Ætna
CANADA

Annual Reports 1985

The Excelsior Life Insurance Company

Ætna Casualty Company of Canada

Contents

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Affaires publiques
Centre Ætna Canada
145, rue King Ouest, Toronto (Ontario) M5H 3T7

This is Ætna Canada

Ætna Canada is a multi-line financial services organization with a singular goal – to improve the personal well-being and financial security of Canadians by providing them with products and services that fit their distinctive needs and lifestyles.

Through the Excelsior Life Insurance Company, the Ætna Casualty Company of Canada and their subsidiaries, Ætna Canada has helped to shape the future for hundreds of thousands of individuals, families and businesses who look to us for a broad range of financial services: personal life and health insurance; annuities and RRSPs; group life, health and pensions; personal automobile and home insurance; commercial automobile and liability insurance; mutual funds; investment counselling and related services.

Innovative products and aggressive marketing strategies have earned Ætna Canada the reputation of a forward-looking organization that anticipates and responds to new and emerging consumer needs.

At the same time, our close association with Ætna Life & Casualty of Hartford, Connecticut, makes us part of a worldwide organization that ranks as the largest investor-owned financial institution in the United States. This is an important strength in the newly emerging global marketplace for financial services.

Financial Highlights

thousands of dollars	1985	1984	% Increase
Assets			
The Excelsior Life Insurance Company	**$1,657,149**	$1,442,246	14.9%
Ætna Casualty Company of Canada	**102,851**	95,710	7.5%
New Sales*			
The Excelsior Life Insurance Company	**108,870**	87,916	23.8%
Ætna Casualty Company of Canada	**23,052**	25,844	(10.8%)
Revenue			
The Excelsior Life Insurance Company	**522,045**	515,629	1.2%
Ætna Casualty Company of Canada	**70,494**	60,342	16.8%
Net Income			
The Excelsior Life Insurance Company	**13,105**	3,723	252.0%
Ætna Casualty Company of Canada	**(1,724)**	(1,625)	(6.1%)
Capital and Retained Earnings			
The Excelsior Life Insurance Company	**113,882**	102,778	10.8%
Ætna Casualty Company of Canada	**21,973**	21,697	1.3%

*weighted by product line

Shaping the Future

Gordon N. Farquhar, Chairman and Chief Executive Officer and Michael A. Stephen, President and Chief Operating Officer

1985 was a very significant year for Ætna Canada. Operating earnings reached record levels in the life company, and several new directions were firmly established throughout our organization. This was achieved during a year of considerable turmoil in the financial services marketplace.

The Excelsior Life Insurance Company

Net operating earnings for The Excelsior Life Insurance Company were the highest in its history at $12.0 million, up from $2.8 million in 1984. This substantial increase was the result of tight expense control and the success of our products and services in the marketplace. Total net income of $13.1 million, up from $3.7 million in 1984, was the second highest in our history.

Solid growth in the group pension area led to an overall sales increase for Excelsior Life of 24% in 1985. Sales of individual products increased 7%, while group products experienced an impressive 29% increase in sales. Total revenue increased 1% in 1985 due to lower single premium annunity sales and an increase in "administrative service only" contracts for group business. Total life insurance in force rose by $.8 billion in the year to $15.9 billion at year-end.

Operating expenses in Excelsior Life decreased 3% in 1985 as programs of expense containment continued to yield positive results. An early retirement program was also introduced in mid-1985 and 22 employees with long, excellent records of service chose to take advantage of it.

Ætna Casualty Company of Canada

The property and casualty industry in Canada continued to suffer throughout the year with record losses due to severely underpriced products. Ætna Casualty Company of Canada recorded a net loss of $1.7 million compared with a $1.6 million loss in 1984. Stringent expense control programs led to a 4% decline in the company's expense ratio.

However, claims incurred increased $10.5 million in 1985, including upward adjustments in claim reserves of $5.8 million. This led to an 8% increase in the loss ratio for Ætna Casualty. Although this ratio is still below the industry average, corrective action is continuing in an attempt to improve results. Underwriting procedures are being closely monitored to ensure the careful selection of risks, and further increases are scheduled for automobile insurance early in 1986. These steps, combined with more adequate rate levels throughout the industry as a whole, are expected to contribute to steady improvement and a return to profitability for Ætna Casualty in 1986. Accordingly, Ætna Life & Casualty of Canada Ltd. contributed $2.0 million in new capital to Ætna Casualty in 1985.

A Commitment to Marketing

Ætna Canada's commitment to marketing has never been stronger. In today's highly competitive environment, our aim is to strengthen Ætna Canada's position as a leading provider of financial products and services.

This marketing commitment was the impetus for management's decision in 1985 to combine Ætna Canada's Life and Casualty operations into a single operating division. The results of this merger will be felt throughout 1986 and beyond as we achieve greater flexibility, expanded product selection, increased productivity and improved service and convenience to our customers.

The desire to tailor our marketing activities more closely to customer needs was also a significant force in the Group Division. This led to the establishment early in 1985 of a separate department specializing in small group business. We are now tapping the enormous potential of this market through the careful development of new products and distribution networks.

At the same time, we formed a new company, Ætna Capital Management Limited, to meet the investment management needs of large pension clients. We also established a separate pension investment department within the Investment Division to provide money management for pooled funds and guaranteed products.

Ætna Canada's distribution network was expanded in 1985 with the introduction of the PRIME agent program, which equips career agents to sell both life and casualty products. In addition, a number of our agents have been licensed to sell mutual funds through Ætna Midland

Doherty Finsco, our joint venture with Midland Doherty. In a unique experiment in sponsored marketing, we also provided personal auto and homeowner products on a payroll deduction basis to the employees of a major group client. These initiatives underscore Ætna Canada's profile as an innovative and market-driven organization.

The establisment of a trust company in British Columbia in 1985 will open up new markets and provide additional avenues for growth and expansion in the evolving financial services industry.

At the same time, we are continuing our pro-active role in pursuit of needed changes in the legislation governing our businesses so that the interests of the Canadian consumer will be well-served.

A Spirit of Unity

The significant developments of the past year could not have been achieved without the commitment of many people at all levels within the Ætna Canada organization. Their drive and determination and their dedication to excellence provide the competitive edge that sets us apart.

The success of Ætna Canada will depend on our corporate resolve to respond to the needs of the marketplace with top quality products and services delivered in an efficient, cost-effective manner at a fair price. We are confident in the ability of our people to adapt to this changing environment with intelligence and vigor. At Ætna Canada, people do make the difference.

Executive and Board Changes

Michael A. Stephen, Executive Vice-President and Chief Operating Officer since 1983, was appointed President and elected a member of the Board of Directors of The Excelsior Life Insurance Company and of The Ætna Casualty Company of Canada at their annual meetings in May, 1985. Gordon N. Farquhar, previously Chairman and President, continued as Chairman and Chief Executive Officer of the two companies.

Also in 1985, Dean E. Wolcott, President, Personal Financial Services Division, of Ætna Life & Casualty in Hartford, Conn., was re-elected a member of the Board after a four year absence. Mr. Wolcott succeeded John M. Galvin, formerly Senior Vice-President in charge of International Insurance Operations for Ætna Life & Casualty. Mr. Galvin had served on the Board as a dynamic and energetic member since November, 1981.

J. Donald Mingay, Management Consultant and former President and Chief Executive Officer of Consumers Glass Company Ltd., retired from the Board of Directors in May, 1985. Mr. Mingay had been a valued member of the Board since 1972, and his wry wit and sound judgement were greatly respected.

A Strategy for Growth

As we enter the second half of the 1980s and begin to shape the next phase of our corporate future, it is important that a consensus be developed about who we are and what we must accomplish:

Ætna Canada's short-term challenges are clear:
- to restore the property and casualty business to an acceptable level of profitability
- to make the new Life and Casualty Division fully operational and effective
- to build on the strengths of our existing distribution channels while continuing to explore other possibilities for networking and synergism
- to seek out additional opportunities for growth and diversification wherever they complement our core business.

These goals will be achieved within a framework that emphasizes service to our customers and responsiveness to their needs.

With a strong marketing direction, an innovative range of products and services, the commitment of a competent staff, and a shared vision of the opportunities and challenges that lie ahead, we are confident that Ætna Canada will become a dynamic force in the Canadian financial services marketplace.

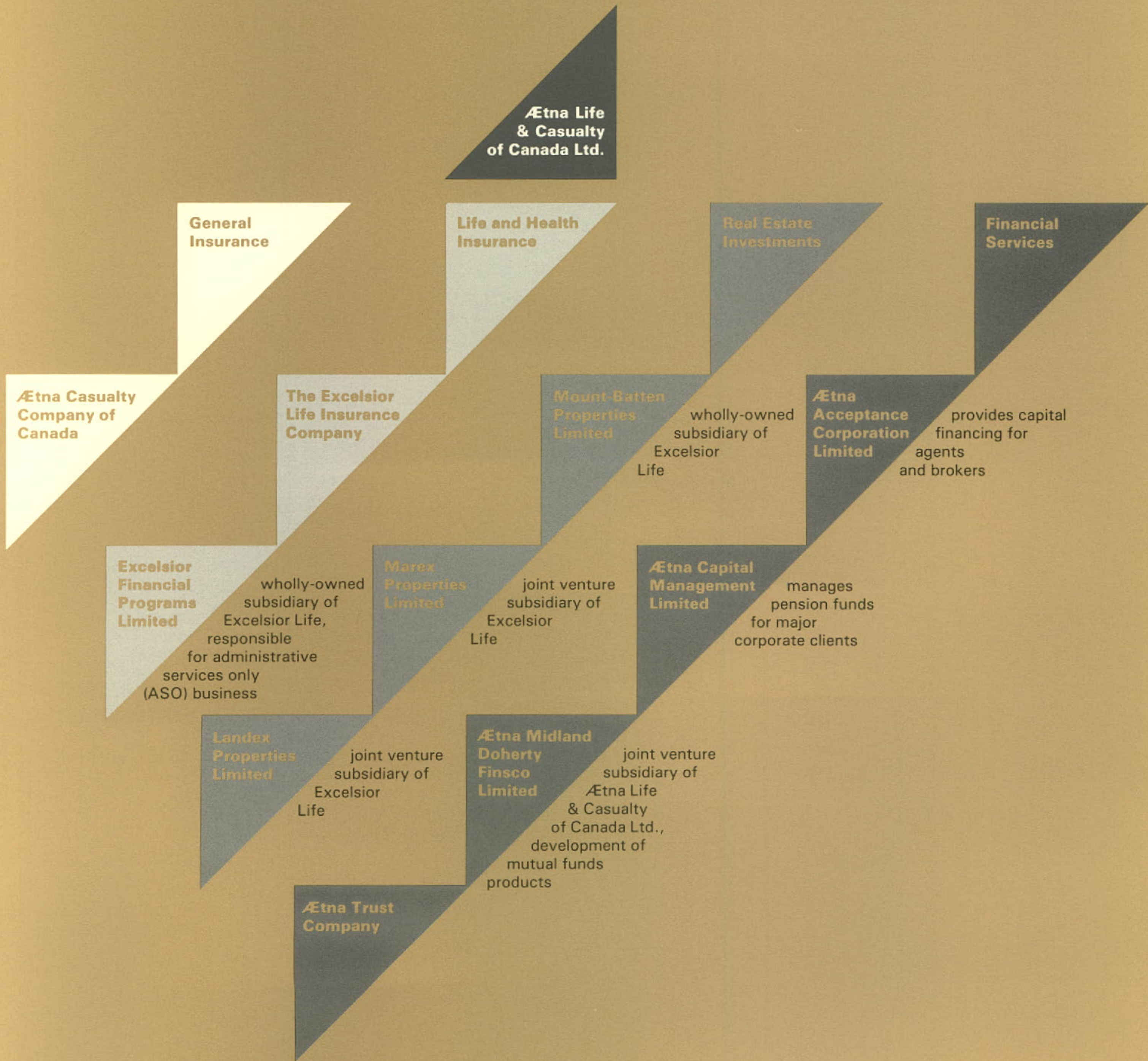
Gordon N. Farquhar
Chairman and
Chief Executive Officer

Michael A. Stephen
President and
Chief Operating Officer

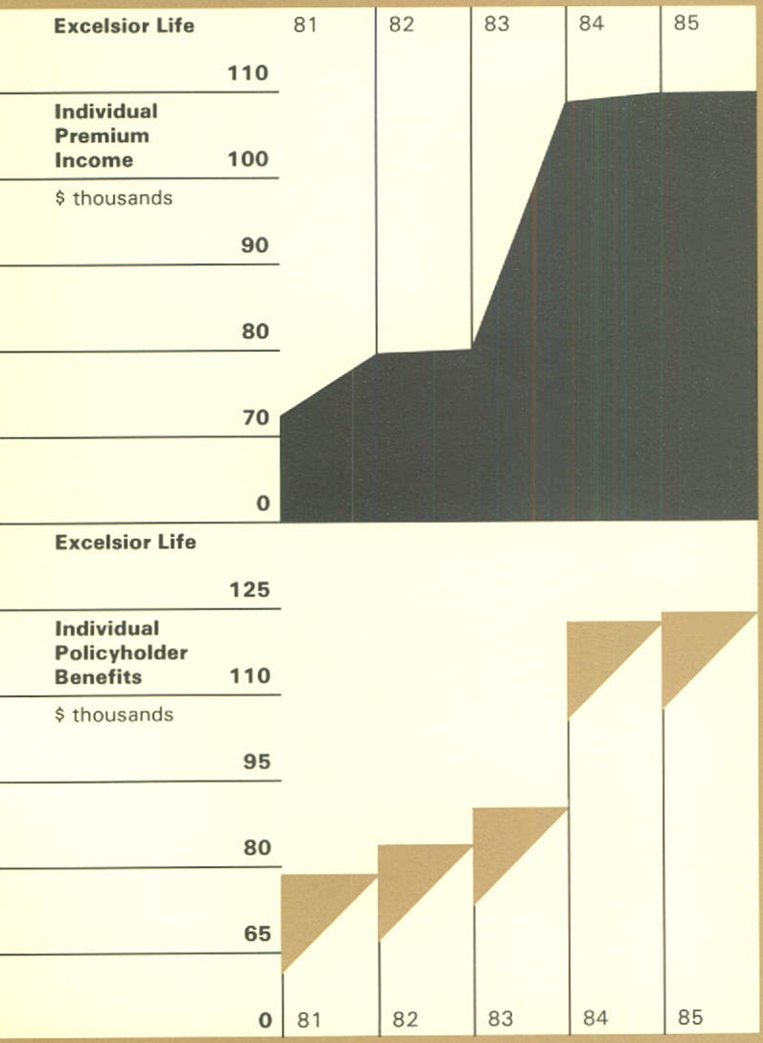
Ætna Life & Casualty, based in Hartford, Connecticut, is among the 15 largest U.S. corporations with offices worldwide.

Its holding company, Ætna Life & Casualty of Canada Ltd., operates a number of related financial service subsidiaries which make up the Ætna Canada organization.

The Ætna Canada Organization



Individual Life and Health



1985 was the most substantial production year ever for the Individual Life and Health Insurance operations of Excelsior Life.

We achieved record sales of $21 million, a 7 per cent increase over 1984. Life insurance in force also rose by 7 per cent to $6.1 billion at year end. Meanwhile, continued emphasis on expense control kept 1985 expenditures well below plan.

These strong sales overall were marred only by a shortfall in sales of non-participating insurance products. We expect to regain our leadership in this area in 1986 with the introduction of a new Life product to complement our innovative Income Plus health product developed in 1985. These interest-sensitive products, along with the success of such recently introduced participating products as Æxtralife and Vanguard, will guarantee our position as a major player in the life and health insurance marketplace.

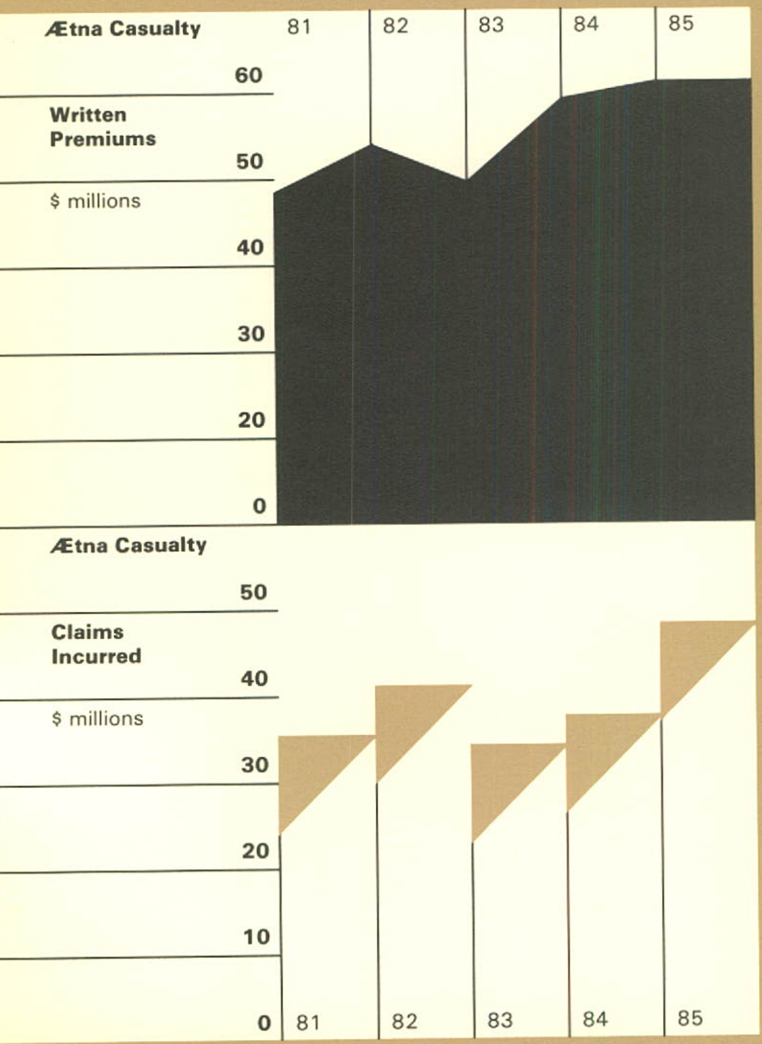
The most significant development in 1985 in our move to become more market-driven was the successful merger of our Individual Life and Health operations with our Casualty operations. Sales operations for the two divisions were combined and decentralized through four new regional offices, and effective management teams put in place to ensure both profitability and a high level of service to our sales representatives and, ultimately, to our customers.

This strengthening of our delivery system, combined with improved standards of service and a more disciplined approach to product design and development, will ensure that Ætna Canada remains responsive to the marketplace with competitive products and services that meet the changing needs of consumers.

"Understanding our customer's needs, wants and desires is our number one priority. Only then can we design products and services that meet those requirements."

Claude Root
Vice President,
Life and Casualty

Casualty



Casualty operations continued to be a major disappointment in 1985, as Ætna Casualty Company of Canada experienced losses for the second year in a row.

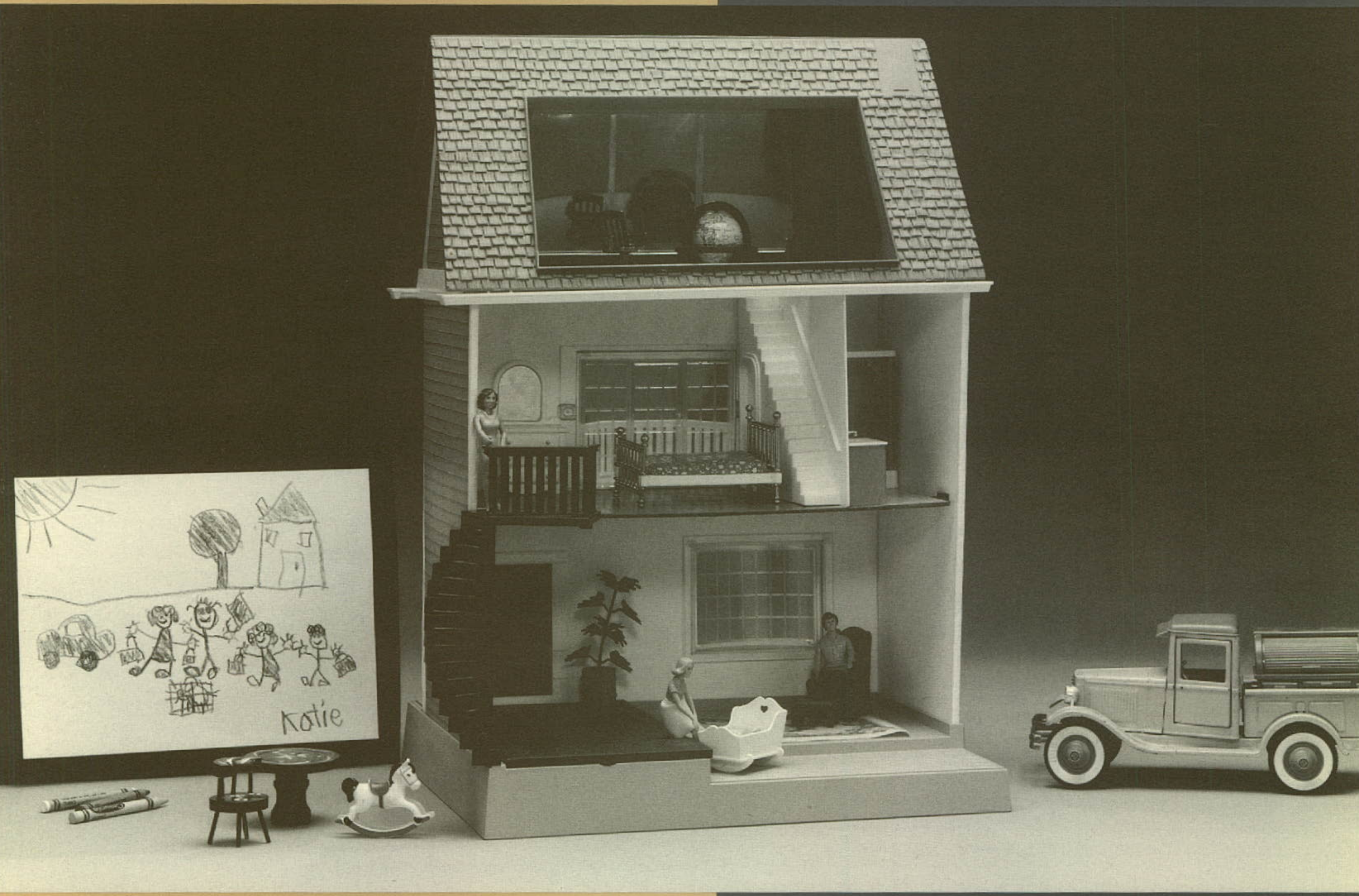
Our commercial auto lines, and personal auto lines in Ontario, suffered the worst damage. All other lines – homeowners', general liability and property, as well as fidelity and surety – were profitable in 1985.

To stem these losses, we capped net written premium at the 1984 level of about $60 million. Problems in the auto line were addressed with rate actions that should have their ultimate effect toward the end of 1986. Likewise, early in 1985, we developed and implemented an entirely new commercial strategy to deal with problems in the commerical auto line and general liability. As a result, we expect dramatically improved results throughout the coming year.

Ætna Casualty's preferred risk strategy was instrumental in maintaining a loss ratio performance below the industry average. Our expense ratio showed improvement last year but was above the industry average. The reorganization of our Life and Casualty operations to achieve economies of scale will help bring expenses into line with the rest of the industry during 1986.

A priority during the past year has been the development of innovative products and services that respond in a timely fashion to evolving consumer needs and preferences. In pursuing this goal, we added PRO MARINE, a well-conceived and designed boat coverage product, to our PRO AUTO and PROTECT line.

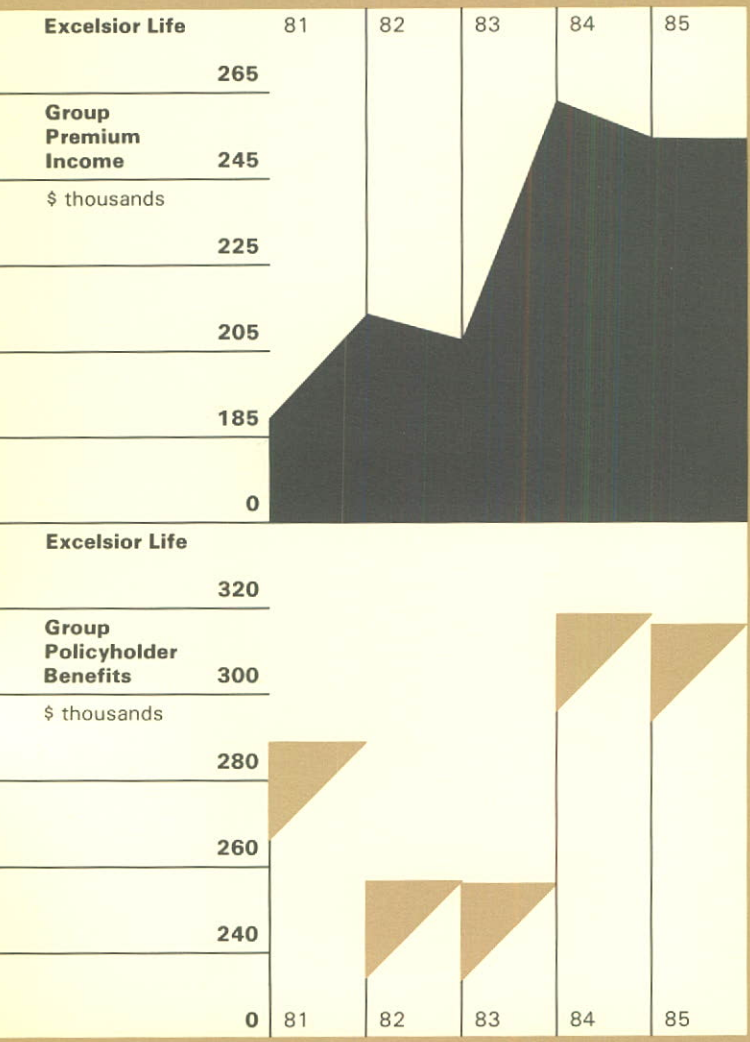
The year ahead is expected to bring new challenges for the casualty industry. Though we expect some of the problems in the auto line will be eased, through revised legislation and changes in interpretation of legislation, the current liability crisis in auto and other areas, encompassing questions of availability and affordability, will continue to be a key issue for our industry in 1986.



"There's no question that 1985 was a very difficult year for casualty. But we've taken some tough action to get us back on track, and the future looks bright."

Charlie Painter
Vice President,
Casualty

Group



Earnings for the Group operations of Excelsior Life showed an impressive increase over the previous year. Sales and revenue, including Administrative Services Only business, were also well above target.

These excellent results were accomplished through improved growth and profitability in both the large and small case markets, and through changes in our operations designed to increase productivity and more effectively control expenses.

To maintain Ætna Canada's reputation as one of the best service companies in the Group marketplace, new administrative procedures were introduced to speed up our claims processing and policy renewals. As a result, we improved our underwriting backlog by 35 per cent and reduced by six per cent the average cost of processing a claim.

Reorganization along market lines was a major initiative in 1985. A new department was created to strengthen our profile in the small business market, and we improved distribution of our products through smaller local/regional networks – including our own Life and Casualty agents – in addition to the large national consulting and brokerage firms.

We experimented with sponsored marketing, offering individual auto/home coverage through payroll deduction to salaried employees of the Ford Motor Company of Canada. This was very well received, and we expect to pursue further opportunities in this largely untapped market.

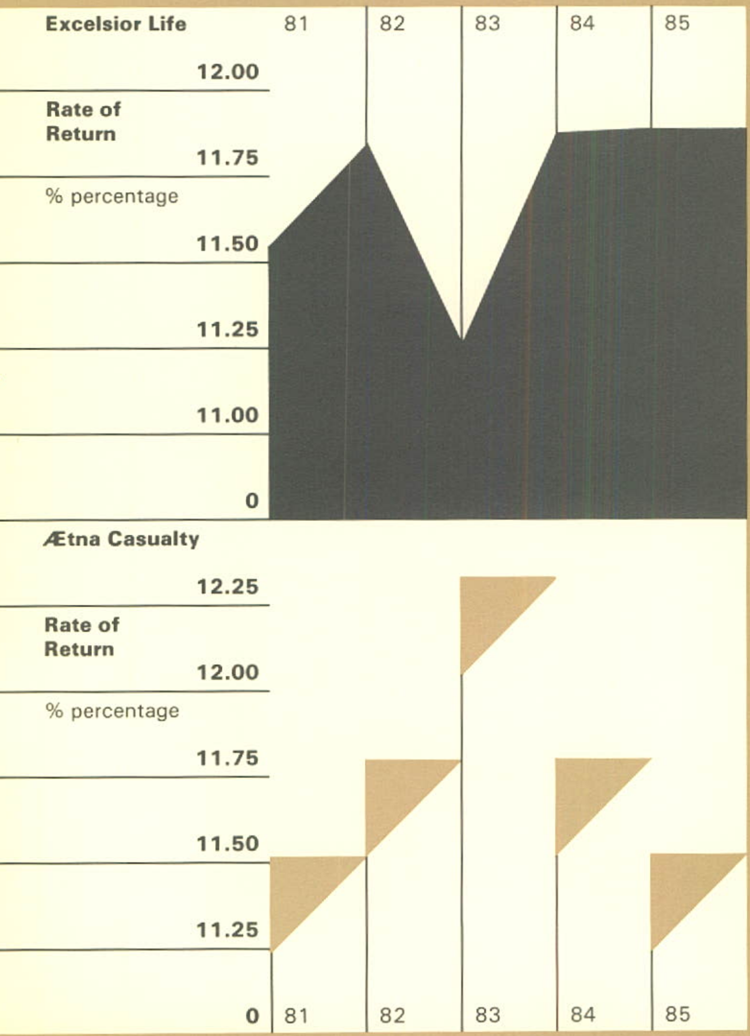
In the year ahead, our small business portfolio will be strengthened by a new administrative system that will allow us to compete in new product designs for pensions. Through networking with other carriers, we also expect to expand our overall small business market.

Cost containment and accurate statistical reporting remain top priorities in providing service to larger life and health insurers. These improved reporting methods will allow us to more closely monitor expenses and underwriting results, ensuring that we continue to manage a profitable book of business.

"We're proud of our place as the sixth largest Group underwriter in Canada. And we're working hard to better it."

Bob Rasmussen
Vice President,
Group

Investment



Total assets for Excelsior Life grew a substantial 15 per cent during 1985 to $1.7 billion. For Ætna Casualty, the growth in assets was less pronounced due to a conscious decision to restrict written premium. In spite of this, we managed a 7 per cent increase to total assets of $103 million.

Erratic interest rates made spread lending operations difficult to manage in 1985; however, we achieved a better than average market share in mortgage investments. Arrears of three months or more were down 25 per cent from 1984, bringing them to their lowest level of the past four years.

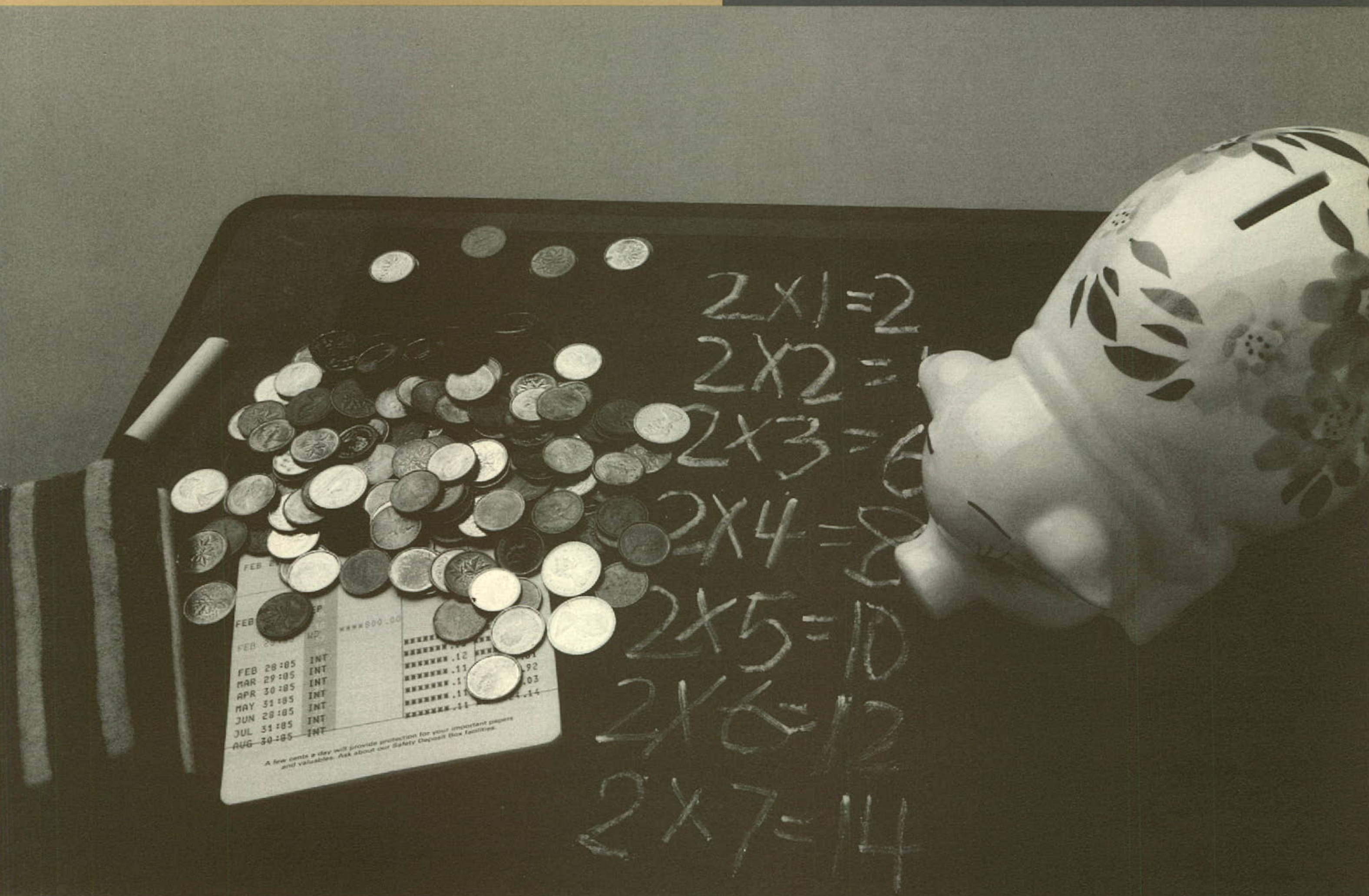
A new company, Ætna Capital Management Limited, began to market specialized investment expertise to money management clients. The Pension Investments Department was also created to carry out general money management in pooled funds and guaranteed products. These two groups have been outstandingly successful in their first partial year of operation, generating $90 million in deposits.

Real estate operations, both direct and through joint venture affiliates and subsidiaries, did well during the year. Acquisitions included interests in Brentwood Village Mall in Calgary, the new Zeller's head office building in Montreal and Churchill Office Park in Ottawa.

With markets expected to remain highly volatile through 1986, the challenge for Ætna Canada's investment operations will be to seize opportunities as they arise. We propose to increase our holdings in mortgages, as against bonds, and replace some bonds with retractable preferred shares for their tax advantage.

Ætna Capital Management Limited will continue to emphasize its specialized product approach – the key to its long-term success. At the same time, we expect Ætna Canada Pension Investments to increase modestly the funds under its management.

On the real estate side, we will continue to enter into syndication projects where they meet our earnings goals.



"Our objective is to provide first-rate service for our customers – both borrowers and money management clients."

Barry Graham
Vice President and Treasurer, Investment

Related Financial Services

In addition to Excelsior Life and Ætna Casualty, Ætna Canada encompasses a number of wholly and jointly owned companies offering specialized financial services. These subsidaries play a key role in our diversification strategy and allow us to satisfy a broad range of financial security needs.

Ætna Midland Doherty Finsco
AMD Finsco was established in 1984 as a joint venture with Midland Doherty Financial Corp., to develop a range of financial products for distribution through both companies.

In its first full year of operation, AMD Finsco has achieved phenomenal success. Its first series of open-end mutual funds had grown to $90.6 million by the end of 1985, and two new growth products, the Canadian Blue Chip Fund and the American Blue Chip Fund, have now been added.

Ætna Capital Management Limited
A wholly owned subsidiary of Ætna Life & Casualty of Canada Ltd., Ætna Capital Management was launched in the spring of 1985 to provide timely, effective investment counselling and money management for large pension clients.

Under the ACM banner, a team of independent investment specialists manages both segregated and pooled funds for more than 30 major clients, including Ætna Canada. The company's early success has exceeded expectations, attracting almost $100 million in pension deposits in its first year of operation.

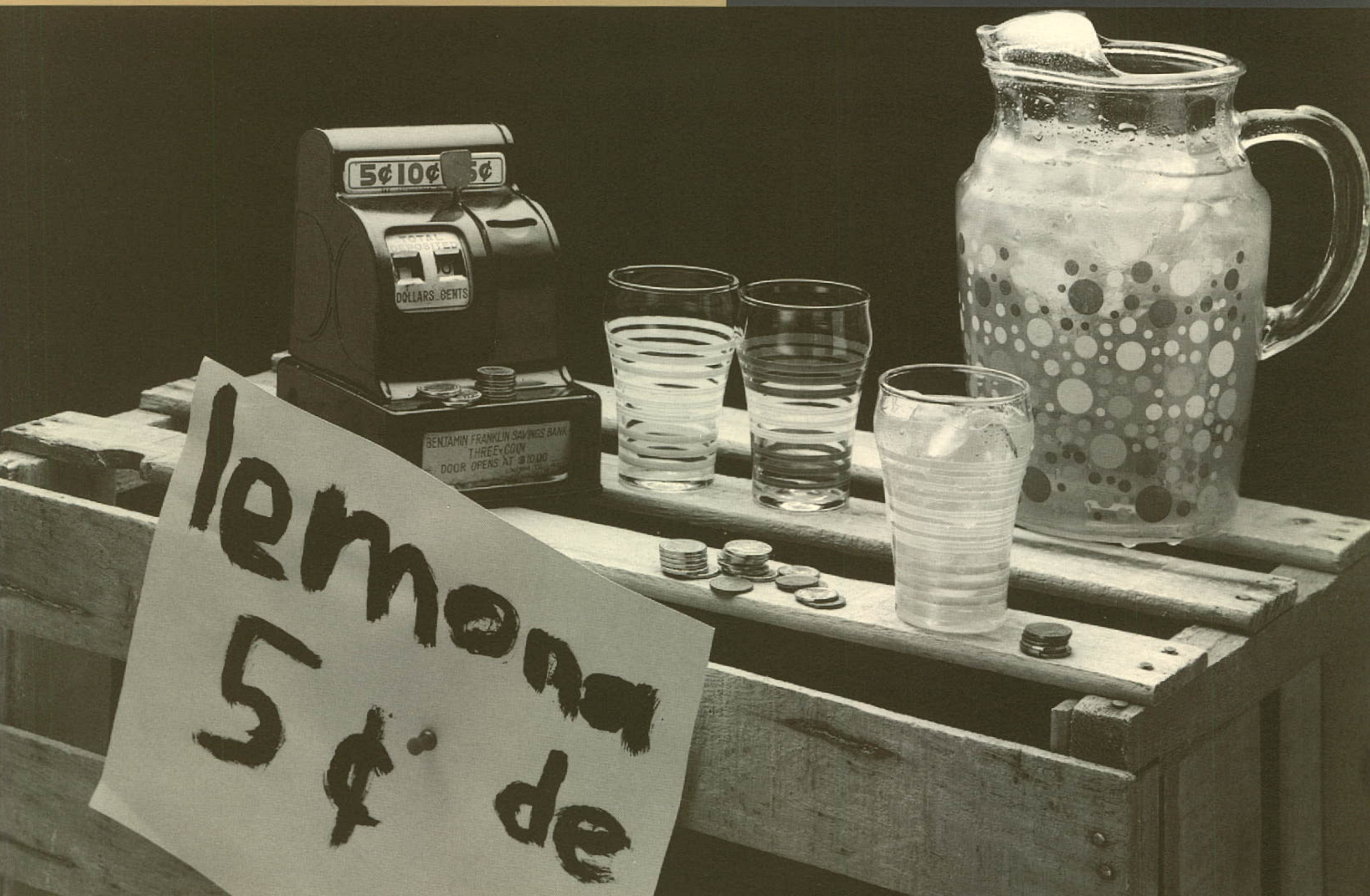
Ætna Trust Company
Ætna Trust is the most recent acquisition in our continuing strategy of diversification. It was licensed in early 1985 to do business in the Province of British Columbia.

Through Ætna Trust, we intend to capture a growing share of the Canadian savings market by offering guaranteed investment products, investment advice and custodial trustee services through our existing agency force.

With the expertise of Ætna Canada to draw on, and the opportunities afforded by increasing investment in western Canada on the part of Pacific Rim countries, we expect Ætna Trust to play a significant role in the future growth of Ætna Canada.

Ætna Acceptance Corporation
Ætna Acceptance Corporation Limited has been in business since 1984, providing financing and similar capital assistance to our agents, brokers and policyholders.

Whether they're buying a personal computer or an entire business, Ætna Acceptance gives agents access to the capital they need, at a price they can afford. It also handles specialized loan arrangements for a number of Ætna Canada policyholders.



"Our goal is not to be the largest or most diverse in the industry, but simply to be the best in the markets in which we do business."

John Stubbs
Vice President,
Law and Corporate Development

Balance Sheet

December 31, 1985
(with comparative figures for 1984)
thousands of dollars

	1985	1984
Assets		
Cash and short term investments	**$ 79,525**	$ 94,116
Bonds and other debt securities	**376,362**	343,649
Stocks	**8,963**	14,950
Mortgage loans	**476,412**	435,095
Investment real estate	**46,569**	16,968
Investment in and advances to subsidiaries and joint ventures	**47,314**	10,787
Policy loans	**25,606**	27,257
Investment income due and accrued	**23,343**	24,798
Other assets	**58,948**	63,313
Separate fund assets	**514,107**	411,313
	$1,657,149	$1,442,246

	1985	1984
Liabilities and Capital and Retained Earnings		
Policy liabilities	**$ 927,560**	$ 838,182
Policy and contract claims	**25,506**	25,146
Policyholders' funds left with company	**16,362**	15,863
Policyholders' dividends and refunds	**5,493**	8,593
Actuarial liabilities	**974,921**	887,784
Mortgages on real estate	**7,475**	3,673
Other liabilities	**46,764**	36,698
Separate fund liabilities	**514,107**	411,313
	1,543,267	1,339,468
Capital and Retained Earnings		
Capital stock	**250**	250
Retained earnings – participating shareholders	**38,678**	36,915
– shareholders	**74,954**	65,613
	113,882	102,778
	$1,657,149	$1,442,246

See accompanying notes to financial statements.

On behalf of the Board

Director Gordon N. Farquhar

Director

Statement of Net Income and Retained Earnings

For the year ended December 31, 1985
(with comparative figures for 1984)
thousands of dollars

	1985	1984
Revenue		
Premium income	**$363,286**	$371,139
Net investment income	**157,163**	140,436
Net income from subsidiaries and joint ventures	**1,596**	4,054
	522,045	515,629
Benefits and expenses		
Current and future benefits	**440,020**	440,897
Operating expenses	**65,031**	67,291
Premium and other taxes	**4,953**	4,595
	510,004	512,783
Net operating income	**12,041**	2,846
Net non-amortizable capital gains	**672**	877
Realization of benefit of a subsidiary's prior years' losses	**392**	–
Net income	**$ 13,105**	$ 3,723
Net income by fund		
Participating policyholders' net income		
Before dividends	**$ 6,022**	$ 5,647
Dividends to participating policyholders	**4,259**	3,686
Participating policyholders' net income	**1,763**	1,961
Shareholders' net income	**11,342**	1,762
Net income	**13,105**	3,723
Dividend to shareholders	**(2,001)**	(2,004)
Retained earnings, beginning of year	**102,528**	100,809
Retained earnings, end of year	**$113,632**	$102,528

See accompanying notes to financial statements.

Statement of Changes in Financial Position

For the year ended December 31, 1985
(with comparative figures for 1984)
thousands of dollars

	1985	1984
Funds provided		
From operations		
Net operating income	**$ 12,041**	$ 2,846
Depreciation	**5,040**	4,176
Increase in policy liabilities	**89,378**	142,198
Other	**(9,140)**	(5,309)
Funds provided from operations	**97,319**	143,911
Principal repayments or sales proceeds of investments		
Bonds and other debt securities	**314,293**	79,946
Stocks	**9,705**	55,945
Investment real estate	**236**	4,696
Mortgage loans	**71,410**	38,400
Subsidiaries and joint ventures	**9,428**	—
Other, net	**6,721**	—
Total funds provided	**509,112**	322,898
Funds applied		
New investments		
Bonds and other debt securities	**333,789**	246,250
Stocks	**2,721**	30,949
Investment real estate	**23,606**	216
Mortgage loans	**115,752**	63,980
Subsidiaries and joint ventures	**43,970**	—
Dividend to shareholders	**2,001**	2,004
Purchase of other assets	**1,864**	5,368
Other, net	**—**	19,212
Total funds applied	**523,703**	367,979
Net decrease in funds	**(14,591)**	(45,081)
Cash and short term investments, beginning of year	**94,116**	139,197
Cash and short term investments, end of year	**$ 79,525**	$ 94,116

See accompanying notes to financial statements.

Notes to Financial Statements

For the year ended December 31, 1985

The Excelsior Life Insurance Company is incorporated under the laws of Canada, is registered under the Canadian and British Insurance Companies Act and is a subsidiary of Ætna Life & Casualty of Canada Ltd. whose ultimate parent is Ætna Life & Casualty Company of Hartford, Connecticut, U.S.A. The Company is licensed to write life and accident and sickness insurance in all provinces and territories in Canada.

1. Summary of significant accounting policies
The accounting policies of the company conform with the requirements for filing with the Department of Insurance of Canada. The significant policies are:

a) The financial statements combine the life and health insurance branches of the company. The life branch also combines the participating policyholders' and non-participating policyholders' funds.

b) Investments in bonds and other debt securities and mortgage loans not in default are carried at amortized cost. Mortgages loans in default are carried at fair value. The difference between the proceeds of the sale of a bond or mortgage loan in the life branch and its amortized cost is considered to be an adjustment of future portfolio yield, deferred on the balance sheet and amortized over the shorter of 20 years or the period to maturity of the security sold. The life branch unamortized balance of net deferred losses at December 31, 1985 was $9,259,000 (1984 – $15,716,000). Gains and losses on sales in the health branch are recognized on the completed transaction basis.

c) Investments in stocks are carried at cost. Gains and losses on the sale of stock in the life branch during the year and the difference between cost and government market value of the life branch stocks at the end of the year are recognized in income through a formula that amortizes the realized and unrealized gains and losses on a 15% declining balance basis. The life branch unamortized balance of net deferred realized and unrealized gains at December 31, 1985 was $4,731,000 (1984 – $5,620,000). Gains and losses on sales in the health branch are recognized on the completed transaction basis.

d) Investment real estate is carried at cost less accumulated depreciation. Depreciation is provided on the sinking fund basis over terms of 20 to 40 years. Accumulated depreciation at December 31, 1985 was $1,426,000 (1984 – $1,196,000). Gains and losses on sales are recognized on the completed transaction basis.

e) Investments in subsidiary and joint venture companies are carried on the equity basis.

f) Policy loans are carried at their unpaid balance and are fully secured by the cash surrender values of the policies on which the respective loans are made.

g) Investments held for separate funds are carried at market value.

h) The policy liabilities represent the amount required, together with future premiums and interest, to provide for future benefits arising from insurance and annuity contracts. The policy liabilities are calculated using interest, mortality, morbidity, expense and withdrawal assumptions appropriate for the policies in force. These assumptions are reviewed regularly, compared to emerging experience and changed when appropriate. Costs of acquiring policies to a maximum statutory amount are deferred and amortized over the policy premium paying period. An amount of $28,998,000 (1984 – $24,986,000) representing unamortized deferred costs has been deducted in arriving at the net policy liabilities.

i) Income taxes are determined using the taxes payable method.

j) Net income is allocated between the participating policyholders' fund and the shareholders' fund on the basis of a complex formula. Earnings considered applicable to shareholders include interest earned on the shareholders' fund, net earnings of the health branch, net earnings of the non-participating policyholders' fund and a percentage as restricted by law, currently 10%, of the net earnings of the participating policyholders' fund allocated for distribution.

2. Bonds and other debt securities, stocks and mortgage loans:

thousands of dollars	1985		1984	
	Cost or Amortized Cost	**Government Market Value**	Cost or Amortized Cost	Government Market Value
Bonds and other debt securities	**$376,362**	**$392,319**	$343,649	$343,266
Stocks – common	**8,232**	**11,973**	13,456	15,238
Stocks – preferred	**731**	**722**	1,494	1,468
Mortgage loans	**476,412**	**491,479**	435,095	427,390
	$861,737	**$896,493**	$793,694	$787,362

3. Separate fund assets:

thousands of dollars	1985	1984
Market value of assets at beginning of year	**$411,313**	$370,625
Transfer from general funds being net deposits by contractholders and investment income less expenses	**97,919**	77,620
Realized and unrealized appreciation (depreciation) of investments	**34,943**	(2,667)
Payments to contractholders	**(30,068)**	(34,265)
Market value of assets at end of year	**$514,107**	$411,313

4. Related party transactions:

In the normal course of business, the company has transactions with related parties including cost sharing arrangements. The major balances at December 31, 1985 arising from transactions with these parties are:

thousands of dollars	Wholly Owned Subsidiaries	Joint Venture Companies	Associated and Affiliated Companies
Short term notes receivable, interest bearing	$ —	$11,949	$ —
Mortgages receivable, interest bearing	—	13,888	—
Intercompany receivables (payables)	(10)	(100)	1,932
Long term advances to related parties, interest bearing	12,005	11,965	—
Long term notes payable, interest bearing	9,800	—	—

In addition to these transactions, the company operates a cash management pool whereby related company bank balances and short term investments are pooled for investment purposes. Detailed accounting and allocation procedures ensure that balances and interest earnings are properly reflected.

5. Lease commitments:

The following is a schedule by year of future minimum lease payments required under operating leases that have initial or remaining non-cancellable lease terms in excess of one year.

Year ending December 31,	thousands of dollars
1986	$ 7,381
1987	7,251
1988	7,637
1989	7,799
1990	7,620
Later years	20,359
Total minimum payments required	$58,047

6. Capital stock:

The company has authorized 250,000 redeemable preference shares with a par value of $100 each and 100,000 common shares with a par value of $5 each. At December 31, 1985, 50,000 common shares had been issued.

7. Requirements under the Canadian and British Insurance Companies Act:

The Canadian and British Insurance Companies Act requires appropriations of retained earnings for several items, the major ones being for investment valuation, cash value deficiency and negative actuarial liabilities. As a result of the foregoing, capital and surplus for purposes of the Act is $61,394,000 (1984 – $55,698,000) of which $31,678,000 (1984 – $29,222,000) is applicable to the participating policyholders' fund.

8. Pension plans:

The company has non-contributory pension plans covering substantially all employees and employee-agents. The actuarial valuation at January 1, 1985 indicated a surplus of $1,672,000 and consequently no pension expense was recorded in 1985. Pension expense for 1984 was $1,830,000.

9. Comparative figures:

Certain changes have been made in the classification of the 1984 balances to conform with presentation in the current year.

Auditors' Report

To the shareholders and participating policyholders of The Excelsior Life Insurance Company:

We have examined the balance sheet of The Excelsior Life Insurance Company as at December 31, 1985 and the statements of net income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1985 and the results of its operations and changes in its financial position for the year then ended in accordance with the basis of accounting described in Note 1 to the financial statements applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

Toronto, Canada
February 10, 1986

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Actuary's Report

I have made the valuation of the actuarial liabilities of The Excelsior Life Insurance Company for its balance sheet at December 31, 1985 and its statement of net income for the year then ended. In my opinion, (i) the valuation conforms to the Recommendations for Insurance Company Financial Reporting of the Canadian Institute of Actuaries, (ii) the amount of the actuarial liabilities makes proper provision for the future payments under the company's policies, (iii) a proper charge on account of those liabilities has been made in the statement of net income and (iv) the amount of appropriated surplus for policies whose cash value exceeds the actuarial liability is proper.

David Congram

David J. Congram, F.I.A., F.C.I.A., A.S.A.
Vice-President, Corporate Actuarial and
Valuation Actuary
February 10, 1986

Balance Sheet

December 31, 1985
(with comparative figures for 1984)
thousands of dollars

	1985	1984
Assets		
Cash and short term investments	**$ 25,055**	$ 24,514
Bonds and other debt securities	**30,880**	31,006
Mortgage loans	**17,485**	12,692
Premiums receivable from policyholders	**1,630**	650
Amounts due from agents	**11,693**	11,409
Furniture and fixtures	**933**	1,029
Deferred acquisition expenses	**8,549**	9,395
Deferred income tax	**3,922**	2,405
Other assets	**2,704**	2,610
	$102,851	$ 95,710

Liabilities and Shareholders' Equity

	1985	1984
Insurance and other liabilities		
Unpaid claims	**$ 42,270**	$ 36,485
Unearned premiums	**30,207**	32,176
Amounts due to affiliates	**1,955**	1,559
Borrowed funds	**2,521**	1,640
Other liabilities	**3,925**	2,153
	80,878	74,013
Shareholders' equity		
Capital stock	**1,900**	1,900
Contributed surplus	**20,173**	18,173
Retained earnings (deficit)	**(100)**	1,624
	21,973	21,697
	$102,851	$ 95,710

See accompanying notes to financial statements.

On behalf of the Board

Director Gordon N. Farquhar

Director [illegible signature]

Statement of Net Loss and Retained Earnings (Deficit)

For the year ended December 31, 1985
(with comparative figures for 1984)
thousands of dollars

	1985	1984
Revenue		
Premiums earned	**$62,696**	$52,955
Net investment income	**7,798**	7,387
	70,494	60,342
Claims and expenses		
Claims incurred and adjustment expenses	**48,183**	37,729
Acquisition expenses	**16,797**	16,304
General expenses	**8,937**	9,043
	73,917	63,076
Operating loss before income taxes	**(3,423)**	(2,734)
Deferred income tax recovery	**(1,561)**	(1,236)
Net operating loss	**(1,862)**	(1,498)
Net realized capital gains (losses) (net of charges for applicable deferred taxes of $44, 1984 – $27)	**138**	(127)
Net loss	**(1,724)**	(1,625)
Retained earnings, beginning of year	**1,624**	3,249
Retained earnings (deficit), end of year	**$ (100)**	$ 1,624

See accompanying notes to financial statements.

Statement of Changes in Financial Position

For the year ended December 31, 1985
(with comparative figures for 1984)
thousands of dollars

	1985	1984
Funds provided		
From operations		
Net operating loss	**$ (1,862)**	$ (1,498)
Depreciation	**148**	138
Increase in deferred income tax	**(1,517)**	(1,209)
Increase in unpaid claims and unearned premiums	**3,816**	7,575
Decrease (increase) in deferred acquisition expenses	**846**	(1,676)
Increase in due to affiliates	**396**	4,959
Other	**(65)**	(69)
Funds provided from operations	**1,762**	8,220
Principal repayments or sale of investments		
Bonds and other debt securities	**19,624**	5,105
Mortgage loans	**2,111**	5,328
Surplus contributed by parent company	**2,000**	—
Increase in borrowed funds	**881**	—
Other, net	**362**	—
Total funds provided	**26,740**	18,653
Funds applied		
New investments		
Bonds and other debt securities	**19,295**	8,053
Mortgage loans	**6,904**	5,365
Decrease in borrowed funds	—	63
Other, net	—	2,337
Total funds applied	**26,199**	15,818
Net decrease in funds	**541**	2,835
Cash and short term investments, beginning of year	**24,514**	21,679
Cash and short term investments, end of year	**$25,055**	$24,514

See accompanying notes to financial statements.

Notes to Financial Statements

For the year ended December 31, 1985

Ætna Casualty Company of Canada is incorporated under the Canadian and British Insurance Companies Act and is a subsidiary of Ætna Life & Casualty of Canada Ltd. whose ultimate parent is Ætna Life & Casualty Company of Hartford, Connecticut, U.S.A. The Company is licensed to write all classes of property and casualty insurance in Canada.

1. Summary of significant accounting policies:

The accounting policies of the company conform with those generally accepted in Canada and comply with the requirements for filing with the Department of Insurance of Canada. The significant policies are:

a) Bonds and other debt securities and mortgages are shown in the balance sheet at amortized cost. Gains and losses on disposal of investments are determined on the completed transaction basis.

b) Furniture and fixtures are carried at cost less accumulated depreciation. Depreciation is provided on furniture and fixtures on the diminishing balance basis at appropriate rates.

c) Insurance premiums are included in income on a daily pro-rata basis over the life of the policies. Acquisition expenses related to unearned premiums, which expenses comprise commissions, premium taxes, and certain expenses of underwriting and issuing policies, are deferred and amortized to income over the periods in which premiums are earned. The method followed in determining the deferred acquisition expenses limits the amount of the deferral to its realizable value by giving consideration to investment income as well as losses and expenses expected to be incurred as the premiums are earned.

d) The company provides for all costs of investigation and settlement of claims incurred prior to the balance sheet date. The provision, while believed to be adequate, is of necessity based on estimates.

e) Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. Unearned premiums on business ceded and estimates of amounts recoverable from reinsurers on unpaid losses are recorded as deductions from unearned premiums and the provision for unpaid claims, respectively.

f) Deferred income taxes or tax benefits are provided for timing differences between the income or loss reported for financial statement purposes and the income or loss reported for tax purposes. Such differences relate primarily to the deferral of acquisition expenses and unearned premiums.

2. Capital stock and contributed surplus:

The company has authorized 100,000 redeemable preferred shares with a par value of $100 each issued in series and 300,000 common shares with a par value of $50 each. At December 31, 1985, 38,000 common shares had been issued. During the year, the parent company paid in $2,000,000 in cash to contributed surplus.

3. Requirements under the Canadian and British Insurance Companies Act:

The Act requires appropriation of retained earnings for several items, the major ones being assets not admitted, including the debit balance of deferred income tax, investment valuation reserve and a reserve for reinsurance ceded to unregistered companies. As a result of the foregoing, capital and surplus for the purposes of the Act is $15,409,000 (1984 – $17,457,000). The Act also limits dividends to shareholders. No dividend is permissible in 1986.

4. Pension plan:

The company has a non-contributory pension plan covering substantially all employees. The actuarial valuation at January 1, 1985 indicated a surplus of $514,000 and consequently no pension expense was recorded in 1985. Pension expense for 1984 was $167,000.

5. Related party transactions:

The company, in its normal course of business, has various agreements with reinsurance companies. One of these is with The Ætna Casualty and Surety Company of Hartford, Connecticut, U.S.A., an affiliated company. All premiums and recoveries under this agreement are recorded in the intercompany account and are settled on a regular periodic basis. Also the company participates in a cash management pool, operated by The Excelsior Life Insurance Company, whereby cash and short term investments are held in that company's name and pooled for investment purposes. Detailed accounting and allocation procedures ensure that balances and interest earnings are properly reflected.

6. Reinsurance ceded:

The company cedes reinsurance to other insurers in order to limit the maximum loss through the spreading of risks. Reinsurance ceded does not relieve the company of primary liability as the originating insurer as a contingent liability exists in the event any reinsurer does not meet its obligations under the reinsurance agreements. The following table sets out the impact of reinsurance ceded on liabilities:

thousands of dollars	**1985**	1984
Gross unpaid claims	**$46,921**	$38,406
Deduction for reinsurance ceded	**4,651**	1,921
Unpaid claims per balance sheet	**$42,270**	$36,485
Gross unearned premiums	**$32,855**	$32,679
Deduction for reinsurance ceded	**2,648**	503
Unearned premiums per balance sheet	**$30,207**	$32,176

The following table sets out the effect of reinsurance ceded on premiums earned and claims incurred:

thousands of dollars	**1985**	1984
Net premiums earned reduced by	**$8,462**	$5,620
Claims incurred reduced by	**$4,232**	$1,786

7. Bonds and other debt securities, and mortgage loans:

thousands of dollars	1985		1984	
	Cost or Amortized Cost	**Government Market Value**	Cost or Amortized Cost	Government Market Value
Bonds and other debt securities	**$30,880**	**$30,946**	$31,006	$30,833
Mortgage loans	**17,485**	**18,055**	12,692	12,755
	$48,365	**$49,001**	$43,698	$43,588

8. Subsequent event:

The parent company paid in an additional $1,500,000 in cash to contributed surplus on February 10, 1986.

Auditors' Report

To the shareholders of Ætna Casualty Company of Canada:

We have examined the balance sheet of Ætna Casualty Company of Canada as at December 31, 1985 and the statements of net loss and retained earnings (deficit) and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1985 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

Toronto, Canada
February 10, 1986

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Responsibility for Financial Statements

Management, Board of Directors and Audit Committee

The financial statements of The Excelsior Life Insurance Company and Ætna Casualty Company of Canada are the product of a number of processes that involve many participants.

These processes include the gathering together of financial data developed from the records of the Companies' day-to-day business transactions. Informed judgments and estimates are used for those transactions that are not yet complete, or for which the ultimate effects cannot be precisely measured. The Companies emphasize the selection and training of personnel who are qualified to perform these functions. In addition, Company personnel are subject to rigorous standards of ethical conduct that are widely communicated throughout the organization.

The Companies have also established internal accounting controls designed to provide reasonable assurance that assets are safeguarded and that transactions are authorized, executed and recorded properly. Company personnel throughout the organization maintain and monitor these internal accounting controls on an on-going basis. In addition, the Companies' internal auditors systematically review and report upon the functioning of these controls with the right of full access to all Company personnel.

The Board of Directors of the Companies have an Audit Committee composed solely of non-officer directors. The Committee meets periodically with the management, the internal auditors and the Companies' independent auditors to review the work of each and to inquire of each as to their assessment of the performance of the others in their work relating to the financial statements.

The Valuation Actuary

The Valuation Actuary is appointed by the Board of Directors of The Excelsior Life Insurance company pursuant to the Canadian and British Insurance Companies Act. His responsibility is to carry out an annual valuation of the Company's policy liabilities for the purpose of issuing reports to the shareholders, policyholders, and the Superintendent of Insurance. In performing this valuation, the actuary makes assumptions as to future rates of interest, mortality, claims experience, policy termination, inflation, reinsurance recoveries, expenses and other contingencies, taking into account the circumstances of the Company and the policies in force.

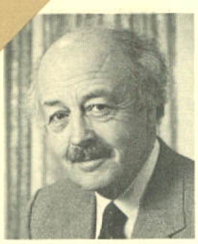
The Independent Auditors

The Independent Auditors are appointed by the shareholders and the policyholders pursuant to the Canadian and British Insurance Companies Act. Their responsibility is to report to the policyholders, shareholders, and the Superintendent of Insurance regarding the fairness of presentation, in accordance with established criteria, of the Company's financial statements. The auditors fulfill this responsibility by carrying out an examination, in accordance with generally accepted auditing standards, of these statements.

Board of Directors

Gordon N. Farquhar
Chairman and CEO
The Excelsior Life
Insurance Company,
Ætna Casualty
Company of Canada
Toronto, Ontario

H. Ian Macdonald
Director of
York International
Toronto, Ontario



J. Keith Reynolds
Partner, Alafin
Consultants Limited
Toronto, Ontario

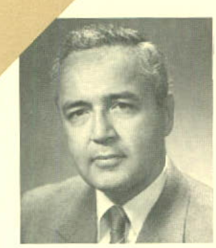
J. Allan Boyle
Director
The Toronto-Dominion
Bank
Toronto, Ontario

H. Gordon MacNeill
President and CEO
Jannock Limited
Toronto, Ontario

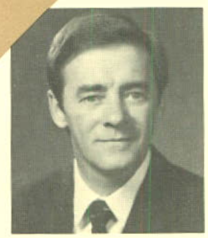
Michael A. Stephen
President and COO
The Excelsior Life
Insurance Company,
Ætna Casualty
Company of Canada
Toronto, Ontario

Fraser M. Fell, Q.C.
Chairman and CEO
Dome Mines Ltd.
Toronto, Ontario

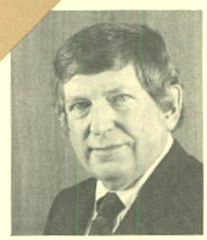
H. Keith Morley
Chairman and CEO
Costain Ltd.
Toronto, Ontario



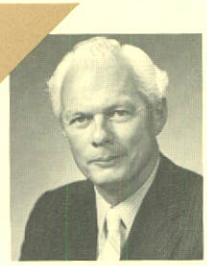
Kenneth P. Veit
President, Ætna
International Inc.,
Ætna Life & Casualty
Company
Hartford, Connecticut



Jean Lambert
Vice President
and Director,
Geoffrion, Leclerc Inc.
Québec, Québec



Arne R. Nielsen
Chairman and CEO
Canadian Superior
Oil Ltd.
Calgary, Alberta



Dean E. Wolcott
President, Personal
Financial Security
Division, Ætna Life
& Casualty Company
Hartford, Connecticut

Senior Officers

Gordon N. Farquhar
Chairman and Chief Executive Officer

Michael A. Stephen
President and Chief Operating Officer

Donald F. Duncan
Senior Vice President and Corporate Actuary

David J. Congram
Vice President, Corporate Actuarial

Barry F.H. Graham
Vice President and Treasurer

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The Excelsior Life Insurance Company

Ætna Casualty Company of Canada

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Managing General Agencies

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Group
Robert Sloane, Manager
Nancy Stirling, Manager (Claims)

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PPI Financial Group Ltd.
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Life and Casualty
Don Ogilvie, Manager

Managing General Agencies
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PPI Financial Group Ltd.

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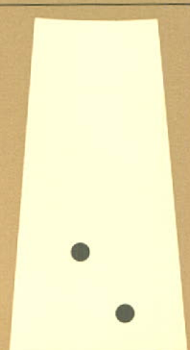

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Saskatoon
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Manitoba

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Merv Evdokimenko, Manager

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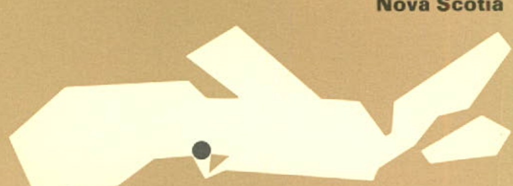

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Mary Dee-Smylie, Manager (Claims)
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PPI & Associates
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Vital Ins. Agency Inc.

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Quebec

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