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# Financial statements of Canadian Lawyers Liability Assurance Society

December 31, 2018

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## Independent Auditor's Report

To the Advisory Board of  
Canadian Lawyers Liability Assurance Society

### Opinion

We have audited the financial statements of Canadian Lawyers Liability Assurance Society (the "Society"), which comprise the statements of financial position as at December 31, 2018, and the statements of comprehensive income (loss), changes in equity and cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Society as at December 31, 2018, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

### Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards ("Canadian GAAS"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Society or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Society's financial reporting process.

### Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian GAAS will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Society's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Society's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Society to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

(To be signed Deloitte LLP)

Chartered Professional Accountants  
Licensed Public Accountants  
Toronto, Ontario  
February 26, 2019

**Canadian Lawyers Liability Assurance Society****Statement of financial position**

As at December 31, 2018

	Notes	<b>2018</b>	<b>2017</b>
		\$	\$
<b>Assets</b>			
Cash at bank		<b>5,081,001</b>	3,140,371
Short term investments	4	<b>7,128,611</b>	11,745,460
Bonds	4	<b>5,911,332</b>	5,091,893
Interest income due and accrued		<b>20,988</b>	18,532
Premiums receivable	6	<b>1,635,998</b>	1,782,634
Prepaid expenses		<b>140,827</b>	139,500
Deferred policy acquisition costs		<b>106,582</b>	103,310
Reinsurers' share of unearned premiums		<b>2,736,021</b>	2,541,253
Reinsurance receivable		<b>2,996,041</b>	617,756
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	5	<b>87,941,000</b>	96,568,000
		<b>113,698,401</b>	121,748,709
<b>Liabilities</b>			
Accounts payable and accrued charges		<b>335,152</b>	513,612
Unearned premiums		<b>3,664,920</b>	3,539,875
Due to reinsurers		<b>1,935,175</b>	1,649,031
Provision for unpaid claims and adjustment expenses	5	<b>95,430,000</b>	104,499,000
		<b>101,365,247</b>	110,201,518
<b>Equity</b>			
Minimum surplus	12	<b>50,000</b>	50,000
Additional surplus	12	<b>12,317,745</b>	11,518,960
Accumulated other comprehensive (loss) income		<b>(34,591)</b>	(21,769)
Total equity		<b>12,333,154</b>	11,547,191
		<b>113,698,401</b>	121,748,709

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

On behalf of the Advisory Board

\_\_\_\_\_, Chair of the Audit Committee

\_\_\_\_\_, Director

# Canadian Lawyers Liability Assurance Society

## Statement of comprehensive income (loss)

Year ended December 31, 2018

	Notes	2018 \$	2017 \$
<b>Premiums</b>			
Written premiums		7,390,585	7,138,422
Reinsurance ceded		5,517,391	5,124,626
Net written premiums		1,873,194	2,013,796
Change in unearned premiums		69,723	80,765
Earned premiums		1,942,917	2,094,561
<b>Expenses</b>			
Claims	5	(586,867)	1,286,787
Premium deficiency adjustment		—	—
Operating expenses	7	1,836,345	2,072,921
Premium taxes		209,892	257,531
		1,459,370	3,617,239
Underwriting income (loss) for the year		483,547	(1,522,678)
Investment income	4	315,238	201,409
Net income (loss) for the year		798,785	(1,321,269)
Change in unrealized losses on available-for-sale financial assets arising during the year		(12,822)	(83,379)
Other comprehensive loss		(12,822)	(83,379)
<b>Comprehensive income (loss)</b>		785,963	(1,404,648)

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

**Canadian Lawyers Liability Assurance Society****Statement of changes in equity**

Year ended December 31, 2018

	Minimum surplus	Additional surplus	Accumulated other comprehensive income	Total equity
	\$	\$	\$	\$
Balance December 31, 2016	50,000	14,340,229	61,610	14,451,839
Net income (loss)	—	(1,321,269)	—	(1,321,269)
Other comprehensive income (loss)	—	—	(83,379)	(83,379)
Distribution of premium surplus	—	(1,500,000)	—	(1,500,000)
Balance December 31, 2017	50,000	11,518,960	(21,769)	11,547,191
Net income (loss)	—	798,785	—	798,785
Other comprehensive income (loss)	—	—	(12,822)	(12,822)
Distribution of premium surplus	—	—	—	—
Balance December 31, 2018	<b>50,000</b>	<b>12,317,745</b>	<b>(34,591)</b>	<b>12,333,154</b>

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

# Canadian Lawyers Liability Assurance Society

## Statement of cash flows

Year ended December 31, 2018

	2018	2017
	\$	\$
<b>Operating activities</b>		
Net income (loss) for the year	798,785	(1,321,269)
Changes in non-cash items		
Interest income due and accrued	(2,456)	2,589
Premiums receivable	146,636	737,746
Reinsurers' share of unearned premiums	(194,768)	1,640,928
Prepaid expenses	(1,327)	—
Deferred policy acquisition costs	(3,272)	50,911
Reinsurance receivable	(2,378,285)	219,858
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	8,627,000	(1,774,000)
Provision for unpaid claims and adjustment expenses	(9,069,000)	3,252,000
Premium deficiency liability		
Unearned premiums	286,144	(865,023)
Due to reinsurers	125,045	(1,721,693)
Accounts payable and accrued charges	(178,460)	(130,292)
Amortization of bond premium	(45,764)	(40,908)
Amortization of bond discount	10,496	8,885
Cash (used in) provided by operating activities	(1,879,226)	59,732
<b>Financing activity</b>		
Refund of premium surplus	—	(1,500,000)
<b>Investing activities</b>		
Purchase of bonds	(1,648,590)	(559,485)
Disposal of bonds	800,000	530,000
Purchase of short term investments	(65,426,955)	(70,356,401)
Disposal of short term investments	70,095,401	70,234,870
Cash provided by (used in) investing activities	3,819,856	(151,016)
Net increase (decrease) in cash	1,940,630	(1,591,284)
Cash balance, beginning of year	3,140,371	4,731,655
<b>Cash beginning, end of year</b>	<b>5,081,001</b>	<b>3,140,371</b>
<b>Cash balance comprises</b>		
Cash at bank	5,081,001	3,140,371
<b>Interest received</b>	<b>277,514</b>	<b>171,976</b>

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



# Canadian Lawyers Liability Assurance Society

## Notes to the financial statements

December 31, 2018

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### 1. Description of business

The Canadian Lawyers Liability Assurance Society (the "Society") was formed under the Reciprocal Insurance Exchange Agreement for select Canadian Law Firms dated December 22, 1986 ("Subscription Agreement"). The Society is licensed by the Superintendent of Insurance, Alberta and other provinces in Canada to provide lawyers professional liability insurance to its subscribers. The Society commenced operations on June 30, 1987.

The address and registered office is Bay Adelaide Centre - West Tower, 333 Bay Street, Suite 3400, Toronto, Ontario, M5H 2S7.

The Society does not have any employees and is managed by an independent third party that reports to the Advisory Board. The Advisory Board has the authority and responsibility for planning, directing and controlling the activities of the entity. The Chair of the Advisory Board receives an annual honorarium of \$150,000 (\$150,000 in 2017) and the other members of the Advisory Board receive no compensation.

### 2. Basis of preparation

#### *Statement of compliance*

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as defined by the International Accounting Standards Board ("IASB").

These financial statements have been prepared on the historical cost basis, except for the valuation of financial instruments which are measured at fair value and outstanding claims and reinsurance are measured at discounted amounts.

### 3. Significant accounting policies

These financial statements reflect the following policies:

#### *Use of estimates and judgments*

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions about the reported amounts of revenues, expenses, assets, and liabilities and the disclosure of contingent liabilities, at the reporting date. These estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and any future periods affected. Information about judgments, estimates and assumptions that have the most significant effect on the amounts reflected in the financial statements are reflected in the following notes:

Notes 8: Reinsurance Program

Notes 5: Provision for unpaid claims and adjustment expenses

#### *Insurance premiums and deferred acquisition costs*

Insurance premiums are recorded as written at the inception date of the policies and deferred as unearned premiums to be taken into income as earned on a pro-rata basis over the terms of the underlying policies. Retro-assessment calls are recorded as written and earned at the date of approval by the Society's Advisory Board. Premium taxes are recorded as deferred policy acquisition costs and expensed in the periods in which related premiums are earned.

### **3. Significant accounting policies (continued)**

#### *Insurance premiums and deferred acquisition costs (continued)*

At each reporting period, liability adequacy tests are performed to ensure that the unearned premiums are sufficient to pay expected claims and expenses. If not, a premium deficiency will occur. Premium deficiencies are recognized initially by reducing the deferred acquisition cost asset and, if necessary, establishing an additional provision.

#### *Reinsurance*

The Society participates in, and enters into, reinsurance contracts in the normal course of business in order to limit the potential for losses arising from certain exposures. Reinsurance premiums are recognized in the same period as the related insurance premiums that are earned as described above.

Reinsurance assets include balances due from reinsurance companies for paid and unpaid losses. Amounts recoverable from reinsurers are estimated and recognized in a manner consistent with the reserve for losses associated with the related reinsurance contract. The Society reflects reinsurance balances on a gross basis in the statement of financial position to reflect the credit risk related to reinsurance.

Certain of the Society's reinsurance contracts contain additional premium liability clauses which require that the Society pay additional premiums if paid claims and case reserves exceed certain pre-determined levels. The Society accrues such additional premiums based upon current actuarial estimates of ultimate loss experience.

#### *Provision for unpaid claims and adjustment expenses*

The provision for unpaid claims and adjustment expenses represents an estimate of the ultimate gross amounts payable for all claims, including investigation costs and the projected final settlement of claims incurred prior to the statement of financial position date. The provision for unpaid claims and adjustment expenses is calculated in accordance with accepted actuarial practice in Canada taking into consideration the time value of money and explicit provisions for adverse deviation ("PFAD"). The estimates of loss activity are, by necessity, subject to uncertainty and are derived from a wide range of possible outcomes. These estimates are continually reviewed as additional information affecting the estimated quantum of claims settlement is obtained. All changes in estimated claim amounts are recorded as incurred claims in the period in which the change in estimate is determined.

The amounts recoverable from reinsurers are calculated based upon the same principles as the gross liability and are reflected as an asset in the statement of financial position.

#### *Investments*

The investment portfolio is comprised of bonds and short term investments which are classified as available-for-sale ("AFS") and their fair value is determined using quoted market bid prices. The Society does not have investments in bonds or other investments for which the fair value is determined using a valuation technique based on assumptions that are not supported by observable market prices or rates.

AFS investments are recorded at fair value with changes in the fair value recorded as unrealized gains and losses, which is included in other comprehensive income ("OCI"). Realized gains and losses on sale, as well as losses from impairment are recorded in net investment income in the statement of comprehensive income.

The Society accounts for the purchase and sale of investments using trade date accounting. Realized gains or losses on sale of investments are determined on a first in first out basis. Transaction costs related to the purchase of these bonds are recorded as part of the carrying value of the bond at the date of purchase. Discounts or premiums on the purchase of bonds are deferred and amortized over the remaining term of the bonds using the effective interest method and recorded in investment income in the statement of comprehensive income.

### **3. Significant accounting policies (continued)**

#### *Impairments*

AFS bonds are assessed for impairment on at least a quarterly basis. Objective evidence of impairment includes financial difficulty of the issuer, bankruptcy or defaults and delinquency in payments of interest or principal. When an investment is impaired it is written down to its fair value and associated unrealized gains or losses accumulated in OCI are reclassified to net investment income in the statement of comprehensive income. Once an impairment loss is recorded to income, the loss can only be reversed for fixed income securities to the extent a subsequent increase in fair value can be objectively correlated to an event occurring after the loss was recognized. Recovery in the fair value of a previously impaired AFS fixed income security up to the original amortized cost is recognized in net income. Following the impairment loss recognition, these assets will continue to be recorded at fair value with changes in fair value recorded to OCI, and tested for further impairment quarterly.

Insurance and reinsurance assets are reviewed for impairment on a quarterly basis. If objective evidence arises indicating a receivable from a policyholder or reinsurer is uncollectible, the carrying amount of the asset is reduced to its expected recoverable amount. The impairment loss is recognized as an expense in the net income.

#### *Future accounting changes*

- (i) Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4):

On September 12, 2016, the IASB issued amendments to IFRS 4 to address accounting mismatches and volatility that may arise in profit or loss in the period between the effective date of IFRS 9, Financial Instruments ("IFRS 9") and the new insurance contracts standard, IFRS 17 Insurance Contracts, issued May 2017. The amendments apply in the same period in which an insurer adopts IFRS 9.

The amendments introduce two approaches that may be adopted by insurers in the period between the effective date of IFRS 9 and IFRS 17, effective January 1, 2022:

- overlay approach – an option for all issuers of insurance contracts to reclassify amounts between profit or loss and other comprehensive income for eligible financial assets by removing any additional accounting volatility that may arise from applying IFRS 9; and
- temporary exemption – an optional temporary exemption from IFRS 9 for entities whose activities are predominately connected with insurance. This exemption allows an entity to continue to apply existing financial instrument requirements in International Accounting Standards ("IAS") 39, Financial Instruments: Recognition and Measurement ("IAS 39") to all financial assets until the earlier of the application of IFRS 17 or January 1, 2022.

The Society has adopted the temporary exemption, and adopted amendments to IFRS 4 in its financial statements for the current year.

An entity is permitted to continue applying IAS 39 if the following conditions are met:

- it has not applied IFRS 9 before; and
- its activities are predominantly connected with insurance on its annual reporting date immediately before April 1, 2016

### **3. Significant accounting policies (continued)**

#### *Future accounting changes (continued)*

##### (i) (continued)

An entity's activities are predominantly connected with insurance if:

- its liabilities arising from contracts in scope of IFRS 4 are significant compared with the total liabilities
- the ratio of its liabilities connected with insurance compared with its total liabilities is:
  - greater than 90 percent; or
  - greater than 80 percent but less than or equal to 90 percent, and the entity does not engage in a significant activity unconnected with insurance

The Society's total liabilities as at December 31, 2015 were \$111,113,316 of which \$110,202,627 pertain to insurance liabilities. Since the Society's predominance ratio is greater than 90%, it qualifies for the temporary exemption.

##### (ii) IFRS 9, Financial Instruments ("IFRS 9"):

On July 24, 2014 the IASB issued the complete IFRS 9 standard. The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight.

IFRS 9 introduces new requirements for the classification and measurement of financial assets. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. The standard introduces additional changes relating to financial liabilities. It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. Special transitional requirements have been set for the application of the new general hedging model.

The Society has adopted the temporary exemption described previously, and will adopt the amendments to IFRS 9 in its financial statements for the annual period in which the Society adopts IFRS 17, Insurance Contracts. The Society continues to assess the impact of these changes on the financial statements.

##### (iii) IFRS 17, Insurance Contracts ("IFRS 17"):

On May 18, 2017 the IASB issued IFRS 17 Insurance Contracts. The new standard is effective for annual periods beginning on or after January 1, 2022. IFRS 17 will replace IFRS 4 Insurance Contracts.

This standard introduces consistent accounting for all insurance contracts. The standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires a company to recognize profits as it delivers insurance services, rather than when it receives premiums.

The Society intends to adopt IFRS 17 in its financial statements for the annual period beginning on its effective date. On November 14, 2018 the IASB voted to propose a one-year deferral of the effective date for IFRS 17, the new insurance contracts Standard, to 2022. The IASB also decided to propose extending to 2022 the temporary exemption for insurers to apply the financial instruments Standard, IFRS 9, so that both IFRS 9 and IFRS 17 can be applied at the same time. The proposed deferral is subject to public consultation, which is expected in 2019. The extent of the impact of adoption of the standard has not yet been determined.

#### 4. Investments

(a) The Society's investments consist of the following:

	<b>December 31, 2018</b>		December 31, 2017	
	<b>Fair value and carrying value</b>	<b>Amortized cost</b>	Fair value and carrying value	Amortized cost
	\$	\$	\$	\$
Short term investments	<b>7,128,611</b>	<b>7,135,002</b>	11,745,460	11,757,685
Bonds	<b>5,911,332</b>	<b>5,939,531</b>	5,091,893	5,101,437
	<b>13,039,943</b>	<b>13,074,533</b>	16,837,353	16,859,122

The difference between amortized cost and market value of the AFS investments consists of gross unrealized gains of \$31,215 (\$39,896 in 2017) and gross unrealized losses of \$65,806 (\$61,665 in 2017).

The Society limits its bonds to securities issued or guaranteed by the Government of Canada, any province of Canada or Canadian corporations having a rating of A or better. Short term investments are invested in securities issued by the Government of Canada or a Canadian Province having a rating of A or better, or a Canadian Chartered Bank having a rating of R-1 or better. These securities have a maturity of less than 1 year from the purchase date.

(b) Maturity profile of investments as at December 31:

	<b>2018</b>		
	<b>Within 1 year</b>	<b>1 - 5 years</b>	<b>Over 5 years</b>
	\$	\$	\$
Short-term investments	<b>7,128,611</b>	—	—
Government of Canada bonds	<b>250,154</b>	<b>647,036</b>	<b>553,910</b>
Canadian public authorities bonds	—	<b>1,176,097</b>	<b>1,086,670</b>
Canadian corporate bonds	<b>200,605</b>	<b>1,297,309</b>	<b>699,551</b>
Total fair value	<b>7,579,370</b>	<b>3,120,442</b>	<b>2,340,131</b>

  

	<b>2017</b>		
	<b>Within 1 year</b>	<b>1 - 5 years</b>	<b>Over 5 years</b>
	\$	\$	\$
Short-term investments	11,745,460	—	—
Government of Canada bonds	250,531	453,264	499,246
Canadian public authorities bonds	351,463	521,034	1,106,356
Canadian corporate bonds	200,316	521,034	351,776
Total fair value	12,547,770	1,495,332	1,957,378

#### 4. Investments (continued)

(c) Net investment income has the following components:

	<b>2018</b>	2017
	\$	\$
Interest income		
Bonds	<b>91,976</b>	84,177
Cash, cash equivalents and short term investments	<b>187,994</b>	85,209
	<b>279,970</b>	169,386
Amortization of discount (premium) on investments	<b>35,268</b>	32,023
Realised gain (loss) on disposal	—	—
Total net investment income	<b>315,238</b>	201,409

(d) Fair value measurements

The Society measures certain assets and liabilities using fair value. Fair value is a market-based measurement and not an entity-specific measurement, and requires the use of a fair value hierarchy with the highest priority given to quoted prices in active markets. Investments measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table presents the Society's financial instruments that have been measured at fair value, on a recurring basis, as at December 31.

	<b>December 31, 2018</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	\$	\$	\$	\$
Cash at bank	<b>5,081,001</b>	—	—	<b>5,081,001</b>
Investments – available-for-sale				
Short term investments	—	<b>7,128,611</b>	—	<b>7,128,611</b>
Bonds	—	<b>5,911,332</b>	—	<b>5,911,332</b>
	<b>5,081,001</b>	<b>13,039,943</b>	—	<b>18,120,944</b>
	<b>December 31, 2017</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	\$	\$	\$	\$
Cash at bank	3,140,371	—	—	3,140,371
Investments – available-for-sale				
Short term investments	—	11,745,460	—	11,745,460
Bonds	—	5,091,893	—	5,091,893
	3,140,371	16,837,353	—	19,977,724

The Society did not have any transfers between any levels during the year.

## **5. Unpaid claims and adjustment expenses**

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

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

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Society's consultants retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices including claims handling and settlement practices, the effect of inflationary trends on future claims settlement costs, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination. The longer the span between the incidence of a loss and the payment or settlement of the claims, the more variable the ultimate settlement amount can be.

Consequently, the establishment of the provision for unpaid claims and adjustment expenses process relies on the judgment and opinions of a large number of individuals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining the provisions necessarily involves risks that the actual results will deviate, perhaps materially, from the best estimates made.

## 5. Unpaid claims and adjustment expenses (continued)

- (b) Activity in the provision for unpaid claims and adjustment expenses is summarized as follows:

	Gross	Ceded	Net
	\$	\$	\$
Provision for unpaid claims and adjustment expenses, December 31, 2016	101,247,000	94,794,000	6,453,000
Incurring claims and claim adjustment expenses			
Provision for current year claims	6,483,000	5,931,000	552,000
Increase (decrease) in provision for claims of prior years	(390,707)	(1,259,494)	868,787
Increase (decrease) in provision due to discount rate change	(1,702,000)	(1,568,000)	(134,000)
Total incurred	4,390,293	3,103,506	1,286,787
Payments and recoveries attributable to			
Current year claims	—	—	—
Prior years claims	(1,138,293)	(1,329,506)	191,213
	(1,138,293)	(1,329,506)	191,213
Provision for unpaid claims and adjustment expenses, December 31, 2017	104,499,000	96,568,000	7,931,000
Incurring claims and claim adjustment expenses			
Provision for current year claims	6,723,000	6,125,000	598,000
Increase (decrease) in provision for claims of prior years	23,656,088	24,763,955	(1,107,867)
Increase (decrease) in provision due to discount rate change	(965,000)	(888,000)	(77,000)
Total incurred	29,414,088	30,000,955	(586,867)
Payments and recoveries attributable to			
Current year claims	—	—	—
Prior years claims	(38,483,088)	(38,627,955)	144,867
	(38,483,088)	(38,627,955)	144,867
Provision for unpaid claims and adjustment expenses, December 31, 2018	<b>95,430,000</b>	<b>87,941,000</b>	<b>7,489,000</b>



## 5. Unpaid claims and adjustment expenses (continued)

### (c) Provision for unpaid claims and adjustment expenses

Under accepted actuarial practice in Canada, the appropriate value of the claims liabilities is the discounted value of such liabilities plus the provision for adverse deviation ("PFAD").

		December 31, 2018			
		Undiscounted	Discounted at 2.40%	Provisions for adverse deviation	Value per accepted actuarial practice
		\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses					
Gross		<b>94,037,000</b>	<b>85,197,000</b>	<b>10,233,000</b>	<b>95,430,000</b>
Recoverable from reinsurers		<b>89,434,000</b>	<b>81,048,000</b>	<b>6,893,000</b>	<b>87,941,000</b>
Net		<b>4,603,000</b>	<b>4,149,000</b>	<b>3,340,000</b>	<b>7,489,000</b>

  

		December 31, 2017			
		Undiscounted	Discounted at 2.15%	Provisions for adverse deviation	Value per accepted actuarial practice
		\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses					
Gross		104,547,000	95,756,000	8,743,000	104,499,000
Recoverable from reinsurers		99,915,000	91,541,000	5,027,000	96,568,000
Net		4,632,000	4,215,000	3,716,000	7,931,000

### (d) Key assumptions

The best estimate of the provision for unpaid claims and adjustment expenses as reported in these financial statements has been determined by the Society's appointed actuary in accordance with accepted actuarial practice as determined by the Standards of Practice of the Canadian Institute of Actuaries ("CIA"), including the selection of appropriate assumptions and methods.

The Incurred But Not Reported ("IBNR") liabilities have been estimated for each coverage period using the Bornhuetter-Ferguson Method which is based on expected claims development patterns and expected losses.

The estimated undiscounted outstanding liabilities are discounted to reflect the time value of money using a selected discount rate of 2.40% (2.15% in 2017) which is based on the expected market yield of the Society's investment portfolio of bonds and short term assets.

Based on the recommended margin for adverse deviation ranges prescribed by the CIA, a provision for adverse deviation is selected for the following variables: claims development, reinsurance recovery and interest rate.

## **5. Unpaid claims and adjustment expenses (continued)**

### **(d) Key assumptions (continued)**

Changes in the assumptions used in the December 31, 2018 actuarial valuation resulted in a total increase in net liabilities of \$517,738 (increase of \$745,000 in 2017), which is due to the change in loss development factors used in the Bornhuetter-Ferguson method and unallocated loss adjustment expense load increased from 2.60% to 2.95% (increased from 1.95% to 2.60% in 2017). The change in the discount rate and provisions for adverse deviation assumptions led to a further decrease in the net liabilities of \$77,000 (decrease of \$134,000 in 2017).

Sensitivities regarding these assumptions are provided in Note 11 Insurance Risk Management.

## **6. Premiums receivable**

All subscribers are large reputable Canadian law firms, and no significant credit risk is expected. All amounts are due by January 1, 2019.

## **7. Expenses by nature**

The following table presents the Society's expenses by nature:

	<b>2018</b>	<b>2017</b>
	<b>\$</b>	<b>\$</b>
Management services	<b>967,759</b>	997,006
Legal and professional	<b>629,380</b>	843,829
Other expenses	<b>239,206</b>	232,086
Total	<b>1,836,345</b>	2,072,921

## **8. Reinsurance program**

(a) The Society has obtained proportional reinsurance coverage which limits its net liability to a maximum amount of \$975,000 effective for the annual coverage period beginning on July 1, 2018 (\$975,000 in July 1, 2017) on any one loss.

(b) Colchester Reinsurance Limited (Colchester) is an off-shore captive reinsurer domiciled in Barbados. The shareholders of Colchester are twelve Toronto based legal firms or their related service corporations. Those twelve shareholders are unrelated to each other. However, each of Colchester's shareholders is, or is related to the Society's current and past subscribers. For the annual coverage period beginning on July 1, 2018, Colchester received from the Society premiums of \$428,716 (\$209,798 in July 1, 2017).

Colchester provides aggregate stop-loss reinsurance protection for a portion of the Society's retained risk. On July 1, 2018 this reinsurance had an attachment point of \$5,000,000 (\$5,000,000 on July 1, 2017), and an annual aggregate limit of \$10,000,000 (\$10,000,000 on July 1, 2017). Starting July 1, 2011, the attachment point and limit were determined with reference to the combined net claim liabilities of the Society and Colchester. Starting on July 1, 2012 the attachment point and limit are solely determined with reference to the net claim liabilities of the Society.

## **8. Reinsurance program (continued)**

- (c) In 2012, the Society initiated a Loss Portfolio Transfer (LPT) with Colchester to transfer the outstanding net retained liabilities for the policy year periods from inception to the period ended June 30, 2012 for a premium of \$44,260,000. The net retained liability was estimated as \$33,103,000 at the time of LPT.

As at December 31, 2018, the total reserves held and recoverable on the Society's financial statements relating to LPT was \$12,779,738 (\$17,961,185 in 2017). A Reinsurance Security Agreement (RSA) is in place which requires Colchester to set up on behalf of the Society deposits equal to 115% of Colchester's share of claim liabilities.

At December 31, 2018 the value of the security deposits exceeds the required amount.

- (d) Reinsurance does not discharge the primary liability of the Society.

## **9. Income taxes**

The Society is a reciprocal as defined under Part 1 of the Alberta Insurance Act, RSA 2000, c I- 3. Accordingly, no provision for income taxes is made in these financial statements.

## **10. Equity**

In accordance with the Reciprocal Insurance Exchange Agreement, subscribers were not obliged to contribute any amounts to the Society in the form of a capital contribution. The subscribers' surplus therefore represents cumulative surplus and may be used to cover potential future catastrophe claims or reduce future premiums, if appropriate. The Agreement provides that additional assessments may be made to cover the actual loss, claims and costs experienced by the Society.

Under the terms of the Society's Reciprocal Insurance Exchange Agreement, the Society is obligated to return a share of the Society's surplus (if any) to a departed Subscriber subsequent to the fifth anniversary of its departure, based on that Subscriber's participation in the Society. A Subscriber withdrew from the Society on June 30, 2012. As a result, an initial refund of premium surplus of \$1,500,000 was made to that Subscriber at December 31, 2017.

## **11. Risk management**

### *Insurance risk management*

The Society accepts insurance risks through its insurance contracts where it assumes the risk of loss from persons or organizations subject to the underlying loss. The Society is exposed to uncertainty surrounding the timing, frequency and severity of claims under these contracts and the principal risk that the actual claims payments exceed the carrying amount of the insurance liabilities or that claims are under-reserved.

The Society manages insurance risk via its underwriting and reinsurance strategy within an overall risk management framework. Pricing is based on assumptions which have regard to trends and past experience. Exposures are managed by having documented underwriting limits and rating criteria. Reinsurance is purchased to mitigate the effect of potential loss to the Society from individual large events. Reinsurance policies are written with approved reinsurers (two of the current reinsurers are unlicensed) on either a proportional, aggregate or excess of loss treaty basis.

## **11. Risk management (continued)**

### *Insurance risk management (continued)*

There is some concentration of risk since all coverage is related to professional liability and the underlying insured's are a homogeneous group since all are engaged in the practice of law in Canada. There is some risk of increased claim activity due to the occurrence of events that could increase the number of or value of legal actions against lawyers. Examples could be changes in legislation or a severe economic downturn. This risk is mitigated to some extent by the use of aggregate and excess of loss reinsurance. Concentration risk regarding reinsurance is mitigated by the use of multiple reinsurers with varying participations and an annual assessment of the financial strength of all reinsurers.

### *Claim development*

Uncertainty exists on reported claims in that all information may not be available at the reporting date; therefore, the claim cost may rise or fall at some date in the future when the information is obtained. In addition, claims may not be reported to the Society immediately; therefore, estimates are made as to the value of claims incurred but not yet reported, a value which may take some months to finally determine. In order to determine the liability, assumptions are developed considering the characteristics of the line of business, the historical pattern of payments, the amount of data available and any other pertinent factors. In general, the longer the term required for the settlement of a group of claims, the more variable the estimates. Short settlement term claims are those which are expected to be substantially paid within a year of being reported. The following table shows the development of claims over a 10 year period, on both a gross and net of reinsurance basis:

## 11. Risk management (continued)

### *Claim development (continued)*

Analysis of claims development – net and gross

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Estimate of ultimate (by underwriting year)											
End of year	8,797,000	8,322,000	4,665,000	463,000	411,000	440,000	424,000	444,000	387,000	208,000	
One year later	9,329,000	9,795,000	107,000	423,000	380,000	413,000	392,000	1,062,000	360,000		
Two years later	8,299,000	2,073,000	107,000	334,000	269,000	308,000	281,000	950,000			
Three years later	20,000	2,073,000	107,000	435,000	197,000	284,000	218,000				
Four years later	20,000	2,073,000	107,000	362,000	131,000	222,000					
Five years later	20,000	2,073,000	107,000	281,000	59,000						
Six years later	20,000	2,073,000	107,000	227,000							
Seven years late	20,000	2,073,000	107,000								
Eight years later	20,000	2,073,000									
Nine years later	20,000										
Current estimate of ultimate	20,000	2,073,000	107,000	227,000	59,000	222,000	218,000	950,000	360,000	208,000	<b>4,444,000</b>
Cumulative payments	(20,000)	(2,073,000)	(107,000)	(203,000)	—	(25,000)	—	(107,000)	—	—	<b>(2,535,000)</b>
Net liability	—	—	—	24,000	59,000	197,000	218,000	843,000	360,000	208,000	<b>1,909,000</b>
Provision for unpaid claims and adjusting expenses											
recoverable from insurers											
Ten year net liability											<b>1,909,000</b>
Effect of discounting and PFAD											<b>2,884,000</b>
Unallocated loss adjustment expense											<b>2,696,000</b>
Provision for unpaid claims and adjusting expenses recoverable											<b>87,941,000</b>
Gross liability in statement of financial position											<b>95,430,000</b>

## **11. Risk management (continued)**

### *Sensitivities*

The insurance claim liabilities are sensitive to the key assumptions that follow. It has not been possible to quantify the sensitivity of certain assumptions such as legislative changes or uncertainty in the estimation process.

The table below shows the effect on net income and equity of a +/- 5% change in the expected losses and the effect of a +/- 0.5% change in the discount rate applied to claims provisions for the year ended December 31, 2018

	<b>2018</b>		<b>2017</b>	
	<b>Net income for the year</b>	<b>Equity</b>	<b>Net income for the year</b>	<b>Equity</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
5% increase in expected losses	(106,000)	(106,000)	(141,000)	(141,000)
5% decrease in expected losses	157,000	157,000	92,000	92,000
0.5% increase in discount rate	151,000	151,000	161,000	161,000
0.5% decrease in discount rate	(156,000)	(156,000)	(168,000)	(168,000)

### Financial risk management

The Society has policies related to the identification, monitoring and mitigation of risks associated with financial instruments. The key risks related to financial instruments are credit risk, liquidity risk and market risk (interest rate, equity and currency). The following describes how the Society manages each of these risks.

#### *(a) Credit risk*

Credit risk is the risk of loss due to the failure of debtors to make payments when due. Credit risks are primarily associated with invested assets and amounts due from policyholders and reinsurance counterparties. The investment portfolio's exposure to credit risk is managed through policies and procedures including a credit evaluation by the investment manager and investment guidelines which specify investment quality and exposure limits. The portfolio is monitored and reviewed regularly by the Board. Premiums due from policyholders present minimal risk due to the short term nature of the receivable and the historic/financial relationship with the Society as a Reciprocal Insurance Exchange. The Society evaluates the financial condition of its reinsurers and monitors concentrations of credit risk of the reinsurers to minimize its exposure to significant losses from their insolvency. The Society believes that it has taken appropriate steps to manage credit risk and has made appropriate provision for any such exposures. One of the primary reinsurers is Colchester Reinsurance Limited as discussed in Note 8. The credit risk related to Colchester is managed by maintaining a security account pursuant to the RSA and a quarterly review of Colchester's financial condition. The balance held in the account at December 31, 2018 is \$49,017,698 (\$62,034,333 in 2017).

## **11. Risk management (continued)**

### *Financial risk management (continued)*

#### *(a) Credit risk (continued)*

##### *(i) Exposure to credit risk*

The following table summarizes the exposure to credit risk related to financial instruments and certain insurance assets at carrying value.

	<b>2018</b>	2017
	\$	\$
Cash	<b>5,081,001</b>	3,140,371
Short term investments	<b>7,128,611</b>	11,745,460
Bonds	<b>5,911,332</b>	5,091,893
Interest income due and accrued	<b>20,988</b>	18,532
Premiums receivable	<b>1,635,998</b>	1,782,634
Reinsurance recoverable	<b>2,996,041</b>	617,756
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	<b>87,941,000</b>	96,568,000
Total credit exposure	<b>110,714,971</b>	118,964,646

##### *(ii) Concentration of credit risk*

The Society utilizes an investment policy to minimize the concentration of credit risk by ensuring diversification across asset classes. The following table summarizes the distribution of investments by credit risk:

	<b>2018</b>	2017
	%	%
R-1 (high)	<b>55%</b>	70%
AAA	<b>11%</b>	7%
AA	<b>34%</b>	23%
	<b>100%</b>	100%

## 11. Risk management (continued)

### *Financial risk management (continued)*

#### *(b) Liquidity risk*

Liquidity risk is the risk that the Society will not be able to meet all cash outflow obligations as they come due. The primary potential cash outflow is the payment of insurance claims and is represented by the provision for unpaid claims and adjustment expenses liability on the statement of financial position. In order to manage the liquidity risk associated with this liability, an investment policy is in place. A summary of the invested assets by term to maturity is provided in Note 4. The following table summarizes the exposure to liquidity risk:

December 31, 2018				
	Due within 1 year	1 to 5 year	Over 5 years	Total
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses (net)	1,079,000	3,786,000	2,624,000	7,489,000
Due to reinsurers	1,935,175			1,935,175
Accounts payable and accrued charges	335,152			335,152
	<b>3,349,327</b>	<b>3,786,000</b>	<b>2,624,000</b>	<b>9,759,327</b>

  

December 31, 2017				
	Due within 1 year	1 to 5 year	Over 5 years	Total
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses (net)	1,159,000	3,918,000	2,854,000	7,931,000
Due to reinsurers	1,649,031	—	—	1,649,031
Accounts payable and accrued charges	513,612	—	—	513,612
	<b>3,321,643</b>	<b>3,918,000</b>	<b>2,854,000</b>	<b>10,093,643</b>

#### *(c) Market risk*

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity markets and foreign currency rates. The primary market risk exposures are discussed below.

##### *(i) Interest rate risk*

Interest rate risk is the risk of financial loss arising from changes in interest rates. Fluctuations in interest rates will impact the market value of the fixed income portion of the investment portfolio. Interest rate fluctuations may create unrealized gains or losses which are recorded as OCI, however, these assets are ordinarily held until maturity which would result in a recovery of par value. A portion of these assets support the net provision for unpaid claims and adjustment expenses which is calculated, in part, using a discount factor based on the market rate of return of the investment portfolio.



## **11. Risk management (continued)**

### *Financial risk management (continued)*

#### *(c) Market risk (continued)*

##### *(i) Interest rate risk (continued)*

The Society is exposed to interest rate risk if the cash flows from the investments are not matched to the liabilities that they support. This risk is partially mitigated by the investment policy which specifies that the timing of the settlement of unpaid claims be considered when selecting the duration of invested assets.

The estimated impact of a 1% increase in interest rates would decrease the market value of the fixed income portion of the investment portfolio by \$326,288 (\$301,584 in 2017) which would be recorded in OCI. This impact would be offset on an economic basis by a decrease in the estimated unpaid claims and adjustment expense of \$297,000 (\$317,000 in 2017) recorded through income. Conversely, a 1% decrease in interest rates would increase the market value of the fixed income portion of the investment portfolio by \$241,045 (\$232,419 in 2017) which would be recorded in OCI. This impact would be more than offset on an economic basis by an increase in the estimated unpaid claims and adjustment expense of \$319,000 (\$342,000 in 2017) recorded through net income.

##### *(ii) Equity risk*

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. To mitigate this risk, the Society's investment policy does not allow exposure to equity markets.

##### *(iii) Currency risk*

The Society does not have any material exposure to foreign currency.

## **12. Surplus management and adequacy**

Equity is comprised of minimum and additional surplus and AOCI. At December 31, 2018, the equity was \$12,333,154 (\$11,547,191 in 2017). The Society's objectives for the management of surplus are for the prudent operation of the reciprocal and to provide relatively predictable premium costs for its members over time. A surplus management policy is approved by the Advisory Board which oversees the surplus management process.

As a reciprocal insurance exchange, the requirement for surplus is lower than that of an incorporated insurance company. A reciprocal may rely on the contractual agreement among its members to contribute to the losses incurred by other members and to make assessments for additional contributions to surplus if required and accordingly, can rely on the credit worthiness of its subscribers.

The Society is regulated by the Superintendent of Insurance, Alberta and in British Columbia, Ontario and Nova Scotia where licenses are held, all of which expect incorporated insurance companies to meet a Minimum Capital Test ("MCT") ratio of capital available to capital required of at least 150%. As of December 31, 2018, the Society's MCT was 496.27% (451.27% in 2017). However, the minimum regulatory standard for reciprocals in Alberta is adjusted equity exceeding \$50,000. The Society's practice is to maintain a surplus level which is significantly higher than the regulatory minimum. The Society's surplus adequacy is evaluated regularly and this evaluation takes into account the gross exposure to risk, the level and nature of reinsurance purchased and the resulting net exposure to members. Input from the appointed actuary, which includes an assessment of loss volatility, is factored into this evaluation.

## 12. Surplus management and adequacy (continued)

In accordance with sections 99 and 100 of the Alberta Insurance Act, the Society is required to maintain a reserve and guarantee fund. At December 31, 2018 the total reserve and guarantee funds required are as follows:

	<b>2018</b>	2017
	<b>\$</b>	<b>\$</b>
Reserve fund		
Net premiums written during the period	<b>7,391,000</b>	7,138,000
Less: Amounts paid to licensed reinsurers	<b>5,465,000</b>	5,075,000
	<b>1,926,000</b>	2,063,000
Requirement	<b>50%</b>	50%
	<b>963,000</b>	1,031,500
Guarantee fund		
Total liabilities	<b>101,365,000</b>	110,202,000
Less: Unearned premiums	<b>3,665,000</b>	3,540,000
Recoverable from licensed reinsurers	<b>87,357,000</b>	95,515,000
Add: Statutory margin	<b>50,000</b>	50,000
	<b>10,393,000</b>	11,197,000
Total of reserve and guarantee fund	<b>11,356,000</b>	12,228,500
Cash and approved securities	<b>18,121,000</b>	19,978,000
Excess of cash and securities over reserve and guarantee fund	<b>6,765,000</b>	7,749,500

## 13. Fair value disclosure

The fair value of the following classes of financial instruments is deemed to approximate carrying value due to the immediate or short term maturity of the financial instruments.

- (a) Cash at bank
- (b) Interest income due and accrued
- (c) Premiums receivable
- (d) Premium taxes receivable
- (e) Reinsurance receivable
- (f) Due to reinsurers
- (g) Accounts payable and accrued charges

#### **14. Contingent Liability**

The Society's Reciprocal Insurance Exchange Agreement (the "Agreement") contains provisions addressing the rights and liabilities of a Subscriber (a "Departing Subscriber") which elects to withdraw from the Society at the end of an Underwriting Period. These include the obligation of the Society to pay to the Departing Subscriber the amount of declared credits or the obligation of the Departing Subscriber to pay to the Society the amount of declared assessments, in each case, based on the Departing Subscriber's participation in the Society. Any such payment obligation to or by a Departing Subscriber is to be determined and paid subsequent to the fifth anniversary of the date of departure of the Departing Subscriber.

A Subscriber elected to withdraw from the Society on June 30, 2012 and, accordingly, a determination of a payment obligation to or by such Departing Subscriber was made subsequent to June 30, 2017. The obligations of the Society and the Departing Subscriber under the Agreement continue to apply, and a determination of any further payment obligation to or by the Departing Subscriber will be made subsequent to June 30, 2022. In the event that it is determined that the Society has a payment obligation to such Departing Subscriber, then depending on the amount of such payment obligation and the amount of the Society's equity at that time, such payment obligation may have a material effect on the equity position of the Society.

A Subscriber elected to withdraw from the Society on June 30, 2017 and, accordingly, a determination of any payment obligation to or by such Departing Subscriber will be made subsequent to June 30, 2022. In the event that it is determined that the Society has a payment obligation to such Departing Subscriber, then depending on the amount of such payment obligation and the amount of the Society's equity at that time, such payment obligation may have a material effect on the equity position of the Society.

#### **15. Date of authorization for issue**

The financial statements were authorized for issue by the Advisory Board on February 26, 2019.