

Third Quarter **2018**

3

Management's Discussion and Analysis
For the quarter ended September 30, 2018

Intact Financial Corporation

INTACT FINANCIAL CORPORATION

Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

The following MD&A is the responsibility of management and has been reviewed and approved by the Board of Directors (or "Board") for the quarter ended September 30, 2018. This MD&A is intended to enable the reader to assess our results of operations and financial condition for the three- and nine-month periods ended September 30, 2018, compared to the corresponding periods in 2017. It should be read in conjunction with our interim Consolidated financial statements, as well as the MD&A and the Consolidated financial statements included in our 2017 Annual Report. This MD&A is dated November 6, 2018.

"Intact", the "Company", "IFC", "we" and "our" are terms used throughout the document to refer to Intact Financial Corporation and its subsidiaries. Further information about Intact Financial Corporation, including the Annual Information Form, may be found online on SEDAR at www.sedar.com.

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Non-IFRS financial measures

We use both IFRS and non-IFRS financial measures to assess our performance. Non-IFRS financial measures do not have any standardized meaning prescribed by IFRS and are unlikely to be comparable to any similar measures presented by other companies. See Section 14 – *Non-IFRS financial measures* for the definition and reconciliation to the most comparable IFRS measures. These measures and other insurance-related terms used in this MD&A are defined in the glossary available in the "Investors" section of our web site at www.intactfc.com.

Cautionary note regarding forward-looking statements

Certain of the statements included in this MD&A about the Company's current and future plans, expectations and intentions, results, levels of activity, performance, goals or achievements or any other future events or developments constitute forward-looking statements. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely", "potential" or the negative or other variations of these words or other similar or comparable words or phrases, are intended to identify forward-looking statements. This MD&A contains forward-looking statements with respect to the acquisition (the "Acquisition") of OneBeacon Insurance Group, Ltd. ("OneBeacon") and the integration and future plans relating to the Acquisition.

Forward-looking statements are based on estimates and assumptions made by management based on management's experience and perception of historical trends, current conditions and expected future developments, as well as other factors that management believes are appropriate in the circumstances. Many factors could cause the Company's actual results, performance or achievements or future events or developments to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the following factors: the Company's ability to implement its strategy or operate its business as management currently expects; its ability to accurately assess the risks associated with the insurance policies that the Company writes; unfavourable capital market developments or other factors which may affect the Company's investments, floating rate securities and funding obligations under its pension plans; the cyclical nature of the P&C insurance industry; management's ability to accurately predict future claims frequency and severity, including in the Ontario personal auto line of business, catastrophe losses caused by severe weather and other weather-related losses, as well as the impact of climate change; Government regulations designed to protect policyholders and creditors rather than investors; litigation and regulatory actions; periodic negative publicity regarding the insurance industry; intense competition; the Company's reliance on brokers and third parties to sell its products to clients and provide services to the Company; the Company's ability to successfully pursue its acquisition strategy; the Company's ability to execute its business strategy; the Company's ability to achieve synergies arising from successful integration plans relating to acquisitions; economic, financial, business and political conditions, as well as their resulting effect on management's estimates and expectations in relation to accretion, equity IRR, net operating income per share, MCT, combined and debt-to-total capital ratio and the other metrics used in relation to the Acquisition; the terms and conditions of the Acquisition; the Company's participation in the Facility Association (a mandatory pooling arrangement among all industry participants) and similar mandated risk-sharing pools; terrorist attacks and ensuing events; the occurrence and frequency of catastrophe events, including a major earthquake; the Company's ability to maintain its financial strength and issuer credit ratings; the Company's access to debt and equity financing; the Company's ability to compete for large commercial business; the Company's ability to alleviate risk through reinsurance; the Company's ability to successfully manage credit risk (including credit risk related to the financial health of reinsurers); the Company's ability to contain fraud and/or abuse; the Company's reliance on information technology and telecommunications systems and potential failure of or disruption to those systems, including evolving cybersecurity risk; the impact of developments in technology on the Company's products and distribution; the Company's dependence on and ability to retain key employees; changes in laws or regulations; general economic, financial and political conditions; the Company's dependence on the results of operations of its subsidiaries and the ability of the Company's subsidiaries to pay dividends; the volatility of the stock market and other factors affecting the trading prices of the Company's securities; the Company's ability to hedge exposures to fluctuations in foreign exchange rates; future sales of a substantial number of its common shares; changes in applicable tax laws, tax treaties or tax regulations or the interpretation or enforcement thereof.

All of the forward-looking statements included in this MD&A and the quarterly earnings press release dated November 6, 2018, are qualified by these cautionary statements and those made in the section entitled Risk management (Sections 19-24) of our MD&A for the year ended December 31, 2017. These factors are not intended to represent a complete list of the factors that could affect the Company. These factors should, however, be considered carefully. Although the forward-looking statements are based upon what management believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. When relying on forward-looking statements to make decisions, investors should ensure the preceding information is carefully considered. Undue reliance should not be placed on forward-looking statements made herein. The Company and management have no intention and undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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Glossary of abbreviations

Description		Description	
AEPS	Adjusted EPS	NAIC	National Association of Insurance Commissioners
AFS	Available for sale	NCIB	Normal course issuer bid
AMF	Autorité des marchés financiers	NEP	Net earned premiums
AOCI	Accumulated OCI	NOI	Net operating income
AROE	Adjusted ROE	NOIPS	NOI per share
BVPS	Book value per share	OCI	Other comprehensive income
CAD	Canadian Dollar	OROE	Operating ROE
CAN	Canada	OSFI	Office of the Superintendent of Financial Institutions
CAT	Catastrophe	P&C	Property & Casualty
DPW	Direct premiums written	PTOI	Pre-tax operating income
EPS	Earnings per share to common shareholders	PYD	Prior year claims development
FVTPL	Fair value through profit and loss	RBC	Risk-based capital
IFRS	International Financial Reporting Standards	ROE	Return on equity
LTM	Last twelve months	S&P	Standard & Poor's
MCT	Minimum capital test	U.S.	United States
MD&A	Management's Discussion and Analysis	USD	U.S. Dollar
MYA	Market yield adjustment		

Important notes

- Unless otherwise noted, DPW refer to DPW normalized for the effect of multi-year policies, excluding industry pools, fronting and exited lines (referred to as "DPW" in this MD&A). DPW for 2017 were adjusted to exclude fronting from P&C Canada, to enhance comparability with our current reporting. *See Table 24 for details on exited lines and Table 26 for the reconciliation to DPW, as reported under IFRS.* All underwriting results and related ratios exclude the MYA and the results of our U.S. Commercial exited lines, unless otherwise noted. The expense and general expense ratios are presented herein net of other underwriting revenues.
- Catastrophe claims are any one claim, or group of claims, equal to or greater than \$7.5 million for P&C Canada (US\$5 million for P&C U.S.) related to a single event (referred to as the "CAT threshold"). A non-catastrophe weather event is a group of claims, which is considered significant but that is smaller than the CAT threshold, related to a single weather event. A large loss is defined as a single claim larger than \$0.25 million for P&C Canada (US\$0.25 million for P&C U.S.) but smaller than the CAT threshold.
- Regulatory Capital Ratios refer to MCT (as defined by OSFI and the AMF in Canada) and RBC (as defined by the NAIC in the U.S.). All references to "total capital margin" in this MD&A include the aggregate of capital in excess of company action levels in regulated entities (170% MCT, 200% RBC) plus available cash in unregulated entities (*see Section 11.2 - Capital position for details*).
- Unless otherwise noted, market share and market related data for P&C Canada are based on the latest available data (H1-2018) from MSA Research Inc. ("MSA") and excludes Lloyd's Underwriters Canada, Insurance Corporation of British Columbia, Saskatchewan Government Insurance, Saskatchewan Auto Fund, Genworth Financial Mortgage Insurance Company Canada and Canada Guaranty Mortgage Insurance Company. MSA data excludes certain Québec regulated entities. Market share and market positioning reflect the impact of announced or completed acquisitions and are therefore presented on a *pro forma* basis.
- Certain totals, subtotals and percentages may not agree due to rounding. Not meaningful (nm) is used to indicate that the current and prior year figures are not comparable, not meaningful, or if the percentage change exceeds 1,000%.

OVERVIEW

Section 1 – Overview of Intact Financial Corporation

1.1 Building a world-class P&C insurer

- We are the largest provider of P&C insurance in Canada and a leading provider of specialty insurance in North America, with close to \$10 billion in annual DPW¹.
- We have approximately 14,000 full- and part-time employees who serve more than five million personal, business, public sector and institutional customers through offices in Canada and the U.S.
- In Canada, we distribute insurance under the Intact Insurance brand through a wide network of brokers, including our wholly-owned subsidiary BrokerLink, and directly to consumers through belairdirect. In the U.S., OneBeacon, our wholly-owned subsidiary, provides specialty insurance products through independent agencies, brokers, wholesalers and managing general agencies.
- We are a proven industry consolidator with a track record of 16 successful P&C acquisitions since 1988.

1.2 Our business segments

We report our financial results under the business segments set out below. The composition of our segments is aligned with our management structure and internal financial reporting based on geography and the nature of our activities.

Intact Financial Corporation

Canada (CAN)	<p>Comprised of the underwriting (P&C Canada) and distribution activities in Canada</p> <ul style="list-style-type: none"> • Underwriting of automobile, home and business insurance contracts to individuals and businesses in Canada. Underwriting results in Canada are reported under three lines of business (<i>see Section 2</i>): <ul style="list-style-type: none"> • Personal auto • Personal property • Commercial, which includes Commercial auto and Commercial P&C • Distribution operations, including the operating results of our wholly-owned broker, BrokerLink, as well as our share of results of broker affiliates. 	  
U.S.	<p>Comprised of the underwriting activities in the U.S. (P&C U.S.)</p> <ul style="list-style-type: none"> • Underwriting of specialty contracts to small and midsize businesses in the U.S., which are reported under: <ul style="list-style-type: none"> • Commercial lines, which include the underwriting results of OneBeacon since September 28, 2017 (<i>see Section 3</i>). 	
Corporate & other (Corporate)	<p>Comprised of the following activities, which are managed at the Corporate level:</p> <ul style="list-style-type: none"> • Investment management • Treasury and capital management • Other corporate activities, including internal reinsurance <p>Operating results include net investment income, finance costs, as well as other income and expenses (including corporate expenses and ancillary income) (<i>see Section 4</i>).</p>	

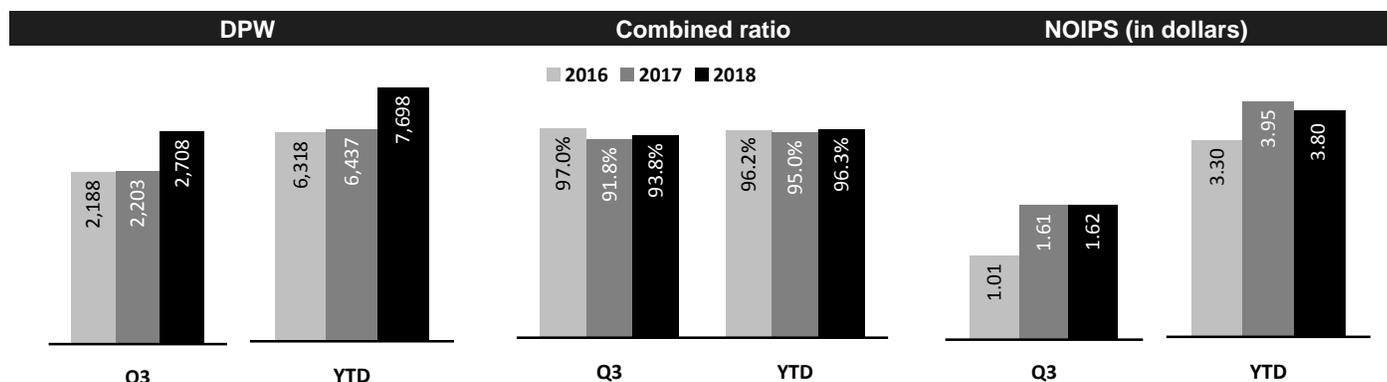
¹ DPW (pro forma) for 2017 are comprised of the DPW of P&C Canada and the DPW (pro forma) of P&C U.S., using an exchange rate of 1.30.

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1.3 Q3-2018 Highlights

- **Net operating income per share of \$1.62**, driven by a solid combined ratio of 93.8% across North America and strong net investment income
- **Premiums grew 23%** fuelled by OneBeacon and strong organic growth in commercial lines
- **Combined ratio of 93.9% in Canada** with significant improvement in personal auto, and **solid OneBeacon results at 93.5%**
- **Operating ROE of 11.6% and a 6% increase in book value per share** over the last twelve months, with \$1.2 billion of total capital margin



We measure our consolidated performance mainly based on NOIPS and our business segment performance based on pre-tax operating income (PTOI). Comparative information has been reclassified accordingly.

Table 1 – Operating performance by segment¹

For the quarters ended September 30,	2018				2017			
	CAN	U.S.	Corporate	Total	CAN	U.S.	Corporate	Total
DPW	2,239	469	-	2,708	2,203	-	-	2,203
NEP	2,114	347	1	2,462	2,082	-	-	2,082
Operating income								
Underwriting income	129	22	1	152	170	-	-	170
Net investment income	-	-	133	133	-	-	101	101
Net distribution income	34	-	-	34	30	-	-	30
Finance costs	-	-	(25)	(25)	-	-	(19)	(19)
Other income (expense)	-	-	(2)	(2)	-	-	(1)	(1)
Pre-tax operating income (PTOI)	163	22	107	292	200	-	81	281
Net operating income (NOI)				237				219
NOIPS (in dollars)				1.62				1.61
For the nine month periods ended September 30,	2018				2017			
	CAN	U.S.	Corporate	Total	CAN	U.S.	Corporate	Total
DPW	6,534	1,164	-	7,698	6,437	-	-	6,437
NEP	6,203	1,001	2	7,206	6,130	-	-	6,130
Operating income								
Underwriting income	204	58	2	264	308	-	-	308
Net investment income	-	-	389	389	-	-	311	311
Net distribution income	110	-	-	110	104	-	-	104
Finance costs	-	-	(76)	(76)	-	-	(57)	(57)
Other income (expense)	-	-	(12)	(12)	-	-	3	3
Pre-tax operating income (PTOI)	314	58	303	675	412	-	257	669
Net operating income (NOI)				558				535
NOIPS (in dollars)				3.80				3.95

¹ Refer to Section 14 – Non-IFRS financial measures.

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1.4 Consolidated performance

Table 2 – Consolidated performance¹

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW	2,708	2,203	23%	7,698	6,437	20%
NEP	2,462	2,082	18%	7,206	6,130	18%
Operating income						
Underwriting income	152	170	(18)	264	308	(44)
Net investment income	133	101	32	389	311	78
Net distribution income	34	30	4	110	104	6
Finance costs	(25)	(19)	(6)	(76)	(57)	(19)
Other income (expense)	(2)	(1)	(1)	(12)	3	(15)
PTOI	292	281	11	675	669	6
NOI	237	219	8%	558	535	4%
Non-operating gains (losses)	(36)	(61)	25	(100)	27	(127)
Effective income tax rate	22.3%	22.3%	- pts	19.5%	19.5%	- pts
Net income	199	171	16%	463	560	(17)%
Underwriting ratios						
Claims ratio	63.8%	63.8%	- pts	66.2%	66.2%	- pts
Expense ratio	30.0%	28.0%	2.0 pts	30.1%	28.8%	1.3 pts
Combined ratio	93.8%	91.8%	2.0 pts	96.3%	95.0%	1.3 pts
Per share measures, basic and diluted (in dollars)						
NOIPS	1.62	1.61	1%	3.80	3.95	(4)%
EPS	1.34	1.25	7%	3.12	4.14	(25)%
AEPS	1.59	1.41	13%	3.82	4.27	(11)%
BVPS	49.27	46.56	6%			
Return on equity for the last 12 months						
OROE	11.6%	13.3%	(1.7) pts			
ROE	9.8%	12.7%	(2.9) pts			
AROE	11.2%	13.6%	(2.4) pts			
Total capital margin	1,177	1,155	22			
Debt-to-total capital ratio	21.7%	24.7%	(3.0) pts			

¹ Refer to Section 14 – Non-IFRS financial measures.

Table 3 – Performance by business segment¹

	Section	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW growth							
Canada	2.1	2,239	2,203	2%	6,534	6,437	2%
U.S.	3.1	469	-	n/a	1,164	-	n/a
		2,708	2,203	23%	7,698	6,437	20%
Combined ratio							
Canada	2.1	93.9%	91.8%	2.1 pts	96.7%	95.0%	1.7 pts
U.S.	3.1	93.5%	-	n/a	94.2%	-	n/a
		93.8%	91.8%	2.0 pts	96.3%	95.0%	1.3 pts
PTOI							
Canada		163	200	(19)%	314	412	(24)%
U.S.		22	-	n/a	58	-	n/a
Corporate and other		107	81	32%	303	257	18%
		292	281	4%	675	669	1%

¹ Refer to Section 14 – Non-IFRS financial measures.

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	Q3-2018 vs Q3-2017	YTD 2018 vs YTD 2017
DPW growth	<ul style="list-style-type: none"> Our premiums grew 23% driven by strong growth in commercial lines across North America, including a 21% contribution from the acquisition of OneBeacon. 	<ul style="list-style-type: none"> Our premiums grew 20%, mainly from the acquisition of OneBeacon which contributed 18% to our topline, as well as strong growth in commercial lines in Canada.
Underwriting performance	<ul style="list-style-type: none"> Overall combined ratio of 93.8% was driven by solid underlying results in both Canada and the U.S. Combined ratio for Canada of 93.9% was essentially in line with last year when excluding the 1.9 point benefit of the 2017 net reserve change. Significant improvement in personal auto underlying performance was offset by elevated large losses in commercial lines. OneBeacon delivered solid results with a combined ratio of 93.5% for the quarter and 94.2% year-to-date. We continue to make solid progress towards our target of a sustainable low-90s combined ratio. 	<ul style="list-style-type: none"> Overall combined ratio of 96.3% reflects solid results from OneBeacon, progress in personal auto and elevated large losses in Canadian commercial lines and personal property. Combined ratio for Canada of 96.7% deteriorated by 1.7 points, as improved underlying results in personal auto were offset by elevated large losses in commercial lines and personal property, and higher non-CAT weather-related losses.
Net investment income	<ul style="list-style-type: none"> Net investment income was up \$32 million in the quarter and \$78 million year-to-date, due to the growth in our investment portfolio following the acquisition of OneBeacon, investment optimization initiatives and higher yields. 	
Net distribution income	<ul style="list-style-type: none"> Net distribution income was solid at \$34 million in the quarter and \$110 million year-to-date, reflecting the continued growth of our broker network. 	
NOIPS	<ul style="list-style-type: none"> NOIPS of \$1.62 was in line with last year. Improved performance in personal auto and strong growth in net investment income were offset by higher large losses in commercial lines. 	<ul style="list-style-type: none"> NOIPS of \$3.80 was down by 4% from last year, reflecting elevated large losses in Canadian commercial lines and personal property as well as higher non-CAT weather-related losses, partially offset by OneBeacon's solid results.
Effective income tax rate	<ul style="list-style-type: none"> Effective income tax rate of 22.3% for the quarter and 19.5% year-to-date were in line with last year as higher net investment income and the inclusion of OneBeacon's income, which are taxed at lower rates, were offset by a one-time adjustment to deferred income taxes in Q3-2018 related to the OneBeacon acquisition. On a year-to date basis, lower non-taxable capital gains also had an impact. 	
Net income	<ul style="list-style-type: none"> Net income of \$199 million was up 16% due to the items discussed above, as well as lower net losses related to investments and lower integration costs. 	<ul style="list-style-type: none"> Net income of \$463 million was down 17% due to the items discussed above as well as net losses related to investments.
Financial condition	<ul style="list-style-type: none"> BVPS increased 6% from a year ago to \$49.27, mainly driven by earnings, net of common share dividends. Our debt-to-total capital ratio of 21.7% as at September 30, 2018 has decreased by 0.8 points in the quarter and continues to track towards our goal of 20% in 2019. We ended the quarter in a strong financial position, with \$1.2 billion of total capital margin. 	

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SEGMENT PERFORMANCE

Section 2 – Canada

2.1 P&C Canada

Table 4 – Underwriting results for P&C Canada¹

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW	2,239	2,203	2%	6,534	6,437	2%
NEP	2,114	2,082	2%	6,203	6,130	1%
Current year claims (excluding CAT claims)	1,305	1,293	12	4,055	3,949	106
Current year CAT claims	97	89	8	275	282	(7)
Unfavourable (favourable) PYD	(20)	(53)	33	(125)	(176)	51
Total net claims	1,382	1,329	53	4,205	4,055	150
Underwriting expenses	603	583	20	1,794	1,767	27
Underwriting income	129	170	(41)	204	308	(104)
Underwriting ratios						
Underlying current year loss ratio	61.7%	62.1%	(0.4) pts	65.3%	64.4%	0.9 pts
CAT loss ratio (including reinst. premiums)	4.6%	4.3%	0.3 pts	4.5%	4.7%	(0.2) pts
Unfavourable (favourable) PYD ratio	(0.9)%	(2.6)%	1.7 pts	(2.0)%	(2.9)%	0.9 pts
Claims ratio	65.4%	63.8%	1.6 pts	67.8%	66.2%	1.6 pts
Commissions	15.7%	15.3%	0.4 pts	15.5%	15.5%	-
General expenses	9.1%	9.1%	-	9.6%	9.6%	-
Premium taxes	3.7%	3.6%	0.1 pts	3.8%	3.7%	0.1 pts
Expense ratio	28.5%	28.0%	0.5 pts	28.9%	28.8%	0.1 pts
Combined ratio²	93.9%	91.8%	2.1 pts	96.7%	95.0%	1.7 pts

¹ Refer to Section 14 – Non-IFRS financial measures.

² The 2017 net reserve change had a favourable impact of 1.9 points in Q3-2017 and 0.7 points YTD-2017. Refer to Section 9.1 – Prior year development for more details.

Table 5 – Performance by line of business – Canada

	Section	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW growth							
Personal auto	2.3	1,003	1,028	(2)%	2,932	2,994	(2)%
Personal property	2.4	606	591	2%	1,669	1,630	2%
Commercial lines	2.5	630	584	8%	1,933	1,813	7%
		2,239	2,203	2%	6,534	6,437	2%
Combined ratio							
Personal auto	2.3	99.0%	105.1%	(6.1) pts	100.3%	101.9%	(1.6) pts
Personal property	2.4	83.8%	85.0%	(1.2) pts	91.6%	92.4%	(0.8) pts
Commercial lines	2.5	94.9%	76.5%	18.4 pts	95.7%	86.3%	9.4 pts
		93.9%	91.8%	2.1 pts	96.7%	95.0%	1.7 pts

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Q3-2018 vs Q3-2017	YTD 2018 vs YTD 2017
<ul style="list-style-type: none"> • DPW growth of 2% in the quarter and year-to-date reflected strong growth in commercial lines. Growth in personal lines was tempered by the impact of our profitability actions in personal auto. • Underlying current year loss ratio improved by 0.4 points to 61.7%, driven by improvement in personal auto. This was offset by elevated large losses in commercial lines and higher non-CAT weather-related losses in personal property. • CAT loss ratio of 4.6% was mostly weather-related. While slightly higher than last year, it remained lower than expected for a third quarter. • PYD ratio was favourable at 0.9% for the quarter and 2.0% year-to-date, as healthy PYD in personal property and commercial lines was offset by unfavourable PYD in personal auto. • Expense ratio remained low at 28.5% in the quarter and 28.9% year-to-date. Though it increased by 0.5 points in the quarter compared to last year, it was essentially unchanged from last year on a year-to-date basis. • Excluding the 1.9 point benefit of the 2017 net reserve change, combined ratio of 93.9% was in line with last year. Improvement in personal auto was offset by higher large losses in commercial lines. 	<ul style="list-style-type: none"> • Despite continued improvement in personal auto, underlying current year loss ratio of 65.3% deteriorated by 0.9 points, driven by an increase in non-CAT weather-related claims as well as higher large losses in commercial lines and personal property. • CAT loss ratio of 4.5% was mostly weather-related and comparable to last year. • Excluding the 0.7 point benefit of the 2017 net reserve change, combined ratio of 96.7% deteriorated by one point mainly from higher large losses in commercial lines and personal property.

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2.2 Personal auto

Table 6 – Underwriting results for personal auto

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW	1,003	1,028	(2)%	2,932	2,994	(2)%
Written insured risks (in thousands)	1,087	1,139	(5)%	3,293	3,402	(3)%
NEP	939	962	(2)%	2,793	2,830	(1)%
Underwriting income (loss)	10	(50)	nm	(7)	(53)	nm
Underlying current year loss ratio	72.5%	77.3%	(4.8) pts	74.7%	76.5%	(1.8) pts
CAT loss ratio (including reinst. premiums)	1.9%	2.0%	(0.1) pts	1.0%	0.9%	0.1 pts
Unfavourable (favourable) PYD ratio	1.9%	3.2%	(1.3) pts	1.6%	1.3%	0.3 pts
Claims ratio	76.3%	82.5%	(6.2) pts	77.3%	78.7%	(1.4) pts
Expense ratio	22.7%	22.6%	0.1 pts	23.0%	23.2%	(0.2) pts
Combined ratio	99.0%	105.1%	(6.1) pts	100.3%	101.9%	(1.6) pts

Q3-2018 vs Q3-2017

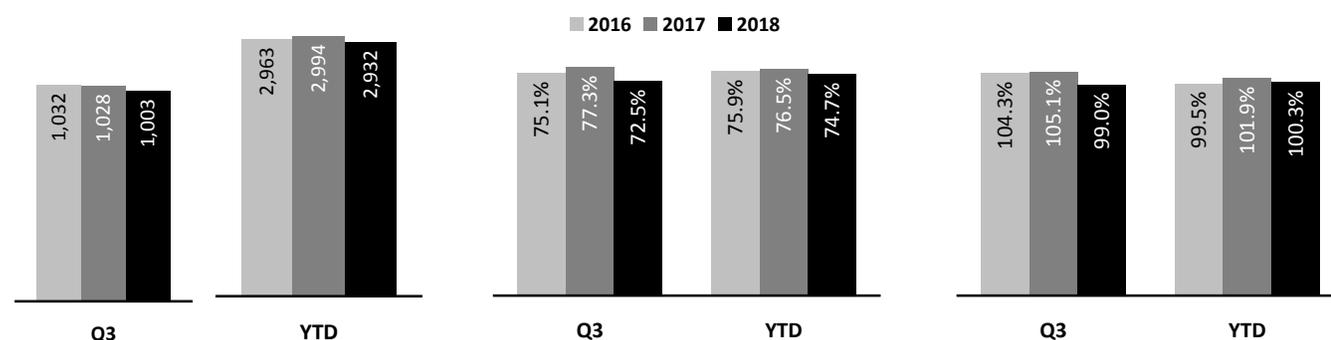
YTD 2018 vs YTD 2017

- **DPW declined by 2% in the quarter and year-to-date**, reflecting continued profitability actions, including rate increases taken ahead of our competitors. Our segmentation initiatives have led to changes in our regional and new business mix, which have improved the portfolio quality while impacting unit growth.
 - **Underlying current year loss ratio of 72.5%** improved by 4.8 points, driven by improving portfolio quality as a result of our segmentation initiatives, as well as claims actions and rate increases which continue to be realized. The benefits of our action plan have resulted in lower claims frequency and severity.
 - **PYD ratio was unfavourable 1.9% in the quarter and 1.6% year-to-date**, driven mostly by unfavourable development on Ontario Accident Benefit (AB) files dating prior to the 2016 reform.
 - **Combined ratio of 99.0%** improved by 6.1 points, reflecting a significant improvement in underlying performance driven by the benefits of our profitability actions.
 - **We remain on track to deliver a mid-90s combined ratio run-rate by the end of the year.** Our action plan is yielding results. We are committed to our target and are well positioned to capture potential growth opportunities as market conditions continue to improve.
- **Underlying current year loss ratio of 74.7%** improved by 1.8 points due to the continued benefits from our action plan including rate increases across the country, offset in part by higher weather-related losses from severe winter conditions.
 - **Combined ratio of 100.3%** improved 1.6 points, as the benefits of our profitability actions were offset by higher weather-related losses from severe winter conditions.

DPW

Underlying current year loss ratio

Combined ratio



Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

2.3 Personal property

Table 7 – Underwriting results for personal property

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW	606	591	2%	1,669	1,630	2%
Written insured risks (in thousands)	658	667	(1)%	1,817	1,839	(1)%
NEP	531	517	3%	1,564	1,518	3%
Underwriting income	85	78	9%	131	116	13%
Underlying current year loss ratio	49.2%	45.1%	4.1 pts	53.7%	49.7%	4.0 pts
CAT loss ratio (including reinst. premiums)	5.6%	10.9%	(5.3) pts	9.4%	13.2%	(3.8) pts
Unfavourable (favourable) PYD ratio	(3.0)%	(2.9)%	(0.1) pts	(4.0)%	(3.0)%	(1.0) pts
Claims ratio	51.8%	53.1%	(1.3) pts	59.1%	59.9%	(0.8) pts
Expense ratio	32.0%	31.9%	0.1 pts	32.5%	32.5%	- pts
Combined ratio	83.8%	85.0%	(1.2) pts	91.6%	92.4%	(0.8) pts

Q3-2018 vs Q3-2017

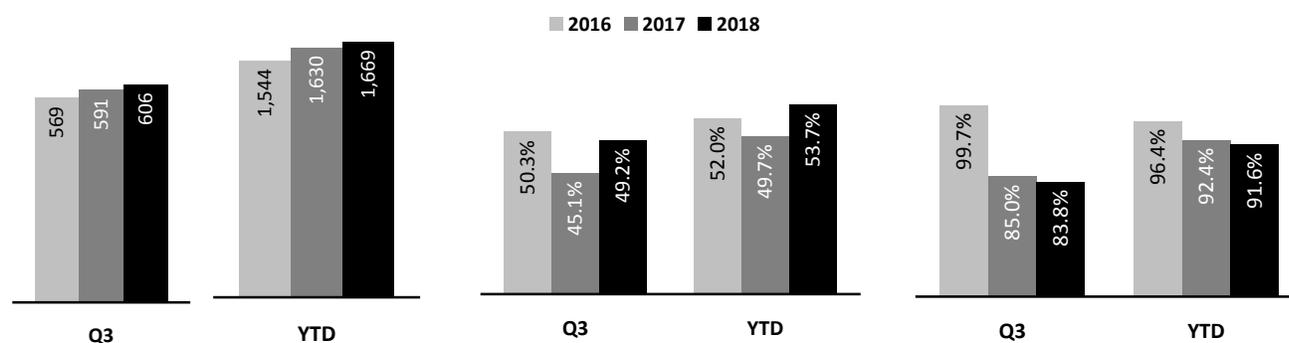
YTD 2018 vs YTD 2017

- **DPW growth of 2% in the quarter and year-to-date** reflected rate increases in firm market conditions, tempered by the impact of profitability actions in personal auto on bundled products.
- **Underlying current year loss ratio was strong at 49.2% in the quarter and 53.7% year-to-date**, though it deteriorated by roughly 4 points from last year's very strong performance, due to higher non-CAT weather-related losses and large losses.
- **CAT loss ratio of 5.6%** was significantly lower than last year and expectations.
- **Favourable PYD ratio of 3.0 % in the quarter and 4.0% year-to-date** remained healthy.
- **Strong combined ratio of 83.8%** improved by 1.2 points driven by lower CAT losses, which were partly offset by higher non-CAT weather-related losses.
- **CAT loss ratio of 9.4%** was in line with expectations, though lower than last year's elevated level.
- **Strong combined ratios of 91.6% for 2018 and 92.4% for 2017 showed resilience** despite the impact of severe weather conditions, remaining at a low-90s level in both years.

DPW

Underlying current year loss ratio

Combined ratio



Management’s Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

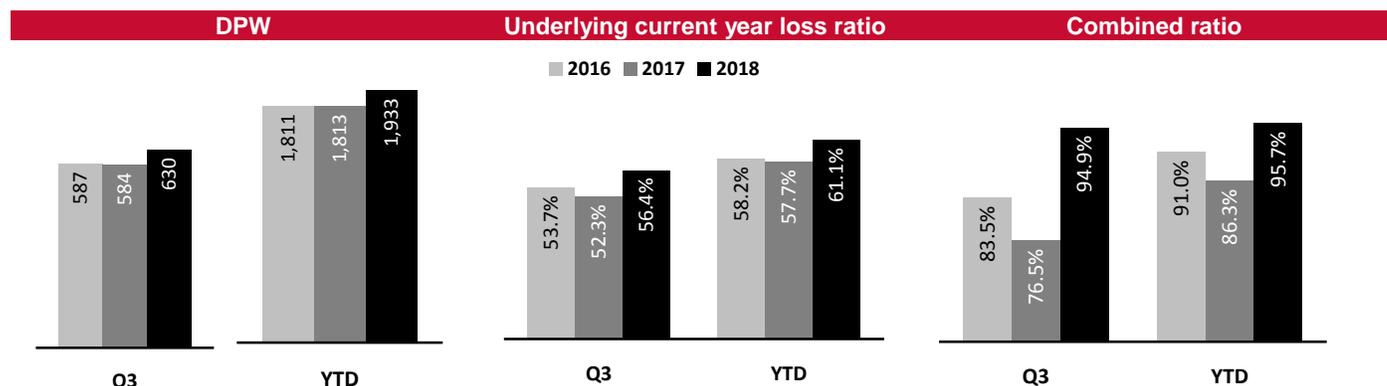
2.4 Commercial lines

Table 8 – Underwriting results for Commercial lines Canada, including Commercial P&C and Commercial auto

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW	630	584	8%	1,933	1,813	7%
Commercial P&C	427	404	6%	1,320	1,254	5%
Commercial auto	203	180	12%	613	559	10%
NEP	644	603	7%	1,846	1,782	4%
Underwriting income (loss)	34	142	(76)%	80	245	(67)%
Underlying current year loss ratio	56.4%	52.3%	4.1 pts	61.1%	57.7%	3.4 pts
CAT loss ratio (including reinst. premiums)	7.6%	2.4%	5.2 pts	5.5%	3.3%	2.2 pts
Unfavourable (favourable) PYD ratio	(3.2)%	(11.5)%	8.3 pts	(5.8)%	(9.4)%	3.6 pts
Claims ratio	60.8%	43.2%	17.6 pts	60.8%	51.6%	9.2 pts
Expense ratio	34.1%	33.3%	0.8 pts	34.9%	34.7%	0.2 pts
Combined ratio¹	94.9%	76.5%	18.4 pts	95.7%	86.3%	9.4 pts

¹ The 2017 net reserve change had a favourable impact of 8.2 points in Q3-2017 and 2.8 points YTD-2017. Refer to Section 9.1 – Prior year development for more details.

Q3-2018 vs Q3-2017	YTD 2018 vs YTD 2017
<ul style="list-style-type: none"> Strong DPW growth of 8% in the quarter and 7% year-to-date, as both segments continue to benefit from rate momentum in firming market conditions and robust growth in specialty lines. Underlying current year loss ratio of 56.4% deteriorated by 4.1 points from last year’s strong performance mainly due to higher fire and water-related large losses. CAT loss ratio was elevated at 7.6% and was up by 5.2 points, mainly from higher non-weather related events, including large commercial fires. Favourable PYD remained healthy at 3.2% for the quarter and 5.8% year-to-date, though it decreased significantly from last year’s unusual level which included the benefit of the 2017 net reserve change. Expense ratio of 34.1% in the quarter and 34.9% year-to-date. Though it increased in the quarter, it was essentially flat on a year-to-date basis. Combined ratio of 94.9% deteriorated by 18.4 points, of which about 8 points relate to the 2017 net reserve change. Large losses and CAT losses were each roughly 5 points higher than last year. The underlying fundamentals of this business remain strong, despite the deterioration from last year’s strong performance. 	<ul style="list-style-type: none"> Underlying current year loss ratio of 61.1% deteriorated by 3.4 points, mainly due to higher large losses in Commercial P&C. CAT loss ratio of 5.5% was higher than expected and mostly driven by severe weather. Combined ratio of 95.7% deteriorated by 9.4 points, largely explained by the 2017 net reserve change (3 points), increased large losses (3 points) and higher CAT losses (2 points).



Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

Section 3 – U.S.

3.1 P&C U.S.

All figures in the table below are shown in CAD, using an average exchange rate of 1.31 for Q3-2018 and 1.29 for YTD 2018.

Table 9 – Underwriting results for P&C U.S. ¹

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
DPW	469	-	n/a	1,164	-	n/a
NEP	347	-	n/a	1,001	-	n/a
Current year claims	198	-	n/a	575	-	n/a
Unfavourable (favourable) PYD	(8)	-	n/a	(10)	-	n/a
Net claims incurred	190	-	n/a	565	-	n/a
Underwriting expenses	135	-	n/a	378	-	n/a
Underwriting income	22	-	n/a	58	-	n/a
Underwriting ratios						
Underlying current year loss ratio	57.0%	-	n/a	57.5%	-	n/a
Unfavourable (favourable) PYD ratio	(2.3)%	-	n/a	(1.0)%	-	n/a
Claims ratio	54.7%	-	n/a	56.5%	-	n/a
Commissions	16.3%	-	n/a	15.8%	-	n/a
General expenses	19.4%	-	n/a	19.4%	-	n/a
Premium taxes	3.1%	-	n/a	2.5%	-	n/a
Expense ratio	38.8%	-	n/a	37.7%	-	n/a
Combined ratio	93.5%	-	n/a	94.2%	-	n/a

¹ Excluding the results of exited lines (see Section 13 – Non-operating results and Section 14 – Non-IFRS financial measures).

Commercial lines (U.S.)

- **Premiums of \$469 million in the quarter** reflected organic growth of 5% on a comparable basis, as growth initiatives are generating strong new business. Growth was in the low double-digits when excluding lines under profitability improvement plans.
- **Underlying current year loss ratio was healthy at 57.0% in the quarter and 57.5% year-to-date**, reflecting continued progress towards our profitability target.
- **PYD was healthy at favourable 2.3% in the quarter and 1.0% year-to-date.**
- **Expense ratio of 38.8%** was in line with expectations for a third quarter, given the seasonality in commissions and premium taxes.
- **We have realized about US\$7 million of synergies in the quarter.** On a run-rate basis, we have exceeded our target of US\$25 million of annual synergies, ahead of schedule.
- **Solid combined ratio of 93.5% in the quarter and 94.2% year-to-date continued to reflect good progress** towards our goal of achieving a combined ratio in the low-90s on a sustainable basis within 24 months.

At the date of acquisition of OneBeacon, we purchased an adverse development coverage (ADC) on claims liabilities for 2016 and prior accident years to mitigate the risk of adverse development on the acquired book of claims liabilities. As at September 30, 2018, significant capacity remains under this coverage. Refer to Note 10 - Reinsurance of the accompanying interim Consolidated financial statements for more details.

Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

Section 4 – Corporate and other

4.1 Corporate and other

Table 10 – Corporate and other

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
Underwriting income ¹	1	-	1	2	-	2
Net investment income (see Section 4.2 below)	133	101	32	389	311	78
Finance costs	(25)	(19)	(6)	(76)	(57)	(19)
Other income (expense) ²	(2)	(1)	(1)	(12)	3	(15)
Corporate and other	107	81	26	303	257	46

¹ Reflected the impact of our internal reinsurance treaty.

² Includes general corporate expenses, consolidation adjustments and other operating items, and can fluctuate from quarter to quarter.

2018 vs 2017

- **Finance costs** increased in 2018 due to the issuance of the Series 7 medium term notes in Q2-2017.

4.2 Net investment income

Table 11 – Net investment income

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
Interest income	89	65	24	257	194	63
Dividend income	53	45	8	158	144	14
Investment income, before expenses	142	110	32	415	338	77
Expenses	(9)	(9)	-	(26)	(27)	1
Net investment income	133	101	32	389	311	78
Average net investments¹	16,601	14,268	16%	16,382	14,003	17%
Market-based yield²	3.44%	3.10%	34 bps	3.39%	3.24%	15 bps

¹ Defined as the mid-month average fair value of net equity and fixed-income securities held during the reporting period.

² Refer to Section 14 – Non-IFRS financial measures.

2018 vs 2017

- **Net investment income increased by \$32 million in the quarter and \$78 million year-to-date**, due to the growth of our investment portfolio following the acquisition of OneBeacon, our optimization initiatives, as well as higher yields.
- **Average net investments increased by 16% in the quarter and 17% year-to-date**, reflecting the addition of the OneBeacon portfolio and the proceeds from the issuance of the Series 7 preferred shares in Q2-2018.

Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

4.3 Net gains (losses)

Net gains (losses) are reported in Non-operating results and included the following items.

Table 12 – Net gains (losses)

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
Fixed-income strategies						
Realized and unrealized gains (losses) on FVTPL bonds	(47)	(67)	20	(133)	(107)	(26)
Other gains (losses)	(5)	1	(6)	(20)	8	(28)
	(52)	(66)	14	(153)	(99)	(54)
Equity strategies						
Realized and unrealized gains (losses): ¹						
equity securities, net of derivatives	32	(6)	38	130	98	32
embedded derivatives	(7)	(10)	3	(13)	(35)	22
Net foreign currency gains on investments	-	-	-	-	32	(32)
Impairment losses on common shares	(4)	(7)	3	(26)	(8)	(18)
	21	(23)	44	91	87	4
Net investment gains (losses)	(31)	(89)	58	(62)	(12)	(50)
Foreign currency ²	1	23	(22)	2	64	(62)
Distribution transactions and other ³	6	7	(1)	14	23	(9)
Net gains (losses)	(24)	(59)	35	(46)	75	(121)
Net gains (losses) excluding FVTPL bonds	23	8	15	87	182	(95)

¹ Excluding foreign currency impact on equity securities, which are reported in Net foreign currency gains on investments.

² In 2017, includes a gain on currency derivatives related to the book value hedge of OneBeacon (\$23 million in Q3-2017 and \$64 million YTD 2017).

³ Includes net gains on investments in associates and joint ventures.

Q3-2018 vs Q3-2017	YTD 2018 vs YTD 2017
<ul style="list-style-type: none"> Realized and unrealized losses on our FVTPL bonds of \$47 million in the quarter and \$133 million year-to-date were driven by higher interest rates in both Canada and the U.S. These losses were offset by the positive impact of increases in the rate used to discount our claims liabilities (referred to as MYA), which amounted to \$42 million in the quarter and \$133 million year-to-date. Net gains excluding FVTPL bonds of \$23 million in Q3-2018 mostly reflected gains from ordinary trading activities on our AFS common shares. Net gains excluding FVTPL bonds of \$8 million in Q3-2017 were driven by a \$23 million gain on currency derivatives related to the book value hedge of OneBeacon, partly offset by mark-to-market losses on our embedded derivatives and impairments of our common equities. 	<ul style="list-style-type: none"> Net gains excluding FVTPL bonds of \$87 million year-to-date 2018 reflected gains realized from ordinary trading activities on our AFS common shares, offset by impairment losses of \$26 million relating mainly to energy stocks. Net gains excluding FVTPL bonds of \$182 million during the first 9 months of 2017 were driven by a \$64 million gain on currency derivatives related to the book value hedge of OneBeacon, realized gains on equity strategies from portfolio re-alignment and net gains from distribution transactions.

Management’s Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

4.4 Capital markets

While the correlation between the performance of capital markets and the performance of our investment portfolio is not perfect, the following market indicators may be useful in understanding the overall performance of our investments.

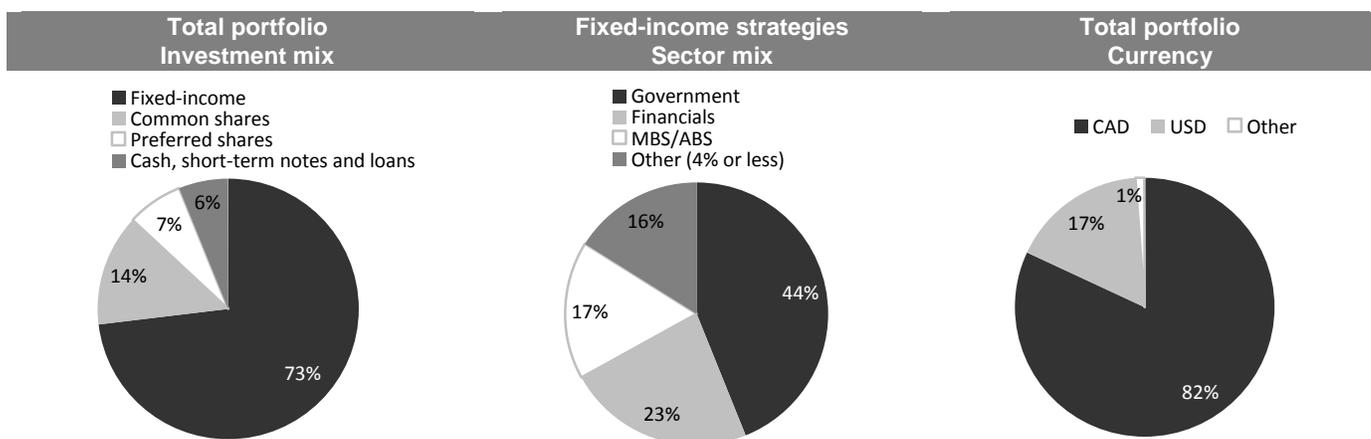
Table 13 – Selected market indicators

Selected market Indicators	Q3-2018	Q3-2017	YTD 2018	YTD 2017
S&P/TSX Composite	(1)%	3%	(1)%	2%
S&P/TSX Financials	3%	4%	- %	5%
S&P/TSX Preferred Share Index	- %	1%	(1)%	7%
5Y Canada Sovereign Index (estimated variance in bps)	27 bps	36 bps	50 bps	65 bps
5Y AA Corporate spread (estimated variance in bps)	(10) bps	(2) bps	6 bps	(16) bps
DJ Dividend 100 Composite (U.S.)	7%	4%	3%	7%
5Y U.S. Sovereign Index (estimated variance in bps)	22 bps	5 bps	75 bps	1 bp
Strengthening (weakening) of USD vs CAD	(2)%	(4)%	3%	(7)%

Comments on capital markets performance

- **The DJ Dividend 100 Composite (U.S.) Index** rose by 7%, while the **S&P/TSX Composite Index** decreased by 1% in the quarter (3% and -1% respectively on a year-to-date basis). This resulted in an increase in the fair value of our common share portfolios.
- **The S&P/TSX Preferred Share Index** was flat in the quarter, resulting in minimal fluctuations in the value of our preferred shares portfolio. On a year-to-date basis, the index fell by 1% which resulted in a slight decrease in the value of our portfolio.
- **Five-year Canadian Sovereign yields and five-year U.S. Sovereign yields** increased by approximately 27 bps and 22 bps, respectively, in Q3-2018 (50 bps and 75 bps respectively on a year-to-date basis), leading to lower bond valuations and mark-to-market losses (see Section 4.3 – Net gains (losses)).

Our net exposure as at September 30, 2018, after reflecting the impact of hedging strategies related to investments and foreign subsidiaries, is outlined below.



ENVIRONMENT & OUTLOOK

Section 5 – Insurance industry

5.1 P&C insurance industry outlook

	P&C insurance industry 12-month outlook	Our response
Personal auto	<ul style="list-style-type: none"> Industry profitability continues to be challenged with average direct loss ratios in the upper 70s in the first half of 2018. Rate actions, increases in residual market volumes together with tightening capacity, confirm our view that the market is firming fast. The industry grew above 6% in the first half of 2018. We expect growth to continue at a mid-single-digit level over the next 12 months. 	<ul style="list-style-type: none"> Our actions continue on pricing, underwriting and claims to tackle trends. We expect to return to a mid-90's combined ratio run-rate by the end of 2018 and sustain that level into 2019. Rate actions ahead of the market are bringing some near term pressure on growth but position us well as market conditions continue to improve. Our brand investments and customer driven enhancements will continue to help selectively grow our market share. We are also investing in telematics, big data, and artificial intelligence to maintain our advantage in data and segmentation.
Personal property	<ul style="list-style-type: none"> As companies are adjusting to changing weather patterns, we expect the current firm market conditions to continue. The industry grew at close to 7% in the first half of 2018, and we expect growth to continue at a mid-single-digit level over the next 12 months. 	<ul style="list-style-type: none"> Product enhancements and pricing actions taken over time have positioned this business very well for the future. We expect to continue to capitalize on market conditions with rate increases to ensure our results remain sustainable even in severe weather conditions.
Commercial lines Canada	<ul style="list-style-type: none"> These lines of business remain competitive, with continued signs of firming market conditions. The industry grew at approximately 6% in the first half of 2018. We expect growth at a mid-single-digit rate in the coming year. 	<ul style="list-style-type: none"> In such an environment we remain disciplined on pricing and underwriting of each risk, while we continue to capture opportunities where we see market inefficiencies. At the same time, our focus on training and service excellence remains. We continue to develop innovative products to address customer needs (e.g. cyber risk coverage and sharing economy). With the acquisition of OneBeacon, we have strengthened our capabilities and product suite in specialty lines.
Distribution	<ul style="list-style-type: none"> The broker channel represents approximately 64% of the total P&C industry and had higher growth than the direct channel in 2017. The broker industry remains fragmented with continuing opportunities for consolidation. 	<ul style="list-style-type: none"> Our multi-channel strategy means we are well positioned to capture opportunities as consumer and technology trends continue to evolve the distribution of insurance. We will continue to grow distribution income by supporting our brokers as they expand and grow their businesses, while actively participating in broker consolidation via BrokerLink. Our brand and technology investments will bolster growth of our bealrirect business.

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	P&C insurance industry 12-month outlook	Our response
U.S. Commercial lines	<ul style="list-style-type: none"> The pricing environment remains competitive, while modest upward trends continue. Coupled with the current favourable economic environment, we expect low-to-mid single-digit growth in the coming year. 	<ul style="list-style-type: none"> Our objective is to grow the U.S. specialty business and operate at a combined ratio in the low-90’s on a sustainable basis within 24 months. Growth opportunities are being pursued in the segments of the portfolio performing at or above expectations. Profitability actions on underperforming lines are well underway and continue to gain traction. Claims efficiency initiatives have been launched and we have already exceeded our expense synergy target annual run-rate of US \$25 million.
Investments	<ul style="list-style-type: none"> Investment yields remain low by historical standards, but there has been upward momentum on interest rates in 2018. 	<ul style="list-style-type: none"> We have added the OneBeacon investment portfolio and are capturing the benefit of higher interest rates, which is generating robust growth in our Net investment income in 2018. Our investment management team continues to optimize the mix of our consolidated investment portfolio, taking into account factors such as risk, return, capital, regulation and the recent tax legislation changes in the U.S.
Overall	<ul style="list-style-type: none"> Overall, we expect the industry’s ROE to improve but remain below its long-term average of 10% over the next 12 months. 	<ul style="list-style-type: none"> Given our action plans and strategies, we expect to outperform the industry’s ROE by more than 500 basis points in the coming year.

5.2 Canadian P&C insurance industry outperformance over time

Industry data below represents IFC’s estimate of its outperformance (underperformance) based on MSA. The industry benchmark consists of the 20 largest comparable companies in the P&C industry based on industry data. *Refer to Important notes on page 3 for further details.*

Table 14 – Canadian P&C Industry – IFC outperformance (underperformance)

	H1-2018	Full year 2017	Full year 2016	Full year 2015	Full year 2014
ROE¹					
P&C Industry	7.4 pts	6.9 pts	5.8 pts	5.1 pts	8.2 pts
DPW growth (including industry pools)					
Industry benchmark	(3.2) pts	(2.4) pts	2.4 pts	3.4 pts	(1.5) pts
Combined ratio (including MYA)					
Industry benchmark	8.0 pts	6.2 pts	4.7 pts	5.2 pts	6.5 pts

¹ IFC’s ROE corresponds to the AROE.

- Our ROE outperformance of 7.4 points versus the P&C insurance industry is above our objective of 5 points and improved by 0.8 points from Q1-2018 mainly due to our underwriting outperformance.
- Our growth underperformance against our industry benchmark was 3.2 points, reflecting robust profitability actions in personal auto. We encountered a similar situation in 2014, when our actions to reduce earthquake exposure and improve the profitability of our personal property portfolio also resulted in a growth underperformance.
- Our combined ratio outperformance against our industry benchmark was 8.0 points, an increase of almost one point compared to Q1-2018. Our solid outperformance is the result of the effectiveness of our disciplined profitability actions in personal property and commercial P&C in recent years.

For additional information on the Canadian P&C insurance industry and the U.S. specialty insurance industry as a whole, *refer to our MD&A for the quarter ended March 31, 2018.*

OTHER DEVELOPMENTS

Section 6 – Recent developments

6.1 At a glance

Innovation

- Leveraging our leadership position in data and data science, we continue to roll-out our new **Machine Learning Algorithms in Rating**. These new algorithms will help us improve our accuracy in segmentation and accelerate profitable growth. In Q3-2018, we have filed for regulatory approval for belairdirect Ontario in personal auto, with a target effective date in December of this year.
- We deployed our **UBI Mobile 2.0 product**, an improved way for customers to track their **my Driving Discount**, using a mobile phone app which includes new variables for generating a client's personalized discount. To help Canadians be safer on the road, we now offer users a new Distracted Driving score. Investing in digital technologies and experiences, including this latest telematics offer, allows us to be more relevant, helpful and present in the lives of our customers.
- **We launched a new version of our mobile application**, giving our customers access to their proof of insurance and other insurance documents, the ability to view their coverages, make changes to their auto policy, and file and track their claims. The app also includes the new UBI 2.0 product.
- In August, **OneBeacon introduced new management liability products** that deliver a more comprehensive coverage to a broad range of private and not-for-profit organizations. The modular policy approach is designed to help minimize gaps in coverage, while providing flexibility to tailor solutions based on each client's unique exposures.

Acquisition and financing activities

- During the quarter, **several brokerages joined the Brokerlink team**, adding many new locations. BrokerLink's scale and reputation, local experts, emphasis on customer service and community involvement were the deciding factors for the brokerages to join the team. These acquisitions included Adriatic Insurance Brokers Ltd., Magermans & Raes Insurance Brokers Ltd., Insurance Protection Group Inc, Speaker & Piuni Limited, as well as Allied Insurance Services Ltd.

Climate adaptation and social responsibility

- In July 2018, **we officially signed to the United Nations Environment Programme (UNEP) Finance Initiative Principles for Sustainable Insurance ("PSI")**. The PSI are a global framework for the insurance industry to address environmental, social and governance risks.
- In September 2018, we **co-hosted the global forum on climate-resilient critical infrastructure** organized by the Geneva Association, the leading international think tank of the insurance industry. Participants included the United Nations (UN), the Organisation for Economic Co-operation and Development (OECD) and insurance industry CEOs. These participants engaged in discussions on critical infrastructure, prioritizing climate change migration and adaptation, challenges and opportunities for scaling up private investments in climate-resilience, and the insurance industry's role as underwriters, risk managers and investors.
- Our CEO, Charles Brindamour, **addressed global political leaders and experts at the G7 Environment, Oceans and Energy Ministers meeting** in Halifax on September 19, 2018. On an Adaptation and Conserving Nature panel, Charles spoke about the role of the insurance industry and public-private partnerships to address the critical need of building climate resilient infrastructure.
- **The Intact Foundation has provided over \$1 million in funding to eight projects nationally** to further Canada's ability to be resilient to the impacts of climate change. Projects funded included FireSmart Canada, which provides detailed and customized wildfire risk assessments for homeowners and ALUS Canada, which encourages climate resiliency for inefficient farmlands.
- **The Intact Centre on Climate Adaptation and the Insurance Bureau of Canada released a joint research report 'Combatting Canada's rising flood costs: Natural infrastructure is an underutilized option'**, which encourages communities to consider natural infrastructure to limit their flood risk and realize cost efficiencies. For example, naturally occurring ponds in Gibbons, B.C., provide up to \$4 million in stormwater storage services annually.

Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

FINANCIAL CONDITION

Section 7 – Financial position

Q3-2018 Highlights

Investment portfolio	Claims liabilities	BVPS for the last 12 months	Debt-to-total capital ratio
\$17 billion	\$11 billion	+6 %	21.7 %

7.1 Balance sheets

Table 15 – Balance sheets

As at	Section	September 30, 2018	December 31, 2017
Assets			
Cash, cash equivalents and short-term notes		491	380
Fixed-income securities		11,193	11,012
Preferred shares		1,342	1,409
Common shares		3,650	3,659
Loans		323	393
Investments	8	16,999	16,853
Premium receivables		3,535	3,351
Reinsurance assets	9	811	822
Deferred acquisition costs		928	881
Other assets		1,755	1,565
Intangible assets and goodwill		4,512	4,445
Total assets		28,540	27,917
Liabilities			
Claims liabilities	9	10,622	10,475
Unearned premiums		5,611	5,365
Financial liabilities related to investments		308	246
Other liabilities		1,924	2,127
Debt outstanding	10	2,189	2,241
Total liabilities		20,654	20,454
Shareholders' equity			
Common shares		2,816	2,816
Preferred shares		1,028	783
Contributed surplus		143	128
Retained earnings		3,733	3,520
AOCI		166	216
Shareholders' equity		7,886	7,463
Book value per share (in dollars)	16.4	49.27	48.00

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(in millions of Canadian dollars, except as otherwise noted)

Section 8 – Investments

Our investment portfolio is mainly comprised of Canadian and U.S. securities. Our invested assets increased to \$17.0 billion as at September 30, 2018, essentially in line with December 31, 2017.

- The Canadian securities mainly comprise a mix of cash and short-term notes, fixed-income securities, preferred shares, common shares and loans.
- The U.S. securities mainly comprise fixed-income securities (including asset-backed securities and corporate bonds) and common shares.

Net exposure by asset class

As part of our investment strategies, from time to time we take long/short equity positions in order to maximize the value added from active equity portfolio management, or to mitigate overall common share market volatility. We also use strategies where market risk from long common share positions is reduced through the use of swap agreements or other hedging instruments.

Table 16 – Investment mix by asset class (net exposure)

As at	September 30, 2018	December 31, 2017
Cash, cash equivalents, and short-term notes	4%	4%
Fixed-income	73%	72%
Preferred shares	7%	8%
Common equities	14%	14%
<hr/>		
Loans	98%	98%
	2%	2%
	100%	100%

Net currency exposure

We hedge the currency exposure of all USD-denominated investments in our Canadian entities using foreign currency contracts, resulting in minimal currency gains or losses. As at September 30, 2018, on a net exposure basis, 82% of our portfolio is denominated in CAD, 17% in USD and 1% in other currencies (79% in CAD, 19% in USD and 2% in other currencies as at December 31, 2017).

Net sectoral exposure

Our fixed-income portfolio remains concentrated in the Government and financial sectors providing liquidity and stability to our balance sheet.

Following the OneBeacon acquisition, our portfolio is comprised of more structured debt securities. As at September 30, 2018, these securities comprised \$710 million of asset-backed securities (“ABS”) and \$1,186 million of mortgage-backed securities (“MBS”). Residential MBS (“RMBS”) and Commercial MBS (“CMBS”) make up respectively 51% and 49% of our MBS portfolio. Approximately 99% of these structured debt securities are rated ‘A’ or better.

We continue to have no exposure to leveraged securities.

High-quality investment portfolio

Fixed income

Our fixed-income portfolio includes high quality Government and corporate bonds. Approximately 92% of our fixed-income portfolio was rated ‘A-’ or better as at September 30, 2018 (90% as at December 31, 2017).

On a consolidated basis, the weighted-average rating of our fixed-income portfolio was ‘AA’ as at September 30, 2018, and December 31, 2017. The average duration of our fixed-income portfolio was 3.71 years as at September 30, 2018 (3.53 years as at December 31, 2017), reflecting the integration of the OneBeacon fixed-income portfolio.

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Preferred shares

Our preferred share portfolio is made up of high-quality Canadian issuers. The weighted-average rating of our preferred share portfolio was 'P2' as at September 30, 2018, and December 31, 2017.

Net pre-tax unrealized gain (loss) on AFS securities

In determining the fair value of investments, we rely on quoted market prices. In cases where an active market does not exist, the estimated fair values are based on recent transactions or current market prices for similar securities.

Table 17 – Net pre-tax unrealized gain (loss) on AFS securities

As at	Sept. 30, 2018	June 30, 2018	March 31, 2018	Dec. 31, 2017	Sept. 30, 2017
Fixed-income securities	(38)	(11)	2	22	25
Preferred shares	62	53	64	79	40
Common shares	148	117	54	212	124
Net pre-tax unrealized gain position	172	159	120	313	189

Quarter	Year-to-date
<ul style="list-style-type: none"> Our pre-tax unrealized gain position increased by \$13 million mainly due to mark-to-market gains on common shares, reflecting the increase in U.S. equity markets in Q3-2018 (see Section 4.4 – Capital markets for more details). 	<ul style="list-style-type: none"> Our pre-tax unrealized gain position decreased by \$141 million driven by gains realized from ordinary trading activities on our common share portfolio.

Gains and losses in the common share portfolio are generally realized on an ongoing basis under normal capital market conditions.

Impairment recognition on AFS common shares

Table 18 – Aging of unrealized losses on AFS common shares

As at	Sept. 30, 2018	June 30, 2018	March 31, 2018	Dec. 31, 2017	Sept. 30, 2017
Less than 25% below book value	70	73	78	34	48
More than 25% below book value for less than 6 consecutive months	2	1	3	4	2
More than 25% below book value for 6 consecutive months or more, but less than 9 consecutive months	10	1	1	13	24
Unrealized on AFS common shares	82	75	82	51	74

Impairment losses on AFS common shares amounted to \$4 million in Q3-2018 and \$26 million YTD 2018. Assuming no trading activity or change in equity markets from September 30, 2018, we project that additional impairment losses of \$11 million could be recognized later in 2018. Since common shares are measured at fair value on our balance sheet, impairment losses have no impact on our BVPS. Refer to Note 2 – Summary of significant accounting policies of the Consolidated financial statements for the year ended December 31, 2017, for additional details on our accounting policy regarding the impairment of financial assets.

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Section 9 – Claims liabilities and reinsurance

9.1 Prior year development

PYD can fluctuate from quarter to quarter and year to year and, therefore, should be evaluated over longer periods of time.

In the past five years, favourable PYD as a percentage of opening reserves ranged between 3% to 6% per year for our Canadian operations, higher than our long-term historical averages.

We expect the average favourable PYD as a percentage of opening reserves to be in the 2% to 4% range over the long term. Higher interest rates will trend PYD around the lower end of this range, with an offset in the current accident year (CAY) loss ratio.

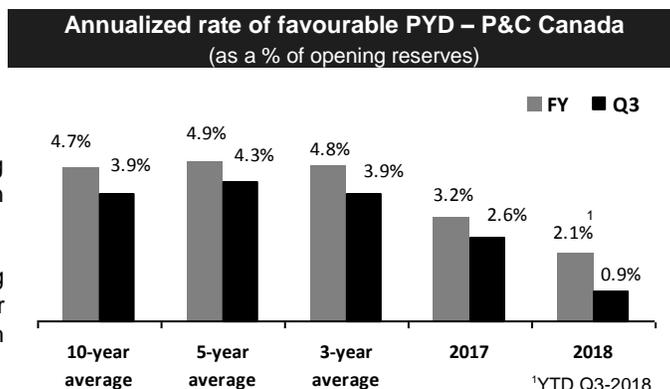


Table 19 – PYD by line of business

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
By line of business						
Personal auto	18	31	(13)	46	37	9
Personal property	(16)	(15)	(1)	(63)	(45)	(18)
Commercial lines – Canada	(22)	(69)	47	(108)	(168)	60
Commercial lines – U.S.	(8)	-	(8)	(10)	-	(10)
Total unfavourable (favourable) development	(28)	(53)	25	(135)	(176)	41
Unfavourable (favourable) annualized rate of PYD¹						
P&C Canada	(0.9)%	(2.6)%	1.7 pts	(2.1)%	(2.9)%	0.8 pts
P&C U.S.	(1.9)%	-	(1.9) pts	(0.8)%	-	(0.8) pts
Consolidated	(1.1)%	(2.6)%	1.5 pts	(1.9)%	(2.9)%	1.0 pts

¹ As a % of opening reserves.

Q3-2017 net reserve change

As a result of the acquisition of OneBeacon, we reviewed our approach for determining the risk margin at the consolidated level, reflecting the benefit of risk diversification between lines of business and geographically, resulting in a reduction in the claims liabilities of our Canadian operations. At the same time, following an extensive file-by-file and actuarial reviews at the portfolio level, we took a more cautious reserve position reflecting uncertainty, mainly in personal auto, leading to an increase in claims liabilities.

The net estimated impact on combined ratio by line of business was as follows:

Table 20 – Q3-2017 net reserve change: net estimated impact on combined ratio by line of business (P&C Canada)

Unfavourable (favourable)	Q3-2017	YTD 2017
By line of business		
Personal auto	2.1 pts	0.8 pts
Personal property	(1.9) pts	(0.7) pts
Commercial lines	(8.2) pts	(2.8) pts
Total impact	(1.9) pts	(0.7) pts

For further details, refer to Section 10.3 of the MD&A for the quarter ended September 30, 2017.

9.2 Reinsurance

In the ordinary course of business, we reinsure certain risks with reinsurers to limit our maximum loss in the event of catastrophic events or other significant losses. Refer to Note 10 - Reinsurance of the accompanying interim Consolidated financial statements for more details.

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Section 10 – Treasury management

10.1 Capital and financing structure

We believe that our optimal financing structure is one where the debt-to-total capital ratio is generally at 20%. We also expect to have approximately 10% of our total capital comprised of preferred shares. As we evolve in an international context, we also ensure that we are able to access funds in multiple currencies. The debt-to-total capital ratio may occasionally exceed 20% with a firm plan to revert back to 20% within a short period of time; in the case of the OneBeacon acquisition, within 24 months following closing. Our debt-to-total capital ratio following this acquisition at the end of September 2017 was 24.7% and has decreased to 21.7% as at September 30, 2018 (23.1% as at December 31, 2017).

Our \$750 million **credit facility** matures on August 28, 2023. There were no outstanding amounts under our credit facility as at September 30, 2018 (\$60 million as at December 31, 2017). All covenants under the credit facility were fully met as at September 30, 2018 and December 31, 2017.

10.2 Credit ratings

Independent third-party rating agencies assess our insurance subsidiaries' ability to meet their ongoing policyholder obligations ("financial strength rating") and our ability to honour our financial obligations ("senior unsecured debt rating"). These ratings remain unchanged since December 31, 2017.

10.3 Understanding our cash flows

Cash flows used in operating activities mainly consist of insurance premiums less claims and expense payments, plus investment income. Cash is used to pay dividends on common and preferred shares. Cash may also be deployed for strategic purposes like business acquisitions, investments in brokerage firms and share buybacks, or to repay outstanding financing. Cash inflows in excess of these outflows are moved to our investment portfolio to generate additional investment income in the future.

Table 21 – Cash flows

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
Net cash flows provided by operating activities	552	422	130	622	758	(136)
Cash flows generated from (deployed on):						
Acquisition of OneBeacon	-	(2,139)	2,139	-	(2,139)	2,139
Equity investments in brokerages and other, net	(60)	(7)	(53)	(65)	(83)	18
Purchases of intangibles and P&E, net	(30)	(24)	(6)	(81)	(74)	(7)
Dividends	(110)	(102)	(8)	(321)	(279)	(42)
Share-based payments in shares	(3)	(3)	-	(32)	(33)	1
NCIB	-	-	-	-	(7)	7
Issuance of common shares	-	731	(731)	-	731	(731)
Issuance of medium-term notes	-	-	-	-	422	(422)
Issuance of Class A Preferred shares	-	145	(145)	243	292	(49)
Amount drawn under our credit facility	(70)	210	(280)	(60)	210	(270)
Net cash inflows (outflows) before investment portfolio sales/purchases	279	(767)	1,046	306	(202)	508
Excess Capital deployed on OneBeacon acquisition	-	660	(660)	-	660	(660)
Proceeds from investment sales (investment purchases)	(136)	470	(606)	(47)	(108)	61
Net increase (decrease) in cash and cash equivalents	143	363	(220)	259	350	(91)

Cash flows provided by operating activities decreased by \$136 million on a year-to-date basis, mainly due to the timing of income tax payments. We have sufficient capital resources, cash flows from operating activities and borrowing capacity to support our current and anticipated activities, scheduled principal and interest payments on our outstanding debt, the payment of dividends and other expected financial requirements in the near term.

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Section 11 – Capital management

Q3-2018 Highlights

Total capital margin	MCT (Canada)	RBC (U.S.)
\$1.2 billion	196%	384%

11.1 Capital management objectives

Our objectives when managing capital consist of:

- maintaining strong regulatory capital levels (see Regulatory capital section below), while ensuring policyholders are well protected; and
- maximizing long-term shareholder value by optimizing capital used to operate and grow the Company.

We seek to maintain adequate capital margin to ensure that the probability of breaching the regulatory minimum requirements is very low. Such levels may vary over time depending on our evaluation of risks and their potential impact on capital. We also keep higher levels of capital margin when we foresee growth or actionable opportunities in the near term. Furthermore, we may return capital to shareholders through annual dividend increases and, when appropriate, through share buybacks.

Capital levels are carefully managed to ensure that we are in compliance with regulatory requirements, internal risk management policies, and to support business expansion. Most of the total capital margin is retained to ensure adequate protection against breaching the regulatory minimum requirements (e.g. from adverse underwriting or market developments), while the remainder would be considered deployable for strategic purposes.

11.2 Capital position

All our regulated P&C insurance subsidiaries are well capitalized on an individual basis with capital levels well in excess of regulator supervisory minimum levels and Company action levels (CALs). CALs represent the thresholds below which regulator notification is required together with a company action plan to restore capital levels.

Table 22 – Estimated aggregated capital position

	September 30, 2018			June 30, 2018			December 31, 2017		
	Canada (MCT)	U.S. (RBC)	IFC capital margin	Canada (MCT)	U.S. (RBC)	IFC capital margin	Canada (MCT)	U.S. (RBC)	IFC capital margin
Regulatory capital ratios (RCRs)	196%	384%	-	201%	405%	-	205%	459%	-
Industry-wide supervisory minimum levels	150%	150%	-	150%	150%	-	150%	150%	-
CALs	170%	200%	-	170%	200%	-	170%	200%	-
Capital above CALs (capital margin)	469	381	850	550	415	965	618	438	1,056
Other regulated/unregulated entities ¹	-	-	327	-	-	278	-	-	79
Total capital margin			1,177			1,243			1,135

¹ Other regulated entities include Split Rock Insurance, Ltd. (Bermuda) and IB Reinsurance Inc. (Barbados).

Total capital margin of \$1,177 million decreased by \$66 million in Q3-2018, mainly due to the repayment of the credit facility. On a year-to-date basis, it increased by \$42 million, reflecting the preferred share issuance in Q2-2018, partly offset by the impact of severe weather and the repayment of the credit facility.

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RISK MANAGEMENT

Section 12 – Sensitivity analyses

Sensitivity analyses are one risk management technique that assists management in ensuring that risks assumed remain within our risk tolerance level. Sensitivity analyses involve varying a single factor to assess the impact that this would have on our results and financial condition. No management action is considered.

Actual results can differ materially from these estimates for a variety of reasons and therefore, these sensitivities should be considered as directional estimates.

Table 23 - Sensitivity analysis (after tax)

For the quarters ended	September 30, 2018			December 31, 2017		
	Net income	OCI	BVPS	Net income	OCI	BVPS
Equity price risk						
Common share prices (10% decrease) ¹	(2)	(211)	(1.53)	(1)	(201)	(1.45)
Preferred share prices (5% decrease) ²	13	(59)	(0.33)	13	(62)	(0.35)
Interest rate risk (100 basis point increase)	(7)	(102)	(0.78)	9	(64)	(0.40)
Currency risk (strengthening of the CAD by 10% vs all currencies) ³						
USD investments supporting P&C Canada	-	-	-	6	(1)	0.04
International equities supporting P&C Canada	-	(18)	(0.13)	-	(19)	(0.14)
Consolidated net assets of foreign subsidiaries	-	(192)	(1.41)	-	(176)	(1.26)

¹ Net of any equity hedges, including the impact of any impairment.

² Including the impact on related embedded derivatives.

³ After giving effect to forward-exchange contracts.

The above analyses were prepared using the following assumptions:

- shifts in the yield curve are parallel;
- interest rates, equity prices and foreign currency move independently;
- credit, liquidity and basis risks have not been considered;
- impact on our pension plans has been considered; and
- risk reduction measures perform as expected, with no material basis risk and no counterparty defaults.

AFS debt or equity securities in an unrealized loss position, as reflected in AOCI, may be realized through sales in the future.

A decline in the price of AFS perpetual preferred shares is recorded in OCI and would normally lead to a lower valuation for associated embedded derivative liabilities which are recorded as gains in Net income. Conversely, an increase in the price of these preferred shares is also recorded in OCI and would normally lead to a higher valuation for associated embedded derivative liabilities which are recorded as losses in Net income.

ADDITIONAL INFORMATION

Section 13 – Non-operating results

Non-operating results, a non-IFRS financial measure, include elements that are not representative of our operating performance because they relate to special items, bear significant volatility from one period to another, or because they are not part of our normal activities. As a result, these elements are excluded from the calculation of NOI and related non-IFRS financial measures.

Table 24 – Non-operating results

	Q3-2018	Q3-2017	Change	YTD 2018	YTD 2017	Change
Net gains (losses) (Table 12)	(24)	(59)	35	(46)	75	(121)
Positive (negative) impact of MYA on underwriting	42	60	(18)	133	81	52
Amortization of intangible assets recognized in business combinations ¹	(22)	(12)	(10)	(65)	(37)	(28)
Integration and restructuring costs ²	(10)	(33)	23	(49)	(45)	(4)
Difference between expected return and discount rate on pension assets	(12)	(11)	(1)	(37)	(33)	(4)
Underwriting results of exited lines	(3)	-	(3)	(22)	-	(22)
Other	(7)	(6)	(1)	(14)	(14)	-
Non-operating gains (losses)	(36)	(61)	25	(100)	27	(127)
Income tax recovery (expense) on the above items	7	13	(6)	14	(2)	16
U.S. Corporate tax reform ³	(9)	-	(9)	(9)	-	(9)
After-tax non-operating gains (losses)	(38)	(48)	10	(95)	25	(120)

¹ Includes \$9 million in Q3-2018 (\$26 million YTD 2018) in connection with the acquisition of OneBeacon.

² Includes \$9 million in Q3-2018 (\$41 million YTD 2018) in connection with the acquisition of OneBeacon.

³ Impact of the U.S. tax reform on deferred tax assets related to the finalization of the OneBeacon purchase price equation.

Non-operating results

- **Net gains and losses** as well as the effect of **MYA** on underwriting results arise mostly from changes in market conditions, which can be volatile to earnings.
- Claims liabilities are discounted at the estimated market yield of the assets backing these liabilities. The impact of changes in the discount rate used to discount claims liabilities based on the change in the market-based yield of the underlying assets is referred to as **MYA**. MYA is included in Net claims incurred in our consolidated statements of income.
- **Integration and restructuring costs** include items such as retention bonuses, the initial net impact of a reinsurance coverage which provides protection against certain negative reserve developments, pre-acquisition finance costs and acquisition-related expenses.
- The **difference between the expected return and discount rate on pension assets** is treated as non-operating results, as the gap in these measures is not reflective of our internal investment management expertise and management of our pension asset portfolio.
- **Underwriting results of exited lines** include the results of the U.S. Commercial's business lines Programs, and Architects and Engineers. In our consolidated statements of income, underwriting results of exited lines are presented in several captions, namely Direct premiums written, Net earned premiums, Net claims incurred and Underwriting expenses.

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Section 14 – Non-IFRS financial measures

Non-IFRS financial measures do not have standardized meanings prescribed by IFRS and may not be comparable to similar measures used by other companies in our industry. These non-IFRS financial measures are used by management and financial analysts to assess our performance. Further, they provide users with an enhanced understanding of our results and related trends and increase transparency and clarity into the core results of the business.

NOI, NOIPS and OROE

- Exclude non-operating results (see Section 13 for details).

Table 25 – Reconciliation of NOI, NOIPS and OROE to net income

	Q3-2018	Q3-2017	YTD 2018	YTD 2017
Net income	199	171	463	560
Add (less) income tax expense (recovery)	57	49	112	136
Add (less) non-operating losses (gains)	36	61	100	(27)
Pre-tax operating income	292	281	675	669
Tax impact on operating income	(55)	(62)	(117)	(134)
NOI	237	219	558	535
Less preferred share dividends	(13)	(8)	(29)	(17)
NOI to common shareholders	224	211	529	518
Divided by weighted-average number of common shares (in millions)	139.2	131.2	139.2	131.1
NOIPS, basic and diluted (in dollars)	1.62	1.61	3.80	3.95
NOI to common shareholders – last 12 months	756	725		
Average common shareholders' equity, excluding AOCI	6,525	5,443		
OROE for the last 12 months	11.6%	13.3%		

All underwriting results and related ratios exclude the MYA and results of our U.S. Commercial exited lines, unless otherwise noted.

DPW

- Represents the total amount of premiums for new and renewal policies billed (written) during the reporting period, normalized for the effect of multi-year policies, excluding industry pools, fronting and exited lines. We consider that this measure better reflects the operating performance of our core operations, and that it is the most useful measure in terms of measuring growth, volume of business and market share.
- This measure matches premiums written to the year in which coverage is provided, whereas under IFRS, the full value of multi-year policies is recognized in the year the policy is written.

Table 26 – Reconciliation of DPW and DPW growth to DPW, as reported under IFRS

	Q3-2018	Q3-2017	YTD 2018	YTD 2017
DPW, as reported under IFRS	2,684	2,203	7,748	6,447
Add (less) impact of industry pools and fronting	(15)	(4)	(74)	(16)
Less DPW of exited lines	(3)	-	(15)	-
DPW (full term)	2,666	2,199	7,659	6,431
Add (less) impact of the normalization for multi-year policies	42	4	39	6
DPW	2,708	2,203	7,698	6,437
DPW growth	23%	1%	20%	2%

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Underlying current year loss ratio

- Represents our current year claims ratio excluding catastrophe losses, reinstatement premiums, and PYD.
- Catastrophe events are not predictable and subject to volatility, and as such, excluding them provides clearer insight into our analysis of current year performance.

Table 27 – Reconciliation of NEP before reinstatement premiums to NEP and of current year claims to net claims incurred, as reported under IFRS

	Q3-2018	Q3-2017	YTD 2018	YTD 2017
NEP, as reported under IFRS	2,471	2,082	7,249	6,130
Less NEP of exited lines	(9)	-	(43)	-
NEP	2,462	2,082	7,206	6,130
Add (less) reinstatement premiums ceded (recovered)	-	-	(1)	-
NEP, before reinstatement premiums	2,462	2,082	7,205	6,130
Net claims incurred, as reported under IFRS	1,548	1,273	4,716	3,986
Add positive (negative) impact of MYA on underwriting results	42	60	133	81
Less difference between expected return and discount rate on pension assets allocated to net claims incurred	(6)	(4)	(17)	(12)
Less net claims of exited lines	(12)	-	(62)	-
Total net claims	1,572	1,329	4,770	4,055
Less current year CAT claims	(97)	(89)	(275)	(282)
Add favourable (unfavourable) PYD	28	53	135	176
Current year claims (excluding CATs and PYD)	1,503	1,293	4,630	3,949
NEP, before reinstatement premiums	2,462	2,082	7,205	6,130
Underlying current year loss ratio	61.0%	62.1%	64.3%	64.4%
CAT loss ratio (including reinst. premiums)	3.9%	4.3%	3.8%	4.7%
Unfavourable (favourable) PYD ratio	(1.1)%	(2.6)%	(1.9)%	(2.9)%
Claims ratio	63.8%	63.8%	66.2%	66.2%

Underwriting income (loss)

Table 28 – Reconciliation of underwriting income to underwriting income, as reported under IFRS

	Q3-2018	Q3-2017	YTD 2018	YTD 2017
Underwriting income, as reported under IFRS¹	179	219	338	356
Less impact of MYA on underwriting results	(42)	(60)	(133)	(81)
Add difference between expected return and discount rate on pension assets	12	11	37	33
Add underwriting results of exited lines	3	-	22	-
Underwriting income	152	170	264	308
Combined ratio	93.8%	91.8%	96.3%	95.0%

¹ Includes the following captions in the Consolidated statements of income: Net earned premiums, Other underwriting revenues, Net claims incurred and Underwriting expenses.

Underwriting expenses

Table 29 – Reconciliation of underwriting expenses to underwriting expenses, as reported under IFRS

	Q3-2018	Q3-2017	YTD 2018	YTD 2017
Underwriting expenses, as reported under IFRS	772	618	2,277	1,870
Less other underwriting revenues	(28)	(28)	(82)	(82)
Less difference between expected return and discount rate on pension assets	(6)	(7)	(20)	(21)
Less underwriting expenses of exited lines	-	-	(3)	-
Underwriting expenses	738	583	2,172	1,767
Expense ratio	30.0%	28.0%	30.1%	28.8%

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ROE

- Excludes the dividends declared on preferred shares.
- Average common shareholder's equity is the mean of the shareholder's equity at the beginning and the end of the period, adjusted for significant capital transactions, if appropriate.

Table 30 – Reconciliation of ROE to net income

	Q3-2018	Q3-2017	YTD 2018	YTD 2017
Net income	199	171	463	560
Less preferred share dividends	(13)	(8)	(29)	(17)
Net income attributable to common shareholders	186	163	434	543
Net income attributable to common shareholders – last 12 months	656	710		
Average common shareholders' equity	6,670	5,595		
ROE for the last 12 months	9.8%	12.7%		

AEPS and AROE

- Exclude the after-tax impact of amortization of intangible assets recognized in business combinations, as well as integration and other acquisition-related costs.
- We believe that these acquisition-related items are not appropriate in assessing our underlying performance.

Table 31 – Reconciliation of AEPS and AROE to net income

	Q3-2018	Q3-2017	YTD 2018	YTD 2017
Net income	199	171	463	560
Adjustments, net of tax				
Add amortization of intangibles recognized in business combinations	18	10	52	30
Add integration and other costs	8	32	37	42
Add negative impact of the U.S. Corporate tax reform	9		9	
Less currency derivative gain related to the acquisition of OneBeacon	-	(20)	-	(55)
Adjusted net income	234	193	561	577
Less preferred share dividends	(13)	(8)	(29)	(17)
Adjusted net income attributable to common shareholders	221	185	532	560
Divided by weighted-average number of common shares (in millions)	139.2	131.2	139.2	131.1
AEPS, basic and diluted (in dollars)	1.59	1.41	3.82	4.27
Adjusted net income attributable to common shareholders - LTM	749	763		
Average common shareholders' equity	6,670	5,595		
AROE for the last 12 months	11.2%	13.6%		

Market-based yield

- Represents the annualized total pre-tax investment income (before expenses), divided by the mid-month average fair value of net equity and fixed-income securities held during the reporting period (average net investments).
- This calculation provides users with a consistent measure of our relative investment performance.

Section 15 – Accounting and disclosure matters

Reference to the accompanying interim Consolidated financial statements	
Summary of significant accounting policies	Standards issued but not yet effective
<i>Note 3</i>	<i>Note 23</i>

15.1 Disclosure controls and procedures

We are committed to providing timely, accurate and balanced disclosure of all material information about the Company and to providing fair and equal access to such information. Management is responsible for establishing and maintaining our disclosure controls and procedures to ensure that information used internally and disclosed externally is complete and reliable. Due to the inherent limitations in all control systems, an evaluation of controls can provide only reasonable, not absolute assurance, that all control issues and instances of fraud or error, if any, within the Company have been detected. We continue to evolve and enhance our system of controls and procedures.

15.2 Internal controls over financial reporting

Management has designed and is responsible for maintaining adequate internal control over financial reporting (“ICFR”) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

No significant changes were made to our ongoing ICFR during the third quarter of 2018 that have materially affected, or are reasonably likely to materially affect, the Company’s ICFR.

Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

Section 16 – Shareholder information

16.1 Authorized share capital

Our authorized share capital consists of an unlimited number of common shares and Class A shares.

16.2 Outstanding share data

Table 32 – Outstanding share data (number of shares)

As at November 2, 2018	
Common shares	139,188,634
Class A	
Series 1 preferred shares	10,000,000
Series 3 preferred shares	8,405,004
Series 4 preferred shares	1,594,996
Series 5 preferred shares	6,000,000
Series 6 preferred shares	6,000,000
Series 7 preferred shares ¹	10,000,000

¹ Series 7 preferred shares were issued on May 29, 2018.

Refer to our Annual Information Form for the year ended December 31, 2017 for information on the rights of shareholders.

16.3 Dividends declared on common shares and preferred shares

Table 33 – Dividends declared per share

	Q4-2018 ¹	Q3-2018
Common shares	0.70	0.70
Class A		
Series 1 preferred shares	0.21225	0.21225
Series 3 preferred shares	0.20825	0.20825
Series 4 preferred shares	0.262705	0.249535
Series 5 preferred shares	0.325	0.325
Series 6 preferred shares	0.33125	0.33125
Series 7 preferred shares	0.30625	0.4162

¹ On November 6, 2018, the Board of Directors approved the quarterly dividend for Q4-2018.

16.4 BVPS

Table 34 – Evolution of BVPS (in dollars)

As at	Q3-2018	Last 12 months
BVPS, beginning of period	48.64	46.56
EPS	1.34	4.71
Dividends on common shares	(0.70)	(2.74)
Impact of market movements on AFS securities ¹	0.08	(0.11)
Net actuarial gains (losses) on employee future benefits ¹	0.16	0.34
Foreign exchange impact ¹	(0.27)	0.39
Other	0.02	0.12
BVPS, end of period	49.27	49.27
Period-over-period increase	1%	6%

¹ Reported in AOCI.

Management's Discussion and Analysis for the third quarter of 2018

(in millions of Canadian dollars, except as otherwise noted)

Section 17 – Selected quarterly information

17.1 Selected quarterly information

Table 35 – Selected quarterly information¹

	Q3	Q2	2018		Q3	Q2	2017	2016
			Q1	Q4			Q1	Q4
DPW	2,708	2,908	2,082	2,293	2,203	2,497	1,737	1,959
Total revenues ²	2,644	2,589	2,496	2,576	2,231	2,204	2,146	2,188
NEP	2,462	2,410	2,334	2,400	2,082	2,051	1,997	2,043
Current year CAT losses	97	142	36	31	89	105	88	34
Favourable PYD	(28)	(32)	(75)	(62)	(53)	(41)	(82)	(62)
Underwriting income	152	93	19	178	170	103	35	153
Combined ratio	93.8%	96.1%	99.2%	92.6%	91.8%	95.0%	98.2%	92.5%
Net investment income	133	134	122	121	101	105	105	104
Net distribution income	34	52	24	28	30	50	24	24
NOI	237	201	120	236	219	193	123	212
Net income	199	161	103	232	171	243	146	171
Per share measures, basic and diluted								
(in dollars)								
NOIPS	1.62	1.38	0.81	1.63	1.61	1.44	0.90	1.58
EPS	1.34	1.10	0.68	1.60	1.25	1.82	1.08	1.27

¹ Refer to Section 14 – Non-IFRS financial measures.

² Total revenues exclude other underwriting revenues and NEP of exited lines.

17.2 Seasonality of the Canadian P&C insurance business

The Canadian P&C insurance business is seasonal in nature. While NEP are generally stable from quarter to quarter, underwriting results are driven by weather conditions which may vary significantly between quarters.

For instance, in 2017 our first and second quarters saw a higher combined ratio including CAT losses than the third and fourth quarters, meaning that underwriting results were relatively less profitable in Q1-2017 and Q2-2017. Excluding CAT losses, the first and fourth quarters of 2017 saw a slightly higher combined ratio than the other quarters in 2017, meaning that underwriting results were relatively less profitable in Q1-2017 and Q4-2017 than the rest of the year.

Table 36 – Seasonal indicator, including CAT losses

	2017	2016	2015	2014	2013	Five-year average
Q1	1.04	0.97	1.02	1.05	0.97	1.01
Q2	1.01	1.04	1.00	1.00	1.00	1.01
Q3	0.97	1.02	1.02	1.00	1.05	1.01
Q4	0.98	0.97	0.96	0.95	0.98	0.97

Table 37 – Seasonal indicator, excluding CAT losses

	2017	2016	2015	2014	2013	Five-year average
Q1	1.03	1.01	1.03	1.04	1.04	1.03
Q2	0.99	0.99	1.01	1.02	0.97	1.00
Q3	0.97	0.99	0.98	0.96	0.97	0.97
Q4	1.01	1.01	0.98	0.98	1.02	1.00

17.3 Expected release dates of our financial results

Q4-2018	Q1-2019	Q2-2019	Q3-2019
February 5, 2019	May 7, 2019	July 30, 2019	November 5, 2019