

# The Empire Life Insurance Company

## Annual Report 2014



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# 2014 FINANCIAL HIGHLIGHTS

**197%**

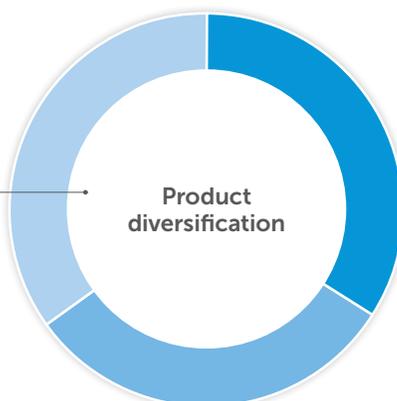
**MCCSR ratio**  
as at December 31, 2014

## 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, 2014

Empire Life is well-diversified across three product lines:

Wealth Management

**34%**



Employee Benefits

**31%**



Individual Insurance

**35%**



Shareholders' Net Income  
2014 (in millions)

**\$98.7**

Shareholders' Net Income  
2013 (in millions): **\$113.3**

Net Premium and Fee Income  
2014 (in millions)

**\$1,055**

Net Premium and Fee Income  
2013 (in millions): **\$972**

Total Assets Under Management  
2014 (in millions)

**\$13,723**

Total Assets Under Management  
2013 (in millions): **\$12,013**

## 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 21, 2014)

## Subordinated Debt Rating of A (low)

Issuer Rating of A

Claims Paying Rating of IC-2  
(2nd of five categories)

DBRS (as at May 23, 2014)

**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 2014 Annual Report.

## MESSAGE FROM THE CHAIRMAN OF THE BOARD

Empire Life experienced another year of profitable growth in 2014. We continue to be successful in helping Canadians build wealth and protect their financial security in a challenging and competitive business environment.

In June 2014, we appointed Mark Sylvia as President and CEO of Empire Life. Mark has an impressive track record of leading and growing Canadian insurance companies by focusing on service, simplicity and strategic partnerships. His vision and focus on measuring to improve and achieving greater profitable growth is already becoming a key focus within the company. The Board has full confidence in Mark's leadership and the management of the company and in its direction.

I wish to recognize and thank Les Herr for his vision and leadership during his tenure as President and CEO and for establishing a strategic direction and foundation for growth that we continue to build upon today.

I would also like to acknowledge the contributions of three Board members who left this past year. Jim Billett has retired, and Paul Weiss and Deanna Rosenswig did not seek re-election. I thank Jim, Paul, Deanna for their leadership and many contributions to our Board.

We are very fortunate to welcome two new Board members in 2014, John Brierley and Jacques Tremblay. I am proud to serve with our Board members who apply their strategic thinking and insights to understand the company's strategy, challenges and successes, while providing thoughtful guidance and deliberation. The depth of talent on our board is considerable and I am very pleased with the work we have accomplished this past year.

Finally, on behalf of the Board of Directors, I wish to thank our shareholders and policyholders for their support and Empire Life employees who continue to demonstrate why this company is one of the best life insurance companies in Canada. Your dedication, commitment and focus on growing Empire Life can never be underestimated and is always deeply appreciated.



Duncan N. R. Jackman  
Chairman of the Board  
February 27, 2015

## MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

The state of the world economy was a major issue in 2014. The impact this has on Canadian equity markets and interest rates is larger than we often anticipate. Against a background of relatively slow economic growth, the TSX index ended the year 7.4% above the previous year's close after hitting a peak of 14.9% above the prior year in early September. This significant decrease in the index over the past four months of 2014 was a signal that investors were concerned about future economic growth.

The Government of Canada 10-year bond yield finished the year at exactly 1.0%, a number which was down from the yield of 1.09% at the beginning of the year. This was also a sign of anticipated weak economic growth ahead.

Do these events impact life insurance companies? The answer to that question is yes, significantly. We rely on investment income from bonds to fund the reserves backing our policy liabilities; to a lesser but important degree we also rely on growth of equity markets. The lower interest rate environment impacts our reinvestment rates, which results in the need to increase our reserves to fund future liabilities.

From a sales perspective, 2014 was a solid year. Our new group insurance sales were \$42 million in 2014 compared to \$52 million in 2013, which is a year-over-year decrease. The group insurance market is in a phase of hyper-competitiveness. Our traditional small employer market niche has become the focus of group insurers who previously concentrated on the larger employer market. This additional competition has lowered prices and we have not been willing to underprice new customers to get new sales.

Our Individual Insurance sales in 2014 were \$59 million compared to \$55 million in 2013. This was a solid result. The demographics that drive new life insurance sales are relatively flat. Our increased sales in 2014 reflect the dedication of our sales and customer service teams who support our advisor partners. This superior service has generated the additional sales achieved in 2014.

Our segregated fund sales achieved a solid increase in 2014. New deposit premiums were \$1.3 billion compared to \$1.0 billion in 2013. This is a growing business. Our products are aimed at the retirement and pre-retirement members of the baby boom generation. This large segment of the Canadian population will be saving at a high rate over the next decade as they move from asset accumulation during their working years, to asset utilization during their retirement years. Our segregated fund and annuity products are able to offer retirement income guarantees not available in other products. Our annuity product sales were \$186 million in 2014, compared to \$159 million in 2013, a solid increase. Our mutual fund sales in 2014 increased to \$68 million compared to \$22 million in 2013. The combined total investment product sales of \$1.566 billion was a 31.5% increase over the 2013 total of \$1.190 billion.

Total assets under management for segregated fund and mutual fund portfolios reached a total of \$7.1 billion in 2014, an increase of \$1.1 billion over the prior year total of \$6.0 billion.

Total general fund assets (including par fund assets) increased to \$6.8 billion in 2014, an increase of \$0.7 billion over the 2013 assets of \$6.1 billion.

## MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Total assets under management increased by \$1.7 billion to \$13.7 billion in 2014 compared to \$12.0 billion in 2013. From a shareholders' net income perspective, 2014 was a better than average year with a net income of 98.7 million. In 2013, we achieved a record net income of \$113.2 million.

We recognize however that the economic trends and strong competition in our industry make it imperative that we improve efficiency not only in our operations but in our capital management and product pricing. We do not see economic conditions improving in the immediate future and we expect continued effective competition from our respected competitors.

Maintaining profitability and growing our business are often competing objectives. We intend to look for growth opportunities that do not sacrifice the fundamental need for an adequate return on investment.

### Meeting the needs of our customers in the digital age

In 2014, we continued to focus on providing superior products and services and making it easy for our distribution partners and customers to do business with us. While the need to protect the financial security of Canadians has not changed, how consumers choose to interact with financial service companies has changed in the digital age. We need to be faster, more responsive and find ways to make it easier for Canadians to buy insurance and other financial products they need, while still benefitting from valuable advice.

In 2014, we launched new social media channels to raise brand awareness and engage with our customers, advisors and communities. We also launched a consumer-advertising campaign, "The Dumbest Way to Die is Without Life Insurance," based on the popular "Dumb Ways to Die" public safety campaign. This helped create awareness of our life insurance products and directed them to [empirelife.ca](http://empirelife.ca) where they could find an advisor and get a quote online. We have seen increasing adoption of our online Fast and Full™ insurance application which provides customers an easy way to access the insurance they need with the help of an advisor. We will continue to build on this platform to target the large numbers of middle-income Canadians who are under-insured.

We added a new income fund early last year to meet the growing demand for income funds, and significantly enhanced our Wealth Management product offering in the fall with new Guaranteed Investment Funds. We believe Canadians want investment products that are simple, easy to understand and that change with their needs as they transition from savings to retirement. We will continue to ensure our products meet the needs of Canadians while balancing this with the risk we accept as a company and our ability to meet the promises to our customers in the future.

In September 2014, we announced that we would partner with Express Scripts Canada to provide pharmacy benefit management services to our group customers, effective February 1, 2015. As medical science continues to evolve and costly new specialty drugs grow in importance, we need to find new ways to help customers protect their employees with comprehensive and cost-effective drug benefits. We believe this partnership with Express Scripts Canada will benefit our customers and their plan members, while managing and reducing drug benefit costs for plan sponsors. We also saw increases in the use of our popular e-Claims system for health claims which makes submitting claims simple, easy to use and cost-efficient.

## MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

We continued to see consolidation in our industry in 2014. We believe we are well-positioned to find growth opportunities as a Canadian-owned insurance company that offers personalized service to our customers and advisor partners.

I would like to close by saying that since joining Empire Life in June of 2014, I have come to appreciate the unique culture of this great company and the passion and commitment of the people who work here. I have said many times in the past, that I have seen companies with good products and processes fail because they did not have engaged people, but I have yet to see a company with superior people fail to succeed. I would also like to acknowledge our distribution partners-the advisors who work faithfully with our customers to build wealth, protect their financial security and provide the service they need.

Finally, I would like to thank my senior leadership team for their support and guidance and our Board of Directors for their continued confidence in our management and commitment to profitably growing our business.



Mark Sylvia  
President and Chief Executive Officer  
February 27, 2015

## 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	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
Expected profit on in-force business	\$ 71.3	\$ 47.6	\$ 20.8	\$ 18.5	\$ 40.0	\$ 39.7			\$ 132.1	\$ 105.8
Impact of new business	(26.8)	(23.8)	(10.2)	(11.9)	(4.0)	(6.9)			(41.0)	(42.6)
Experience gains & losses	12.4	1.1	(1.9)	4.7	(0.5)	59.8			10.0	65.6
Management actions and changes in assumptions	(3.3)	(3.3)	3.8	0.1	5.8	3.9			6.3	0.7
Other	—	—	—	—	(7.3)	—			(7.3)	—
Earnings on operations before income taxes	53.6	21.6	12.5	11.4	34.0	96.5	—	—	100.1	129.5
Earnings on surplus	—	—	—	—	—	—	30.8	17.4	30.8	17.4
Income before income tax	<b>\$ 53.6</b>	\$ 21.6	<b>\$ 12.5</b>	\$ 11.4	<b>\$ 34.0</b>	\$ 96.5	<b>\$ 30.8</b>	\$ 17.4	<b>\$ 130.9</b>	\$ 146.9
Income taxes	11.9	2.9	3.5	2.8	8.4	24.3	8.4	3.6	32.2	33.6
Shareholders' Net Income	<b>\$ 41.7</b>	\$ 18.7	<b>\$ 9.0</b>	\$ 8.6	<b>\$ 25.6</b>	\$ 72.2	<b>\$ 22.4</b>	\$ 13.8	<b>\$ 98.7</b>	\$ 113.3

## SOURCES OF EARNINGS

### Wealth Management

Wealth Management's 2014 earnings on operations were higher than the level achieved in 2013. In 2014 there was an increase in expected profit on in-force business primarily due to the segregated fund business. Higher net income on in-force business in 2014 was primarily due to growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products. The growth in these fees was primarily due to favourable stock market conditions, strong segregated fund product sales in 2014 and GMWB price increases. The favourable stock market conditions had a positive impact on average assets under management and management fees earned, as stock markets were higher on average during 2014 than they were during 2013.

Experience gains in 2014 were higher than 2013 levels primarily due to improved investment experience resulting from market interest rate movements and the availability of assets at attractive yields for matching fixed interest annuity contract liabilities.

These items were partly offset by lower earnings from higher new business strain in 2014 due to the strong segregated fund product sales in 2014 relative to 2013.

Earnings resulting from management actions and changes in assumptions in 2014 were unchanged from 2013 levels and continued to be primarily related to annuitant mortality assumptions.

### Employee Benefits

Employee Benefit's earnings on operations were higher than the level achieved in 2013. In 2014 there was an increase in expected profit on in-force business due to growth of the in-force block of business.

There were also increased earnings due to lower new business strain in 2014 resulting from lower sales in 2014 relative to 2013.

In addition, there was a favourable update of policy liability assumptions in 2014 relative to 2013 primarily due to waiver of premium assumptions for group life products in 2014.

These items were partly offset by a decrease in earnings from experience gains and losses as a loss from claims experience occurred in 2014 versus a gain in 2013 due to unfavourable health claims and long-term disability results in 2014.

### Individual Insurance

The decrease in Individual Insurance earnings on operations was primarily due to lower experience gains. The most significant item was worsened investment experience which was primarily due to a significant decrease in long-term interest rates in 2014, compared to the significant increase that occurred in 2013. While the impact of this on net income is largely reduced due to a corresponding change in insurance contract liabilities, net income is impacted as it is not possible to perfectly match future liability cash flows with future asset cash flows.

## SOURCES OF EARNINGS

In addition, there was a decrease in earnings resulting from other items in 2014 due to increased premium tax rates in the province of Quebec on both inforce policies and new policies sold. Some inforce policies allow for an adjustment to prices or charges to cover the cost of the additional tax. However, some inforce policies are fully guaranteed and cannot be adjusted, resulting in a strengthening of insurance contract liabilities of \$7.3 million.

These items were partly offset by improved new business strain in 2014. Lower new business strain resulted from higher prices on long-term products and a product mix shift toward lower strain products such as term life.

In addition, there were improved results from management actions and changes in assumptions in 2014. This was primarily due a favourable settlement on a lawsuit resulting in a gain for Empire Life in 2014. This was partly offset by a strengthening of reserves in 2014 versus a release in the 2013 update of policy liability assumptions.

### Capital & Surplus

2014 earnings from Capital and Surplus were higher than 2013 primarily due to gains on the sale of available for sale (AFS) bond investments in 2014, compared to losses from the sale of AFS bond investments in 2013.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This document has been prepared for the purpose of providing Management's Discussion and Analysis (MD&A) of the operating results and financial condition of The Empire Life Insurance Company ("Empire Life" or the "Company") for the years ended December 31, 2014 and 2013. This MD&A should be read in conjunction with the Company's December 31, 2014 consolidated financial statements, which form part of The Empire Life Insurance Company 2014 Annual Report dated February 27, 2015. 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 may contain certain forward-looking statements that are subject to risks and uncertainties that may cause the results or events mentioned in this discussion to differ materially from actual results or events. No assurance can be given that results, performance or achievement expressed in, or implied by, any forward-looking statements within this discussion will occur, or if they do, that any benefits may be derived from them.

## Financial Analysis

### Overview

(millions of dollars)	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Shareholders' net income</b>	\$ 18.2	\$ 29.9	\$ 98.7	\$ 113.3

Empire Life reported full year shareholders' net income of \$98.7 million for 2014, compared to \$113.3 million for 2013.

For the year shareholders' net income was lower relative to 2013 primarily due to lower Individual Insurance product line net income. This product line's lower result was primarily due to the unfavourable impact of long-term interest rate movements experienced in 2014, compared to favourable movements in 2013. This was partly offset by a strong improvement in Wealth Management product line net income. This product line's improved result was primarily due to the growth in segregated fund management fees and growth in segregated fund guarantee fees related to guaranteed minimum withdrawal benefit (GMWB) products. This improvement in fee income was primarily due to the positive impact of favourable stock market conditions, strong segregated fund product sales in 2014 and GMWB price increases.

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 2014 net income compared to 2013 is shown in the Product Line Results sections later in this report.

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

On March 5, 2014 the Chairman of the Board of Directors of Empire Life announced that Leslie C. Herr would be leaving his position as President and Chief Executive Officer of Empire Life effective May 30, 2014, would continue to provide advice to the Board and the new President and CEO following his departure in May, and would step down from his role as Chairman of the Board for Empire Life Investments Inc., a subsidiary of Empire Life, effective May 30, 2014. On May 13, 2014 the Chairman of the Board of Directors of Empire Life announced the appointment of Mark Sylvia as President and Chief Executive Officer of Empire Life and Chairman of the Board for Empire Life Investments Inc. effective June 2, 2014.

The following table provides a summary of Empire Life results by major product line (figures in Management's Discussion and Analysis may differ due to rounding):

For the twelve months ended December 31 (millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
<b>Revenue</b>										
Net premium income	\$ 186	\$ 159	\$ 319	\$ 307	\$ 362	\$ 356	\$ —	\$ —	\$ 867	\$ 822
Fee and other income	178	140	9	8	1	1	—	2	188	151
Investment income	49	54	4	4	151	140	42	42	246	240
Realized gain on FVTPL investments	9	7	—	—	65	38	—	—	74	45
Realized gain (loss) on available for sale investments including impairment write downs	—	1	—	—	—	—	13	(3)	13	(2)
Fair value change in FVTPL investments	20	(36)	4	(7)	514	(306)	—	—	538	(349)
	<b>442</b>	<b>325</b>	<b>336</b>	<b>312</b>	<b>1,093</b>	<b>229</b>	<b>55</b>	<b>41</b>	<b>1,926</b>	<b>907</b>
<b>Expenses</b>										
Benefits and expenses	388	302	317	294	1,049	132	16	21	1,770	749
Income and other taxes	12	4	10	9	17	31	10	4	49	48
	<b>400</b>	<b>306</b>	<b>327</b>	<b>303</b>	<b>1,066</b>	<b>163</b>	<b>26</b>	<b>25</b>	<b>1,819</b>	<b>797</b>
<b>Net income after tax</b>	<b>\$ 42</b>	<b>\$ 19</b>	<b>\$ 9</b>	<b>\$ 9</b>	<b>\$ 27</b>	<b>\$ 66</b>	<b>\$ 29</b>	<b>\$ 16</b>	<b>\$ 107</b>	<b>\$ 110</b>
Policyholders' portion									9	(3)
Shareholders' net income									<b>\$ 98</b>	<b>\$ 113</b>
<b>Assets under management</b>										
General fund assets	\$ 1,063	\$ 1,105							\$ 6,779	\$ 6,126
Segregated fund assets	\$ 6,926	\$ 5,932			\$ 22	\$ 22			\$ 6,948	\$ 5,954
Mutual fund assets	\$ 109	\$ 38							\$ 109	\$ 38
Annualized premium sales			\$ 42	\$ 52	\$ 59	\$ 55				

### Total Revenue

(millions of dollars)	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Revenue</b>				
Net premium income	\$ 215	\$ 215	\$ 867	\$ 822
Investment income	63	64	246	240
Fair value change in FVTPL investments including realized amounts	212	5	612	(304)
Realized gain (loss) on AFS investments including impairment write downs	1	(2)	13	(2)
Fee and other income	50	40	188	150
Total	<b>\$ 541</b>	<b>\$ 322</b>	<b>\$ 1,926</b>	<b>\$ 906</b>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year, total revenue at Empire Life increased by 113% to \$1.93 billion compared to \$906 million in 2013. Revenue volatility was primarily driven by the impact of market interest rate movements on Fair value change in FVTPL investments. Major revenue items are discussed below.

Net premium income for the year increased in 2014 relative to 2013. The increase related primarily to the Wealth Management product line.

Fair value change in FVTPL investments including realized amounts often causes large revenue volatility. These assets experienced a net gain in 2014 compared to a net loss in 2013. In 2014 the large gain was primarily from an increase in bond prices (due to a decrease in market interest rates). In 2013 the loss was primarily from a decrease in bond prices (due to an increase in market interest rates). The impact of this on net income is largely 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 including impairment write downs was a gain in 2014 versus losses in 2013. The increased revenue was due to gains from the sale of AFS equities and bonds in 2014, compared to losses primarily from the sale of AFS bonds in 2013. 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 and other income increased in 2014 relative to 2013 primarily due to growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products. The growth in these fees was primarily due to favourable stock market conditions, strong segregated fund product sales in 2014 and GMWB price increases. The favourable stock market conditions had a positive impact on average assets under management and management fees earned, as stock markets were higher on average during 2014 than they were during 2013.

### Total Benefits and Expenses

(millions of dollars)	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Benefits and expenses</b>				
Net benefits and claims	\$ 168	\$ 145	\$ 645	\$ 560
Net change in insurance contract liabilities	232	43	745	(160)
Change in investment contracts provision	1	—	2	1
Policy dividends	7	6	24	22
Operating expenses	40	36	147	139
Net commissions	51	47	193	168
Interest expense	2	6	14	19
<b>Total</b>	<b>\$ 501</b>	<b>\$ 283</b>	<b>\$ 1,770</b>	<b>\$ 749</b>

Total benefits and expenses at Empire Life for the year increased by 136% to \$1.77 billion compared to \$749 million in 2013. Expense volatility was primarily driven by the impact of market interest rate 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 year to date for all lines of business except Individual Insurance, which declined slightly year to date. 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 can be larger or smaller than the claims incurred depending on whether claims experience has been favourable or unfavourable. Claims experience is the combination of claims incurred compared to claims expected in product pricing and in 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. The main reason for the large change from 2013 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.

Net commissions increased year over year due to the increase in Wealth Management product sales.

Interest expense decreased in 2014 relative to 2013 due to the redemption of \$200 million 6.73% subordinated debentures on May 20, 2014.

### Product Line Results - Wealth Management

(millions of dollars)	As at December 31,			
	2014		2013	
<b>Assets under management</b>				
General fund annuities	\$	1,063	\$	1,105
Segregated funds		6,926		5,932
Mutual funds		109		38

(millions of dollars)	Fourth quarter		Year					
	2014	2013	2014	2013				
<b>Selected financial information</b>								
Fixed interest annuity premiums	\$	45	\$	44	\$	186	\$	159
Segregated fund gross sales		404		302		1,312		1,009
Segregated fund net sales		184		107		479		231
Segregated fund fee income		46		37		175		139
Mutual fund gross sales		23		10		68		22
Mutual fund net sales		19		10		62		20
Mutual fund fee income		—		—		1		—
Net income (loss) after tax fixed income annuity portion	\$	4	\$	(4)	\$	8		—
Net income after tax segregated fund portion		9		7		37		22
Net loss after tax mutual fund portion		(1)		(1)		(3)		(3)
<b>Net income (loss) after tax</b>	<b>\$</b>	<b>12</b>	<b>\$</b>	<b>2</b>	<b>\$</b>	<b>42</b>	<b>\$</b>	<b>19</b>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Assets in Empire Life general fund annuities decreased by 4%, while segregated fund assets increased by 17% during the last 12 months. The increase over the last 12 months for segregated funds was attributable to positive investment returns, due to the stock market increase since December 31, 2013, and strong net sales (gross sales net of withdrawals) described below.

Premium income for the Wealth Management product line is comprised solely of new deposits on fixed interest annuities and excludes deposits on the segregated fund and mutual fund products. For the year, fixed interest annuity premiums were up 17% compared to 2013. The increase was primarily due to increased sales of fixed interest deferred annuities.

For the year, segregated fund gross sales were up \$303 million, a 30% increase from 2013. \$205 million of this increase was from 75% maturity guarantee products, which increased 49%. GMWB and 100% maturity guarantee product sales also increased, growing by \$69 million and \$29 million respectively.

Segregated fund net sales for the year were up 108% compared to 2013 due to the above mentioned gross sales result.

For the year, segregated fund fee income increased by 26% in 2014 relative to 2013. The increase was due to growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products. The growth in these fees was primarily due to favourable stock market conditions, strong segregated fund product sales in 2014 and GMWB price increases. The favourable stock market conditions had a positive impact on average assets under management and management fees earned, as stock markets were higher on average during 2014 than they were during 2013.

Empire Life launched its new mutual fund business during the first quarter in 2012. Therefore, Empire Life's mutual fund business is still in its early stages of development and represents a small portion of the Wealth Management product line. For the year, mutual fund gross sales were up 209% in 2014 compared to 2013. Mutual fund gross sales continued to steadily improve during 2014 as sales for the fourth quarter came in at \$23 million compared to \$19 million, \$13 million, \$14 million and \$10 million for the previous four quarters respectively. In January 2014 a new mutual fund was added, the Empire Life Emblem Diversified Income Portfolio. With a target asset mix of 80% fixed income and 20% equities, it is designed for conservative investors seeking predictable and diversified income. This new fund is aimed at providing income solutions for the growing number of Canadians in retirement.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

During the fourth quarter and for the year earnings from this product line increased relative to 2013. The following table provides a breakdown of the components of this year over year change in net income.

(millions of dollars)	Fourth quarter		Year	
<b>Wealth Management Net Income Analysis</b>				
Net income after tax 2014	\$	12	\$	42
Net income after tax 2013		2		19
<b>Increase net income after tax</b>	<b>\$</b>	<b>10</b>	<b>\$</b>	<b>23</b>
<b>Components of increase</b>				
2013 loss from update of policy liability assumptions	\$	2	\$	2
2014 loss from update of policy liability assumptions		(2)		(2)
Increase in inforce profit margins		3		17
Improved annuitant mortality experience		3		4
Improved investment experience		5		5
Higher new business strain		(1)		(3)
Total	<b>\$</b>	<b>10</b>	<b>\$</b>	<b>23</b>

In both 2013 and 2014, the update of policy liability assumptions was unfavourable by \$2 million. In both years the updates for general fund annuities related primarily to annuitant mortality assumptions.

Higher net income on inforce business in 2014 was primarily due to growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products. The growth in these fees was primarily due to favourable stock market conditions, strong segregated fund product sales in 2014 and GMWB price increases. The favourable stock market conditions had a positive impact on average assets under management and management fees earned, as stock markets were higher on average during 2014 than they were during 2013.

Improved annuitant mortality experience relates to the fixed interest immediate annuity business.

Improved investment experience resulted from market interest rate movements and the availability of assets at attractive yields for matching fixed interest annuity contract liabilities.

Lower net income from higher new business strain caused a year over year decrease in net income. Higher new business strain primarily resulted from higher segregated fund sales.

In the fourth quarter, Empire Life made significant changes to its segregated funds product line. Empire Life has closed its existing segregated funds products to new policies effective October 31, 2014. In addition, on November 3, 2014 Empire Life launched a new suite of investment products including a new segregated funds family called Empire Life Guaranteed Investment Funds, as well as a stand-alone Guaranteed Interest Contract (GIC) and new version of its GMWB product. Fees charged to the customer on the new product line are higher than the existing product line. The new product line's pricing and features are Empire Life's response to the economic, regulatory and competitive landscape in the life insurance industry.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Product Line Results - Employee Benefits

(millions of dollars)	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Selected financial information</b>				
Annualized premium sales	\$ 9	\$ 12	\$ 42	\$ 52
Premium income	80	78	319	307
<b>Net income after tax</b>	<b>\$ 2</b>	<b>\$ 1</b>	<b>\$ 9</b>	<b>\$ 9</b>

For the year, sales in this product line decreased by 19% in 2014 relative to 2013. However, the 2014 level of sales while below last year were relatively strong due to relatively stable economic conditions. This product line's premium income increased by 4% relative to 2013 due to continuing growth of the inforce block.

During the fourth quarter and for the year earnings from this product line increased relative to 2013. The following table provides a breakdown of the components of this year over year change in net income.

(millions of dollars)	Fourth quarter	Year
<b>Employee Benefits Net Income Analysis</b>		
Net income after tax 2014	\$ 2	\$ 9
Net income after tax 2013	1	9
<b>Increase in net income after tax</b>	<b>\$ 1</b>	<b>—</b>
<b>Components of increase</b>		
2014 gain from update of policy liability assumptions	\$ 3	\$ 3
Increase in inforce profit margins	—	2
Worsened claims experience	(2)	(5)
<b>Total</b>	<b>\$ 1</b>	<b>—</b>

In 2014, the favourable update of policy liability assumptions was primarily due to updated waiver of premium methods and assumptions for group life products.

Higher net income on inforce business in 2014 was due to growth of the inforce block of business.

In 2014 worsened claims experience relates to unfavourable health claims and long-term disability results.

## Product Line Results - Individual Insurance

(millions of dollars)	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Selected financial information</b>				
Annualized premium sales	\$ 14	\$ 18	\$ 59	\$ 55
Premium income	91	93	362	356
<b>Net income (loss) after tax</b>				
Net income (loss) after tax shareholders' portion	\$ (1)	\$ 25	\$ 25	\$ 72
Net income (loss) after tax policyholders' portion	8	(4)	2	(6)
<b>Net income after tax</b>	<b>\$ 7</b>	<b>\$ 21</b>	<b>\$ 27</b>	<b>\$ 66</b>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year, annualized premium sales in this product line increased by 7% compared to 2013, and premium income increased by 2% compared to 2013. This product line's full year sales result is attributable primarily to increased sales of term life products. 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 and for the year, earnings from this product line decreased relative to 2013. The following table provides a breakdown of the components of this year over year change in net income.

(millions of dollars)	Fourth quarter	Year
<b>Individual Insurance Net Income Analysis</b>		
Net income after tax 2014	\$ 7	\$ 27
Net income after tax 2013	21	66
<b>Decrease in net income after tax</b>	<b>\$ (14)</b>	<b>\$ (39)</b>
<b>Components of income decrease</b>		
2013 gain from update of policy liability assumptions	\$ (2)	\$ (2)
2014 gain from update of policy liability assumptions	5	5
Worsened investment experience	—	(43)
Quebec premium tax increase	(5)	(5)
Worsened mortality, surrender and other experience	(12)	(2)
Lower new business strain	—	2
Favourable legal settlement	—	6
Total	<b>\$ (14)</b>	<b>\$ (39)</b>

In 2013, the update of policy liability assumptions was favourable by \$2 million.

In 2014, the update of policy liability assumptions was favourable by \$5 million. The following table provides a breakdown of the components of this amount:

Components of income increase from update of policy liability assumptions	Year
Net re-investment assumptions (primarily related to changes in methods)	\$ 70
Mortality	27
Lapse (primarily related to changes in methods)	(87)
Other	(5)
Total 2014 gain from update of policy liability assumptions	<b>\$ 5</b>

In May 2014, final revisions to the Canadian actuarial standards of practice with respect to economic reinvestment assumptions used in the valuation of insurance contract liabilities were released. The changes relate to assumed future interest rates, credit spreads and the use of non-fixed income assets to match insurance contract liabilities. This revised standard, which took effect on October 15, 2014 was used to calculate the above mentioned \$70 million after tax reserve release resulting from investment return assumption updates. Management estimates that the impact of implementing this revised standard at the beginning of 2014 would have been a reserve release of approximately \$60 million after tax. Accordingly management estimates that a reserve release of approximately \$10 million after tax (\$70 million minus \$60 million) relates to all other investment return assumption updates and changes in methods for 2014.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Empire Life uses an ultimate reinvestment rate (“URR”) assumption of 4.0% (3.0% for 2013). Empire Life uses a best estimate return assumption for equities used to match long-term liabilities of 7.5% (7.7% for 2013). This equity return assumption is then reduced by margins to determine the net return used in the valuation. Additional information regarding investment return assumptions can be found in note 27(b)i)(2) to the consolidated financial statements.

The refinements of lapse rate assumptions for 2014 was primarily related to emerging lapse rate experience for certain cost of insurance structures offered within universal life products and for critical illness products as well as regular updates for other individual life products.

For the year, investment experience weakened significantly year over year primarily due to the unfavourable impact from long-term interest rate movements in 2014, compared to favourable movements in 2013. These interest rates decreased significantly in 2014 compared to significant increases in 2013 (as shown in the following table).

	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Interest rate movement</b>				
30 year Canadian federal government bond yield				
End of period	2.36 %	3.24%	2.36 %	3.24%
Beginning of period	2.67 %	3.07%	3.24 %	2.37%
Change during period	(0.31)%	0.17%	(0.88)%	0.87%

While the impact of bond asset market value changes on net income is largely reduced due to a corresponding change in insurance contract liabilities, net income is impacted as it is not possible to perfectly match future liability cash flows with future asset cash flows.

During the fourth quarter, the province of Quebec increased premium tax rates on both inforce policies and new policies sold. Some inforce policies allow for an adjustment to prices or charges to cover the cost of the additional tax. However, some inforce policies are fully guaranteed and cannot be adjusted, resulting in a strengthening of reserves of \$5 million after tax.

Higher net income from lower new business strain caused a year over year improvement in net income. Lower new business strain resulted from higher prices on long-term products and a product mix shift toward lower strain products such as term life.

During the second quarter a favourable settlement on a lawsuit resulted in a \$5.5 million gain after tax for Empire Life.

### Results - Capital and Surplus

(millions of dollars)	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Net income after tax</b>				
Net income after tax shareholders' portion	\$ 6	\$ 2	\$ 22	\$ 14
Net income after tax policyholders' portion	1	1	7	2
Net income after tax	\$ 7	\$ 3	\$ 29	\$ 16

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 for the year Capital and Surplus earnings increased relative to 2013.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

The following table provides a breakdown of the components of this year over year change in net income.

(millions of dollars)	Fourth quarter		Year
<b>Capital and Surplus Net Income Analysis</b>			
Net income after tax 2014	\$	7	\$ 29
Net income after tax 2013		3	16
<b>Increase in net income after tax</b>	<b>\$</b>	<b>4</b>	<b>\$ 13</b>
<b>Components of increase</b>			
Increased net income from sale of investments	\$	3	\$ 11
Lower interest expense		3	4
Lower investment and other income		(2)	(2)
Total	\$	4	\$ 13

Increased net income from sale of investments was due to gains from the sale of AFS equities and bonds in 2014, compared to losses primarily from the sale of AFS bonds in 2013.

Lower interest expense was due to the redemption of \$200 million 6.73% subordinated debentures on May 20, 2014.

Lower investment and other income was primarily due to a decrease in investment management service fee income from a former related company.

## Total Cash Flow

(millions of dollars)	Year	
	2014	2013
<b>Cash Flow provided from (used for)</b>		
Operating Activities	\$ 152	\$ 222
Investing Activities	119	(509)
Financing Activities	(249)	256
Net change in cash and cash equivalents	\$ 22	\$ (31)

The decrease in cash provided from operating activities in 2014 relative to 2013 was primarily due to increased cash outflows related to annuity business in 2014 and higher cash outflows related to income taxes in 2014.

The decrease in cash used for investing activities during 2014 relative to 2013 was primarily driven by financing activities. In 2013 cash used for investing activities included the investment of proceeds from the May 31, 2013 issuance of \$300 million of subordinated debentures (described below). In addition, 2013 cash used for investing activities included the completion of asset mix changes that began late in 2012. A sale of equity assets backing Capital and Surplus was completed in 2012, and proceeds were partially re-invested in fixed income assets backing Capital and Surplus in 2012. The remainder of the re-investment into fixed income assets occurred in the first quarter of 2013. In 2014 cash provided from investing activities included the sale of investments to fund Empire Life's May 20, 2014 redemption of \$200 million of subordinated debentures (described below).

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The decrease in cash provided from financing activities during 2014 relative to 2013 was primarily driven by debt issuance and redemption activities. In 2013 Empire Life issued \$300 million of subordinated debentures on May 31, 2013. The Debentures will mature on May 31, 2023 and bear interest at a fixed annual rate of 2.870% for the first five years, payable semi-annually, and a variable annual rate equal to the 3-month Bankers' Acceptance Rate plus 1.05% for the last five years, payable quarterly. In 2014 Empire Life redeemed its \$200 million 6.73% subordinated debentures at par on May 20, 2014. In addition Empire Life paid \$34 million of dividends to common shareholders during 2014 compared to \$24 million during 2013.

### Capital Resources

	Dec 31 2014	Sep 30 2014	Jun 30 2014	Mar 31 2014	Dec 31 2013
<b>MCCSR Ratio</b>	<b>197%</b>	231%	231%	250%	267%

Empire Life continues to maintain a strong balance sheet and capital position. The A (Excellent) rating given to Empire Life by A.M. Best Company provides third party confirmation of this strength. Empire Life's risk-based regulatory capital ratio, as measured by Minimum Continuing Capital and Surplus Requirements (MCCSR), of 197% as at December 31, 2014 continued to be above requirements, and above minimum internal targets.

The MCCSR ratio decreased by 34 points from the previous quarter and by 70 points on a full year basis. The change was primarily due to increases in required regulatory capital, as shown in the table below.

(millions of dollars)	Dec 31 2014	Sep 30 2014	Jun 30 2014	Mar 31 2014	Dec 31 2013
<b>Available regulatory capital</b>					
Tier 1	\$ 872	\$ 856	\$ 839	\$ 808	831
Tier 2	452	436	430	529	533
<b>Total</b>	<b>\$ 1,324</b>	<b>\$ 1,292</b>	<b>\$ 1,269</b>	<b>\$ 1,337</b>	<b>1,364</b>
<b>Required regulatory capital</b>	<b>\$ 671</b>	<b>\$ 560</b>	<b>\$ 549</b>	<b>\$ 535</b>	<b>511</b>

The increase in Tier 1 available regulatory capital from the previous quarter and on a full year basis was primarily due to net income. For the quarter, this was partly offset by an increase in negative reserves which decrease Tier 1 (but increase Tier 2 as described below). On a full year basis, the Tier 1 increase was partly offset by the payment of a common share dividend of \$34 million during the first quarter (the dividend decreased Empire Life's MCCSR ratio by 10 points).

Tier 2 available regulatory capital increased from the previous quarter primarily due to an increase in negative reserves which increase Tier 2 (but decrease Tier 1 as described above). The decrease in Tier 2 available regulatory capital on a full year basis was primarily due to Empire Life's redemption of \$200 million 6.73% subordinated debentures at par on May 20, 2014 (the redemption decreased Empire Life's MCCSR ratio by 19 points).

## MANAGEMENT'S DISCUSSION AND ANALYSIS

Regulatory capital requirements increased significantly from the previous quarter and on a full year basis. \$102 million of the increase for both periods was due to a comprehensive review and update of the methods and assumptions used in Empire's stochastic model for determining required regulatory capital and policy liabilities for Empire's segregated fund product guarantees. In addition, for the quarter and the year required regulatory capital increased from the impact of higher investment exposures which were caused by increased investment in bonds and stocks. For the year required regulatory capital also increased from the impact of lower interest rates which increased required regulatory capital related to lapse risk.

### Comprehensive Income

(millions of dollars)	Fourth quarter		Year	
	2014	2013	2014	2013
<b>Comprehensive income</b>				
Shareholders' net income	\$ 18.2	\$ 29.9	\$ 98.7	\$ 113.3
Other comprehensive income (loss)				
Unrealized fair value increase (decrease) on AFS investments	10.6	1.2	38.3	(18.9)
Realized loss (gain) on AFS investments reclassification to net income	(0.7)	1.6	(9)	1.9
	9.9	2.8	29.3	(17)
Amortization of loss on derivative investments designated as cash flow hedges reclassified to net income	—	0.2	0.2	0.6
Items that will not be reclassified to net income:				
Remeasurements of defined benefit plans	10.7	(0.1)	3.2	12.9
	20.6	2.9	32.7	(3.5)
Less: Participating Policyholders	(1.4)	(1.9)	(0.5)	(3.1)
Other comprehensive income (loss), attributable to shareholders	19.2	1.0	32.2	(6.6)
Comprehensive income, attributable to shareholders	\$ 37.4	\$ 30.9	\$ 130.9	\$ 106.7

For the year 2014, Empire Life earned other comprehensive income of \$32.7 million primarily due to unrealized fair value increases relating to AFS bonds and stocks. For the year 2013, Empire Life incurred an other comprehensive loss of \$3.5 million primarily due to unrealized investment losses relating to AFS bonds.

For the year 2014, Empire Life experienced a \$3.2 million gain after tax on the remeasurement of post-employment defined benefit ("DB") plans. This gain was primarily due to the impact of higher stock markets on DB plan assets, partly offset by a loss on DB plan liabilities. The loss on DB plan liabilities resulted from lower market interest rates partly offset by gains related to updated plan membership experience data and mortality assumption updates.

For the year 2013, Empire Life experienced a \$12.9 million gain after tax on its DB plans. The gain for the year was primarily due to the impact of higher equity markets on DB plan assets. DB plan liabilities also experienced a net gain due to higher interest rates partly offset by losses due primarily to updated mortality.

Unrealized fair value increases and decreases on AFS bonds in other comprehensive income do not impact MCCSR. Remeasurement of DB plans do not immediately impact MCCSR as each quarter's remeasurement gain or loss is amortized over 12 quarters for MCCSR purposes.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Industry Dynamics and Management's Strategy

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

Based on general fund and segregated fund assets, Empire Life is among the ten largest life insurance companies in Canada. Empire Life has less than six per cent market share in all three of its product lines. To be priced competitively in the marketplace while simultaneously providing acceptable long-term financial contribution to shareholders, Empire Life, as a mid-sized company, must find a way to 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.

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 is expecting to grow market share through this long-term performance along with broadened distribution reach and the addition of new funds and fund products such as the new segregated funds family called Empire Life Guaranteed Investment Funds launched in the fourth quarter of 2014. Empire Life achieved strong growth in assets under management from its segregated fund business in 2014. However, Empire Life has taken several steps to limit GMWB risk exposure. The above mentioned fourth quarter product launch by Empire included a new version of its GMWB product. The new version commands a higher price and reduces the amount of risk Empire Life is taking on, while still offering a competitive guaranteed income solution to customers. Empire Life will continue to monitor the competitive landscape for this product.

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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. Unless a company opts for increased levels of reinsurance, current price levels in the Canadian marketplace create new business strain that has a 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 term life. 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. 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 has been reviewing its Individual Insurance products 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's MCCR ratio, among other things, is sensitive to stock market volatility, due primarily to liability and capital requirements related to segregated fund guarantees. As of December 31, 2014 Empire Life had \$6.9 billion of segregated fund assets and liabilities. Of this amount, approximately \$6.7 billion have guarantees. The following table provides a percentage breakdown by type of guarantee:

	Dec 31 2014	Dec 31 2013
<b>Percentage of segregated fund liabilities with:</b>		
75% maturity guarantee and a 100% death benefit guarantee	53.2%	57.4%
100% maturity and death benefit guarantees (with a minimum of 15 years between deposit and maturity date)	5.4%	5.2%
100% maturity and death benefit guarantees (guaranteed minimum withdrawal benefit (GMWB))	41.4%	37.4%

All Empire Life segregated fund guarantees are policy based (not deposit-based), thereby lowering Empire Life's stock market sensitivity relative to products with 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. Based on stock market levels at December 31 for 2014 and 2013, the sensitivity of shareholders' net income to changes in segregated fund guarantee insurance contract liabilities resulting from stock market increases and decreases is as follows:

\$ millions	10% Increase	10% Decrease	20% Increase	20% Decrease
<b>Sensitivity To Segregated Fund Guarantees:</b>				
2014 Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
2013 Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ nil

## 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:

	10% Increase	10% Decrease	20% Increase	20% Decrease
<b>Sensitivity To Stock Markets:</b>				
December 31, 2014 MCCR Ratio	8.8 %	(11.2)%	14.9 %	(24.4)%
December 31, 2013 MCCR Ratio	(1.2)%	1.2 %	(2.3)%	2.5 %

The 2014 amounts in the above tables include the effect of Empire's equity risk hedging program (described below). Sensitivity to equities is larger in 2014 than 2013 primarily due to the comprehensive review and update of the methods and assumptions used in Empire's stochastic model for determining required regulatory capital and policy liabilities for Empire's segregated fund product guarantees.

Prior to the fourth quarter of 2014, Empire Life has not hedged its segregated fund guarantee risk (except for the reinsurance agreement described below). Empire has equity market risk related to its segregated fund products and from equity assets backing life insurance liabilities. During the fourth quarter of 2014, Empire initiated a semi-static hedging program. The objective of the hedging program is to partially protect Empire from possible future MCCR ratio declines that might result from adverse stock market price changes. The hedging program presently employs put options and short positions on key equity indices. Empire intends to protect 10% to 20% of overall income and MCCR equity risk exposure by expanding the hedging program during 2015 and subsequent years.

There is income statement volatility from this hedging program. Based on current equity market levels, Empire 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 of 2014 Empire Life experienced a small loss of \$0.4 million after tax on its hedging program. During 2015 and subsequent years, Empire Life expects to expand its hedging program and expects an increase in income statement volatility as a result.

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.

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 (millions of dollars)	Guarantee > Fund Value		Death Benefit > Fund Value		GMWB Top-up	Actuarial	MCCR
	Fund Value	Amount At Risk	Fund Value	Amount At Risk	Amount At Risk	Liabilities	Required Capital
December 31, 2014	\$ 49	\$ 2	\$ 360	\$ 10	\$ 380	nil	\$ 102
December 31, 2013	\$ 29	\$ 3	\$ 264	\$ 18	\$ 328	nil	nil

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The first four columns of the above table show all segregated fund policies where the future maturity guarantee, or future death benefit guarantee, is greater than the fund value. The amount at risk represents the excess of the future maturity guarantee or future death benefit guarantee amount over the fund value for these policies. The fifth column of the above table shows GMWB top-up exposure. The GMWB top-up 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. 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 is calculated based on the probability that Empire Life will ultimately have to make payment to the segregated fund policyholders for any fund value deficiency that may exist upon future maturity of the segregated fund policies, or upon future death of the segregated fund policyholders, or upon the occurrence of future top-up payments to GMWB policyholders. The amounts at risk in December 2014 decreased from the December 2013 levels for maturity guarantee, and death benefit guarantee exposure due primarily to the increase in many global stock markets. The amount at risk in December 2014 increased from the December 2013 levels for GMWB top-up exposure, due primarily to strong GMWB sales in 2014. The MCCR required capital increased due to the comprehensive review and update of the methods and assumptions used in Empire's stochastic model for determining required regulatory capital and policy liabilities for Empire's segregated fund product guarantees.

In addition, Empire Life's MCCR ratio is sensitive to changes in market interest rates. The impact of an immediate 1% decrease in interest rates, and a 1% 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 available for sale (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 1% decrease in interest rates.

	Before The Sale of AFS Assets	After The Sale of AFS Assets
	1% Decrease	1% Decrease
<b>Sensitivity To Market Interest Rates:</b>		
December 31, 2014 MCCR Ratio	(32)%	(25)%
December 31, 2013 MCCR Ratio	(35)%	(23)%

In addition to the discussion of risks included in this MD&A, a comprehensive discussion of the material risks that impact Empire Life is included in the Annual Information Form of Empire Life's parent company, E-L Financial Corporation Limited, which is available at [www.sedar.com](http://www.sedar.com). Additional disclosures of Empire Life's sensitivity to risks are included in note 27 to the consolidated financial statements.

### 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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## 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 27 to the consolidated financial statements.

## Financial instrument 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. Additional information regarding financial instrument classification is included in notes 2d, 3a, 3e, and 10c.

## 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 2j, and 12.

## 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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Outlook

In 2014 Canada's economy remained stable, but experienced relatively weak growth. 2014 headlines in Canada were filled with economic concerns about commodity prices, over-valued housing markets and high consumer debt levels. Global concerns in 2014 about European sovereign debt eased in 2014, and the US economy improved significantly, improving consumer confidence. As a result, global credit and stock markets have improved significantly from the economic turmoil of 2008 and early 2009. Canadian long-term interest rates decreased significantly in 2014 after increasing significantly in 2013, and have now been lower than typical levels for 4 years. Global stock markets remained volatile, but most significant markets rose in 2014. This was particularly the case in the U.S., where stock markets provided investors with strong returns in 2014. Canada's main stock market rose in 2014, but was much weaker than the US due to the steep drop in world oil prices and other commodities. Stock market conditions mainly impact inforce profit margin results and new business growth for the segregated fund and mutual fund portions of Empire Life's Wealth Management product line. Looking forward, consumers continue to be somewhat 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 financial crisis compared to many other countries, Canada's economy is growing slowly and there continues to be uncertainty resulting in mixed economic indicators. Growth rates in western Canada are expected to slow down due to the large drop in world oil prices. Lower gas prices and a weaker Canadian dollar are expected to improve growth in Ontario and Quebec. However, the auto sector in Ontario is very uncertain given GM's unclear future intentions regarding manufacturing in Ontario. As a result businesses across Canada remain cautious and this could cause pressure in the near term on growth prospects for the Employee Benefits product line.

A key issue for the Individual Insurance product line since 2011 has been the 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 2013 they decreased significantly during 2014. Empire Life has also decreased its emphasis on long-term products in favour of shorter term products, such as 10 year term life. 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 2015.

Regulatory change related to segregated fund guarantees continues to evolve. OSFI continues to review the overall approach for determining capital requirements for segregated fund risks.

Longer term accounting standard changes are expected by 2018 or later regarding International Financial Reporting Standards (IFRS) for Insurance Contracts. In a parallel process, capital adequacy standards are also becoming more aligned with international frameworks. Both of these changes aim at consistent measurement. For Insurance Contracts accounting the goal is global consistency under IFRS as opposed to the differing approaches in each country that exist today. 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 Empire Life's future net income and capital ratios, however, much remains unknown.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

In 2011 OSFI implemented substantial regulatory changes for Canadian banks related to Basel III capital standards. These new banking regulations provide a transition plan for banks to move towards more restrictive capital requirements, including tighter restrictions on bank issued financial instruments. New financial instruments issued by banks must comply with these new regulations in order to be included in the banks' capital ratios. We are not aware of any plans by OSFI to make similar changes for life insurance companies.

OSFI's Corporate Governance Guideline (compliance required January 31, 2014) includes requirements related to board responsibilities, the independence of oversight functions, enhancing risk reporting and commissioning third party reviews of board and oversight function effectiveness. OSFI's Regulatory Compliance Management Guideline (compliance required by May 1, 2015) establishes requirements for managing regulatory compliance risk inherent in an insurers business activities. OSFI's Own Risk Solvency Assessment Guideline (effective January 1, 2014) requires insurers to complete a self-assessment process that aims to link an insurer's risk profile to its capital needs.

The Canadian Securities Administrators (CSA) is increasing disclosure requirements for mutual fund companies, including point of sale requirements (effective mid-2014) and customer relationship model initiatives (staggered implementation with full effectiveness mid-2016). Mutual fund fees continue to be an area of interest for Canadian securities regulators. The CSA has 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. We continue to watch these developments as they may also impact 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) has 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.

## Quarterly Results

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

(millions of dollars)	Dec 31 2014	Sep 30 2014	Jun 30 2014	Mar 31 2014	Dec 31 2013	Sep 30 2013	Jun 30 2013	Mar 31 2013
<b>Revenue</b>	\$ 541	\$ 381	\$ 480	\$ 524	\$ 322	\$ 235	\$ 61	\$ 289
<b>Shareholders' Net income</b>	\$ 18	\$ 24	\$ 38	\$ 18	\$ 30	\$ 32	\$ 40	\$ 11

For the fourth quarter of 2014, total revenue at Empire Life increased by 68% to \$541 million compared to \$322 million in the fourth quarter of 2013. The increase was due primarily to an increase in FVTPL investments in 2014 resulting from an increase in bond prices in 2014 compared to losses on FVTPL investments in 2013 resulting from a decrease in bond prices in 2013 (see Total Revenue section earlier in this report).

For the fourth quarter net income was lower relative to last year due primarily to worsened lapse and mortality experience relating to the Individual Insurance product line in 2014. See Product Line Results sections earlier in this report for further information on quarterly results.

## 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 and the accounting requirements of the Office of the Superintendent of Financial Institutions, Canada.

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 Canadian GAAP. 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, 2014. Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2014.

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 27, 2015



Gary J. McCabe  
*Senior Vice-President and Chief Financial Officer*  
Kingston, Ontario  
February 27, 2015

# 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, 2014 and the consolidated statements of operations, comprehensive income, changes in equity, and cash flows for the year 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 audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the 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 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, 2014 and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.



PricewaterhouseCoopers LLP

*Chartered Professional Accountants, Licensed Public Accountants*

Toronto, Ontario

February 27, 2015

# 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, 2014 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 27, 2015

# CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands of Canadian dollars)

As at December 31	2014	2013
<b>Assets</b>		
Cash and cash equivalents (Note 3)	\$ 239,102	\$ 217,350
Investments		
Short-term investments (Note 3)	26,892	25,448
Bonds (Note 3)	4,958,086	4,333,512
Common and preferred shares (Note 3)	985,694	1,009,608
Mortgages (Note 3)	323,117	299,353
Loans on policies (Note 3)	46,434	44,855
Policy contract loans (Note 3)	86,698	90,275
Total investments	6,426,921	5,803,051
Accrued investment income	25,048	24,058
Insurance receivables (Note 4)	41,743	41,014
Deferred income taxes (Note 18)	—	2,400
Other assets (Note 5)	19,957	11,669
Property and equipment (Note 6)	21,125	22,043
Intangible assets (Note 7)	4,832	4,317
Segregated fund assets (Note 8)	6,948,475	5,954,508
<b>Total Assets</b>	<b>\$ 13,727,203</b>	<b>\$ 12,080,410</b>
<b>Liabilities</b>		
Accounts payable and other liabilities (Note 11)	\$ 56,021	\$ 55,833
Insurance payables (Note 9)	73,710	78,940
Current income taxes payable	7,804	9,306
Reinsurance liabilities (Note 10)	490,575	284,627
Insurance contract liabilities (Note 10)	4,713,462	4,175,238
Investment contract liabilities	11,626	12,687
Policyholders' funds on deposit	31,332	30,937
Provision for profits to policyholders	24,913	23,893
Deferred income taxes (Note 18)	8,243	—
Subordinated debt (Note 23)	298,763	498,343
Segregated fund policy liabilities	6,948,475	5,954,508
	12,664,924	11,124,312
<b>Equity</b>		
Capital stock (Note 25)	985	985
Contributed surplus	19,387	19,387
Retained earnings (Note 24)	1,019,084	945,692
Accumulated other comprehensive income (loss)	22,823	(9,966)
	1,062,279	956,098
<b>Total Liabilities and Equity</b>	<b>\$ 13,727,203</b>	<b>\$ 12,080,410</b>

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



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



**Mark Sylvia**  
President and Chief Executive Officer

# CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands of Canadian dollars except per share amounts)

For the year ended December 31	2014	2013
<b>Revenue</b>		
Gross premiums (Note 13)	\$ 971,552	\$ 918,521
Premiums ceded to reinsurers ( Note 13)	(104,059)	(96,977)
Net premiums (Note 13)	867,493	821,544
Investment income (Note 3)	245,881	240,159
Fair value change in fair value through profit or loss assets	538,036	(349,037)
Realized gain (loss) on fair value through profit or loss assets sold	74,469	45,445
Realized gain (loss) on available for sale assets including impairment write downs (Note 3)	12,621	(2,488)
Fee income (Note 14)	187,516	150,589
Total revenue	1,926,016	906,212
<b>Benefits and Expenses</b>		
Gross benefits and claims paid (Note 15)	726,219	616,009
Claims recovery from reinsurers (Note 15)	(80,881)	(56,472)
Gross change in insurance contract liabilities (Note 15)	538,224	(200,203)
Change in insurance contract liabilities ceded (Note 15)	205,948	39,819
Change in investment contracts provision	2,282	945
Policy dividends	23,898	22,098
Operating expenses (Note 17)	146,969	139,450
Commissions	195,588	170,579
Commission recovery from reinsurers	(2,447)	(2,322)
Interest expense	14,180	18,977
Total benefits and expenses	1,769,980	748,880
Premium tax	14,259	14,011
Investment and capital tax	4,100	3,900
<b>Net Income Before Income Taxes</b>	<b>137,677</b>	<b>139,421</b>
Income taxes (Note 18)	30,301	29,385
<b>Net Income</b>	<b>\$ 107,376</b>	<b>\$ 110,036</b>
<b>Net Income (Loss) Attributable to:</b>		
Participating Policyholders	8,670	(3,243)
Shareholders	98,706	113,279
<b>Total</b>	<b>\$ 107,376</b>	<b>\$ 110,036</b>
Earnings per share - basic and diluted	\$ 100.20	\$ 115.00
(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	2014	2013
<b>Net Income</b>	<b>\$ 107,376</b>	<b>\$ 110,036</b>
<b>Other comprehensive income (loss), net of income taxes:</b>		
Items that may be reclassified subsequently to net income:		
Unrealized fair value change on available for sale investments (Note 18)	38,349	(18,881)
Fair value change on available for sale investments reclassified to net income, including impairment write downs (Note 18)	(8,975)	1,887
Net unrealized fair value increase	29,374	(16,994)
Amortization of loss on derivative investments designated as cash flow hedges reclassified to net income (Note 18)	233	574
Items that will not be reclassified to net income:		
Remeasurements of post-employment benefit liabilities (Note 18)	3,182	12,934
Total other comprehensive income	32,789	(3,486)
<b>Comprehensive Income</b>	<b>\$ 140,165</b>	<b>\$ 106,550</b>
<b>Comprehensive income (loss) attributable to:</b>		
Participating Policyholders	\$ 9,218	\$ (156)
Shareholders	130,947	106,706
Total	\$ 140,165	\$ 106,550

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	2014			2013		
	Shareholders'	Policyholders'	Total	Shareholders'	Policyholders'	Total
<b>Capital stock</b>	\$ 985	\$ —	\$ 985	\$ 985	\$ —	\$ 985
<b>Contributed surplus</b>	19,387	—	19,387	19,387	—	19,387
<b>Retained earnings</b>						
Retained earnings - beginning of year	901,821	43,871	945,692	812,642	47,114	859,756
Net income (loss)	98,706	8,670	107,376	113,279	(3,243)	110,036
Dividends to common shareholders	(33,984)	—	(33,984)	(24,100)	—	(24,100)
Retained earnings - end of period	966,543	52,541	1,019,084	901,821	43,871	945,692
<b>Accumulated other comprehensive income (loss)</b>						
Accumulated other comprehensive income (loss) - beginning of year	(16,917)	6,951	(9,966)	(10,344)	3,864	(6,480)
Other comprehensive income (loss)	32,241	548	32,789	(6,573)	3,087	(3,486)
Accumulated other comprehensive income (loss) - end of period	15,324	7,499	22,823	(16,917)	6,951	(9,966)
<b>Total equity</b>	\$ 1,002,239	\$ 60,040	\$ 1,062,279	\$ 905,276	\$ 50,822	\$ 956,098
<b>Composition of accumulated other comprehensive income (loss) - end of period</b>						
Unrealized gain (loss) on available for sale financial assets	\$ 23,889	\$ 8,707	\$ 32,596	\$ (5,214)	\$ 8,436	\$ 3,222
Unamortized gain (loss) on cash flow hedges	—	—	—	(233)	—	(233)
Remeasurements of post-employment benefit liabilities	(9,287)	(486)	(9,773)	(12,313)	(642)	(12,955)
Shareholder portion of policyholders' accumulated other comprehensive income	722	(722)	—	843	(843)	—
Total accumulated other comprehensive income (loss)	\$ 15,324	\$ 7,499	\$ 22,823	\$ (16,917)	\$ 6,951	\$ (9,966)

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	2014	2013
<b>Operating Activities</b>		
Net income	\$ 107,376	\$ 110,036
Non-cash items affecting net income		
Change in contract liabilities	540,506	(199,258)
Change in reinsurance liability	205,948	39,819
Fair value change in fair value through profit or loss assets	(538,036)	349,037
Realized (gain) loss on assets including impairment write downs on available for sale assets	(87,090)	(42,957)
Amortization related to invested assets	(71,714)	(70,842)
Amortization related to capital assets	4,720	4,613
Deferred income taxes	9,496	(2,462)
Other items	(19,359)	33,760
Cash provided from (used for) operating activities	151,847	221,746
<b>Investing Activities</b>		
Portfolio investments		
Purchases and advances	(1,543,975)	(2,110,910)
Sales and maturities	1,659,452	1,612,993
Loans on policies		
Advances	(12,017)	(10,333)
Repayments	21,530	14,575
Decrease (increase) in short-term investments	(1,444)	(9,008)
Net purchase of capital assets	(4,317)	(6,485)
Cash provided from (used for) investing activities	119,229	(509,168)
<b>Financing Activities</b>		
Dividends to common shareholders (Note 19)	(33,984)	(24,100)
Interest paid on subordinated debt	(15,340)	(17,765)
Debt issue (Note 23)	—	298,255
Debt repayment (Note 23)	(200,000)	—
Cash provided from (used for) financing activities	(249,324)	256,390
<b>Net Change in Cash and Cash Equivalents</b>	<b>21,752</b>	<b>(31,032)</b>
<b>Cash and Cash Equivalents - Beginning of Period</b>	<b>217,350</b>	<b>248,382</b>
<b>Cash and Cash Equivalents - End of Period</b>	<b>\$ 239,102</b>	<b>\$ 217,350</b>
Supplementary cash flow information related to operating activities:		
Income taxes paid, net of (refunds)	\$ 32,566	\$ 24,074
Interest income received	147,293	138,902
Dividend income received	30,353	32,897

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 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). 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 on February 27, 2015.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### (a) Basis of Preparation

The annual consolidated financial statements of the Company for the year ended December 31, 2014 have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and applicable at December 31, 2014.

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.

### (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, Empire Life Investments Inc. The Company owns 100% of the voting shares and maintains control of its subsidiary. Control is defined as the power to govern the financial and operating activities of an entity so as to obtain the benefits from its activities. The financial statements of its subsidiary are included in the Company's results from the day control was established, the commencement of operations, and will be deconsolidated should control cease. The financial statements of the subsidiary 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 consolidated financial statements 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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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.

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, 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 2e), 2k), 10 and 27b).

ii) Financial instrument 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 2d), 3a), 3e), and 10c).

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 2k) and 12.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## iv) Impairment

Available for sale 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 available for sale 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 2e), 3b), 10c) and 27a).

## (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 cash equivalents, and exchange traded common and preferred shares.

**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 government bonds, certain corporate and private bonds and short-term investments.

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**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 Investments

Cash and cash equivalents and short-term investments 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 and 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, 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 statement 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 statement 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 statement of operations.

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 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 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 are designated as fair value through profit or loss. Therefore, they are initially recorded at fair value on the acquisition date and subsequently revalued at their fair value. Derivative financial instruments with a positive fair value are recorded as assets while derivative financial instruments with a negative fair value are recorded as liabilities. Changes in fair value are recorded in Fair value change in fair value through profit or loss 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 observable 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. 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

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losses are established to adjust the carrying value of these assets to their net recoverable amount and the impairment loss is 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 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 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## (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 statement of operations. Reinsurance recoveries on claims incurred are recorded as Claims recovery from reinsurers in the Consolidated statement of operations. The reinsurers' share of Insurance contract liabilities is recorded as Reinsurance assets or Reinsurance liabilities in the Consolidated statement 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 statement of operations.

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

## (f) Property and Equipment

Property and equipment comprises own use land, building, 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 the 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.

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 statement 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 statement of operations.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## (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 statement 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 statement 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. 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 statement 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 and maturity benefit 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 27 (a) i) (1).

## (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 statement of operations.

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## (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 AOCI. Past-service costs are recognized immediately in 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## (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 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 the Canadian Asset Liability Method (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.

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## 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 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 statement 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 at the Consolidated statement of financial position date. 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 Change in insurance contract liabilities in the Consolidated statement 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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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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 statement of operations. Deposits and withdrawals are recorded in Investment contract liabilities on the Consolidated statement 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 statement of financial position. The costs deferred in the period and amortization of deferred costs form part of the change in insurance contract liabilities on the Consolidated statement of operations.

## (l) 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 expensed through the Consolidated statement 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 AOCI is reported separately in the Policyholders' equity section of the Consolidated statements of changes in equity.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 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 Company'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/Liability Management Committee oversees sensitivity to interest rates. The objective is to maximize investment yields while managing the default, liquidity and reinvestment risks at acceptable and measurable low levels.

## 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 accounts, 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 accounts, income taxes are allocated to the participating account in proportion to total taxable income for the Company.

## (m) Fee Income

Fee income includes fund Management fees, Policy administration fees and surrender charges, and is recognized on an accrual basis. Fee income earned for investment management and administration of the segregated and mutual funds is generally calculated and recorded as revenue daily based on the funds' closing net asset values.

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## (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 statement 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 statement 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 statement of operations.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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For monetary financial assets designated as AFS, translation differences are recognized in the Consolidated statement 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 equity is recognized in the Consolidated statement of operations.

## (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 financial assets, 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 at 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

Basic earnings per share (EPS) is calculated by dividing the net income (loss) for the period attributable to common share owners 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 earnings per share are the same as basic earnings per share.

## (u) Future Accounting Changes

### *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. The standard is effective for annual periods beginning on or after January 1, 2017, with retrospective application. The Company is currently evaluating the impact of IFRS 15 on its consolidated financial statements.

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## *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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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## 3. FINANCIAL INSTRUMENTS

### (a) Summary of Cash and Investments

The carrying values of cash and investments are as follows:

Asset category	As at December 31, 2014			As at December 31, 2013		
	Designated Fair Value Through Profit or Loss	Available for Sale	Total Carrying Value	Designated Fair Value Through Profit or Loss	Available for Sale	Total Carrying Value
Cash and cash equivalents	\$ 239,102	\$ —	\$ 239,102	\$ 217,350	\$ —	\$ 217,350
Short-term investments						
Canadian federal government	3,310	4,961	8,271	7,325	—	7,325
Canadian provincial governments	1,782	—	1,782	—	—	—
Corporate	16,839	—	16,839	18,123	—	18,123
Total short-term investments	21,931	4,961	26,892	25,448	—	25,448
Bonds						
Bonds issued or guaranteed by:						
Canadian federal government	72,626	165,921	238,547	59,870	197,160	257,030
Canadian provincial and municipal governments	2,479,365	284,502	2,763,867	2,034,681	252,445	2,287,126
Total government bonds issued or guaranteed	2,551,991	450,423	3,002,414	2,094,551	449,605	2,544,156
Canadian corporate bonds by industry sector:						
Financial services	545,554	437,673	983,227	495,906	472,359	968,265
Infrastructure	241,371	20,079	261,450	219,882	24,241	244,123
Utilities	246,080	30,881	276,961	224,452	34,962	259,414
Communications	1,608	28,007	29,615	2,194	37,014	39,208
Energy	52,759	60,643	113,402	49,294	35,535	84,829
Consumer staples	78,546	68,319	146,865	67,223	9,903	77,126
Industrials	47,240	1,564	48,804	40,343	6,469	46,812
Health care	70,683	14,050	84,733	54,621	5,246	59,867
Materials	10,615	—	10,615	9,712	—	9,712
Total Canadian corporate bonds	1,294,456	661,216	1,955,672	1,163,627	625,729	1,789,356
Total bonds	3,846,447	1,111,639	4,958,086	3,258,178	1,075,334	4,333,512
Preferred shares						
Canadian	186,856	9,323	196,179	224,313	69,905	294,218
Total preferred shares	186,856	9,323	196,179	224,313	69,905	294,218
Common shares						
Canadian						
Common shares	526,613	61,481	588,094	476,742	65,778	542,520
Real estate limited partnership units	47,512	—	47,512	41,081	—	41,081
U.S.	139,988	—	139,988	116,699	—	116,699
Other	13,921	—	13,921	15,090	—	15,090
Total common shares	728,034	61,481	789,515	649,612	65,778	715,390
Loans and Receivables						
Mortgages	—	—	323,117	—	—	299,353
Loans on policies	—	—	46,434	—	—	44,855
Policy contract loans	—	—	86,698	—	—	90,275
Total	\$ 5,022,370	\$ 1,187,404	\$ 6,666,023	\$ 4,374,901	\$ 1,211,017	\$ 6,020,401

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

As at December 31	2014			2013		
	Level 1	Level 2	Total Fair Value	Level 1	Level 2	Total Fair Value
Cash and cash equivalents	\$ 42,594	\$ 196,508	\$ 239,102	\$ 53,394	\$ 163,956	\$ 217,350
Fair value through profit or loss:						
Bonds	—	3,846,447	3,846,447	—	3,258,178	3,258,178
Common shares	680,522	47,512	728,034	608,531	41,081	649,612
Preferred shares	186,856	—	186,856	224,313	—	224,313
Short-term investments	—	21,931	21,931	—	25,448	25,448
Available for sale:						
Bonds	—	1,111,639	1,111,639	—	1,075,334	1,075,334
Common shares	61,481	—	61,481	65,778	—	65,778
Preferred shares	9,323	—	9,323	69,905	—	69,905
Short-term investments	—	4,961	4,961	—	—	—
Loans and Receivables						
Mortgages	—	338,160	338,160	—	304,134	304,134
Loans on policies	—	46,434	46,434	—	44,855	44,855
Policy contract loans	—	86,698	86,698	—	90,275	90,275
<b>Total</b>	<b>\$ 980,776</b>	<b>\$ 5,700,290</b>	<b>\$ 6,681,066</b>	<b>\$ 1,021,921</b>	<b>\$ 5,003,261</b>	<b>\$ 6,025,182</b>

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, 2014 or during the year ended December 31, 2013.

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 27 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 and where otherwise stated)

Impaired Loans	As at December 31, 2014			As at December 31, 2013		
	Recorded Investment	Allowance for Impairment	Carrying Amount	Recorded Investment	Allowance for Impairment	Carrying Amount
Mortgages	\$ 6,303	\$ 2,295	\$ 4,008	\$ 7,076	\$ 2,374	\$ 4,702
Policy contract loans	813	541	272	813	556	257
<b>Total</b>	<b>\$ 7,116</b>	<b>\$ 2,836</b>	<b>\$ 4,280</b>	<b>\$ 7,889</b>	<b>\$ 2,930</b>	<b>\$ 4,959</b>

The Company holds collateral of \$4,045 (2013 \$4,725) in respect of these mortgages and \$272 (2013 \$257) in respect of these policy contract loans as at December 31, 2014. Mortgage loans are secured by real estate, and policy contract loans are secured by life insurance.

Continuity of Allowance for Loan Impairment	2014	2013
Allowance - beginning of year	\$ 2,930	\$ 3,411
Provision for loan impairment	536	488
Write-off of loans	(630)	(969)
<b>Allowance - End of Year</b>	<b>\$ 2,836</b>	<b>\$ 2,930</b>

The Company has recorded interest income of \$727 (2013 \$810) on these assets.

As at December 31, 2014 loans and receivables past due but not impaired are \$ nil (2013 \$ nil).

## ii) Available for Sale

For the year-ended December 31, 2014, the Company reclassified a pre-tax loss of \$221 from OCI to Net income due to write downs of impaired AFS common and preferred shares (2013 \$409). 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 27 Risk Management.

## (c) Hedge Accounting

In conjunction with the issuance of unsecured subordinated debentures in 2009 (Note 23), the Company entered into a bond forward derivative with a notional amount of \$75,000 which matured on May 13, 2009. This derivative had been accounted for as a hedging item in a cash flow hedging relationship until May 20, 2014, when the Company redeemed the debenture at par.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## (d) Investment Income

Investment income is comprised of the following:

For the year ended December 31	2014	2013
Interest income	\$ 215,036	\$ 206,741
Dividend income	30,583	32,797
Other	798	1,109
Provision for loan impairment	(536)	(488)
<b>Investment Income</b>	<b>\$ 245,881</b>	<b>\$ 240,159</b>

Included in interest income is \$65,336 (2013 \$63,220) relating to assets not classified as FVTPL.

## (e) 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.

	As At December 31, 2014			As At December 31, 2013		
	Notional Principal	Fair Value Assets	Fair Value Liabilities	Notional Principal	Fair Value Assets	Fair Value Liabilities
Exchange-traded						
Equity index futures	\$ 51,773	\$ 869	\$ 1,201	\$ 28,261	\$ 1,145	—
Equity options	119,990	1,922	—	—	—	—
Over-the-counter						
Foreign currency forwards	151,731	584	137	123,469	471	130
<b>Total</b>	<b>\$ 323,494</b>	<b>\$ 3,375</b>	<b>\$ 1,338</b>	<b>\$ 151,730</b>	<b>\$ 1,616</b>	<b>130</b>

All contracts mature in less than one year. Fair value asset amounts and fair value liability amounts are reported on the Consolidated statement of financial position as Other assets and Accounts payable and other liabilities respectively.

For analysis of the Company's risks arising from financial instruments, refer to Note 27 Risk Management.

## 4. INSURANCE RECEIVABLES

As at December 31	2014	2013
Due from policyholders	\$ 3,501	\$ 4,057
Due and accrued from reinsurers	16,530	20,165
Fees receivable	18,501	13,414
Other	3,211	3,378
<b>Insurance Receivables</b>	<b>\$ 41,743</b>	<b>\$ 41,014</b>

All amounts are expected to be recovered within one year of the Consolidated statement 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 and where otherwise stated)

## 5. OTHER ASSETS

Other assets consist of the following:

As at December 31	2014	2013
Trade accounts receivable	\$ 15,331	\$ 8,397
Prepaid expenses	4,626	3,272
<b>Other Assets</b>	<b>\$ 19,957</b>	<b>\$ 11,669</b>

All amounts are expected to be recovered within one year of the Consolidated statement of financial position date.

These financial instruments are short-term in nature and their fair values approximate carrying value.

## 6. PROPERTY AND EQUIPMENT

	Land	Buildings	Furniture and Equipment	Leasehold Improvements	Total
<b>Cost</b>					
As at January 1, 2013	\$ 2,728	\$ 12,873	\$ 19,040	\$ 5,878	\$ 40,519
Additions	—	—	2,822	751	3,573
Disposals	(410)	—	—	—	(410)
As at December 31, 2013	2,318	12,873	21,862	6,629	43,682
Additions	—	74	3,045	(288)	2,831
Disposals	—	—	—	—	—
<b>As at December 31, 2014</b>	<b>\$ 2,318</b>	<b>\$ 12,947</b>	<b>\$ 24,907</b>	<b>\$ 6,341</b>	<b>\$ 46,513</b>
<b>Amortization</b>					
As at January 1, 2013	—	\$ (1,836)	\$ (12,385)	\$ (3,471)	\$ (17,692)
Charge for the year	—	(552)	(2,550)	(845)	(3,947)
Disposals	—	—	—	—	—
As at December 31, 2013	—	(2,388)	(14,935)	(4,316)	(21,639)
Charge for the year	—	(524)	(2,385)	(840)	(3,749)
Disposals	—	—	—	—	—
<b>As at December 31, 2014</b>	<b>\$ —</b>	<b>\$ (2,912)</b>	<b>\$ (17,320)</b>	<b>\$ (5,156)</b>	<b>\$ (25,388)</b>
<b>Carrying Amount</b>					
December 31, 2013	\$ 2,318	\$ 10,485	\$ 6,927	\$ 2,313	\$ 22,043
<b>December 31, 2014</b>	<b>\$ 2,318</b>	<b>\$ 10,035</b>	<b>\$ 7,587</b>	<b>\$ 1,185</b>	<b>\$ 21,125</b>

There were no asset impairments in 2014 or 2013.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## 7. INTANGIBLE ASSETS

	Intangible Assets	
<b>Cost</b>		
As at January 1, 2013	\$	39,939
Additions		2,912
Disposals		—
As at December 31, 2013		42,851
Additions		1,486
Disposals		—
<b>As at December 31, 2014</b>	<b>\$</b>	<b>44,337</b>
<b>Amortization</b>		
As at January 1, 2013	\$	(37,868)
Charge for the year		(666)
Disposals		—
As at December 31, 2013		(38,534)
Charge for the year		(971)
Disposals		—
<b>As at December 31, 2014</b>	<b>\$</b>	<b>(39,505)</b>
<b>Carrying Amount</b>		
December 31, 2013	\$	4,317
<b>December 31, 2014</b>	<b>\$</b>	<b>4,832</b>

The Company's total amount of research and development expenditure recognized as an expense during 2014 is \$3,658 (2013 \$3,848).

There were no asset impairments during 2014 or 2013.

## 8. SEGREGATED FUNDS

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

As at December 31	2014		2013	
Cash and cash equivalents	\$	162,646	\$	81,079
Short-term investments		152,395		171,903
Bonds		1,567,578		1,347,287
Common and preferred shares		5,067,181		4,414,766
Net other assets		24,977		27,885
		<b>6,974,777</b>		6,042,920
Less segregated funds held within general fund investments		(26,302)		(88,412)
<b>Total</b>	<b>\$</b>	<b>6,948,475</b>	<b>\$</b>	<b>5,954,508</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts 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, 2014			As at December 31, 2013		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Cash and cash equivalents	\$ 26,829	\$ 135,817	\$ 162,646	\$ 61,504	\$ 19,575	\$ 81,079
Common and preferred shares	5,067,181	—	5,067,181	4,414,766	—	4,414,766
Bonds	—	1,567,578	1,567,578	—	1,347,287	1,347,287
Short-term investments	—	152,395	152,395	—	171,903	171,903
<b>Total</b>	<b>\$ 5,094,010</b>	<b>\$ 1,855,790</b>	<b>\$ 6,949,800</b>	<b>\$ 4,476,270</b>	<b>\$ 1,538,765</b>	<b>\$ 6,015,035</b>

There were no transfers between Level 1 and Level 2, and there were no Level 3 investments during the year ended December 31, 2014 or during the year ended December 31, 2013.

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

For the year ended December 31	2014	2013
Segregated funds - beginning of year	\$ 5,954,508	\$ 5,014,392
Additions to segregated funds:		
Amount received from policyholders	1,650,775	1,410,240
Interest	57,360	52,730
Dividends	123,868	111,164
Other income	29,743	23,971
Net realized gains on sale of investments	481,448	273,734
Net unrealized increase in fair value of investments	34,206	438,167
	<b>2,377,400</b>	<b>2,310,006</b>
Deductions from segregated funds:		
Amounts withdrawn or transferred by policyholders	1,242,284	1,184,549
Management fees and other operating costs	203,259	168,058
	<b>1,445,543</b>	<b>1,352,607</b>
Net change in segregated funds held within general fund investments	<b>62,110</b>	<b>(17,283)</b>
<b>Segregated Funds - End of Year</b>	<b>\$ 6,948,475</b>	<b>\$ 5,954,508</b>

(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. The impact of market price fluctuations in segregated funds on the shareholders' net income is disclosed in the Risk Management Note 27 a(i).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## 9. INSURANCE PAYABLES

As at December 31		2014	2013
Claims due and accrued	\$	27,771	\$ 39,034
Payable to agents		11,936	9,939
Premiums paid in advance		2,456	2,579
Due to reinsurance companies		10,804	8,630
Other		20,743	18,758
<b>Insurance Payables</b>	<b>\$</b>	<b>73,710</b>	<b>\$ 78,940</b>

Of the above total, \$1,280 (2013 \$1,836) is expected to be settled more than one year after the Consolidated statement of financial position date. Most of these financial instruments are short-term in nature and their fair value approximates carrying value. In the absence of an active market for the amount to be settled more than one year after the Consolidated statement of financial position date, the carrying value provides a reasonable approximation of fair value.

## 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 asset (liability) is 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.

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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## Concentration of Insurance Contract Liabilities

As at December 31	2014			2013		
	Gross Insurance Contract Liabilities	Reinsurance Assets (Liabilities)	Net	Gross Insurance Contract Liabilities	Reinsurance Assets (Liabilities)	Net
Participating Individual						
Life	\$ 523,424	\$ (2,667)	\$ 526,091	\$ 456,433	\$ (2,552)	\$ 458,985
Other	292	—	292	430	—	430
Non-participating Individual						
Life	2,842,061	(584,900)	3,426,961	2,375,625	(372,024)	2,747,649
Annuity	1,009,782	14,617	995,165	1,048,353	15,239	1,033,114
Health	141,503	9,715	131,788	96,392	9,099	87,293
Non-participating Group						
Life	22,194	568	21,626	28,746	927	27,819
Annuity	61,490	—	61,490	64,300	—	64,300
Health	202,641	72,092	130,549	182,448	64,684	117,764
Segregated fund deferred acquisition costs	(89,925)	—	(89,925)	(77,489)	—	(77,489)
<b>Total</b>	<b>\$ 4,713,462</b>	<b>\$ (490,575)</b>	<b>\$ 5,204,037</b>	<b>\$ 4,175,238</b>	<b>\$ (284,627)</b>	<b>\$ 4,459,865</b>

The Company expects to pay \$4,563,763 (2013 \$4,004,629) of Insurance contract liabilities and \$492,065 (2013 \$288,153) of Reinsurance liabilities more than one year after the Consolidated statement of financial position date. The balance is expected to be settled within one year.

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

	2014	2013
Segregated funds deferred acquisition costs - beginning of year	\$ 77,489	\$ 71,839
Deferred during year	40,992	32,012
Amortized during year	(28,556)	(26,362)
<b>Segregated Funds Deferred Acquisition Costs - end of Year</b>	<b>\$ 89,925</b>	<b>\$ 77,489</b>

Of the above total, \$36,364 (2013 \$31,535) 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 and where otherwise stated)

## (b) Change in Insurance Contract Liabilities and Reinsurance Assets/Liabilities

For the year ended December 31,	2014			2013		
	Gross Insurance Contract Liabilities	Reinsurance Assets (Liabilities)	Net	Gross Insurance Contract Liabilities	Reinsurance Assets (Liabilities)	Net
Insurance contracts - beginning of year	\$ 4,175,238	\$ (284,627)	\$ 4,459,865	\$ 4,375,441	\$ (244,808)	\$ 4,620,249
Changes in methods and assumptions						
improvements in mortality/morbidity experience	(141,617)	(113,471)	(28,146)	(74,377)	(59,800)	(14,577)
lapse assumption updates	77,408	(40,400)	117,808	42,242	(1,450)	43,692
update of investment return assumptions	(88,465)	4,607	(93,072)	(1,433)	3,402	(4,835)
model enhancements	(5,882)	(257)	(5,625)	(13,912)	2,184	(16,096)
other changes	(16,331)	(18,442)	2,111	(7,600)	(140)	(7,460)
Normal changes						
new business	125,003	(1,731)	126,734	112,569	2,491	110,078
in-force business	588,108	(36,254)	624,362	(257,692)	13,494	(271,186)
<b>Insurance Contracts - End of Year</b>	<b>\$ 4,713,462</b>	<b>\$ (490,575)</b>	<b>\$ 5,204,037</b>	<b>\$ 4,175,238</b>	<b>\$ (284,627)</b>	<b>\$ 4,459,865</b>

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

The updates for mortality/morbidity experience for 2014 are primarily related to favourable mortality experience for individual life business. In addition, there were refinements to the mortality study to reflect mortality experience for higher face amount policies and renewable term business. The updates for mortality/morbidity experience for 2013 are primarily related to favourable mortality experience for individual life business.

The refinements to lapse rate assumptions for 2014 are primarily related to emerging lapse rate experience for certain cost of insurance structures offered within Empire Life's universal life product and for the Company's critical illness products as well as regular updates for Empire Life's other individual life insurance products. The refinements to lapse rate assumptions for 2013 are primarily related to lapse rate assumptions for renewable term products, which take into account the Canadian Institute of Actuaries' Renewal Lapse Experience Study for 10-Year Term Insurance (released January 2014) as well as Empire Life's emerging lapse rate experience.

The update in investment return assumptions for 2014 was primarily due to revised Canadian actuarial standards of practice effective October 15, 2014, which prescribed higher long-term ultimate risk-free reinvestments for non-fixed income assets and lower limits for the projected amount of equities backing individual life insurance liabilities. In addition, there were several refinements to the CALM model for future reinvestment assumptions. The update in investment return assumptions for 2013 was primarily due to the impact of the higher interest rate environment on the initial reinvestment rate assumption, which was offset by lower ultimate reinvestment rates related to continuing decreases in the moving average of Government of Canada long-term bond rates over the last 10 years.

The model enhancements for 2014 are related to refinements to the valuation models for group life waiver of premium business. The model enhancements for 2013 are related to the refinements of CALM valuation models for universal life business to more accurately reflect the timing of asset default rates and investment expense on reinvestment cash flows and revise the calculation of projected valuation interest rates. In addition, refinements were made to the valuation models for participating business.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

Other changes for 2014 relate to lower expense unit costs resulting from refinements to expense studies that were offset by refinements for modelling unearned reinsurance premiums and other minor changes to assumptions and methodologies. Other changes for 2013 relate primarily to lower unit costs for individual life insurance business. There were several other minor changes to assumptions and methodologies.

Normal changes in the policy liabilities are further explained as follow:

The change in new business reflects changes in the volume and mix of business from year to year.

The change for in-force business is primarily attributable to the fair value change in liabilities due to a decrease in interest rates in 2014, and an increase in interest rates in 2013.

## (c) Mix of Assets Allocated to Insurance, Annuity, Investment Contract Liabilities and Equity

As at December 31, 2014

	Insurance Liabilities	Annuity Liabilities	Investment Contract Liabilities	Equity and Other Liabilities	Total
Cash & short-term investments	\$ 122,349	\$ 3,919	\$ 43	\$ 139,683	\$ 265,994
Bonds	3,318,781	578,019	6,393	1,054,893	4,958,086
Mortgages	56,852	263,352	2,913	—	323,117
Preferred shares	29,963	164,398	1,818	—	196,179
Common shares	728,034	—	—	61,481	789,515
Loans on policies	46,434	—	—	—	46,434
Policy contract loans	296	35,925	397	50,080	86,698
Other	14,085	5,579	62	92,979	112,705
<b>Total</b>	<b>\$ 4,316,794</b>	<b>\$ 1,051,192</b>	<b>\$ 11,626</b>	<b>\$ 1,399,116</b>	<b>\$ 6,778,728</b>

As at December 31, 2013

	Insurance Liabilities	Annuity Liabilities	Investment Contract Liabilities	Equity and Other Liabilities	Total
Cash & short-term investments	\$ 86,443	\$ 24,074	\$ 280	\$ 132,001	\$ 242,798
Bonds	2,630,849	565,870	6,573	1,130,220	4,333,512
Mortgages	41,433	254,958	2,962	—	299,353
Preferred shares	45,831	203,144	2,360	42,883	294,218
Common shares	649,612	—	—	65,778	715,390
Loans on policies	44,855	—	—	—	44,855
Policy contract loans	1,140	38,527	448	50,160	90,275
Other	13,567	5,616	64	86,254	105,501
<b>Total</b>	<b>\$ 3,513,730</b>	<b>\$ 1,092,189</b>	<b>\$ 12,687</b>	<b>\$ 1,507,296</b>	<b>\$ 6,125,902</b>

Provisions made for anticipated future losses of principal and interest on investments and included as a component of policy liabilities are \$169,800 (2013 \$114,000)

## (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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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.

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	2014	2013
<b>Assets:</b>		
Cash and short-term investments	\$ 265,994	\$ 242,798
Canada and provincial bonds	2,869,167	2,425,017
Other readily-marketable bonds and stocks	2,514,664	2,369,078
<b>Total Liquid Assets</b>	<b>\$ 5,649,825</b>	<b>\$ 5,036,893</b>
<b>Liabilities:</b>		
Demand liabilities with fixed values	\$ 548,289	\$ 511,709
Demand liabilities with market value adjustments	1,125,761	1,120,376
<b>Total Liquidity Needs</b>	<b>\$ 1,674,050</b>	<b>\$ 1,632,085</b>

## 11. ACCOUNTS PAYABLE AND OTHER LIABILITIES

Accounts payable and other liabilities consist of:

As at December 31	2014	2013
Accounts payable	\$ 23,574	\$ 23,904
Post-employment benefit liability	17,560	18,317
Accrued interest on subordinated debt	767	2,371
Other	14,120	11,241
<b>Accounts Payable and Other Liabilities</b>	<b>\$ 56,021</b>	<b>\$ 55,833</b>

Of the above total, \$17,560 (2013 \$18,317) is expected to be settled more than one year after the Consolidated statement of financial position date. All other amounts are short-term in nature and their fair value approximates carrying value. In the absence of an active market for post-employment benefit liabilities, the actuarially determined value provides a reasonable approximation of fair value.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## 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 Company's Board of Directors. The pension benefit payments are from trustee-administered funds.

The Company's staff pension benefit 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 of Directors three times each year. The Audit Committee of the Board of Directors 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

As at December 31	Pension Benefits		Other Post Employment Benefits	
	2014	2013	2014	2013
Present value of obligations	\$ 192,948	\$ 177,592	\$ 10,531	\$ 10,017
Fair value of plan assets	185,919	169,292	—	—
Post-employment benefit asset (liability)	\$ (7,029)	\$ (8,300)	\$ (10,531)	\$ (10,017)

The post-employment benefit asset (liability), net of the cumulative impact of the asset ceiling, is included in the Consolidated statement of financial position in Accounts payables and other liabilities.

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

As at December 31	Pension Benefits		Other Post Employment Benefits	
	2014	2013	2014	2013
<b>Present Value of Defined Benefit Obligation</b>				
Opening defined benefit obligation	\$ 177,592	\$ 172,925	\$ 10,017	\$ 9,815
Current service cost	5,965	6,603	47	54
Past service cost	236	—	—	—
Interest expense	8,317	7,117	468	397
Decrease (increase) in net income before tax	14,518	13,720	515	451
<b>Remeasurements</b>				
(Gain)/loss from changes in demographic assumptions	(2,354)	5,986	(500)	1,135
(Gain)/loss from changes in financial assumptions	20,545	(10,385)	1,000	(905)
Actuarial (gain) loss from member experience	(10,638)	3,052	(181)	(228)
Decrease (increase) in OCI before tax	7,553	(1,347)	319	2
Employee contributions	1,929	2,053	—	—
Benefits paid	(8,644)	(9,759)	(320)	(251)
Closing defined benefit obligation	\$ 192,948	\$ 177,592	\$ 10,531	\$ 10,017

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

As at December 31	Pension Benefits	
	2014	2013
Fair Value of Defined Benefit Assets		
Fair value at beginning of year	\$ 169,292	\$ 147,787
Interest income	8,082	6,189
Administrative expense	(635)	(635)
Increase (decrease) in net income before tax	7,447	5,554
Remeasurements		
Return on plan assets, excluding amounts included in interest income	12,201	16,247
(Gain)/loss from changes in demographic assumptions	—	—
(Gain)/loss from changes in financial assumptions	—	—
Actuarial (gain) loss from member experience	—	—
Change in effect of asset limit	—	—
Increase (decrease) in OCI before tax	12,201	16,247
Plan transfers / curtailments	—	—
Employer contributions	3,694	7,410
Employee contributions	1,929	2,053
Benefits paid	(8,644)	(9,759)
Fair value of Plan assets at end of year	\$ 185,919	\$ 169,292

The actual return on plan assets net of administrative expense, for the year ended December 31, 2014 was a gain of \$19,648 (2013 gain of \$21,801).

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	
	2014	2013	2014	2013
Operating expense				
Current service cost	\$ 5,965	\$ 6,603	\$ 47	\$ 54
Past service cost	236	—	—	—
Interest expense	8,317	7,117	468	397
Interest income on plan assets	(8,082)	(6,189)	—	—
Administrative expense	635	635	—	—
Decrease (increase) in net income before tax	\$ 7,071	\$ 8,166	\$ 515	\$ 451
Remeasurements				
Return on plan assets, excluding amounts included in interest income	\$ (12,201)	\$ (16,247)	\$ —	\$ —
(Gain)/loss from changes in demographic assumptions	(2,354)	5,986	(500)	1,135
(Gain)/loss from changes in financial assumptions	20,545	(10,385)	1,000	(905)
Actuarial (gain) loss from member experience	(10,638)	3,052	(181)	(228)
Change in effect of asset limit	—	—	—	—
Decrease (increase) in OCI before tax	\$ (4,648)	\$ (17,594)	\$ 319	\$ 2

Defined benefit plan expense is recognized in Operating expenses. Remeasurements in the defined benefit plan are included in OCI. Operating expenses also include \$670 (2013 \$544) of pension expense related to the defined contribution component of the pension plan.

Expected contributions (including both employer and employee amounts) to the Company's defined benefit pension plans for the year ending December 31, 2015 are approximately \$5,239.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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	2014		2013			
Equity						
Canadian						
Consumer discretionary	\$	4,006	2%	\$	6,633	4%
Consumer staples		8,504	5%		3,483	2%
Energy		13,169	7%		10,839	6%
Financials		23,096	12%		21,702	13%
Industrials		9,202	5%		4,437	3%
Information technology		7,251	4%		4,072	2%
Materials		682	0%		4,053	2%
Telecom services		3,188	2%		1,401	1%
Utilities		2,218	1%		1,975	1%
Total Canadian		71,316	38%		58,595	34%
Foreign		39,064	21%		43,974	26%
Total Equity		110,380	59%		102,569	60%
Debt						
Government of Canada		6,469	3%		10,244	6%
Provincial governments		14,520	8%		12,216	8%
Municipal governments		1,920	1%		1,140	1%
Canadian corporations		33,213	18%		25,793	15%
Total Debt		56,122	30%		49,393	30%
Cash, cash equivalent, accruals		5,261	3%		4,046	2%
Mutual Funds		7,296	4%		6,254	4%
Other		6,860	4%		7,030	4%
Total fair value of assets	\$	185,919	100%	\$	169,292	100%

All equities are classified as level 1 and all debt is classified as level 2 in the fair value hierarchy.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

The following weighted average assumptions were used in actuarial calculations:

As at December 31	Pension Benefits		Other Post Employment Benefits	
	2014	2013	2014	2013
Defined benefit obligation as at December 31:				
Discount rate - defined benefit obligation	4.0%	4.8%	3.9%	4.8%
Discount rate - net interest	4.8%	4.2%	4.8%	4.1%
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	7.8%	8.1%
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

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	2014	2013
Males aged 65 at measurement date	21.49	22.49
Females aged 65 at measurement date	23.96	24.52
Males aged 40 at measurement date	22.88	23.58
Females aged 40 at measurement date	25.18	25.37

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 Statement of financial position.

As at December 31, 2014	Change in Assumption	Impact on Pension Benefits		Impact on Other Post Employment Benefits	
		Increase	Decrease	Increase	Decrease
Discount rate	1%	(22,545)	31,159	(1,337)	1,640
Rate of compensation increase	1%	9,593	(8,327)	n/a	n/a
Health care cost increase	1%	n/a	n/a	1,505	(1,255)
Claim rate	10%	n/a	n/a	998	(998)
Life expectancy	1 year	4,216	(4,330)	503	(491)

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

As at December 31, 2013	Change in Assumption	Impact on Pension Benefits		Impact on Other Post Employment Benefits	
		Increase	Decrease	Increase	Decrease
Discount rate	1%	(21,927)	30,011	(982)	1,181
Rate of compensation increase	1%	8,556	(7,414)	n/a	n/a
Health care cost increase	1%	n/a	n/a	1,397	(1,083)
Claim rate	10%	n/a	n/a	924	(926)
Life expectancy	1 year	4,267	(4,558)	495	(514)

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

As at December 31	2014	2013
Staff pension plan	14	14
Supplemental employee retirement plan	11	11
Other post-employment benefits	15	13

## 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, 2014			
	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' other comprehensive income	\$ 8,460	\$ (8,460)	\$ 16,919	\$ (16,919)
Policyholders' other comprehensive income	\$ 404	\$ (404)	\$ 808	\$ (808)

	As at December 31, 2013			
	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' other comprehensive income	\$ 7,760	\$ (7,760)	\$ 15,520	\$ (15,520)
Policyholders' other comprehensive income	\$ 369	\$ (369)	\$ 738	\$ (738)

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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, 2014			
	100bps Increase	100bps Decrease	200bps Increase	200bps Decrease
Shareholders' other comprehensive income	\$ (2,538)	\$ 3,154	\$ (4,464)	\$ 6,929
Policyholders' other comprehensive income	\$ (121)	\$ 151	\$ (213)	\$ 331

	As at December 31, 2013			
	100bps Increase	100bps Decrease	200bps Increase	200bps Decrease
Shareholders' other comprehensive income	\$ (2,152)	\$ 2,607	\$ (3,847)	\$ 5,671
Policyholders' other comprehensive income	\$ (104)	\$ 126	\$ (185)	\$ 273

## 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.

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 is due to be completed as at December 31, 2016.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## 13. INSURANCE PREMIUMS

For the year ended December 31	2014			2013		
	Gross	Reinsurance Ceded	Net	Gross	Reinsurance Ceded	Net
Life premiums	\$ 450,133	\$ (78,702)	\$ 371,431	\$ 439,465	\$ (73,683)	\$ 365,782
Health premiums	335,044	(25,093)	309,951	319,334	(22,856)	296,478
Total life and health premiums	785,177	(103,795)	681,382	758,799	(96,539)	662,260
Annuity premiums	186,375	(264)	186,111	159,722	(438)	159,284
Total Insurance Premiums	\$ 971,552	\$ (104,059)	\$ 867,493	\$ 918,521	\$ (96,977)	\$ 821,544

## 14. FEE INCOME

For the year ended December 31	2014	2013
Investment management, policyholder administration and guarantee fees	\$ 179,537	\$ 143,442
Surrender charges and other miscellaneous fees	7,979	7,147
Fee Income	\$ 187,516	\$ 150,589

## 15. BENEFITS AND EXPENSES

### (a) Insurance Contract Benefits and Claims Paid

For the year ended December 31	2014			2013		
	Gross	Reinsurance Ceded	Net	Gross	Reinsurance Ceded	Net
Life claims	\$ 192,165	\$ (63,289)	\$ 128,876	\$ 169,046	\$ (41,789)	\$ 127,257
Health claims	244,151	(14,399)	229,752	221,903	(11,491)	210,412
Total life and health claims	436,316	(77,688)	358,628	390,949	(53,280)	337,669
Annuity benefits	289,903	(3,193)	286,710	225,060	(3,192)	221,868
Benefits and Claims Paid	\$ 726,219	\$ (80,881)	\$ 645,338	\$ 616,009	\$ (56,472)	\$ 559,537

### (b) Change in Insurance Contract Liabilities and Reinsurance Ceded

For the year ended December 31	2014			2013		
	Gross	Reinsurance Ceded	Net	Gross	Reinsurance Ceded	Net
Life	\$ 526,875	\$ 213,350	\$ 740,225	\$ (150,411)	\$ 37,845	\$ (112,566)
Health	65,304	(8,024)	57,280	(610)	486	(124)
Total life and health	592,179	205,326	797,505	(151,021)	38,331	(112,690)
Annuity	(53,955)	622	(53,333)	(49,182)	1,488	(47,694)
Change in Insurance Contract Liabilities	\$ 538,224	\$ 205,948	\$ 744,172	\$ (200,203)	\$ 39,819	\$ (160,384)

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## 16. 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.

The Capital and Surplus segment is made up of assets held in the shareholders' and participating policyholders' equity accounts.

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

	For the year ended December 31, 2014				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Net premiums from external customers	\$ 186,106	\$ 318,942	\$ 362,445	\$ —	\$ 867,493
Interest income	39,712	6,149	130,332	38,843	215,036
Total investment income	48,998	4,104	150,543	42,236	245,881
Fair value change in fair value through profit or loss assets	19,981	4,270	513,949	(164)	538,036
Realized gain (loss) on fair value through profit or loss assets	9,174	489	65,220	(414)	74,469
Realized gain (loss) on available for sale assets including impairment write downs	39	48	10	12,524	12,621
Fee income from external customers	177,368	8,571	1,327	250	187,516
Net benefits and claims	286,714	237,540	121,084	—	645,338
Net change in insurance contract liabilities	(53,330)	6,596	790,906	—	744,172
Change in investment contract provision	2,282	—	—	—	2,282
Policy dividends	—	—	23,898	—	23,898
Amortization of capital assets	1,939	1,183	1,598	—	4,720
Total operating expenses	61,087	41,826	42,637	1,419	146,969
Net commission expense	91,307	31,025	70,809	—	193,141
Interest expense	—	—	—	14,180	14,180
Premium tax	—	6,943	7,316	—	14,259
Investment and capital tax	—	—	4,100	—	4,100
Income tax expense (recovery)	11,733	3,475	5,219	9,874	30,301
Net income (loss) after tax	41,872	9,019	27,526	28,959	107,376

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

	For the year ended December 31, 2013				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Net premiums from external customers	\$ 159,284	\$ 306,585	\$ 355,675	\$ —	\$ 821,544
Interest income	41,489	5,633	122,508	37,111	206,741
Total investment income	53,213	4,256	140,199	42,491	240,159
Fair value change in fair value through profit or loss assets	(36,256)	(6,561)	(306,220)	—	(349,037)
Realized gain (loss) on fair value through profit or loss assets	7,173	299	37,973	—	45,445
Realized gain (loss) on available for sale assets including impairment write downs	162	195	150	(2,995)	(2,488)
Fee income from external customers	140,211	7,605	1,009	1,764	150,589
Net benefits and claims	221,868	219,151	118,518	—	559,537
Net change in insurance contract liabilities	(47,694)	2,996	(115,686)	—	(160,384)
Change in investment contract provision	945	—	—	—	945
Policy dividends	—	—	22,098	—	22,098
Amortization of capital assets	1,729	1,306	1,578	—	4,613
Total operating expenses	55,249	41,926	40,798	1,477	139,450
Net commission expense	71,838	30,172	66,247	—	168,257
Interest expense	—	—	—	18,977	18,977
Premium tax	—	6,697	7,314	—	14,011
Investment and capital tax	—	—	3,900	—	3,900
Income tax expense (recovery)	2,938	2,790	19,182	4,475	29,385
Net income (loss) after tax	18,651	8,647	66,407	16,331	110,036

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

	As at December 31, 2014				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Assets excluding segregated funds	\$ 1,062,818	\$ 160,465	\$ 4,156,329	\$ 1,399,116	\$ 6,778,728
Segregated funds	6,926,322	—	22,153	—	6,948,475
<b>Total assets</b>	<b>\$ 7,989,140</b>	<b>\$ 160,465</b>	<b>\$ 4,178,482</b>	<b>\$ 1,399,116</b>	<b>\$ 13,727,203</b>

	As at December 31, 2013				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Assets excluding segregated funds	\$ 1,104,876	\$ 154,470	\$ 3,359,260	\$ 1,507,296	\$ 6,125,902
Segregated funds	5,932,724	—	21,784	—	5,954,508
<b>Total assets</b>	<b>\$ 7,037,600</b>	<b>\$ 154,470</b>	<b>\$ 3,381,044</b>	<b>\$ 1,507,296</b>	<b>\$ 12,080,410</b>

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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## 17. OPERATING EXPENSES

Operating expenses include the following:

For the year ended December 31	2014	2013
Salary and benefits expense	\$ 85,309	\$ 83,713
Professional services	14,914	14,273
Rent, leasing and maintenance	10,473	10,826
Amortization and depreciation of capital assets	4,720	4,613
Other	31,553	26,025
<b>Total</b>	<b>\$ 146,969</b>	<b>\$ 139,450</b>

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

## 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	2014	2013
Current income tax expense	\$ 20,805	\$ 31,847
Deferred income tax expense (benefit) relating to the origination and reversal of temporary differences	9,496	(2,462)
<b>Income Tax Expense</b>	<b>\$ 30,301</b>	<b>\$ 29,385</b>

During 2014 the Company paid income tax installments totaling \$32,566 (2013 \$24,074).

The Company has an Ontario minimum tax carry-forward of \$1,549 expiring in 17 years. Management considers it more likely than not that these tax carry-forwards will be realized before they expire.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## (b) Variance from Statutory Provision

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

<b>For the year ended December 31</b>	<b>2014</b>	<b>2013</b>
Net income before income taxes	\$ 137,677	\$ 139,421
Income tax provision at statutory rates	36,511	36,919
Increase (decrease) resulting from:		
Tax paid dividends on stocks	(6,494)	(7,515)
Miscellaneous	284	(19)
<b>Income Tax Expense</b>	<b>\$ 30,301</b>	<b>\$ 29,385</b>

The current enacted corporate tax rates as they impact the Company in 2014 stand at 26.52% (2013 26.48%). This rate is expected to remain unchanged through to 2018. 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 statement of financial position. These differences arise in the following items:

<b>As at December 31</b>	<b>2014</b>	<b>2013</b>
Insurance contracts	\$ (10,479)	\$ (11,298)
Portfolio investments	(6,839)	(7,707)
Taxes recoverable in future years	6,011	16,942
Post-employment benefit plans	4,655	4,772
Other, net	(1,591)	(309)
<b>Deferred Income Tax Asset (Liability)</b>	<b>\$ (8,243)</b>	<b>\$ 2,400</b>

Of the above total, \$4,304 (2013 \$6,833) is expected to be received (paid) more than one year after the Consolidated statement of financial position date.

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

<b>For the year ended December 31</b>	<b>2014</b>	<b>2013</b>
Deferred income tax asset (liability) - beginning of year	\$ 2,400	\$ 4,596
Deferred income tax (expense) benefit		
Statement of operations	(9,496)	2,462
Other comprehensive Income	(1,147)	(4,658)
<b>Deferred income tax asset (liability) - end of year</b>	<b>\$ (8,243)</b>	<b>\$ 2,400</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## (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	2014			2013		
	Before Tax	Tax Provision (Recovery)	After Tax	Before Tax	Tax Provision (Recovery)	After Tax
Unrealized fair value change on available for sale investments	\$ 52,187	\$ 13,838	\$ 38,349	\$ (25,682)	\$ (6,801)	\$ (18,881)
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(12,621)	(3,646)	(8,975)	2,488	601	1,887
Amortization of loss on derivative investments designated as cash flow hedges reclassified to net income	344	111	233	849	275	574
Remeasurements of post-employment benefit liabilities	4,329	1,147	3,182	17,592	4,658	12,934
<b>Total other comprehensive income (loss)</b>	<b>\$ 44,239</b>	<b>\$ 11,450</b>	<b>\$ 32,789</b>	<b>\$ (4,753)</b>	<b>\$ (1,267)</b>	<b>\$ (3,486)</b>

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

For the year ended December 31	2014			2013		
	Before Tax	Tax Provision (Recovery)	After Tax	Before Tax	Tax Provision (Recovery)	After Tax
Unrealized fair value change on available for sale investments	\$ 45,445	\$ 12,050	\$ 33,395	\$ (31,046)	\$ (8,222)	\$ (22,824)
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(6,047)	(1,755)	(4,292)	4,173	1,086	3,087
Amortization of loss on derivative investments designated as cash flow hedges reclassified to net income	344	111	233	849	275	574
Remeasurements of post-employment benefit liabilities	4,117	1,091	3,026	16,752	4,436	12,316
Shareholder portion of policyholder other comprehensive income (loss)	(75)	46	(121)	368	94	274
<b>Total other comprehensive income (loss)</b>	<b>\$ 43,784</b>	<b>\$ 11,543</b>	<b>\$ 32,241</b>	<b>\$ (8,904)</b>	<b>\$ (2,331)</b>	<b>\$ (6,573)</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

For the year ended December 31	2014			2013		
	Before Tax	Tax Provision (Recovery)	After Tax	Before Tax	Tax Provision (Recovery)	After Tax
Unrealized fair value change on available for sale investments	\$ 6,742	\$ 1,788	\$ 4,954	\$ 5,364	\$ 1,421	\$ 3,943
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(6,574)	(1,891)	(4,683)	(1,685)	(485)	(1,200)
Remeasurements of post-employment benefit liabilities	212	56	156	840	222	618
Shareholder portion of policyholder other comprehensive income (loss)	75	(46)	121	(368)	(94)	(274)
<b>Total other comprehensive income (loss)</b>	<b>\$ 455</b>	<b>\$ (93)</b>	<b>\$ 548</b>	<b>\$ 4,151</b>	<b>\$ 1,064</b>	<b>\$ 3,087</b>

## 19. DIVIDENDS

Shareholder dividends paid in 2014 and 2013 were \$33,984 and \$24,100, respectively. This represents a dividend pay out rate of \$34.4985 per share in 2014 and \$24.4652 per share in 2013.

## 20. 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, 2014 and December 31, 2013 the Company was in compliance with these ratios.

As at December 31	2014	2013
Tier 1 Regulatory Capital	\$ 872,275	\$ 830,538
Tier 2 Regulatory Capital	452,203	532,961
<b>Total Regulatory Capital</b>	<b>\$ 1,324,478</b>	<b>\$ 1,363,499</b>

## 21. COMMITMENTS AND CONTINGENCIES

### 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 2014 were \$3,026 (2013 \$3,250). The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

	2014	2013
2014	\$ —	\$ 3,011
2015	2,466	1,859
2016	2,159	1,521
2017	1,914	1,274
2018	1,656	1,016
2019 (and thereafter for comparative)	1,593	1,577
2020 (and thereafter)	679	—
	\$ 10,467	\$ 10,258

## Investment Commitments

In the normal course of business, investment commitments are outstanding which are not reflected in the consolidated financial statements. At December 31, 2014 there were \$8,942 (2013 \$11,430) of outstanding commitments to purchase units in a real estate limited partnership. These commitments are payable on demand and mature within 6 months.

## 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.

## 22. RELATED PARTY TRANSACTIONS

The Company is a 98.3% owned subsidiary of E-L Financial Services Limited which in turn is an 81.0% owned subsidiary of E-L Financial Corporation Limited. 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 its Shareholder and other companies under common control or common influence involving the leasing of office property, investment management services and miscellaneous office services. During 2014, the Company earned investment management service fees of \$101 (2013 \$1,631) from related companies under common shareholder control. For all other services, the amounts earned and expensed were not significant. Some directors and officers have insurance 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:

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

For the year ended December 31		2014	2013
Salaries and other short-term employee benefits	\$	6,829	\$ 6,369
Post-employment benefits		530	565
<b>Total</b>	<b>\$</b>	<b>7,359</b>	<b>\$ 6,934</b>

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

Management has established procedures to review and approve transactions with related parties and reports annually to the Conduct Review Committee of the Board of Directors on the procedures followed and the results of the review.

## 23. 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 will be 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.

On May 20, 2009, the Company issued \$200,000 principal amount of unsecured subordinated debentures with a maturity date of May 20, 2019. The interest rate from May 20, 2009 until May 20, 2014 is 6.73%, and the rate from May 20, 2014 until May 20, 2019 will be equal to the 3-month Canadian Deposit Offering Rate plus 5.75%. Interest is payable semi-annually at May 20 and November 20 until May 20, 2014, quarterly thereafter with the first such payment on August 20, 2014. The Company redeemed these debentures on May 20, 2014 at par.

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

The fair value of these debentures is \$305,199 as of December 31, 2014 (2013 \$500,609), and is within level 2 of the fair value hierarchy. The fair value is provided by a third party bond pricing service.

## 24. SHAREHOLDERS' EQUITY ENTITLEMENT

Shareholders' entitlement to \$5,478 (2013 \$5,718) of shareholders' equity is contingent upon future payment of dividends to participating policyholders.

## 25. CAPITAL STOCK

(a) Authorized

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

(b) Issued and fully paid

As at December 31		2014	2013
Number of common shares: 985,076	\$	985	\$ 985

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## 26. SUPPLEMENTARY PARTICIPATING POLICYHOLDER INFORMATION

### Participating Account Assets

As at December 31	2014	2013
Assets backing participating account equity	\$ 60,040	\$ 50,822
Assets backing participating account liabilities	\$ 579,832	\$ 510,765

### Transfers to Shareholders' Account

In 2014, the Company transferred \$2,016 (2013 \$2,292), equal to 8.3% of the distributable participating profits, from the participating account to the shareholders' account.

## 27. RISK MANAGEMENT

The Company is subject to a number of risks relating to its business, including investment risks and insurance risks. The goal of the Company's risk management process is to ensure that the operations of the Company that expose it to risk are consistent with the Company's objectives and risk philosophy while maintaining an appropriate risk/reward balance and enhancing stakeholder value. 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 a Management Risk Committee with Board reporting responsibility. The Company's risk management framework is based on the former Office of the Superintendent of Financial Institutions (OSFI) Standards of Sound Business Practices and is tailored to the Company's circumstances and business risks, capturing its risk philosophy and risk appetite. Risk management policy development is centralized under the leadership of the Vice-President Risk Management and applies to all business units. On February 27, 2015 the Board approved the establishment of a Risk and Capital Committee and a Chief Risk Officer position. 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. There is executive representation and oversight on various interdisciplinary risk control committees, and the Company follows the same reporting and disclosure discipline as its public company parent, E-L Financial. The Company formally establishes and documents its values and risk tolerances through several company-wide policies including a Code of Ethics, Corporate Disclosure principles, risk management, capital management and whistleblower policies. The Company's strategic risk management policies (such as product design and pricing, investment policies and capital management) are also approved by its Board, or one of its subcommittees.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

The Company is exposed to investment and insurance 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 specific risks that management considers to be most significant in terms of likelihood and the potential adverse impact on the Company, are outlined below:

(a) Investment Risk:

- i) Market Risk, including:
  - (1) Market Price Fluctuations
  - (2) Interest Rate Risk
  - (3) Foreign Currency Risk
- ii) Liquidity Risk
- iii) Credit Risk

(b) Insurance Risk:

- i) Experience Risk
  - (1) Mortality
  - (2) Investment Returns
  - (3) Policy Termination (Lapse)
  - (4) Expenses
  - (5) Morbidity
- ii) Product Design and Pricing Risk
- iii) Underwriting and Claims Risk
- iv) Reinsurance Risk

(a) Investment Risk

The disclosures in Note 3 provide the breakdown of investments by type and by geographic region. The fair values of these investments are inherently volatile and frequently change in value as a result of factors beyond the Company's control, including general economic and capital market conditions.

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

(1) Market Price Fluctuations

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, the management fees collected on segregated fund contracts, mutual funds and on index funds within

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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 are generally assumed by the policyholders. Market value variations of such assets will result in variations in the income of the Company to the extent fees are determined in relation to the value of such funds. 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 hedging program. The objective of the hedging program is to partially protect the Company from possible future MCCR ratio declines that might result from adverse stock market price changes. The hedging program presently employs put options and short positions on key equity indices. The Company intends to protect 10% to 20% of overall income and MCCR equity risk exposure by expanding the hedging program during 2015 and subsequent years. 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 limited to \$100 million. 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 (MCCR) position. Regulatory pressure to increase capital escalates as the MCCR 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 Investment Committee of the Board.

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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 of Directors, on portfolio content, asset mix, the Company's matched position, the performance of general and segregated funds and compliance with the investment guidelines.

The Company has an Asset/Liability Management Committee, which meets regularly and reports at least quarterly to the Investment Committee of the Board. The mandate of the Asset/Liability Management Committee is to monitor 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/Liability 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 a Hedging Policy to support general fund hedging programs. The policy outlines objectives, risk limits and authority associated with its hedging activities. Management monitors its hedging activities on a regular basis and reports, at least quarterly, to the Board on the status of the 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 ALM Committee reports quarterly to the Investment Committee of the Board on the nature and value of the Company's segregated fund guarantee liabilities, including potential top-up exposure and capital requirements.

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

The following table summarizes the 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. For segregated fund guarantee policy liabilities the level of sensitivity is highly

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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 guarantee policy liabilities represent the impact on shareholders' net income. The impact of a change in future equity return assumptions can be found in Note 27 b) (i) (2) under the Insurance Risk Investment Returns section.

<b>As at December 31, 2014</b>					
	<b>10% Increase</b>	<b>10% Decrease</b>	<b>20% Increase</b>	<b>20% Decrease</b>	
Shareholders' net income	\$ 20,635	\$ (19,397)	\$ 41,805	\$ (36,694)	
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil	
Shareholders' other comprehensive income	\$ 2,133	\$ (2,133)	\$ 4,266	\$ (4,266)	
Policyholders' other comprehensive income	\$ 2,380	\$ (2,380)	\$ 4,760	\$ (4,760)	
Segregated fund guarantee policy liabilities	\$ nil	\$ nil	\$ nil	\$ nil	

<b>As at December 31, 2013</b>					
	<b>10% Increase</b>	<b>10% Decrease</b>	<b>20% Increase</b>	<b>20% Decrease</b>	
Shareholders' net income	\$ 20,125	\$ (20,125)	\$ 40,272	\$ (40,272)	
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil	
Shareholders' other comprehensive income	\$ 1,800	\$ (1,800)	\$ 3,600	\$ (3,600)	
Policyholders' other comprehensive income	\$ 3,036	\$ (3,036)	\$ 6,072	\$ (6,072)	
Segregated fund guarantee policy liabilities	\$ nil	\$ nil	\$ nil	\$ nil	

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

<b>As at December 31</b>	<b>2014</b>	<b>2013</b>
Holdings of common equities in the 10 issuers to which the Company had the greatest exposure	\$ 279,662	\$ 260,775
Percentage of total cash and investments	4.2%	4.3%
Exposure to the largest single issuer of common equities	\$ 47,487	\$ 41,081
Percentage of total cash and investments	0.7%	0.7%

## (2) Interest Rate Risk

Interest rate risk is the risk of economic loss due to the need to reinvest or divest during periods of changing interest rates. Changes in interest rates, as a result of the general market volatility or as a result of specific social, political or economic events, could have an adverse effect on the Company's business and profitability in several ways. Certain of the Company's product offerings contain guarantees and, if long-term interest rates fall below those guaranteed rates, the Company may be required to increase 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.

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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 immediate financial impact on Net income and OCI as a result of a change in interest rates. The impact of a change in future interest rate assumptions on Insurance contract liabilities can be found in Note 27 b) (i) (2) under the Insurance Risk Investment Return section.

<b>As at December 31, 2014</b>						
	<b>100bps Increase</b>		<b>100bps Decrease</b>		<b>200bps Increase</b>	<b>200bps Decrease</b>
Shareholders' net income	\$	nil	\$	nil	\$	nil
Policyholders' net income	\$	nil	\$	nil	\$	nil
Shareholders' other comprehensive income	\$	(38,645)	\$	49,866	\$	110,952
Policyholders' other comprehensive income	\$	(2,238)	\$	2,511	\$	5,300

<b>As at December 31, 2013</b>						
	<b>100bps Increase</b>		<b>100bps Decrease</b>		<b>200bps Increase</b>	<b>200bps Decrease</b>
Shareholders' net income	\$	nil	\$	nil	\$	nil
Policyholders' net income	\$	nil	\$	nil	\$	nil
Shareholders' other comprehensive income	\$	(36,712)	\$	45,492	\$	99,801
Policyholders' other comprehensive income	\$	(2,187)	\$	2,460	\$	5,193

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 ALM 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 Currency Risk

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

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The Company's primary foreign currency exposure arises from portfolio investments denominated in US dollars. A 10% fluctuation in the US dollar would have an impact of approximately \$nil (2013 \$1,430) on net income, \$nil (2013 \$nil) on shareholders' OCI and \$nil (2013 \$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 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.

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

## ii) Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. The majority of the Company's obligations relate to its policy liabilities, the duration of which varies by line of business and expectations relating to key policyholder actions or events (i.e. cash withdrawal, mortality, and morbidity). The remaining obligations of the Company relate to the subordinated debt (refer to Note 23 - Subordinated Debt) and to ongoing operating expenses as they fall due, which are expected to settle in a very short period of time.

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

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

The Company maintains a liquidity policy requiring an assessment of the Company's liquidity risk and specific procedures so that liquidity needs are met. Compliance with the policy is monitored by the ALM 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).

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

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 2014 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, 2014					
	1 year or less	1 - 5 years	5 - 10 years	Over 10 years	Total
Insurance contract liabilities	\$ 150,297	\$ 186,989	\$ 418,045	\$ 15,967,863	\$ 16,723,194
Investment contract liabilities	1,983	6,739	3,964	3,189	15,875
Subordinated debt	8,610	30,094	320,039	—	358,743
Other liabilities	164,583	6,461	17,560	—	188,604
Total liabilities	325,473	230,283	759,608	15,971,052	17,286,416
Operating lease commitments	2,466	7,322	679	—	10,467
<b>Total</b>	<b>\$ 327,939</b>	<b>\$ 237,605</b>	<b>\$ 760,287</b>	<b>\$ 15,971,052</b>	<b>\$ 17,296,883</b>

As at December 31, 2013					
	1 year or less	1 - 5 years	5 - 10 years	Over 10 years	Total
Insurance contract liabilities	\$ 169,841	\$ 267,826	\$ 468,223	\$ 14,564,254	\$ 15,470,144
Investment contract liabilities	2,729	6,294	5,085	3,068	17,176
Subordinated debt	214,218	32,883	326,235	—	573,336
Other liabilities	164,239	—	18,317	—	182,556
Total liabilities	551,027	307,003	817,860	14,567,322	16,243,212
Operating lease commitments	3,011	5,670	1,577	—	10,258
<b>Total</b>	<b>\$ 554,038</b>	<b>\$ 312,673</b>	<b>\$ 819,437</b>	<b>\$ 14,567,322</b>	<b>\$ 16,253,470</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

The Company is able to fund its short-term cash outflows by generating positive cash inflows from operations and from investment income earned on its investment portfolio. The ALM 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, 2014, 4.0% (2013 4.0%) of cash and investments were held in these shorter duration investments.

### iii) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company is subject to credit risk which arises from debtors or counterparties who are unable to meet their obligations under debt or derivative instruments. This credit risk is derived primarily from investments in bonds, debentures, preferred shares, 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 of the Board of Directors and by 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 implicitly in the interest rate assumption.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

As at December 31	2014	2013
Cash and cash equivalents	\$ 239,102	\$ 217,350
Short-term investments	26,892	25,448
Bonds	4,958,086	4,333,512
Preferred shares	196,179	294,218
Mortgages	323,117	299,353
Reinsurance	99,707	91,967
Loans on policies	46,434	44,855
Policy contract loans	86,698	90,275
Accrued investment income	25,048	24,058
Insurance receivables	41,743	41,014
Trade accounts receivable	15,331	8,397
<b>Total</b>	<b>\$ 6,058,337</b>	<b>\$ 5,470,447</b>

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

The Company has made provision in its Statement 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)).

## 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	2014		2013	
	Fair Value	% of Fair Value	Fair Value	% of Fair Value
AAA	\$ 269,223	5%	\$ 290,418	7%
AA	1,395,341	28%	1,190,826	27%
A	2,578,045	53%	2,257,568	52%
BBB	714,717	14%	594,134	14%
BB	760	—%	566	—%
<b>Total</b>	<b>\$ 4,958,086</b>	<b>100%</b>	<b>\$ 4,333,512</b>	<b>100%</b>

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 comparables rated by recognized rating agencies and/or methodologies used by recognized rating agencies.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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

As at December 31	2014	2013
Provincial bond holdings	\$ 2,630,620	\$ 2,167,988
Percentage of total bond holdings	53.0%	50.0%

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

As at December 31	2014		2013	
	Fair Value	% of Fair Value	Fair Value	% of Fair Value
1 year or less	\$ 106,297	2%	\$ 61,367	1%
1 - 5 years	671,657	14%	658,374	15%
5 - 10 years	489,124	10%	492,778	11%
Over 10 years	3,691,008	74%	3,120,993	73%
<b>Total</b>	<b>\$ 4,958,086</b>	<b>100%</b>	<b>\$ 4,333,512</b>	<b>100%</b>

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	2014	2013
Holdings of fixed income securities* in the 10 issuers (excluding federal governments) to which the Company had the greatest exposure	\$ 3,242,685	\$ 2,803,115
Percentage of total cash and investments	48.6%	46.6%
Exposure to the largest single issuer of corporate bonds	\$ 123,415	\$ 130,849
Percentage of total cash and investments	1.9%	2.2%

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

## (2) Preferred Shares

The Company's preferred share investments are all issued by Canadian companies, with 10% (2013 33%) of these investments rated as P1 and the remaining 90% (2013 67%) rated as P2.

## (3) Mortgages

Mortgages in the province of Ontario represent the largest concentration with \$320,262 or 99% (2013 \$296,025 or 99%) of the total mortgage portfolio.

## (b) 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	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
Net premium income	\$ 186	\$ 159	\$ 319	\$ 307	\$ 362	\$ 356	\$ —	\$ —	\$ 867	\$ 822
Fee and other income	178	140	9	8	1	1	—	2	188	151
<b>Total</b>	<b>\$ 364</b>	<b>\$ 299</b>	<b>\$ 328</b>	<b>\$ 315</b>	<b>\$ 363</b>	<b>\$ 357</b>	<b>\$ —</b>	<b>\$ 2</b>	<b>\$ 1,055</b>	<b>\$ 973</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

The Company is in the business of measuring and managing risk, as reflected in the valuation of insurance contract liabilities. The Company is exposed to various insurance risks, and the most important insurance risks of the Company include:

- i) Experience Risk, including:
  - (1) Mortality
  - (2) Investment Returns
  - (3) Policy Termination (Lapse)
  - (4) Expenses
  - (5) Morbidity
- ii) Product Design and Pricing Risk
- iii) Underwriting and Claims Risk
- iv) Reinsurance Risk

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

i) Experience Risk

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

The computation of insurance liabilities and related reinsurance recoverable requires “best estimate” assumptions covering the remaining life of the policies. Assumptions in use are based on past experience, current internal data, external market indices and benchmarks which reflect current observable market trends and other published information. These assumptions are made for mortality, morbidity, investment returns, 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 Canadian Institute of Actuaries (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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

Policy liability assumptions are reviewed and updated at least annually and the impact of changes in those assumptions is reflected in earnings in the year of the change. 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, 2014. 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 \$11,800 (\$11,100 - for 2013).

For annuity business, lower mortality is financially adverse so a 2% decrease in the best estimate mortality assumption would increase policy liabilities thereby decreasing net income by approximately \$4,100 (\$3,600 for 2013).

## (2) Investment Returns

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

The impact of an immediate change in interest rates can be found in Note 27 a) (i) (2) under the Investment Risk section. 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% change in interest rates would cause a change in reinvestment assumption for the next 40-years, resulting in an increase to policy liabilities thereby reducing net income by approximately \$57,000 (not available for 2013) . 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 the revised Canadian actuarial standards of practice effective October 15, 2014, 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%.

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% (3.0% for 2013) to adjust for credible adverse scenarios.

For the life insurance business, the Company's policy is to also 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 9.2% (9.2% for 2013). The Company uses an assumption of 7.5% (7.7% for 2013) 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 can be found in Note 27 a) (i) (1) under the Investment Risk section. 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 \$91,900 (\$85,800 in 2013).

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. The Company does not use equity investments to match annuity liability cash flows.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

## (3) Policy Termination (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 \$113,100 (\$100,600 in 2013). 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.

## (4) 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.

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 \$5,800 (\$5,700 in 2013).

## (5) 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.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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 (\$5,100 in 2013).

## ii) Product Design and Pricing Risk

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

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

The Company manages product design and pricing risk through a variety of enterprise-wide programs and controls. The 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 Dynamic Capital Adequacy Testing and reports annually to the Company's Audit Committee on the Company's financial condition, outlining the impact on capital levels should future experience be adverse. The Company has also developed a Product Design and Pricing Risk Management Policy for each of its major product lines. This policy, which is established by management and approved by the Company's Board of Directors, defines the Company's product design and pricing risk management philosophy. The policy sets out product design and pricing approval authorities, product concentration limits, and required product development monitoring processes and controls.

## iii) Underwriting and Claims Risk

The Company is subject to the risk of financial loss resulting from the selection and underwriting of risks to be insured and from the adjudication and settlement of claims. Many of the Company's individual insurance and group disability products provide benefits over the policyholder's lifetime. Actual claims experience may differ

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

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 Company's Board of Directors. 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.

#### iv) 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. 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) Financial 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.

### 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.

### 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 Canadian life and health insurance industry provides a wide range of financial security products to more than 26 million Canadians and their dependents. The industry develops guidelines, voluntarily and proactively, to respond to emerging issues and to ensure consumer interests are protected.

### 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

### 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.

### 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).

### 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 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.

## GLOSSARY OF TERMS (unaudited)

### 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.

# PARTICIPATING ACCOUNT MANAGEMENT POLICY

## Purpose

The Participating Account Management Policy sets out the management objectives for oversight of 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 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

### 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

# PARTICIPATING ACCOUNT MANAGEMENT POLICY

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.

## 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.

## Participating Policy Dividends and Bonus Policy

This dividend policy applies to all policies issued in the participating account of The Empire Life Insurance Company (“Empire Life” or the “Company”) 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.

## 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 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.

# PARTICIPATING POLICYHOLDER DIVIDENDS AND BONUS POLICY

## 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.

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 professional 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 Board of Directors and an internal risk management department that supports enterprise risk management activities. On February 27, 2015 the Board approved the establishment of a Risk and Capital Committee and a Chief Risk Officer position. 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 eleven times in 2014 and is scheduled to meet seven times in 2015.

The risk management functions overseen by the Board include those relating to market price fluctuations, interest rate risk, credit risk, foreign currency risk, reinsurance risk, liquidity risk, other risks associated with policy liabilities (including mortality risk, investment return risk, policy termination (lapse) risk, expense risk, morbidity risk and risks associated with segregated fund policy guarantees), regulatory risk, and operational risk (including product design and pricing risk, underwriting and claims 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.

## CORPORATE GOVERNANCE OVER RISK MANAGEMENT

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 activities mandated to the Company's Asset/Liability Management Committee.

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 (established February 27, 2015) 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 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](http://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

500-2550 Victoria Park Avenue  
Toronto, Ontario M2J 5A9  
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

#### Edmonton Group Sales Office

1980-10020 101 A Avenue  
Edmonton, Alberta T5J 3G2  
780 482-4241  
1 866 990-9925

### 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

500-2550 Victoria Park Avenue  
Toronto, Ontario M2J 5A9  
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

**Andrew S. Birrell**<sup>5</sup>  
Chief Financial Officer  
Guardian Financial Services

**John F. Brierley**<sup>1, 5</sup>  
Corporate Director

**Edward M. Iacobucci**<sup>1, 4</sup>  
Dean, Faculty of Law  
University of Toronto

**Duncan N.R. Jackman**<sup>1, 2, 3, 4, 5</sup>  
Chairman of the Board  
The Empire Life Insurance Company

**Clive P. Rowe**<sup>2, 5</sup>  
Partner  
Oskie Capital

**Stephen J.R. Smith**<sup>2, 3</sup>  
Chairman and President  
First National Financial LP

**Mark M. Taylor**<sup>2</sup>  
Executive Vice-President and Chief Financial  
Officer  
E-L Financial Corporation Limited

**Jacques Tremblay**<sup>1, 3, 5</sup>  
Partner  
Oliver Wyman Actuarial Consulting

**Jonathan J. Yates**<sup>5</sup>  
Chief Executive Officer  
Guardian Financial Services

## POLICYHOLDERS' DIRECTORS

**Mark J. Fuller**<sup>2, 3, 4</sup>  
President and Chief Executive Officer  
Ontario Pension Board

**Harold W. Hillier**<sup>2, 4</sup>  
Corporate Director

**Richard E. Rooney**<sup>2, 3</sup>  
President  
Burgundy Asset Management Ltd.

**Mark Sylvia**<sup>5</sup>  
President and Chief Executive Officer  
The Empire Life Insurance Company

**Douglas C. Townsend**<sup>1, 3, 5</sup>  
President  
Townsend Actuarial Consulting Ltd.

## HONORARY CHAIRMAN

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

## HONORARY DIRECTOR

**The Right Honourable John N. Turner**

<sup>1</sup> Member of Audit Committee

<sup>2</sup> Member of Investment Committee

<sup>3</sup> Member of Human Resources Committee

<sup>4</sup> Member of Conduct Review Committee

<sup>5</sup> Member of Risk and Capital Committee (effective Feb 27, 2015)

# CORPORATE MANAGEMENT

**Mark Sylvia**

President and Chief Executive Officer

**Anne E. Butler**

Senior Vice-President, Human Resources, Communication and Legal Services

**Richard Cleaver**

Senior Vice-President and Chief Technology Officer

**J. Edward Gibson**

Senior Vice-President and Chief Actuary

**Sean E. Kilburn**

Senior Vice-President, Life Insurance

**Gary J. McCabe**

Senior Vice-President and Chief Financial Officer

**Gaelen Morphet**

Senior Vice-President and Chief Investment Officer

**Steve S. Pong**

Senior Vice-President, Group Solutions

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## EMPIRE LIFE ANNUAL REPORT 2014

The Empire Life Insurance Company (Empire Life) offers competitive individual and group life and health insurance, investment and retirement products to help you build wealth and protect your financial security.

Empire Life is among the top 10 life insurance companies in Canada<sup>1</sup> and is rated A (Excellent) by A.M. Best Company<sup>2</sup>. Our vision is to be known for simplicity, being easy to do business with and having a personal touch.

<sup>1</sup> *The Globe and Mail Report on Business*, June 2014, based on revenue

<sup>2</sup> As at May 21, 2014

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Policies are issued by The Empire Life Insurance Company.