12,370 (2015 \$34,185).

(b) Variance from statutory provision

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

For the year ended December 31	2016	2015
Net income before income taxes	\$ 206,871	\$ 129,950
Income tax provision at statutory rates	55,214	34,580
Increase (decrease) resulting from:		
Tax paid on dividends	(7,343)	(7,503)
Miscellaneous	1,834	415
Income tax expense	\$ 49,705	\$ 27,492

The current enacted corporate tax rates as they impact the Company in 2016 stand at 26.69% (2015 26.61%). Expected future tax rates are as follows:

2017	26.66%
2018	26.64%
2019	26.61%
2020	26.58%
2021	26.59%

The impact of future enacted corporate tax rates has been taken into consideration in the deferred tax calculation.

(c) Deferred income taxes

In certain instances the tax basis of assets and liabilities differs from the carrying amount. These differences will give rise to deferred income taxes, which are reflected on the Consolidated Statements of Financial Position. These differences arise in the following items:

As at December 31	2016	2015
Insurance contracts	\$ (7,041)	\$ (8,485)
Portfolio investments	(5,584)	(5,896)
Taxes recoverable in future years	3,698	2,847
Post-employment benefit plans	5,475	6,300
Other, net	(5,537)	(2,676)
Deferred income tax asset (liability)	\$ (8,989)	\$ (7,910)

Of the above total, \$4,827 is expected to be paid (2015 \$403 received) more than one year after the Consolidated Statements of Financial Position date.

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The net movement on the deferred income tax account is as follows:

For the year ended December 31		2016	2015
Deferred income tax asset (liability) - beginning of year	\$	(7,910) \$	(8,243)
Deferred tax asset from preferred share issue (Note 20)		248	—
Deferred income tax benefit (expense)			
Statement of operations		639	(761)
Other comprehensive income		(1,966)	1,094
Deferred income tax asset (liability) - end of year	\$	(8,989) \$	(7,910)

- (d) Income taxes included in other comprehensive income
Other comprehensive income (loss) is presented net of income taxes.

The following income tax amounts are included in each component of **total OCI**.

For the year ended December 31	2016			2015		
	Before tax	Tax provision (recovery)	After tax	Before tax	Tax provision (recovery)	After tax
Unrealized fair value change on available for sale investments	\$ 8,576	\$ 2,289	\$ 6,287	\$ 5,612	\$ 1,494	\$ 4,118
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(11,740)	(3,187)	(8,553)	(19,128)	(5,206)	(13,922)
Remeasurements of post-employment benefit liabilities (Note 12)	7,366	1,966	5,400	(4,110)	(1,094)	(3,016)
Total other comprehensive income (loss)	\$ 4,202	\$ 1,068	\$ 3,134	\$ (17,626)	\$ (4,806)	\$ (12,820)

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

For the year ended December 31	2016			2015		
	Before tax	Tax provision (recovery)	After tax	Before tax	Tax provision (recovery)	After tax
Unrealized fair value change on available for sale investments	\$ 3,465	\$ 925	\$ 2,540	\$ 5,775	\$ 1,537	\$ 4,238
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(8,759)	(2,358)	(6,401)	(17,762)	(4,783)	(12,979)
Remeasurements of post-employment benefit liabilities (Note 12)	7,024	1,875	5,149	(3,919)	(1,043)	(2,876)
Shareholder portion of policyholder other comprehensive income (loss)	156	39	117	(171)	(52)	(119)
Total other comprehensive income (loss)	\$ 1,886	\$ 481	\$ 1,405	\$ (16,077)	\$ (4,341)	\$ (11,736)

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

For the year ended December 31	2016			2015		
	Before tax	Tax provision (recovery)	After tax	Before tax	Tax provision (recovery)	After tax
Unrealized fair value change on available for sale investments	\$ 5,111	\$ 1,364	\$ 3,747	\$ (163)	\$ (43)	\$ (120)
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(2,981)	(829)	(2,152)	(1,366)	(423)	(943)
Remeasurements of post-employment benefit liabilities (Note 12)	342	91	251	(191)	(51)	(140)
Shareholder portion of policyholder other comprehensive income (loss) (Note 23)	(156)	(39)	(117)	171	52	119
Total other comprehensive income (loss)	\$ 2,316	\$ 587	\$ 1,729	\$ (1,549)	\$ (465)	\$ (1,084)

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19. Earnings Per Share

Earnings per share (EPS) is calculated by dividing common shareholders' net income by the weighted average number of common shares outstanding. The preferred shares issued in 2016 (refer to Note 20) do not dilute EPS as the preferred shares are not convertible into common shares.

Details of the calculation of the net income and the weighted average number of shares used in the EPS computations are as follows:

For the year ended December 31	2016	2015
Basic and diluted EPS		
Common shareholders' net income	\$ 152,721	\$ 108,577
Weighted average number of common shares outstanding	985,076	985,076
Basic and diluted EPS	\$ 155.03	\$ 110.22

20. Capital Stock

As at	December 31, 2016			December 31, 2015		
	Shares authorized	Shares issued and outstanding	Amount	Shares authorized	Shares issued and outstanding	Amount
Preferred shares						
Series 1	unlimited	5,980,000	\$ 149,500	—	—	\$ —
Common shares	2,000,000	985,076	\$ 985	2,000,000	985,076	\$ 985

In the first quarter of 2016, Empire Life issued to the public 5,980,000 Non-Cumulative Rate Reset Preferred Shares, Series 1 (Series 1 Preferred Shares) at \$25 per share. Holders of Series 1 Preferred Shares are entitled to receive fixed non-cumulative quarterly dividends yielding 5.75% annually, as and when declared by the Board of Directors of Empire Life, for the initial period ending on and including April 17, 2021. Thereafter, the dividend rate will be reset every five years at a rate equal to the 5-year Government of Canada bond yield plus 4.99%. Holders of Series 1 Preferred Shares will have the right, at their option, to convert their shares into Non-Cumulative Floating Rate Preferred Shares, Series 2 (Series 2 Preferred Shares), subject to certain conditions, on April 17, 2021 and on April 17 every five years thereafter. Holders of the Series 2 Preferred Shares will be entitled to receive non-cumulative quarterly floating dividends, as and when declared by the Board of Directors of Empire Life, at a rate equal to the three-month Government of Canada Treasury Bill yield plus 4.99%.

The cost of issuance of the Series 1 Preferred Shares, \$5,150 less \$1,375 of income tax, was charged to retained earnings.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

21. Dividends

Preferred shareholder dividends

On February 25, 2016 the Board approved a cash dividend of \$0.2402 per share on the issued and outstanding Series 1 Preferred Shares, payable on the 17th day of April, 2016.

On April 28, 2016 the Board approved a cash dividend of \$0.359375 per share on the issued and outstanding Series 1 Preferred Shares, payable on the 17th day of July, 2016.

On July 28, 2016 the Board approved a cash dividend of \$0.359375 per share on the issued and outstanding Series 1 Preferred Shares, payable on the 17th day of October, 2016.

On October 27, 2016 the Board approved a cash dividend of \$0.359375 per share on the issued and outstanding Series 1 Preferred Shares, payable on the 17th day of January, 2017.

On February 24, 2017, subsequent to the date of these financial statements, the Board approved a cash dividend of \$0.359375 per share on the issued and outstanding Series 1 Preferred Shares, payable on the 17th day of April, 2017.

Common shareholder dividends

There were no common shareholder dividends paid in 2016 or 2015.

22. Shareholders' Equity Entitlement

Shareholders' entitlement to \$4,357 (2015 \$4,586) of shareholders' equity is contingent upon future payment of dividends to participating policyholders.

23. Supplementary Participating Policyholder Information

As at December 31	2016	2015
Assets backing participating account equity	\$ 51,127	\$ 52,837
Assets backing participating account liabilities	\$ 618,314	\$ 609,423

Transfers to shareholders' account

In 2016, the Company transferred \$2,206 (2015 \$2,057), equal to 7.8% (2015 7.9%) of the distributable participating profits, from the participating account to the shareholders' account.

24. Segmented Information

The Company operates in the Canadian life insurance industry and follows a product line management approach for internal reporting and decision making. A description of the product lines is as follows:

The Wealth Management product line includes segregated funds, mutual funds, guaranteed interest rate annuities and annuities providing income for life.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

Capital and Surplus is made up of assets held in the shareholders' and participating policyholders' equity accounts and other corporate items not allocated to other segments.

Operating results are segmented into three product lines along with the Company's capital and surplus as follows:

	For the year ended December 31, 2016				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Net premiums from external customers	\$ 175,832	\$ 338,908	\$ 366,760	\$ —	\$ 881,500
Interest income	31,983	6,074	150,642	29,890	218,589
Total investment income	41,125	3,723	175,785	34,280	254,913
Fair value change in fair value through profit or loss assets	(4,290)	322	21,692	(5,851)	11,873
Realized gain (loss) on fair value through profit or loss assets	(173)	647	47,979	(28,339)	20,114
Realized gain (loss) on available for sale assets including impairment write downs	(162)	(158)	6	12,053	11,739
Fee income from external customers	217,430	9,767	1,035	137	228,369
Net benefits and claims	209,659	258,986	124,105	—	592,750
Net change in insurance contract liabilities	6,039	(4,392)	205,651	—	207,298
Change in investment contract provision	40	—	—	—	40
Policy dividends	—	—	28,564	—	28,564
Amortization of property and equipment and intangibles	1,562	1,218	2,285	—	5,065
Total operating expenses	47,053	41,333	55,489	1,129	145,004
Net commission expense	84,883	33,558	76,718	—	195,159
Interest expense	—	—	—	9,297	9,297
Premium tax	—	9,604	9,925	—	19,529
Investment and capital tax	—	—	3,996	—	3,996
Income tax expense (recovery)	20,008	4,124	25,689	(116)	49,705
Net income (loss) after tax	62,080	9,996	83,120	1,970	157,166

	For the year ended December 31, 2015				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Net premiums from external customers	\$ 143,991	\$ 325,223	\$ 366,002	\$ —	\$ 835,216
Interest income	35,854	6,036	140,376	38,415	220,681
Total investment income	43,673	3,558	171,119	40,860	259,210
Fair value change in fair value through profit or loss assets	(28,153)	(2,137)	(56,408)	1,021	(85,677)
Realized gain (loss) on fair value through profit or loss assets	1,276	1,223	38,114	1,620	42,233
Realized gain (loss) on available for sale assets including impairment write downs	(30)	72	444	18,642	19,128
Fee income from external customers	205,957	9,265	1,338	258	216,818
Net benefits and claims	259,497	252,654	130,180	—	642,331
Net change in insurance contract liabilities	(110,032)	(5,238)	240,742	—	125,472
Change in investment contract provision	426	—	—	—	426
Policy dividends	—	—	25,991	—	25,991
Amortization of property and equipment and intangibles	1,748	1,039	1,582	—	4,369
Total operating expenses	52,604	41,976	51,586	999	147,165
Net commission expense	86,019	32,592	69,797	—	188,408
Interest expense	—	—	—	8,959	8,959
Premium tax	—	7,216	7,010	—	14,226
Investment and capital tax	—	—	4,000	—	4,000
Income tax expense (recovery)	18,980	2,219	(7,440)	13,733	27,492
Net income (loss) after tax	59,220	5,785	(1,257)	38,710	102,458

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Assets are segmented into three product lines along with the Company's capital and surplus as follows:

	For the year ended December 31, 2016				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Assets excluding segregated funds	\$ 969,991	\$ 152,586	\$ 4,613,014	\$ 2,044,552	\$ 7,780,143
Segregated funds	8,061,128	—	20,905	—	8,082,033
Total assets	\$ 9,031,119	\$ 152,586	\$ 4,633,919	\$ 2,044,552	\$ 15,862,176

	For the year ended December 31, 2015				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Assets excluding segregated funds	\$ 959,181	\$ 162,597	\$ 4,301,805	\$ 1,572,138	\$ 6,995,721
Segregated funds	7,347,426	—	20,397	—	7,367,823
Total assets	\$ 8,306,607	\$ 162,597	\$ 4,322,202	\$ 1,572,138	\$ 14,363,544

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. Segregated fund assets are not available to pay liabilities of the general fund.

25. Commitments and Contingencies

Investment Commitments

In the normal course of business, outstanding investment commitments are not reflected in the Consolidated Financial Statements. In January 2016 the Company made a \$20,000 commitment to purchase additional units in a real estate limited partnership. Draws on this commitment are payable on demand up to and including July 31, 2018.

On January 29, 2016, a cash call was settled to purchase units for \$2,000 in this real estate limited partnership.

On June 29, 2016, a cash call was settled to purchase units for \$6,667 in this real estate limited partnership.

On July 14, 2016, a cash call was settled to purchase units for \$1,666 in this real estate limited partnership.

At December 31, 2016 there remained \$9,667 (December 31, 2015, \$ nil) of outstanding cash calls to purchase units in the real estate limited partnership.

Lease commitments

The Company has entered into various operating leases as lessee for office space and certain computer and other equipment. Operating lease payments in 2016 were \$2,884 (2015 \$3,079). The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

As at December 31	2016	2015
2016	\$ —	\$ 2,662
2017	2,934	2,098
2018	2,880	1,840
2019	2,816	1,777
2020	1,694	761
2021 (and thereafter)	5,647	—
	\$ 15,971	\$ 9,138

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Other contingencies

The Company operates in the insurance industry and is subject to legal proceedings in the normal course of business. While it is not practicable to forecast or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings (including litigation) will have a material effect on its results and financial position.

The Company by-laws provide indemnification to its current and former directors, officers and employees to the extent permitted by law, against contractual indemnities and 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 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.

26. Related Party Transactions

The Company is a 98.3% owned subsidiary of E-L Financial Services Limited (ELFS) which in turn is a 100.0% owned subsidiary of E-L Financial Corporation Limited (E-L). E-L owns, directly and indirectly through ELFS, 99.2% of the common shares of Empire Life. The Company's ultimate controlling party is The Honourable Henry N. R. Jackman together with a trust created in 1969 by his father, Henry R. Jackman. In the normal course of business, the Company enters into transactions with E-L and other companies under common control or common influence involving the leasing of office property, investment management services and miscellaneous office services. The amounts earned and expensed were not significant. Some directors and officers have insurance and investment policies underwritten by the Company.

Compensation of key management personnel

Key management personnel are comprised of directors and executive officers of the Company. The remuneration of key management personnel is as follows:

For the year ended December 31		2016	2015
Salaries and other short-term and long-term employee benefits	\$	6,554	\$ 6,314
Post-employment benefits		524	616
Total	\$	7,078	\$ 6,930

Post-employment benefits are comprised of employer current service costs for pension and other post-employment benefits.

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27. Capital Management

The Company aims to manage its regulatory capital in order to meet the regulatory capital adequacy requirements of the *Insurance Companies Act* (Canada) as established and monitored by OSFI. Under the guidelines established by OSFI, the Company's regulatory capital consists of two tiers. The Company's Tier 1 regulatory capital includes common shares, contributed surplus, retained earnings and participating policyholders' equity. Tier 2 regulatory capital includes the accumulated unrealized gains on AFS equity securities, net of tax, negative reserves on insurance contract liabilities and subordinated debt. OSFI's target Tier 1 and total regulatory capital ratios for Canadian life insurance companies are 105% and 150% respectively. As at December 31, 2016 and December 31, 2015 the Company was in compliance with these ratios.

As at December 31	2016	2015
Tier 1 Regulatory Capital	\$ 1,206,134	\$ 917,617
Tier 2 Regulatory Capital	707,205	504,430
Total Regulatory Capital	\$ 1,913,339	\$ 1,422,047

28. Risk Management

The Company is exposed to risks arising from its investing activities and its insurance operations and to general reputation risk associated with these activities and its ability to manage specific risks. The following sections describe the principal risks and associated risk management strategies for the risks that management considers to be most significant in terms of likelihood and the potential adverse impact on the Company: market, liquidity, credit and insurance.

Caution related to sensitivities

In the sections that follow, the Company provides sensitivities and risk exposure measures for certain risks. These include sensitivities due to specific changes in market prices and interest rates, based on the market prices, interest rates, assets, liabilities and business mix in place as at the calculation dates. The sensitivities are calculated independently for each risk factor, assuming that all other risk variables remain constant. Actual results can differ materially from these estimates for a variety of reasons, including the interaction among these factors when more than one factor changes; changes in actuarial and investment return and future investment activity assumptions; actual experience differing from the assumptions; changes in business mix, effective tax rates and other market factors; and the general limitations of the Company's internal models used for purposes of these calculations. Changes due to new sales or maturities, asset purchases/sales, or other management actions could also result in material changes to these reported sensitivities. For these reasons, the sensitivities should only be viewed as directional estimates of the underlying sensitivities for the respective factors based on the assumptions outlined, and should not be viewed as predictors for the Company's future Net income, OCI, and capital sensitivities. Changes in risk variables in excess of the ranges illustrated may result in other than proportionate impacts.

(a) Market risk

Market risk is the risk of loss arising from adverse changes in market rates and prices such as interest rates, trading prices of equities, real estate and other securities, credit spreads and foreign 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. Under the Canadian insurance accounting and regulatory regime the Company's results for any period reflect equity market values and interest rates at the end of the period through mark-to-market accounting. Consequently, a decline in public equity market values or changes in interest rates or spreads could result in material changes to net income attributed to shareholders, increases to regulatory capital requirements and reduction in the Company's capital ratios.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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The Company buys investment quality bonds to support, to a very large extent, the liabilities under the insurance and annuity policies of the Company. The Company's investment strategy also includes the use of publicly-listed "large cap" common stocks to support the liabilities under its insurance policies. 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.

Furthermore, a decrease in the fair value of the Company's common stock portfolio results in reduced shareholders' equity, reduced policyholders' surplus and a reduced Minimum Continuing Capital and Surplus Requirements (MCCSR) position. Regulatory pressure to increase capital escalates as the MCCSR position 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 oversight of its investment managers by the Chief Investment Officer, the Asset Management Committee, and the Investment Committee of the Board. The Investment Committee actively monitors the portfolio size and asset mix.

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 the Board. The investment guidelines are designed to limit overall investment risk by defining investment objectives, eligible investments, diversification criteria, exposure, 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, 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 has an Asset Management Committee, which meets regularly and reports at least quarterly to the Investment Committee of the Board. The mandate of the Asset Management Committee includes monitoring of the matched position of Empire's investments in relation to its liabilities within the various segments of the Company's operations. The matching process is designed to require that assets supporting policy liabilities closely match 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. Asset segmentation guidelines, which are reviewed regularly with the Investment Committee, have been established to govern these activities. The Asset Management Committee reports regularly to the Investment Committee on the Company's matched positions, asset mixes, and investment allocation decisions relative to the Company's asset segments.

The Company has established a Capital Management Policy, capital management levels that exceed regulatory minimums and Dynamic Capital Adequacy Testing (DCAT) 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 and liquidity. Management monitors its MCCSR position on a regular basis and reports at least quarterly to the Board on the Company's MCCSR.

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For the Company, the most significant market risks are equity risk, interest rate risk and foreign exchange rate risk.

(1) Equity risk

The Company's investment portfolio consists primarily of bonds and equity securities and the fair value of its investments varies according to changes in general economic and securities market conditions, including volatility and declines 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, and the management fees collected on segregated fund contracts, mutual funds 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 and mutual funds is generally assumed by the policyholders and unit holders, respectively. 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. 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, MCCR position and results of operations. The Company has reinsured a portion of its segregated fund death benefit guarantee. During the fourth quarter of 2014, the Company initiated a semi-static, economic hedging program. The objective of the economic hedging program is to partially protect the Company from possible future MCCR ratio declines that might result from adverse stock market price changes. The program presently employs put options and futures on key equity indices. Improper use of these instruments could have an adverse impact on earnings. The Company 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 to all counterparties limited to \$100 million.

The Company has an Equity Risk Hedging Policy to support general fund economic hedging programs. The policy outlines objectives, risk limits and authorities associated with its economic hedging activities. Management monitors its economic hedging activities on a regular basis and reports, at least quarterly, to the Risk and Capital Committee of the Board on the status of the economic hedging program.

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 CIA. Product development and pricing policies also require consideration of portfolio risk and capital requirements in the design, development and pricing of the products. The Asset Management Committee reports quarterly to the Risk and Capital 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.

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The following table summarizes the estimated potential impact on the Company of a 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. The amounts in the following table include the effect of Empire Life's general fund equity risk economic hedging program (described above). For segregated fund guarantees the level of sensitivity is highly dependent on the level of the stock market at the time of performing the estimate. If period end equity markets are high relative to market levels at the time that segregated fund policies were issued, the sensitivity is reduced. If period end equity 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 guarantees represent the impact on shareholders' net income.

As at December 31, 2016				
	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' net income (including segregated fund guarantees)*	\$ 17,682	\$ (15,674)	\$ 36,045	\$ (35,579)
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ 2,340	\$ (2,340)	\$ 4,680	\$ (4,680)
Policyholders' other comprehensive income	\$ 2,563	\$ (2,563)	\$ 5,126	\$ (5,126)

As at December 31, 2015				
	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' net income (including segregated fund guarantees)*	\$ 11,804	\$ (6,789)	\$ 27,044	\$ (18,989)
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ 2,141	\$ (2,141)	\$ 4,282	\$ (4,282)
Policyholders' other comprehensive income	\$ 2,392	\$ (2,392)	\$ 4,784	\$ (4,784)

*Includes the estimated impact on fee income net of trailer commissions after tax for a three month period

For the life insurance business, the Company's policy is to use equity investments to cover estimated insurance liability cash flows of non-participating life and universal life products beyond 20 years following the balance sheet date. The value of the liabilities supported by these equities depends on assumptions about the future level of equity markets. The best estimate return assumptions for equities are primarily based on long-term historical averages of total returns (including dividends) for the Canadian equity market, which is 9.1% (2015 8.9%). The Company uses an assumption of 7.6% (2015 7.8%) to include provisions for moderate changes in equity rates of return determined in accordance with Canadian actuarial standards of practice. The returns are then reduced by margins to determine the net returns used in the valuation. Changes in the current market would result in changes to these assumptions.

The impact of an immediate change in equity markets is described above. If the change in equity markets persisted for one year, then a change to the actuarial future equity market return assumption would be made. For non-participating insurance business, a 1% decrease in future equity market returns would result in an increase to policy liabilities thereby reducing Net income by approximately \$111,600 (2015 \$116,500).

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The following table identifies the concentration of the Company's common equity holdings in Empire Life's investment portfolios:

As at December 31		2016		2015
Holdings of common equities in the 10 issuers to which the Company had the greatest exposure	\$	330,213	\$	286,544
Percentage of total cash and investments		4.5%		4.2%
Exposure to the largest single issuer of common equities	\$	75,594	\$	60,396
Percentage of total cash and investments		1.0%		0.9%

(2) Interest rate risk

Interest rate risk arises when economic losses are incurred 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 policy liabilities 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 to customers, 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 have an adverse effect on the Company's financial position and operating results.

The following tables summarize the estimated immediate financial impact on Net income and OCI as a result of an immediate change in interest rates.

As at December 31, 2016

		50 bps Increase		50 bps Decrease		100 bps Increase		100 bps Decrease
Shareholders' net income	\$	8,451	\$	(9,438)	\$	16,030	\$	(19,995)
Policyholders' net income	\$	169	\$	(184)	\$	323	\$	(386)
Shareholders' other comprehensive income	\$	(33,479)	\$	39,351	\$	(61,087)	\$	84,574
Policyholders' other comprehensive income	\$	(1,586)	\$	1,745	\$	(3,014)	\$	3,649

As at December 31, 2015

		50 bps Increase		50 bps Decrease		100 bps Increase		100 bps Decrease
Shareholders' net income	\$	8,640	\$	(9,700)	\$	16,349	\$	(20,608)
Policyholders' net income	\$	516	\$	(565)	\$	987	\$	(1,186)
Shareholders' other comprehensive income	\$	(29,672)	\$	34,385	\$	(54,631)	\$	73,483
Policyholders' other comprehensive income	\$	(1,368)	\$	1,452	\$	(2,652)	\$	2,987

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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 assets supporting policy liabilities are combined with estimated future reinvestment rates based on both the current economic outlook and the Company's expected future asset mix. In order to provide a margin that recognizes the mismatch of assets and liabilities, 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, bond 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 contract liabilities have a longer term than most available bonds and mortgages, the Company needs to reinvest net cash flows arising in the future to extend the duration of its assets. Under Canadian actuarial standards of practice, the yields assumed for these future reinvestments are related to current interest rates, the current economic outlook and the Company's expected future asset mix. The reinvestment assumption grades from the initial reinvestment rate (IRR) assumption to the ultimate reinvestment rate (URR) assumption over the rolling 40-year period following the balance sheet date.

The estimated impact of an immediate change in interest rates is described above. If interest rates increase or decrease during the next year, then a change to the IRR assumption would be required to take into account the then-current economic outlook. For non-participating insurance business, a 1% decrease in interest rates would cause a decrease in reinvestment assumption for the next 40-years, resulting in an increase to policy liabilities thereby reducing net income by approximately \$47,400 (2015 \$56,200). This assumes no change in the URR assumption.

For investment income expected to be earned on reinvestments beyond the rolling 40-year period, the Company uses an URR assumption. Under Canadian actuarial standards of practice, the URR assumption is prescribed as a long-term ultimate risk-free reinvestment rate of 3.3% plus a maximum amount for credit spreads minus asset default rates of 0.8%. The prescribed level of the URR assumption may be periodically changed by the actuarial standards setting body. As interest rates are currently lower than they were when the current URR assumptions were set, there may be a downward bias if the rates were to be updated.

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 contract liabilities are then adjusted to provide for credible adverse future scenarios. The Company uses an URR of 4.0% (2015 4.0%) to adjust for credible adverse 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. For annuity business, the impact a 1% decrease in assumed IRR has on policy liabilities and subsequently on Net income is negligible as a result of the matching process described above.

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Interest rate risk in Empire Life's investment portfolio 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, as well as establish diversification criteria, exposure, concentration and asset quality limits for these investments. The Asset Management Committee oversees sensitivity to interest rates. The objective is to maximize investment yields while managing the default, liquidity and reinvestment risks at acceptable levels and within risk tolerances. Product development and pricing policies and practices also require consideration of interest rate risk in the design, development and pricing of the products.

(3) Foreign exchange rate risk

Foreign exchange rate risk arises when the fair value of cash flows of a financial instrument fluctuate due to changes in exchange rates. This can create an adverse effect on earnings and equity when measured in 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 \$11,095 (2015 \$ nil) on shareholders' Net income, \$ nil (2015 \$ nil) on shareholders' OCI and \$ nil (2015 \$ nil) on policyholders' OCI. The Company's exposure to foreign currency risk in its financial liabilities is not material.

The Company 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. The Company manages this risk by applying limits established by the Risk and Capital 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 to all counterparties limited to \$100 million.

The Company has a Foreign Exchange Risk Management Policy which outlines objectives, risk limits and authority associated with any foreign exchange rate exposure. Oversight and management of this policy falls under the responsibility of the Asset Management Committee, which reports exposures and any breaches to the Investment Committee of the Board.

(b) Liquidity risk

Liquidity risk is the risk that an entity will not be able to fund all cash outflow commitments or obligations as they fall due or that, in order to fund commitments, an entity may have to sell assets at depressed prices resulting in losses at time of sale. Cash outflows could be in the form of benefit payments to policyholders, expenses, asset purchases and interest on debt. 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 debt (refer to Note 13 - 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. 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.

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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 by the Asset Management Committee and exposures and breaches are reported to the Investment Committee of the Board. The Company's current liquidity position as at December 31 is provided in a table in Note 10(e). 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.

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 deviations, used in the determination of policy liabilities. The actuarial and other policy liability amounts included in the Company's 2016 Consolidated 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.

As at December 31, 2016					
	1 year or less	1 - 5 years	5 - 10 years	Over 10 years	Total
Insurance contract liabilities	\$ 72,467	\$ 218,061	\$ 531,530	\$ 18,003,489	\$ 18,825,547
Investment contract liabilities	1,784	7,864	4,794	3,986	18,428
Subordinated debt	15,376	46,884	530,518	—	592,778
Preferred shares	8,596	160,087	—	—	168,683
Accounts payable and Other liabilities	220,540	7,191	20,505	—	248,236
Total liabilities	318,763	440,087	1,087,347	18,007,475	19,853,672
Operating lease commitments	2,934	8,220	4,297	520	15,971
Total	\$ 321,697	\$ 448,307	\$ 1,091,644	\$ 18,007,995	\$ 19,869,643

As at December 31, 2015					
	1 year or less	1 - 5 years	5 - 10 years	Over 10 years	Total
Insurance contract liabilities	\$ 90,776	\$ 191,264	\$ 473,493	\$ 17,495,346	\$ 18,250,879
Investment contract liabilities	2,263	6,061	3,468	3,373	15,165
Subordinated debt	8,610	24,210	311,238	—	344,058
Accounts payable and Other liabilities	168,734	6,050	23,174	—	197,958
Total liabilities	270,383	227,585	811,373	17,498,719	18,808,060
Operating lease commitments	2,662	6,476	—	—	9,138
Total	\$ 273,045	\$ 234,061	\$ 811,373	\$ 17,498,719	\$ 18,817,198

The Asset 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 cash, cash equivalents and short-term investments to meet its short-term funding requirements. As at December 31, 2016, 6.2% (2015 3.4%) of cash and investments were held in these shorter duration investments.

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(c) Credit risk

Credit risk is the possibility of loss from amounts either owed by financial counterparties, such as debtors, reinsurers and other financial institutions, or in connection with issuers of securities held in an asset portfolio. 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, cash and cash equivalents, mortgages and 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 Risk and Capital Committee of the Board respectively. 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 Reinsurance Risk Management Policy (along with supporting material in the Product Design and Pricing Risk Management Policy) 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.

Credit risk analysis includes the consideration of credit spreads. From an investment perspective, when buying credit the Company is guided by two principles; first that there is a high likelihood of return of principal and second that there is an acceptable return on investment. The Company looks to obtain a risk/reward balance that aligns with its objectives and risk philosophy. When determining insurance contract liabilities, credit spreads and changes in credit spreads are reflected in the interest rate assumption.

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

As at December 31		2016	2015
Cash and cash equivalents	\$	368,873	\$ 199,770
Short-term investments		102,874	33,652
Bonds		5,521,172	5,193,439
Preferred shares		285,184	194,680
Derivative assets		3,855	14,649
Mortgages		264,309	289,221
Reinsurance		95,473	94,922
Loans on policies		47,969	46,925
Policy contract loans		80,944	84,921
Accrued investment income		40,551	26,023
Insurance receivables		53,097	47,909
Trade accounts receivable		33,731	20,803
Total	\$	6,898,032	\$ 6,246,914

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

The Company has made provision in its Consolidated Statements of Financial Position for credit losses. Provisions have been made partly through reduction in the value of the assets (see Note 3(b)) and partly through a provision in policy liabilities (see Note 10(c)).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Concentration of credit risk

(1) Bonds and debentures

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

As at December 31	2016		2015	
	Fair value	% of Fair value	Fair value	% of Fair value
AAA	\$ 380,423	7%	\$ 308,435	6%
AA	591,132	11%	524,546	10%
A	3,689,809	66%	3,628,158	70%
BBB (and lower ratings)	859,808	16%	732,300	14%
Total	\$ 5,521,172	100%	\$ 5,193,439	100%

Credit ratings are normally obtained from Standard & Poor's (S&P) and Dominion Bond Rating Service (DBRS). In the event of a split rating, the lower rating is used. Issues not rated by a recognized rating agency (i.e. S&P, DBRS, or Moody's) are rated internally by the Investment Department. The internal rating assessment is documented referencing suitable comparable investments rated by recognized rating agencies and/or methodologies used by recognized rating agencies.

Provincial bonds represent the largest concentration in the bond portfolio, as follows:

As at December 31	2016	2015
Provincial bond holdings	\$ 2,925,004	\$ 2,845,599
Percentage of total bond holdings	53.0%	55.0%

The following table profiles the bond portfolio by contractual maturity, using the earliest contractual maturity date:

As at December 31	2016		2015	
	Fair value	% of Fair value	Fair value	% of Fair value
1 year or less	\$ 59,872	1%	\$ 66,769	1%
1 - 5 years	586,444	11%	560,124	11%
5 - 10 years	637,529	12%	571,599	11%
Over 10 years	4,237,327	76%	3,994,947	77%
Total	\$ 5,521,172	100%	\$ 5,193,439	100%

The following table discloses the Company's holdings of fixed income securities in the 10 issuers (excluding the federal government) to which the Company had the greatest exposure, as well as exposure to the largest single issuer of corporate bonds.

As at December 31	2016	2015
Holdings of fixed income securities* in the 10 issuers (excluding federal governments) to which the Company had the greatest exposure	\$ 3,534,308	\$ 3,480,719
Percentage of total cash and investments	46.5%	50.8%
Exposure to the largest single issuer of corporate bonds	\$ 154,112	\$ 151,859
Percentage of total cash and investments	2.0%	2.2%

*Fixed income securities includes bonds, debentures, preferred shares and short term investments.

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(2) Preferred shares

The Company's preferred share investments are all issued by Canadian companies, with 1% (2015 4%) of these investments rated as P1 and the remaining 99% (2015 96%) rated as P2.

(3) Mortgages

Mortgages in the province of Ontario represent the largest concentration with \$264,309 or 100% (2015 \$288,622 or 99%) of the total mortgage portfolio.

(d) Insurance risk

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

(millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital & Surplus		Total	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
For the year ended December 31										
Net premium income	\$ 176	\$ 144	\$ 339	\$ 325	\$ 367	\$ 366	\$ —	\$ —	\$ 882	\$ 835
Fee and other income	217	207	9	9	2	1	—	—	228	217
Total	\$ 393	\$ 351	\$ 348	\$ 334	\$ 369	\$ 367	\$ —	\$ —	\$ 1,110	\$ 1,052

Insurance risk is the risk that actual experience related to claims, benefit payments, expenses, cost of embedded product options and cost of guarantees associated with insurance risks, does not emerge as expected. The Company is exposed to various insurance risks as a result of the business it writes, including: mortality, policyholder behaviour (termination or lapse), expenses, morbidity, longevity, product design and pricing risk, underwriting and claims risk and reinsurance risk.

The Company regularly evaluates its exposure to foreseeable risks through stress testing techniques including DCAT analysis.

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, longevity, lapse, expenses, inflation and 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. These margins are intended to allow for possible deterioration in experience and to provide greater confidence that policy liabilities are adequate to pay future benefits. The effect of these margins is to increase policy liabilities over the best estimate assumptions.

The margins for adverse deviation used by the Company are within the target range established by the CIA. A correspondingly larger margin is included in the insurance contract liabilities if an assumption is susceptible to change or if there is more uncertainty about the best estimate assumption. Each margin is reviewed annually for continued appropriateness.

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Policy liability assumptions are reviewed and updated at least annually by the Company's Appointed Actuary. The impact of changes in those assumptions is reflected in earnings in the year of the change. Details related to the changes in assumptions are also discussed with the Audit Committee of the Board. The methods for arriving at the most important of these assumptions are outlined below. Also included are measures of the Company's estimated net income sensitivity to changes in best estimate assumptions in the non-participating insurance liabilities, based on a starting point and business mix as of December 31, 2016. For participating business it is assumed that changes will occur in policyholder dividend scales corresponding to changes in best estimate assumptions such that the net change in participating insurance contract liabilities is immaterial.

(1) 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.

For non-participating insurance business, a 2% increase in the best estimate mortality assumption would increase policy liabilities thereby decreasing Net income by approximately \$9,700 (2015 \$11,900).

For annuity business, lower mortality (or longevity) is financially adverse so a 2% decrease in the best estimate mortality assumption would increase policy liabilities thereby decreasing Net income by approximately \$4,000 (2015 \$4,500).

(2) Policyholder behaviour (termination or lapse)

Policy termination (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 policy termination assumptions are used for permanent cash-value business, for renewable term insurance, term insurance to age 100 and for universal life insurance. In setting policy termination 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 policy termination rates early in the life of the policy would tend to reduce profits for shareholders. An increase in policy termination rates later in the life of the policy would tend to increase profits for shareholders if the product is lapse supported (such as term insurance to age 100), but decrease shareholder profits for other types of policies.

For non-participating insurance and annuity business a 10% adverse change in the lapse assumption would result in an increase to policy liabilities thereby decreasing Net income by approximately \$118,400 (2015 \$113,500). For products where fewer terminations would be financially adverse to the Company, the change is applied as a decrease to the lapse assumption. Alternatively, for products where more terminations would be financially adverse to the Company, the change is applied as an increase to the lapse assumption.

(3) 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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For non-participating insurance business and annuity business combined, a 5% increase in the maintenance expense assumption would result in an increase to policy liabilities thereby reducing net income by approximately \$5,900 (2015 \$5,500).

(4) Morbidity

The Company carries out annual internal studies of its own morbidity experience where morbidity refers to both the rates of accident or sickness and the rates of recovery from the accident or sickness. The valuation assumptions are based on a combination of internal experience and recent CIA industry experience.

For individual critical illness business, the incidence rates (or rates of accident or sickness) are the key assumption related to morbidity. An increase in incidence rates would result in an increase in the number of claims which increases expenditures and reduces shareholders' profits. For group long-term disability business the termination rates (or rates of recovery) are the key assumption related to morbidity. A decrease in termination rates would result in disability claims persisting longer which increases expenditures.

For non-participating insurance business where morbidity is a significant assumption, a 5% adverse change in the assumption would result in an increase to policy liabilities thereby reducing Net income by approximately \$6,500 (2015 \$6,300).

(5) 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 key programs and controls are described as follows. 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 DCAT and reports annually to the 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 Risk Management Policy for each of its major product lines. This policy, which is established by management and approved by the Risk and Capital Committee of the Board, 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 monitoring processes and controls.

(6) 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.

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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 Risk Management Policy for each of its major product lines. This policy is established by management and approved by the Risk and Capital Committee of the Board. Together, these policies define the Company's underwriting and claims management philosophy. These policies also set out 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 and the Board approves changes to these retention limits.

(7) Reinsurance risk

The Company is subject to the risk of financial loss due to inadequate 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 reinsurance market conditions, both in terms of price and availability, which can also affect earnings.

The Reinsurance Risk Management Policy establishes reinsurance objectives and limits, and requires ongoing evaluation of reinsurers for financial soundness. As reinsurance does not release a company from its primary commitments to its policyholders, an ongoing oversight process is critical. Management reports annually to the Risk and Capital Committee of the Board on reinsurance activities. Most of the Company's individual life reinsurance (with the exception of its renewable term 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 renewable term 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 retention 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. A portion of Empire Life's segregated fund death benefit exposure is reinsured. All Empire Life segregated fund policyholders with death benefit guarantees of at least \$2 million are included in this agreement.

As a result of this reinsurance strategy, the Company utilizes lower than average levels of reinsurance, compared to Canadian competitors, and absorbs the resultant negative impact on short-term earnings due to additional sales strain. The Company does not have any assumed reinsurance business.

GLOSSARY OF TERMS (unaudited)

Accumulated Other Comprehensive Income (AOCI)

A separate component of shareholders' and policyholders' equity which includes net unrealized gains and losses on available for sale securities, unamortized gains and losses on cash flow hedges, unrealized foreign currency translation gains and losses and remeasurement of post-employment benefit liabilities. These items have been recognized in comprehensive income, but excluded from net income.

Active Market

An active market is a market in which the items traded are homogeneous, willing buyers and sellers can normally be found at anytime and prices are available to the public.

Available For Sale (AFS) Finance Assets

Non-derivative financial assets that are designated as AFS or that are not classified as loans and receivables, held to maturity investments, or held for trading. Most financial assets supporting capital and surplus are classified as AFS.

Canadian Asset Liability Method (CALM)

The prescribed method for valuation of policy liabilities in Canada. CALM is a prospective basis of valuation which uses the full gross premium for the policy, the estimated expenses and obligations under the policy, current expected experience assumptions plus a margin for adverse deviations, and scenario testing to assess interest rate risk and market risks.

Canadian Institute of Actuaries (CIA)

As the national organization of the Canadian actuarial profession, the CIA means to serve the public through the provision by the profession of actuarial services and advice of the highest quality. The CIA ensures that the actuarial services provided by its members meet accepted professional standards; and assists actuaries in Canada in the discharge of their professional responsibilities.

Canadian Life and Health Insurance Association (CLHIA)

The Canadian Life and Health Insurance Association (CLHIA) is an organization representing life insurance and health insurance providers in Canada. The industry develops guidelines, voluntarily and proactively, to respond to emerging issues and to ensure consumer interests are protected.

Chartered Professional Accountants of Canada (CPA Canada)

Canada's not-for-profit association for Chartered Professional Accountants (CPA) provides information and guidance to its members, students and capital markets. Working in collaboration with its provincial member organizations, CPA Canada supports the setting of accounting, auditing and assurance standards for business, not-for-profit organizations and government, and develops and delivers education programs.

Earnings on Surplus

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

Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Expected Profit from In-Force Business

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

GLOSSARY OF TERMS (unaudited)

Experience Gains and Losses

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

Fair Value Through Profit or Loss (FVTPL)

Invested assets are classified as financial instruments at FVTPL if they are held for trading, or if they are designated by management under the fair value option. Most financial assets supporting insurance contract liabilities and investment contract liabilities are classified as FVTPL.

Impact on New Business

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

International Financial Reporting Standards (IFRS)

Refers to the international accounting standards that were adopted in Canada, effective January 1, 2011; these are now Canadian Generally Accepted Accounting Principles (CGAAP) for publicly accountable enterprises.

Management Actions and Changes in Assumptions

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

Minimum Continuing Capital and Surplus Requirements (MCCSR)

The ratio of the available regulatory capital of a life insurance company to its required regulatory capital, each as calculated under the Office of the Superintendent of Financial Institutions' (OSFI) published guidelines.

Other Comprehensive Income (OCI)

Unrealized gains and losses, primarily on financial assets backing Capital and Surplus, are recorded as Other Comprehensive Income ("OCI") or Other Comprehensive Loss ("OCL"). When these assets are sold or written down the resulting gain or loss is reclassified from OCI to net income. Remeasurements of post-employment benefit liabilities are also recorded as OCI or OCL. These remeasurements will not be reclassified to net income and will remain in AOCI.

Office of the Superintendent of Financial Institutions Canada (OSFI)

The primary regulator of federally chartered financial institutions and federally administered pension plans in Canada. OSFI's mission is to safeguard policyholders, depositors and pension plan members from undue loss.

Participating Policies

The participating account includes all policies issued by the Company that entitle its policyholders to participate in the profits of the participating account. The Company has discretion as to the amount and timing of dividend payments which take into consideration the continuing solvency of the participating account.

Return on Common Shareholders' Equity (ROE)

A profitability measure that presents the net income available to common shareholders as a percentage of the average capital deployed to earn the income.

PARTICIPATING ACCOUNT MANAGEMENT POLICY

Purpose

The Participating Account Management Policy sets out the management objectives for oversight of the participating account of The Empire Life Insurance Company (“Empire Life” or the “Company”).

Scope

This policy applies to all policies issued in the participating account of Empire Life that entitle its policyholders to participate in the profits of the participating account. Most policies are credited with dividends annually, while a few older plans receive the dividends every five years as per contractual provisions.

Policy

Description of the Participating Account and its Policies

Empire Life maintains an account in respect of participating policies (“participating account”), separate from those maintained in respect of other policies, in the form and manner determined by the Office of the Superintendent of Financial Institutions under section 456 of the Insurance Companies Act. The participating account includes all policies issued by Empire Life that entitle its policyholders to participate in the profits of the participating accounting.

Empire Life does not maintain sub-accounts within the participating account for life, disability and annuity plans, other funds, or blocks of business acquired from other companies. Empire Life does not have any closed blocks of participating business established as part of the demutualization of a mutual company into a shareholder company.

Investment Policy

The general fund investments in the participating account are subject to limits established by the Insurance Companies Act and to investment guidelines established by the Investment Committee of Empire Life’s Board of Directors (the “Board”). The investment guidelines are designed to limit overall investment risk by defining investment objectives, eligible investments, diversification criteria, exposure, concentration and asset quality limits for eligible investments. Interest rate risk is managed through Investment Committee established limits and regular reporting by management to the Investment Committee and the Board. The Asset 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.

Within the participating account, Empire Life has established three asset segments to nominally match the investments to the specific type of liabilities or surplus as follows: Protection Par, Miscellaneous Insurance Par and Policyholders’ Surplus. Each asset segment is assigned specific assets in an amount approximately equal to its total liabilities or surplus. Each asset segment is also subject to asset segmentation guidelines established by the Asset Management Committee and approved by the Investment Committee.

The Investment Committee receives monthly reporting on general fund asset mix and performance and investment transactions for all funds by asset segment. 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 investment guidelines are reviewed at least annually by the Board.

Investment Income Allocation

Investment income is recorded directly to each asset segment. A portion of investment income is allocated to or from the Shareholders’ Capital and Surplus segment from or to the participating account’s asset segments in proportion to the deficiency or excess of funds over assets of each segment.

PARTICIPATING ACCOUNT MANAGEMENT POLICY

Expense Allocation

General expenses are allocated to the participating account using cost centre methods. Expenses associated directly with the participating account are so charged. Expenses arising from or varying directly with various functional activities are charged to the participating account in proportion to statistics appropriate to each cost centre. Expenses incurred by overhead cost centers are charged to the participating account in proportion to expenses directly charged.

Investment expenses are allocated monthly to the participating account in proportion to the Company's total funds at the beginning of each month.

Premium taxes are allocated in proportion to taxable premiums. Other taxes, licenses, and fees are allocated to lines of business using cost centre methods.

Income Tax Allocation

Income taxes are allocated to the participating account in proportion to total taxable income for the Company. Deferred tax assets and liabilities are treated consistently between participating and non-participating accounts.

Surplus Management

The level of surplus in the participating account will be managed by Company management taking into consideration the continuing solvency of the participating account, the participating account's ability to fulfill all of its contractual obligations and the extent to which existing participating business is financing new participating business.

Transfers to Shareholder Accounts

It is Empire Life's intention to transfer the full permitted percentage of distributable participating profits to the shareholder accounts as allowed by section 461 of the Insurance Companies Act.

Appointed Actuary

Annually, the Board will consider the Appointed Actuary's opinion on the continuing fairness of this policy to participating policyholders.

Process to Approve (and Frequency)

This policy is reviewed annually by the Vice President & Product Actuary. All non-material amendments must be approved by the Chief Actuary. Material amendments must be approved by the Board. The principal factors that would be expected to change the policy include changes in legislation, regulation of participating account, accepted actuarial practice, capital requirements, taxation and accounting rules or fundamental changes to the circumstances of the Company.

This policy will also be reviewed if the Company decides to stop accepting new business in the participating account.

PARTICIPATING POLICYHOLDER DIVIDENDS AND BONUS POLICY

Purpose

The Participating Policyholder Dividends and Bonus Policy (the “dividend policy”) sets out the process for determining, recommending and declaring dividends for policies issued in the participating account of The Empire Life Insurance Company (“Empire Life” or the “Company”).

Scope

This dividend policy applies to all policies issued in the participating account of Empire Life that entitle its policyholder to participate in the profits of the participating account. Most policies are credited with dividends annually, while a few older plans receive the dividends every five years as per contractual provisions.

Policy Dividends are Declared at the Discretion of the Board

The aggregate amount of dividend and allocation of the dividend to the different classes of participating policies is declared annually at the discretion of the Board of Directors (the “Board”) of Empire Life under section 464(1) of the Insurance Companies Act. Before declaring the aggregate amount of dividend, the Board will consider Company management’s recommendations for policyholder dividends and the Appointed Actuary’s opinion on the conformity of the proposed dividend to this policy and its fairness to participating policyholders. Company management’s recommendations and the Appointed Actuary’s opinions shall be prepared in compliance with applicable legislative and regulatory requirements, and generally accepted actuarial practice with such changes as determined by the Office of the Superintendent of Financial Institutions.

Principal Factors that Affect the Aggregate Amount of Dividends

The aggregate amount of dividends will reflect operating income on all participating life, annuity and disability coverages, dividends on deposit, participating paid-up additions and participating term additions, as well as income attributable to surplus in the participating account. The aggregate amount of dividends will also be influenced by considerations such as, solvency of the participating account, its ability to fulfill all contractual obligations, the extent to which surplus in the participating account is financing new business, changes in legislation, regulation of the participating account, taxation, accounting rules or fundamental changes in the circumstances of the Company.

Principal Sources of Income

The principal sources of income considered for determining the aggregate amount of dividends are investment income, asset defaults, mortality, lapses, expenses and taxes. The actual experience of the participating account will be reviewed annually by Company management. The sources of income may be adjusted to smooth fluctuations in experience and provide for transitions during periods of major change over a period not to exceed five years. The Company uses a temporary contribution to policyholder surplus philosophy, so that contributions to policyholder surplus from participating account income are expected to be returned to policyholders over the lifetime of the policy. Since actual experience cannot be known in advance, the aggregate amount of dividends and allocation of the dividends cannot be guaranteed. As a result, dividends will increase or decrease depending on actual experience.

Dividend Allocation

Policyholders participate in this distribution through the setting of dividend scales, which allocate the aggregate amount of dividends among different dividend classes. The Company establishes dividend classes for participating policyholders based on the original pricing assumptions used when setting the guaranteed values provided by the policies. The Company uses a combination of factor-based and pricing methods when setting the dividend scale to allocate the aggregate amount of dividends among different dividend classes. The basic concept of this method is to allocate the aggregate amounts of dividends among dividend classes in the same proportion as the policies are considered to have contributed to the aggregate amount of dividends over the long term. The fundamental objective in the allocation of dividends is the maintenance of reasonable equity between dividend classes and between generations of policyholders, taking into account practical considerations and limits.

PARTICIPATING POLICYHOLDER DIVIDENDS AND BONUS POLICY

Company management will review the underlying experience, assumptions and procedures for participating dividend scales annually. Material changes in actual experience will be passed through to participating policyholders within two years of the experience change to the extent that they are not anticipated in the current dividend scale. Company management will prepare a written report which describes the underlying experience, assumptions and procedures for the proposed dividend scale recommendations.

The dividend scales may also be adjusted to reflect specific policyholder behaviour, such as experience for lapses or for policy loans taken at guaranteed rates.

For certain blocks of policies, the policyholder dividend scale may be determined using methods which are designed to approximate the contribution to income of those blocks.

Termination dividends are not payable under any participating policies issued by Empire Life.

Appointed Actuary

Annually, the Board will consider the Appointed Actuary's opinion on the continuing fairness of this policy to participating policyholders.

Process to Approve (and Frequency)

This policy is reviewed annually by the Vice President & Product Actuary. All non-material amendments must be approved by the Chief Actuary. Material amendments must be approved by the Board. The principal factors that would be expected to change the policy include changes in legislation, regulation of participating account, accepted actuarial practice, capital requirements, taxation and accounting rules or fundamental changes to the circumstances of the Company.

This policy will also be reviewed if the Company decides to stop accepting new business in the participating account.

CORPORATE GOVERNANCE OVER RISK MANAGEMENT

The Empire Life Insurance Company (the “Company”) is a stock company that has both shareholders and participating policyholders. The Company also has a mutual fund subsidiary, Empire Life Investments Inc. (“ELII”).

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

Management is responsible for identifying risks and determining their impact upon the Company. Management is also responsible for establishing appropriate policies, procedures, and controls to mitigate risks. The Company has an internal risk management committee, which reports to the Risk and Capital Committee of the Board of Directors and an internal risk management department, led by the Chief Risk Officer, which supports enterprise risk management activities across the Company. An internal audit function is responsible for assessing the adequacy and adherence to the systems of internal control. The results of internal audit’s reviews are reported to management and to the Audit Committee of the Board of Directors regularly throughout the year.

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

The Board of Directors has plenary power. The Board’s responsibility is to oversee the conduct of the business and affairs of the Company including oversight and monitoring of the Company’s risk management. The Board discharges these responsibilities directly and through delegation to Board Committees and management. The Board met nine times in 2016 and is scheduled to meet at least six times in 2017.

The risk management functions overseen by the Board include those relating to market risk (including interest rate risk, equity risk, real estate risk and foreign exchange rate risk), liquidity risk, credit risk, insurance risk (including mortality risk, policyholder behavior (termination or lapse) risk, expense risk, morbidity risk as well as product design and pricing risk, underwriting and claims risk and reinsurance risk), operational risk (including legal and regulatory risk, model risk, human resources risk, third party risk and technology, information security and business continuity risk) and business and strategic risk. Primary responsibility for oversight of some of these risks is delegated to five standing Committees of the Board, whose roles and responsibilities are specifically defined. Those not delegated to a standing Committee remain with the Board. The following is a brief summary of some of the key responsibilities of the five Committees.

The Audit Committee has statutory responsibility under the Act to oversee, on behalf of the Board, the Company’s financial reporting, accounting and financial reporting systems and internal controls. The Committee also oversees work related to stress testing.

The Investment Committee assists the Board in monitoring the Company’s investment and lending policies, standards and procedures and in monitoring the Company’s investment activities and portfolios. Some of the activities of the Investment Committee are prescribed by the Company’s Investment Guidelines, which reflect the requirements of the Act. The Committee also monitors the Company’s asset/liability management activities.

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

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

The Risk and Capital Committee is responsible for oversight of the Company’s risk and capital management activities. The Committee also monitors capital utilization as well as risk identification and assessment in accordance with approved risk management policies and the approved risk appetite framework.

CORPORATE INFORMATION

Corporate Head Office

259 King Street East
Kingston, Ontario
Canada K7L 3A8
1 877 548-1881
info@empire.ca
www.empire.ca

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

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

RETAIL SALES OFFICES

WESTERN CANADA

Vancouver Retail Sales Office

N302-5811 Cooney Road, North Tower
Richmond, British Columbia V6X 3M1
604 232-5557
1 888 627-3591

Calgary Retail Sales Office

100-1401 1st Street S.E.
Calgary, Alberta T2G 2J3
403 269-1000
1 800 656-2878

Winnipeg Retail Sales Office

200-5 Donald Street
Winnipeg, Manitoba R3L 2T4
204 452-9138
1 866 204-1001

ONTARIO

Burlington Retail Sales Office

601-5500 North Service Road
Burlington, Ontario L7L 6W6
905 335-6558
1 888 548-4729

Toronto Retail Sales Office

200 -36 York Mills Road
Toronto, Ontario M2P 2E9
416 494-0900
1 888 548-4729

QUEBEC

Montréal Retail Sales Office

1600-600 de Maisonneuve Boulevard W.
Montréal, Quebec H3A 3J2
514 842-9151
1 800 371-9151

Québec Retail Sales Office

100-1220 Lebourgneuf Boulevard
Québec, Quebec G2K 2G4
418 628-1220
1 888 816-1220

GROUP SALES OFFICES

WESTERN CANADA

Vancouver Group Sales Office

N302-5811 Cooney Road, North Tower
Richmond, British Columbia V6X 3M1
604 232-5558
1 800 547-0628

Calgary Group Sales Office

100-1401 1st Street S.E.
Calgary, Alberta T2G 2J3
403 262-6386
1 888 263-6386

ONTARIO

Burlington Group Sales Office

601-5500 North Service Road
Burlington, Ontario L7L 6W6
905 335-6558
1 800 663-9984

Toronto Group Sales Office

200-36 York Mills Road
Toronto, Ontario M2P 2E9
416 494-6834
1 800 361-7980

Ottawa Group Sales Office

Northwood Executive Centre
43 Auriga Street, Suite 129
Nepean, Ontario K2E 7Y8
613 548-1881 ext. 8636
1 877 548-1881 ext. 8636

London Group Sales Office

380 Wellington Street, Suite 658
London, Ontario N6A 5B5
519 438-1751

QUEBEC

Montréal Group Sales Office

1600A-600 de Maisonneuve Boulevard W.
Montréal, Quebec H3A 3J2
514 842-0003
1 800 561-3738

BOARD OF DIRECTORS

SHAREHOLDERS' DIRECTORS

John F. Brierley^{1, 2, 5}
Corporate Director

Edward M. Iacobucci^{1, 2, 3}
Dean, Faculty of Law
University of Toronto

Duncan N.R. Jackman^{3, 5}
Chairman of the Board
The Empire Life Insurance Company

Clive P. Rowe^{4, 5}
Partner
Oskie Capital

Stephen J.R. Smith^{4, 5}
Chairman and President
First National Financial LP

Mark M. Taylor^{1, 4}
Corporate Director

POLICYHOLDERS' DIRECTORS

Mark J. Fuller^{2, 3, 5}
President and Chief Executive Officer
Ontario Pension Board

Harold W. Hillier^{1, 2, 4}
Corporate Director

Mark Sylvia
President and Chief Executive Officer
The Empire Life Insurance Company

Jacques Tremblay⁵
Partner
Oliver Wyman Actuarial Consulting

HONORARY CHAIRMAN

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

HONORARY DIRECTOR

The Right Honourable John N. Turner

¹ Member of Audit Committee

² Member of Conduct Review Committee

³ Member of Human Resources Committee

⁴ Member of Investment Committee

⁵ Member of Risk and Capital Committee

CORPORATE MANAGEMENT

Mark Sylvia

President and Chief Executive Officer

Richard Carty

General Counsel and Senior Vice-President, Human Resources

Richard Cleaver

Senior Vice-President and Chief Technology Officer

Ron Friesen

Senior Vice-President and Chief Financial Officer

Edward Gibson

Senior Vice-President and Chief Actuary

Ian Hardacre

Senior Vice-President and Chief Investment Officer

Sean Kilburn

Senior Vice-President, Retail

Steve Pong

Senior Vice-President, Group Solutions

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EMPIRE LIFE ANNUAL REPORT 2016

The Empire Life Insurance Company (Empire Life) is a proud Canadian company that has been in business since 1923. We offer individual and group life and health insurance, investment and retirement products, including mutual funds through our wholly-owned subsidiary Empire Life Investments Inc.

Empire Life is among the top 10 life insurance companies in Canada¹ and is rated A (Excellent) by A.M. Best Company². Our mission is to make it simple, fast and easy for Canadians to get the investment, insurance and group benefits coverage they need to build wealth, generate income, and achieve financial security.

Follow Empire Life on Twitter @EmpireLife or visit our website, www.empire.ca for more information.

¹ Based on general fund and segregated fund assets in Canada as at December 31, 2015 as reported in regulatory filings

² As at May 27, 2016

Transfer Agent and Registrar

CST Trust Company
320 Bay Street, 3rd Floor
Toronto, Ontario, M5H 4A6
Phone: 416-682-3860
Toll Free: 800-387-0825
www.canstockta.com

Stock Exchange Listing

Preferred Shares, Series 1 EML.PR.A

Reporting Procedure for Accounting and Auditing Matters

If you have a complaint regarding accounting, internal controls or auditing matters or a concern regarding questionable accounting or auditing matters, you should submit your written complaint or concern to:

Mr. John Brierley
The Empire Life Insurance Company
259 King Street East
Kingston, ON, K7L 3A8
Email: jfbrierley@sympatico.ca
Phone: 905-338-7290

You may submit your complaint or concern anonymously. Your submission will be kept confidential and will be treated in accordance with the Company's policy for reporting accounting and auditing matters.

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Policies are issued by The Empire Life Insurance Company.

Insurance & Investments – Simple. Fast. Easy.®

www.empire.ca info@empire.ca

