

Second Quarter **2011**

2

Management's Discussion and Analysis
For the quarter ended June 30, 2011

Intact Financial Corporation

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

August 3, 2011

The following Management's Discussion and Analysis ("MD&A"), which was approved by the Board of Directors for the quarter ended June 30, 2011, is intended to enable the reader to assess the Company's results of operations and financial conditions for the three and six-month periods ended June 30, 2011, compared to the corresponding periods in 2010. It should be read in conjunction with the Company's unaudited interim Consolidated financial statements and accompanying notes, as well as the MD&A and the audited Consolidated financial statements in the Company's 2010 Annual Report. All amounts herein are expressed in Canadian dollars.

The Company uses both International Financial Reporting Standards ("IFRS") and certain non-IFRS measures to assess performance. Non-IFRS measures do not have any standardized meaning prescribed by IFRS and are unlikely to be comparable to any similar measures presented by other companies. Management of Intact Financial Corporation analyzes performance based on underwriting ratios such as combined, general expenses and claims ratios as well as other performance measures such as return on equity ("ROE") and operating return on equity. These measures and other insurance related terms are defined in the Company's glossary available on the Intact Financial Corporation web site at www.intactfc.com in the "Investor Relations" section. Additional information about Intact Financial Corporation, including the Annual Information Form, may be found online on SEDAR at www.sedar.com.

International Financial Reporting Standards

The six-month period ended June 30, 2011 MD&A reflects the Company's adoption of IFRS as issued by the International Accounting Standards Board. Certain 2010 comparative figures have been restated in accordance with IFRS except as noted otherwise. Section 10.3 of this MD&A provides details on the impact of adopting IFRS, while Tables 30 and 31 present a reconciliation of the Company's key performance indicators from those previously prepared under Canadian GAAP to those prepared under IFRS.

Note 15 of the Company's unaudited interim Consolidated financial statements contains a detailed description of our conversion to IFRS, including accounting policies adopted and a line-by-line reconciliation of financial statements previously prepared under Canadian GAAP to those under IFRS for the six months ended June 30, 2010 and for the year ended December 31, 2010.

The full year impact of adopting IFRS in 2010 on net operating income per share was minimal, at \$0.03. Earnings per share and return on equity were impacted by a greater amount, increasing by \$0.67 and 3.0 percentage points, respectively, when compared to Canadian GAAP. The variance for EPS is attributable to a higher level of realized gains resulting from the retrospective application of impairment rules on available-for-sale equity instruments, including perpetual preferred shares. ROE increased due to these realized gains as well as due to the reduction in shareholders' equity from the transition adjustment related to employee future benefits.

Forward-looking statements

This document contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from these forward-looking statements as a result of various factors, including those discussed hereinafter or in the Company's 2010 Annual Information Form. Please read the cautionary note in section 12.1 of this document.

Certain totals, subtotals and percentages may not agree due to rounding. A change column has been provided for convenience showing the variation between the current period and the prior period. Not applicable (n/a) is used to indicate that the current and prior year figures are not comparable, not meaningful, or if the percentage change exceeds 1,000%. "Intact", the "Company", "IFC" and "we" are terms used throughout the document to refer to Intact Financial Corporation and its subsidiaries. For captions used in this MD&A, words such as "Income", "Earnings" and "Gains" will always be placed before the words "Expense", "Loss" and "Losses".

Important notes:

- All references to direct premiums written in this MD&A exclude industry pools, unless otherwise noted.
- All references to "excess capital" in this MD&A include excess capital in the P&C insurance subsidiaries at 170% minimum capital test ("MCT") plus liquid assets in the holding company, unless otherwise noted.
- Catastrophe claims are any one claim, or group of claims, equal to or greater than \$5 million, related to a single event.
- All underwriting results and related ratios exclude the market yield adjustment ("MYA"), except if noted otherwise.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Table of contents

Section 1 - Intact Financial Corporation	2
Section 2 - Overview of consolidated performance	3
Section 3 - Canadian property and casualty insurance industry 12-month outlook	5
Section 4 - Business developments and operating environment	6
Section 5 - Operating results.....	8
Section 6 - Non operating results	13
Section 7 - Investments.....	14
Section 8 - Selected quarterly information.....	16
Section 9 - Financial condition	17
Section 10 - Accounting and disclosure matters	25
Section 11 - Risk management.....	29
Section 12 - Other matters	29

Section 1 - Intact Financial Corporation

Overview

Intact Financial Corporation is the largest provider of property and casualty (“P&C”) insurance in Canada, insuring approximately four million individuals and businesses through our insurance subsidiaries. With an estimated 11% market share in Canada, we are the largest private sector provider of P&C insurance in Ontario, Québec, Alberta and Nova Scotia. We distribute insurance under the Intact Insurance brand through a wide network of brokers and our wholly-owned subsidiary, BrokerLink. We also distribute insurance direct to consumers through our belairdirect and GP Car and Home brands. We manage our own investment portfolio of approximately \$8.6 billion.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Section 2 - Overview of consolidated performance

Second quarter highlights

- Net operating income per share of \$0.87, despite \$0.84 per share in losses from natural catastrophes
- Q2 combined ratio of 97.0% driven by very strong underwriting results from our auto businesses
- Operating ROE of 13.6% with an 11% increase in book value per share in the last 12 months
- AXA Canada acquisition progressing well, on-track to close this fall

Consolidated financial results

Table 1 – Key components of net income

(in millions of dollars, except as otherwise noted)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Direct premiums written (excluding pools)	1,354	1,318	3%	2,297	2,232	3%
Net underwriting income (excluding MYA) (table 4)	33	66	(50)%	91	135	(33)%
Combined ratio (excluding MYA)	97.0%	93.7%	3.3 pts	95.8%	93.5%	2.3 pts
Net investment income (table 9)	75	76	(1)%	149	149	-
Finance costs	8	8	-	15	14	7%
Total gains excluding fair-value-through-profit-or-loss ("FVTPL") fixed income securities (table 12)	44	34	29%	128	78	64%
Net income before income tax expenses	152	181	(16)%	360	364	(1)%
Income tax expense	29	40	(28)%	80	82	(2)%
Effective income tax rate	19.1%	22.1%	(3.0) pts	22.2%	22.5%	(0.3) pts
Net income	123	141	(13)%	280	282	(1)%
Net operating income (table 2)	95	119	(20)%	197	232	(15)%
Earnings per share ("EPS") – basic and diluted (in dollars)	1.12	1.22	(8)%	2.54	2.40	6%
Net operating income per share (in dollars)	0.87	1.04	(16)%	1.78	1.98	(10)%
Return on equity ("ROE") for the last 12 months	17.3%	n/a ¹	n/a	-	-	-
Return on equity ("ROE") YTD annualized	-	-	-	18.9%	19.7%	(0.8) pts
Operating return on equity for the last 12 months	13.6%	n/a ¹	n/a	-	-	-
Operating return on equity YTD annualized	-	-	-	14.4%	17.6%	(3.2) pts
Book value per share (in dollars)	26.89	24.32	11%	-	-	-

¹ ROE and Operating return on equity (OROE) are not presented for the comparative period due to the adoption of IFRS in 2011. ROE and OROE as reported in Q2 2010 under Canadian GAAP were 11.5% and 11.7% respectively.

Second quarter 2011

Underwriting performance was good in Q2-2011 with a combined ratio of 97.0%, but was 3.3 points weaker than Q2-2010 as strong core underwriting in our auto businesses and continued favourable prior year claims development (largely driven by industry pools) were more than offset by significantly higher catastrophe losses. The \$50 million impact on our after-tax results from the Slave Lake wildfires (90% of which was attributable to personal property) was in-line with our previously disclosed estimate of \$45-55 million, but results in the quarter were also affected by a number of severe storms, amounting to \$42 million after-tax. The underlying current year loss ratio (excluding catastrophes and prior year claims development) improved 3.9 points year-over-year.

Net investment income remained stable in the second quarter at \$75 million, representing a market-based yield of 4.2%. Cash and investments amounted to \$8.6 billion at the end of June 2011, comparable to year end 2010 and \$0.4 billion higher than one year ago.

Direct premiums written growth was 3% year-over-year. Growth of 2% in personal lines reflects slower growth in our direct businesses, notably in Ontario from our continued prudent approach to growth, while commercial lines grew 5% year-over-year with improving unit growth in both auto and P&C. We continue to expect top-line growth to improve by year-end from our organic growth initiatives, improving industry pricing conditions, primarily in personal lines, and a rebound in growth in our Ontario auto business.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

The Company's financial position remains strong with book value per share of \$26.89, 11% higher than a year ago (IFRS adjusted). Our operating return on equity reached 13.6% for the last 12 months, while strong investment gains from continued portfolio rebalancing resulted in a return on equity of 17.3%.

Year to date 2011

Underwriting income declined \$44 million in the first half of the year, with a combined ratio of 95.8%, versus 93.5% in H1-2010. The change was driven by a significant increase in catastrophe losses, which grew from \$19 million in 2010 to \$118 million in 2011, attributable to the Slave Lake wildfires and a number of severe storms in the second quarter. Partly offsetting these losses was improved underlying current year results and higher favourable prior year claims development (\$154 million versus \$114 million). The underlying current year loss ratio (excluding catastrophes and prior year claims development) improved 1.4 points in H1-2011 versus H1-2010. Overall, improved results in our auto businesses were partly offset by declines in personal property and commercial P&C.

Net operating income was \$197 million, down approximately 15% reflecting the lower underwriting results. The market yield of the investment portfolio remained robust at 4.1%, generating \$149 million of investment income over the first half of 2011.

The healthy investment income and significant improvement in investment gains offset much of the decrease in underwriting income and resulted in net income for the first half of 2011 of \$280 million, down less than 1% from \$282 million in the comparable period last year.

Section 3 - Canadian property and casualty insurance industry 12-month outlook

IFC is well-positioned to continue outperforming the P&C insurance industry in the current environment due to its significant scale, pricing and underwriting discipline, prudent investment and capital management practices, and strong financial position.

	P&C insurance industry	IFC’s strategy
Pricing and claims environment (12-month outlook)	<ul style="list-style-type: none"> Industry premiums are likely to increase at a similar rate as in 2010, with mid single digit growth in personal auto (driven by Ontario), upper single digit growth in personal property (reflecting the impact of water related losses and more frequent and/or severe storms) and low single digit growth in commercial lines. Loss ratio improvement is expected from personal auto (assuming Ontario reforms bring anticipated cost savings and are effective at slowing claims inflation) and personal property (as a result of the benefit from continued premium increases). We do not anticipate loss ratio improvement in commercial lines, but expect pricing conditions to improve at a moderate pace over time, following several years of soft industry pricing. 	<ul style="list-style-type: none"> IFC maintains its disciplined pricing strategy while capitalizing on its strong position to grow organically as market pricing becomes more rational. We will maintain our disciplined approach to the Ontario auto market as the results of the reforms unfold and the efforts to curb fraud and abuse are successful. We maintain our focus on the actions taken to create a sustainable competitive advantage in the home insurance line of business. In commercial lines, we intend to build on our loss ratio advantage to accelerate our penetration in small to mid-sized businesses.
Capital markets	<ul style="list-style-type: none"> Capital markets remain volatile, as economic data (particularly outside of Canada) raise questions about the sustainability of the global recovery. Low interest rates continue to pressure investment yields which could influence higher premiums across the industry. Debt and equity capital markets are in a state of flux, with periodic windows of opportunity for companies to raise capital at reasonable rates. Recent inflation data and comments from the Bank of Canada lead us to believe that interest rates, which are currently very low, might begin to increase in the near term. Despite this, we estimate that the industry’s pre-tax investment yield will decline, given its asset mix and duration. Global capital requirements are evolving quickly and generally becoming more stringent. This is also true in Canada where the Office of the Superintendent of Financial Institutions Canada (“OSFI”) recently published a draft guideline on proposed changes to the MCT which could potentially reduce industry capital ratios. 	<ul style="list-style-type: none"> The Company successfully completed three financings related to the announced acquisition of AXA Canada Inc. (“AXA Canada”) since the end of May 2011 resulting in gross proceeds as follows: <ul style="list-style-type: none"> \$962 million in the form of subscription receipts; \$250 million in preferred shares; \$100 million in 50-year term notes. IFC maintains a strong financial position with \$758 million in excess capital and a debt to total capital ratio of 14.4% as at the end of Q2-2011. Our \$8.6 billion cash and investment portfolio is largely Canadian-denominated with minimal U.S. exposure. IFC’s investment portfolio has a differentiated asset strategy and slightly longer duration than the typical industry portfolio. As such, we expect our yield to decline to a lesser extent on a relative basis. Capital requirements are not expected to negatively impact IFC to the same degree as the overall P&C insurance industry, given the composition of our investment portfolio and the nature of our claims liabilities.
Overall	<ul style="list-style-type: none"> The industry’s return on equity was approximately 7% in 2010 and 8% in Q1-2011. Although the combined ratio may improve, we believe this would be largely offset by a reduction in the level of investment income. Consequently, we do not expect material improvement in ROEs in the near term. 	<ul style="list-style-type: none"> We strongly believe the Company is likely to outperform the industry’s ROE by at least 500 basis points in the next 12 months, due to the following: <ul style="list-style-type: none"> Our 2010 outperformance was approximately 700 basis points (and close to 1,300 basis points in Q1-2011). We expect to maintain a combined ratio advantage, due to continued robust action plans across all lines of business, in addition to an expanding yield advantage.

Section 4 - Business developments and operating environment

Overall, the underwriting environment continues to evolve as expected with an improved pricing dynamic in a number of business lines and jurisdictions due to three main factors affecting the industry as a whole: 1) Continued pressure on underwriting margins, 2) low investment yields and consequently, 3) low returns on capital. These factors continue to support better pricing conditions, industry capacity reductions and further market consolidation, benefiting strong and disciplined players in the market such as IFC.

AXA Canada acquisition

On May 31, 2011, IFC entered into a share purchase agreement (the "Share Purchase Agreement") with Paris-based AXA S.A. for the acquisition of all of the issued and outstanding shares of its affiliate AXA Canada for \$2.6 billion in cash (the "Acquisition").

The Company has considerable experience with acquisitions, and has successfully integrated 11 acquired companies since 1988. The integration planning process was initiated immediately following the announcement of the Acquisition. Numerous task forces were established, comprised of employees from both IFC and AXA, charged with reviewing the activities, processes and systems of both companies, identifying potential synergies and developing the appropriate action plans to ensure an efficient and successful integration. The Acquisition is expected to close in the fall of 2011, once all regulatory approvals are received.

Concurrent with the execution of the Share Purchase Agreement, IFC entered into: (i) a commitment letter with a Canadian bank (the "Acquisition Lender") pursuant to which the Acquisition Lender has agreed, on its own behalf and in its capacity as administrative agent, to provide IFC with committed senior, unsecured facilities (the "Acquisition Credit Facilities") in an aggregate amount of up to \$1.3 billion for the purpose of funding a portion of the purchase price for the Acquisition and (ii) an agreement with a group of underwriters with respect to an offering of up to 20,125,000 Subscription Receipts (the "Subscription Receipt Offering") which was completed on June 9, 2011 resulting in gross proceeds of \$961,975,000. The gross proceeds from the Subscription Receipt Offering are being held in escrow and will be used to fund a portion of the purchase price for the Acquisition subject to the terms of the Subscription Receipts and a subscription receipt agreement (the "Subscription Receipt Agreement") dated June 9, 2011 between IFC, Computershare Trust Company of Canada, as escrow agent, and the lead underwriters of the Subscription Receipt Offering. On July 8, 2011, IFC closed a private placement offering of \$100 million aggregate principal amount of unsecured 50-year term notes due July 8, 2061 (the "Series 3 Notes"). On July 12, 2011, IFC closed an offering of 10,000,000 Non-cumulative Rate Reset Class A Shares Series 1 (the "Series 1 Preferred Shares") at a price of \$25.00 per Series 1 Preferred Share for aggregate gross proceeds of \$250 million. The terms of the Series 3 Notes and the Series 1 Preferred Shares are available at our SEDAR profile at www.sedar.com (see *Financing* in section 9.4 for more details on the financing structure).

The proceeds from the Subscription Receipt Offering, together with the Acquisition Credit Facilities, the net proceeds of the offering of Series 3 Notes and Series 1 Preferred Shares and a portion of IFC's existing cash resources, will be used to fund the purchase price for the Acquisition.

A full description of the Acquisition is contained in a material change report dated June 9, 2011 (the "Material Change Report"), including:

- information relating to the combined business of IFC and AXA Canada;
- information relating to the business of AXA Canada;
- a summary of the terms of the Share Purchase Agreement;
- a summary of the terms of the commitment letter relating to the Acquisition Credit Facilities and a description of the financing of the Acquisition;
- a summary of the terms of the Subscription Receipts and the Subscription Receipt Agreement;
- audited consolidated financial statements for AXA Canada as at and for the year ended December 31, 2010 and unaudited interim consolidated financial statements of AXA Canada as at and for the three months ended March 31, 2011; and
- unaudited *pro forma* financial information, including IFC unaudited *pro forma* consolidated statement of income for the year ended December 31, 2010, IFC unaudited *pro forma* consolidated statement of comprehensive income for the three months ended March 31, 2011 and IFC unaudited *pro forma* balance sheet as at March 31, 2011, in each case, reflecting the Acquisition.

The Material Change Report is available at our SEDAR profile at www.sedar.com.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Canadian P&C insurance industry results – Q1-2011 comparison

The Canadian P&C insurance results for Q1-2011 are available. Highlights are as follows:

	P&C industry ¹	Top 20 Benchmark ²	Intact
DPW growth	3.2%	4.3%	2.6%
Combined ratio ³	97.2%	98.3%	93.2%
Return on equity (YTD annualized)	8.4%	8.3%	21.2%

Industry data source: MSA Research Inc.

¹ Excludes Lloyd's, ICBC, SGI, SAF, MPI and Genworth

² Excludes Lloyd's, Genworth and Intact

³ Combined ratio includes MYA

We continued to outperform the Canadian P&C insurance industry's 20 largest companies ("Top 20 Benchmark") in Q1-2011. While our direct premiums written growth was below the Top 20 Benchmark, our disciplined approach to pricing enabled us to deliver a combined ratio 5.1 percentage points lower than the Top 20 Benchmark during Q1-2011. The combination of superior underwriting results and our capital management activities led to a return on equity outperformance of 12.9 percentage points versus our industry Top 20 Benchmark, despite having over \$784 million of excess capital.

Ontario auto

Last September, the Ontario government's auto reforms were implemented, offering greater choice for consumers while creating a more stable cost environment. The reforms also directly targeted abuse and fraud in the auto insurance system, which increase costs and lead to higher premiums. As time has elapsed following implementation, the initial encouraging signs have gained credibility, and indicate that results for that line of business should improve in the coming 12-15 months. We are more optimistic that the benefits from the reforms will materialize as originally outlined (6 points of loss ratio improvement for the industry). Apart from the government reforms, the Company has taken actions to combat fraud and abuse in the system. Initial signs are encouraging and we believe we can generate additional loss ratio improvement from these actions.

According to industry results, the loss ratio in Ontario auto for Q1-2011, excluding IFC, was 81.8%, improved from 93.5% a year earlier and 101.6% in 2010, as prior rate increases and benefits from auto reforms began to take hold. In the second quarter of 2011, the Financial Services Commission of Ontario ("FSCO") approved rate increases of 3.36% for companies that filed a request.

Capital markets

The Canadian equity market gave back its gains from the beginning of the year in the second quarter, as the S&P/TSX Index decreased 5.8% while the preferred share index was flat. Movements in our equity investment values are generally in line with the equity markets' performance, although our exposures to individual sectors may be different. For example, we do not have significant exposure to materials. The \$21.3 million positive impact on our unrealized gain position in Q2-2011 from the 5 year Government of Canada rate decreasing approximately 41 basis points was partly mitigated by spreads on 5 year corporate bonds widening by an estimated 14 basis points. Overall, the decline in equity markets resulted in a lower unrealized gain position on our equity investment portfolios.

Industry pools

Industry pools consist of the "residual market" (or Facility Association) as well as risk-sharing pools ("RSP") in Alberta, Ontario, Québec, New Brunswick and Nova Scotia. In the first quarter, the net impact of industry pools positively impacted personal auto net underwriting income by \$12.0 million year-over-year, excluding MYA. This variance reflects favourable prior year claims development with significant improvement in Ontario in Q2-2011. Results for industry risk sharing pools tend to fluctuate between periods.

Normal course issuer bid

On February 8, 2011, the Board of Directors authorized the renewal of the Company's NCIB to begin on February 22, 2011, following the expiry of the previous program, to repurchase for cancellation up to 5,523,548 common shares, representing approximately 5% of its outstanding shares. We repurchased 127,000 common shares during the second quarter, but subsequently suspended the NCIB following our announcement of the Acquisition.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Seasonality of the business

The property and casualty insurance business is seasonal in nature. While net premiums earned are generally stable from quarter to quarter, net underwriting income is typically highest in the second quarter of each year. This is driven mainly by weather conditions which may vary significantly between quarters.

Section 5 - Operating results

5.1 Net operating income

Table 2 - Components of net operating income

(in millions of dollars)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Net underwriting income (table 4)	33	66	(50)%	91	135	(33)%
Net investment income (table 9)	75	76	(1)%	149	149	-
Other income, net	7	8	(13)%	7	9	(22)%
Pre-tax operating income	115	150	(23)%	247	293	(16)%
Tax impact	(20)	(31)	n/a	(50)	(61)	n/a
Net operating income	95	119	(20)%	197	232	(15)%

Changes in pre-tax operating income can be further analyzed as follows:

Table 3 - Changes in pre-tax operating income (year-over-year)

(in millions of dollars)	Q2-2011	YTD 2011
Pre-tax operating income, as reported in 2010 (IFRS adjusted)	150	293
Changes in net underwriting income :		
Change in favourable prior year claims development	33	40
Other changes in net underwriting income	20	14
Change in catastrophe losses	(86)	(99)
Change in current accident year income from Facility Association	-	1
Total change in net underwriting income	(33)	(44)
Change in net investment income	(1)	-
Change in other income, net	(1)	(2)
Total change in pre-tax operating income	(35)	(46)
Pre-tax operating income, as reported in 2011	115	247

Operating income (net and pre-tax) and net operating income per share are non-IFRS measures. Net operating income is defined as net income excluding the market yield adjustment and total net gains, after tax. Pre-tax operating income is defined as net operating income before income taxes. Net operating income per share is equal to net operating income for the period divided by the average outstanding number of shares for the same period. These measures are used by management and financial analysts to assess the Company's performance; however, they may not be comparable to similar metrics published by other companies.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

5.2 Underwriting results

Table 4 - Components of underwriting results

(in millions of dollars, except as otherwise noted)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Net premiums earned	1,075	1,054	2%	2,143	2,073	3%
Net claims:						
Current year claims (excluding catastrophes)	666	681	(2)%	1,422	1,392	2%
Current year loss ratio	62.0%	64.6%	(2.6) pts	66.4%	67.1%	(0.7) pts
Current year catastrophes	105	19	453%	118	19	521%
(Favourable) prior year claims development	(72)	(39)	n/a	(154)	(114)	n/a
Total net claims	699	661	6%	1,386	1,297	7%
Claims ratio	65.1%	62.7%	2.4 pts	64.7%	62.6%	2.1 pts
Commissions, premium taxes, general expenses	343	327	5%	666	641	4%
Expense ratio	31.9%	31.0%	0.9 pts	31.1%	30.9%	0.2 pts
Net underwriting income	33	66	(50)%	91	135	(33)%
Combined ratio	97.0%	93.7%	3.3 pts	95.8%	93.5%	2.3%

Second quarter 2011

Net premiums earned were up 2% in Q2-2011, lower than the increase in written premiums over the past 12 months, as a result of \$23 million of reinsurance reinstatement premiums mainly related to the Slave Lake wildfires. The current year loss ratio improved by 3.9 points in Q2-2011 versus Q2-2010 (after adjusting net premiums earned for the impact of reinstatement premiums), largely driven by improved results from our auto businesses. Losses from catastrophes, including Slave Lake and numerous wind and water events in Québec and Ontario in the quarter, amounted to \$105 million and offset higher favourable prior year claims development, explaining the lower underwriting income compared to last year.

Based on an improved recent claims experience, favourable prior year claims development, at 6.9% of opening reserves on an annualized basis, was higher than the 3.9% in Q2-2010, and above the Company's historical level of 3%-4%.

General expenses are higher than last year due to various planned items, including increases in marketing and pension expense, while commission expenses are down as a result of lower profitability. The net impact is a 0.9 percentage point increase in the expense ratio.

Year to date 2011

Net premiums earned were up 3% in the first six months of the year, slightly lower than the increase in written premiums, as a result of reinsurance reinstatement premiums related to the Slave Lake wildfires. The current year loss ratio was 1.4 points improved in H1-2011 versus H1-2010 (after adjusting net premiums earned for the impact of reinstatement premiums), largely driven by improved results from our auto businesses. Losses from catastrophes, including Slave Lake and numerous wind and water events in Québec and Ontario during the year, amounted to \$118 million and offset higher favourable prior year claims development, explaining the lower underwriting income compared to last year.

Based on a continued improved claims experience, favourable prior year claims development, at 7.4% of opening reserves on an annualized basis, was higher than the 5.7% in H1-2010, and above the Company's historical level of 3%-4%.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

5.3 Underwriting results by lines of business – personal lines

Table 5 - Underwriting results for personal lines

(in millions of dollars, except as otherwise noted)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Direct premiums written						
Automobile	674	665	1%	1,133	1,117	1%
Property	321	311	3%	533	512	4%
Total	995	976	2%	1,666	1,629	2%
Written insured risks (thousands)						
Automobile	756	751	1%	1,270	1,262	1%
Property	460	464	(1)%	773	782	(1)%
Total	1,216	1,215	-	2,043	2,044	-
Net premiums earned						
Automobile	549	539	2%	1,089	1,056	3%
Property	250	244	3%	502	481	4%
Total	799	783	2%	1,591	1,537	4%
Net underwriting income (loss)						
Automobile	79	23	244%	91	39	133%
Property	(74)	(1)	n/a	(54)	28	n/a
Total (excluding MYA)	5	22	(77)%	37	67	(45)%
Market yield adjustment	(20)	(20)	n/a	(9)	(18)	n/a
Net underwriting income (loss) (including MYA)	(15)	2	n/a	28	49	(43)%

Table 6 - Underwriting ratios for personal lines

	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Personal auto						
Claims ratio	59.3%	69.3%	(10.0) pts	65.8%	70.0%	(4.2) pts
Expense ratio	26.4%	26.4%	-	25.8%	26.3%	(0.5) pts
Combined ratio	85.7%	95.7%	(10.0) pts	91.6%	96.3%	(4.7) pts
Personal property						
Claims ratio	93.0%	65.0%	28.0 pts	75.1%	58.9%	16.2 pts
Expense ratio	36.5%	35.3%	1.2 pts	35.6%	35.2%	0.4 pts
Combined ratio	129.5%	100.3%	29.2 pts	110.7%	94.1%	16.6 pts
Personal lines – total						
Claims ratio	69.9%	68.0%	1.9 pts	68.7%	66.5%	2.2 pts
Expense ratio	29.5%	29.2%	0.3 pts	28.9%	29.1%	(0.2) pts
Combined ratio	99.4%	97.2%	2.2 pts	97.6%	95.6%	2.0 pts

Second quarter 2011

Direct premiums written growth in personal auto was 1%, as slower growth in our direct businesses, notably in Ontario from our continued prudent approach to growth again impacted DPW in this segment of business. The combined ratio improved significantly from last year to 85.7%, given the meaningful improvement in our loss ratio in Ontario during the quarter and higher favourable prior year claims development (largely attributable to industry pools). The initial encouraging signs from auto reforms have gained credibility, and indicate that results for that line of business should improve in the coming 12-15 months. We are more optimistic that the benefits from the reforms will materialize as originally outlined, but remain disciplined in this market despite the continued improvement in our loss ratio in Ontario auto in Q2-2011. The underlying current year loss ratio (excluding catastrophes and prior year claims development) was lower by 9.1 points year-over-year.

Direct premiums written growth in personal property slowed to 3%, reflecting increases in rates and amounts insured, which was offset by a change in mix and a reduction of units. Growth in the segments where policies are sold as a bundle with auto was also impacted by our approach to growth in our Ontario auto business. Benefits from our actions were overshadowed by substantial losses from catastrophes in the quarter, resulting in a combined ratio of 129.5%, 29.2 points higher than Q2-2010. The Slave Lake wildfires added 20.7 points to the combined ratio in Q2-2011. The underlying current year loss ratio (excluding catastrophes and prior year claims development) was lower by 1.1 points year-over-year.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Year to date 2011

Personal auto underwriting results improved on a year-over-year basis with the combined ratio progressing from 96.3% to 91.6% in the first six months of 2011, mainly due to the continued improvement in Ontario auto. Direct premiums written increased 1% versus the same period in 2010, reflecting the slower growth in our direct businesses, notably in Ontario.

The significant year-over-year drop in underwriting income in personal property was due to an elevated level of catastrophe losses in the first half of 2011, versus favourable weather conditions in the first six months of 2010. The overall combined ratio deteriorated from 94.1% in H1-2010 to 110.7% (100.6% excluding the impact of the Slave Lake wildfires) for the first six months of 2011. Direct premiums written increased 4% reflecting higher premiums, partly offset by a 1% decline in written insured risks.

5.4 Underwriting results by lines of business – commercial lines

Table 7 - Underwriting results for commercial lines

(in millions of dollars, except as otherwise noted)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Direct premiums written						
Automobile	108	101	7%	183	171	7%
P&C	251	241	4%	448	432	4%
Total	359	342	5%	631	603	5%
Written insured risks (thousands)						
Automobile	92	85	8%	156	146	7%
P&C	71	69	3%	127	123	3%
Total	163	154	6%	283	269	5%
Net premiums earned						
Automobile	84	80	5%	166	159	4%
P&C	192	191	1%	386	377	2%
Total	276	271	2%	552	536	3%
Net underwriting income (loss)						
Automobile	21	20	5%	27	24	13%
P&C	7	24	(71)%	27	44	(39)%
Total (excluding MYA)	28	44	(36)%	54	68	(21)%
Market yield adjustment	(11)	(10)	n/a	(5)	(9)	n/a
Net underwriting income (including MYA)	17	34	(50)%	49	59	(17)%

Table 8 - Underwriting ratios for commercial lines

	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Commercial auto						
Claims ratio	43.5%	43.6%	(0.1) pts	52.7%	53.9%	(1.2) pts
Expense ratio	31.9%	31.0%	0.9 pts	30.7%	30.8%	(0.1) pts
Combined ratio	75.4%	74.6%	0.8 pts	83.4%	84.7%	(1.3) pts
Commercial P&C						
Claims ratio	54.5%	49.0%	5.5 pts	52.9%	50.0%	2.9 pts
Expense ratio	41.7%	38.6%	3.1 pts	40.1%	38.4%	1.7 pts
Combined ratio	96.2%	87.6%	8.6 pts	93.0%	88.4%	4.6 pts
Commercial lines – total						
Claims ratio	51.2%	47.4%	3.8 pts	52.9%	51.1%	1.8 pts
Expense ratio	38.8%	36.4%	2.4 pts	37.3%	36.2%	1.1 pts
Combined ratio	90.0%	83.8%	6.2 pts	90.2%	87.3%	2.9 pts

Second quarter 2011

Insured risks were up 8% in commercial auto leading to a 7% increase in direct premiums written in Q2-2011 versus Q2-2010. The combined ratio at 75.4% was slightly higher than last year's very strong 74.6% as higher favourable prior year claims development was offset by lower current accident year results.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

In commercial P&C, direct premiums written growth of 4% was driven by both rate increases and unit growth in major markets, a sign that our actions are generating positive results. The combined ratio was 8.6 points higher than Q2-2010 as higher favourable prior year claims development was offset by lower current accident year results from higher catastrophe losses, the impact of reinsurance reinstatement premiums and higher severity due to large losses.

Year to date 2011

Overall, direct premiums written in commercial lines increased 5% year-to-date with a 5% increase in written insured risks. The growth over the first six months reflects the success of our strategies, which achieved growth in units in spite of rate increases.

The strong year-to-date underwriting performance in commercial auto, with a combined ratio of 83.4%, is slightly better than last year as the drop in current year results was more than offset by higher favourable prior year claims development. In commercial P&C, underwriting results were less strong year-over-year, with a combined ratio of 93.0% as higher favourable prior year claims development was more than offset by the combination of higher catastrophe losses and lower current accident year results.

5.5 Investment income

Table 9

(in millions of dollars, except as otherwise noted)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Interest income	48	48	-	96	96	-
Dividend income	33	33	-	65	63	3%
Investment income, before expenses	81	81	-	161	159	1%
Expenses	(6)	(5)	n/a	(12)	(10)	n/a
Net investment income	75	76	(1)%	149	149	-
Market-based yield	4.2%	4.4%	(0.2) pts	4.1%	4.3%	(0.2) pts

Although our market-based yield declined from 4.4% in Q2-2010 to 4.2% in Q2-2011, net investment income remained stable at \$75 million mainly as a result of the growth in invested assets. The market-based yield is a non-IFRS measure defined as the annualized total pre-tax investment income (before expenses) divided by the average fair values of equity and fixed income securities held during the reporting period. The market-based yield may not be comparable to that of other companies since it is a non-IFRS measure.

5.6 Reconciliation to IFRS net income

Net operating income and net operating income per share are non-IFRS measures and as such must be reconciled to net income under IFRS as it appears in the Company's unaudited interim Consolidated financial statements.

Table 10 - Reconciliation to net income

(in millions of dollars, except as otherwise noted)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Net income	123	141	(13)%	280	282	(1)%
Add losses (deduct gains) excluding FVTPL debt securities (table 12) and others	(44)	(34)	(10)	(128)	(78)	(50)
Add market yield effect (table 13)	4	1	3	9	2	7
Add amortization of intangible assets recognized in business combinations	3	2	1	6	5	1
Add tax impact	9	9	-	30	21	9
Net operating income (excluding MYA)	95	119	(20)%	197	232	(15)%
Average outstanding shares (millions)	109	115	(6)	110	117	(7)
Net operating income per share (in dollars)	0.87	1.04	(0.17)	1.78	1.98	(0.20)

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Section 6 - Non operating results

6.1 Net income before income tax expenses

Non operating results include net investment gains and losses and the market yield effect, all on a pre-tax basis. A summary of changes in net income before income tax expenses is as follows:

Table 11 - Changes in net income before income tax expenses (year-over-year)

(in millions of dollars, except as otherwise noted)	Q2-2011	YTD 2011
Net income before income tax expenses, as reported in 2010 (IFRS adjusted)	181	364
Change in pre-tax operating income (table 3)	(35)	(46)
Change in net investment gains (losses) excluding FVTPL debt securities (table 12)	10	50
Change in market yield effect (table 13)	(4)	(8)
Net income before income tax expenses, as reported in Q2-2011	152	360
Income tax	29	(80)
Net income reported in 2011	123	280

6.2 Net investment gains (losses)

Table 12

(in millions of dollars)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Debt securities						
Gains on available for sale ("AFS") securities	3	1	2	3	7	(4)
Losses on derivatives	(4)	(2)	(2)	(3)	(2)	(1)
Gains (losses) on fixed income securities and related derivatives	(1)	(1)	-	-	5	(5)
Equity securities						
Gains, net of stand-alone derivatives	48	14	34	146	65	81
Impairment losses	(4)	(5)	1	(6)	(8)	2
Gains (losses) on embedded derivatives	1	26	(25)	(12)	16	(28)
Gains on equity securities and related derivatives	45	35	10	128	73	55
Total gains excluding FVTPL debt securities	44	34	10	128	78	50
Gains (Losses) on FVTPL debt securities	27	29	(2)	5	25	(20)
Total net gains, before income taxes	71	63	8	133	103	30

The Company recorded net investment gains of \$44 million excluding FVTPL bonds, compared to gains of \$34 million in Q2-2010. The gains resulted mainly from the continued rebalancing and normal rolling of the Company's common share portfolio during the quarter, but were magnified by the unrealized gain position of the portfolio.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

6.3 Market yield effect

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 called Market Yield Adjustment (“MYA”). The MYA to claims liabilities is offset by gains and losses on FVTPL fixed income securities with the objective that these items offset each other with a minimal overall impact to income. The difference between the MYA and the gains and losses on FVTPL fixed income securities is referred to as the “market yield effect” in this MD&A.

The process of matching the weighted-dollar duration of the claims liabilities to assets classified as FVTPL works well under normal conditions. However, market fluctuations, changes in yield curve, trading and changes in asset mix can result in a positive or negative market yield effect.

Table 13 - Market yield effect

(in millions of dollars, except as otherwise noted)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Negative impact of MYA on underwriting	(31)	(30)	(1)	(14)	(27)	13
Net gains on FVTPL debt securities	27	29	(2)	5	25	(20)
Market yield effect	(4)	(1)	(3)	(9)	(2)	(7)

Section 7 - Investments

The Company's portfolio of investments is managed by Intact Investment Management Inc. (“IIM”), a wholly owned subsidiary of Intact Financial Corporation. The assets are managed by IIM in accordance with the Company's investment policy which has not substantially changed since December 31, 2010.

7.1 Investment mix

Table 14 - Investment mix (in accordance with IFRS)

	June 30, 2011	As a % of Total	December 31, 2010	As a % of Total
Short-term notes, including cash and cash equivalents	93	1%	501	6%
Fixed income securities	4,625	54%	4,458	52%
Preferred shares	1,558	18%	1,503	17%
Common shares	2,018	23%	1,877	22%
Loans	331	4%	314	3%
Total investments	8,625	100%	8,653	100%

The Company's cash and short-term investments are typically used in the first quarter of each year to cover the Company's seasonal outflows. This explains the reduction of cash and short-term investments since the end of 2010.

The following table illustrates the Company's asset mix after reflecting the impact of hedging strategies.

Table 15 - Investment mix (net of hedging positions)

	June 30, 2011	As a % of Total	December 31, 2010	As a % of Total
Short-term notes, including cash and cash equivalents	93	1%	501	6%
Fixed income securities	5,167	66%	4,857	61%
Preferred shares	1,236	16%	1,252	16%
Common shares	1,035	13%	1,027	13%
Loans	331	4%	314	4%
Total investments	7,862	100%	7,951	100%

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

7.2 Quality of the investment portfolio

The investment portfolio includes high-quality government and corporate bonds, as well as Canadian equity securities of large, publicly-traded, dividend-paying companies. Approximately 99.2% of the bonds are rated 'A' or better and 79.9% of the preferred shares are highly-rated as 'P1' or 'P2'. In addition, IFC does not invest in leveraged securities and the exposure to the U.S. market is minimal. IFC manages its investments prudently to protect capital and generate superior after-tax returns.

Net pre-tax unrealized gains and losses on available-for-sale securities

Table 16

(in millions of dollars)	IFRS					Canadian GAAP
	June 30, 2011	March 31, 2011	December 31, 2010	September 30, 2010	June 30, 2010	December 31, 2010
Debt securities	40	19	37	73	53	37
Common shares	56	101	139	98	19	117
Preferred shares	245	281	262	244	196	(46)
Total net pre-tax unrealized gains (losses) position	341	401	438	415	268	108

The Company also adopted the IFRS impairment criteria for its AFS securities on transition to IFRS. The above unrealized gains at each quarter have been restated accordingly. The impact of adopting the new criteria was the retroactive recognition of impairment losses which impacted the opening balance sheet under IFRS as explained in section 10.3. Subsequent changes to the market values of the impaired securities were recorded as unrealized gains and losses in accumulated other comprehensive income ("AOCI"). These gains and losses are realized when the securities are sold.

In determining the fair value of investments, the Company relies mainly on quoted market prices. There are no investments in the AFS or FVTPL categories which are not quoted on an active market, except for a limited amount of fixed income securities that the Company holds.

Impairment recognition

Under IFRS, the Company determines, at each balance sheet date, whether there is objective evidence that available-for-sale equity instruments are impaired. Objective evidence for an available-for-sale equity instrument also includes a significant or prolonged decline in fair value of the instrument below its cost.

Table 17 - Aging of unrealized losses on AFS common shares

(in millions of dollars, except as otherwise noted)	IFRS					Canadian GAAP
	June 30, 2011	March 31, 2011	December 31, 2010	September 30, 2010	June 30, 2010	December 31, 2010
Less than 25% below book value	24	8	10	15	24	13
More than 25% below book value for less than 6 consecutive months	3	2	-	2	9	-
More than 25% below book value for more than 6 consecutive months	4	-	1	5	-	1
Net unrealized losses on AFS common shares	31	10	11	22	33	14

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Section 8 - Selected quarterly information

Table 18

(in millions of dollars, except as otherwise noted)	IFRS						Canadian GAAP		
	Q2-2011	Q1-2011	Q4-2010	Q3-2010	Q2-2010	Q1-2010	Q4-2009	Q3-2009	Q2-2009
Written insured risks (thousands)	1,379	946	1,054	1,247	1,369	944	1,046	1,244	1,376
Direct premiums written (excluding pools)	1,354	943	1,060	1,206	1,318	914	1,011	1,144	1,251
Total revenues	1,247	1,225	1,196	1,226	1,220	1,148	1,125	1,116	1,065
Net premiums earned	1,075	1,068	1,092	1,067	1,054	1,019	1,037	1,019	1,011
(Favourable) unfavourable prior year claims development	(72)	(81)	(53)	(25)	(39)	(75)	(66)	(14)	(7)
Net underwriting income (loss)	33	58	22	37	66	69	56	(53)	43
Combined ratio (%)	97.0%	94.6%	98.0%	96.6%	93.7%	93.2%	94.6%	105.2%	95.7%
Net operating income	95	101	80	90	119	113	98	22	93
Net income (loss)	123	157	106	109	141	141	97	(8)	74
EPS basic/diluted (dollars)	1.12	1.42	0.95	0.96	1.22	1.19	0.81	(0.07)	0.62
Net operating income per share (dollars)	0.87	0.91	0.71	0.79	1.04	0.95	0.82	0.18	0.77

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Section 9 - Financial condition

9.1 IFRS Balance sheet highlights

The table below shows the significant balance sheet captions as at June 30, 2011, December 31, 2010 and January 1, 2010.

Table 19

(in millions of dollars, except as otherwise noted)	As at		
	June 30, 2011	December 31, 2010	January 1, 2010
Investments			
Cash and cash equivalents	12	138	60
Debt securities	4,706	4,821	4,784
Preferred shares	1,558	1,503	1,582
Common shares	2,018	1,877	1,312
Loans	331	314	319
Total investments	8,625	8,653	8,057
Premiums receivables	1,850	1,762	1,640
Deferred acquisition costs	437	420	396
Reinsurance assets	311	235	261
Intangible assets and goodwill	392	381	338
Other assets	654	624	619
Total assets	12,269	12,075	11,311
Claims liabilities	4,541	4,379	4,270
Unearned premiums	2,662	2,586	2,464
Debt outstanding	496	496	398
Financial liabilities	801	715	406
Other liabilities	827	930	856
Total liabilities	9,327	9,106	8,394
Share capital and contributed surplus	1,070	1,089	1,144
Retained earnings	1,689	1,596	1,527
Accumulated other comprehensive income	183	284	246
Shareholders' equity	2,942	2,969	2,917
Book value per share (dollars)	26.89	26.47	24.33

Cash and cash equivalents

See Section 9.4 - *Liquidity and capital resources*.

Investments

See Section 7 - *Investments*.

Premiums receivable, deferred acquisition costs and unearned premiums

The increase in premiums receivable, deferred acquisition costs and unearned premiums is consistent with the growth and seasonality of the business.

Reinsurance assets

Reinsurance assets, which comprise recoverable reserves and ceded unearned premiums, have increased mostly due to reinsurance recoverables on natural catastrophes.

Other assets

The increase in other assets reflects increases in prepaid balances.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Shareholders' equity

See Section 9.3 – Shareholders' equity.

9.2 Prior year claims development (excluding MYA)

The following table shows the development of claims liabilities for the 10 most recent accident years. The reserve estimates are evaluated quarterly for redundancy or deficiency. The evaluation is based on actual payments in full or partial settlement of insurance contracts and current estimates of claims liabilities for claims still open or claims still unreported. Prior year claims development can fluctuate from quarter to quarter and year to year, and therefore, should be evaluated over longer periods of time. The historical rate of favourable prior year claims development as a percentage of opening claims has been approximately 3%-4% per year over the long term.

Table 20

(in millions of dollars, except as otherwise noted)	Total	Accident year									
		2010	2009	2008	2007	2006	2005	2004	2003	2002	2001 & earlier
Original reserve		1,488	1,430	1,376	1,282	1,178	1,119	1,118	973	839	2,418
(Favourable) unfavourable development during Q2-2011 excluding MYA	(72)	(54)	(2)	(1)	(4)	(6)	-	(2)	(4)	(1)	2
(Favourable) unfavourable development during YTD-2011 excluding MYA	(154)	(100)	(7)	(1)	(10)	(12)	(9)	(6)	(5)	(4)	-
Cumulative development As a % of original reserve		(6.7)%	(6.0)%	(3.8)%	(3.5)%	(7.1)%	(14.9)%	(26.3)%	(22.8)%	(6.6)%	2.7%

Table 21 - Annualized rate of favourable prior year claims development

(annualized rate)	Q2-2011	Q2-2010	Full year 2010
(Favourable) unfavourable prior year claims development as a % of opening reserves	(6.9)%	(3.9)%	(4.8)%

Q2-2011 favourable prior year claims development was an annualized 6.9%. Excluding MYA, favourable prior year claims development was \$72 million in the second quarter of 2011 (compared to \$39 million in Q2-2010).

9.3 Shareholders' equity

Share capital

As at August 2, 2011 there were 109,428,665 common shares issued and outstanding. Refer to the Company's Annual Information Form for more detailed information on the rights of common shareholders.

On June 9, 2011, the Company completed its Subscription Receipt Offering, resulting in the issuance of 20,125,000 Subscription Receipts that are each convertible into a common share upon closing of the Acquisition.

On July 12, 2011, the Company closed an offering of 10,000,000 Series 1 Preferred Shares. The Series 1 Preferred Shares are convertible into Non-cumulative Floating Rate Class A Shares Series 2 (the "Series 2 Preferred Shares"), subject to certain conditions, on December 31, 2017 and on December 31 every five years thereafter.

See section 9.4 - Liquidity and capital resources for more information.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Long-term incentive plan

Members of Management and certain key employees participate in the long term incentive program of the Company ("LTIP"). Under the initial LTIP, these employees were granted each year share units as a portion of their remuneration. Each such award vests and is paid out in shares at the end of a three-year performance cycle based on determined Company's metrics relative to the Canadian P&C insurance industry (the "industry"); such shares are restricted and cannot be traded for an additional period of two years after vesting.

The Board of Directors approved a change to the LTIP in 2010. Under this new program, participants are awarded notional share units referred to as Performance Stock Units ("PSUs") and Restricted Stock Units ("RSUs"). The payout for the PSUs is based on a specific target composed of the difference between the three-year average return on equity of the Company and that of the Canadian P&C industry. RSUs automatically vest three years from the year of the grant. Vesting for RSUs is not linked to the Company's performance.

The Company re-estimates the number of awards that are expected to vest at each reporting date. At the time of the payout, the Company purchases on the market an amount of common shares based upon the performance targets achieved with respect to the vesting of the PSU and an amount of common shares equal to the amount of RSU with respect to the vesting of RSU. This type of compensation is measured at the fair value of the award at the grant date and recognized as an expense over the vesting period with a corresponding increase reported in contributed surplus.

As at June 30, 2011, the number of PSUs and RSUs accrued by participants was 614,045 and 265,760, respectively for a total outstanding of 879,805 units.

Accumulated other comprehensive income (loss)

AOCI reflects the net unrealized gains related to AFS assets and the net actuarial gains or losses related to employee future benefit plans.

Table 22

(in millions of dollars)	June 30, 2011		
	Pre-tax	Taxes	After-tax
Opening net unrealized gains (losses) on January 1, 2011 (IFRS adjusted)	396	(112)	284
Change in fair values during the period	56	(18)	38
Realized net gains (losses) reclassified to income during the period	(152)	43	(109)
Net actuarial gains (losses) on employee future benefit plans	(41)	11	(30)
Net unrealized AFS and actuarial gains (losses) at June 30, 2011	259	(76)	183

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

9.4 Liquidity and capital resources

Cash flows

Table 23 - Cash flow and liquidity

(in millions of dollars)	Q2-2011	Q2-2010	Change	YTD 2011	YTD 2010	Change
Selected inflows (outflows)						
Operating activities:						
Cash provided by operating activities	92	195	(103)	76	168	(92)
Investing activities:						
Net cash inflows (outflows) from sales (purchases) of investments	(92)	(138)	46	46	132	(86)
Net purchases of brokerages and books of business and property and equipment	(19)	(20)	1	(38)	(39)	1
Financing activities:						
Dividends paid	(40)	(39)	(1)	(81)	(79)	(2)
Net proceeds from debt issuance	-	-	-	-	98	(98)
Common shares repurchased for cancellation	(7)	(74)	67	(129)	(241)	112
Change in cash and cash equivalents during the period	(66)	(76)	10	(126)	39	(165)

Lower cash flow mostly explained by increased commission payouts and timing of supplier payments.

Capital management

As at June 30, 2011, the Company had a total of \$758 million in excess capital over an MCT of 170% compared to total excess capital of \$807 million at the end of 2010. The decline in excess capital position reflects the common shares repurchased under the NCIB for a total consideration of \$129 million and dividends paid to shareholders of \$81 million partly offset by the profitability for the first six months of 2011.

The capital of the Company is managed on a consolidated basis as well as individually for each regulated subsidiary. The P&C insurance subsidiaries of the Company are subject to the regulatory capital requirements defined by OSFI and the Insurance Companies Act ("ICA"). OSFI has established an MCT guideline which sets out 100% as the minimum and 150% as the supervisory target MCT standards for P&C insurance companies. Taking into account Intact's most significant risks that could deteriorate its capital position below the supervisory target and forecasted business environment, the Company established an internal target MCT of 170%.

The following table presents the MCT ratio of the Company's insurance subsidiaries with a total for all companies. The Company's MCT level at June 30, 2011 was very strong at 227.5%. The decrease from December 31, 2010 mainly reflects increased capital requirements on claims liabilities due to growth of the business and on the change in investment mix.

Table 24 - MCT – P&C Insurance Companies

(in millions of dollars, except as otherwise noted)	Intact Insurance	Belair Insurance	Nordic Insurance	Novex Insurance	Trafalgar Insurance	Total
At June 30, 2011						
Total capital available	1,894	226	302	229	208	2,859
Total capital required	837	101	116	107	96	1,257
Excess capital	1,057	125	186	122	112	1,602
MCT %	226.3%	223.7%	259.6%	213.7%	218.7%	227.5%
Excess at 150%	639	75	127	68	65	974
Excess at 170%	471	54	104	47	46	722
At December 31, 2010						
Total capital available	1,923	233	384	226	203	2,969
Total capital required	843	99	144	99	87	1,272
Excess capital	1,080	134	240	127	116	1,697
MCT %	228.1%	234.8%	266.7%	229.4%	233.1%	233.4%
Excess at 150%	659	84	168	78	73	1,062
Excess at 170%	490	64	139	59	55	807

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Total capital available and total capital required represent amounts applicable to the Company's P&C insurance subsidiaries and are determined in accordance with prescribed OSFI rules. Total capital available mostly represents total equity less specific deductions for disallowed assets including goodwill and intangibles. Total capital required is calculated by classifying assets and liabilities into categories and applying prescribed risk factors to each category. As at June 30, 2011, the Company's P&C insurance subsidiaries were in compliance with both OSFI and ICA requirements as well as being above internal targets.

MCT sensitivity

The MCT is impacted by many factors including changes in equity market performance, interest rates and underwriting profitability. Based on IFC's MCT of 227.5% as at June 30, 2011, the following table sets out the estimated immediate impact or sensitivity of the Company's MCT ratio to certain sudden but independent changes in interest rates and equity market prices as at June 30, 2011. Actual results can differ materially from these estimates for a variety of reasons and therefore these sensitivities should be considered as directional estimates of the underlying factors.

Table 25 - MCT Sensitivity

	Interest Rate ¹ 1% Increase	Equity Markets ² 10% Decline
MCT Impact ⁽³⁾	(5)%	(4)%

¹ The yield curve experiences an instantaneous parallel shift.

² A shock of -10% is applied to all common share holdings net of any equity hedges that the Company may have. In addition, a shock of approximately -5% is applied to all preferred shares.

³ Capital sensitivities are calculated independently for each risk factor and assume that all other risk variables remain constant. No management action is considered.

Credit ratings

Following the announcement of the Acquisition (see section 4), DBRS has affirmed its rating mainly based on the strategic fit, strong financial performance of AXA Canada, robust projected pro forma earnings coverage and the Company's intention to reduce leverage over the near term. However, Moody's has put IFC and its regulated subsidiaries under review. Assuming the acquisition closes as proposed, Moody's expects to lower IFC's and its regulated subsidiaries ratings by one notch as they believe that benefits from the enhanced business profile are offset by higher leverage and a significant increase in goodwill and intangibles. A.M. Best has put IFC and its regulated subsidiaries under review with negative implications to reflect increased financial leverage, significant amount of goodwill and intangibles and execution risk associated with the integration. The ratings will remain under review until completion of the transaction and until A.M. Best conducts further analysis and discussions with management.

Table 26 - Financial strength ratings and credit ratings

	A. M. Best	Moody's	DBRS
Credit ratings of Intact Financial Corporation	a-	A3	A (low)
Financial strength ratings of the insurance subsidiaries of Intact Financial Corporation	A+	Aa3	n/a
	Under review with negative implication on June 6, 2011	Under review with possible downgrade on May 31, 2011	Affirmed on May 31, 2011

Financing

Subscription Receipts Offering

IFC entered into an underwriting agreement on June 2, 2011 with a syndicate of underwriters, co-led by CIBC World Markets Inc. and TD Securities Inc. (the "Underwriters"), under which the Underwriters agreed to purchase from IFC and sell to the public 17,500,000 subscription receipts at a price of \$47.80 per Subscription Receipt for gross proceeds to IFC of \$837 million with an over-allotment option to purchase an additional 2,625,000 subscription receipts exercisable at the same offering price for an additional \$125 million.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

The gross proceeds from the Offering will be held in escrow and are intended to be used by IFC to fund a portion of the purchase price for the Acquisition. The closing of the Acquisition is expected to occur in the fall of 2011 and is subject to receipt of insurance regulatory approvals and the satisfaction of certain closing conditions.

If the Acquisition is not completed by January 31, 2012 or if the Share Purchase Agreement relating to the Acquisition is terminated in accordance with its terms before that date, the holders of Subscription Receipts will be entitled to receive their full subscription price together with their share of any interest that was earned during the term of escrow (less any applicable withholding taxes, if any).

On June 9, 2011, the Offering was closed, resulting in gross proceeds to IFC of \$962 million (including the proceeds from the exercise of the over-allotment option by the Underwriters) and the subscription receipts commenced trading on the Toronto Stock Exchange under the symbol IFC.R.

Preferred Share Offering

IFC entered into an agreement to issue and sell 9,000,000 Non-cumulative Rate Reset Class A Shares Series 1, on June 22, 2011, at a price of \$25.00 per Series 1 Preferred Share, for aggregate gross proceeds of \$225 million to a syndicate of underwriters led by CIBC, RBC Capital Markets, Scotia Capital Inc. and TD Securities Inc. with an over-allotment option to purchase an additional 1,000,000 Series 1 Preferred Shares, at the same price for an additional \$25 million. The net proceeds of the offering, together with the proceeds of the Subscription Receipt Offering, are intended to fund a portion of the purchase price of the Acquisition.

The holders of Series 1 Preferred Shares will be entitled to receive fixed non-cumulative preferential cash dividends, as and when declared by the Board of Directors of Intact, on a quarterly basis, for the initial fixed rate period ending on December 31, 2017, based on an annual rate of 4.20%. The dividend rate will be reset on December 31, 2017 and every five years thereafter at a rate equal to the 5-year Government of Canada bond yield plus 1.72%. Holders will have the right to convert their Series 1 Preferred Shares into Non-cumulative Floating Rate Class A Shares Series 2, subject to certain conditions, on December 31, 2017 and on December 31 every five years thereafter. The holders of Series 2 Preferred Shares will be entitled to receive floating rate non-cumulative preferential cash dividends, as and when declared by the Board of Directors of Intact, at a rate equal to the 90-day Canadian Treasury Bill rate plus 1.72%. The offering closed on July 12, 2011, resulting in gross proceeds to IFC of \$250 million (including the over allotment option proceeds).

Term Notes ("Notes")

On July 8, 2011, IFC issued \$100 million aggregate principal amount of unsecured 50-year term notes due July 8, 2061 by way of private placement. The Series 3 Notes will be direct unsecured obligations of IFC and will rank equally with all other unsecured and unsubordinated indebtedness of IFC. The Series 3 Notes will bear interest at the rate of 6.20% per annum payable semi-annually. The net proceeds of the Series 3 Notes are intended to fund a portion of the purchase price for the Acquisition.

The following table details the two series of the Company's current debt outstanding as at June 30, 2011:

Table 27

(in millions of dollars, except as otherwise noted)	Medium term notes	
	Series 1	Series 2
Date issued	August 31, 2009	November 23, 2009 and March 23, 2010
Maturity date	September 3, 2019	November 23, 2039
Principal amount outstanding	\$250	\$250
Fixed annual	5.41%	6.40%
Semi-annual coupon payment due on:	March 3, September 3	May 23, November 23

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Table 28 - Fair value and carrying value of medium term notes

	As at June 30, 2011		As at December 31, 2010		As at January 1, 2010	
	Carrying value	Fair value	Carrying value	Fair value	Carrying value	Fair value
Medium term notes, series 1	249	267	249	265	249	253
Medium term notes, series 2	247	268	247	269	149	147
Total debt outstanding	496	535	496	534	398	400

Credit Facilities

The Company has a three-year unsecured, revolving term facility of \$250 million which matures on December 20, 2013. This credit facility may be drawn as prime loans at the prime rate plus a margin or as bankers' acceptances at the bankers' acceptance rate plus a margin. Under the terms of the facility, the Company must maintain a debt to total capital ratio of 25% or less and maintain an interest coverage ratio of 3 to 1. As of June 30, 2011, the Company had not drawn down under the facility and was in full compliance with the covenants of the facility.

On May 31, 2011, IFC entered into a commitment letter with the Acquisition Lender' pursuant to which the Acquisition lender has agreed, on its own behalf and in its capacity as administrative agent, to provide the Acquisition Credit Facilities' for the purpose of funding a portion of the purchase price for the Acquisition. Furthermore, the Acquisition Lender has agreed to make available a revolving loan facility in the aggregate principal amount of \$250 million (the "Revolving Facility") that will be available from and after the completion of the Acquisition to replace IFC's existing revolving credit facility.

The Acquisition Credit Facilities are comprised of a 12-month bridge facility in the amount of \$500 million (the "Bridge Facility"); a two-year term loan facility in the amount of \$500 million (the "Tranche A Facility"); and a three-year term loan facility in the amount of \$300 million (the "Tranche B Facility"). As part of the covenants under the Acquisition Credit Facilities and the Revolving Facility, IFC will be required to maintain:

- (a) an interest coverage ratio on a consolidated basis of not less than 3:1; and,
- (b) a ratio of funded debt to total capitalization on a consolidated basis of not greater than 0.25:1 provided that:
 - i. this ratio will be temporarily increased to not greater than 0.35:1 if IFC draws down the Bridge Facility at the closing of the Acquisition and subsequently reduced to 0.30:1 when the Bridge Facility has been repaid in full and reduced further to 0.25:1 on the date that is 12 months after the closing date of the Acquisition;
 - ii. this ratio will be 0.30:1 if IFC has not drawn down the Bridge Facility at the closing of the Acquisition and subsequently reduced to 0.25:1 on the date that is 12 months after the closing date of the Acquisition.

Base Shelf Prospectus and MTN Supplement

On July 5, 2011, IFC obtained a receipt for a final short form base shelf prospectus filed with the securities regulatory authorities in each of the provinces and territories of Canada that will allow the Company to offer up to \$2.5 billion in any combination of debt, preferred or common share securities, subscription receipts, warrants, share purchase contracts and units over the next 25 months. This prospectus replaces a similar one filed in May 2009, which expired in June. The Company also filed a supplement to its base shelf prospectus to establish a medium term note ("MTN") program that would allow the Company to issue up to \$750 million in unsecured medium term notes. The preferred share and term notes offerings were not done under the base shelf prospectus and the MTN supplement.

Dividend increase

On February 8, 2011, the Board of Directors increased the quarterly dividend by 9%, or three cents, to 37 cents per share on its outstanding common shares. The decision reflected the Company's objective of returning value to shareholders, the strength of the Company's financial position and quality of operating earnings. This is the sixth consecutive year the Company has increased its dividend. A quarterly dividend of \$41 million was paid on June 30, 2011 to shareholders of record on June 15, 2011.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Normal course issuer bid

On February 22, 2010, the Company commenced a normal course issuer bid ("NCIB") to purchase during the next 12 months ending February 21, 2011, up to 5% of its public float. On August 5, 2010, the Company announced an increase in the maximum number of shares it could repurchase under the NCIB from 5% to 10% of its public float. On February 9, 2011 the Company announced that it would renew its NCIB program to repurchase approximately 5% of its outstanding shares. The new program began on February 22, 2011 for a 12-month period. We have suspended the NCIB following our announcement of the Acquisition.

As at June 30, 2011, 2.8 million (June 30, 2010 – 5.6 million) common shares had been repurchased for cancellation under the NCIB at an average price of \$47.03 per share (June 30, 2010 - \$43.43 per share) for a total consideration of \$129 million (June 30, 2010 - \$241 million). Total cost paid, including fees, was first charged to share capital to the extent of the average carrying value of the common shares purchased for cancellation and the excess of \$105 million (June 30, 2010 - \$192 million) was charged to retained earnings.

Table 29 – Normal course issuer bid

	Maximum shares to be purchased (in units)	Three-month period ended June 30, 2011	YTD June 30, 2011	From inception to June 30, 2011
February 22, 2010 to February 21, 2011 Program	11,955,826			
Number of common shares repurchased for cancellation (in units)		-	1,979,500	9,706,502
Weighted-average price per share (in dollars)		-	\$46.69	\$44.61
Consideration paid (in millions of dollars)		-	\$91	\$433
February 22, 2011 to February 21, 2012 Program	5,523,548			
Number of common shares repurchased for cancellation (in units)		127,000	771,400	771,400
Weighted-average price per share (in dollars)		\$49.73	\$47.89	\$47.89
Consideration paid (in millions of dollars)		\$7	\$38	\$38
Total for the period				
Number of common shares repurchased for cancellation (in units)		127,000	2,750,900	n/a
Weighted-average price per share (in dollars)		\$49.73	\$47.03	n/a
Consideration paid (in millions of dollars)		\$7	\$129	n/a

Off-balance sheet arrangements

Securities lending

The Company participates in a securities lending program to generate fee income. This program is managed by the Company's custodian, a major Canadian financial institution, whereby the Company lends securities it owns to other financial institutions to allow them to meet their delivery commitments. As at June 30, 2011, the Company had loaned securities (which are reported in Investments on the Company's unaudited interim Consolidated balance sheet) with a fair value of \$1,712 million (compared to \$1,332 million as at December 31, 2010). Collateral is provided by the counterparty and is held in trust by the custodian for the benefit of the Company until the underlying security has been returned to the Company. The collateral cannot be sold or re-pledged externally by the Company, unless the counterparty defaults on its financial obligations. Additional collateral is obtained or refunded on a daily basis as the market value of the loaned securities fluctuates. The collateral consists of government securities with an estimated fair value of 105% of the fair value of the loaned securities and amounts to \$1,797 million at June 30, 2011 (compared to \$1,399 million as at December 31, 2010).

Section 10 - Accounting and disclosure matters**10.1 Internal controls over financial reporting**

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

To facilitate the adoption of IFRS, the Company has implemented a one-time control over the transition to IFRS. However, no significant changes were made to the Company's on-going internal controls over financial reporting during the period ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

10.2 Critical accounting estimates and assumptions

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period. The results of the Company reflect management's judgments regarding the impact of prevailing global credit and equity market conditions. Given the uncertainty surrounding the continued volatility in these markets, and the general lack of liquidity in financial markets, the actual financial results could differ from those estimates.

10.3 International Financial Reporting Standards

The Company's unaudited interim Consolidated financial statements have been prepared in accordance with IFRS. The Company's principal accounting policies under IFRS are included in Note 2 to the unaudited interim Consolidated financial statements as at and for the period ending March 31, 2011. Those policies which have been significantly impacted by transition to IFRS are summarized below.

Employee future benefits – Net actuarial gains and losses

Under Canadian GAAP, net actuarial gains and losses resulting from the fluctuation of the benefit plan obligation present value and the fair value of the benefit plan assets were subject to amortization under the "corridor" approach. Under IFRS, entities have the choice of recognizing ongoing actuarial gains and losses in the income statement over time similar to the "corridor" approach, or alternatively, immediately recognizing actuarial gains and losses in OCI in the period in which they occur.

The Company has elected to recognize actuarial gains and losses immediately in OCI. The present value of the accrued benefit obligations, net of the fair value of plan assets are, therefore, recognized on the unaudited interim Consolidated balance sheet. The Company believes this accounting policy provides greater transparency to shareholders and stakeholders. The transition adjustment under IFRS for this accounting policy choice was a net reduction in shareholders' equity of \$101 million after-tax as at December 31, 2010 (see Table 31).

Financial instruments

Under Canadian GAAP, available-for-sale equity instruments were measured at fair value with changes in fair value reported, net of income taxes, to OCI until the asset was disposed of or had become other than temporarily impaired. At the end of each balance sheet date a quantitative assessment was made to identify available-for-sale equity instruments which had a significant or prolonged decline in fair value. Management then applied judgment based on each issuer's financial condition to determine if the decline was "other than temporary" and if objective evidence of impairment existed.

Under IFRS, the impairment assessment is similar but is less judgmental as determination of whether an available-for-sale equity instruments decline is "other than temporary" is not required. Therefore, impairment losses under IFRS will likely be recognized earlier than under Canadian GAAP. In addition, under IFRS perpetual preferred shares are assessed for impairment using the equity impairment rules, whereas under Canadian GAAP debt impairment rules were appropriate.

At the transition date to IFRS, retrospective application of these rules was required. This resulted in reclassification from OCI to opening retained earnings for impairments which would have occurred prior to January 1, 2010 under IFRS rules. This

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

reclassification has no overall impact on the Company's shareholders' equity (see Table 31). Net investment gains (losses) reported under Canadian GAAP for the financial year 2010 were restated under IFRS as these prior period IFRS impairments impact the measurement of realized gains and losses in 2010 under IFRS (see Table 30).

The following tables reconcile our restatements of previously reported key indicators under Canadian GAAP to IFRS.

Table 30 - Reconciliation of the key profitability indicators for the three-month and six-month periods ended June 30, 2010 and December 31, 2010.

For the three months ended June 30, 2010	Canadian GAAP	Employee future benefits and other adjustments	Financial instruments	IFRS
Net income	120	(2)	23	141
Net operating income	119	-	-	119
Earnings per share – basic and diluted (in dollars)	1.04	(0.02)	0.20	1.22
Net operating income per share (in dollars)	1.03	0.01	-	1.04
Return on equity ("ROE") YTD annualized				n/a
Operating return on equity YTD annualized				n/a
For the six months ended June 30, 2010				
Net income	240	(3)	45	282
Net operating income	231	1	-	232
Earnings per share ("EPS") – basic and diluted (in dollars)	2.05	(0.03)	0.38	2.40
Net operating income per share (in dollars)	1.97	0.01	-	1.98
Return on equity ("ROE") YTD annualized				19.7%
Operating return on equity YTD annualized				17.6%
For the year ended December 31, 2010				
Net income	420	(4)	81	497
Net operating income	399	3	-	402
Earnings per share ("EPS") – basic and diluted (in dollars)	3.65	(0.03)	0.70	4.32
Net operating income per share (in dollars)	3.47	0.03	-	3.50
Return on equity ("ROE") YTD annualized	13.9%	0.2 pts	2.8 pts	16.9%
Operating return on equity YTD annualized	13.2%	1.8 pts	-	15.0%

Table 31 - Reconciliation of the key financial position indicators as at January 1, 2010 and December 31, 2010.

As at January 1, 2010	Canadian GAAP	Employee future benefits and other adjustments	Financial instruments	IFRS
Total assets	11,351	(40)	-	11,311
Total liabilities	8,369	25	-	8,394
Share capital and contributed surplus	1,144	-	-	1,144
Retained earnings	1,902	(65)	(310)	1,527
Accumulated other comprehensive income (loss)	(64)	-	310	246
Shareholders' equity	2,982	(65)	-	2,917
Book value per share (in dollars)	24.88	(0.55)	-	24.33
As at December 31, 2010				
Total assets	12,149	(74)	-	12,075
Total liabilities	9,079	27	-	9,106
Share capital and contributed surplus	1,089	-	-	1,089
Retained earnings	1,894	(70)	(228)	1,596
Accumulated other comprehensive income (loss)	87	(31)	228	284
Shareholders' equity	3,070	(101)	-	2,969
Book value per share (in dollars)	27.37	(0.90)	-	26.47

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

10.4 New accounting standards and policies

Future accounting changes

The Company made no significant accounting policy changes for the three-month period ended June 30, 2011.

Standards issued but not yet effective

The Company is currently analyzing the impact the following standards will have on its Consolidated financial statements:

Financial instruments: Classification and Measurement

In November 2009, the IASB issued IFRS 9 - *Financial Instruments*. This standard represents the completion of the first part of a three-part project to replace IAS 39 - *Financial Instruments: recognition and measurement*. The new standard reduces complexity by replacing the many different rules in IAS 39. The key features for the new standard are as follows:

- a business model test is applied first in determining whether a financial asset is eligible for amortized cost measurement. The business model objective is based on holding financial assets in order to collect contractual cash flows rather than realizing cash flows from the sale of the financial assets,
- in order to be eligible for amortized cost measurement an asset must have contractual cash flow characteristics representing principal and interest,
- all other financial assets are measured at fair value on the balance sheet,
- an entity can elect on initial recognition to present the fair value changes on an equity investment that is not held for trading directly in OCI. The dividends on investments for which this election is made must be recognized in Net income (loss) attributable to shareholders but gains or losses are not removed from OCI when the equity investment is disposed of, and
- if a financial asset is eligible for amortized cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch.

The standard is effective for years beginning on or after January 1, 2013. The IASB are preparing to re-expose IFRS 9 in the second half of 2011. Further, an IASB staff paper has recommended that the re-exposed standard only be effective for years beginning on or after January 1, 2015.

Consolidated financial statements

IFRS 10 - *Consolidated financial statements* replaces IAS 27 - *Consolidated and separate financial statements* and SIC-12 - *Consolidation - special purpose entities* and establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more entities. The main features are as follows:

- the principle of control sets out the three elements of control: (1) power over the investee; (2) exposure, or rights, to variable returns from involvement with the investee; (3) the ability to use power over the investee to affect the amount of the investor's returns, and
- when preparing consolidated financial statements, an entity must use uniform accounting policies for reporting like transactions and other events in similar circumstances. Intragroup balances and transactions must be eliminated. Non-controlling interests in subsidiaries must be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

The standard is effective for years beginning on or after January 1, 2013.

Joint arrangements

IFRS 11 - *Joint arrangements* replaces IAS 31 - *Interest in joint ventures* and SIC-13 - *Jointly controlled entities - non-monetary contributions by venturers* and is to be applied by all entities that are a party to a joint arrangement, whereby two or more parties have joint control. The key features of this new standard are as follows:

- joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control,

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

- joint arrangements are classified into two types – joint operations and joint ventures,
- an entity determines the type of arrangement in which it is involved by considering its rights and obligations,
- a joint operator will recognize and measure the assets, liabilities, revenues and expenses in relation to its interest in the arrangement, and
- a joint venturer will recognize an investment and measure it using the equity method.

The standard is effective for years beginning on or after January 1, 2013.

Disclosure of interests in other entities

IFRS 12 – *Disclosure of interests in other entities*, replaces the disclosure requirements of IAS 27 – *Consolidated and separate financial statements*, IAS 28 – *Investments in associates*, and IAS 31 – *Interests in joint ventures*. The IFRS establishes disclosure objectives according to which an entity discloses information regarding consolidated entities, associates, joint arrangements, unconsolidated structured entities and non-controlling interests.

The standard is effective for years beginning on or after January 1, 2013.

Fair value measurement

In May 2011, the IASB issued IFRS 13 – *Fair value measurement* with a view to set out a single IFRS framework for defining, measuring and disclosing fair value. Its main features are as follows:

- defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date,
- the fair value measurement requires an entity to determine the following:
 - the particular asset or liability being measured;
 - for a non-financial asset, the highest and best use of the asset and whether the asset is used in combination with other assets or on a stand alone basis;
 - the market in which an orderly transaction would take place for the asset or liability; and
 - the appropriate valuation technique(s) to use when measuring fair value. The technique(s) should maximize the use of relevant observable inputs and minimize unobservable inputs. Those inputs should be consistent with the inputs a market participant would use when pricing the asset or liability, and
- the entity is to disclose those valuation techniques and inputs used to develop the fair value measurements.

The standard is effective for years beginning on or after January 1, 2013.

Employee benefits

In June 2011, the IASB completed its project to improve the accounting for pension and other post-employment benefits by issuing an amended version of IAS 19 – *Employee benefits*. The amendments make important improvements by:

- eliminating an option to defer the recognition of gains and losses, known as the “corridor method”, improving comparability and faithfulness of presentation,
- streamlining the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring remeasurements to be presented in other comprehensive income (OCI), thereby separating those changes from changes that many perceive to be the results of an entity's day-to-day operations,
- enhancing the disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans.

The standard is effective for years beginning on or after January 1, 2013.

10.5 Related-party transactions

All related-party transactions are with entities associated with the Company's distribution channels.

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

Section 11 - Risk management

The Company has not significantly changed its risk management strategy presented in the 2010 annual MD&A.

11.1 Estimated impact of changes in interest rates and equity prices

Impact of changes in interest rates and common equity prices

For our AFS fixed income or preferred securities, a 100 basis point increase in interest rates would increase income before taxes by approximately \$22 million, as a result of marking to market the written call option liabilities embedded in the Company's redeemable preferred shares and the marking to market of derivative positions. A 100 basis point increase would also decrease OCI by approximately \$154 million. Conversely, a 100 basis point decrease in interest rates would decrease income before taxes and increase OCI by the same amounts, respectively. The impacts described here are approximately linearly related to the change in interest rates.

Furthermore, a 10% increase in equity markets and a 5% increase in preferred shares would decrease income before taxes by \$17 million, as a result of marking to market the written call option liabilities embedded in the Company's redeemable preferred shares. However, it would result in a linear increase of OCI by \$183 million. Conversely, a 10% decrease in equity prices and a 5% decrease in preferred shares would increase income before taxes and decrease OCI by the same amounts, respectively. The impacts described here are approximately linearly related to the change in the equity market.

The above sensitivity analyses were prepared using the key assumptions described below:

- the securities in the Company's portfolio are not impaired;
- interest rates and equity prices move independently;
- shifts in the yield curve are parallel;
- credit and liquidity risks have not been considered;
- for our FVTPL debt securities, the estimated impact on income before taxes is assumed to be offset by the MYA. In addition, it is important to note that AFS securities in an unrealized loss position, as reflected in OCI, may at some point in the future be realized either through a sale or impairment.

Section 12 - Other matters

12.1 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.

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 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; 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; the Company's ability to successfully pursue its acquisition strategy; the Company's ability to execute its business strategy; the terms and conditions of, and regulatory approvals relating to, the Acquisition; timing for completion of the Acquisition; synergies arising from, and the Company's integration plans

Intact Financial Corporation

Management's Discussion and Analysis – second quarter 2011

relating to the Acquisition; the Company's financing plans for the Acquisition; management's estimates and expectations in relation to resulting accretion, internal rate of return and debt to capital position at closing of the Acquisition and thereafter, as applicable; various other actions to be taken or requirements to be met in connection with the Acquisition and integrating the Company and AXA Canada after completion 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 of catastrophic events; the Company's ability to maintain its financial strength ratings; 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 reliance on information technology and telecommunications systems; the Company's dependence on key employees; general economic, financial and political conditions; the Company's dependence on the results of operations of its subsidiaries; the volatility of the stock market and other factors affecting the Company's share price; and future sales of a substantial number of its common shares.

All of the forward-looking statements included in this MD&A are qualified by these cautionary statements and those made in the "Risk Management" section of our MD&A for the year ended December 31, 2010. 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.