



**First Quarter Report to Shareholders  
for the quarter ended March 31, 2012**

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*"Westaim" or the "Company" in this Management's Discussion and Analysis ("MD&A") refers to The Westaim Corporation on a consolidated basis. This MD&A, which has been approved by the Westaim Board of Directors, should be read in conjunction with Westaim's unaudited interim consolidated financial statements including notes for the three months ended March 31, 2012 and 2011 as set out on pages 31 to 56 of this Quarterly Report. Financial data in this MD&A has been derived from the unaudited interim consolidated financial statements for the three months ended March 31, 2012 and 2011 and is intended to enable the reader to assess Westaim's results of operations for the three months ended March 31, 2012 and financial condition as at March 31, 2012. The Company reports its consolidated financial statements using accounting policies consistent with International Financial Reporting Standards ("IFRS"). All amounts are in Canadian dollars unless otherwise indicated. The following commentary is current as of May 15, 2012. Additional information relating to Westaim is available on SEDAR at [www.sedar.com](http://www.sedar.com). Certain totals, subtotals and percentages may not reconcile due to rounding.*

### **Non-GAAP measures**

*Westaim uses both IFRS and non-generally accepted accounting principles ("non-GAAP") measures to assess performance. The Company cautions readers about non-GAAP measures that do not have a standardized meaning under IFRS and are unlikely to be comparable to similar measures used by other companies. Westaim analyzes insurance operations performance based on operating income and loss ratios, expense ratios and combined ratios. The loss ratio equals net claims and adjustment expenses divided by net premiums earned. The expense ratio equals the sum of commissions, premium taxes and general and administrative expenses divided by net premiums earned. The combined ratio is the sum of the loss ratio and the expense ratio. A combined ratio below 100% demonstrates underwriting profit whereas a combined ratio over 100% demonstrates an underwriting loss. Book value per share represents shareholders' equity at the end of the period, determined on an IFRS basis, divided by the total number of common shares plus convertible preferred shares outstanding on the same date.*

### **Future Oriented Financial Information**

*This MD&A may contain 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 2011 Annual Information Form. Please refer to the cautionary note in Section 17 of this MD&A.*

The Westaim Corporation  
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1. THE COMPANY

Westaim is a publicly traded Canadian-based financial services holding company that invests directly and indirectly through acquisitions, joint ventures and other arrangements, with the objective of providing its shareholders with capital appreciation and real wealth preservation. Westaim's strategy is to pursue investment opportunities to grow shareholder value (as measured by book value per share) over the long term.

The Company holds all the issued and outstanding shares of JEVCO Insurance Company ("Jevco"). Jevco is a leading Canadian property and casualty ("P&C") insurer that sells P&C products through a distribution network of over 2,000 independent brokers.

2. OVERVIEW OF PERFORMANCE

Highlights (millions except per share data)	Three months ended March 31	
	2012	2011
Direct premiums written	\$ 79.3	\$ 66.3
Net premiums written	\$ 75.8	\$ 62.9
Net premiums earned	\$ 77.0	\$ 70.5
Underwriting expenses	71.8	70.4
Underwriting income	5.2	0.1
Investment return	9.3	8.7
Corporate costs excluding share-based compensation	(2.3)	(0.8)
Share-based compensation	(4.3)	(2.3)
Other income	-	2.3
Income before income taxes	7.9	8.0
Income tax expense	(3.5)	(2.3)
<b>Net income</b>	<b>\$ 4.4</b>	<b>\$ 5.7</b>
Earnings per share		
- Net income – basic and diluted	\$ 0.01	\$ 0.01
Book value per share	\$ 0.66	\$ 0.59
Loss ratio	62.9%	72.5%
Expense ratio	30.4%	27.4%
Combined ratio	93.3%	99.9%
Net income	\$ 4.4	\$ 5.7
Other comprehensive income (loss)	2.4	(2.5)
<b>Comprehensive income</b>	<b>\$ 6.8</b>	<b>\$ 3.2</b>

## 2. OVERVIEW OF PERFORMANCE (continued)

### Consolidated Results – Three months ended March 31, 2012

For the three months ended March 31, 2012, the Company reported consolidated net income of \$4.4 million compared to consolidated net income of \$5.7 million for the three months ended March 31, 2011.

Income before income taxes for the three months ended March 31, 2012 was \$7.9 million (2011 - \$8.0 million). Underwriting income was \$5.2 million (2011 - \$0.1 million) and investment return, which includes investment income, foreign exchange gains and losses and net realized investment gains, was \$9.3 million (2011 - \$8.7 million). Share-based compensation costs were \$4.3 million (2011 - \$2.3 million) and other corporate costs were \$2.3 million (2011 - \$0.8 million).

Income tax expense for the three months ended March 31, 2012 was \$3.5 million (2011 - \$2.3 million). Investment return included in net income for the first quarter of 2012 of \$9.3 million (2011 - \$8.7 million) consists of net investment income earned on portfolio investments of \$7.3 million (2011 - \$6.8 million), net income related to instalment insurance premiums of \$0.5 million (2011 - \$0.7 million), foreign exchange losses of \$0.3 million (2011 - \$0.7 million) and net realized investment gains of \$1.8 million (2011 - \$1.9 million).

Other comprehensive income for the three months ended March 31, 2012 was \$2.4 million income (\$2011 - \$2.5 million loss). Net unrealized investment gains, excluding foreign exchange differences, for the three months ended March 31, 2012 of \$3.2 million (2011 - \$3.7 million loss) relating to the available-for-sale investment portfolio are excluded from net income and are included in other comprehensive income, net of income tax expense of \$0.8 million (2011 - \$1.2 million recovery).

For the three months ended March 31, 2012, net unrealized losses of \$1.0 million (2011 - \$1.2 million) relating to the held-to-maturity investment portfolio are excluded from net income and other comprehensive income.

## 3. SUBSEQUENT EVENT

Subsequent to quarter end, on May 2, 2012 the Company announced that it had entered into a definitive agreement (the "Agreement") with Intact Financial Corporation ("Intact") pursuant to which, subject to the terms and conditions of the Agreement, Intact has agreed to purchase from the Company all of the issued and outstanding shares in the capital of Jevco for \$530 million in cash (the "Transaction"). Adjusting for the payment of a \$30 million cash dividend from Jevco to Westaim during the first quarter of fiscal 2012, the purchase price is approximately 1.38 times the unconsolidated net book value of Jevco as at December 31, 2011.

The Agreement, as it is an event subsequent to the first quarter ended March 31, 2012, is not reflected in the Westaim first quarter statements of financial position, operations, equity and cash flow. The gain on sale of Jevco will be determined once all required shareholder and regulatory approvals have been received and other conditions of the Agreement have been met, likely upon the closing of the Transaction.

The Agreement contains a non-solicitation covenant on the part of Westaim, subject to customary "fiduciary out" provisions that entitle Westaim to consider and accept a superior proposal, a right in favour of Intact to match any superior proposal and the payment to Intact of a termination fee of \$18.5 million if the Transaction is not completed as a result of a superior proposal.

The Transaction is expected to close during the fall of 2012 conditional upon, among other things, the approval of Westaim's shareholders and the receipt of required regulatory approvals.

#### 4. DESCRIPTION OF INSURANCE BUSINESS

Established in 1980, Jevco is a provider of property and casualty insurance that operates in Canada distributing its specialty insurance products through a network of independent brokers to both individual and commercial customers. Jevco's vision is to be a first choice specialty insurer while striving to become a recognized alternative to the large players in certain niche insurance markets where it believes it has, or can obtain, a sustainable competitive advantage. The insurance products offered consist of (a) non-standard automobile insurance, (b) insurance for recreational vehicles and motorcycles, (c) standard automobile insurance in Quebec, (d) commercial automobile insurance, (e) property and liability insurance, and (f) surety products.

##### Personal Lines

Personal Lines include non-standard and standard automobile insurance, motorcycle and recreational vehicle insurance.

##### *Personal Automobile*

Personal automobile lines include the run-off of the discontinued "Kplus" product (which targeted risks between the standard and non-standard markets) and the results from mandatory participation in provincial Facility Associations which provide automobile insurance coverage to individuals who are unable to purchase coverage in the voluntary market.

The Company writes non-standard automobile insurance in the provinces of Ontario, Alberta and Quebec as well as standard automobile insurance in Quebec. Jevco began writing non-standard automobile insurance in Ontario effective October 1, 2009.

Non-standard automobile insurance covers individuals who do not qualify for standard automobile insurance because of their payment history, driving record, vehicle type or other factors. Non-standard automobile insurance is accompanied by increased loss exposure, higher claims experience and higher incidence of consumer and service provider fraud. These factors are mitigated by higher premium rates and the tendency of high-risk individuals to own lower value automobiles and to purchase coverage at the minimum prescribed limits. When the driving records of non-standard drivers improve, they may qualify to obtain insurance in the standard market at lower premium rates. As a result, non-standard automobile insurance policies experience a lower retention rate than that of standard market risk policies.

Standard automobile insurance provides coverage for standard risk drivers of private passenger automobiles. Premiums for these policies are usually lower than premiums charged in the non-standard market for comparable coverage. The frequency and severity of accidents and other loss events are also typically lower.

##### *Motorcycle and Recreational Vehicles*

The Company writes motorcycle insurance in the provinces of Ontario, Alberta and Quebec and is the leading writer of motorcycle insurance in Canada. Motorcycle insurance consists primarily of liability, physical damage and personal injury insurance coverage. The Company also writes insurance for ATVs, snowmobiles and watercraft in the Province of Quebec.

##### Commercial Lines

Commercial Lines include property and liability, automobile and surety insurance as well as the run-off of discontinued long haul trucking and home warranty lines.

##### *Property and Liability*

This business focuses on insuring against damage to property and accidents that may occur on such property. It consists of risks that are either difficult to place due to class, age, location or occupancy of the risk. These risks are characterized by high premiums and limited coverage. The Company's specialty property business includes insurance for restaurants, rental properties and garages.

##### *Commercial Automobile*

The Company focuses on specialty or niche types of products such as taxi, driver training, light commercial business vehicles, short or long haul trucking risks and other specialty risks such as sand and gravel, logging and tow trucks. Its strategy is to operate as a niche underwriter of classes that are more difficult to underwrite but where it has considerable expertise and experience. Early in 2011, the Company cautiously re-entered the long haul trucking market supported by a sound reinsurance program.

4. DESCRIPTION OF INSURANCE BUSINESS (continued)

*Surety*

The Company writes contract, commercial, fiduciary and customs and excise bonds. Contract bonds (which include performance, labour and material) guarantee the performance of a construction contract while commercial bonds, which are primarily license type bonds, satisfy the needs of provincial governments which require contractors to be licensed in the province in which they operate. Customs and excise bonds provide security for the benefit of the Canada Revenue Agency in the event there is a failure to remit payment of any duties and taxes.

5. ANALYSIS OF FINANCIAL RESULTS

The Company's operating results include the results from the insurance operations of Jevco.

5.1 Underwriting Income

Details of premiums and underwriting income by lines of business are as follows:

(millions)	Three months ended March 31, 2012			Three months ended March 31, 2011		
	Personal Lines	Commercial Lines	Total	Personal Lines	Commercial Lines	Total
Direct premiums written	\$ 51.9	\$ 27.4	\$ 79.3	\$ 45.4	\$ 20.9	\$ 66.3
Net premiums written	\$ 50.2	\$ 25.6	\$ 75.8	\$ 43.5	\$ 19.4	\$ 62.9
Underwriting income (loss):						
Net premiums earned	\$ 52.6	\$ 24.4	\$ 77.0	\$ 50.2	\$ 20.3	\$ 70.5
Underwriting expenses	46.2	25.6	71.8	53.7	16.7	70.4
Underwriting income (loss)	\$ 6.4	\$ (1.2)	\$ 5.2	\$ (3.5)	\$ 3.6	\$ 0.1
Loss ratio	60.7%	67.6%	62.9%	83.8%	44.5%	72.5%
Expense ratio	27.2%	37.2%	30.4%	23.1%	37.9%	27.4%
Combined ratio	87.9%	104.8%	93.3%	106.9%	82.4%	99.9%

The underwriting income for the three months ended March 31, 2012 was \$5.2 million (2011 - \$0.1 million), producing a loss ratio of 62.9% (2011 - 72.5%) and an expense ratio of 30.4% (2011 - 27.4%). In the three months ended March 31, 2012, Personal Lines produced an underwriting income of \$6.4 million (2011 - \$3.5 million loss) and Commercial Lines produced an underwriting loss of \$1.2 million (2011 - \$3.6 million income).

The expense ratio for Commercial Lines is significantly higher compared to Personal Lines due to higher commissions paid on commercial business as well as higher salary costs for the level of underwriting expertise required on commercial products.

Analysis of the underwriting performance is provided below by line of business.

Personal Lines

The Personal Lines division produced an underwriting income in the quarter ended March 31, 2012 of \$6.4 million (2011 - \$3.5 million loss). Underwriting results included favourable development of prior years' claims in the three months ended March 31, 2012 of \$8.5 million (2011 - \$1.1 million unfavourable).

The improved results in the first quarter of 2012 compared to the first quarter of 2011 were mainly due to favourable development in the Ontario non-standard automobile line of business. Management decisions taken over the past 18 months, along with changes to the Ontario Automobile Insurance reform legislation, continue to have a positive impact on the organization.

Commercial Lines

The Commercial Lines division posted an underwriting loss in the quarter ended March 31, 2012 of \$1.2 million (2011 - \$3.6 million income). Current year losses attributable to the commercial automobile and property and liability lines were partially offset by favourable development of prior years' claims in the first quarter of 2012 of \$1.3 million (2011 - \$5.1 million). In the first quarter of 2012, the Company experienced two large prior year claims in the surety lines which were more than offset by favourable prior year development in all other lines.

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5. ANALYSIS OF FINANCIAL RESULTS (continued)

5.2 Investment Income and Net Realized and Unrealized Gains

(millions)	Three months ended March 31			
	2012		2011	
	Return	Annualized % return	Return	Annualized % return
<u>Insurance Company Portfolio</u>				
Income net of expenses	\$ 7.3	3.0%	\$ 6.8	2.7%
Realized gains	1.8	0.7%	1.9	0.8%
Foreign currency loss	(0.3)	-0.1%	(0.7)	-0.3%
Unrealized investment gains (losses)				
- available-for-sale investments	3.2		(3.7)	
- held-to-maturity investments	(1.0)		(1.2)	
	<u>2.2</u>	0.9%	<u>(4.9)</u>	-2.0%
Insurance Company Portfolio	\$ 11.0	4.5%	\$ 3.1	1.3%
Net instalment premium income	<u>0.5</u>		<u>0.7</u>	
	<u>\$ 11.5</u>		<u>\$ 3.8</u>	
Average portfolio investments				
- measured at amortized cost	\$ 982.5		\$ 990.2	

*Three months ended March 31, 2012*

Investment income net of expenses for the three months ended March 31, 2012 was \$7.3 million (2011 - \$6.8 million), resulting in an annualized yield for the quarter of 3.0% (2011 - 2.7%). The portfolio is heavily concentrated in short duration, high quality fixed income securities to protect the portfolio from the impact of rising yields and further interest rate increases from the Bank of Canada. Investment income for the current period includes dividend income related to the August 2011 purchase of equity investments which at March 31, 2012 comprised approximately 12% of the investment portfolio.

On the portfolio backing the insurance operations, realized gains for the three months ended March 31, 2012 were \$1.8 million (2011 - \$1.9 million) and unrealized gains for the same period were \$2.2 million (2011 - \$4.9 million loss). Included in the unrealized gains for the three months ended March 31, 2012 was \$3.5 million in market value appreciation of the common equity portfolio.

Net instalment premium income in the three months ended March 31, 2012 of \$0.5 million (2011 - \$0.7 million) represents interest of \$1.0 million (2011 - \$1.1 million), net of expenses of \$0.5 million (2011 - \$0.4 million), earned from lending funds to policyholders to cover the cost of insurance premiums.

5.3 Corporate Costs

Corporate costs, excluding share-based compensation, for the three months ended March 31, 2012 were \$2.3 million (2011 - \$0.8 million). Corporate costs include fees for management services provided by Goodwood Management Inc. ("Goodwood"), as discussed in Section 11, *Related Party Transactions* of this MD&A. Corporate costs are \$1.5 million higher in the three months ended March 31, 2012 compared to the first quarter of 2011 due to costs incurred to investigate an investment opportunity which Westaim decided not to pursue.

5.4 Share-based Compensation

Share-based compensation expense for the quarter ended March 31, 2012 was \$4.3 million (2011 - \$2.3 million). Share-based compensation expense relates to the revaluation of the Company's outstanding restricted share units granted to Goodwood, and revaluation of outstanding deferred share units granted to directors of the Company and officers of Jevco.

5.5 Other Income

In connection with its acquisition of Jevco in 2010, the Company paid an amount of \$20.0 million to be held in escrow in respect of some of the claims reserve for Jevco's insurance business existing at the time of closing. In the event that the related claims reserve development from December 31, 2009 until December 31, 2012 was adverse to Jevco, the purchase price would have been reduced, to a maximum amount of \$20.0 million. In March 2011, this escrow amount was released upon agreement between the parties in exchange for a payment of \$2.25 million to the Company, which has been classified as other income.

5. ANALYSIS OF FINANCIAL RESULTS (continued)

5.6 Income Taxes

For the three months ended March 31, 2012, the Company's income tax expense was \$3.5 million compared to expense of \$2.3 million for the three months ended March 31, 2011. The increase was primarily attributable to unrecognized non-deductible temporary differences in the current period.

5.7 Other Comprehensive Income

Other comprehensive income consists of the change in unrealized gains of the available-for-sale investments, net of foreign exchange gains and losses and income taxes. Unrealized foreign exchange gains and losses under IFRS are reported directly in net income. For the three months ended March 31, 2012, the net unrealized gain on the available-for-sale investment portfolio was \$2.9 million (2011 - \$4.4 million loss). After excluding foreign exchange losses of \$0.3 million (2011 - \$0.7 million) and deducting income tax expense of \$0.8 million (2011 - \$1.2 million recovery), a \$2.4 million net of tax unrealized investment gain (2011 - \$2.5 million loss) was included in other comprehensive income. Section 5.2 includes an explanation of the change in investment gains in the three months ended March 31, 2012 and 2011.

6. ANALYSIS OF FINANCIAL POSITION

The Company's consolidated statement of financial position is comprised of the following:

(millions)	March 31, 2012	December 31, 2011
<b>Assets</b>		
Cash and cash equivalents	\$ 49.4	\$ 24.3
Investments	982.8	1,018.6
Instalment premiums	63.3	62.8
Recoverable from reinsurers	31.9	34.0
Claims recoverable from other insurers	51.1	51.0
Deferred policy acquisition expenses	36.0	35.6
Other assets	72.1	69.8
<b>Total assets</b>	<b>\$ 1,286.6</b>	<b>\$ 1,296.1</b>
<b>Liabilities</b>		
Unearned premiums	\$ 163.5	\$ 164.4
Unpaid claims and adjustment expenses	661.1	675.1
Other liabilities	38.0	39.4
	862.6	878.9
Shareholders' equity	424.0	417.2
<b>Total liabilities and shareholders' equity</b>	<b>\$ 1,286.6</b>	<b>\$ 1,296.1</b>

6.1 Cash and Cash Equivalents

At March 31, 2012, the Company had consolidated cash and cash equivalents of \$49.4 million compared to \$24.3 million at December 31, 2011. Of this balance, \$6.2 million (December 31, 2011 - \$9.7 million) was held by Jevco to support the insurance operations. See further discussion below in Section 9, *Liquidity and Capital Resources* of this MD&A.



6. ANALYSIS OF FINANCIAL POSITION (continued)

6.2 Investments

The Company's investment portfolio of \$982.8 million at March 31, 2012 (December 31, 2011 - \$1,018.6 million) consisted of investments held to support the insurance business.

Insurance companies must comply with applicable regulations that prescribe the type, quality and concentration of investments. These regulations permit investments in government, provincial, municipal and corporate bonds, and preferred and common equities, within specified limits and subject to certain qualifications. The Company has its own investment policies and guidelines which meet or exceed the regulatory requirements as well as additional risk management policies to address credit risk, interest rate risk, equity prices risk, liquidity risk and asset diversification. The Investment Committee of the Board of Jevco and senior management monitor the Company's risk exposures and activities that give rise to these exposures.

(millions)	March 31, 2012	December 31, 2011
Carrying value of investment portfolio:		
Term deposits	\$ 17.1	\$ 84.8
Government bonds	275.1	261.9
Corporate debt securities	449.5	432.9
Mortgage and other asset backed securities	118.7	122.0
Total fixed income investments	860.4	901.6
Common shares	108.4	103.9
Preferred shares	14.0	13.1
Total investments	\$ 982.8	\$ 1,018.6

Carrying value is fair value for available-for-sale investments and amortized cost for held-to maturity investments.

The Company manages its investments to support the liabilities of its insurance operations, to preserve capital and to generate attractive, after-tax investment returns while adhering to a low risk philosophy. The investment portfolio consists primarily of corporate and government bonds with relatively short durations. Within the mortgage and other asset backed securities category are government guaranteed residential mortgage backed securities and very high quality consumer credit securities. In August 2011, the Company invested approximately 10% of its investment portfolio in Canadian dividend paying common equities with the intention of generating an attractive yield along with long term capital appreciation. Exposure to foreign currencies, including the United States dollar, is considered to be low, with \$16.1 million invested in U.S. dollar denominated securities at March 31, 2012, primarily to match an equivalent amount of United States dollar claims related liabilities. Investments are managed by unrelated third-party investment management firms and the Company monitors their performance and their compliance with both their individual mandate and the Company's investment policies and guidelines.

By virtue of the nature of the Company's business activities, financial instruments make up the majority of the statement of financial position. The risks which arise from holding financial instruments include credit risk, market risk, liquidity risk and cash flow risk. These risks may be caused by factors specific to an individual instrument or factors affecting all instruments traded in the market. The Company has a comprehensive risk management framework to monitor, evaluate and manage the risks assumed in conducting its business.

For a more detailed analysis and quantification of market risk, see Note 21 to the unaudited consolidated financial statements for the three months ended March 31, 2012.

6.3 Instalment Premiums

The instalment premiums asset at March 31, 2012 was \$63.3 million (December 31, 2011 - \$62.8 million). Premiums are typically payable at the time of policy issue or renewal. The Company offers the option to pay in monthly instalments. The insured pays an additional amount for this option, reflecting handling costs and foregone investment income to the Company.

6. ANALYSIS OF FINANCIAL POSITION (continued)

6.4 Recoverable from Reinsurers

At March 31, 2012, amounts recoverable from reinsurers totaled \$31.9 million (December 31, 2011 - \$34.0 million). The table below summarizes the credit exposure of the Company for amounts recoverable from reinsurers, by rating assigned by A.M. Best.

Financial strength ratings of reinsurers (millions)	March 31, 2012		December 31, 2011	
	Amount	Percentage	Amount	Percentage
A++	\$ 0.1	-	\$ 0.2	1%
A+	9.5	30%	9.7	29%
A	21.1	66%	22.9	67%
Other	1.2	4%	1.2	3%
	\$ 31.9	100%	\$ 34.0	100%

In the normal course of business, the Company seeks to reduce the loss that may arise from a catastrophe or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. Failure of reinsurers to honour their obligations could result in losses to the Company.

For a more detailed discussion of the Company's reinsurance program, see Section 7, *Reinsurance* of this MD&A and Note 5 to the unaudited consolidated financial statements for the three months ended March 31, 2012.

6.5 Claims Recoverable from Other Insurers

Claims recoverable from other insurers totaled \$51.1 million at March 31, 2012 (December 31, 2011 - \$51.0 million). In accordance with the Insurance Act of Ontario (the "Act"), an insurance company has a right of indemnification for certain benefits paid to its own insured from the insurer of a third party at fault. The Act also provides for an arbitration process when the two insurers are not in agreement as to the amount of losses to be transferred. Claims recoverable from other insurers represent management's estimate of the amounts recoverable. Failure of other insurers to honour their obligations could result in losses to the Company.

6.6 Deferred Policy Acquisition Expenses

At March 31, 2012, deferred policy acquisition expenses were \$36.0 million (December 31, 2011 - \$35.6 million). The Company defers brokers' commissions, premium taxes and other underwriting and marketing costs relating to the acquisition of premiums written to the extent they are considered recoverable. These costs are expensed as the related premiums are earned. The method followed in determining the deferred policy acquisition expenses limits the deferral to its realizable value by giving consideration to estimated future claims and expenses to be incurred as premiums are earned. Anticipated investment income is considered in determining the realizable value of the deferred policy acquisition expenses. Changes in estimates are reflected in the statement of operations in the period in which such estimates are updated.

6.7 Other assets

Other assets include investment income due and accrued, accounts receivable, income tax assets, property and equipment, and intangible assets.

6.8 Unearned Premiums

At March 31, 2012, the unearned premium liability was \$163.5 million (December 31, 2011 - \$164.4 million). Unearned premiums represent the portion of premiums written related to the unexpired risk portion of the policy at the end of the period. The Company earns motorcycle premiums unevenly over the period of risk covered by each policy based on past experience and on all other lines evenly over the period covered by each individual insurance contract.

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6. ANALYSIS OF FINANCIAL POSITION (continued)

6.9 Unpaid Claims and Adjustment Expenses

At March 31, 2012, the provision for unpaid claims and adjustment expenses was \$661.1 million (December 31, 2011 - \$675.1 million). The table below shows the unpaid claims and adjustment expenses by Personal and Commercial Lines of business, direct and net. The net unpaid claims and adjustment expenses are net of both external reinsurance and amounts recoverable from other insurers which are presented as assets in the consolidated statement of financial position.

(millions)	March 31, 2012		December 31, 2011	
	Direct	Net	Direct	Net
Personal Lines	\$ 466.7	\$ 403.2	\$ 478.3	\$ 412.7
Commercial Lines	194.4	176.8	196.8	179.1
	\$ 661.1	\$ 580.0	\$ 675.1	\$ 591.8

A provision for unpaid claims and adjustment expenses includes several components: a provision for unpaid claims based on an estimated liability on individual reported claims (more commonly known as case reserves), an estimated provision for claims that have not yet been reported and expected future development on case reserves, collectively known as the incurred but not reported claims provision ("IBNR"), an estimate of allocated loss adjustment expenses (primarily defense costs) and unallocated loss adjustment expenses (primarily the adjustment handling costs by claims personnel) expected to be incurred in the future. At March 31, 2012, the direct unpaid claims and adjustment expenses of \$661.1 million (December 31, 2011 - \$675.1 million) consisted of \$442.0 million (December 31, 2011 - \$459.9 million) related to case reserves and \$219.1 million (December 31, 2011 - \$215.2 million) related to IBNR.

An evaluation of the adequacy of the provision for unpaid claims and adjustment expenses is completed at the end of each quarter. This evaluation includes a re-estimation of the provision for unpaid claims and adjustment expenses relating to each preceding financial year compared to the provision that was originally established. The results of this comparison and the changes in the provisions for unpaid claims and adjustment expenses for the three months ended March 31, 2012 and for the year ended December 31, 2011 are as follows:

(millions)	Three months ended March 31, 2012	Year ended December 31, 2011
<u>Unpaid claims and adjustment expenses</u>		
Beginning of period	\$ 675.1	\$ 705.1
Reinsurers' share	(32.3)	(28.2)
Other insurers' share	(51.0)	(40.2)
Beginning of period, net	591.8	636.7
Paid during the period	(60.2)	(262.7)
Increase due to current year claims	57.5	249.9
Decrease due to prior years' claims	(9.8)	(36.4)
Change in discount rates and provision for adverse deviation	0.7	4.3
End of period, net	580.0	591.8
Reinsurers' share	30.0	32.3
Other insurers' share	51.1	51.0
End of period	\$ 661.1	\$ 675.1

Favourable prior years' claims development in the three months ended March 31, 2012 of \$9.8 million and for the year ended December 31, 2011 of \$36.4 million represents 1.7% and 5.7%, respectively, of opening net unpaid claims and adjustment expenses.

The establishment of a provision for unpaid claims represents management's best estimate of the ultimate cost of both reported but unsettled claims and unreported claims utilizing actuarial and statistical procedures. The provision for unpaid claims represents the discounted estimates of the ultimate net cost of all unpaid claims and loss adjustment expenses plus provisions for adverse deviation. Establishing the provision for unpaid claims relies on the judgment and opinions of a large number of individuals, including the opinions of the Appointed Actuary. Management regularly reviews its estimates and adjusts as experience develops and new information becomes available. In establishing the provision for unpaid claims, the Company also takes into account estimated recoveries, reinsurance, salvage and subrogation.

Factors affecting the provision for unpaid claims include the continually evolving and changing regulatory and legal environments, actuarial studies, professional experience and the expertise of claims personnel and independent adjusters retained to handle individual claims. Changes in claims handling procedures and the individuals involved in the reserving process also affect the provision for unpaid claims. Quality of the data used for projection purposes, existing claims management practices (including claims handling and settlement practices), the effect of inflationary trends on future claims settlement costs, court decisions, economic conditions and public attitudes, all affect the provision for unpaid claims.

## 6. ANALYSIS OF FINANCIAL POSITION (continued)

Time is a critical part of the provision's determination, since the longer the span between the incidence of a loss and the payment or claim settlement, the more variable the ultimate settlement amount can be. Short-tailed claims, such as property claims, tend to be more predictable than long-tailed claims such as general liability and automobile accident benefit claims. The provision for unpaid claims is discounted to reflect the time value of expected future payouts of claims. Adjustments to estimates of the provision for unpaid claims are reflected in the consolidated statement of operations in the period in which they become known. Even after such adjustments, ultimate liability or recovery may exceed or be less than the revised estimates. A change that increases the provision for unpaid claims is known as an unfavourable development and will reduce net income whereas a change that decreases the provision for unpaid claims is known as a favourable development and will increase net income.

Management has the responsibility to ensure that the provision for unpaid claims, including IBNR, is appropriate. Management establishes, maintains and evaluates its respective provisions for unpaid claims and evaluates all of its respective policy coverages and paid and open claim level data to ascertain claim frequency and severity trends, as well as the effects of inflation or changes in operating structure or process may have on future loss settlements. Management reviews the information by product and geographic regions to monitor emergence of any patterns. Management incorporates all of the above information to record its best estimate of the provision for unpaid claims.

Management also uses actuarial and statistical procedures to allocate the IBNR by accident years and coverages, programs and/or lines of business.

### 6.10 Other Liabilities

Other liabilities of \$38.0 million at March 31, 2012 (December 31, 2011 - \$39.4 million) include accounts payable, accrued liabilities and a leasehold inducement of \$2.5 million (December 31, 2011 - \$2.6 million) which is amortized to income over the term of the lease. Other liabilities also include a site restoration provision of \$2.4 million at March 31, 2012 (December 31, 2011 - \$2.4 million). The provision relates to site restoration costs associated with soil and groundwater reclamation and remediation costs. The Company conducts periodic reviews of the underlying assumptions supporting the provision, including remediation costs and regulatory requirements. Potential reimbursements of costs resulting from indemnifications provided by previous owners of the industrial sites have not been recognized in these consolidated financial statements. Any future reimbursements will be recorded when received.

### 6.11 Shareholders' equity

The details of shareholders' equity are as follows:

(millions)	March 31, 2012	December 31, 2011
Common shares	\$ 656.6	\$ 656.6
Preferred shares	30.8	30.8
Warrants	1.9	1.9
Contributed surplus	12.9	12.9
Accumulated other comprehensive income	13.6	11.2
Deficit	(291.8)	(296.2)
Shareholders' equity	<u>\$ 424.0</u>	<u>\$ 417.2</u>

Accumulated other comprehensive income represents the unrealized gains in the insurance company available-for-sale investment portfolio. The decrease in deficit of \$4.4 million from December 31, 2011 to March 31, 2012 is due to the net income for the three months ended March 31, 2012.

## 7. REINSURANCE

The Company's reinsurance program is designed with the objective of protecting capital and increasing underwriting capacity. The Company has policies to evaluate the financial condition of its reinsurers and monitors concentrations of credit risk arising from common ownership, geography, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer's insolvency. The reinsurers chosen to participate in the program have a minimum rating at inception of A- from A.M. Best or S&P.

In 2012, the Company has reinsurance protection which limits the maximum amount on any one loss to \$2.25 million (2011 - \$2.0 million) in the event of a liability claim to a maximum of \$30.0 million (2011 - \$30.0 million), and \$1.0 million (2011 - \$0.75 million) in the event of a property claim to a maximum of \$10.0 million (2011 - \$10.0 million). In addition, the Company has property catastrophe reinsurance which provides coverage in the event of a series of claims arising out of a single occurrence. Reinsurance limits this exposure to \$2.5 million (2011 - \$2.5 million) per occurrence to a maximum of \$25.0 million (2011 - \$25.0 million).

## 8. OUTLOOK

Westaim completed a positive first quarter allowing the Company's book value per share to appreciate by 1% from \$0.65 at December 31, 2011 to \$0.66 at March 31, 2012.

### Subsequent event

Subsequent to quarter end, on May 2, 2012, Westaim entered into an Agreement with Intact as described in Section 3, *Subsequent Event* of this MD&A. The Transaction is expected to close in the fall of 2012. Following the Transaction, it is expected that Westaim will distribute substantially all of the net proceeds from the sale, in the form of a return of capital to the shareholders of Westaim.

The Board of Directors of Westaim, after consultation with its financial and legal advisors, unanimously approved entering into the Agreement and recommends that Westaim shareholders approve the Transaction at a special meeting of shareholders to be convened and held for the purpose of approving the Transaction. Full details of the Transaction will be included in a management information circular and related proxy materials (collectively, the "Circular") to be mailed to Westaim shareholders in accordance with applicable securities laws. Westaim expects to mail the Circular to Westaim shareholders on or about June 8, 2012.

Shareholders representing in the aggregate approximately 48.6% of the outstanding common shares and approximately 53.7% of all outstanding shares entitled to vote at the special meeting of Westaim shareholders (namely, Alberta Investment Management Corporation, on behalf of certain funds whose investments it manages, Goodwood Inc., Goodwood Management Inc. and the directors and executive officers of Westaim and Jevco) have agreed to vote their Westaim shares in favour of the Transaction.

### Jevco

The Ontario non-standard automobile line of business, which represents approximately half of the Personal Lines Gross Written Premium, continues to respond favorably to the 2010 initiatives taken by management. Management believes these initiatives, along with Ontario legislative changes enacted in September 2010 aimed at controlling the costs of accident benefit claims, improved the loss ratio of this line of business in 2011 in line with industry peers, and profits continued to show this improvement in Q1 2012 and are expected to continue to improve in 2012. Favourable results for the first quarter 2012 compared to the first quarter of 2011 for the motorcycle lines reflect the benefit of the implementation of Jevco's 2011 motorcycle premium rate increase of 7.3% effective May 1, 2011 for new business and June 10, 2011 for renewal business. The 2012 motorcycle rate increase of 8% became effective March 15, 2012 for new business and is effective May 15, 2012 for renewal business (before the expected start of the Motorcycle season). Management believes the impact of these rate increases, along with certain product changes in 2012, will enhance the performance of this line of business going forward.

In Commercial Lines, Jevco continues to build upon its core specialty lines of surety, commercial automobile and specialty commercial risks including the recent return to long-haul trucking. The re-entry into the long-haul trucking business was cautious and modest growth is expected in 2012. In the Surety business, management expects to be able to retain the Company's market share in 2012 despite the potential of a slow economy.

The interest rate environment continues to produce low investment yields relative to historical levels. During the third quarter of 2011, due to the decline in the equity markets and more attractive equity valuations, Jevco reallocated approximately \$100 million of its investment portfolio into high quality, dividend paying Canadian common and preferred equities which contributed a net investment gain of \$3.5 million to comprehensive income in the first quarter of 2012. Going forward, the Company will continue to take advantage of its short duration portfolio to redeploy capital opportunistically in high quality bonds and equities at the appropriate time.

Jevco is well positioned with a March 31, 2012 Minimum Capital Test ("MCT") ratio of 314% and an A.M. Best financial strength rating of B++ (Good). In March 2012, A.M. Best affirmed its financial strength rating of Jevco of B++ (Good) and revised the outlook for the rating to positive from stable.

## 9. LIQUIDITY AND CAPITAL RESOURCES

### Capital Management

The Company's guiding principles for capital management are to maintain the stability and safety of the Company for its stakeholders through optimal capital mix and an adequate level of capital, satisfy all regulatory requirements, ensure the return on capital meets the Board of Directors' expectations relative to the risk taken, and minimize the after-tax cost of capital.

Towards achieving these objectives, the Company employs a strong and efficient capital base and manages capital in accordance with policies established by the Board of Directors. These policies relate to capital strength and capital mix. The Company has a capital management process in place to measure, deploy and monitor its available capital to assess its adequacy on a continuous basis. Management develops the capital strategy and oversees the capital management processes of the Company. Capital is managed using both regulatory capital measures and internal metrics. The Company's capital is primarily derived from share capital, contributed surplus and retained earnings.

As specified in the capital guidelines of the Office of the Superintendent of Financial Institutions Canada ("OSFI"), property and casualty insurance companies are required to maintain an MCT ratio with a supervisory target of 150%. In some cases, OSFI may establish an alternative supervisory target level based upon an individual institution's risk profile. Jevco's policy is to maintain its MCT ratio at a minimum target of 220%. This capital target ratio is reviewed by the Board of Directors at least annually. At March 31, 2012, the MCT ratio of Jevco was 314% compared to 326% at December 31, 2011, a reduction in the ratio of 12%. The positive effect on the MCT of the first quarter comprehensive income and current tax savings resulting from the utilization of available tax losses was more than offset by the impact of a \$30 million dividend paid to the holding company. Management performs dynamic capital adequacy testing on the Company to evaluate the potential effects on the Company's financial condition with a set of specified changes in risk factors, corresponding to extreme events that are plausible, but unlikely. Under each scenario, the MCT ratio exceeded the supervisory target MCT ratio and Jevco's financial condition was considered to be satisfactory.

In addition, management periodically performs scenario stress-testing analysis and comparisons of actual, projected and targeted capital positions to ensure adequacy of actual capital.

On August 24, 2011, Westaim announced that the Toronto Stock Exchange (the "TSX") had approved a notice of the Company's intention to make a normal course issuer bid. Pursuant to the terms of the bid, Westaim may purchase its own common shares for cancellation through the facilities of the TSX at the prevailing market price of the common shares. It is expected that the maximum number of common shares which may be purchased by the Company will not exceed 30,173,238, being 10% of the 301,732,838 common shares which were in the "public float" on August 24, 2011. Purchases are subject to a daily maximum of 79,235 common shares, except where such purchases are made in accordance with the "block purchase" exemption under applicable TSX policy. Between January 1, 2012 and May 15, 2012, no shares were purchased under the normal course issuer bid. As at March 31, 2012 and May 15, 2012, 6,455,000 common shares had been purchased pursuant to the normal course issuer bid.

### Cash Flow

The Company manages its liquidity to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. The Company believes it has the flexibility to obtain from internal sources the funds needed to fulfill its cash requirements during the following financial year and to satisfy regulatory capital requirements. The liquidity requirements of the Company's business are met primarily by funds generated from operations, asset maturities and income received on investments. Cash provided from these sources is used primarily for claims and claims adjustment expense payments and operating expenses. The timing and amount of catastrophe claims are inherently unpredictable and may create increased liquidity requirements.

The Westaim Corporation  
Management's Discussion and Analysis  
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9. LIQUIDITY AND CAPITAL RESOURCES (continued)

The following tables illustrate the duration of the financial assets of the Company compared to its financial obligations:

March 31, 2012 (millions)	One year or less	1 to 3 years	4 to 5 Years	More than 5 years	No specific date	Total
Financial assets:						
Cash and cash equivalents	\$ 49.4	\$ -	\$ -	\$ -	\$ -	\$ 49.4
Investment income due and accrued	10.0	-	-	-	-	10.0
Investments available-for-sale	168.0	405.1	95.8	94.2	122.4	885.5
Investments held-to-maturity	-	-	-	97.3	-	97.3
Instalment premiums	63.3	-	-	-	-	63.3
Accounts receivable	28.0	0.3	-	-	-	28.3
Recoverable from reinsurers	10.9	12.3	5.5	3.2	-	31.9
Claims recoverable from other insurers	17.5	19.7	8.7	5.2	-	51.1
Total financial assets	347.1	437.4	110.0	199.9	122.4	1,216.8
Financial obligations:						
Accounts payable and accrued liabilities	22.4	6.4	-	-	3.4	32.2
Income taxes, due and accrued	0.8	-	-	-	-	0.8
Unearned premiums	163.5	-	-	-	-	163.5
Unpaid claims and adjustment expenses	223.2	253.7	116.0	68.2	-	661.1
Lease commitments	3.0	6.0	5.8	26.8	-	41.6
Site restoration provision	-	-	-	-	2.4	2.4
Total financial obligations	12.9	266.1	121.8	95.0	5.8	901.6
Financial assets net of financial obligations	\$ (65.8)	\$ 171.3	\$ (11.8)	\$ 104.9	\$ 116.6	\$ 315.2

December 31, 2011 (millions)	One year or less	1 to 3 years	4 to 5 years	More than 5 years	No specific date	Total
Financial assets:						
Cash and cash equivalents	\$ 24.3	\$ -	\$ -	\$ -	\$ -	\$ 24.3
Investment income due and accrued	5.6	-	-	-	-	5.6
Investments available-for-sale	183.6	343.6	189.3	87.6	117.0	921.1
Investments held-to-maturity	-	-	-	97.5	-	97.5
Instalment premiums	62.8	-	-	-	-	62.8
Accounts receivable	27.4	-	-	-	-	27.4
Recoverable from reinsurers	11.7	12.9	6.0	3.4	-	34.0
Claims recoverable from other insurers	17.6	19.4	8.9	5.1	-	51.0
Total financial assets	333.0	375.9	204.2	193.6	117.0	1,223.7
Financial obligations:						
Accounts payable and accrued liabilities	25.5	5.3	-	-	2.7	33.5
Income taxes, due and accrued	0.8	-	-	-	-	0.8
Unearned premiums	164.4	-	-	-	-	164.4
Unpaid claims and adjustment expenses	231.7	257.5	117.8	68.1	-	675.1
Lease commitments	3.0	5.5	5.4	24.9	-	38.8
Site restoration provision	-	-	-	-	2.4	2.4
Total financial obligations	425.4	268.3	123.2	93.0	5.1	915.0
Financial assets net of financial obligations	\$ (92.4)	\$ 107.6	\$ 81.0	\$ 100.6	\$ 111.9	\$ 308.7

The Company's investment guidelines stress preservation of capital and market liquidity to support payment of liabilities. The matching of the duration of financial assets and liabilities is monitored to ensure that all obligations will be met.

9. LIQUIDITY AND CAPITAL RESOURCES (continued)

Indemnification

In connection with the sale of the operations and assets of a subsidiary, the subsidiary provided an indemnity to the purchaser against certain losses to an aggregate maximum of US\$11 million. The Company also agreed to indemnify the directors, officers and employees of the purchaser, for an indefinite period, from certain potential environmental costs relating to premises formerly leased by the subsidiary.

Regulatory Compliance

Jevco is regulated by OSFI and is required to maintain a level of capital sufficient to support the volume and risk profile of Jevco's business. Generally, OSFI requires insurers to achieve a ratio of at least 150% under an MCT formula.

Dividends

No dividends were paid in the three months ended March 31, 2012 or 2011. The Company's current policy is to retain its cash reserves to finance investments and operations.

Share Capital

At March 31, 2012 and May 15, 2012, the Company had 580,343,960 common shares and 63,852,912 Series 1 Class A non-voting, convertible participating preferred shares ("Series 1 Class A preferred shares") outstanding. Also outstanding at March 31, 2012 were 400,000 stock options, 26,849,193 restricted share units exercisable at future dates for cash and with the right to purchase common shares, and 10,000,000 warrants exercisable for Series 1 Class A preferred shares. Subsequent to quarter end, an additional 9,665,709 restricted share units were granted.

The Company's authorized share capital consists of an unlimited number of common shares, Class A preferred shares and Class B preferred shares. The Series 1 Class A preferred shares are entitled to dividends as the directors may declare, provided that an equal dividend is declared on the common shares, and rank equally with the common shares with respect to liquidation proceeds. The Series 1 Class A non-voting preferred shares are convertible into common shares, on a one to one basis, subject to any adjustments resulting from subdivision or consolidation of the common shares, provided that the conversion does not result in the holder owning common shares exceeding an ownership limit of 40%.

Share-based compensation plans

On April 12, 2010, the Board of Directors of the Company approved the adoption of a comprehensive long-term equity incentive plan (the "Incentive Plan"), ratified at the Company's annual general meeting of shareholders held on May 12, 2010, designed to combine the Company's prior equity incentive plans, being the Employee and Director Stock Option Plan, the Directors and Officers Share Purchase Program, the Restricted Share Unit Plan, and the Deferred Share Unit Plan, collectively, the "Prior Plans". All awards granted under the Prior Plans remain in full force and effect in accordance with their terms, however, no additional grants will be made under the Prior Plans. See Note 17 to the unaudited consolidated financial statements for the three months ended March 31, 2012.

Volatility of Share Price

The price of the common shares may be volatile even though there have been no material changes in the Company's business or finances. In the past, securities class action litigation has often been brought against companies that experience volatility in the market price of their securities. Whether or not meritorious, litigation brought against the Company could result in substantial costs, divert management's attention and resources and harm the Company's financial condition and results of operations.

Market for Securities

The common shares of The Westaim Corporation are listed on the TSX under the symbol "WED".



## 10. RISKS

Westaim and/or Jevco are subject to a number of risks, including the risks described below. The risks and uncertainties described below are those believed to be material, but they may not be the only ones faced by Westaim or Jevco. If any of the following risks, or any other risks and uncertainties that have not yet been identified by Westaim or Jevco or that Westaim or Jevco currently considers not to be material, actually occur or become material risks, the business, prospects, financial condition, results of operations and cash flows of Westaim and/or Jevco could be materially and adversely affected.

### Risk Factors Related to Jevco

#### *Financial Risk*

Further information regarding financial risk is included in Notes 11 and 21 to the unaudited consolidated financial statements for the three months ended March 31, 2012.

#### *Strategic Risk*

*The insurance and related industries and businesses in which Jevco operates may be subject to periodic negative publicity which may negatively impact its financial results.*

Jevco's products and services are ultimately distributed to individual consumers. From time-to-time, consumer advocacy groups or the media may focus attention on insurance products and services, thereby subjecting the industry to periodic negative publicity. Jevco also may be negatively impacted if participants in one or more of its markets engage in practices resulting in increased public attention to its businesses. Negative publicity may also result in increased regulation and legislative scrutiny of practices in the property and casualty insurance industry as well as increased litigation. These factors may further increase Jevco's costs of doing business and adversely affect its profitability by impeding its ability to market its products and services, requiring Jevco to change its products or services or by increasing the regulatory burdens under which it operates.

*The highly competitive environment in which Jevco operates could have an adverse effect on its business, results of operations and financial condition.*

The markets in which Jevco operates are highly competitive. Jevco competes with major insurers, many of which have more financial, marketing, management, technical personnel and other resources than Jevco. There may also be other companies of which Jevco is not aware that may be planning to enter the insurance industry. Insurers in Jevco's markets generally compete on the basis of price, consumer recognition, coverages offered, claims handling, financial stability, customer service and geographic coverage. Although Jevco's pricing is influenced to some degree by that of Jevco's competitors, Jevco generally believes that it is not in its best interest to compete solely on price, and may from time-to-time experience a loss of market share during periods of intense price competition. Jevco's business could be adversely impacted by the loss of business to competitors offering competitive insurance products at lower prices in an attempt to gain market share. This competition could affect Jevco's ability to attract and retain profitable business.

In Jevco's non-standard automobile business, Jevco competes with both large national underwriters and smaller regional companies. Jevco's competitors include other companies that, like Jevco, serve the independent agency market, as well as companies that sell insurance directly to customers. Direct underwriters may have certain competitive advantages over agency underwriters, including increased name recognition, loyalty of the customer base to the insurer rather than to an independent agency and reduced costs to acquire policies. Any new, proposed or potential legislative or industry developments could further increase competition in Jevco's markets.

New competition from these developments could cause the demand for Jevco's products to decrease, which would adversely affect Jevco's profitability. From time-to-time, Jevco's markets may also attract competition from new entrants. In some cases, such entrants may, because of inexperience, the desire for new business or for other reasons, price their insurance below the rates that Jevco believes offer acceptable premiums for the related risk. Further, a number of Jevco's competitors, including new entrants to Jevco's markets, are developing e-business capabilities which may impact the level of business transacted through Jevco's more traditional distribution channels or that may affect pricing in the market as a whole. As new competitors enter the market and as new products are introduced, Jevco may encounter additional and more intense competition and there can be no assurance that Jevco will maintain or increase its revenues or be profitable. To a large degree, the future revenues of Jevco are dependent upon its ability to continue to develop and market its products and to enhance its products to meet changes in customer needs.

Although Jevco's business strategy assumes that the industry will generate competition, there can be no assurance as to how any level of competition may impact the future revenues of Jevco.

## 10. RISKS (continued)

*If Jevco is unable to maintain its current claims-paying ratings, Jevco's ability to write insurance and to compete with other insurance companies may be adversely impacted.*

Third party rating agencies assess and rate the claims-paying ability of insurers and reinsurers based upon criteria that they have established. Periodically these rating agencies evaluate Jevco to confirm that it continues to meet the criteria of the ratings previously assigned to it. Financial strength ratings are an important factor in establishing the competitive position of insurance companies and may be expected to have an effect on an insurance company's premiums.

Jevco is rated B++ (Good) by A.M. Best (fifth highest of 15 rating levels) with a positive outlook. A.M. Best issues independent opinions of an insurer's financial strength and its ability to meet policyholder obligations. According to A.M. Best, entities with a B++ rating are deemed "secure" and this rating is assigned to companies that have, in their opinion, a good ability to meet their ongoing insurance obligations. A positive outlook indicates a possible rating upgrade over an intermediate term, generally defined as 12 to 36 months, due to favourable financial/market trends relative to the current rating level.

There can be no assurances that A.M. Best will not downgrade Jevco's ratings in the future. If Jevco is unable to maintain its current ratings, its ability to write insurance business and compete with other insurance companies may be adversely affected. Rating agencies evaluate insurance companies based on financial strength and the ability to pay claims, factors that are more relevant to policyholders than to investors. Financial strength ratings by rating agencies are not ratings of securities or recommendations to buy, hold or sell any security and should not be relied upon as such.

*Jevco's business could be adversely affected as a result of changing political, regulatory, economic or other influences.*

The insurance industry is subject to changing political, economic and regulatory influences. These factors affect the practices and operation of insurance and reinsurance organizations. The governments in jurisdictions in which Jevco operates have periodically considered programs to reform or amend their respective insurance and reinsurance systems. Recently, the insurance and reinsurance regulatory framework has been subject to increased scrutiny in many jurisdictions.

Changes in current insurance regulation may include increased governmental involvement in the insurance industry, initiatives aimed at premium controls, changes to minimum capital requirements, changes in loss transfer legislation, or initiatives that may otherwise change the business and economic environment in which insurance industry participants operate. Historically, the insurance industry has been under pressure from time-to-time from regulators, legislators or special interest groups to reduce, freeze or set rates at levels that are not necessarily related to underlying costs or risks, including initiatives to roll back automobile and other personal line rates. These changes may limit Jevco's ability to price insurance adequately and could require Jevco to discontinue unprofitable product lines, make unplanned modifications to its products and services, or result in delays or cancellations of sales of its products and services. Jevco cannot predict the future impact of changing laws or regulations on its operations and any changes could have a material adverse effect on its results of operations or financial condition.

Where OSFI is concerned about an unsafe course of conduct or an unsound practice in conducting the business of a federally regulated insurance company, OSFI may direct the insurance company to refrain from a course of action or to perform acts necessary to remedy the situation. In certain circumstances, OSFI may take control of the assets of an insurance company or take control of the company itself. More restrictive laws, rules or regulations may be adopted in the future that could make compliance more difficult and/or expensive. Specifically, recently adopted legislation addressing privacy issues, among other matters, is expected to lead to additional regulation of the insurance industry in the coming years, which could result in increased expenses or restrictions on Jevco's operations.

The financial performance of the insurance industry has historically tended to fluctuate in cyclical patterns of "soft" markets characterized generally by increased competition, resulting in lower premium rates and underwriting standards, followed by "hard" markets characterized generally by lessening competition, stricter underwriting standards and increasing premium rates. Jevco's profitability tends to follow this cyclical market pattern with profitability generally increasing in hard markets and decreasing in soft markets. These fluctuations in demand and competition could produce underwriting results that would have a negative impact on Jevco's results of operations and financial condition.

## 10. RISKS (continued)

### *Operational Risk*

*Jevco's provision for unpaid claims may be inadequate, which would result in a reduction in its net income and might adversely affect its financial condition.*

Jevco's provisions for unpaid claims do not represent an exact calculation of its actual liability, but are estimates involving actuarial and statistical projections at a given point in time of the expected cost of the ultimate settlement and administration of known and unknown claims incurred prior to period end. The process for establishing the provision for unpaid claims reflects the uncertainties and significant judgmental factors inherent in estimating future results of both known and unknown claims and as such, the process is inherently complex and imprecise. These estimates are based upon various factors, including:

- actuarial projections of the cost of settlement and administration of claims reflecting facts and circumstances then known;
- estimates of future trends in claims severity and frequency;
- judicial theories of liability;
- variability in claims handling procedures;
- economic factors such as inflation;
- judicial and legislative trends, and actions such as class action lawsuits and judicial interpretation of coverage or policy exclusions; and
- level of insurance fraud.

Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact Jevco's ability to accurately assess the risks of the policies that it writes. In addition, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the insurer and additional lags between the time of reporting and final settlement of claims.

Jevco regularly refines its estimates in an ongoing process as claims are reported and settled. The following factors may have a substantial impact on Jevco's future claims and adjustment expenses incurred and reported:

- the amounts of claims payments;
- the expenses that Jevco incurs in resolving claims;
- legislative and judicial developments;
- changes in economic conditions, including inflation; and
- provision for adverse deviation and discount rate assumptions.

As time passes and more information about the claims becomes known, the estimates are appropriately adjusted upward or downward to reflect this additional information. Because of the elements of uncertainty encompassed in this estimation process, and the extended time it can take to settle many of the more substantial claims, several years of experience may be required before a meaningful comparison can be made between actual losses and the original provision for unpaid claims.

Actual claims and claims adjustment expenses that Jevco incurs under insurance policies that Jevco writes may deviate, perhaps substantially, from the amounts of provisions reflected in its financial statements. To the extent that actual claims incurred exceed its expectations and exceed the provision for unpaid claims reflected on Jevco's financial statements, Jevco will be required to reflect those changes by increasing its provision for unpaid claims. In addition, government regulators could require that Jevco increase its provisions if they determine that Jevco's provisions for unpaid claims are understated. When Jevco increases the provision for unpaid claims, the resulting reduction in its surplus could cause a downgrading of its ratings. Any such downgrade could, in turn, adversely affect Jevco's ability to sell insurance policies. See the risk factors regarding claims-paying ratings above for a more detailed discussion of the impact of a ratings downgrade.

*Jevco relies on independent brokers and is exposed to risks in connection with such reliance.*

Jevco markets and distributes insurance products through a network of independent brokers across Canada. As a result, it relies heavily on these brokers to attract new business and service existing clients. These brokers typically represent more than one insurance company, which may expose Jevco to competition within the agencies and, therefore, Jevco cannot rely on their commitment to its insurance products. In some markets, Jevco operates pursuant to "open market" arrangements in which it has no formal relationships with the brokers who place its risk in these markets. Loss of all or a substantial portion of the business provided by these intermediaries could have a material adverse effect on Jevco's business, results of operations and financial condition or a material decrease in the number of brokers that choose to sell Jevco's products.

In accordance with industry practice, Jevco's customers often pay the premiums for their policies to brokers for payment to Jevco. These premiums are considered paid when received by the broker and thereafter the customer is no longer liable to Jevco for those amounts, whether or not Jevco has actually received the premiums from the broker. Consequently, Jevco assumes a degree of risk associated with its reliance on independent brokers in connection with the settlement of insurance balances.

## 10. RISKS (continued)

*The majority of Jevco's direct premiums written are derived from the non-standard automobile and recreational vehicle insurance markets. If the demand for insurance in these markets declines, Jevco's results of operations could decline significantly.*

Jevco is one of the largest writers of non-standard automobile insurance in Ontario and of recreational vehicle insurance in Canada. The size of both of these insurance markets can be affected significantly by many factors outside of Jevco's control, such as the underwriting capacity and underwriting criteria of standard automobile insurance carriers, and Jevco may be specifically affected by these factors. Additionally, an economic downturn in one or more of Jevco's principal markets could result in fewer automobile or recreational vehicle sales, resulting in less demand for these insurance products. To the extent that these insurance markets are affected adversely for any reason, Jevco's direct premiums written will be disproportionately affected due to Jevco's substantial reliance on these insurance markets.

*If reinsurance rates rise significantly or reinsurance becomes unavailable or reinsurers are unable to pay Jevco's claims, Jevco may be adversely affected.*

Jevco purchases reinsurance from third parties in order to reduce its liability on individual risks, however, reinsurance does not relieve Jevco of its primary liability to its policyholders and, as a result, Jevco bears credit risk with respect to its reinsurance. A third party reinsurer's insolvency or inability or unwillingness to make payments under the terms of a reinsurance treaty could have a material adverse effect on Jevco's financial condition or results of operations. The majority of Jevco's amounts recoverable from third party reinsurers and other insurers are unsecured.

Jevco's reinsurance arrangements are with a limited number of reinsurers. This reinsurance may cause an adverse effect on Jevco's results of operations if one or more of its reinsurers are unable to meet its financial obligations. Jevco cannot ensure that its reinsurers will pay all reinsurance claims on a timely basis or at all. Jevco evaluates each reinsurance claim based on the facts of the case, historical experience with the reinsurer on similar claims, and existing law and includes in its reserve for uncollectible reinsurance any amounts deemed uncollectible. The inability to collect amounts due to Jevco under reinsurance arrangements would reduce Jevco's net income and cash flow.

The amount and cost of reinsurance available to Jevco's insurance companies are subject, in large part, to prevailing market conditions beyond Jevco's control and may affect Jevco's level of business and profitability. Jevco's ability to provide insurance at competitive premium rates and coverage limits on a continuing basis depends in part upon the extent to which Jevco can obtain adequate reinsurance in amounts and at rates that will not adversely affect Jevco's competitive position.

In addition, there can be no assurance that developments may not occur in the future which might cause a shortage of reinsurance capacity in those classes of business which Jevco underwrites, which could result in the curtailment of issuing of policies in a certain line of business or containing limits above a certain size. Jevco cannot provide assurances that it will be able to maintain its current reinsurance facilities, which generally are subject to annual renewal. If Jevco is unable to renew any of these facilities upon their expiration or to obtain other reinsurance facilities in adequate amounts and at favourable rates, Jevco may need to modify its underwriting practices or reduce its underwriting commitments.

*Jevco's business is heavily dependent on technology and Jevco is at risk of its technology being inadequate or inappropriate.*

Jevco is heavily dependent on systems technology to process large volumes of transactions and there would be a risk if the technology employed is inadequate or inappropriate to support current and future business needs and objectives of Jevco. Jevco continues to implement new computer applications as part of a comprehensive approach to improve systems technology, however, in the event of a technology failure, there is no assurance that Jevco will be able to respond effectively and with minimal disruption.

### **Compliance Risk**

*Jevco's business is subject to risks related to litigation and regulatory actions.*

Jevco is a defendant in a number of claims relating to its insurance and other related business operations. Jevco may from time-to-time be subject to a variety of legal and regulatory actions relating to its current and past business operations, including, but not limited to:

- disputes over coverage or claims adjudication;
- disputes regarding sales practices, disclosure, premium refunds, licensing, regulatory compliance and compensation arrangements;
- disputes with its agents, producers or network providers over compensation and termination of contracts and related claims;
- disputes relating to customers regarding the ratio of premiums to benefits in its various business lines;
- disputes with taxing authorities regarding its tax liabilities; and
- disputes relating to certain businesses acquired or disposed of by it.

## 10. RISKS (continued)

In addition, plaintiffs continue to bring new types of legal claims against insurance and related companies. Current and future court decisions and legislative activity may increase Jevco's exposure to these types of claims. Multiparty or class action claims may present additional exposure to substantial economic, non-economic or punitive damage awards. The loss of even one of these claims, if it resulted in a significant damage award or a judicial ruling that was otherwise detrimental, could create a precedent in the insurance industry that could have a material adverse effect on Jevco's results of operations and financial condition. This risk of potential liability may make reasonable settlements of claims more difficult to obtain. Jevco cannot determine with any certainty what new theories of recovery may evolve or what their impact may be on its business.

Jevco may be subject to governmental or administrative investigations and proceedings in the context of its highly regulated sectors of activity. Jevco cannot predict the outcome of these investigations, proceedings and reviews, and cannot give assurances that such investigations, proceedings or reviews or related litigation or changes in operating policies and practices would not materially adversely affect its results of operations and financial condition. In addition, if Jevco were to experience difficulties with its relationship with a regulatory body in a given jurisdiction, it could have a material adverse effect on its ability to do business in that jurisdiction.

*If Jevco fails to comply with applicable insurance laws or regulatory requirements, Jevco's business, results of operations and financial condition could be adversely affected.*

Jevco is subject to numerous laws and regulations. These laws and regulations delegate regulatory, supervisory and administrative powers to federal and provincial agencies. Such regulation generally is designed to protect policyholders rather than shareholders, and is related to matters including:

- rate setting;
- risk-based capital and solvency standards;
- restrictions on the amount, type, nature, quality and quantity of investment securities;
- the maintenance of adequate reserves for unearned premiums and unpaid claims;
- restrictions on the types of terms that can be included in insurance policies;
- standards for accounting;
- marketing practices;
- claims settlement practices;
- the examination of insurance companies by regulatory authorities, including periodic financial and market conduct examinations;
- the licensing of insurers and their agents;
- limitations on dividends and transactions with affiliates;
- approval of certain reinsurance transactions; and
- insolvency proceedings.

In addition, these regulations typically require Jevco to periodically file financial statements and annual reports, and other information with insurance regulatory authorities, including information concerning its capital structure, ownership, financial condition and general business operations.

Jevco allocates considerable time and resources to comply with these requirements. Any failure to comply with applicable laws or regulations could result in the imposition of fines or significant restrictions on Jevco's ability to do business, which could adversely affect its results of operations or financial condition. In addition, any changes in laws or regulations, including the adoption of consumer initiatives regarding rates charged for automobile or other insurance coverage or claims handling procedures, could materially adversely affect Jevco's business, results of operations and financial condition.

OSFI has solvency requirements and uses the MCT ratio as its benchmark. If Jevco does not comply with these minimum capital requirements, it may be restricted or prohibited from operating. If Jevco is required to increase its reserves in the future, as a result of unexpectedly poor claims experience or otherwise, Jevco may violate these minimum capital requirements unless it is able to take actions to improve its solvency. As a result, its business, results of operations, and financial condition may be materially adversely affected.

It is not possible to predict the future impact of changing federal, state and provincial regulation on Jevco's operations, and there can be no assurance that laws and regulations enacted in the future will not be more restrictive than existing laws and regulations.

10. RISKS (continued)

*Human Resources Risk*

*Jevco's business depends upon key employees, and if Jevco is unable to retain the services of these key employees or to attract and retain additional qualified personnel, Jevco's business may suffer.*

Jevco's success has been, and will continue to be, dependent on its ability to retain the services of its existing key employees and to attract and retain additional qualified personnel in the future. The loss of the services of any of its key employees, or the inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of Jevco's business operations.

**Risk Factors Related to the Agreement (described in Section 3, *Subsequent Event* of this MD&A)**

*Failure to satisfy closing conditions of the Agreement may delay or prevent completion of the Transaction.*

Completion of the Transaction is conditional upon the receipt of certain regulatory authorizations, consents, or other approvals, including required approvals under the *Insurance Companies Act* (Canada) and the *Competition Act* (Canada) as well as the satisfaction of other conditions. Westaim and Intact have agreed to pursue all required approvals and to otherwise satisfy the conditions of closing in accordance with the Agreement. These approvals may impose conditions or obligations on Intact or Jevco and such conditions may jeopardize or delay completion of the Transaction. Further, no assurance can be given that the required approvals will be obtained or conditions satisfied and, even if all such approvals are obtained, no assurance can be given as to the terms, conditions and timing of the approvals or that they will satisfy the terms of the Agreement.

*Failure to complete the Transaction could negatively impact the stock price and the future business and financial results of Westaim.*

If the Transaction is not completed, the business of Westaim may be adversely affected. Additionally, if the Transaction is not completed, Westaim may be required to reimburse Intact for its expenses related to the Transaction or may be liable to Intact for damages, and, in any event, will have to pay its own costs relating to the Transaction, such as legal, accounting, financial advisor, filing, printing and mailing fees. Any of the foregoing, or other risks arising in connection with the failure of the Transaction, including the diversion of management attention from pursuing other opportunities during the pendency of the Transaction, may have an adverse effect on the business, financial results and stock price of Westaim.

*The pendency of the Transaction could adversely affect the business and operations of Westaim and/or Jevco.*

In connection with the pending Transaction, third parties utilized or relied on by Westaim or Jevco may make decisions, which could negatively impact Westaim or Jevco regardless of whether the Transaction is completed. For example, current and prospective employees or customers of Jevco may experience uncertainty about the future of Jevco following the Transaction or in the event that the Transaction is not completed, which may materially and adversely affect the ability of each of Jevco and Westaim to attract and retain key personnel or to retain or attract customers.

*There can be no assurance Westaim will continue to meet applicable listing requirements of the TSX following completion of the Transaction.*

Westaim's common shares currently trade on the TSX. Following the completion of the Transaction, Westaim's remaining business operations may not continue to meet the applicable listing requirements of the TSX. In the event Westaim fails to meet any of the continued listing requirements of the TSX, the common shares may be delisted. If the securities of Westaim are not listed on the TSX or an alternative exchange, there will be no public market through which the securities may be sold and traded and shareholders of Westaim may not be able to dispose of their securities. This can be expected to affect the liquidity of the common shares and the transparency and availability of trading prices.

**Other Risk Factors Related to Westaim**

*A single shareholder may be able to exert significant influence over Westaim's affairs.*

Her Majesty the Queen in Right of the Province of Alberta ("HMQ"), acting for and on behalf of certain Alberta public sector pension plans, endowments and government funds holds a significant number of Non-Voting Shares as well as warrants entitling it to purchase additional Non-Voting Shares. Accordingly, HMQ has significant influence over the business and affairs of Westaim and has the ability to take shareholder actions irrespective of the vote of any other shareholders, including the ability to prevent certain transactions that it does not believe are in its best interest. This significant influence may discourage transactions involving a change of control of Westaim, including transactions in which minority shareholders of Westaim might otherwise receive a premium for their shares over the then-current market price.

Furthermore, HMQ generally has the right (subject to applicable securities laws) at any time to sell Westaim Shares held by it or to sell its interest in Westaim to a third party without the approval of the minority shareholders and without providing for a purchase of such shareholders' shares. Accordingly, Westaim Shares held by minority shareholders may be less liquid and worth less than they would be if HMQ did not have the ability to influence matters affecting Westaim.

10. RISKS (continued)

*Westaim may require significant additional funding.*

Westaim's future capital requirements will depend upon many factors, including the expansion of Jevco's sales and marketing efforts, the status of competition and potential acquisitions. There can be no assurance that any additional financing will be available to Westaim on acceptable terms, or at all. If additional funds are raised by issuing equity securities, further dilution to the existing shareholders will result. If adequate funds are not available, Westaim or Jevco may be required to delay, scale back or eliminate its programs. Accordingly, the inability to obtain such financing could have a material adverse effect on Westaim's business, financial condition and results of operations.

11. RELATED PARTY TRANSACTIONS

Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including directors of the Company and its subsidiaries.

Members of the Company's key management personnel may, from time to time, purchase insurance offered by the Company in the ordinary course of its business. The terms and conditions of these transactions are substantially similar to the terms and conditions generally available to the public or the Company's employees in general.

Compensation for key management personnel of the Company, including non-executive directors, is as follows:

(millions)	Three months ended March 31	
	2012	2011
Salaries and other benefits	\$ 1.6	\$ 1.2
Share-based payments	0.7	0.2
	<u>\$ 2.3</u>	<u>\$ 1.4</u>

No loans were extended to key management personnel during the three months ended March 31, 2012, and there were no outstanding amounts as at March 31, 2012.

Management services agreement

The Company has entered into a management services agreement ("MSA") with Goodwood to manage the day-to-day affairs of the Company and to present investment opportunities for the Board of Directors to consider. Under the MSA, Goodwood provides the services of two directors, one of whom is also the President and Chief Executive Officer, as well as the services of a Chief Financial Officer and other personnel as required.

Goodwood earns a fixed fee to be determined annually by an independent committee of the Board of Directors based on the recommendations of an independent compensation consultant. The fixed fee compensates Goodwood for the time and attention of its officers and employees incurred in furtherance of the Company's business as well as for the office space, equipment, supplies and other facilities provided or made available by Goodwood to the Company. Goodwood is also entitled to participate in an annual incentive bonus plan for the purpose of recognizing the contribution of Goodwood to the Company's business and affairs during the preceding year.

Fees earned by Goodwood under the MSA in the three months ended March 31, 2012 were \$0.6 million (2011 - \$0.6 million) inclusive of harmonized sales tax.

Subsequent to quarter end, on April 20, 2012, Goodwood was granted 9,665,709 restricted share units. In the second quarter of 2011, Goodwood was granted 9,665,709 restricted share units which vest evenly over three years and are payable in cash when vested, with the right to purchase common shares of the Company. Also in the second quarter of 2011, 8,591,741 restricted share units were exercised with a cash payment of \$4.5 million to Goodwood. On May 12, 2011, 6,164,574 common shares were issued to Goodwood at a price of \$0.528 per share.

## 12. DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

### Disclosure Controls and Procedures ("DC&P")

DC&P are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed with or submitted to various securities regulators is recorded, processed, summarized and reported within the time periods specified. This information is gathered and reported to the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), so that timely decisions can be made regarding disclosure.

The Company's management, under the supervision of, and with the participation of, the CEO and CFO, have designed and evaluated the Company's DC&P, as required in Canada by "National Instrument – 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings". Based on this evaluation, the CEO and CFO have concluded that, as of March 31, 2012, the Company's DC&P were effective.

### Internal Control over Financial Reporting ("ICFR")

Designing, establishing and maintaining adequate ICFR is the responsibility of the Company's management. ICFR is a process designed by, or under the supervision of, senior management, and affected by the Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and preparation of the Company's consolidated financial statements in accordance with IFRS. Management is responsible for establishing and maintaining ICFR and has designed such controls to ensure that the required objectives of these internal controls have been met. Management uses the Internal Control – Integrated Framework to evaluate the effectiveness of internal control over financial reporting, which is a recognized and suitable framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company regularly reviews and enhances its systems of controls and procedures. However, because of the inherent limitations in all control systems, management acknowledges that ICFR will not prevent or detect all misstatements due to error or fraud. Prior to its release, this quarterly report to shareholders was reviewed by the Audit Committee and, on the Audit Committee's recommendation, approved by the Company's Board of Directors, similar to prior quarters.

There were no changes in the Company's ICFR that occurred during the quarter ended March 31, 2012 that have materially affected, or are reasonably likely to materially affect, ICFR.

As of March 31, 2012, the CEO and the CFO of the Company have evaluated the effectiveness of the Company's ICFR. Based on those evaluations, the CEO and CFO have concluded that at March 31, 2012, the controls and procedures were operating effectively. There are no material weaknesses that have been identified by management in this regard.

## 13. CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions, some of which relate to matters that are uncertain. As more information becomes known, these estimates and assumptions could change and thus have a material impact on the Company's financial condition and results of operations in the future. The Company has established detailed policies and control procedures that are intended to ensure that management's judgments and estimates are well controlled, independently reviewed and consistently applied from period to period. Management believes that its estimates for determining the valuation of the Company's assets and liabilities are appropriate.

### Provision for Unpaid Claims and Adjustment Expenses

Significant judgment is required to determine amounts recorded in the consolidated financial statements for the provision for unpaid claims. The process for establishing the provision for unpaid claims reflects the uncertainties and significant judgmental factors inherent in predicting future results of both known and unknown claims. As such, the process is inherently complex and imprecise and estimates are constantly refined. The process of establishing the provision for unpaid claims relies on the judgment and opinions of a large number of individuals, including the opinions of the Appointed Actuary. Further information regarding estimates used in determining the Company's provision for unpaid claims is discussed in Section 6, *Analysis of Financial Position* of this MD&A and in Notes 11 and 21 to the unaudited consolidated financial statements for the three months ended March 31, 2012.

### Impairment of Investments

The establishment of impairment on an investment security requires a number of judgments and estimates. Management performs a quarterly analysis of the investment holdings to determine if declines in market value require a write-down due to impairment. Further information regarding analysis procedures used in determining impairment is discussed in Note 4 to the unaudited consolidated financial statements for the three months ended March 31, 2012.



#### 14. CRITICAL ACCOUNTING POLICIES AND RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

As required for publicly accountable enterprises, the Company reported in accordance with IFRS commencing with the fiscal year beginning on January 1, 2011. Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with Canadian generally accepted accounting principles ("CGAAP"). The Company's accounting policies are disclosed in Note 2 to the unaudited consolidated financial statements for the three months ended March 31, 2012.

#### 15. FUTURE ACCOUNTING PRONOUNCEMENTS

IFRS 9 "*Financial Instruments*" ("IFRS 9") was issued in November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 "*Financial Instruments – Recognition and Measurement*" ("IAS 39"), for debt instruments with a new mixed measurement model having only two categories: "amortized cost" and "fair value through profit or loss". IFRS 9 also replaces the models for measuring equity instruments, and such instruments will either be categorized as "fair value through profit or loss" or at "fair value through other comprehensive income". Requirements for financial liabilities were added to IFRS 9 in October 2010 and largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss will generally be recorded in other comprehensive income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015. The Company has not yet determined the impact of the standard.

IFRS 10 "*Consolidated Financial Statements*" ("IFRS 10"), issued in May 2011, replaces IAS 27 "*Consolidated and Separate Financial Statements*" and SIC-12 "*Consolidation – Special Purpose Entities*". The Company does not currently apply SIC-12 as it does not have special purpose entities. IFRS 10 defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. IFRS 10 also sets out the accounting requirements for the preparation of consolidated financial statements. The three elements of control identified in IFRS 10 are power over the investee, exposure or rights to variable returns from involvement with the investee and investor ability to use power over the investee to affect the amount of the investor's returns. The Company expects that the adoption of IFRS 10 will not have a material impact on its financial statements.

IFRS 12 "*Disclosure of Interests in Other Entities*" ("IFRS 12") requires a company to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. IFRS 12 is required to be applied by an entity that has an interest in subsidiaries. The Company expects that the adoption of IFRS 12 will not have a material impact on its financial statements.

IFRS 13 "*Fair Value Measurement*" ("IFRS 13"), issued in May 2011, establishes a single source of guidance for fair value measurement under IFRS. IFRS 13 defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. IFRS 13 does not include requirements on when fair value measurement is required; it prescribes how fair value is to be measured if another IFRS or IAS requires it. IFRS 13 should be applied prospectively from the beginning of the annual period in which it is adopted. The Company has not yet determined the impact of IFRS 13 on its financial statements.

IFRS 10, IFRS 12 and IFRS 13 are effective for annual periods beginning on or after January 1, 2013.

16. QUARTERLY FINANCIAL INFORMATION

(millions)	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010
Direct premiums written	\$ 79.3	\$ 71.5	\$ 88.3	\$ 123.9	\$ 66.3	\$ 72.1	\$ 83.6	\$ 117.7
Net premiums earned	75.8	74.0	93.2	88.4	70.5	69.2	88.5	78.6
Net premiums and investment results included in net income	86.3	83.3	107.0	96.9	79.2	79.1	100.5	86.8
Net underwriting income	5.2	5.3	4.5	4.8	0.1	0.6	2.1	3.0
Net income	4.4	9.2	11.3	6.6	5.7	3.3	21.7	4.9
Combined ratio	93.3%	92.9%	95.1%	94.6%	99.9%	99.1%	97.5%	96.2%

Net premiums written and net premiums earned reflect the premiums written by Jevco. Due to the cyclical nature of certain lines of business such as motorcycle insurance, non-standard automobile insurance and surety, a significant portion of premium is written in the spring months. As a result, premiums written are typically highest in the second quarter. Net premiums earned tend to be highest over the second and third quarters when motorcycle and watercraft insurance premiums are recognized at a correspondingly higher rate. Combined ratios are typically higher through the winter months, as inclement weather has an impact on claims frequency.

Income in the third quarter of 2010 and the fourth quarter of 2011 included \$15.3 million and \$2.9 million, respectively, relating to the recognition of deferred income tax assets for non-capital losses which were expected to be realized following an internal corporate reorganization in each of those quarters.

17. FUTURE ORIENTED FINANCIAL INFORMATION

Certain portions of this MD&A, as well as other public statements by the Company, contain forward-looking statements. In particular, the words "strategy", "may", "will", "continue", "developed", "objective", "potential", "exploring", "could", "expect", "expected", "expects", "tends", "indicates", and words and expressions of similar import, are intended to identify forward-looking statements. Such forward-looking statements include but are not limited to statements concerning: strategies, alternatives and objectives to maximize value for shareholders; expectations and assumptions relating to the Company's business plan; the effect of adverse changes in equity markets or the Company's operations; the Company's ability to compete successfully in the insurance industry; expectations that the Company can continue to set its premiums at a level which produces an acceptable return compared to the risk assumed; the Company's ability to realize its investment objectives; the adequacy of the Company's provision for unpaid claims; the Company's ability to maintain its claims paying ratings; the Company's ability to obtain reinsurance with reliable carriers at acceptable rates; expectations regarding the Company's assets and liabilities; the Company's ability to retain key employees, customers and broker relationships; management's belief that its estimates for determining the valuation of the Company's assets and liabilities are appropriate; the Company's views regarding potential future remediation costs; the effect of changes to interpretations of tax legislation on income tax provisions in future periods; and the Company's determination that the adoption of new accounting standards will not have a material impact on its consolidated financial statements.

These statements are based on current expectations that are subject to risks, uncertainties and assumptions and the Company can give no assurance that these expectations are correct. By their nature, these statements are subject to inherent risks and uncertainties that may be general or specific. A variety of material factors, many of which are beyond the Company's control, may affect the operations, performance and results of the Company and its business, and could cause actual results to differ materially from the expectations expressed in any of these forward-looking statements.

The Company's actual results could differ materially from those anticipated by these forward-looking statements for various reasons generally beyond the Company's control, including but not limited to: (i) difficult economic conditions or a prolonged economic downturn may adversely affect the Company's business; (ii) the Company may not be able to realize its investment objectives or its liquid assets may prove to be insufficient to meet future obligations; (iii) the Company or the insurance industry generally may be subject to negative publicity; (iv) the highly competitive nature of the insurance industry; (v) the Company may be unable to maintain its claims paying ratings; (vi) the Company's business could be affected by political, regulatory, economic or other influences; (vii) the Company's provision for unpaid claims may be inadequate; (viii) the Company relies on independent brokers for much of its business; (ix) a majority of the Company's direct premiums written are concentrated in the non-standard automobile and recreational vehicle insurance markets; (x) rising reinsurance rates or a lack of available reinsurance may adversely affect the Company's business; (xi) risks related to litigation and regulatory actions; (xii) failure to comply with applicable insurance laws or regulatory requirements may adversely affect the Company's business; (xiii) the Company's business depends upon certain key employees; (xiv) the Company may have undisclosed liabilities; (xv) the Company may require significant additional funding; and (xvi) other risk factors set forth in the Company's Annual Report or Annual Information Form. Except as required by law, the Company disclaims any intention or obligation to revise forward-looking statements, whether as a result of new information, future developments, or otherwise. All forward-looking statements are expressly qualified in their entirety by this cautionary statement.

The Westaim Corporation  
Consolidated Statements of Financial Position  
(unaudited)

(thousands of Canadian dollars)	March 31 2012	December 31 2011
<b>ASSETS</b>		
Cash and cash equivalents	\$ 49,445	\$ 24,347
Investment income due and accrued	10,047	5,567
Investments (note 4)	982,829	1,018,559
Instalment premiums (note 2g)	63,290	62,781
Income taxes recoverable	14	115
Accounts receivable	28,337	27,454
Recoverable from reinsurers (note 5)	31,893	33,970
Claims recoverable from other insurers (note 6)	51,054	50,969
Deferred policy acquisition expenses (note 2j)	35,985	35,601
Deferred income taxes (note 7)	7,020	10,108
Property and equipment (note 8)	22,995	22,818
Intangible assets (note 9)	3,675	3,844
	<b>\$ 1,286,584</b>	<b>\$ 1,296,133</b>
<b>LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 32,274	\$ 33,523
Income taxes due and accrued	788	821
Unearned premiums (note 10)	163,456	164,437
Unpaid claims and adjustment expenses (note 11)	661,079	675,094
Leasehold inducements (note 2p)	2,548	2,594
Site restoration provision (note 12)	2,413	2,401
	<b>862,558</b>	<b>878,870</b>
Commitments and contingent liabilities (note 13)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 14)	687,402	687,402
Warrants (note 14)	1,900	1,900
Contributed surplus (notes 2r and 14)	12,890	12,890
Accumulated other comprehensive income (note 2s)	13,651	11,242
Deficit	(291,817)	(296,171)
	<b>424,026</b>	<b>417,263</b>
	<b>\$ 1,286,584</b>	<b>\$ 1,296,133</b>

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

The Westaim Corporation  
Consolidated Statements of Operations  
(unaudited)

(thousands of Canadian dollars except share and per share data)	Three months ended March 31	
	2012	2011
<b>Written premiums</b>		
Direct	\$ 79,309	\$ 66,304
Reinsurers' share of written premiums	(3,496)	(3,407)
<b>Net written premiums</b>	<b>\$ 75,813</b>	<b>\$ 62,897</b>
<b>Revenue</b>		
Premiums earned	\$ 80,290	\$ 74,038
Reinsurers' share of premiums earned	(3,318)	(3,501)
Investment income (note 15)	8,743	8,506
Investment expenses (notes 15 and 16)	(925)	(1,013)
Realized gains and losses on sale of investments	1,824	1,908
Foreign exchange loss	(304)	(719)
	86,310	79,219
<b>Underwriting expenses</b>		
Claims and adjustment expenses	47,168	50,350
Reinsurers' share of claims and adjustment expenses	1,221	784
Commissions and premium taxes	14,615	12,566
General and administrative expenses	8,767	6,725
<b>Net underwriting expenses (note 16)</b>	<b>71,771</b>	<b>70,425</b>
Operating income	14,539	8,794
Corporate costs (note 16)	(6,673)	(3,188)
Site restoration provision recovery (note 12)	(12)	147
Other income	-	2,250
	(6,685)	(791)
Income before income taxes	7,854	8,003
Income tax expense (note 7)		
Current	1,245	191
Deferred	2,255	2,080
	3,500	2,271
<b>Net income</b>	<b>\$ 4,354</b>	<b>\$ 5,732</b>
<b>Earnings per share (note 19)</b>		
Net income - basic and diluted	\$ 0.01	\$ 0.01
<b>Weighted average number of common and Series 1 Class A preferred shares outstanding (in thousands)</b>		
Basic	644,197	644,425
Diluted	662,451	657,435

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

The Westaim Corporation  
Consolidated Statements of Comprehensive Income  
(unaudited)

(thousands of Canadian dollars)	Three months ended March 31	
	2012	2011
Net income	\$ 4,354	\$ 5,732
Other comprehensive income (loss)		
Investment gains and losses, net of income tax <sup>(1)</sup>	3,753	(1,294)
Reclassification of net realized gains to net income, net of income tax <sup>(2)</sup>	(1,344)	(1,258)
Total other comprehensive income (loss)	2,409	(2,552)
Comprehensive income	\$ 6,763	\$ 3,180

<sup>(1)</sup> Net of current income tax recovery of \$74 and deferred income tax expense of \$1,314 for the three months ended March 31, 2012  
(deferred income tax recovery of \$544 for the three months ended March 31, 2011)

<sup>(2)</sup> Net of deferred income tax recovery of \$480 for the three months ended March 31, 2012  
(deferred income tax recovery of \$618 for the three months ended March 31, 2011)

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

The Westaim Corporation  
Consolidated Statements of Changes in Equity  
(unaudited)

Three months ended March 31, 2012						
(thousands of Canadian dollars)	Share Capital	Warrants	Contributed Surplus	Accumulated other comprehensive income	Deficit	Total Equity
Balance at January 1, 2012	\$ 687,402	\$ 1,900	\$ 12,890	\$ 11,242	\$ (296,171)	\$ 417,263
Comprehensive income	-	-	-	2,409	4,354	6,763
Balance at March 31, 2012	\$ 687,402	\$ 1,900	\$ 12,890	\$ 13,651	\$ (291,817)	\$ 424,026

Three months ended March 31, 2011						
(thousands of Canadian dollars)	Share Capital	Warrants	Contributed Surplus	Accumulated other comprehensive income	Deficit	Total Equity
Balance at January 1, 2011	\$ 691,435	\$ 1,900	\$ 8,734	\$ 4,177	\$ (328,922)	\$ 377,324
Comprehensive income	-	-	-	(2,552)	5,732	3,180
Common shares issued and paid (note 14)	15	-	-	-	-	15
Balance at March 31, 2011	\$ 691,450	\$ 1,900	\$ 8,734	\$ 1,625	\$ (323,190)	\$ 380,519

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

The Westaim Corporation  
Consolidated Cash Flow Statements  
(unaudited)

(thousands of Canadian dollars)	Three months ended March 31	
	2012	2011
<b>Operating activities</b>		
Net income	\$ 4,354	\$ 5,732
Items not affecting cash		
Net realized gains on sale of investments	(1,824)	(1,908)
Share-based compensation	4,281	2,342
Deferred income taxes - net income	2,255	2,080
Amortization of bond premiums and discounts	2,287	2,295
Depreciation of property and equipment and amortization of intangible assets	871	749
Changes in non-cash balances		
Recoverable from reinsurers	2,077	4,741
Recoverable from other insurers	(85)	(4,661)
Deferred policy acquisition expenses	(384)	1,316
Unearned premiums	(981)	(7,734)
Unpaid claims and adjustment expenses	(14,015)	(15,440)
Net change in other non-cash balances	(10,593)	4,640
Cash used in operating activities	(11,757)	(5,848)
<b>Investing activities</b>		
Purchase of investments	(290,858)	(1,181,519)
Proceeds from sale and redemption of investments	328,592	1,173,599
Purchase of property and equipment and intangible assets	(879)	(1,449)
Cash provided from (used in) investing activities	36,855	(9,369)
Net increase (decrease) in cash and cash equivalents	25,098	(15,217)
Cash and cash equivalents, beginning of period	24,347	32,897
Cash and cash equivalents, end of period	\$ 49,445	\$ 17,680
Cash and cash equivalents is comprised of:		
Cash	\$ 49,445	\$ 17,680
Included in operating cash flows:		
Interest paid	\$ -	\$ 18
Income taxes paid	\$ 1,218	\$ 191

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

The Westaim Corporation  
Notes to Consolidated Financial Statements (unaudited)  
For the three months ended March 31, 2012 and 2011  
(Currency amounts in thousands of Canadian dollars unless otherwise indicated)

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1 Nature of Operations and Basis of Preparation

The Westaim Corporation (the "Company") was incorporated on May 7, 1996 by articles of incorporation under the Business Corporations Act (Alberta). The Company trades on the Toronto Stock Exchange under the symbol WED. The Company's registered office is located at 201-212 King Street West, Toronto, Ontario, Canada. These annual financial statements were authorized for issue by the Board of Directors of the Company on May 15, 2012.

The Company, through its wholly-owned subsidiary, Jevco Insurance Company ("Jevco"), operates in the insurance industry in Canada. Jevco is federally incorporated and regulated by the Office of the Superintendent of Financial Institutions ("OSFI") and is licensed in all provinces and territories in Canada to write all classes of insurance, other than life. Jevco primarily writes insurance in Quebec, Ontario and Alberta. Note 22 *Subsequent Event* provides information regarding an agreement to sell the Company's investment in Jevco subject to, among other things, shareholder and regulatory approvals.

These financial statements also include, on a consolidated basis, the accounts of wholly-owned subsidiaries, Westaim Holdings Limited ("WHL"), 2266098 Ontario Ltd., 2301862 Ontario Ltd. and 2301863 Ontario Ltd.

These financial statements are prepared in compliance with International Financial Reporting Standards ("IFRS"), including International Accounting Standard ("IAS") 34 "Interim Financial Reporting". The seasonality of the insurance business is reflected in the quarterly results of operations, particularly in the net premiums earned and the claims and adjustment expenses. Net premiums earned are reported unevenly over the risk period of the insurance policy coverage and are higher in the second and third financial quarters due to the motorcycle and watercraft insurance as further described in note 2n. Claims and adjustment expenses may vary from quarter to quarter due to the seasonality of weather conditions.

All currency amounts are expressed in thousands of Canadian dollars except earnings per share data, unless otherwise noted.

2 Summary of Significant Accounting Policies

The significant accounting policies used to prepare these financial statements are as follows:

*(a) Principles of consolidation*

The financial statements of entities which are controlled by the Company through voting equity interests, referred to as subsidiaries, are consolidated. The financial results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Intercompany balances and transactions are eliminated upon consolidation.

*(b) Use of estimates*

The preparation of financial statements 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 date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and changes in estimates are recorded in the reporting period in which they are determined. Key estimates are discussed in the following accounting policies and applicable notes.

*(c) Judgments made by management*

Key areas where management has made difficult, complex or subjective judgments in the process of applying the Company's accounting policies, often as a result of matters that are inherently uncertain, include: valuation techniques for fair value determination of investments, investment impairment, income taxes, provision for unpaid claims and adjustment expenses, and site restoration provision. For additional information on these judgments, see note 4 for investments, note 7 for income taxes, note 11 for unpaid claims and adjustment expenses and note 12 for site restoration provision.

*(d) Foreign currency translation*

The Canadian dollar is the functional and presentation currency of the Company. Transactions in foreign currencies are translated into Canadian dollars at rates of exchange prevailing at the time of such transactions. Monetary assets and liabilities are translated at current rates of exchange. Translation differences on available-for-sale investments are classified as relating either to the amortized cost of the investment or to other changes in the carrying value of the investment. Translation differences relating to the change in amortized cost are recognized in investment income; other translation differences are recognized in foreign exchange gain (loss) in the statement of operations.



## 2 Summary of Significant Accounting Policies (continued)

### *(e) Cash and cash equivalents*

Cash and cash equivalents consist of cash on deposit and highly liquid short-term investments with original maturities of 90 days or less, with the exception of cash equivalents designated as a component of the investment portfolio which are classified as investments.

Cash and cash equivalents which are not designated as a component of the investment portfolio are classified in the financial instrument category of loans and receivables for purposes of measurement. Cash and cash equivalents are valued at fair value at the issuance date and subsequently at amortized cost using the effective interest method. Carrying value is a reasonable approximation of fair value.

### *(f) Investments and investment income*

Investments are classified according to four accounting models: available-for-sale, fair value through profit or loss ("FVTPL"), held-to-maturity and cost. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Most of the investments are classified as available-for-sale because the Company's risk management strategy is to manage its investments to support its insurance liabilities.

Available-for-sale investments are carried at their fair value whereby the unrealized gains and losses are included in accumulated other comprehensive income ("AOCI") until sale or impairment is recognized, at which time cumulative unrealized gains or losses are transferred to net income. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect objective evidence of impairment in value are included in 'realized gains and losses on sale of investments'. Changes in the fair value of investments designated as FVTPL are charged or credited to investment income for the current reporting period. Held-to-maturity investments are carried at amortized cost using the effective interest method. When a reliable estimate of the fair value of unquoted equity investments cannot be determined, the equity investment is reported at cost.

The Company accounts for investments using settlement date accounting. Transaction costs for FVTPL investments are expensed. Transaction costs for all other categories of investments are capitalized and, when applicable, amortized over the expected life of the investment using the effective interest method. Interest income on available-for-sale and held-to-maturity investments is calculated using the effective interest method and is included in investment income. Dividend income on common and preferred shares is included in investment income on the ex-dividend date.

The Company conducts quarterly reviews to identify and evaluate investments that show objective indications of possible impairment. Impairment exists when there is objective evidence that, as a result of one or more events occurring after the initial recognition of a debt investment, the estimated future cash flows of the investment have been affected. For available-for-sale equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

### *(g) Instalment premiums*

Insurance policies that provide for premiums to be paid by instalments are initially reported in written premiums and subsequently included in net income over the term of the policy. The instalment premiums asset represents the premiums related to the unexpired portion of the period of risk.

Interest charged on instalment premiums is reported with investment income. Administrative expenses related to instalment premiums are reported with investment expenses.

### *(h) Recoverable from reinsurers*

Estimates of amounts recoverable from reinsurers on unpaid claims and adjustment expenses are reported separately from related estimated amounts payable to policyholders. Unearned premiums and deferred policy acquisition expenses are also reported before reduction for amounts ceded to reinsurers and the reinsurer's portion is classified with amounts recoverable from reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with liabilities associated with the reinsured policy. Amounts recoverable from reinsurers are assessed for indicators of impairment at the end of each reporting period. An impairment loss is recognized and the amount recoverable from reinsurers is reduced by the amount by which the carrying value exceeds the expected recoverable amount under the impairment analysis.

## 2 Summary of Significant Accounting Policies (continued)

### *(i) Claims recoverable from other insurers*

The expected recoveries from other insurers on claims paid to policyholders are recognized as amounts recoverable at the same time as the related liability is recognized using principles consistent with the Company's method for establishing the related liability. Claims recoverable from other insurers are assessed for indicators of impairment at the end of each reporting period. An impairment loss is recognized and the amount of claims recoverable from other insurers is reduced by the amount by which the carrying value exceeds the expected recoverable amount under the impairment analysis.

### *(j) Deferred policy acquisition expenses*

The Company defers brokers' commissions, premium taxes and other underwriting and marketing expenses relating to premiums written to the extent the expenses are considered recoverable. These costs are expensed as the related premiums are earned. Changes in estimates are reported as expenses in the reporting period in which they are determined. Anticipated future claims, expenses and investment income are considered in determining the recoverability of the carrying value of the deferred policy acquisition expenses. Deferred policy acquisition costs are recognized in expenses within twelve months of initial deferral.

### *(k) Income taxes*

Income tax expense is recognized in the statement of operations and the statement of other comprehensive income. Current tax is based on taxable income which differs from net income as reported in the statement of operations and statement of other comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible.

Deferred tax assets are generally recognized for all deductible temporary income tax differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets and liabilities are determined based on the enacted or substantively enacted tax laws and rates that are anticipated to apply in the year of realization. The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of the related assets and liabilities. The carrying amount of the deferred tax asset is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Income tax assets and liabilities are offset when the Company intends to settle on a net basis and there is a legally enforceable right to offset.

### *(l) Property and equipment*

Property and equipment are reported at cost less accumulated depreciation. Depreciation of property and equipment is provided using the straight-line method over the estimated useful lives of such assets. The useful lives are 19 to 43 years for buildings, 5 to 15 years for leasehold improvements, 5 to 7 years for furniture and equipment, and 3 to 5 years for computers and automobiles. At the end of each reporting period, management reviews the carrying amounts of property and equipment for indication of impairment. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of fair value less cost to sell and value in use.

### *(m) Intangible assets*

Intangible assets are reported at amortized cost and consist of purchased software and internally developed software. Amortization of intangible assets is provided using the straight-line method over estimated useful lives of 3 to 5 years. At the end of each reporting period, management reviews the carrying amounts of intangible assets for indication of impairment. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of fair value less cost to sell and value in use.

## 2 Summary of Significant Accounting Policies (continued)

### *(n) Premiums and unearned premiums*

Written premiums are the premiums from policies written during the current reporting period.

Premiums earned relate to the portion of the written premiums corresponding to the coverage provided in the current reporting period. The Company earns motorcycle and watercraft premiums unevenly over the period of risk covered by the policy based on its experience. The Company earns premium revenue on all other lines evenly over the period covered by each individual insurance contract.

Unearned premiums reported in the statement of financial position represent the portion of premiums written related to the unexpired risk portion of the policy at the end of the reporting period. The remaining risk periods of the policies as of the date of the statement of financial position are one year or less.

The reinsurers' share of unearned premiums is recognized as amounts recoverable from reinsurers using principles consistent with the Company's method for determining the unearned premiums liability.

### *(o) Unpaid claims and adjustment expenses*

The provision for unpaid claims and adjustment expenses includes an estimate of the cost of projected final settlements of insurance claims incurred on or before the statement of financial position date, including claims incurred but not reported ("IBNR") by policyholders and an estimate of the full amount of all expected expenses. The provision takes into consideration the time value of money using discount rates based on projected investment income from the assets supporting the provisions and includes an explicit provision for adverse deviation. Expected recoveries on unpaid claims and adjustment expenses are recognized as amounts recoverable from other insurers or reinsurers at the same time using principles consistent with the Company's method for establishing the related liability.

These estimates of future claims payments and adjustment expenses are subject to uncertainty and are selected from a wide range of possible outcomes. All provisions are periodically reviewed and evaluated in light of emerging claims experience and changing circumstances. The resulting changes in estimates of the ultimate liability are reported as net claims and adjustment expenses in the reporting period in which they are determined.

### *(p) Leasehold inducements*

Leasehold inducements are liabilities associated with the initial benefits received by the Company related to the rental of office premises. Leasehold inducements are amortized over the term of the lease on a straight-line basis and classified with office expenses (note 16).

### *(q) Site restoration provision*

Future site restoration costs relate to industrial sites previously owned by the Company and are estimated taking into consideration the anticipated method and extent of the remediation consistent with regulatory requirements, industry practices, current technology and possible uses of the site. The estimated amount of future restoration costs is reviewed periodically based on available information. The amount of a provision is the present value of the estimated future restoration costs discounted using the rate of interest of a high quality government bond.

Potential recoveries of costs resulting from indemnifications provided by previous owners of the Company's industrial sites have not been recognized in these financial statements. Any future recoveries of site restoration costs will be recorded when received.

### *(r) Contributed surplus*

Contributed surplus consists of amounts related to stock options as described in the share-based compensation accounting policy note in (u) below and, for share capital of the Company repurchased by the Company, the amount by which the average carrying value of the shares exceeded the cost to repurchase the shares.

### *(s) Accumulated other comprehensive income*

Certain gains and losses arising from changes in fair value are temporarily recorded outside the statement of operations in AOCI as a separate component of shareholders' equity. Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes the current reporting period change in unrealized gains and losses on available-for-sale investments, other than foreign exchange gains and losses, net of related income tax expense.

## 2 Summary of Significant Accounting Policies (continued)

### *(t) Employee future benefits*

The Company provides employees with benefits under defined contribution plans. Expenses are recognized in the reporting period in which services are rendered.

### *(u) Share-based compensation*

The Company maintains share-based compensation plans, which are described in note 17. Any consideration paid by stock option holders for the purchase of stock is credited to share capital. The cost of stock options is recognized over the period from the issue date to the vesting date and recorded as a component of equity in contributed surplus.

Obligations related to Deferred Share Units ("DSUs") and Restricted Share Units ("RSUs") are accrued as liabilities when a change in value occurs and recognized in compensation expense over the applicable vesting period.

### *(v) Earnings per share*

Basic earnings per share is calculated by dividing net income by the total of the weighted average number of common shares outstanding during the reporting period plus the weighted average number of preferred shares outstanding during the reporting period. The preferred shares are considered in-substance common shares.

Diluted earnings per share is calculated on the basis of the weighted average number of shares outstanding during the reporting period plus an estimate of the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method. No adjustments to net income are required for dividends, interest or other changes in income for purposes of calculating diluted earnings per share.

### *(w) Automobile insurance industry pools*

When certain automobile owners are unable to obtain insurance via the voluntary insurance market, they are insured via the Facility Association ("FA"). In addition, entities can choose to cede certain risks to FA administered risk sharing pools ("RSP"). The related risks associated with FA insurance policies and policies ceded by companies to the RSP are aggregated and shared by the entities in the property and casualty insurance industry, generally in proportion to market share. The Company applies the same accounting policies to FA and RSP insurance it assumes as it does to insurance policies issued by the Company directly to its policyholders. Ceded and assumed RSP and FA premiums are reported in direct written premiums in the statement of operations.

## 3 Accounting Standards Issued But Not Yet Applied

IFRS 9 "*Financial Instruments*" ("IFRS 9") was issued in November 2009 and will replace IAS 39 "*Financial Instruments: Recognition and Measurement*" ("IAS 39"). IFRS 9 prescribes a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules permissible under IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. IFRS 9 also requires a single impairment method to be used, replacing the multiple impairment methods permissible under IAS 39. The Company has not yet determined the impact of IFRS 9 on its financial statements. IFRS 9 is effective for years beginning on or after January 1, 2015.

IFRS 10 "*Consolidated Financial Statements*" ("IFRS 10"), issued in May 2011, replaces IAS 27 "*Consolidated and Separate Financial Statements*" and SIC-12 "*Consolidation – Special Purpose Entities*". The Company does not currently apply SIC-12 as it does not have special purpose entities. IFRS 10 defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. IFRS 10 also sets out the accounting requirements for the preparation of consolidated financial statements. The three elements of control identified in IFRS 10 are power over the investee, exposure or rights to variable returns from involvement with the investee and investor ability to use power over the investee to affect the amount of the investor's returns. The Company expects that the adoption of IFRS 10 will not have a material impact on its financial statements.

IFRS 12 "*Disclosure of Interests in Other Entities*" ("IFRS 12") requires a company to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. IFRS 12 is required to be applied by an entity that has an interest in subsidiaries. The Company expects that the adoption of IFRS 12 will not have a material impact on its financial statements.

The Westaim Corporation  
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3 Accounting Standards Issued But Not Yet Applied (continued)

IFRS 13 "Fair Value Measurement" ("IFRS 13"), issued in May 2011, establishes a single source of guidance for fair value measurement under IFRS. IFRS 13 defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. IFRS 13 does not include requirements on when fair value measurement is required; it prescribes how fair value is to be measured if another IFRS or IAS requires it. IFRS 13 should be applied prospectively from the beginning of the year in which it is adopted. The Company has not yet determined the impact of IFRS 13 on its financial statements.

IFRS 10, IFRS 12 and IFRS 13 are effective for years beginning on or after January 1, 2013, with earlier adoption permitted.

4 Investments

The table below provides details of the investments classified by category:

Category of investments:	March 31, 2012	December 31, 2011
Available-for-sale - carried at fair value	\$ 885,075	\$ 920,591
Held-to-maturity - carried at amortized cost	97,254	97,468
Available-for-sale - carried at cost	500	500
	\$ 982,829	\$ 1,018,559

The following tables provide details of the amortized cost and fair value of available-for-sale investments, carried at fair value:

	March 31, 2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Short-term investments	\$ 17,058	\$ -	\$ 1	\$ 17,057
Canadian bonds - Government	201,791	808	331	202,268
Canadian bonds - Corporate	395,710	9,229	558	404,381
Canadian bonds - Mortgage backed	38,497	648	51	39,094
Canadian bonds - Other asset backed	78,730	924	8	79,646
United States bonds - Corporate	20,242	499	9	20,732
	752,028	12,108	958	763,178
Common shares - Canadian	101,553	8,265	1,902	107,916
Preferred shares - Canadian	13,062	947	28	13,981
	\$ 866,643	\$ 21,320	\$ 2,888	\$ 885,075

  

	December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Short-term investments	\$ 84,780	\$ 6	\$ -	\$ 84,786
Canadian bonds - Government	187,681	1,463	273	188,871
Canadian bonds - Corporate	371,600	8,854	378	380,076
Canadian bonds - Mortgage backed	40,526	937	7	41,456
Canadian bonds - Other asset backed	79,615	933	41	80,507
United States bonds - Corporate	28,142	282	104	28,320
	792,344	12,475	803	804,016
Common shares - Canadian	100,605	4,918	2,090	103,433
Preferred shares - Canadian	12,072	1,116	46	13,142
	\$ 905,021	\$ 18,509	\$ 2,939	\$ 920,591

The Westaim Corporation  
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4 Investments (continued)

The following tables present the amortized cost and fair value of held-to-maturity investments, carried at amortized cost:

	March 31, 2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Canadian bonds - Government	\$ 72,846	\$ 6,355	\$ -	\$ 79,201
Canadian bonds - Corporate	24,408	1,874	-	26,282
	\$ 97,254	\$ 8,229	\$ -	\$ 105,483

	December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Canadian bonds - Government	\$ 73,006	\$ 7,634	\$ -	\$ 80,640
Canadian bonds - Corporate	24,462	1,679	-	26,141
	\$ 97,468	\$ 9,313	\$ -	\$ 106,781

The available-for-sale investments carried at cost consist of an investment in a private company. This equity investment is carried at cost as it does not have a quoted price in an active market and its fair value cannot be measured reliably. Should there be objective evidence that the investment is impaired, an impairment loss will be recorded.

*Fair value determination*

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act and are best evidenced by quoted market prices, if they exist. The calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values.

The Company uses a fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value. The extent of the Company's use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information (Level 3) in the valuation of the Company's investments at March 31, 2012 and December 31, 2011 is as follows:

March 31, 2012	Fair value	Level 1	Level 2	Level 3
<b>Available-for-sale investments:</b>				
Short-term investments	\$ 17,057	\$ -	\$ 17,057	\$ -
Canadian bonds - Government	202,268	-	202,268	-
Canadian bonds - Corporate	404,381	-	403,431	950
Canadian bonds - Mortgage backed	39,094	-	39,094	-
Canadian bonds - Other asset backed	79,646	-	79,646	-
United States bonds - Corporate	20,732	-	20,732	-
Common shares - Canadian	107,916	107,916	-	-
Preferred shares - Canadian	13,981	13,981	-	-
	\$ 885,075	\$ 121,897	\$ 762,228	\$ 950
<b>Held-to-maturity investments:</b>				
Canadian bonds - Government	\$ 79,201	\$ -	\$ 79,201	\$ -
Canadian bonds - Corporate	26,282	-	26,282	-
	\$ 105,483	\$ -	\$ 105,483	\$ -

The Westaim Corporation  
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4 Investments (continued)

December 31, 2011	Fair value	Level 1	Level 2	Level 3
<b>Available-for-sale investments:</b>				
Short-term investments	\$ 84,786	\$ -	\$ 84,786	\$ -
Canadian bonds - Government	188,871	-	188,871	-
Canadian bonds - Corporate	380,076	-	379,176	900
Canadian bonds - Mortgage backed	41,456	-	41,456	-
Canadian bonds - Other asset backed	80,507	-	80,507	-
United States bonds - Corporate	28,320	-	28,320	-
Common shares - Canadian	103,433	103,433	-	-
Preferred shares - Canadian	13,142	13,142	-	-
	\$ 920,591	\$ 116,575	\$ 803,116	\$ 900
<b>Held-to-maturity investments:</b>				
Canadian bonds - Government	\$ 80,640	\$ -	\$ 80,640	\$ -
Canadian bonds - Corporate	26,141	-	26,141	-
	\$ 106,781	\$ -	\$ 106,781	\$ -

The investment classified as level 3 and held at March 31, 2012 with a fair value of \$950 (December 31, 2011 - \$900) was originally acquired at a cost of \$900. During the three months ended March 31, 2012, an increase in fair value of \$50 for this investment was determined based on internal valuation models. No change in level of classification of this investment was required for the three months ended March 31, 2012 or for the year ended December 31, 2011.

*Impairment Analysis*

Management performs a quarterly analysis of investment holdings to determine whether there is objective evidence that the estimated cash flows of the investments have been affected. The analysis includes the following procedures as deemed appropriate by management:

- assessing whether any credit losses are expected for those investments. This assessment includes consideration of, among other things, all available information and factors having a bearing upon collectability such as changes to credit rating by rating agencies, financial condition of the issuer, expected cash flows and value of any underlying collateral;
- identifying all security holdings in unrealized loss positions that have existed for at least six months or other circumstances that management believes may impact the recoverability of the investment;
- obtaining a valuation analysis from third party investment managers regarding the intrinsic value of these holdings based on their knowledge, experience and other market based valuation techniques;
- reviewing the trading range of certain investments over the preceding year;
- assessing whether declines in market value for debt investment holdings represent objective evidence of impairment based on their investment grade credit ratings from third party security rating agencies;
- assessing whether declines in market value for any debt investment holdings with non-investment grade credit rating represent objective evidence of impairment based on the history of its debt service record; and
- determining necessary provisions for declines in market values for which there is objective evidence of impairment based on analyses performed.

The risks and uncertainties inherent in the assessment methodology utilized to determine whether declines in market value represent objective evidence of impairment include, but may not be limited to, the following:

- the opinion of professional investment managers could be incorrect;
- the past trading patterns of individual investments may not reflect future valuation trends;
- the credit ratings assigned by independent credit rating agencies may be incorrect due to unforeseen or unknown facts related to a company's financial situation; and
- the debt service pattern of non-investment grade investments may not reflect future debt service capabilities and may not reflect unknown underlying financial problems.

As a result of the impairment analysis performed by management, no write-downs were required for the three months ended March 31, 2012 and 2011.

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5 Recoverable from Reinsurers

The amount recoverable from reinsurers is detailed as follows:

	March 31, 2012	December 31, 2011
Unearned premiums	\$ 1,867	\$ 1,690
Unpaid claims and adjustment expenses (note 11)	30,026	32,280
	\$ 31,893	\$ 33,970

Details of the change in the unpaid claims and adjustment expenses recoverable from reinsurers for the three months ended March 31, 2012 and 2011 are included in note 11c.

The Company follows the policy of underwriting and reinsuring contracts of insurance, which limits its net exposure to a maximum amount on any one claim. The Company has reinsurance protection which limits the maximum amount on any one claim to \$2,250 (2011 - \$2,000) in the event of a liability claim to a maximum of \$30,000 (2011 - \$30,000) and \$1,000 (2011 - \$750) in the event of a property claim to a maximum of \$10,000 (2011 - \$10,000). In addition, the Company has property catastrophe reinsurance which provides coverage in the event of a series of claims arising out of a single occurrence. The reinsurance limits this exposure to \$2,500 (2011 - \$2,500) per occurrence to a maximum of \$25,000 (2011 - \$25,000).

Credit risk related to reinsurance is described in note 21.

6 Claims Recoverable from Other Insurers

In accordance with the Insurance Act of Ontario (the "Act"), the Company has a right of indemnification for certain policy benefits paid to its own insured from the insurer of a third party at fault. The Act provides for an arbitration process when insurers are not in agreement as to the amount of claims to be transferred. Failure of other insurers to honor their obligations could result in losses to the Company.

7 Income Taxes

Income taxes are recognized for deferred income taxes attributed to estimated differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases.

The deferred income tax asset consists of deferred taxes related to the following:

	March 31, 2012	December 31, 2011
Non-capital loss carry-forwards	\$ -	\$ 2,862
Unpaid claims and adjustment expenses	7,487	7,653
Intangible assets, property and equipment	(1,170)	(1,231)
Other	703	824
Deferred income tax asset	\$ 7,020	\$ 10,108

As the realization of any related tax benefits is not probable, no deferred income tax assets have been recognized for the following:

	March 31, 2012	December 31, 2011
Non-capital loss carry-forwards	\$ 41,552	\$ 37,774
Capital loss carry-forwards	96,194	96,194
Scientific research and experimental development expenditures	6,280	6,280
Deductible temporary differences	29,325	28,333
Investment tax credits	8,672	8,672



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7 Income Taxes (continued)

The unrecognized non-capital losses and investment tax credits will expire at various times to the end of 2032, as follows:

Non-capital losses by year of expiry:		Investment tax credits by year of expiry:	
2014	\$ 13,528	2018	\$ 3,241
2015	452	2019	888
2027	7,883	2020	961
2028	6,151	2021	823
2029	9,048	2022	643
2030	103	2023	324
2031	610	2024	175
2032	3,777	Beyond 2024	1,617
	\$ 41,552		\$ 8,672

Temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognized were \$81,964 at March 31, 2012 (December 31, 2011 - \$99,131). The Company is able to control the timing of the reversal of these temporary differences and it is not probable that these temporary differences will reverse in the foreseeable future.

The major components of the income tax provision recognized in the statement of operations are as follows:

	Three months ended March 31	
	2012	2011
Current tax expense in respect of the current period	\$ 1,245	\$ 191
Deferred tax expense:		
Origination and reversal of temporary differences due to:		
Non-capital losses	2,077	3,201
Unpaid claims and adjustment expenses	166	269
Other	12	(1,390)
Income tax expense	\$ 3,500	\$ 2,271

The following is a reconciliation of income taxes calculated at the statutory income tax rate to the income tax expense included in the statement of operations:

	Three months ended March 31	
	2012	2011
Income before income taxes	\$ 7,854	\$ 8,003
Statutory income tax rate	26%	28%
Income taxes at statutory income tax rate	2,042	2,241
Variations due to:		
Non-deductible and non-taxable items	194	87
Unrecognized temporary differences	973	-
Other	291	(57)
Income tax expense	\$ 3,500	\$ 2,271

8 Property and Equipment

During the three months ended March 31, 2012, details of the movement in the carrying values by class of property and equipment are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
January 1, 2012	\$ 1,283	\$ 15,621	\$ 3,041	\$ 1,937	\$ 751	\$ 185	\$ 22,818
Additions	-	51	63	10	538	-	662
Depreciation	-	(138)	(66)	(158)	(99)	(24)	(485)
March 31, 2012	\$ 1,283	\$ 15,534	\$ 3,038	\$ 1,789	\$ 1,190	\$ 161	\$ 22,995

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8 Property and Equipment (continued)

Details of cost and accumulated depreciation of property and equipment at March 31, 2012 are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
Cost	\$ 1,283	\$ 16,636	\$ 3,331	\$ 2,794	\$ 2,201	\$ 286	\$ 26,531
Accumulated depreciation	-	(1,102)	(293)	(1,005)	(1,011)	(125)	(3,536)
	\$ 1,283	\$ 15,534	\$ 3,038	\$ 1,789	\$ 1,190	\$ 161	\$ 22,995

During the year ended December 31, 2011, details of the movement in the carrying values by class of property and equipment are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
January 1, 2011	\$ 1,283	\$ 16,227	\$ 2,779	\$ 1,969	\$ 241	\$ 159	\$ 22,658
Additions	-	39	489	760	901	108	2,297
Depreciation	-	(645)	(227)	(792)	(391)	(82)	(2,137)
December 31, 2011	\$ 1,283	\$ 15,621	\$ 3,041	\$ 1,937	\$ 751	\$ 185	\$ 22,818

Details of cost and accumulated depreciation of property and equipment at December 31, 2011 are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
Cost	\$ 1,283	\$ 16,584	\$ 3,268	\$ 2,784	\$ 1,663	\$ 286	\$ 25,868
Accumulated depreciation	-	(963)	(227)	(847)	(912)	(101)	(3,050)
	\$ 1,283	\$ 15,621	\$ 3,041	\$ 1,937	\$ 751	\$ 185	\$ 22,818

9 Intangible Assets

	Three months ended March 31, 2012			Year ended December 31, 2011		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Balance at beginning of period	\$ 6,049	\$ (2,205)	\$ 3,844	\$ 3,068	\$ (1,093)	\$ 1,975
Additions	217	-	217	2,981	-	2,981
Amortization	-	(386)	(386)	-	(1,112)	(1,112)
Balance at end of period	\$ 6,266	\$ (2,591)	\$ 3,675	\$ 6,049	\$ (2,205)	\$ 3,844

10 Unearned Premiums

The Company earns motorcycle and watercraft premiums unevenly over the period of risk covered by the policy based on claims reporting patterns specific to its motorcycle and watercraft experience. The Company earns premium revenue on all other lines evenly over the period covered by each individual insurance contract. Unearned premiums reported in the statement of financial position represent the portion of premiums written related to the unexpired risk portion of the policy at the end of the reporting period. The unearned premiums liability at December 31, 2011 was tested to ensure the liability was sufficient to pay for future claims and expenses to service the unexpired policies to which the liability was related. This test, known as the liability adequacy test, is performed annually by the Appointed Actuary.

In Canada, automobile insurance premium rates, other than for fleet automobiles are regulated by provincial government authorities. Regulation of premium rates is based on claims and other costs of providing insurance coverage. Regulatory approvals can limit or reduce premium rates that can be charged, or delay the implementation of changes in rates. A significant portion of the Company's revenue is subject to regulatory approvals.

The unearned premiums amount corresponds to policies with less than twelve months duration.

## 11 Unpaid Claims and Adjustment Expenses

### *(a) Nature of unpaid claims and adjustment expenses*

The establishment of the provision for unpaid claims and adjustment expenses is based on known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. These factors include the Company's own experience with similar cases and historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims and adjustment expenses, product mix and concentration, claims severity and claim frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Company's claim departments' personnel and independent adjusters retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices including claims handling and settlement practices, the effect of inflationary trends on future claims settlement costs, investment rates of return, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination, since the longer the span between the incidence of a loss and the settlement of the claims, the more variable the ultimate settlement amount can be. Accordingly, short-tailed claims, such as property claims, tend to be more reasonably predictable than long-tailed claims, such as general liability and automobile accident benefit claims.

The process of establishing the provision relies on the judgment and opinions of a large number of individuals, on historical precedents and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The provision reflects expectations of the ultimate cost of resolution and administration of claims based on an assessment of facts and circumstances then known together with a review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors.

Variables affecting the determination of the provision are the receipt of additional claims information and other internal and external factors, such as changes in claims handling procedures, economic inflation, legal and judicial trends, legislative changes, and inclusion of exposures not contemplated at the time of policy inception. The provision for claims and adjustment expenses is reviewed separately by, and must be acceptable to, management of the Company, the Appointed Actuary and an external valuation actuary during the Company's triennial actuarial examination.

### *(b) Methodologies and assumptions*

The best estimates of future claims and adjustment expenses have been determined from the projected ultimate claims and adjustment expenses based on the reported / paid claims development method, the Bornhuetter-Ferguson method, the Berquist-Sherman method and the expected claims method. Considerations in the choice of methods to estimate ultimate claims included, among other factors, the line of business, the number of years' experience and the age of the accident years being developed. A description of each of these methods is as follows:

#### *(i) Reported / paid claims development method*

The distinguishing characteristics of the development method are that ultimate claims for each accident year are produced from recorded values assuming the future claim development is similar to the prior years' development. The underlying assumption is that claims recorded to date will continue to develop in a similar manner in the future.

#### *(ii) Bornhuetter-Ferguson method*

The key assumption of the Bornhuetter-Ferguson method is that unreported claims will develop based on expected claims. In other words, the claims reported to date contain no informational value as to the amount of claims yet to be reported. It is most frequently used for lines of business with long settlement patterns, and lines of business subject to the occurrence of large claims.

#### *(iii) Berquist-Sherman method*

The adjusted reported development method, also known as the Berquist-Sherman method, is analogous to the reported / paid claims development method except that the reported claims used in the calculation of development factors are first adjusted to a common case reserve adequacy basis. A case reserve is a provision for unpaid claims and adjustment expenses for known claims. Compared to the reported / paid claims method, which relies on consistency in reserving philosophies and procedures to produce reliable results, the Berquist-Sherman method modifies the raw data to restate historical case reserves to the level that the current case reserves would imply, after the consideration of trend.

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11 Unpaid Claims and Adjustment Expenses (continued)

(iv) Expected claims method

Using the expected claims method, ultimate claims projections are based upon prior measures of the anticipated claims. An expected claims ratio is applied to the measure of exposure to determine estimated ultimate claims for each year. This method is more commonly used in lines of business with longer emergence and settlement patterns.

For each line of business, a roll-forward of the liabilities to March 31, 2012 was performed based on the December 31, 2011 analysis. The March 31, 2012 liabilities were based on actuarial assumptions as established in the September 30, 2011 analysis and the December 31, 2011 IBNR reserves and adjusted, as appropriate, based on the actual claims experience. This approach is based on the assumption that the change in reported / paid development factors for the three months would not be significantly affected by the development of reported claims during the three months ended March 31, 2012. In addition, this approach is based on the Bornhuetter-Ferguson method principles, where the March 31, 2012 IBNR reserves are calculated based on the September 30, 2011 IBNR reserves projected to December 31, 2011 based on the selected reported / paid development factors, adjusted if necessary, and then added to the actual reported claims valued as of March 31, 2012 to determine the ultimate claims as of December 31, 2011. Variations in the ultimate claims by lines of business and/or accident years from December 31, 2011 to March 31, 2012 may exist. The same approach was followed in 2011 to determine the actual reported claims and IBNR at December 31, 2011.

Claims paid and reported, direct and net of reinsurance recoveries and net of salvage and subrogation, were tracked by lines of business, accident years and development periods in a format known as claims development triangles (note 21). Selected claims development factors were calculated based on the historical development pattern of the reported claims development triangles. Judgment was used whenever there was a wide variability in the past development factors due to a small claims sample or due to a new class of business; development factors which seemed abnormal were disregarded in selecting the claims development factors. Owing to the changes in reserving philosophy and practices stemming from new claims management, significant variations were observed in the development triangles. The Berquist-Sherman method was used to adjust the historical claims information for these changes.

Claims data includes external claims adjustment expenses, and for a portion of the portfolio includes internal claims adjustment expenses ("IAE"). For the portion of the portfolio which includes IAE, a provision for IAE has been determined based on the ratio of paid IAE to paid claims. This method assumes that half of the IAE is required when the claim is first recorded. The remaining half of the IAE is required to maintain the claim. This IAE percentage is applied to the pure IBNR and to half of the case reserves plus IBNR for known claims. For the remainder of the portfolio, the IAE are included in the claims data.

The provision for unpaid claims and adjustment expenses is discounted using an interest rate based on the Company's projected investment income from the assets supporting the unpaid claims and adjustment expense liabilities, and reflecting the estimated timing of payments and recoveries. The discount rate used as at March 31, 2012 was 3.05% (December 31, 2011 - 3.1%). Reinsurance recoverable estimates and claims recoverable from other insurers are discounted in a manner consistent with the method used to establish the related liability.

The undiscounted reserves do not include provisions for adverse deviation whereas the discounted provision for unpaid claims and adjustment expenses, discounted claims recoverable from other insurers and discounted reinsurance recoverable estimates include provisions for adverse deviation to allow for possible deterioration of experience relating to asset default, interest rate risk, claims development and recoverability of reinsurance balances.

The following table shows unpaid claims and adjustment expenses on an undiscounted basis and a discounted basis:

	March 31, 2012		December 31, 2011	
	Undiscounted	Discounted	Undiscounted	Discounted
Unpaid claims and adjustment expenses	\$ 636,264	\$ 661,079	\$ 651,007	\$ 675,094
Claims recoverable from other insurers	(49,137)	(51,054)	(49,151)	(50,969)
Recoverable from reinsurers (note 5)	(28,899)	(30,026)	(31,128)	(32,280)
Net unpaid claims and adjustment expenses	\$ 558,228	\$ 579,999	\$ 570,728	\$ 591,845

An evaluation of the adequacy of claims liabilities is completed at the end of each financial quarter. This evaluation includes a re-estimation of the liability for unpaid claims and adjustment expenses compared to the liability that was originally established.

(c) *Changes in assumptions*

Unpaid claims and adjustment expenses at March 31, 2012 were compared to the expected reported claims to determine whether the current actuarial assumptions are adequate for the determination of the IBNR provision at March 31, 2012. As a result, it was

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11 Unpaid Claims and Adjustment Expenses (continued)

determined that although the actual reported claims and adjustment expenses for the three months for most lines of business were generally lower than the expected claims and adjustment expenses, no significant adjustments were made to the IBNR provision at March 31, 2012.

The discount rate is selected based on the expected yields of the assets supporting the policy liabilities. As at March 31, 2012, the discount rate was reduced by 5 basis points as compared to the December 31, 2011 discount rate, which along with related changes in provision for adverse deviation, resulted in an increase in the claims liabilities of \$654. As at December 31, 2011, the discount rate was reduced by 60 basis points as compared to the December 31, 2010 discount rate which, along with related changes in provision for adverse deviation, resulted in an increase in the claims liabilities of \$4,359.

Sensitivity to changes in assumptions is discussed with insurance risk in note 21.

The change in the provision for unpaid claims and adjustment expenses is as follows:

	Three months ended March 31, 2012			Year ended December 31, 2011		
	Direct	Ceded	Net	Direct	Ceded	Net
Balance, net of recoveries, at January 1	\$624,125	\$ 32,280	\$591,845	\$664,825	\$ 28,172	\$636,653
Paid during the year	(61,267)	(1,033)	(60,234)	(269,736)	(6,988)	(262,748)
Change in provision related to:						
Current year claims	58,819	1,279	57,540	256,058	6,120	249,938
Prior years claims	(12,281)	(2,475)	(9,806)	(36,255)	102	(36,357)
Discount rates and provision for adverse deviation	629	(25)	654	9,233	4,874	4,359
Balance, net of recoveries, at end of period	610,025	30,026	579,999	624,125	32,280	591,845
Recoverable from other insurers	51,054	-	51,054	50,969	-	50,969
Unpaid claims and adjustment expenses	\$ 661,079	\$ 30,026	\$ 631,053	\$ 675,094	\$ 32,280	\$ 642,814

The provision for unpaid claims and adjustment expenses by case reserves and IBNR is as follows:

	March 31, 2012			December 31, 2011		
	Direct	Ceded	Net	Direct	Ceded	Net
Case reserves	\$ 442,016	\$ 11,934	\$ 430,082	\$ 459,934	\$ 13,486	\$ 446,448
IBNR	219,063	18,092	200,971	215,160	18,794	196,366
	\$ 661,079	\$ 30,026	\$ 631,053	\$ 675,094	\$ 32,280	\$ 642,814

The provision for unpaid claims and adjustment expenses by major lines of business is as follows:

	March 31, 2012	December 31, 2011
Personal lines	\$ 466,708	\$ 478,261
Commercial lines	194,371	196,833
	\$ 661,079	\$ 675,094

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12 Site Restoration Provision

The site restoration provision is based on periodic independent estimates of costs associated with soil and groundwater reclamation and remediation of industrial sites formerly owned by the Company. The change in site restoration provision is as follows:

	Three months ended March 31, 2012	Year ended December 31, 2011
Balance at beginning of period	\$ 2,401	\$ 2,495
Expenditures	-	(158)
Changes due to passage of time and discount rates	12	64
Balance at end of period	\$ 2,413	\$ 2,401

Change in estimates of future expenditures are as a result of periodic reviews of the underlying assumptions supporting the provision, including remediation costs and regulatory requirements. The Company does not expect to settle any portion of the site restoration provision within twelve months after March 31, 2012.

Potential reimbursements of costs resulting from indemnifications provided by previous owners of the industrial sites have not been recognized in these financial statements. Any future reimbursements will be recorded when received.

13 Commitments and Contingent Liabilities

(a) In connection with its operations, the Company is from time to time named as defendant in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal expenses in excess of amounts provided for. The Company does not believe that it will incur any significant additional expenses in connection with such actions.

(b) The Company has operating leases for office space in major cities across Canada with remaining lease terms of up to 15 years. Future minimum annual lease payments under operating leases and subleases are:

Not later than one year	\$ 3,044
Later than one year and not later than five years	\$ 11,799
Later than five years	\$ 26,842

(c) The Company has purchased a number of annuities in settlement of claims which at the time of purchase resulted in derecognition of the related liability from the statement of financial position. These annuities have been purchased from registered Canadian life insurers with high claims paying ability ratings as determined by outside rating organizations. The total value of the annuities purchased by the Company at March 31, 2012 was \$56,275 (December 31, 2011 - \$56,275). The Company has a credit risk with respect to the failure of these life insurers. The Company has assessed the fair value of this credit risk as insignificant based on the claims paying ability of the life insurers and historical experience.

(d) In connection with the sale of the operations and assets of WHL, WHL agreed to indemnify the purchaser against certain liabilities or losses as described in the asset purchase agreement to an aggregate maximum of US\$11,000, subject to certain exclusions. The Company also agreed to indemnify the purchaser and the purchaser's directors, officers and employees, for an indefinite period, from certain environmental liabilities and costs relating to the premises formerly leased by WHL in Fort Saskatchewan, Alberta. No amounts have been accrued related to these indemnities.

(e) The Company has agreements to indemnify its Officers and Directors for certain events or occurrences while the Officer or Director is or was serving at the Company's request in such capacity. The maximum potential amount of future payments is unlimited. However, the Company maintains Director and Officer Liability insurance coverage that enables the Company to recover a portion of any future payments.

(f) The Company has provided indemnifications to third parties with respect to future site restoration costs to be incurred on properties previously owned by the Company. These estimated costs have been included in the site restoration provision (note 12).

(g) From time to time, the Company pledges assets to third parties to collateralize liabilities incurred under its insurance policies or for services provided by the third parties. At March 31, 2012, the amount of pledged assets was \$500 (December 31, 2011 - \$500). Collateral pledging transactions are conducted under terms that are common and customary to standard collateral pledging and are subject to the Company's risk management controls.

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14 Share Capital, Warrants and Contributed Surplus

*Share Capital*

The Company's authorized share capital consists of an unlimited number of common shares with no par value, Class A preferred shares with no par value and Class B preferred shares with no par value.

The Company's share capital at March 31, 2012 and December 31, 2011 is as follows:

(thousands)	March 31, 2012		December 31, 2011	
	Number	Stated Capital	Number	Stated Capital
Common shares issued and fully paid	580,344	\$ 656,618	580,344	\$ 656,618
Series 1 Class A preferred shares issued and fully paid	63,853	30,784	63,853	30,784
	644,197	\$ 687,402	644,197	\$ 687,402

There were no changes in the Company's common shares outstanding during the three months ended March 31, 2012. In the three months ended March 31, 2011, 70,000 common shares were issued upon the exercise of 70,000 stock options for proceeds of \$15.

The Series 1 Class A preferred shares rank equally with the common shares with respect to liquidation proceeds and are entitled to dividends as the directors may declare, provided that an equal dividend is declared on the common shares. The Series 1 Class A preferred shares are non-voting and convertible into common shares, on a one to one basis, subject to any adjustments resulting from subdivision or consolidation of the common shares and provided that the conversion does not result in the holder owning common shares exceeding an ownership limit of 40%. No shares of the Company are held by the Company or by its subsidiaries. There were no changes in the Company's Series 1 Class A preferred shares outstanding during the three months ended March 31, 2012 and 2011.

*Warrants*

10,000,000 warrants to purchase an equal number of Series 1 Class A preferred shares of the Company at an exercise price of \$0.50 per share are issued and outstanding with an expiry date of February 9, 2013. The fair value of the warrants at the time of issuance on February 9, 2010 was \$1,900, which was estimated using the Black-Scholes option pricing model assuming a risk-free interest rate of 1.59% and a volatility of 30.0%.

*Contributed Surplus*

In August 2011, the Company filed a normal course issuer bid which entitles the Company to acquire up to 30,173,238 common shares between August 30, 2011 and August 29, 2012. In 2012 no shares were purchased under the normal course issuer bid. In 2011, the Company repurchased 6,455,000 common shares on the open market through the normal course issuer bid at an average price per share of \$0.4875, for an aggregate consideration of \$3,147. The amount by which the average carrying value exceeded the cost of reacquiring the shares of \$4,156 was credited to contributed surplus.

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15 Investment Income

The following table provides details of the investment income:

	Three months ended March 31	
	2012	2011
Interest income	\$ 6,614	\$ 7,269
Dividend income	1,131	100
Instalment premiums financing income	998	1,137
Investment income	8,743	8,506
Investment expenses	(925)	(1,013)
Net investment income	\$ 7,818	\$ 7,493

16 Expenses

The following table summarizes expenses by function as presented in the statement of operations:

Expenses by function	Three months ended March 31	
	2012	2011
Investment	\$ 925	\$ 1,013
Underwriting	71,771	70,425
Corporate	6,673	3,188
	\$ 79,369	\$ 74,626

The following table summarizes the expenses by nature:

Expenses by nature	Three months ended March 31	
	2012	2011
Claims	\$ 41,279	\$ 45,807
Reinsurers' share of claims and adjustment expenses	1,221	785
Commissions	12,133	10,231
Premium taxes	2,482	2,336
Salaries and benefits	9,546	7,747
Share-based compensation	4,281	2,342
Office expenses	5,863	3,751
Professional fees	1,822	884
Depreciation of property and equipment	485	497
Amortization of intangible assets	386	252
Management services	646	586
Investment management fees	318	416
Surety administrative charges	(1,093)	(1,008)
	\$ 79,369	\$ 74,626

For the three months ended March 31, 2012, \$538 (2011 - \$388) was included in salaries and benefits for future employee benefits under defined contribution plans, and \$790 (2011 - \$369) was included in office expenses for lease expenses.



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17 Share-based Compensation

Under the Company's comprehensive long-term equity incentive plan, as approved by the Board of Directors and ratified by the shareholders, the Company may grant share-based awards for an initial number of 63,858,049 common shares of the Company.

**Stock Options** – Changes to the number of stock options for the three months ended March 31, 2012 and 2011 are as follows:

	Three months ended March 31, 2012		Three months ended March 31, 2011	
	Number (thousands)	Weighted Average Exercise Price in dollars	Number (thousands)	Weighted Average Exercise Price in dollars
Common share stock options				
Outstanding at beginning of period	475	\$ 3.30	1,072	\$ 4.03
Exercised	-	\$ -	(70)	\$ 0.22
Expired and forfeited	(75)	\$ 5.60	(136)	\$ 10.82
Outstanding at end of period	400	\$ 2.87	866	\$ 3.27

All stock options outstanding are exercisable. Information about stock options outstanding at March 31, 2012 is as follows:

Range of Exercise Prices in dollars	Number (thousands)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price in dollars
\$0.22 - \$0.99	27	5.7 years	\$ 0.22
\$1.00 - \$3.99	323	2.9 years	\$ 2.58
\$4.00 - \$6.18	50	3.9 years	\$ 6.18
	400	3.2 years	\$ 2.87

**Deferred Share Units** – DSUs are granted to non-executive Directors of the Company as well as non-executive Directors, officers and employees of Jevco and are issued at the market value of the Company's shares at the date of grant. Directors may elect to receive DSUs in lieu of fees, which are issued at the market value of the Company's shares at the date of grant (prior to June 30, 2010 were issued at 90% of the market value). DSUs issued to officers and employees of Jevco vest as to one-third on the first anniversary, one-third on the second anniversary and one-third on the third anniversary of their date of grant. Vested DSUs are paid out in cash when the participant ceases to be a director, officer or employee.

Changes to the number of DSUs for the three months ended March 31, 2012 and 2011 are as follows:

DSUs (thousands)	Three months ended March 31	
	2012	2011
Outstanding at beginning of period	5,538	4,609
Granted	180	189
Outstanding at end of period	5,718	4,798

No DSUs were exercised in the three months ended March 31, 2012 and 2011. For the three months ended March 31, 2012, compensation expense relating to DSUs was \$701 (2011 – \$206). At March 31, 2012, a liability of \$3,424 (December 31, 2011 - \$2,723) has been accrued with respect to issued DSUs.

**Restricted Share Units** – RSUs granted vest over three years, one third on each of the one year, two year and three year anniversary of the grant date, and are payable in cash when vested. The holder may elect to apply all or part of such cash payment to a subscription for common shares of the Company.

The number of RSUs outstanding during the three months ended March 31, 2012 and 2011 was 26,849,193 and 25,775,225 respectively. No RSUs were granted or exercised during the three months ended March 31, 2012 and 2011. After quarter end, on April 20, 2012, 9,665,709 RSUs were granted.

Compensation expense with respect to RSUs for the three months ended March 31, 2012 was \$3,580 (2011 - \$2,136). At March 31, 2012, accounts payable and accrued liabilities included accrued expense related to these RSUs of \$11,795 (December 31, 2011 - \$8,216).

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18 Related Party Transactions

*Management services agreement*

The Company has entered into a management services agreement ("MSA") with Goodwood to manage the day-to-day affairs of the Company and to present strategic investment opportunities for the Board of Directors to consider. Goodwood is required to provide certain services to the Company including the services of two directors, one of whom is also President and Chief Executive Officer, and a Chief Financial Officer. The MSA currently provides that Goodwood will be paid an annual service fee designed to compensate Goodwood for the time and attention of its officers and employees incurred in furtherance of the Company's business as well as for the office space, equipment, supplies and other facilities provided or made available by Goodwood to the Company. The amount of the services fee will be based on the latest report prepared by an independent compensation consultant. Goodwood will also be entitled to participate in an annual incentive bonus plan for the purpose of recognizing the contribution of Goodwood to the Company's business.

For the three months ended March 31, 2012, Goodwood earned fees, inclusive of harmonized sales tax, of \$646 (2011 - \$586). At March 31, 2012, fees of \$215 (December 31, 2011 - \$226) were included in accounts payable and accrued liabilities.

All RSUs outstanding are held by Goodwood (note 17).

*Transactions with key management personnel*

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including directors of the Company and its subsidiaries.

Compensation expenses related to key management personnel for the three months ended March 31, 2012 and 2011 are as follows:

	Three months ended March 31	
	2012	2011
Salaries and other short-term employee benefits	\$ 1,563	\$ 1,166
Post-employment benefits	57	21
Share-based compensation	701	206
	\$ 2,321	\$ 1,393

Accounts payable and accrued liabilities include \$374 (December 31, 2011 - \$747) to a company controlled by a member of key management personnel and his family.

19 Earnings per Share

The Company uses the treasury stock method to calculate diluted earnings per share. Following the treasury stock method, the numerator for the Company's diluted earnings per share calculation remains unchanged from the basic earnings per share calculation, as the assumed exercise of the Company's restricted share units, warrants and stock options does not result in an adjustment to income.

The reconciliation from the basic number of shares to the diluted number of shares used in the denominator to calculate earnings per share is as follows:

Number of common shares and Series 1 Class A preferred shares (in thousands)	Three months ended March 31	
	2012	2011
Number of shares for basic earnings per share	644,197	644,425
Effect of dilutive securities:		
- restricted share units	17,053	11,213
- warrants	1,184	1,775
- stock options	17	22
Number of shares for diluted earnings per share	662,451	657,435

The Series 1 Class A preferred shares are considered in-substance common shares and are included in the calculation of earnings per share.

Stock options to purchase 400,000 common shares were outstanding at March 31, 2012 ((March 31, 2011 - 866,500). Of the stock options outstanding at March 31, 2012, 372,800 (March 31, 2011 - 839,300) were excluded in the calculation of diluted earnings per share because the exercise price of the stock options was greater than the weighted average market value of the common shares in the quarter.

## 20 Capital Management

The Company's objectives when managing capital are:

- meeting regulatory requirements;
- maintaining a strong credit rating; and
- maximizing shareholder value.

In order to achieve the Company's capital management objectives, it employs a strong and efficient capital base and manages capital in accordance with policies established by the Board of Directors. These policies relate to capital strength, capital mix, dividends and return on capital. The Company has a capital management process in place to measure, deploy and monitor its available capital to assess its adequacy on a continuous basis.

Management develops the capital strategy and oversees the capital management processes. Capital is managed using both regulatory capital measures and internal metrics.

The Company's capital consists of its shareholders' equity. These funds are mainly invested in the equity of Jevco. Jevco is regulated by OSFI and is required to maintain a level of capital sufficient to support the volume and risk profile of Jevco's business. Generally, OSFI requires insurers to achieve a ratio of at least 150% of an MCT formula.

## 21 Risk Management

By virtue of the nature of the insurance company business, financial instruments comprise the majority of the Company's statement of financial position. The most significant identified risks to the Company which arise from holding financial instruments include credit risk, market risk, liquidity risk and insurance underwriting risk. The market risk exposure of the Company is related to changes in interest rates and adverse movement in equity prices. The insurance underwriting risk of the Company is primarily related to pricing risk, concentration of risk and reserving risk. The Investment Committee of the Board of Jevco and senior management monitor the Company's risk exposures and activities that give rise to these exposures. The Appointed Actuary performs quarterly and annual analyses of the effect of various projected adverse scenarios on the financial condition of the Company which are compared to a base scenario using the Company's business plan. Management considers the results of these analyses in its risk management procedures. The Company has a comprehensive risk management framework to monitor, evaluate and manage the risks assumed in conducting its business.

Further details are provided below on the risk management objectives and policies as they relate to specific financial risks:

### Credit risk

The Company is exposed to credit risk principally through its investments and balances recoverable from reinsurers. The Company monitors concentration and credit risk through policies to limit and monitor its exposure to individual issuers or related groups, with the exception of Canadian government bonds, as well as through ongoing review of the credit ratings of issuers held in the investment portfolio. The Company has policies to evaluate the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer's insolvency.

The tables below summarize the Company's credit exposure from its fixed income investments by DBRS Limited rating.

Available-for-sale fixed income portfolio (measured at fair value)

DBRS Limited rating	March 31, 2012		December 31, 2011	
AAA	\$ 321,028	42.1%	\$ 359,155	44.7%
AA	251,969	33.0%	257,502	32.0%
A	168,455	22.1%	166,658	20.7%
BBB	20,776	2.7%	18,456	2.3%
Not rated	950	0.1%	2,245	0.3%
	\$ 763,178	100.0%	\$ 804,016	100.0%

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21 Risk Management (continued)

Held-to-maturity fixed income portfolio (measured at amortized cost)

DBRS Limited rating	March 31, 2012		December 31, 2011	
AAA	\$ 18,866	19.4%	\$ 18,883	19.4%
AA	64,978	66.8%	65,140	66.8%
A	13,410	13.8%	13,445	13.8%
	\$ 97,254	100.0%	\$ 97,468	100.0%

At March 31, 2012, 97.2% (December 31, 2011 – 97.4%) of the Company's available-for-sale fixed income portfolio and 100.0% (December 31, 2011 – 100.0%) of the held-to-maturity fixed income portfolio was rated "A" or better.

Credit exposure for amounts recoverable from reinsurers, by rating assigned by A.M. Best to the applicable reinsurers is as follows:

A.M. Best rating	March 31, 2012		December 31, 2011	
A++	\$ 114	0.4%	\$ 180	0.5%
A+	9,526	29.9%	9,723	28.6%
A	21,090	66.1%	22,884	67.4%
B++	271	0.8%	284	0.8%
Not rated	892	2.8%	899	2.7%
	\$ 31,893	100.0%	\$ 33,970	100.0%

Interest rate risk

The Company is subject to risk exposure due to changes in interest rates. Because the investments are mainly comprised of fixed income securities, periodic changes in interest rates impact the financial results to the extent that reinvestment yields are different than the original yields on maturing securities. Also, during periods of rising interest rates, the market value of the existing fixed income securities will generally decrease and realized gains on fixed income securities will likely be reduced. The reverse is true during periods of declining interest rates. Offsetting the effect on assets, any change in interest rates has an impact on the market yield rate which is used for discounting unpaid claims and adjustment expenses.

The Company manages interest rate risk by monitoring the matching of the duration of the assets and liabilities. Duration is a measure used to estimate the extent market values of fixed income instruments change with changes in interest rates. Using this measure, it is estimated that:

- (i) An immediate hypothetical 100 basis point (1.0%) parallel increase in interest rates would decrease the fair value of the available-for-sale fixed income investments by approximately \$18,000 at March 31, 2012 (December 31, 2011 - \$18,400), representing 2.4% (December 31, 2011 - 2.3%) of the fair value of \$763,178 (December 31, 2011 - \$804,016) of the available-for-sale fixed income investments portfolio.
- (ii) An immediate hypothetical 100 basis point (1.0%) parallel decrease in interest rates would increase the carrying value of the net unpaid claims and adjustment expenses by approximately \$12,700 at March 31, 2012 (December 31, 2011 - \$12,900), representing 2.2% (December 31, 2011 - 2.2%) of the \$579,999 (December 31, 2011 - \$591,845) carrying value of the unpaid claims and adjustment expenses, net of amounts recoverable from reinsurers and other insurers.

Computation of the prospective effect of hypothetical interest rate changes is based on numerous assumptions, including maintenance of the existing level and composition of fixed income security assets at the indicated date, and should not be relied on as indicative of future results. The computation is based on the following assumptions:

- the fixed income investments in the Company's portfolio are not impaired;
- credit and liquidity risks have not been considered;
- interest rates and equity prices move independently; and
- shifts in the yield curve are parallel.

Equity prices risk

The Company is exposed to general and specific equity risk through its preferred share and common share investments. General equity risk is the risk of price volatility due to changes in general economic or stock market conditions. Specific equity risk is the risk of price fluctuations due to entity specific characteristics.

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21 Risk Management (continued)

Company management estimates that a 10% decrease in the prices of common and preferred shares held as at March 31, 2012 would have decreased other comprehensive income before tax by \$12,190 (December 31, 2011 - \$11,658). A 10% increase in the prices of common and preferred shares held would have increased other comprehensive income by a corresponding amount.

Liquidity risk

Liquidity risk is the risk of having insufficient cash resources to meet current financial obligations without raising funds at unfavorable rates or selling assets on a forced basis. Liquidity risk arises from general business activities and in the course of managing assets and liabilities. There is risk of loss to the extent that the sale of a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows. The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. Liquidity requirements are met primarily through funds generated from operations, asset maturities and income and other returns received on investments. Cash provided from these sources is used primarily for claims and claims adjustment expense payments and operating expenses. To meet these cash requirements, the Company has policies to limit and monitor its exposure to individual issuers or related groups and to ensure that assets and liabilities are broadly matched in terms of their duration and currency.

The following tables summarize the carrying values of financial instruments by contractual maturity or expected cash flow dates (the actual dates may differ from contractual maturity because certain securities and debentures have the right to call or prepay obligations with or without call or prepayment penalties):

At March 31, 2012	Less than one year	One to five years	Five to ten years	More than ten years	No Specific Date	Total
<b>Financial assets:</b>						
Cash and cash equivalents	\$ 49,445	\$ -	\$ -	\$ -	\$ -	\$ 49,445
Investment income due and accrued	10,047	-	-	-	-	10,047
Investments available-for-sale	168,024	500,912	80,889	13,353	122,397	885,575
Investments held-to-maturity	-	-	97,254	-	-	97,254
Instalment premiums	63,290	-	-	-	-	63,290
Accounts receivable	27,968	369	-	-	-	28,337
Recoverable from reinsurers	10,946	17,729	2,806	412	-	31,893
Claims recoverable from other insurers	17,522	28,381	4,492	659	-	51,054
	\$ 347,242	\$ 547,391	\$ 185,441	\$ 14,424	\$ 122,397	\$ 1,216,895
<b>Financial liabilities:</b>						
Accounts payable and accrued liabilities	\$ 22,403	\$ 6,446	\$ -	\$ -	\$ 3,425	\$ 32,274
Unpaid claims and adjustment expenses	223,180	369,675	55,993	12,231	-	661,079
	\$ 245,583	\$ 376,121	\$ 55,993	\$ 12,231	\$ 3,425	\$ 693,353
<b>At December 31, 2011</b>						
	Less than one year	One to five years	Five to ten years	More than ten years	No Specific Date	Total
<b>Financial assets:</b>						
Cash and cash equivalents	\$ 24,347	\$ -	\$ -	\$ -	\$ -	\$ 24,347
Investment income due and accrued	5,567	-	-	-	-	5,567
Investments available-for-sale	183,573	532,861	81,595	5,987	117,075	921,091
Investments held-to-maturity	-	-	97,468	-	-	97,468
Instalment premiums	62,781	-	-	-	-	62,781
Accounts receivable	27,454	-	-	-	-	27,454
Recoverable from reinsurers	11,659	18,884	2,989	438	-	33,970
Claims recoverable from other insurers	17,493	28,334	4,485	657	-	50,969
	\$ 332,874	\$ 580,079	\$ 186,537	\$ 7,082	\$ 117,075	\$ 1,223,647
<b>Financial liabilities:</b>						
Accounts payable and accrued liabilities	\$ 25,502	\$ 5,298	\$ -	\$ -	\$ 2,723	\$ 33,523
Unpaid claims and adjustment expenses	231,692	375,285	59,408	8,709	-	675,094
	\$ 257,194	\$ 380,583	\$ 59,408	\$ 8,709	\$ 2,723	\$ 708,617

## 21 Risk Management (continued)

The liquidity of the Company's investment portfolio is sufficient to generate cash to meet short term operational needs that are not met through cash flows from operations.

The carrying value of the provision for unpaid claims and adjustment expenses is based on the present value of future cash flows with provisions for adverse deviation and is considered to be an indicator of fair value as there is no ready market for the trading of insurance policy liabilities. Similarly, the carrying values of claims recoverable from other insurers and recoverable from reinsurers are indicators of fair value as they are calculated on the same basis as the provision for unpaid claims and adjustment expenses. Investments are carried at fair value, amortized cost or cost as described in note 4. The carrying value of all other financial instruments approximates their fair value due to the short term to maturity of those financial instruments.

The annual coupon rates for the fixed term investments range from 0.8% to 12.2% at March 31, 2012 (1.0% to 12.2% at December 31, 2011). The average effective book yield using amortized cost and the contractual interest rates, adjusted for amortization of premiums and discounts at March 31, 2012 is 2.9% (December 31, 2011 - 2.8%).

### *Insurance risk*

Insurance risk is the risk that the total cost of claims, adjustment and acquisition expenses will exceed premiums received and can arise from numerous factors. The Company has identified pricing risk, concentration of risk and reserving risk as its most significant sources of insurance risks. The Company's underwriting objective is to develop business within its target market on a prudent and diversified basis and to achieve profitable underwriting results.

### *Pricing risk*

Pricing risk arises when actual claims experience differs from the assumptions included in pricing calculations. Historically, the underwriting results of the property and casualty industry have fluctuated significantly due to the cyclicity of the insurance market. The market cycle is affected by the frequency and severity of claims, levels of capacity and demand, general economic conditions and price competition. The Company focuses on profitable underwriting using a combination of experienced underwriting staff, pricing models and price adequacy monitoring tools. The Company prices its products taking into account numerous factors including claims frequency and severity trends, product line expense ratios, special risk factors associated with the capital required to support the product line, and the investment income earned on that capital. The Company's pricing is designed to ensure an appropriate return on capital while also providing long-term rate stability. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

### *Concentration of risk*

The Company writes property and casualty insurance contracts generally over twelve-month durations. The most significant risks arise from natural disasters, climate change and other catastrophes. A concentration of risk may also arise from a single insurance contract issued to a particular demographic type of policyholder, within a geographical location or to types of commercial business. The relative variability of the outcome is mitigated if there is a large portfolio of similar risks. The Company's exposure to concentration of insurance risk is mitigated by a portfolio diversified across different geographic areas and lines of business. The Company has a reinsurance program to limit the exposure to catastrophic losses from any one catastrophe (note 5).

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21 Risk Management (continued)

The Company has approximately 64% of its business in Ontario and is exposed to trends, social inflation, judicial changes and regulatory changes affecting this business. The geographical diversity by location of the underlying insurance risk is summarized below by reference to premiums written for the three months ended March 31, 2012 and 2011:

	Three months ended March 31, 2012			Three months ended March 31, 2011		
	Direct	Ceded	Net	Direct	Ceded	Net
Ontario	\$ 50,341	\$ 1,981	\$ 48,360	\$ 40,913	\$ 1,974	\$ 38,939
Quebec	19,933	1,062	18,871	17,256	967	16,289
Alberta	5,790	203	5,587	5,750	241	5,509
Other	3,245	250	2,995	2,385	225	2,160
	\$ 79,309	\$ 3,496	\$ 75,813	\$ 66,304	\$ 3,407	\$ 62,897

The portfolio of insurance by personal and commercial lines is summarized below by reference to premiums written for the three months ended March 31, 2012 and 2011:

	Three months ended March 31, 2012			Three months ended March 31, 2011		
	Direct	Ceded	Net	Direct	Ceded	Net
Personal lines	\$ 51,899	\$ 1,710	\$ 50,189	\$ 45,398	\$ 1,890	\$ 43,508
Commercial lines	27,410	1,786	25,624	20,906	1,517	19,389
	\$ 79,309	\$ 3,496	\$ 75,813	\$ 66,304	\$ 3,407	\$ 62,897

*Reserving risk*

Reserving risk arises when actual ultimate paid claims and adjustment expenses are different from the estimated unpaid claims and adjustment expenses reserve. Reserving risk includes both the risk that reserves are too low with the result that not enough reserves are provided for the payment of claims, and the risk that reserves are too high because management is overly conservative in establishing reserves. Reserving patterns are the basis of the actuarial projection of future claims costs and inconsistent patterns can have a significant impact on the financial position of the Company. Reserve changes associated with claims of prior periods are recognized in the current period, which impacts current period earnings. Claims data included in the reserving is used for product and reinsurance pricing; inaccurate reserving levels may cause delays in establishing proper pricing.

*Sensitivity analyses*

Risks associated with property and casualty insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The Company considers that the liability for its unpaid claims and adjustment expenses recognized in the statement of financial position is adequate. However, actual experience will differ from the expected outcome.

Among all the lines of business, the non-standard automobile line of business in Ontario has the largest unpaid claims and adjustment expense liabilities. Given the nature of this line of business and the fact that it has a very long tail (meaning claims may take a long period of time to settle), the estimate of this line is the most critical to the assumptions used. If the tail factor selection on this line of business was 5% higher, the net unpaid claims and adjustment expense liabilities would be increased by approximately \$34,700. The net effect on net income and shareholders' equity would be a reduction of approximately \$25,600. If the expected loss ratios used in the calculation of the IBNR reserves were 5% higher in all accident years, the net unpaid claims and adjustment expense liabilities would be approximately \$6,100 higher, generating a net reduction in net income and shareholders' equity of approximately \$4,500. Changes in assumptions on other lines of business are considered to be less material.

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21 Risk Management (continued)

The following claims development tables show the development of actual claims and adjustment expenses compared to the provisions for unpaid claims and adjustment expenses on a direct basis and a net of reinsurance recoverable basis.

Claims development – Direct:

	Accident year						Total March 31, 2012
	2007	2008	2009	2010	2011	2012	
Estimates of ultimate claims and adjustment expenses as at:							
December 31, 2007	\$ 293,594						
December 31, 2008	298,017	\$ 334,040					
December 31, 2009	299,667	331,591	\$ 332,529				
December 31, 2010	298,751	325,375	328,792	\$ 252,560			
December 31, 2011	290,901	326,139	323,240	249,492	\$ 256,058		
March 31, 2012	289,987	323,535	322,546	245,535	254,329	\$ 58,819	\$ 1,494,751
Direct cumulative claims and adjustment expense payments to:							
December 31, 2007	\$ 67,085						
December 31, 2008	114,736	\$ 87,041					
December 31, 2009	176,509	176,551	\$ 123,994				
December 31, 2010	206,365	209,125	186,346	\$ 90,990			
December 31, 2011	234,177	236,373	216,947	138,316	\$ 90,248		
March 31, 2012	236,954	243,831	223,459	146,691	105,322	\$ 14,100	\$ 970,357
Provision for years 2007 to 2012							524,394
Provision for years prior to 2007							62,733
Unpaid claims and adjustment expenses, net of recoveries - undiscounted							587,127
Effect of discounting and provision for adverse development							22,898
Unpaid claims and adjustment expenses, net of recoveries from other insurers							610,025
Recoverable from other insurers							51,054
Unpaid claims and adjustment expenses (note 11)							\$ 661,079

Claims development – Net of reinsurance recoverable:

	Accident year						Total March 31, 2012
	2007	2008	2009	2010	2011	2012	
Estimates of net ultimate claims and adjustment expenses as at:							
December 31, 2007	\$ 247,821						
December 31, 2008	251,157	\$ 283,984					
December 31, 2009	253,500	283,006	\$ 301,526				
December 31, 2010	250,386	277,098	296,202	\$ 250,662			
December 31, 2011	242,686	277,413	290,070	245,489	\$ 249,938		
March 31, 2012	241,871	275,058	289,766	242,479	248,407	\$ 57,540	\$ 1,355,121
Net cumulative claims and adjustment expense payments to:							
December 31, 2007	\$ 52,247						
December 31, 2008	88,460	\$ 69,226					
December 31, 2009	136,568	133,992	\$ 97,222				
December 31, 2010	166,383	163,921	158,357	\$ 90,948			
December 31, 2011	192,671	190,594	188,854	138,235	\$ 90,196		
March 31, 2012	195,357	198,052	195,255	146,499	105,243	\$ 14,099	\$ 854,505
Provision for years 2007 to 2012							500,616
Provision for years prior to 2007							57,612
Unpaid claims and adjustment expenses, net of recoveries - undiscounted							558,228
Effect of discounting and provision for adverse development							21,771
Unpaid claims and adjustment expenses, net of reinsurance and recoveries from other insurers							579,999
Recoverable from other insurers							51,054
Net unpaid claims and adjustment expenses (note 11)							\$ 631,053



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22 Operating Segment

The Company has one reportable segment which comprises the Company's property and casualty insurance business. All other includes corporate activities. The accounting policies of the reportable segment are the same as the Company's accounting policies described in note 2. Segment net income represents segment net income without allocation of certain administration costs.

	Three months ended March 31, 2012			Three months ended March 31, 2011		
	Insurance segment	All other	Total	Insurance segment	All other	Total
Revenue	\$ 86,267	\$ 43	\$ 86,310	\$ 79,190	\$ 29	\$ 79,219
Underwriting expenses	71,771	-	71,771	70,425	-	70,425
Amortization and depreciation expense	871	-	871	749	-	749
Income tax expense	3,500	-	3,500	2,271	-	2,271
Net income (loss)	10,423	(6,069)	4,354	5,975	(243)	5,732
Other comprehensive income (loss)	2,409	-	2,409	(2,552)	-	(2,552)
Comprehensive income (loss)	12,832	(6,069)	6,763	3,423	(243)	3,180

  

	March 31, 2012			December 31, 2011		
	Insurance segment	All other	Total	Insurance segment	All other	Total
Assets	\$ 1,240,852	\$ 45,732	\$ 1,286,584	\$ 1,279,524	\$ 16,609	\$ 1,296,133
Liabilities	842,400	20,158	862,558	863,903	14,967	878,870

23 Subsequent Event

On May 2, 2012, the Company announced it had entered into an agreement (the "Agreement") with an unrelated party (the "Purchaser") to sell all the issued and outstanding shares in the capital of Jevco to the Purchaser for \$530,000 in cash (the "Transaction"). The Transaction is expected to be concluded in the fall of 2012 and is conditional upon, among other things, approval of the Company's shareholders and receipt of required regulatory approvals.

The Agreement contains a non-solicitation covenant on the part of the Company, subject to provisions that entitle the Company to consider and accept a superior proposal, a right in favour of the Purchaser to match any superior proposal, and payment to the Purchaser of a termination fee of \$18,500 if the Transaction is not completed as a result of a superior proposal.

The insurance segment presented in note 22 *Operating Segment* consists solely of Jevco, and includes Jevco's total assets and liabilities as at March 31, 2012 and December 31, 2011, and Jevco's total revenues and expenses for the three months ended March 31, 2012 and 2011.



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