ACE AVIATION

Consolidated Financial Statements and Notes
2010

February 9, 2011

PRICEWATERHOUSECOOPERS

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February 9, 2011

Independent Auditor's Report

To the Shareholders
of ACE Aviation Holdings Inc.

We have audited the accompanying consolidated financial statements of ACE Aviation Holdings Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations, changes in shareholders' equity, comprehensive income (loss) and cash flow for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of ACE Aviation Holdings Inc. and its subsidiaries as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants[1]

[1] Chartered accountant auditor permit No. 18144

Consolidated Statement of Operations

For the year ended December 31 (Canadian dollars in millions except per share figures)		2010	2009 * Notes 1 & 3
Operating revenues			
Passenger		$ -	$ 7,196
Cargo		-	282
Other		-	728
		-	8,206
Operating expenses			
Aircraft fuel		-	2,056
Wages, salaries and benefits		-	1,472
Airport and navigation fees		-	822
Capacity purchase with Jazz		-	825
Depreciation and amortization		-	545
Aircraft maintenance		-	625
Food, beverages and supplies		-	248
Communications and information technology		-	255
Aircraft rent		-	276
Commissions		-	156
Other		10	1,170
		10	8,450
Operating loss		**(10)**	**(244)**
Non-operating income (expense)			
Interest income		14	17
Interest expense		-	(321)
Interest capitalized		-	4
Loss on other assets		-	(70)
Loss on repurchase of ACE convertible senior notes and preferred shares	Note 6	-	(44)
Gain (loss) on ACE's investment in Air Canada	Note 3	43	(630)
Proportionate share of Air Canada's income (loss)	Note 3	43	(7)
Gain on financial instruments recorded at fair value	Note 9	5	94
Loss on investment in ACTS Aero	Note 3	(1)	-
Other		-	(5)
		104	(962)
Income (loss) before the following items		**94**	**(1,206)**
Non-controlling interest		-	(13)
Foreign exchange gain		-	531
Recovery of (provision for) income taxes	Note 4		
Current		-	2
Future		4	(6)
Income (loss) for the year		**$ 98**	**$ (692)**
Income (loss) per share	Note 7		
Basic		$ 3.00	$ (19.56)
Diluted		$ 3.00	$ (19.56)

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3). The accompanying notes are an integral part of these financial statements.*

Consolidated Statement of Financial Position

As at December 31 (Canadian dollars in millions)		2010	2009
ASSETS			
Cash and cash equivalents		$ 363	$ 71
		363	71
Investment in Air Canada	Note 3	107	99
Air Canada warrants	Note 3	5	-
Loan receivable from Air Canada	Note 3	-	150
Interest receivable	Note 3	-	3
Commodity taxes receivable	Note 4	6	-
		$ 481	**$ 323**
LIABILITIES			
Commodity taxes payable	Note 4	$ 6	$ -
Accounts payable and accrued liabilities		3	3
		9	3
SHAREHOLDERS' EQUITY			
Share capital		95	104
Contributed surplus		347	358
Retained earnings (deficit)		6	(92)
Accumulated other comprehensive income (loss)		24	(50)
		472	320
		$ 481	**$ 323**

The accompanying notes are an integral part of these financial statements.
Guarantees - Refer to Note 11.

On behalf of the Board of Directors:

(signed) Robert A. Milton
Robert A. Milton
Chief Executive Officer

(signed) David I. Richardson
David I. Richardson
Chair of the Audit, Finance and Risk Committee

Consolidated Statement of Changes in Shareholders' Equity

For the year ended December 31 (Canadian dollars in millions)		2010	2009 * Notes 1 & 3
Share capital			
Common shares, beginning of period		$ 104	$ 100
Repurchase and cancellation of common shares	Note 6	(9)	-
Issue of shares through stock options exercised		-	4
Total share capital		95	104
Contributed surplus			
Balance, beginning of period		358	163
Repurchase and cancellation of common shares	Note 6	(11)	-
Repurchase and cancellation of ACE convertible senior notes and preferred shares		-	199
Deconsolidation of ACE's investment in Air Canada		-	(6)
Fair value of stock options recognized as compensation expense		-	2
Total contributed surplus		347	358
Retained earnings (deficit)			
Balance, beginning of period		(92)	600
Income (loss) for the period		98	(692)
Retained earnings (deficit)		6	(92)
Accumulated other comprehensive income (loss)			
Balance, beginning of period		(50)	(606)
Other comprehensive income		74	556
Total accumulated other comprehensive income (loss)		24	(50)
Total retained earnings (deficit) and accumulated other comprehensive income (loss)		30	(142)
Total shareholders' equity		**$ 472**	**$ 320**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

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

Consolidated Statement of Comprehensive Income (Loss)

For the year ended December 31 (Canadian dollars in millions)		2010	2009 * Notes 1 & 3
Comprehensive income (loss)			
Income (loss) for the year		$ 98	$ (692)
Other comprehensive income (loss), net of taxes:			
Deconsolidation of ACE's investment in Air Canada	Note 3	-	176
Proportionate share of Air Canada's other comprehensive income	Note 3	50	15
Unrealized gain on available-for-sale ("AFS") investment in Air Canada	Note 3	24	-
Net losses on fuel derivatives under hedge accounting		-	(1)
Reclassification of net realized losses (gains) on fuel derivatives to income		-	366
Total comprehensive income (loss)		**$ 172**	**$ (136)**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

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

Consolidated Statement of Cash Flow

For the year ended December 31 (Canadian dollars in millions)		2010	2009 * Notes 1 & 3
Cash flows from (used for)			
Operating			
Income (loss) for the year		$ 98	$ (692)
Adjustments to reconcile to net cash from operations			
Loss (gain) on ACE's investment in Air Canada	Note 3	(43)	630
Proportionate share of Air Canada's loss (income)	Note 3	(43)	7
Air Canada warrants issued under the Credit Facility	Note 9	(5)	-
Depreciation and amortization		-	545
Loss on other assets		-	70
Foreign exchange gain		-	(505)
Future income taxes		(4)	6
Excess of employee future benefit funding over expense		-	(334)
Non-controlling interest		-	13
Fuel and other derivatives		-	20
Fuel hedge collateral deposits, net		-	228
Loss on repurchase of ACE convertible senior notes and preferred shares	Note 6	-	44
Loss on investment in ACTS Aero	Note 3	1	-
Changes in non-cash working capital balances		3	(230)
Other		-	30
		7	**(168)**
Financing			
Repurchase and cancellation of ACE common shares	Note 6	(20)	-
Repurchase of ACE convertible senior notes	Note 6	-	(297)
Repurchase of ACE convertible preferred shares	Note 6	-	(260)
Air Canada borrowings		-	776
Air Canada shares issued under public offering	Note 3	-	230
Air Canada warrants issued under the Air Canada public offering and Air Canada credit facility	Note 3	-	24
Reduction of long-term debt and capital lease obligations		-	(882)
		(20)	**(409)**
Investing			
Proceeds from sale of Air Canada shares	Note 3	156	-
Repayment of loan receivable from Air Canada	Note 3	150	-
Loss on investment in ACTS Aero	Note 3	(1)	-
Deconsolidation of Air Canada cash	Note 3	-	(1,277)
Short-term investments		-	338
Additions to capital assets		-	(200)
Proceeds from contractual commitment		-	230
Proceeds from sale of assets		-	96
Proceeds from sale-leaseback transactions		-	172
Other		-	(18)
		305	**(659)**
Increase (decrease) in cash and cash equivalents		**292**	**(1,236)**
Cash and cash equivalents, beginning of year		71	1,307
Cash and cash equivalents, end of year		**$ 363**	**$ 71**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

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

For the years ended December 31, 2010 and 2009
(Canadian dollars in millions except share amounts)

1. BASIS OF PRESENTATION

ACE Aviation Holdings Inc. ("ACE"), which was incorporated on June 29, 2004, is an investment holding company of aviation interests. Reference to the "Corporation" in the following notes to the financial statements refers to, as the context may require, ACE and its aviation interests collectively, ACE and one or more of its aviation interests, one or more of ACE's aviation interests, or ACE itself. Refer to Note 3 for a description of ACE's investments. These financial statements include the accounts of ACE and certain inactive subsidiaries.

These financial statements have been prepared on a going concern basis of presentation.

As described in Note 3, effective October 27, 2009, ACE no longer consolidates Air Canada's financial position, operating results and cash flows. For the period from October 27, 2009 to December 23, 2010, ACE's investment in Air Canada was accounted for using the equity method whereby the Air Canada investment carrying value was adjusted to include the Corporation's proportionate share of Air Canada's earnings and other comprehensive income.

Also as described in Note 3, effective December 23, 2010, ACE completed a secondary offering on a bought deal basis of 44,000,000 Class B Voting Shares of Air Canada. As a result, ACE ceased to have the ability to exercise significant influence over Air Canada and the retained investment in Air Canada was classified as available-for-sale ("AFS"). For convenience purposes, the Corporation elected to account for ACE's proportionate share of Air Canada earnings to December 31, 2010. Financial instruments classified as AFS are carried at fair value and any gains or losses are recognized directly in other comprehensive income.

The result is as follows:

- The Consolidated statement of operations and related notes for the year ending December 31, 2010 reflect ACE's proportionate share of Air Canada's earnings using the equity method of accounting. For the period from December 24, 2010 to December 31, 2010 ACE's investment in Air Canada is accounted for as an AFS financial asset. The Consolidated statement of operations and related notes for the year ending December 31, 2009 reflect ten months of Air Canada consolidated operating results and two months of ACE's proportionate share of Air Canada's earnings using the equity method of accounting.

- The Consolidated statement of financial position and related notes as at December 31, 2010 reflect the Air Canada investment as AFS. The Consolidated statement of financial position and related notes as at December 31, 2009 reflect the Air Canada investment using the equity method of accounting.

- The Consolidated statement of comprehensive income (loss) and related notes for the year ending December 31, 2010 reflect ACE's proportionate share of Air Canada comprehensive income (loss). For the period from December 24, 2010 to December 31, 2010 ACE's investment in Air Canada is accounted for as an AFS financial asset. The Consolidated statement of comprehensive income (loss) and related notes for the year ending December 31, 2009 reflect ten months of Air Canada consolidated comprehensive income (loss) and two months of ACE's proportionate share of Air Canada comprehensive income (loss).

- The Consolidated statement of cash flow and related notes for the year ending December 31, 2010 reflect ACE's cash flows. The Consolidated statement of cash flow and related notes for the year ending December 31, 2009 reflect ten months of Air Canada consolidated cash flows and two months of ACE's cash flows.

These consolidated financial statements are expressed in millions of Canadian dollars and are prepared in accordance with generally accepted accounting principles in Canada ("GAAP").

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) PRINCIPLES OF CONSOLIDATION

These consolidated financial statements include the accounts of the Corporation and its aviation interests, with adjustments for non-controlling interests. Until October 27, 2009, the consolidated financial statements of the Corporation also included the accounts of variable interest entities for which the Corporation was the primary beneficiary. All inter-company balances and transactions were eliminated.

Air Canada was consolidated up to October 27, 2009 (Refer to Note 3).

B) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Significant estimates made in the preparation of the consolidated financial statements include those used in accounting for income taxes (Note 4), the impairment considerations on long-lived assets and the carrying value of financial instruments recorded at fair value.

C) CASH AND CASH EQUIVALENTS

Cash includes $353 pertaining to investments with original maturities of three months or less at December 31, 2010 (2009 - $40). Investments include bankers' acceptances and bankers' discount notes, which may be liquidated promptly and have original maturities of three months or less. The weighted average interest rate on investments as at December 31, 2010 is 1.02% (2009 - 0.22%).

D) FINANCIAL INSTRUMENTS

Financial assets and financial liabilities, including derivatives, are recognized on the Consolidated Statement of Financial Position when the Corporation becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. The Corporation's own credit risk and the credit risk of the counterparty are taken into consideration in determining the fair value of financial assets and financial liabilities, including derivative instruments. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is "trading" in an instrument or alternatively the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in Non-operating income (expense). Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest method. Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in Other Comprehensive Income ("OCI"). Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Derivative instruments are measured at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair value of derivative instruments are recognized in Non-operating income (expense).

For financial instruments measured at amortized cost, transaction costs or fees, premiums or discounts earned or incurred are recorded, at inception, net against the fair value of the financial instrument. Interest expense is recorded using the effective interest method. For any guarantee issued that meets the definition of a guarantee pursuant to Accounting Guideline 14, *Disclosure of Guarantees*, the inception fair value of the obligation relating to the guarantee is recognized and amortized over the term of the guarantee. It is the Corporation's policy to not re-measure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has the following classifications:

- Cash and cash equivalents are classified as held-for-trading and any period change in fair value is recorded through interest income.

- As of December 23, 2010, Investment in Air Canada is classified as available-for-sale and any period change in fair value is recorded through other comprehensive income.

- Air Canada warrants issued under the Credit Facility are classified as held-for-trading and any period change in fair value is recorded through Gain (loss) on financial instruments recorded at fair value.

- Loan receivable, interest receivable and commodity taxes receivable, are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in the statement of operations, as applicable.

- Accounts payable and accrued liabilities are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest expense is recorded in the statement of operations, as applicable.

E) EQUITY INVESTMENTS

Investments subject to significant influence are accounted for using the equity method which reflects the costs of the investment and the Corporation's proportionate share of the investee's profits or losses, other comprehensive income or losses, capital transactions and dividends received. The Corporation does not record a negative investment in its investees when the Corporation is unlikely to share in such losses unless the Corporation has guaranteed the obligations of the investee, has committed to provide further financial support to the investee or the investee seem assured of imminently returning to profitability. When there is a loss in value of an investment accounted for using the equity method that is other than a temporary decline, the investment is written down to its fair value with a loss recognized in the statement of operations. Such write-downs are not reversed if there is a subsequent increase in value.

Upon the loss of significant influence, the retained interest represents carrying amount of the net assets of the investee and is adjusted for reclassification of items previously recognised in accumulated other comprehensive income.

F) RELATED PARTY TRANSACTIONS

Related party transactions not in the normal course of operations are measured at the exchange amount when the change in ownership interest in the item transferred is substantive and the exchange amount is supported by independent evidence; otherwise it is recorded at the carrying amount. Related party transactions in the normal course of operations are measured at the exchange amount.

G) INCOME TAXES

The Corporation utilizes the asset and liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount and the tax basis of assets and liabilities. Future income tax assets and liabilities are measured using substantively enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. Income taxes are recognized in the income statement except to the extent that it relates to items charged or credited to Shareholders' equity, in which case the taxes are netted with such items. The effect on future income tax assets and liabilities of a change in tax rates is recognized in earnings in the period when the change is substantively enacted. Future income tax assets are recognized to the extent that realization is considered more likely than not. The

Corporation applied fresh start reporting on September 30, 2004 under which the assets and liabilities of the Corporation were comprehensively revalued, excluding goodwill ("fresh start"). The benefit of future income tax assets that existed at fresh start, and for which a valuation allowance is recorded, have been recognized first to reduce to nil any remaining intangible assets (on a pro-rata basis) that were recorded upon fresh start reporting with any remaining amount as a credit to Shareholders' equity, up to October 27, 2009 (Refer to Note 3). The benefit of future income tax assets that arise after fresh start are recognized in the Consolidated Statement of Operations to the extent that realization is considered more likely than not.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES SPECIFIC TO AIR CANADA WHICH IS PROVIDED IN SUPPORT OF THE 2009 COMPARATIVES

H) PASSENGER AND CARGO REVENUES

Airline passenger and cargo advance sales are deferred and included in current liabilities. Advance sales also include the proceeds from the sale of flight tickets to Aeroplan, a corporation that provides loyalty program services to Air Canada and purchases seats from Air Canada pursuant to the Commercial Participation and Services Agreement between Aeroplan and Air Canada (the "CPSA"). Passenger and cargo revenues are recognized when the transportation is provided, except for revenue on unlimited flight passes which is recognized on a straight-line basis over the period during which the travel pass is valid. Air Canada has formed alliances with other airlines encompassing loyalty program participation, code sharing and coordination of services including reservations, baggage handling and flight schedules. Revenues are allocated based upon formulas specified in the agreements and are recognized as transportation is provided.

Air Canada performs regular evaluations on the deferred revenue liability which may result in adjustments being recognized as revenue. Due to the complex pricing structures; the complex nature of interline and other commercial agreements used throughout the industry; historical experience over a period of many years; and other factors including refunds, exchanges and unused tickets, certain amounts are recognized as revenue based on estimates. Events and circumstances may result in actual results that are different from estimates.

I) CAPACITY PURCHASE AGREEMENTS – JAZZ AND TIER III CARRIERS

Air Canada has capacity purchase agreements with Jazz and certain other regional carriers, which are referred to as Tier III carriers, operating aircraft of 18 seats or less. Under these agreements, Air Canada markets, tickets and enters into other commercial arrangements relating to these flights and records the revenue it earns under Passenger revenue. Operating expenses under capacity purchase agreements include the capacity purchase fees, which, under a capacity purchase agreement between Air Canada and Jazz (the "Jazz CPA"), include a variable component that is dependent on Jazz aircraft utilization, a fixed component and pass-through costs. Pass-through costs are non-marked-up costs charged to Air Canada and include fuel, airport and user fees and other costs. These expenses are recorded in the applicable category within Operating expenses.

The following table outlines expenses and pass through costs under the Jazz CPA for 2009.

	2009 *	
Expenses from Jazz CPA	$	825
Pass through fuel expense from Jazz CPA		211
Pass through airport expense from Jazz CPA		165
Pass through other expense from Jazz CPA		27
	$	**1,228**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

Due to terms of the Jazz CPA, Jazz is deemed to be a variable interest entity. Notwithstanding that Air Canada is not the primary beneficiary of Jazz, Air Canada holds a significant variable interest in Jazz through the contractual arrangements with Jazz.

J) AEROPLAN LOYALTY PROGRAM

Air Canada is an Aeroplan partner providing certain of Air Canada's customers with Aeroplan Miles, which can be redeemed by customers for air travel or other rewards acquired by Aeroplan.

Under the CPSA, Aeroplan purchases passenger tickets from Air Canada to meet its obligation for the redemption of Aeroplan Miles for air travel. The proceeds from the sale of passenger tickets to Aeroplan are included in Advance ticket sales. Revenue related to these passenger tickets is recorded in passenger revenues when transportation is provided.

For Aeroplan Miles earned by Air Canada customers, Air Canada purchases Miles from Aeroplan in accordance with the terms of the CPSA. The cost of purchasing Aeroplan Miles from Aeroplan is accounted for as a sales incentive and charged against passenger revenues when the points are issued, which occurs upon the qualifying air travel being provided to the customer.

K) OTHER REVENUES

Other revenue includes revenues from the sale of the ground portion of vacation packages, ground handling services and other airline related services. Vacation package revenue is recognized as services are provided over the period of the vacation. Other airline related service revenues are recognized as the products are sold to passengers or the services are provided.

Other revenue also includes revenue related to the lease or sublease of aircraft to third parties. Lease or sublease revenues are recognized on a straight line basis over the term of the lease or sublease. Rental revenue from operating leases and subleases amounted to $105 in 2009.

In certain subleases of aircraft to Jazz, Air Canada reports the sublease revenues net against aircraft rent expense as the terms of the sublease match the terms of Air Canada's lease. Air Canada acts as lessee and sublessor in these matters.

Administrative service revenues are recognized as services are provided. Real estate rental revenues are recognized on a straight line basis over the term of the lease.

L) EMPLOYEE FUTURE BENEFITS

The cost of pensions, other post-retirement and post-employment benefits earned by employees is actuarially determined annually as at December 31. The cost is determined using the projected benefit method prorated on service, market interest rates, and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and health care costs.

A market-related valuation method is used to value plan assets for the purpose of calculating the expected return on plan assets. Under the selected method, the differences between investment returns during a given year and the expected investment returns are amortized on a straight line basis over four years.

Past service costs arising from plan amendments are amortized on a straight-line basis over the expected average remaining service period of employees active at the date of amendment. This period does not exceed the expected average remaining service period of such employees up to the full eligibility date. The expected average remaining service period of active employees (or expected average remaining life expectancy of retired members for a plan with no active members) is between 7 and 16 years for pension plans and between 10 and 11 years for post retirement and post employment benefit plans.

Cumulative unrecognized net actuarial gains and losses in excess of 10% of the greater of the projected benefit obligation or market-related value of plan assets at the beginning of the year are amortized over the expected remaining service life of active employees.

Certain Air Canada employees are contractually assigned to Aveos and are members of Air Canada-sponsored defined benefit pension plans and also participate in Air Canada-sponsored health, life and disability benefit plans. Other Air Canada employees were contractually assigned to Aeroplan until the date of transition to employment at Aeroplan and then ceased to accrue benefits under the Corporation-sponsored defined benefit pension plans and under the Corporation-sponsored health, life and disability benefit plans. These consolidated financial statements include all of the assets and liabilities of all sponsored plans of Air Canada. Pension and other employee benefits expenses are recorded net of costs recovered from these entities pertaining to employees contractually assigned by Air Canada to these entities based on an agreed upon formula. The cost recovery reduces Air Canada's benefit cost.

M) EMPLOYEE PROFIT SHARING PLAN

Air Canada has employee profit sharing plans. Expenses are calculated annually on full calendar year results and recorded throughout the year as a charge to salary and wage expense based on the estimated annual payment under the plan.

N) STOCK-BASED COMPENSATION PLANS

Certain employees of Air Canada participate in Air Canada's Long-Term Incentive Plan, which provide for the grant of stock options and Performance Share Units ("PSUs').

The Corporation changed its accounting policy for awards of stock based compensation granted to Corporation employees with a graded vesting schedule. Prior to January 1, 2009, the fair value of stock options with a graded vesting schedule was recognized as compensation expense and a credit to Contributed surplus on a straight line basis over the applicable vesting period. Effective January 1, 2009, the fair value of stock options with a graded vesting schedule is determined based on different expected lives for the options that vest each year, as it would be if the award were viewed as several separate awards, each with a different vesting date, and it is accounted for on that basis. The new accounting policy provides more reliable and relevant information about the effects of the transactions. For a stock option award attributable to an employee who is eligible to retire at the grant date, the fair value of the stock option award is expensed on the grant date. For a stock option award attributable to an employee who will become eligible to retire during the vesting period, the fair value of the stock option award is recognized over the period from the grant date to the date the employee becomes eligible to retire. The amount of compensation cost recognized at any date at least equals the value of the vested options at that date.

The impact of the change in accounting policy for awards granted to Corporation employees with a graded vesting schedule was immaterial to any prior period and therefore no adjustments were made to such prior periods.

For grants of PSUs that are accounted for as equity settled instruments, Air Canada recognizes Compensation expense offset by Contributed surplus equal to the market value of an Air Canada common share at the date of grant on a straight line basis over the applicable vesting period. Compensation expense is adjusted for subsequent changes in management's estimate of the number of PSUs that are expected to vest. For grants of PSUs that are accounted for as cash settled instruments, Air Canada recognizes Compensation expense offset by Other long-term liabilities equal to the market value of an Air Canada common share at the date of grant on a straight line basis over the applicable vesting period. Compensation expense is adjusted for subsequent changes in the market value of Air Canada common shares and management's estimate of the number of PSUs that are expected to vest.

Air Canada also maintains an employee share purchase plan. Under this plan, contributions by Air Canada employees are matched to a specific percentage by Air Canada. Employees must remain with the Corporation until March 31 of the subsequent year for vesting of Air Canada's contributions. These contributions are included in Wages, salaries, and benefits expense as earned.

O) MAINTENANCE AND REPAIRS

Maintenance and repair costs for both leased and owned aircraft, including line maintenance, component overhaul and repair, and maintenance checks, are charged to Operating expenses as incurred, with the exception of maintenance and repair costs related to return conditions on short-term aircraft leases, which are accrued over the term of the lease. Line maintenance consists of routine daily and weekly scheduled maintenance inspections and checks, overhaul and repair involves the inspection or replacements of major parts, and maintenance checks consist of more complex inspections and servicing of the aircraft.

P) OTHER OPERATING EXPENSES

Included in Other operating expenses are expenses related to building rent and maintenance, terminal handling, professional fees and services, crew meals and hotels, advertising and promotion, insurance costs, credit card fees, ground costs for Air Canada Vacations packages, and other expenses. Expenses are recognized as incurred.

Q) FINANCIAL INSTRUMENTS AND HEDGE ACCOUNTING

Under the Corporation's risk management policy derivative financial instruments are used only for risk management purposes and not for generating trading profits.

Financial assets and financial liabilities, including derivatives, are recognized on the Consolidated Statement of Financial Position when the Corporation becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Effective January 1, 2009, the Corporation adopted the recommendations of the Emerging Issues Committee of the CICA relating to Abstract EIC-173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. Under this Abstract, the Corporation's own credit risk and the credit risk of the counterparty are taken into consideration in determining the fair value of financial assets and financial liabilities, including derivative instruments. The adoption of this guidance had no significant impact on the Corporation’s consolidated financial statements as collateral deposits with fuel derivative counterparties and master netting arrangements are considered in determining whether a credit risk adjustment is required on the valuation of the derivatives. Measurement in subsequent periods is dependent upon the classification of the financial instrument as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is “trading” in an instrument or alternatively the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. For financial instruments classified as other than held-for-trading, transaction costs are added to the initial fair value of the related financial instrument.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in Non-operating income (expense). Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are measured at amortized cost using the effective interest method of amortization. Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in Other Comprehensive Income (“OCI”), as described below. Investments in equity instruments classified as available-for- sale that do not have a quoted market price in an active market are measured at cost.

Air Canada enters into interest rate, foreign currency, and fuel derivatives to manage the associated risks. Derivative instruments are recorded on the Consolidated Statement of Financial Position at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair value of derivative instruments are recognized in Non-operating income (expense) with the exception of foreign exchange risk management contracts, which are recorded in Foreign exchange gain (loss), and fuel derivatives designated as effective cash flow hedges, as further described below. These contracts are included in the Consolidated Statement of Financial Position at fair value in prepaid expenses and other current assets, deposits and other assets, accounts payable and accrued liabilities, or other long-term liabilities based on the terms of the contractual agreements. All cash flows associated with purchasing and selling derivatives are classified as operating cash flows in the Consolidated Statement of Cash Flow.

For financial instruments measured at amortized cost, transaction costs or fees, premiums or discounts earned or incurred are recorded, at inception, net against the fair value of the financial instrument. Interest expense is recorded using the effective interest method. For any guarantee issued that meets the definition of a guarantee pursuant to Accounting Guideline 14, *Disclosure of Guarantees*, the inception fair value of the obligation relating to the guarantee is recognized and amortized over the term of the guarantee. It is the Corporation's policy to not re-measure the fair value of the financial guarantee unless it qualifies as a derivative.

The Corporation has implemented the following classifications:

- Cash and cash equivalents and short-term investments are classified as held-for-trading and any period change in fair value is recorded through interest income.
- Restricted cash is classified as held-for-trading.
- Aircraft related and other deposits are classified as held-to-maturity investments and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.
- Accounts receivable are classified as loans and receivables and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.
- Accounts payable, credit facilities, bank loans and the financial liability component of convertible notes and convertible preferred shares are classified as other financial liabilities and are measured at amortized cost using the effective interest rate method. Interest income is recorded in net income, as applicable.

Fuel Derivatives Under Hedge Accounting

Prior to Air Canada discontinuing hedge accounting for all fuel derivatives effective the third quarter of 2009 as described below, Air Canada had designated certain of its fuel derivatives as cash flow hedges. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in Other comprehensive income ("OCI") while the ineffective portion is recognized in Non-operating income (expense). Upon maturity of the fuel derivatives, the effective gains and losses previously recognized in Accumulated OCI ("AOCI") are recorded in fuel expense.

Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. The amounts previously recognized in AOCI are reclassified to fuel expense during the periods when the derivative matures.

After considering the costs and benefits specific to the application of cash flow hedge accounting, Air Canada elected to discontinue hedge accounting for all fuel derivatives effective the third quarter of 2009. The derivative instruments will continue to be recorded at fair value in each period with both realized and unrealized changes in fair value recognized immediately in earnings in non-operating income (expense). Amounts deferred to AOCI for derivatives previously designated under hedge accounting will be taken into fuel expense in the period in which the derivative was originally scheduled to mature.

R) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at the date of the Consolidated Statement of Financial Position. Non-monetary assets and liabilities, revenues and expenses arising from transactions denominated in foreign currencies, are translated at the historical exchange rate or the average exchange rate during the period, as applicable. Adjustments to the Canadian dollar equivalent of foreign denominated monetary assets and liabilities due to the impact of exchange rate changes are recognized in Foreign exchange gain (loss).

S) RESTRICTED CASH

Restricted cash with maturities greater than one year from the balance sheet date is recorded in deposits and other assets. This restricted cash relates to funds on deposit with various financial institutions as collateral for letters of credit and other items.

T) AIRCRAFT FUEL INVENTORY AND SPARE PARTS INVENTORY

Inventories of aircraft fuel and spare parts and supplies are measured at the lower of cost and net realizable value, with cost being determined using a weighted average formula.

Air Canada did not recognize any write-downs on inventories or reversals of any previous write-downs during the periods presented. Included in aircraft maintenance is $69 related to spare parts and supplies consumed during the year.

U) PROPERTY AND EQUIPMENT

Property and equipment is initially recorded at cost. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments.

Property and equipment are depreciated to estimated residual values based on the straight-line method over their estimated service lives. Property and equipment under capital leases and within variable interest entities are depreciated to estimated residual values over the life of the lease. Aircraft and flight equipment, including spare engines and related parts ("rotables") are depreciated over 20 to 25 years, with 10% to 20% estimated residual values. Aircraft reconfiguration costs are amortized over 3 to 5 years. Betterments to owned aircraft are capitalized and amortized over the remaining service life of the aircraft. Betterments to aircraft on operating leases are amortized over the term of the lease.

Buildings are depreciated over their useful lives not exceeding 50 years on a straight line basis. An exception to this is where the useful life of the building is greater than the term of the land lease. In these circumstances, the building is depreciated over the life of the lease. Leasehold improvements are amortized over the lesser of the lease term or 5 years. Ground and other equipment is depreciated over 3 to 25 years.

V) INTEREST CAPITALIZED

Interest on funds used to finance the acquisition of new flight equipment and other property and equipment is capitalized for periods preceding the dates that the assets are available for service. Capitalized interest related to the acquisition of new flight equipment and other property and equipment is included in purchase deposits within Property and equipment using the effective interest rate method. Capitalized interest also includes financing costs charged by the manufacturer on capital commitments.

W) INTANGIBLE ASSETS

Effective January 1, 2009 the Corporation adopted the new CICA accounting standard section 3064, *Goodwill and Intangible Assets* which provides guidance on the recognition, measurement, presentation and disclosure for goodwill and intangible assets, other than the initial recognition of goodwill or intangible assets acquired in a business combination. The Corporation's accounting policy for intangible assets is consistent with the new standard and as a result, no adjustment was recorded on transition.

As a result of the application of fresh start reporting, intangible assets were recorded at their estimated fair values at September 30, 2004. For periods subsequent to September 30, 2004, intangible assets are initially recorded at cost. Indefinite life assets are not amortized while assets with finite lives are amortized on a straight line basis to nil over their estimated useful lives.

	Estimated Useful Life
International routes and slots	Indefinite
Air Canada trade name	Indefinite
Other marketing based trade names	Indefinite
Star Alliance membership	25 years
Other contract and customer based intangible assets	10 to 15 years
Technology based intangible assets	1 to 5 years

X) AIRCRAFT LEASE PAYMENTS IN EXCESS OF OR LESS THAN RENT EXPENSE

Total aircraft operating lease rentals over the lease term are amortized to operating expense on a straight-line basis. Included in deposits and other assets and other long-term liabilities are the differences between the straight line aircraft rent expense and the payments as stipulated under the lease agreement.

Y) ASSET RETIREMENT OBLIGATIONS

Air Canada records an asset and related liability for the costs associated with the retirement of long-lived tangible assets when a legal liability to retire such assets exists. The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and then amortized over its estimated useful life. In subsequent periods, the asset retirement obligation is adjusted for the passage of time through charges to income and any changes in the amount of the underlying cash flows through increases or decreases to the asset retirement obligation and related asset. A gain or loss may be incurred upon settlement of the liability.

Z) VARIABLE INTEREST ENTITIES

Aircraft Leasing Transactions

Air Canada has aircraft leasing transactions with a number of special purpose entities that are variable interest entities (a “VIE”) under Accounting Guideline 15 of the CICA Handbook, Variable Interest Entities (“AcG-15”). As a result of Air Canada being the primary beneficiary of these VIEs, Air Canada consolidates leasing entities covering 44 aircraft.

Fuel Facilities Arrangements

Air Canada participates in fuel facilities arrangements operated through fuel facility corporations (the "Fuel Facility Corporations"), along with other airlines to contract for fuel services at various major Canadian airports. The Fuel Facility Corporations are organizations incorporated under federal or provincial business corporations acts in order to acquire, finance and lease assets used in connection with the fuelling of aircraft and ground support equipment. The Fuel Facilities Corporations operate on a cost recovery basis.

3. INVESTMENTS

As at December 31, 2010, ACE's principal investments (excluding cash and cash equivalents) are:

(1) an 11.11% (31 million Class B Voting Shares) ownership interest in Air Canada; and

(2) 2.5 million warrants for the purchase of Air Canada Class B Voting Shares at exercise prices of $1.44 (1.25 million warrants) and $1.51 (1.25 million warrants) per share.

Air Canada is Canada's largest domestic and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are provided by Jazz Aviation LP ("Jazz") (the successor to Jazz Air LP) through a capacity purchase agreement between Air Canada and Jazz. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. In addition, Air Canada provides certain passenger charter services.

Investment in Air Canada (Class B Voting Shares)

The following table details the carrying value of ACE's investment in Air Canada until December 31, 2010:

Carrying value of ACE's investment in Air Canada as at October 27, 2009	**$**	**721**
Air Canada dilution loss		(411)
Carrying value of ACE's investment in Air Canada as at October 27, 2009 subsequent to the dilution loss		310
Proportionate share of loss from October 27 to December 31, 2009		(7)
Proportionate share of other comprehensive income from October 27 to December 31, 2009		15
Provision for loss on ACE's investment in Air Canada		(219)
Carrying value of ACE's investment in Air Canada as at December 31, 2009	**$**	**99**
Proportionate share of earnings from January 1 to December 23, 2010		43
Proportionate share of other comprehensive income from January 1 to December 23, 2010		50
Carrying value of ACE's investment in Air Canada as at December 23, 2010		192
Carrying value of Air Canada shares sold on December 23, 2010 (44 million Class B shares)		(113)
Carrying value of ACE's remaining investment in Air Canada (31 million Class B shares)		79
Unrealized gain on ACE's AFS investment in Air Canada (31 million Class B shares)		32
Fair value of ACE's investment in Air Canada as at December 23, 2010		111
Unrealized loss on ACE's AFS investment in Air Canada		(4)
Fair value of ACE's investment in Air Canada as at December 31, 2010	**$**	**107**

- *The fair value of ACE's holdings of Air Canada shares of $111 as at December 23, 2010 and $107 as at December 31, 2010 are based on the closing prices of $3.58 per Air Canada Class B Voting Share as at December 23, 2010 and $3.45 per Air Canada Class B Voting Share as at December 31, 2010, as quoted on the Toronto Stock Exchange.*

Significant events during 2009

Dilution of ACE's investment in Air Canada

Air Canada Pension MOUs

During 2009, Air Canada entered into Pension funding agreements with all of Air Canada's Canadian-based unions (the "Pension MOUs"). Pursuant to the Pension MOUs, on October 26, 2009 Air Canada issued to a trust 17,647,059 Class B Voting Shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (in both cases after taking into account such issuance).

Air Canada Share and Warrant Offering

On October 27, 2009 Air Canada completed a bought deal public offering pursuant to which it sold to an underwriting syndicate 160,500,000 units (the "Units") of Air Canada at a price of $1.62 per Unit for aggregate gross proceeds to Air Canada of $260 (net proceeds of $249 after expenses and underwriter fees).

Each Unit was comprised of one Class A Variable Voting Share or one Class B Voting Share (together, the "Shares") of Air Canada, and one-half of one share purchase warrant. Each whole share purchase warrant is defined as a "Warrant". Each Warrant entitles the holder thereof to acquire one Class A Variable Voting Share or one Class B Voting Share (each, a "Warrant Share") at an exercise price of $2.20 per Warrant Share, at any time prior to October 27, 2012. In the event that, prior to the time of expiry of the Warrants, the 20-day volume weighted average trading price of the Class A Variable Voting Shares on the Toronto Stock Exchange ("TSX") is equal to or greater than $4.00 or the 20-day volume weighted average trading price of the Class B Voting Shares on the TSX is equal to or greater than $4.00 (each, an "Acceleration Event"), Air Canada shall have the right, at its option, within 10 business days after the Acceleration Event, to accelerate the time of expiry of the Warrants.

Air Canada dilution and resulting loss of control

As a result of the shares issued by Air Canada completed on October 26, 2009 and October 27, 2009, ACE's ownership interest in Air Canada was reduced from 75% to 27% such that ACE ceased to control Air Canada. As a result, ACE recorded a dilution loss of $411.

As of October 27, 2009, ACE no longer consolidated Air Canada's financial position, operating results and cash flows. ACE's investment in Air Canada was subsequently accounted for using the equity method (up to December 23, 2010) whereby the Air Canada investment carrying value is adjusted to include the Corporation's pro rata share of post-dilution earnings and other comprehensive income. An equity loss of $7 was recorded representing ACE's pro rata share of post-dilution earnings through to December 31, 2009. The proportionate share of Air Canada other comprehensive income of $15 was recorded representing ACE's pro rata share of post-dilution other comprehensive income through to December 31, 2009.

In December 2009, ACE recorded a Provision for loss on its Air Canada investment of $219 as a result of adjusting the carrying value due to an other than temporary decline in the value of the Corporation's investment in Air Canada to $99 based on Air Canada's closing market price as at December 31, 2009 ($1.32 per Class B share) as quoted on the TSX. The loss on ACE's investment in Air Canada of $630, included in the Consolidated statement of operations, is comprised of the Air Canada dilution loss of $411 and the Provision for loss on Air Canada investment of $219.

Loan to Air Canada

On July 29, 2009, ACE participated in the $600 Air Canada Credit Facility with a number of other lenders providing financing of $150 which represented 25% of the Credit Facility.

The terms of the Credit Facility permitted, on or before the first anniversary of the Air Canada Credit Facility and subject to satisfaction of certain conditions, Air Canada to request an increase to the facility by up to an additional $100 by obtaining new commitments from either the existing or new lenders. ACE's pro-rata share of the Credit Facility was repayable in 16 consecutive quarterly installments commencing in August 2010 of $7.5 with the final installment of $30 due in July 2014. Any increase to the facility would increase, on a pro rata basis, the scheduled repayments, including the final payment.

The Credit Facility bore interest at a rate based upon the greater of the bankers' acceptance rate or 3.00% plus 9.75% (12.75% as at December 31, 2009). The Credit Facility could be repaid at any time, in whole or in part, with the payment of applicable fees, subject to a minimum repayment of $10.

Air Canada's obligations under the Credit Facility were secured by a first priority security interest and hypothec over substantially all the present and after-acquired property of Air Canada and its subsidiaries, subject to certain exclusions and permitted liens. The Credit Facility contained customary representations and warranties and was subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants required Air Canada to maintain, as of the last business day of each month, a minimum liquidity level (as defined per the Credit Facility and generally based upon the balances as reported in Cash and cash equivalents and Short-term investments) of $800 and a minimum EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non-operating income (expense) and special items) and an interest coverage ratio test determined as at the end of each fiscal quarter.

A requirement of the Credit Facility was that Air Canada maintain securities of $800 in accounts subject to securities control agreements. The securities in such accounts would become restricted if Air Canada defaulted on certain terms of the agreement.

2.5 million warrants

Under the Credit Facility, ACE received 1,250,000 warrants on July 30, 2009 for the purchase of Air Canada Class B Voting Shares with an exercise price of $1.51 dollars per share, exercisable at any time, and expiring four years after the date of issuance. On October 19, 2009, ACE received an additional 1,250,000 warrants for the purchase of Air Canada Class B Voting Shares with an exercise price of $1.44 dollars per share, exercisable at any time, and expiring four years after the date of issuance.

The warrants are presented as Air Canada warrants issued under the Credit Facility and any changes in fair value are recorded within Gain on financial instruments recorded at fair value in the consolidated statement of operations. The fair value of the 2,500,000 warrants amounted to $5 as at December 31, 2010 (nil as at December 31, 2009) using the Black-Scholes option valuation model.

Significant events during 2010

$163 Bought Deal Secondary Offering of Class B Voting Shares of Air Canada

As described above, prior to December 23, 2010, ACE's investment in Air Canada was accounted for using the equity method of accounting whereby the Air Canada investment carrying value was adjusted to include the Corporation's proportionate share of Air Canada's earnings and other comprehensive income. For the period ended December 23, 2010, equity income of $43 was recorded representing ACE's proportionate share of Air Canada's earnings, after adjustments. For the period ended December 23, 2010, other comprehensive income of $50 was recorded representing ACE's proportionate share of Air Canada's other comprehensive income.

On December 23, 2010, ACE completed a secondary offering on a bought deal basis of 44,000,000 Class B Voting Shares of Air Canada at an offering price of $3.70 dollars per Class B Voting Share for aggregate gross proceeds of $163 (net proceeds of approximately $156). The carrying value of the Air Canada shares sold was $113 and a gain on disposal of such 16% interest of $43 was recognized in Gain (loss) on ACE's investment in Air Canada.

Following the offering, ACE beneficially owns 31,000,000 Class B Voting Shares of Air Canada representing 11.11% of the Class A Variable Voting Shares and Class B Voting Shares of Air Canada issued and outstanding on a combined basis.

As a result of the reduction of ACE's ownership interest in Air Canada from 27% to 11.11% on December 23, 2010, ACE ceased to have the ability to exercise significant influence over Air Canada. The retained investment in Air Canada was classified as available-for-sale ("AFS") and was remeasured to fair value of $111 (based on Air Canada's closing market price as at December 23, 2010 of $3.58 dollars per Class B Voting Share as quoted on the TSX). An unrealized gain on AFS investment in Air Canada of $32 ($27, net of taxes) was recognized in Other comprehensive income.

Financial instruments classified as AFS are carried at fair value and any gains or losses are recognized directly in other comprehensive income. For the period from December 23, 2010 to December 31, 2010, the fair value of ACE's AFS investment in Air Canada was reduced to $107 at December 31, 2010 resulting in an other comprehensive loss of $4 ($3, net of taxes) which was recognized in Unrealized gain (loss) on AFS investment in Air Canada.

<u>Repayment of loan receivable from Air Canada</u>

On July 15, 2010, ACE reached an agreement with Air Canada with respect to the prepayment terms associated with Air Canada's secured credit facility whereby, under certain conditions, the applicable percentage payable in respect of a prepayment was reduced from 3.0% to 1.0%. Air Canada entered into similar agreements with the other lenders who participated in the $600 Credit Facility in July 2009.

On August 3, 2010, Air Canada repaid to ACE its share of the outstanding debt under the Credit Facility in the amount of $150 together with interest and prepayment fees for total proceeds to ACE of $156.

<u>ACTS Aero</u>

On January 22, 2010, ACE entered into a Restructuring and Lockup Agreement with Aveos, Aero Technical Support & Services Holdings sarl ("ACTS Aero"), lenders and other shareholders. The restructuring was completed on March 12, 2010. Under the terms of the restructuring, ACE transferred its shares in ACTS Aero to a newly formed company, in which ACE has no interest, for nil consideration. Under the terms of a Release Agreement entered into on March 12, 2010, ACE and ACTS LP were released from substantially any claims that may arise under the Asset Purchase Agreement relating to the monetization of ACTS on October 16, 2007, in return for a payment of $1.25 which was recorded as a Loss on investment in ACTS Aero in 2010.

4. FUTURE INCOME TAXES

Future income taxes

As at December 31, 2010, the Corporation had determined that it is more likely than not that future income tax assets of $158 (2009 - $216) are not recoverable and have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income.

Taxes payable and future income tax liability

	2010	2009 *
Future tax assets		
Loss carry forwards	$ 102	$ 36
Investments at equity	42	164
Other	14	16
Net future tax assets	**158**	**216**
Less valuation allowance	(158)	(216)
Net recorded future income tax asset (liability)	**$ -**	**$ -**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

The recognition and measurement of future tax assets involves dealing with uncertainties in the amount and tax attributes associated with past transactions involving complex tax regulations in a number of jurisdictions. Such amounts may be revised based on the ongoing audits further discussed below.

The reconciliation of income tax attributable to continuing operations, computed at the statutory tax rates, to income tax expense is as follows:

	2010	2009 *
Provision (recovery) based on combined federal and provincial rates	$ 27	$ (213)
Non-taxable portion of capital (gains) losses	(13)	(90)
Non-deductible expenses	-	10
Dilution of ACE's investment in Air Canada	-	40
Effect of tax rate changes on future income taxes	(1)	80
Other	1	8
	14	(165)
Valuation allowance	(18)	169
Provision for (recovery of) income taxes	**$ (4)**	**$ 4**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

Significant components of the provision for income taxes attributable to continuing operations are as follows:

	2010	2009 *
Current tax expense (recovery)	$ -	$ (2)
Future income tax recovery relating to temporary differences	15	(243)
Future income tax expense from tax rate changes	(1)	80
Valuation allowance	(18)	169
Provision for (recovery of) income taxes	**$ (4)**	**$ 4**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

In 2010, ACE recorded an Income tax provision of $4 against the Unrealized gain on available-for-sale investment in Air Canada of $28, resulting in an unrealized gain of $24, net of income taxes within the Consolidated Statement of Comprehensive Income. The related liability is offset by a recovery of valuation allowance of $4 recorded in the Consolidated Statement of Operations (2009 – Provision of $4). As a result, no future income tax liability is presented on the Consolidated Statement of Financial Position.

Current income taxes recovered in 2010 by the Corporation were nil (2009 – receipt of $2).

Non-capital and Capital Losses

The balances of tax attributes as at December 31, 2010, namely the balances of non-capital loss carry forwards, vary amongst different taxing jurisdictions. The following are the Federal tax loss expiry dates:

	Tax Losses
2014	$ 23
2026	6
2028	37
2029	18
	$ 84

As at December 31, 2010 ACE also has estimated net capital losses (after 50 per cent capital loss adjustment) of $310 (2009 - $47) that have no expiry date. These estimates are subject to revision based on the ongoing tax audits further discussed below. The increase of $263 principally arose from capital losses arising on the secondary offering of 44,000,000 Class B Voting Shares of Air Canada in December 2010 and on the transfer of ACE's shares in ACTS Aero for nil consideration in March 2010. The estimated adjusted cost base of ACE's remaining 31,000,000 Class B Voting shares in Air Canada is $437 ($14.09 per Class B share).

Certificates of Discharge and ongoing tax audits

ACE has applied for Certificates of Discharge from the Canada Revenue Agency (“CRA”) and Revenu Québec.

ACE is assisting the CRA and Revenu Québec with their audits of ACE's income tax returns for the years 2005 to 2009. In addition to the audits of income tax returns, audits in respect of other taxes, including GST and QST, are ongoing.

In late 2010, ACE received notices of reassessment from Revenu Québec in the amount of $37.7. The reassessments primarily relate to audits of GST and QST in respect of ACTS LP, and its predecessor ACTS Limited Partnership, for periods prior to ACE’s monetization of ACTS LP in October 2007. Of the amount of such reassessments, $5.7 remains payable at December 31, 2010. This amount was paid in January 2011.

$35.4 of the reassessments are recoverable from Air Canada and other parties. $29.2 was recovered by December 31, 2010 leaving $6.2 to be recovered at December 31, 2010. $5.3 of this amount was recovered in January 2011. The total recoverable of $35.4 includes $33.4 recoverable from Air Canada and $1.1 from Aveos following their filings of related Input Tax Credits from the Canada Revenue Agency. ACE has agreed to indemnify and hold harmless Air Canada and Aveos from loss should the additional ITC claims be reassessed in the future.

The net impact to ACE of the reassessments of $37.7 above is expected to be $2.3, which was provisioned for by ACE in the Consolidated Statement of Operations.

It is possible that the ongoing audits of income tax returns and other taxes may lead to reassessments in the future.

5. STOCK-BASED COMPENSATION

ACE Stock Option Plan

Certain of the Corporation's employees participated in the ACE stock option plan. Plan participation is limited to employees holding positions that, in the ACE Board's view (or a committee selected by the Board), have a significant impact on ACE's long term results. The stock option plan provides that the options will have an exercise price of not less than 100% of the market price of the underlying shares at the time of grant. Under the terms of the stock option plan, fifty percent of all options vest over four years. The remaining options vest upon performance conditions that are based on net income targets established by the ACE Board over the same time period. All options expire after seven years. The terms of ACE's stock option plan specify that upon the retirement of the employee, options granted to that employee may be exercised as the options vest within three years of such retirement.

In compliance with the terms of the ACE stock option plan, in November 2007, the Board of ACE resolved to immediately vest all remaining unvested ACE stock options. This resulted in the immediate expense recognition of all deferred stock based compensation on outstanding ACE options granted, less amounts previously recognized as compensation expense. As a result of this immediate vesting of all ACE options granted, no further stock based compensation expense is expected to be recorded related to the ACE stock option plan.

In May 2009, the Chairman, President and Chief Executive Officer of ACE requested that the after-tax amount of severance and benefits of $4.2 be paid to him in the form of shares of ACE. As a result, on May 22, 2009, the Chairman, President and Chief Executive Officer's after-tax amount was used to acquire and retain 784,350 Class B Voting Shares of ACE. Such subscription was effected through a grant of options that were exercised immediately upon the grant at an exercise price of $5.34, which was equal to the market price determined under the terms of the Stock Option Plan.

In 2010, the amount credited to share capital for ACE stock options exercised was nominal (2009 - $4). For ACE stock options exercised, shares from treasury are issued by the Corporation.

A summary of the activity related to the Corporation employees participating in the ACE stock option plan is as follows:

	2010		2009	
	Options	Weighted Average Exercise Price/Share	Options	Weighted Average Exercise Price/Share
Beginning of year	47,812	$ 14.61	61,230	$ 14.11
Granted	-	-	784,350	5.34
Exercised	(7,236)	11.05	(784,350)	5.34
Forfeited	(3,076)	13.82	(13,418)	12.34
Outstanding options, end of year	**37,500**	**$ 15.36**	**47,812**	**$ 14.61**
Options exercisable, end of year	**37,500**	**$ 15.36**	**47,812**	**$ 14.61**

		2010 Outstanding Options			2010 Exercisable Options	
Range of Exercise Prices	Expiry Dates	Number of Options Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
$11.05	2011	17,740	1	$ 11.05	17,740	$ 11.05
$19.23	2013	19,760	2	19.23	19,760	19.23
		37,500		**$ 15.36**	**37,500**	**$ 15.36**

		2009 Outstanding Options			2009 Exercisable Options	
Range of Exercise Prices	**Expiry Dates**	**Number of Options Outstanding**	**Weighted Average Remaining Life (Years)**	**Weighted Average Exercise Price/Share**	**Number of Exercisable Options**	**Weighted Average Exercise Price/Share**
$11.05	2011	27,010	2	$ 11.05	27,010	$ 11.05
$19.23	2013	20,802	3	19.23	20,802	19.23
		47,812		**$ 14.61**	**47,812**	**$ 14.61**

6. SHAREHOLDERS' EQUITY

The issued and outstanding common shares of ACE, along with potential common shares, are set out below.

Outstanding shares ('000s)		2010	2009
Issued and Outstanding			
Class A variable voting shares		26,049	25,643
Class B voting shares		6,424	10,048
Total issued and outstanding		**32,473**	**35,691**
Potential common shares			
Stock options	Note 5	38	48
Total potential common shares		**38**	**48**

Share capital and other equity are comprised of:

(a) Common shares

Class A Variable Voting Shares

The Class A Variable Voting Shares may be held only by persons who are not Canadians and are entitled to one vote per Class A Variable Voting Share unless (i) the number of Class A Variable Voting Shares outstanding (including the Convertible Preferred Shares, on an as-converted basis), as a percentage of the total number of votes attaching to voting shares outstanding exceeds 25% or (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting exceeds 25% of the total number of votes that may be cast at such meeting. If either of the above noted thresholds would otherwise be surpassed at any time, the vote attached to each Class A Variable Voting Share will decrease proportionately such that (i) the Class A Variable Voting Shares as a class (including the Convertible Preferred Shares on an as-converted basis) do not carry more than 25% of the aggregate votes attached to all issued and outstanding voting shares of ACE and (ii) the total number of votes cast by or on behalf of holders of Class A Variable Voting Shares (including the Convertible Preferred Shares on an as-converted basis) at any meeting do not exceed 25% of the votes that may be cast at such meeting.

Class B Voting Shares

The Class B Voting Shares may be held only by persons who are Canadians. Each Class B Voting Share shall confer the right to one (1) vote in person or by proxy at all meetings of shareholders of the ACE.

Substantial Issuer Bid – January 2010

On January 6, 2010, ACE accepted for purchase and cancellation a total of 1,401,094 Class A Variable Voting Shares and 1,824,711 Class B Voting Shares at $6.20 per share for an aggregate purchase price of $20 in accordance with the terms of a substantial issuer bid.

Upon purchase and cancellation by ACE of the Class A variable voting shares and Class B voting shares, Share capital decreased by $9 and Contributed surplus decreased by $11.

(b) Convertible Preferred Shares

As at September 30, 2004, 12,500,000 Convertible Preferred Shares were issued for consideration of $250 before fees of $12. For accounting purposes, the Convertible Preferred Shares were presented as a compound instrument. At the date of issuance, the value ascribed to the holders' conversion option, which was presented as equity, was $123 less allocated fees of $6; the value ascribed to the financial liability was $127. The Convertible Preferred Shares increased by 5% per annum, compounded semi-annually from the date of issuance ("Fully Accreted Value") resulting in an accretion on the financial liability at an effective interest rate of 12%.

In January 2009 and March 2009, the Corporation completed two substantial issuer bids to purchase for cancellation 9.3 million of its convertible preferred shares at a purchase price of $20 dollars per preferred share. The Corporation paid an aggregate purchase price of $186 for the shares tendered. The repurchase price of these instruments, allocated to the liability components of these compound instruments, exceeded the respective carrying values resulting in a loss of $32 being recorded in 2009 within Non-operating expense. The residual equity components of the instruments amounting to $87 have been transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity.

In September 2009, the Corporation entered into an agreement with Morgan Stanley Canada Limited pursuant to which the Corporation indirectly acquired for cancellation all of its remaining 3.2 million convertible preferred shares at a price of $23 dollars per preferred share. The Corporation paid an aggregate purchase price of $74. The repurchase price of these instruments, allocated to the liability components of these compound instruments, exceeded the respective carrying values resulting in a loss of $10 being recorded in 2009 within Non-operating expense. The residual equity components of the instruments amounting to $23 have been transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity.

(c) Convertible Senior Notes

During 2005, the Corporation issued $330 of Convertible senior notes due 2035 (“Convertible Notes”) for net proceeds of $319. For accounting purposes, the Convertible Notes were presented as a compound instrument with the conversion option reflected in other equity above. In 2008, Convertible senior notes with a face value of $1 (2007 - $6) were converted at the option of the holder.

In January 2009, ACE completed a substantial issuer bid to purchase for cancellation 80% of its Convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 for the notes tendered. The repurchase price of these instruments, allocated to the liability components of these compound instruments, exceeded the respective carrying values resulting in a loss of $1 being recorded in 2009 within Non-operating expense. The residual equity components of the instruments amounting to $72 were transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity.

On December 14, 2009, the Corporation paid an aggregate purchase price of $64 for the redemption of the remaining convertible senior notes. The repurchase price of these instruments, allocated to the liability components of these compound instruments, exceeded the respective carrying values resulting in a loss of $1 being recorded in 2009 within Non-operating expense. The residual equity components of the instruments amounting to $17 were transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity.

Accumulated Other Comprehensive Income (Loss)

The following table outlines the components of Accumulated other comprehensive income (loss) as at December 31:

As at December 31	2010	2009
Accumulated other comprehensive income (loss)		
Unrealized gain on AFS investment in Air Canada (net of income taxes of $4)	$ 24	$ -
Proportionate share of Air Canada's other comprehensive loss representing net loss from fuel derivatives designated under hedge accounting	-	(50)
Total accumulated other comprehensive income (loss)	**$ 24**	**$ (50)**

7. EARNINGS PER SHARE

The following table outlines the calculation of basic and diluted loss per share:

(in millions, except per share amounts)	2010	2009
Numerator:		
Numerator for basic income (loss) per share:		
Net income (loss) for the year	$ 98	$ (692)
Effect of potential dilutive securities:		
Stock options	-	-
Convertible instruments	-	-
Adjusted numerator for diluted income (loss) per share	**$ 98**	**$ (692)**
Denominator:		
Denominator for basic income (loss) per share:		
Weighted-average shares	33	35
Effect of potential dilutive securities:		
Stock options	-	-
Convertible instruments	-	-
Adjusted denominator for diluted income (loss) per share	**33**	**35**
Basic income (loss) per share	**$ 3.00**	**$ (19.56)**
Diluted income (loss) per share	**$ 3.00**	**$ (19.56)**

The calculation of earnings per share is based on whole dollars and not on rounded millions.
As a result, the above amounts may not be recalculated to the per share amount disclosed above.

The dilutive effect of outstanding stock options on earnings per share is based on the application of the treasury stock method. Under this method, the proceeds from the exercise of such securities are assumed to be used to purchase Class B Voting Shares.

Excluded from the calculation of diluted earnings per share in 2010 were 37,500 (2009 – 47,812) outstanding options where the options' exercise prices were greater than the average market price of the common shares for the year.

All Convertible senior notes and Convertible preferred shares are anti-dilutive for the years ended December 31, 2009 and were excluded from the calculation. In addition, as described in Note 6, as at December 31, 2009 the ACE balance of Convertible senior notes and Convertible preferred shares is nil.

8. SUPPLEMENTARY INFORMATION

ACE's investment in Air Canada was changed on October 27, 2009 from the consolidation to the equity method of accounting reported under the CIE segment. On December 23, 2010, ACE's investment in Air Canada was classified as an available-for-sale financial instrument.

The under-noted reconciliation provides supplementary information to separate CIE from Air Canada results included in the consolidated financial statements.

	2010	2009 * Notes 1 & 3		
	ACE	Air Canada *	CIE	Total ACE
Passenger revenue	$ -	$ 7,196	$ -	$ 7,196
Cargo revenue	-	282	-	282
Other revenue	-	728	-	728
External revenue	-	8,206	-	8,206
Inter-segment revenue	-	1	(1)	-
Total revenues	**-**	**8,207**	**(1)**	**8,206**
Aircraft fuel	-	2,056	-	2,056
Wages, salaries and benefits	-	1,468	4	1,472
Airport and navigation fees	-	822	-	822
Capacity purchase with Jazz	-	825	-	825
Depreciation and amortization	-	550	(5)	545
Aircraft maintenance	-	625	-	625
Food, beverages and supplies	-	248	-	248
Communications and information technology	-	255	-	255
Aircraft rent	-	276	-	276
Commissions	-	156	-	156
Other	10	1,162	8	1,170
Total operating expenses	**10**	**8,443**	**7**	**8,450**
Operating loss	**(10)**	**(236)**	**(8)**	**(244)**
Interest income	14	12	5	17
Interest expense	-	(316)	(5)	(321)
Interest capitalized	-	4	-	4
Loss on other assets	-	(70)	-	(70)
Loss on repurchase of ACE convertible senior notes and preferred shares	-	-	(44)	(44)
Gain (loss) on ACE's investment in Air Canada	43	-	(630)	(630)
Proportionate share of Air Canada's income (loss)	43	-	(7)	(7)
Gain on financial instruments recorded at fair value	5	94	-	94
Other non-operating expense	(1)	(5)	-	(5)
Non-controlling interest	-	(12)	(1)	(13)
Foreign exchange gain	-	531	-	531
Recovery of (provision for) income taxes	4	(1)	(3)	(4)
Segment net income (loss)	**$ 98**	**$ 1**	**$ (693)**	**$ (692)**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3).*

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Summary of Financial Instruments

	Carrying Amounts					
	December 31, 2010					December 31, 2009
	Financial instruments classification					
	Held for trading	Available for sale	Loans and receivables	Liabilities at amortized cost	Total	
Financial Assets						
Cash and cash equivalents	$ 363	$ -	$ -	$ -	$ 363	$ 71
Investment in Air Canada	-	107	-	-	107	-
Loan receivable from Air Canada	-	-	-	-	-	150
Interest receivable	-	-	-	-	-	3
Commodity taxes receivable	-	-	6	-	6	-
Derivative instruments						
Air Canada warrants	5	-	-	-	5	-
	$ 368	$ 107	$ 6	$ -	$ 481	$ 224
Financial Liabilities						
Accounts payable and accrued liabilities	$ -	$ -	$ -	$ 3	$ 3	$ 3
	$ -	$ -	$ -	$ 3	$ 3	$ 3

There have been no changes in classification of financial instruments since December 31, 2009 except for the reduction of ACE's ownership interest in Air Canada from 27% to 11.11% on December 23, 2010, ACE ceased to have the ability to exercise significant influence over Air Canada. The 11.11% retained investment in Air Canada was classified as AFS.

Following is a classification of fair value measurements recognized in the Consolidated Statement of Financial Position using a fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Cash and cash equivalents includes $353 ($40 as at December 31, 2009) pertaining to investments with original maturities of three months or less which have been valued using significant other observable inputs (level 2).

- The Investment in Air Canada of $107 has been valued using quoted prices in active markets for identical assets (level 1).

- The Air Canada warrants of $5 have been valued using significant other observable inputs (level 2).

Summary of Gain on Financial Instruments Recorded at Fair Value

	2010	2009 *
Air Canada warrants issued under the Credit Facility	$ 5	$ -
Fuel derivatives not under hedge accounting	-	98
Other	-	(4)
Gain on financial instruments recorded at fair value	**$ 5**	**$ 94**

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE (Refer to Notes 1 & 3)*

Risk Management

As at December 31, 2010, ACE's financial instruments include cash and cash equivalents in the amount of $363 ($71 as at December 31, 2009), a secured loan receivable of nil from Air Canada ($150 as at December 31, 2009), Air Canada warrants of $5 (nil as at December 31, 2009), commodity taxes receivable of $6 (nil as at December 31, 2009), interest receivable of nil from Air Canada ($3 as at December 31, 2009) and accounts payable and accrued liabilities of $3 ($3 as at December 31, 2009). The risk exposure related to these holdings is described below.

Liquidity risk

Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities. This risk is mitigated by the fact that as at December 31, 2010, the Corporation had Cash and cash equivalents of $363 and accounts payable and accrued liabilities of $3.

Credit Risk

Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. The Corporation is exposed to credit risk from its cash and cash equivalents. The maximum exposure of which is represented by the carrying amounts reported on the balance sheet. This risk is mitigated by the fact that cash and cash equivalents are held by major Canadian Banks. The Corporation's target is that no one financial institution holds more than 25% of the total.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market factors. Market factors include three types of risks: currency risk, interest rate risk and equity risk. The Corporation is exposed to interest rate risk and equity risk.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Corporation is exposed to interest rate risk from its holding in cash and cash equivalents of $363. The weighted average interest rate on ACE's cash and cash equivalents at December 31, 2010, is approximately 1.02%, which results in limited downside risk.

Equity Risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Corporation is exposed to equity risk from its holding of 31,000,000 Air Canada shares and 2,500,000 warrants for the purchase of Air Canada shares.

10. CAPITAL DISCLOSURES

ACE is an investment holding company of aviation interests which include, as at December 31, 2010, an 11.11% non-controlling interest in Air Canada.

Capital managed by ACE, summarized from the consolidated statement of financial position, is as follows:

	2010	2009
Shareholders' equity	472	320
Capital	**$ 472**	**$ 320**

As at December 31, 2010, ACE's capital amounted to $472, an increase of $152 during 2010.

ACE's business strategy, to maximize shareholder value and to return capital to its shareholders, has influenced its capital management objectives. Consistent with those objectives, during 2009 and 2010, the ACE Board of Directors authorized the return of capital to its shareholders and noteholders through the purchase and cancellation of ACE's Class A variable voting shares, Class B voting shares, convertible preferred shares and convertible senior notes and the redemption of its remaining convertible senior notes.

Going forward, the Board will continue to review alternatives to maximize the return to its shareholders.

11. CONTINGENCIES, GUARANTEES AND INDEMNITIES

Guarantee of Air Canada obligation

On May 7, 2009, ACE intervened into the employment agreement between Air Canada and Mr. Calin Rovinescu, its President and Chief Executive Officer, to guarantee the payments required of Air Canada under the agreement. In addition, ACE agreed to cause to be issued an irrevocable bank letter of credit to a maximum of $5.

On March 11, 2010, the subject agreement was amended such that the guarantee shall automatically terminate upon the earlier of (i) April 1, 2014 and (ii) the date on which the shareholders of ACE approve the winding-up and liquidation of ACE, in the event that such approval is requested by ACE of its shareholders. Notwithstanding the foregoing, in the event of such approval by ACE's shareholders and that a liquidator is not appointed within 180 days of the shareholders' vote approving the winding-up and liquidation of ACE, the guarantee shall automatically resume and continue in full force and effect, and shall thereafter automatically terminate upon the earlier of (i) April 1, 2014 and (ii) the date on which such a liquidator shall have been appointed for the winding-up and liquidation of ACE. This agreement was also further amended such that ACE is not required to issue the bank letter of credit.

Indemnification agreements

Refer to Note 4 for a description of indemnification agreements between ACE, Air Canada and Aveos related to certain commodity tax reassessments.

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2010

Management's Discussion and Analysis of Results of Operations and Financial Condition

February 9, 2011

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1. Preface

ACE Aviation Holdings Inc. ("ACE"), which was incorporated on June 29, 2004, is an investment holding company of aviation interests. ACE is listed on the Toronto Stock Exchange ("TSX") where its Class A variable voting shares and Class B voting shares are traded under the symbols ACE.A and ACE.B, respectively.

On January 6, 2010, ACE completed a substantial issuer bid for the purchase and cancellation of 3.2 million shares at $6.20 per share for an aggregate purchase price of $20 million.

On August 3, 2010, Air Canada repaid to ACE its share of the outstanding debt under Air Canada's secured credit facility (the "Credit Facility") in the amount of $150 million together with interest and prepayment fees for total proceeds to ACE of $156 million. This prepayment followed the completion of Air Canada's offerings of approximately $1.1 billion, consisting of two series of senior secured first lien notes and one series of senior secured second lien notes, which closed on August 3, 2010.

On December 23, 2010, ACE completed a secondary offering on a bought deal basis of 44,000,000 Class B voting shares of Air Canada at an offering price of $3.70 per Class B Voting Share for aggregate gross proceeds of $163 million (net proceeds of approximately $156 million). Following the offering, ACE beneficially owns 31,000,000 Class B voting shares of Air Canada representing 11.11% of the Class A variable voting shares and Class B voting shares of Air Canada issued and outstanding on a combined basis.

As at January 31, 2011, ACE's principal assets are cash and cash equivalents of approximately $363 million, an 11.11% equity interest in Air Canada and 2.5 million Air Canada warrants. Going forward, the Board will continue to review alternatives to maximize the return to its shareholders.

ACE's financial statements have been prepared on a going concern basis of presentation. The going concern basis of presentation assumes continuity of operations, realization of assets and satisfaction of liabilities in the ordinary course of business. ACE's results reflect the consolidation of Air Canada up to October 26, 2009. After that date, ACE's investment in Air Canada was accounted for using the equity method of accounting. Effective December 23, 2010, ACE ceased to have the ability to exercise significant influence over Air Canada. The retained investment was classified as an available-for-sale ("AFS") financial instrument.

This MD&A should be read in conjunction with ACE's audited consolidated financial statements and notes for 2010. Reference to "Corporation" in this MD&A refers to, as the context may require, ACE and its aviation interests collectively, ACE and one or more of its aviation interests, one or more of ACE's aviation interests, or ACE itself. Except as otherwise noted, all monetary amounts are stated in Canadian dollars. Except as otherwise noted, this MD&A is current as of February 9, 2011.

Forward-looking statements are included in this MD&A. See "Caution Regarding Forward-Looking Information" in section 2 of this MD&A for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of the risks relating to ACE, see section 14 "Risk Factors" of this MD&A.

The ACE Audit, Finance & Risk Committee has reviewed this MD&A and the 2010 audited consolidated financial statements and notes and ACE's Board of Directors approved these documents prior to their release. For further information on ACE's public disclosure file, including ACE's Annual Information Form, please consult SEDAR at www.sedar.com, or ACE's website at www.aceaviation.com.

2. Caution Regarding Forward-Looking Information

ACE's public communications may include written or oral forward-looking statements within the meaning of applicable securities laws. Such statements are included in this MD&A and may be included in other filings with regulatory authorities and securities regulators. Forward-looking statements may relate to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. These statements may involve, but are not limited to, comments relating to strategies, expectations, planned operations or future actions. These forward-looking statements are identified by the use of terms and phrases such as "anticipate", "believe", "could", "estimate", "expect", "intend", "may", "plan", "predict", "project", "will", "would", and similar terms and phrases, including references to assumptions.

Forward-looking statements, by their nature, are based on assumptions and are subject to important risks and uncertainties. Any forecasts or forward-looking predictions or statements cannot be relied upon due to, amongst other things, changing external events and general uncertainties of the business. Actual results may differ materially from results indicated in forward-looking statements due to a number of factors, including without limitation, market, regulatory developments or proceedings, and actions by third parties as well as the factors identified throughout this MD&A and, in particular, those identified in section 14 "Risk Factors" of this MD&A. The forward-looking statements contained in this MD&A represent ACE's expectations as of the date of this MD&A, and are subject to change after such date. However, ACE disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

3. ACE's Assets, Obligations and Net Assets at Fair Value

The following table presents the net assets of ACE, on a per share basis, at fair value as at January 31, 2011 and December 31, 2010. This presentation is not intended to reflect ACE's net asset value on a liquidation basis and does not purport to represent the fair value of ACE as a whole or per share.

(Canadian dollars in millions)	**January 31 2011**	**December 31 2010**
Cash and cash equivalents	$ 363	$ 363
Air Canada shares (1)	99	107
Air Canada warrants(1)	4	5
Commodity taxes receivable(2)	1	6
	467	481
Commodity taxes payable(2)	-	(6)
Current obligations	(4)	(3)
Contingencies (2) (3)	-	-
	(4)	(9)
Net assets at fair value	**$ 463**	**$ 472**
Net assets at fair value per share – Basic	**$ 14.26**	**$ 14.55**

Net assets at fair value per share is non-GAAP information and is not prepared in accordance with standards prescribed by Canadian generally accepted accounting principles ("GAAP") and may not be comparable to other similar information provided by other companies.

(1) *As detailed in Section 4 of this MD&A, on December 23, 2010, ACE completed a secondary offering on a bought deal basis of 44,000,000 Class B voting shares of Air Canada at an offering price of $3.70 per share. As at January 31, 2010, ACE held an 11.11% ownership interest in Air Canada consisting of 31,000,000 Class B voting shares. Under the Credit Facility, ACE had received 1,250,000 warrants on July 30, 2009, for the purchase of Air Canada Class B voting shares with an exercise price of $1.51 per share, exercisable at any time, and expiring four years after the date of issuance. An additional 1,250,000 warrants for the purchase of Air Canada Class B voting shares were issued to ACE under the terms of the Credit Facility on October 19, 2009 with an exercise price of $1.44 per share, exercisable at any time, and expiring four years after the date of issuance. The fair value of ACE's holdings of Air Canada shares of $99 million as at January 31, 2011 and $107 million as at December 31, 2010 is based on the closing prices of $3.18 per Air Canada Class B share as at January 31, 2011 and $3.45 per Air Canada Class B share as at December 31, 2010, as quoted on the TSX.*

(2) *ACE has applied for Certificates of Discharge from the Canada Revenue Agency ("CRA") and Revenu Québec.*

ACE is assisting the CRA and Revenu Québec with their audits of ACE's income tax returns for the years 2005 to 2009. In addition to the audits of income tax returns, audits in respect of other taxes, including GST and QST, are ongoing.

In late 2010, ACE received notices of reassessment from the CRA and Revenu Québec in the amount of $37.7 million. The reassessments primarily relate to audits of GST and QST in respect of ACTS LP, and its predecessor ACTS Limited Partnership, for periods prior to ACE's monetization of ACTS LP in October 2007. Of the amount of such reassessments, $5.7 million remains payable at December 31, 2010. This amount was paid in January 2011.

$35.4 million of the reassessments are recoverable from Air Canada and other parties. $29.2 million was recovered by December 31, 2010 leaving $6.2 million to be recovered at December 31, 2010. $5.3 million of this amount was recovered in January 2011. The total recoverable amount of $35.4 million includes $33.4 million recoverable from Air Canada and $1.1 million from Aveos following their filings of related Input Tax Credits from the Canada Revenue Agency. ACE has agreed to indemnify and hold harmless Air Canada and Aveos from loss should the additional ITC claims be reassessed in the future.

The net impact to ACE of the reassessments of $37.7 million above is expected to be $2.3 million, which was provisioned for by ACE in the Consolidated Statement of Operations.

It is possible that the ongoing audits of income tax returns and other taxes may lead to reassessments in the future.

(3) *Should ACE proceed to a liquidation in the future, additional costs and other liabilities may arise.*

4. ACE's Assets

As at January 31, 2010, ACE's principal assets are:

- cash and cash equivalents of $363 million.
- a 11.11% (31,000,000 Class B Voting Shares) ownership interest in Air Canada; and
- 2.5 million warrants for the purchase of Air Canada Class B voting shares at exercise prices of $1.44 (1.25 million warrants) and $1.51 (1.25 million warrants) per share.

Air Canada is Canada's largest domestic and international airline and the largest provider of scheduled passenger services in the Canadian market, the Canada-US transborder market as well as the international markets to and from Canada. Certain of the scheduled passenger services offered on domestic and Canada-US transborder routes are provided by Jazz Aviation LP ("Jazz") (the successor to Jazz Air LP) through a capacity purchase agreement between Air Canada and Jazz. Through Air Canada's global route network, virtually every major market throughout the world is served either directly or through the Star Alliance network. In addition, Air Canada provides certain passenger charter services.

Investment in Air Canada (Class B voting shares)

The following table details the carrying value and fair value of ACE's investment in Air Canada until January 31, 2011:

Carrying value of ACE's investment in Air Canada as at October 27, 2009	**$**	**721**
Air Canada dilution loss		(411)
Carrying value of ACE's investment in Air Canada as at October 27, 2009 subsequent to the dilution loss		310
Proportionate share of loss from October 27 to December 31, 2009		(7)
Proportionate share of other comprehensive income from October 27 to December 31, 2009		15
Provision for loss on ACE's investment in Air Canada		(219)
Carrying value of ACE's investment in Air Canada as at December 31, 2009	**$**	**99**
Proportionate share of earnings from January 1 to December 23, 2010		43
Proportionate share of other comprehensive income from January 1 to December 23, 2010		50
Carrying value of ACE's investment in Air Canada as at December 23, 2010		192
Carrying value of Air Canada shares sold on December 23, 2010 (44 million Class B shares)		(113)
Carrying value of ACE's remaining investment in Air Canada (31 million Class B shares)		79
Unrealized gain on AFS investment in Air Canada (31 million Class B shares)		32
Fair value of ACE's investment in Air Canada as at December 23, 2010 *		111
Unrealized loss on AFS investment in Air Canada		(4)
Fair value of ACE's investment in Air Canada as at December 31, 2010 *	**$**	**107**
Fair value of ACE's investment in Air Canada as at January 31, 2011 *	**$**	**99**

** The fair value of ACE's holdings of Air Canada shares of $111 million as at December 23, 2010, $107 million as at December 31, 2010 and $99 million as at January 31, 2011 are based on the closing prices of $3.58 per Air Canada Class B share as at December 23, 2010 $3.45 per Air Canada Class B share as at December 31, 2010,and $3.18 per Air Canada Class B share as at January 31, 2011, as quoted on the TSX.*

Significant events during 2010

$163 million Bought Deal Secondary Offering of Class B Voting Shares of Air Canada

On December 23, 2010, ACE completed a secondary offering on a bought deal basis of 44,000,000 Class B Voting Shares of Air Canada at an offering price of $3.70 per Class B Voting Share for aggregate gross proceeds of $163 million (net proceeds of approximately $156 million). The carrying value of the Air Canada shares sold was $113 million and a gain of $43 million was recognized in Gain (loss) on ACE's investment in Air Canada.

Following the offering, ACE beneficially owns 31,000,000 Class B Voting Shares of Air Canada representing 11.11% of the Class A Variable Voting Shares and Class B Voting Shares of Air Canada issued and outstanding on a combined basis.

As a result of the reduction of ACE's ownership interest in Air Canada from 27% to 11.11% on December 23, 2010, ACE ceased to have the ability to exercise significant influence over Air Canada. The retained investment in Air Canada was classified as available-for-sale and was remeasured to fair value of $111 million (based on Air Canada's closing market price as at December 23, 2010 of $3.58 per Class B share as quoted on the TSX). An unrealized gain on AFS investment in Air Canada of $32 million ($27 million, net of taxes) was recognized in Other comprehensive income.

Financial instruments classified as AFS are carried at fair value and any gains or losses are recognized directly in other comprehensive income. For the period from December 23, 2010 to December 31, 2010, ACE's AFS investment in Air Canada fair value decreased to $107 million. The $4 million ($3 million, net of taxes) decrease was recorded as an other comprehensive loss.

Repayment of loan receivable from Air Canada

On July 15, 2010, ACE reached an agreement with Air Canada with respect to the prepayment terms associated with Air Canada's secured credit facility whereby, under certain conditions, the applicable percentage payable in respect of a prepayment was reduced from 3.0% to 1.0%. Air Canada entered into similar agreements with the other lenders who participated in the $600 million Credit Facility in July 2009.

On August 3, 2010, Air Canada repaid to ACE its share of the outstanding debt under the Credit Facility in the amount of $150 million together with interest and prepayment fees for total proceeds to ACE of $156 million. This prepayment followed the completion of Air Canada's offerings of approximately $1.1 billion, consisting of two series of senior secured first lien notes and one series of senior secured second lien notes, which closed on August 3, 2010.

Significant events during 2009

Dilution of ACE's investment in Air Canada and resulting loss of control

During 2009, Air Canada entered into Pension funding agreements with all of Air Canada's Canadian-based unions (the "Pension MOUs"). Pursuant to the Pension MOUs, on October 26, 2009 Air Canada issued, to a trust, 17,647,059 Class B Voting Shares. This number of shares represented 15% of the shares of Air Canada issued and outstanding as at the date of the Pension MOUs and the date of issuance (in both cases after taking into account such issuance).

On October 27, 2009 Air Canada completed a bought deal public offering pursuant to which it sold to an underwriting syndicate 160,500,000 units (the "Units") of Air Canada at a price of $1.62 per Unit for aggregate gross proceeds to Air Canada of $260 million (net proceeds of $249 million after expenses and underwriter fees).

Each Unit was comprised of one Class A variable voting share or one Class B voting share (together the "Shares") of Air Canada, and one-half of one share purchase warrant. Each whole share purchase warrant is defined as a "Warrant". Each Warrant entitles the holder thereof to acquire one Class A variable voting share or one Class B voting share (each, a "Warrant Share") at an exercise price of $2.20 per Warrant Share, at any time prior to October 27, 2012. In the event that, prior to the time of expiry of the Warrants, the 20-day volume weighted average trading price of the Variable Voting Shares on the TSX is equal to or greater than $4.00 or the 20-day volume weighted average trading price of the Voting Shares on the TSX is equal to or greater than $4.00 (each, an "Acceleration Event"), Air Canada shall have the right, at its option, within 10 business days after the Acceleration Event, to accelerate the time of expiry of the Warrants.

As a result of the shares issued by Air Canada completed on October 26, 2009 and October 27, 2009, ACE's ownership interest in Air Canada was reduced from 75% to 27% such that ACE ceased to control Air Canada. As a result, ACE recorded a dilution loss of $411 million.

As of October 27, 2009, ACE no longer consolidated Air Canada's financial position, operating results and cash flows. ACE's investment in Air Canada was subsequently accounted for using the equity method of accounting (up to December 23, 2010) whereby the Air Canada investment carrying value was adjusted to include the Corporation's pro rata share of post-dilution earnings and other comprehensive income. An equity loss of $7 million was recorded representing ACE's pro rata share of post-dilution earnings through to December 31, 2009. The proportionate share of Air Canada other comprehensive income of $15 million was recorded representing ACE's pro rata share of post-dilution other comprehensive income through to December 31, 2009.

In December 2009, ACE recorded a Provision for loss on its Air Canada investment of $219 million as a result of adjusting the carrying value due to an other than temporary decline in the value of the Corporation's investment in Air Canada to $99 million based on Air Canada's closing market price as at December 31, 2009 ($1.32 per Class B share) as quoted on the TSX. The loss on ACE's investment in Air Canada of $630 million, included in the Consolidated statement of operations, is comprised of the Air Canada dilution loss of $411 million and the Provision for loss on Air Canada investment of $219 million.

Loan to Air Canada

On July 29, 2009, ACE participated in the $600 million Credit Facility with a number of other lenders providing financing of $150 million which represented 25% of the Credit Facility.

The terms of the Credit Facility permitted, on or before the first anniversary of the Credit Facility and subject to satisfaction of certain conditions, Air Canada to request an increase to the facility by up to an additional $100 million by obtaining new commitments from either the existing or new lenders. ACE's pro-rata share of the Credit Facility was repayable in 16 consecutive quarterly installments commencing in August 2010 of $7.5 million with the final installment of $30 million due in July 2014.

The Credit Facility bore interest at a rate based upon the greater of the bankers' acceptance rate or 3.00% plus 9.75% (12.75% as at December 31, 2009). The Credit Facility was repayable at any time, in whole or in part, with the payment of applicable fees, subject to a minimum repayment of $10 million.

Air Canada's obligations under the Credit Facility were secured by a first priority security interest and hypothec over substantially all the present and after-acquired property of Air Canada and its subsidiaries, subject to certain exclusions and permitted liens. The Credit Facility contained customary representations and warranties and was subject to customary terms and conditions (including negative covenants, financial covenants and events of default). Financial covenants required Air Canada to maintain, as of the last business day of each month, a minimum liquidity level (as defined per the Credit Facility and generally based upon the balances as reported in Cash and cash equivalents and Short-term investments) of $800 million and a minimum EBITDAR (earnings before interest, income taxes, depreciation, amortization, aircraft rentals, certain non-operating income (expense) and special items) and an interest coverage ratio test determined as at the end of each fiscal quarter.

Air Canada was required under the Credit Facility to maintain securities of $800 million in accounts subject to securities control agreements which securities would become restricted if Air Canada defaulted on certain terms of the agreement.

2.5 million warrants

Under the Credit Facility, ACE received 1,250,000 warrants on July 30, 2009 for the purchase of Air Canada Class B Voting Shares with an exercise price of $1.51 per share, exercisable at any time, and expiring four years after the date of issuance. On October 19, 2009, ACE received an additional 1,250,000 warrants for the purchase of Air Canada Class B Voting Shares with an exercise price of $1.44 per share, exercisable at any time, and expiring four years after the date of issuance.

The warrants are presented as Air Canada warrants issued under the Credit Facility and any changes in fair value are recorded within Gain on financial instruments recorded at fair value in the consolidated statement of operations. The fair value of the 2,500,000 warrants amounted to $5 million as at December 31, 2010 (nil as at December 31, 2009) using the Black-Scholes option valuation model.

ACTS Aero

On January 22, 2010, ACE entered into a Restructuring and Lockup Agreement with Aveos, Aero Technical Support & Services Holdings sarl ("ACTS Aero"), lenders and other shareholders. The restructuring was completed on March 12, 2010. Under the terms of the restructuring, ACE transferred its shares in ACTS Aero to a newly formed company, in which ACE had no interest, for nil consideration. Under the terms of a Release Agreement entered into on March 12, 2010, ACE and ACTS LP were released from substantially any claims that may arise under the Asset Purchase Agreement relating to the monetization of ACTS on October 16, 2007, in return for a payment of $1.25 million which is recorded as a Loss on investment in ACTS Aero in 2010.

5. Accounting Policies

This MD&A should be read in conjunction with ACE's audited consolidated financial statements and notes for 2010. ACE prepares its financial statements, on a going concern basis of presentation, in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

ACE's results reflect the consolidation of Air Canada only up to October 27, 2009. After that date, ACE's investment in Air Canada was accounted for using the equity method of accounting. Effective December 23, 2010, ACE was deemed to have ceased to have the ability to exercise significant influence over Air Canada and as a result, the retained investment in Air Canada was classified as an available-for-sale financial instrument. Consequently, ACE's results of operations for 2010 are not directly comparable to its operating results for 2009.

For additional information on ACE's significant accounting policies and methods used in preparation of ACE's 2010 audited consolidated financial statements and notes, please refer to Note 2 to ACE's 2010 audited consolidated financial statements.

The preparation of ACE's financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent liabilities and reported amounts of revenues and expenses for the period of the financial statements. ACE evaluates these estimates and assumptions on a regular basis, based on historical experience and other relevant factors. Actual amounts could differ materially from those estimates and assumptions. Refer to section 13 of this MD&A for a discussion of ACE's critical accounting estimates.

5.1 Update on the Progress of the International Financial Reporting Standards Conversion Plan

The Canadian Accounting Standards Board has confirmed January 1, 2011 as the conversion date for Canadian publicly accountable enterprises to start using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures.

The Corporation has developed a plan to convert its consolidated financial statements to IFRS. Updates regarding the progress of the conversion plan are provided to the Corporation's Audit, Finance and Risk Committee on a quarterly basis.

The plan addresses the impact of IFRS on accounting policies and implementation decisions, infrastructure, business activities and control activities. The IFRS conversion plan is progressing as anticipated.

The following information has been provided solely for the purpose of allowing investors and others to obtain a better understanding of the Corporation's IFRS conversion plan and the resulting expected effects on the Corporation's financial statements. Readers are cautioned that it may not be appropriate to use such information for any other purpose. The accounting policy differences identified in this MD&A should not be considered as complete or final as further changes, or other effects and other policy differences may be identified prior to the release of the Q1 2011 interim financial information in accordance with IFRS. In addition, the information provided reflects the Corporation's current assumptions, estimates and expectations, all of which are subject to change. Circumstances may arise, including changes in IFRS, regulations or economic conditions, which could change these assumptions, estimates or expectations or the information provided.

First time adoption of IFRS

With regard to IFRS transition, the Corporation has essentially completed its analysis on the optional exemptions available under IFRS 1 "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"). IFRS 1, provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exceptions, in certain areas, to the general requirement for full retrospective application of IFRSs. The decisions about the optional exemptions available under IFRS 1 are preliminary and may be subject to change based on changes in circumstances.

The IFRS 1 exemptions that are expected to apply to the Corporation upon adoption are summarized in the following table:

Optional exemption under IFRS 1	Summary of Exemption Available	Policy Selection
Compound financial instruments	IAS 32 Financial Instruments: Presentation requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of IAS 32 involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to IFRS.	The Corporation has elected to apply the exemption and not separate the two portions of equity as the liability components are no longer outstanding at the date of transition to IFRS.
Business Combination	The Corporation may elect not to apply IFRS 3 (as amended in 2008) retrospectively to past business combinations prior to the date of transition to IFRS. Such election has the effect of leaving past business combinations as previously reported.	The Corporation has elected not to apply IFRS 3 (as amended in 2008) retrospectively to business combinations that occurred before October 27, 2009, the date on which ACE ceased to control Air Canada.

Summary of accounting policy changes under IFRS

The Corporation has identified the following differences between its current accounting policies and those required or expected to apply in preparing IFRS financial statements which are summarized in the following table:

Accounting policy	Accounting policy changes under IFRS and expected impact
Consolidation - Loss of Control	Under IAS 27 "Consolidated and separate financial statements", upon loss of control resulting in significant influence, any retained investment in a former subsidiary is remeasured at fair value and a gain or loss is recognised in profit or loss (comprised of a gain or loss on the interest disposed of, and a gain or loss from remeasurement to fair value of any retained non-controlling equity investment in the former subsidiary). The fair value of the retained investment is the deemed cost for the purposes of applying the equity method of accounting. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** Under existing Canadian GAAP, any retained non-controlling equity investment in the former subsidiary would not be remeasured to fair value and no remeasurement gain or loss would be recognised in profit or loss. **Expected impact to the opening balance sheet:** As a result of the shares issued by Air Canada on October 26, 2009 and October 27, 2009, ACE's ownership interest in Air Canada was reduced from 75% to 27% such that ACE ceased to control Air Canada. Refer to Note 3 of the Corporation's audited consolidated financial statements. Under IFRS, the equity investment in Air Canada was restated to fair value of $94 million as at October 27, 2009. Subsequently, for the period from October 27, 2009 to December 31, 2009, the carrying value was adjusted to include the Corporation's proportionate share of Air Canada's loss under IFRS of $13 million, other comprehensive income under IFRS of nil and other equity accounting adjustments reflecting additional amortization on ACE's proportionate fair value of Air Canada's assets acquired of $1 million. Under existing Canadian GAAP, the equity investment in Air Canada was $310 million as at October 27, 2009 following the recognition of a dilution loss. Subsequently, for the period from October 27, 2009 to December 31, 2009, the carrying value was adjusted to include the Corporation's proportionate share of Air Canada's loss of $7 million, other comprehensive income of $15 million and an impairment loss as at December 31, 2009 of $219 million. As a result, under IFRS, the carrying value of the equity investment in Air Canada is $80 million as at January 1, 2010. Under Canadian GAAP, the carrying value of the equity investment in Air Canada is $99 million as at January 1, 2010. The Corporation will decrease the carrying value of its equity investment in Air Canada by an amount of $19 million on transition to IFRS as at January 1, 2010. In addition, as at October 27, 2009, the cumulative amount deferred in other comprehensive loss relating to Air Canada of $50 million was reclassified to retained earnings (deficit). **Expected impact subsequent to transition:** The proportionate share of Air Canada's income from January 1, 2010 to December 23, 2010 will be adjusted to reflect amounts recognized under IFRS by Air Canada.

Accounting policy	Accounting policy changes under IFRS and expected impact
Investments Subject to Significant Influence	Investments subject to significant influence are accounted for using the equity method of accounting which reflects the costs of the investment and the Corporation's proportionate share of the investee's profits or losses, other comprehensive income or losses, capital transactions and dividends received. When an associate accounted for under the equity method of accounting incurs losses, the carrying amount of the investor's interest is reduced, but not below zero. Further losses are recognised by the investor only to the extent that the investor has an obligation to fund losses. There is no specific guidance related to investments subject to significant influence when a return to profitability is considered imminent. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** Under existing Canadian GAAP, investments subject to significant influence are accounted for using the equity method of accounting which reflects the costs of the investment and the Corporation's proportionate share of the investee's profits or losses, other comprehensive income or losses, capital transactions and dividends received. The Corporation does not record the losses of investee's when the Corporation is unlikely to share in such losses unless the Corporation has guaranteed the obligations of the investee, has committed to provide further financial support to the investee or the investee seem assured of imminently returning to profitability. **Expected impact to the opening balance sheet:** No expected impact other than the adjustments described in the Consolidation – Loss of Control section. **Expected impact subsequent to transition:** No expected impact.

Accounting policy	Accounting policy changes under IFRS and expected impact
Impairment	Under IAS 39, Financial Instruments – Recognition and Measurement, an investor must assess whether objective evidence of an impairment exists in its associate or equity accounted investee. If impairment testing is required then the investor would apply the guidance of IAS 36. IAS 36 impairment testing of assets is based on comparing the carrying amount of the asset or group of assets to their recoverable amount. Recoverable amount is calculated as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. Value in use is calculated based upon a discounted cash flow analysis. In addition, IAS 36 requires, under certain circumstances, the reversal of impairment losses. An equity accounted investment is written down if its carrying amount is impaired. Such write-downs may be reversed if there is a subsequent increase in value. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** Under existing Canadian GAAP, when there is a loss in value of an investment accounted for using the equity method of accounting that is other than a temporary, the investment is written down to its fair value with a loss recognized in the statement of operations. Such write-downs are not reversed if there is a subsequent increase in value. **Expected impact to the opening balance sheet:** As described in the Consolidation – Loss of Control section, as a result of the shares issued by Air Canada on October 26, 2009 and October 27, 2009, ACE's ownership interest in Air Canada was reduced from 75% to 27% such that ACE ceased to control Air Canada. Refer to Note 3 of the Corporation's audited consolidated financial statements. Under IFRS, the equity investment in Air Canada was restated to fair value of $94 million as at October 27, 2009. Subsequently, for the period from October 27, 2009 to December 31, 2009, the carrying value was adjusted to include the Corporation's proportionate share of Air Canada's loss under IFRS of $13 million, other comprehensive income under IFRS of nil and other equity accounting adjustments reflecting additional amortization on ACE's proportionate fair value of Air Canada's assets acquired of $1 million. Under existing Canadian GAAP, the equity investment in Air Canada was $310 million as at October 27, 2009 following the recognition of a dilution loss. Subsequently, for the period from October 27, 2009 to December 31, 2009, the carrying value was adjusted to include the Corporation's proportionate share of Air Canada's loss of $7 million, other comprehensive income of $15 million and an impairment loss as at December 31, 2009 of $219 million. As a result, under IFRS, the carrying value of the equity investment in Air Canada is $80 million as at January 1, 2010. Under Canadian GAAP, the carrying value of the equity investment in Air Canada is $99 million as at January 1, 2010. There was no impairment recognized under IFRS on transition. In addition, as at October 27, 2009, the cumulative amount deferred in other comprehensive loss relating to Air Canada of $50 million was reclassified to retained earnings (deficit). **Expected impact subsequent to transition:** Impairments may be recognized more frequently under IFRS, however they may be reversed in future periods.

Accounting policy	Accounting policy changes under IFRS and expected impact
Loss of Significant Influence	Under IAS 28 "Investments in Associates", upon the loss of significant influence, any retained investment is remeasured to fair value and a gain or loss is recognised in profit or loss. The fair value of the retained investment is the deemed cost for the purposes of applying the financial instruments standards. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** Under existing Canadian GAAP, upon the loss of significant influence, the retained interest represents carrying amount of the net assets of the investee and is adjusted for reclassification of items previously recognised in accumulated other comprehensive income. The adjusted carrying value of the retained investment is the deemed cost for the purposes of applying the financial instruments standards. **Expected impact to the opening balance sheet:** No expected impact. **Expected impact subsequent to transition:** On December 23, 2010, as a result of the reduction of ACE's ownership interest in Air Canada, ACE ceased to have the ability to exercise significant influence over Air Canada. The retained investment in Air Canada was classified as available-for-sale ("AFS") and remeasured to fair value of $111 million under Canadian GAAP and IFRS. The remeasurement to fair value on December 23, 2010 is recognized through other comprehensive income under existing Canadian GAAP and through the statement of operations under IFRS.

Accounting policy	Accounting policy changes under IFRS and expected impact
Provisions and contingent liabilities	IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", requires a provision to be recognized when: there is a present obligation as a result of a past transaction or event; it is probable that an outflow of resources will be required to settle the obligation; and a reliable estimate can be made of the obligation. "Probable" in this context means more likely than not. Under IAS 37, there are a number of different estimation techniques to arrive at the best estimate, including the single most likely outcome, the weighted average of all possible outcomes or the midpoint where there is a range of equally possible outcomes. **Policy choices:** There are no policy choices available under IFRS. **Differences from existing Canadian GAAP:** Under Canadian GAAP, the criterion for recognition in the financial statements is "likely", which is a higher threshold than "probable" and estimable. Where there is a range of equally possible outcomes, the provision is recorded at the low point of the range. **Expected impact to the opening balance sheet:** No expected impact. **Expected impact subsequent to transition:** Provisions may be recognized more frequently under IFRS.

Estimated Adjustments to Shareholders' Equity on Adoption of IFRS

Unaudited **(Canadian dollars in millions)**	**Canadian GAAP 2010 January 1 2010**	**IFRS transitional adjustment January 1 2010**	**IFRS January1 2010**
Assets			
Cash and cash equivalents	$ 71		$ 71
Investment in Air Canada	99	(19)	80
Loan receivable from Air Canada	150		150
Interest receivable	3		3
	$ 323	**(19)**	**$ 304**
Liabilities			
Accounts payable and accrued liabilities	$ 3		$ 3
Shareholders' equity			
Share capital	104		104
Contributed surplus	358		358
Deficit	(92)	(69)	(161)
Accumulated other comprehensive income (loss)	(50)	50	-
	320	(19)	301
	$ 323	**(19)**	**$ 304**

* *The estimated adjustments to Shareholders' Equity on adoption of IFRS is intended to highlight areas which the Corporation expects, and should not be regarded as final.*

6. Results of Operations – Quarter 4 2010

(Canadian dollars in millions)	Quarter 4 2010
Operating revenue	$ -
Operating expenses	3
Operating loss	**(3)**
Non-operating income (expense)	
Interest income	1
Gain on ACE's investment in Air Canada	43
Proportionate share of Air Canada's income	40
Gain on financial instruments recorded at fair value	1
	85
Income before the following items	82
Recovery of income taxes	4
Income for the period	**$ 86**

The under-noted reconciliation provides supplementary information to separate CIE from Air Canada results included in the consolidated financial statements for the fourth quarter of 2009 when Air Canada's results were consolidated up to October 27, 2009.

(Canadian dollars in millions)	Quarter 4 2009 Air Canada	CIE	ACE
Operating revenue			
Passenger revenue	$ 727	$ -	$ 727
Cargo revenue	34	-	34
Other revenue	54	-	54
	815	-	815
Operating expenses			
Aircraft fuel	209	-	209
Wages, salaries and benefits	135	-	135
Airport and navigation fees	79	-	79
Capacity purchase with Jazz	79	-	79
Depreciation and amortization	55	-	55
Aircraft maintenance	68	-	68
Food, beverages and supplies	26	-	26
Communications and information technology	26	-	26
Aircraft rent	26	-	26
Commissions	16	-	16
Other operating expenses	100	1	101
	819	1	820
Operating loss	**(4)**	**(1)**	**(5)**
Non-operating income (expense)			
Interest income	-	3	3
Interest expense	(29)	-	(29)
Interest capitalized	-	-	-
Loss on ACE's investment in Air Canada	-	(630)	(630)
Loss on repurchase of ACE convertible senior notes	-	(1)	(1)
Gain on financial instruments recorded at fair value	21	-	21
Equity and other investment loss	-	(7)	(7)
	(8)	(635)	(643)
Loss before the following items	**(12)**	**(636)**	**(648)**
Non-controlling interest	(1)	8	7
Foreign exchange loss	(18)	-	(18)
Recovery of income taxes	-	3	3
Loss for the period	**$ (31)**	**$ (625)**	**$ (656)**

ACE's results reflect the consolidation of Air Canada only up to October 27, 2009. After that date, ACE's investment in Air Canada was accounted for using the equity method of accounting. On December 23, 2010, Air Canada was classified as an available-for-sale financial instrument. Consequently, ACE's results of operations for 2010 are not directly comparable to its results of operations for 2009.

ACE recorded an operating loss of $3 million in Quarter 4 2010 compared to an operating loss of $5 million in Quarter 4 2009. ACE's consolidated results for Quarter 4 2009 included an operating loss from Air Canada of $4 million.

ACE recorded operating revenues of nil and operating expenses of $3 million in Quarter 4 2010. In the same period in 2009, ACE recorded operating revenues of $815 million and operating expenses of $820 million mainly as a result of its consolidation of Air Canada results.

Non-operating income amounted to $85 million in Quarter 4 2010 compared to non-operating expense of $643 million in Quarter 4 2009. Included in Quarter 4 2010 non-operating income was a gain on ACE's investment in Air Canada of $43 million and ACE's proportionate share of Air Canada's income of $40 million for the period up to December 23, 2010. Refer to Section 4 of the MD&A for additional information. Included in Q4 2009 non-operating expense was a loss on ACE's investment in Air Canada of $630 million which is comprised of the Air Canada dilution loss of $411 million and the Provision for loss on Air Canada investment of $219 million.

ACE recorded an Income tax provision of $4 million against the Unrealized gain on available-for-sale investment in Air Canada of $28 million, resulting in an unrealized gain of $24 million, net of income taxes within the Consolidated Statement of Comprehensive Income. The related liability is offset by a recovery of valuation allowance of $4 million recorded in the Consolidated Statement of Operations (Quarter 4 2009 – Recovery of $3 million). As a result, no future income tax liability is presented on the Consolidated Statement of Financial Position.

Income in Quarter 4 2010, amounted to $86 million or $2.64 per diluted share. In Quarter 4 2009, ACE recorded a loss of $656 million or $(18.38) per diluted share.

7. Results of Operations – 2010

(Canadian dollars in millions)	2010
Operating revenue	$ -
Operating expenses	10
Operating loss	**(10)**
Non-operating income (expense)	
Interest income	14
Gain on ACE's investment in Air Canada	43
Proportionate share of Air Canada's income	43
Gain on financial instruments recorded at fair value	5
Loss on investment in ACTS Aero	(1)
	104
Income before the following items	94
Recovery (provision for) of income taxes	4
Income for the period	**$ 98**

The under-noted reconciliation provides supplementary information to separate CIE from Air Canada results included in the consolidated financial statements for the period up to October 27 2009 when Air Canada's results were consolidated.

	2009		
(Canadian dollars in millions)	**Air Canada**	**CIE**	**ACE**
Operating revenue			
Passenger revenue	$ 7,196	$ -	$ 7,196
Cargo revenue	282	-	282
Other revenue	729	(1)	728
	8,207	(1)	8,206
Operating expenses			
Aircraft fuel	2,056	-	2,056
Wages, salaries and benefits	1,468	4	1,472
Airport and navigation fees	822	-	822
Capacity purchase with Jazz	825	-	825
Depreciation and amortization	550	(5)	545
Aircraft maintenance	625	-	625
Food, beverages and supplies	248	-	248
Communications and information technology	255	-	255
Aircraft rent	276	-	276
Commissions	156	-	156
Other operating expenses	1,162	8	1,170
	8,443	7	8,450
Operating loss	**(236)**	**(8)**	**(244)**
Non-operating income (expense)			
Interest income	12	5	17
Interest expense	(316)	(5)	(321)
Interest capitalized	4	-	4
Loss on other assets	(70)	-	(70)
Loss on repurchase of ACE convertible senior notes and preferred shares	-	(44)	(44)
Loss on ACE's investment in Air Canada	-	(630)	(630)
Proportionate share of Air Canada's loss	-	(7)	(7)
Gain on financial instruments recorded at fair value	94	-	94
Other	(5)	-	(5)
	(281)	(681)	(962)
Loss before the following items	**(517)**	**(689)**	**(1,206)**
Non-controlling interest	(12)	(1)	(13)
Foreign exchange gain	531	-	531
Provision for income taxes	(1)	(3)	(4)
Net income (loss) for the period	**$ 1**	**$ (693)**	**$ (692)**

ACE's results reflect the consolidation of Air Canada up to October 26, 2009. After that date, ACE's investment in Air Canada was accounted for using the equity method of accounting. On December 23, 2010, Air Canada was classified as an available-for-sale financial instrument. Consequently, ACE's results of operations for 2010 are not directly comparable to its results of operations for 2009.

ACE recorded an operating loss of $10 million in 2010 compared to an operating loss of $244 million in 2009. ACE's consolidated results for 2009 included an operating loss from Air Canada of $236 million.

ACE recorded operating revenues of nil and operating expenses of $10 million in 2010. In the same period in 2009, ACE recorded operating revenues of $8,206 million and operating expenses of $8,450 million mainly as a result of its consolidation of Air Canada's results.

Non-operating income amounted to $104 million in 2010 compared to non-operating expense of $962 million in 2009. Included in 2010 non-operating income was a gain on ACE's investment of $43 million and ACE's proportionate share of Air Canada's income of $43 million. Refer to Section 4 of the MD&A for additional information. In 2009, ACE recorded a loss on its investment in Air Canada in the amount of $630 million. ACE recorded a loss on repurchase of the convertible senior notes and preferred shares within Non-operating expense in the amount of $44 million. The repurchase prices of these investments, allocated to the liability components of these compound instruments, exceeded the respective carrying values. The residual equity components of the instruments amounting to $199 million were transferred directly to Contributed surplus in the consolidated statement of changes in shareholders' equity. Included in 2009 was a non-operating expense of $281 million from Air Canada.

ACE recorded an Income tax provision of $4 million against the Unrealized gain on available-for-sale investment in Air Canada of $28 million, resulting in an unrealized gain of $24 million, net of income taxes within the Consolidated Statement of Comprehensive Income. The related liability is offset by a recovery of valuation allowance of $4 million recorded in the Consolidated Statement of Operations (2009 – Provision of $4 million). As a result, no future income tax liability is presented on the Consolidated Statement of Financial Position.

Income in 2010 amounted to $98 million or $3.00 per basic and diluted share. In 2009, ACE recorded a loss of $692 million or $(19.56) per basic and diluted share.

8. Financial and Capital Management

The following table summarizes ACE's statement of financial position as at December 31, 2010 and as at December 31, 2009.

Consolidated Statement of Financial Position (Canadian dollars in millions)	**December 31, 2010**	**December 31, 2009**
Assets		
Cash and cash equivalents	$ 363	$ 71
Investment in Air Canada	107	99
Air Canada warrants	5	-
Loan receivable from Air Canada	-	150
Interest receivable	-	3
Commodity taxes receivable	6	-
	$ 481	**$ 323**
Liabilities		
Commodity taxes payable	$ 6	$ -
Accounts payable and accrued liabilities	3	3
	9	**3**
Shareholders' equity	**472**	**320**
	$ 481	**$ 323**

** Refer to Section 12 for Off-balance sheet arrangements.*

8.1 Analysis of Financial Position

The following discussion is based upon ACE's consolidated statement of financial position as at December 31, 2010, versus ACE's statement of financial position as at December 31, 2009.

Cash and cash equivalents

As at December 31, 2010, ACE's cash and cash equivalents amounted to $363 million. As at December 31, 2009, ACE's cash and cash equivalents was $71 million. Refer to section 8.2 of this MD&A for a discussion of the change in cash and cash equivalents up to December 31, 2010.

Investment in Air Canada

On December 23, 2010, ACE completed a secondary offering on a bought deal basis of 44,000,000 Class B Voting Shares of Air Canada at an offering price of $3.70 per Class B Voting Share for aggregate gross proceeds of $163 million (net proceeds of approximately $156 million). See Section 4 of this MD&A for additional information. The net increase of $8 million in ACE's investment in Air Canada during 2010 was due to ACE's proportionate share of Air Canada's other comprehensive income during that period of $50 million, ACE's proportionate share of Air Canada's income during the period of $43 million, ACE's unrealized gain on AFS investment in Air Canada of $28 million offset by the carrying value of the Air Canada shares sold of $113 million.

Air Canada warrants

The fair value of the 2,500,000 warrants amounted to $5 million as at December, 2010 (nil as at December 31, 2009) using the Black-Scholes option valuation model.

Loan Receivable from Air Canada

As at December 31, 2009, ACE's Loan Receivable from Air Canada amounted to $150 million. On August 3, 2010, Air Canada repaid to ACE its share of the outstanding debt under the Credit Facility in the amount of $150 million together with interest and prepayment fees for total proceeds to ACE of $156 million.

Commodity taxes receivable and Commodity taxes payable

ACE has applied for Certificates of Discharge from the Canada Revenue Agency and Revenu Québec.

ACE is assisting them with their audits of ACE's income tax returns for the years 2005 to 2009. In addition to the audits of income tax returns, audits in respect of other taxes, including GST and QST, are ongoing.

In late 2010, ACE received notices of reassessment from Revenu Québec in the amount of $37.7 million. The reassessments primarily relate to audits of GST and QST in respect of ACTS LP, and its predecessor ACTS Limited Partnership, for periods prior to ACE's monetization of ACTS LP in October 2007. Of the amount of such reassessments, $5.7 million remains payable at December 31, 2010. This amount was paid in January 2011.

$35.4 million of the reassessments are recoverable from Air Canada and other parties. $29.2 million was recovered by December 31, 2010 leaving $6.2 million to be recovered at December 31, 2010. $5.3 million of this amount was recovered in January 2011. The total recoverable of $35.4 million includes $33.4 million recoverable from Air Canada and $1.1 million from Aveos following their filings of related Input Tax Credits from the Canada Revenue Agency. ACE has agreed to indemnify and hold harmless Air Canada and Aveos from loss should the additional ITC claims be reassessed in the future.

The net impact to ACE of the reassessments of $37.7 million above is expected to be $2.3 million, which was provisioned for by ACE in the Consolidated Statement of Operations.

It is possible that the ongoing audits of income tax returns and other taxes may lead to reassessments in the future.

Shareholders' equity

As at December 31, 2010, ACE's shareholders' equity amounted to $472 million, an increase of $152 million during 2010. This was due to income for the year of $98 million and other comprehensive income of $74 million, partially offset by the completion of a substantial issuer bid in Quarter 1 by ACE for the purchase and cancellation of 1.4 million Class A variable voting shares and 1.8 Class B voting shares at $6.20 per share for an aggregate purchase price of $20 million. This was recorded as a reduction in share capital of $9 million and contributed surplus of $11 million.

8.2 Cash Flows

Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE.

The following table summarizes ACE's cash flows for the indicated periods.

	Quarter 4			
(Canadian dollars in millions)	**2010**	**2009**	**2010**	**2009**
Cash from (used for) operating activities	$ (4)	$ 19	$ 7	$ (168)
Cash from (used for) for financing activities	-	160	(20)	(409)
Cash from investing activities	156	(1,284)	305	(659)
Net change in cash and cash equivalents during the period	**152**	**(1,105)**	**292**	**(1,236)**
Cash and cash equivalents - Beginning of period	**211**	**1,176**	**71**	**1,307**
Cash and cash equivalents - End of period	**$ 363**	**$ 71**	**$ 363**	**$ 71**

The following summarizes significant transactions or factors which impacted ACE's cash and cash equivalents in 2010:

- In January 2010, the Corporation completed a substantial issuer bid to purchase for cancellation 1.4 million of its Class A variable voting shares and 1.8 million of its Class B voting shares at $6.20 per share. On January 6, 2010, the Corporation paid an aggregate purchase price of $20 million for the shares tendered.

- In August 2010, Air Canada repaid to ACE its share of the outstanding debt under the Credit Facility in the amount of $150 million together with interest and prepayment fees for total proceeds to ACE of $156 million. Refer to Section 4 of this MD&A for additional information.

- In December 2010, ACE completed a secondary offering on a bought deal basis of 44,000,000 Class B Voting Shares of Air Canada at an offering price of $3.70 per Class B Voting Share for aggregate gross proceeds of $163 million (net proceeds of approximately $156 million). Following the offering, ACE beneficially owns 31,000,000 Class B Voting Shares of Air Canada representing 11.11% of the Class A Variable Voting Shares and Class B Voting Shares of Air Canada issued and outstanding on a combined basis.

The following summarizes significant transactions or factors which impacted ACE's unconsolidated cash and cash equivalents in 2009:

- In January 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 80% of its convertible senior notes outstanding as at December 31, 2008, at a purchase price of $900 dollars in cash for each $1,000 dollars principal amount of notes. The aggregate principal amount of the repurchased Convertible senior notes was $259 million. On January 21, 2009, the Corporation paid an aggregate purchase price of $233 million for the notes tendered.

- In January 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 8.3 million of its convertible preferred shares at a purchase price of $20 dollars per preferred share. On

January 21, 2009, the Corporation paid an aggregate purchase price of $166 million for the shares tendered.

- In March 2009, the Corporation completed a substantial issuer bid to purchase for cancellation 1.0 million of its convertible preferred shares at a purchase price of $20 dollars per preferred share. On March 23, 2009, the Corporation paid an aggregate purchase price of $20 million for the shares tendered.

- In July 2009, ACE participated in the Air Canada credit facility providing financing of $150 million, which represented 25% of the Credit Facility entered into at that time. The Credit Facility was a five-year facility repayable in sixteen (16) consecutive quarterly installments commencing in August 2010 with the final balloon installment due in July 2014. The Credit Facility bore interest at a rate based upon the greater of the bankers' acceptance rate or 3.00% plus 9.75%. On August 3, 2010, Air Canada repaid to ACE its share of the outstanding debt under the Credit Facility in the amount of $150 million together with interest and prepayment fees for total proceeds to ACE of $156 million.

- In September 2009, ACE entered into an agreement with Morgan Stanley Canada Limited pursuant to which ACE indirectly purchased for cancellation all of its remaining 3.2 million preferred shares at a price of $23.00 per share for an aggregate purchase price of $74 million.

- In December 2009, ACE redeemed the remaining convertible senior notes for an aggregate purchase price of $64 million.

8.3 Capital Management

Capital managed by ACE, summarized from the consolidated statement of financial position, is as follows:

	2010	2009
Shareholders' equity	472	320
Capital	$ 472	$ 320

As at December 31, 2010, ACE's capital amounted to $472 million, an increase of $152 million during 2010.

ACE's business strategy, to maximize shareholder value and to return capital to its shareholders, has influenced its capital management objectives. Consistent with those objectives, during 2009 and 2010, the ACE Board of Directors authorized the return of capital to its shareholders and noteholders through the purchase and cancellation of ACE's Class A variable voting shares, Class B voting shares, convertible preferred shares and convertible senior notes and the redemption of its remaining convertible senior notes.

Going forward, the Board will continue to review alternatives to maximize the return to its shareholders.

8.4 Share Information

At January 31, 2011, the issued and outstanding common shares of ACE, along with common shares potentially issuable, were as follows:

Number of shares (000)	January 31, 2011	December 31, 2010
Issued and outstanding common shares		
Class A variable voting shares	26,049	26,049
Class B voting shares	6,424	6,424
Total issued and outstanding common shares (1)	**32,473**	**32,473**
Common shares potentially issuable		
Stock options (2)	38	38
Total outstanding and potentially issuable common shares	**32,511**	**32,511**

(1) On January 6, 2010, ACE accepted for purchase and cancellation a total of 1,401,094 Class A variable voting shares and 1,824,711 Class B voting shares at $6.20 per share for an aggregate purchase price of $20 million in accordance with the terms of a substantial issuer bid.

(2) The Corporation's stock option plan is described in Note 5 to the 2010 annual audited consolidated financial statements. At January 31, 2011, a total of 37,500 stock options with a weighted exercise price of $15.36 were outstanding.

9. Quarterly Financial Information

The quarterly information presented below is not directly comparable as a result of ACE's investment in Air Canada being changed on October 27, 2009 from consolidation to the equity method of accounting.

($ millions, except per share amounts)	Q1 2009	Q2 2009	Q3 2009	Q4(1) 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010
Operating revenues	$ 2,391	$ 2,330	$ 2,670	$ 815	$ -	$ -	$ -	$ -
Operating expenses	(2,583)	(2,445)	(2,602)	(820)	(2)	(3)	(1)	(3)
Operating income (loss)	**(192)**	**(115)**	**68**	**(5)**	**(2)**	**(3)**	**(1)**	**(3)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax(2)	(152)	225	130	(651)	(14)	(47)	79	89
Net income (loss)	**$ (344)**	**$ 110**	**$ 198**	**$ (656)**	**$ (16)**	**$ (50)**	**$ 78**	**$ 86**
Earnings (loss)(3)								
Per share – basic	**$ (9.87)**	**$ 3.16**	**$5.57**	**$(18.38)**	**$(0.48)**	**$(1.56)**	**$2.41**	**$2.64**
Per share – diluted	**$ (9.87)**	**$ 2.68**	**$5.15**	**$(18.38)**	**$(0.48)**	**$(1.56)**	**$2.41**	**$2.64**

(1) The results, financial position and cash flows of Air Canada are not consolidated with ACE effective October 27, 2009.

(2) Quarter 1 2009 includes a loss on repurchase of the convertible senior notes and preferred shares of $33 million relating to the substantial issuer bids completed in January 2009 and March 2009. Quarter 3 2009 includes a loss on repurchase of the preferred shares of $10 million relating to the acquisition for cancellation of the remaining preferred shares in September 2009. Quarter 4 2009 includes a dilution loss of $411 million as a result of the shares issued by Air Canada reducing ACE's ownership interest from 75% to 27% and includes a provision for loss on ACE's Air Canada investment of $219 million as a result of adjusting the carrying value of ACE's investment in Air Canada to $99 million based on Air Canada's market price as at December 31, 2009. Quarter 4 2010 includes a gain of $43 million on ACE's sale of 44,000,000 Class B voting shares of Air Canada.

(3) *Earnings (loss) per share includes the impact of a substantial issuer bid completed by ACE on January 6, 2010 whereby ACE accepted for purchase and cancellation a total of 1,401,094 Class A variable voting shares and 1,824,711 Class B voting shares.*

10. Selected Annual Information

The following table provides selected annual information for ACE for the years 2010, 2009 and 2008. The information provided below may not be directly comparable as a result of changes in accounting policies relating to Air Canada.

($ millions, except per share figures)	**2010**	**2009** (1)	**2008**
Operating revenues	$ -	$ 8,206	$ 11,080
Operating expenses	(10)	(8,450)	(11,154)
Operating income (loss) before the provision for cargo investigations	**(10)**	**(244)**	**(74)**
Provision for cargo investigations (2)	-	-	(125)
Operating income (loss)	**(10)**	**(244)**	**(199)**
Total non-operating income (expense), non-controlling interest, foreign exchange gain (loss) and income tax (3)	108	(448)	79
Net income (loss)	**$ 98**	**$ (692)**	**$ (120)**
Earning (loss) per share			
- Basic	**$3.00**	**$(19.56)**	**$ (2.59)**
- Diluted	**$3.00**	**$(19.56)**	**$ (2.59)**
Cash, cash equivalents and short-term investments	**$ 363**	**$ 71**	**$ 1,813**
Total assets	**$ 481**	**$ 323**	**$ 11,871**
Total long-term liabilities (4)	**$ -**	**$ -**	**$ 7,804**

(1) *The operating results, financial position and cash flows of Air Canada are not consolidated with ACE effective October 27, 2009.*

(2) *Air Canada recorded a provision for cargo investigations of $125 million in 2008.*

(3) *Non-operating income (expense) includes a gain of $43 million on ACE's sale of Air Canada shares in 2010, losses on ACE's investment in Air Canada of $630 million in 2009 and gains on assets which amounted to $946 million in 2008. Also included are net gains on foreign exchange of $531 million in 2009 and net losses on foreign exchange of $655 million in 2008.*

(4) *Total long-term liabilities include long-term debt (including current portion) and capital leases, convertible preferred shares, pension and other benefit liabilities and other long-term liabilities.*

11. Financial Instruments and Risk Management

Risk Management

As at December 31, 2010, ACE's financial instruments include cash and cash equivalents in the amount of $363 million ($71 million as at December 31, 2009), Air Canada warrants of $5 million (nil as at December 31, 2009), commodity taxes receivable of $6 million (nil as at December 31, 2009), interest receivable of nil from Air Canada ($3 million as at December 31, 2009) and accounts payable of accrued liabilities of $3 million ($3 million as at December 31, 2009). At December 31, 2009, ACE had a secured loan receivable of $150 million from Air Canada. The risk exposure related to these holdings is described below.

Liquidity risk
Liquidity risk is the risk that the Corporation will encounter difficulty in meeting obligations associated with its financial liabilities. This risk is mitigated by the fact that as at December 31, 2010, the Corporation had Cash and cash equivalents of $363 million and accounts payable and accrued liabilities $3 million.

Credit Risk
Credit risk is the risk of loss due to a counterparty's inability to meet its obligations. The Corporation is primarily exposed to credit risk from its cash and cash equivalents. The maximum exposure of which is represented by the carrying amounts reported on the balance sheet. This risk is mitigated by the fact that cash and cash equivalents are held by major Canadian banks. The Corporation's target is that no one financial institution holds more than 25% of the total.

Market Risk
Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market factors. Market factors include three types of risks: currency risk, interest rate risk and equity risk. The Corporation is exposed to interest rate risk and equity risk. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Corporation is exposed to interest rate risk from its holding in cash and cash equivalents of $363 million. The weighted average interest rate on ACE's cash and cash equivalents at December 31, 2010, is approximately 1.02%, which results in limited downside risk. Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. The Corporation is exposed to equity risk from its holding of 31,000,000 Air Canada shares and 2,500,000 Air Canada warrants

Summary of Gain on Financial Instruments Recorded at Fair Value

	2010	2009 *
Air Canada warrants issued under the Credit Facility	$ 5	$ -
Fuel derivatives not under hedge accounting	-	98
Other	-	(4)
Gain on financial instruments recorded at fair value	$ 5	$ 94

** Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE.*

12. Off-Balance Sheet Arrangements

Guarantees

On May 7, 2009, ACE intervened into the employment agreement between Air Canada and Mr. Calin Rovinescu, its President and Chief Executive Officer, to guarantee the payments required of Air Canada under the agreement. In addition, ACE agreed to cause to be issued an irrevocable bank letter of credit to a maximum of $5 million.

On March 11, 2010, the subject agreement was amended such that the guarantee shall automatically terminate upon the earlier of (i) April 1, 2014 and (ii) the date on which the shareholders of ACE approve the winding-up and liquidation of ACE, in the event that such approval is requested by ACE of its shareholders. Notwithstanding the foregoing, in the event of such approval by ACE's shareholders and that a liquidator is not appointed within 180 days of the shareholders' vote approving the winding-up and liquidation of ACE, the guarantee shall automatically resume and continue in full force and effect, and shall thereafter automatically terminate upon the earlier of (i) April 1, 2014 and (ii) the date on which such a liquidator shall have been appointed for the winding-up and liquidation of ACE. This agreement was also further amended such that ACE is not required to issue the bank letter of credit.

Indemnification agreements

Refer to Note 4 of the consolidated financial statements for a description of indemnification agreements between ACE, Air Canada and Aveos related to certain commodity tax reassessments.

13. Critical Accounting Estimates

Effective October 27, 2009, the operating results, financial position and cash flows of Air Canada are not consolidated with ACE. Refer to Section 4 "ACE's Assets" in this MD&A.

Critical accounting estimates are those that are most important to the portrayal of the Corporation's financial condition and results of operations. They require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ from those estimates under different assumptions or conditions.

The Corporation has identified the following area that contains critical accounting estimates utilized in the preparation of its consolidated financial statements:

Income Taxes
The Corporation utilizes the assets and liability method of accounting for income taxes under which future income tax assets and liabilities are recognized for the estimated future income tax consequences attributable to differences between the financial statement carrying value amount and the tax basis of assets and liabilities. Management uses judgment and estimates in determining the appropriate rates and amounts in recording future taxes, giving consideration to timing and probability. Actual taxes could significantly vary from these estimates as a result of future events, including changes in income tax law or the outcome of reviews by tax authorities and related appeals. The resolution of these uncertainties and the associated final taxes may result in adjustment to the Corporation's tax assets and tax liabilities.

Future income tax assets are recognized to the extent that realization is considered more likely than not. The Corporation considers past results, current trends and outlooks for future years in assessing realization of income tax assets.

14. Risk Factors

The risks described herein may not be the only risks faced by the Corporation. Other risks which the Corporation is not aware of or which the Corporation currently deems to be immaterial may surface and have a material adverse impact on the Corporation's business, results from operations and financial condition.

A Substantial Portion of ACE's Cash is Invested in Cash Equivalents

A substantial portion of ACE's cash is invested in cash equivalents which are subject to credit exposure and interest rate fluctuations which could change the value of these investments. These investments are made in accordance with an investment policy approved by the Board of Directors. Although ACE's investment policy is designed to provide for short-term liquidity and low levels of risk, such investments are subject to credit exposure and interest rate fluctuations. Consequently, the value of such investments could increase or decrease accordingly. Any decrease in the fair value of these investments would reduce the amount available for distribution to stakeholders.

Shares and Warrants in Air Canada

The value of ACE's equity interests in Air Canada is subject to market conditions based on the financial performance of Air Canada and to any risks and uncertainties relating to Air Canada, as well as any, movements in the price of publicly-traded airline stocks and general market conditions. Any decrease in the market price of Air Canada shares will reduce the value of these shares and warrants which can be realized.

Tax Audits

ACE has applied for Certificates of Discharge from the Canada Revenue Agency and Revenu Québec. ACE is assisting them with their audits of ACE's income tax returns for the years 2005 to 2009. In addition to the audits of income tax returns, audits in respect of other taxes, including GST and QST, are ongoing. It is possible that the audits, which relate to ACE and its subsidiaries, may lead to some assessments in the future. Also refer to Section 3 and 8.1 of this MD&A for a description of indemnification agreements between ACE, Air Canada and Aveos related to commodity tax assessments.

Liquidation

If ACE subsequently proceeds with the liquidation of its net assets, ACE will again adopt a liquidation basis of presentation which will result in net assets in liquidation being presented on a net realizable basis. As part of a liquidation process, a claims process would be initiated pursuant to which any claims against the corporation would be identified and resolved. It is possible, that through this process, additional liabilities could be identified.

15. Controls and Procedures

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

Disclosure controls and procedures within the Corporation have been designed to provide reasonable assurance that all relevant information is identified to its Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

Internal controls over financial reporting have been designed by management, with the participation of the Corporation's Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), to provide reasonable assurance regarding the reliability of the Corporation's financial reporting and its preparation of financial statements for external purposes in accordance with GAAP.

The Corporation will file certifications, signed by the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), with the Canadian Securities Administrators ("CSA") upon filing of the Corporation's 2011 Annual Information Form. In those filings, the Corporation's CEO and CFO will certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporation's disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting. The Corporation's CEO and CFO also certify the appropriateness of the financial disclosures in the Corporation's interim filings with securities regulators. In those interim filings, the Corporation's CEO and CFO certify the design of the Corporation's disclosure controls and procedures and the design of internal controls over financial reporting.

Management's Report on Disclosure Controls and Procedures

Management, with the participation of the Corporation's CEO and CFO, assessed the effectiveness of the Corporation's disclosure controls and procedures and concluded, as at December 31, 2010, that such disclosure controls and procedures were designed to provide reasonable assurance that:

(i) material information relating to the Corporation was made known to its Disclosure Policy Committee by others; and

(ii) information required to be disclosed by the Corporation in its annual filings, interim filings and other reports filed or submitted by the Corporation under securities legislation was recorded, processed, summarized and reported within the time periods specified in securities legislation.

Management's Report on Internal Controls over Financial Reporting

Management, with the participation of the Corporation's CEO and CFO, assessed the effectiveness of the Corporation's internal controls over financial reporting. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control - Integrated Framework. Based on that evaluation, management and the CEO and CFO have concluded that, as at December 31, 2010, the Corporation's internal controls over financial reporting were effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. This evaluation took into consideration the Corporation's Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

Changes in Internal Controls over Financial Reporting

There have been no changes to the Corporation's internal controls over financial reporting during the year ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, its internal controls over financial reporting.