

Financial statements of

Canadian Lawyers Liability Assurance Society

December 31, 2017

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Independent Auditor's Report

To the Advisory Board of
Canadian Lawyers Liability Assurance Society

We have audited the accompanying financial statements of Canadian Lawyers Liability Assurance Society, which comprise the statement of financial position as at December 31, 2017, and the statements of comprehensive income (loss), changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, 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.

Auditor's Responsibility

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Canadian Lawyers Liability Assurance Society as at December 31, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



Chartered Accountants
Licensed Public Accountants
February 22, 2018

Canadian Lawyers Liability Assurance Society
Statement of financial position
As at December 31

	2017	2016
	\$	\$
Assets		
Cash at bank	3,140,371	4,731,655
Short term investments (Note 4)	11,745,460	11,587,109
Bonds (Note 4)	5,091,893	5,150,585
Interest income due and accrued	18,532	21,121
Premiums receivable (Note 6)	1,782,634	2,520,380
Prepaid expenses	139,500	139,500
Deferred policy acquisition costs	103,310	154,221
Reinsurers' share of unearned premiums	2,541,253	4,182,181
Reinsurance receivable	617,756	837,614
Provision for unpaid claims and adjustment expenses recoverable from reinsurers (Note 5)	96,568,000	94,794,000
Total assets	121,748,709	124,118,366
Liabilities		
Accounts payable and accrued charges	513,612	643,905
Unearned premiums	3,539,875	5,261,568
Due to reinsurers	1,649,031	2,514,054
Provision for unpaid claims and adjustment expenses (Note 5)	104,499,000	101,247,000
Total liabilities	110,201,518	109,666,527
Equity		
Minimum surplus (Note 12)	50,000	50,000
Additional surplus (Note 12)	11,518,960	14,340,229
Accumulated other comprehensive (loss) income	(21,769)	61,610
Total equity	11,547,191	14,451,839
Total liabilities and equity	121,748,709	124,118,366

Accompanying notes are an integral part of the financial statements.

On behalf of the Advisory Board

Chair of the Audit Committee

Director

Ken Crofoot

Canadian Lawyers Liability Assurance Society**Statement of comprehensive income (loss)**

Years ended December 31

	2017	2016
	\$	\$
Premiums		
Written premiums	7,138,422	10,610,344
Reinsurance ceded	5,124,626	8,433,679
Net written premiums	2,013,796	2,176,665
Change in unearned premiums	80,765	121,054
Earned premiums	2,094,561	2,297,719
Expenses		
Claims (Note 5)	1,286,787	(155,233)
Premium deficiency adjustment	-	-
Operating expenses (Note 7)	2,072,921	1,965,608
Premium taxes	257,531	327,434
	3,617,239	2,137,809
Underwriting (loss) income for the year	(1,522,678)	159,910
Investment income (Note 4)	201,409	170,280
Net (loss) income for the year	(1,321,269)	330,190
Change in unrealized losses on available-for-sale financial assets arising during the year	(83,379)	(65,817)
Other comprehensive loss	(83,379)	(65,817)
Comprehensive (loss) income	(1,404,648)	264,373

Accompanying notes are an integral part of the financial statements.

Canadian Lawyers Liability Assurance Society

Statement of changes in equity

Years ended December 31

	Minimum surplus	Additional surplus	Accumulated other comprehensive income	Total equity
	\$	\$	\$	\$
Balance December 31, 2015	50,000	14,010,039	127,427	14,187,466
Net income (loss)	-	330,190	-	330,190
Other comprehensive income (loss)	-	-	(65,817)	(65,817)
Balance December 31, 2016	50,000	14,340,229	61,610	14,451,839
Net income (loss)	-	(1,321,269)	(83,379)	(1,404,648)
Other comprehensive income (loss)	-	(1,321,269)	(83,379)	(1,404,648)
Refund of premium surplus	-	(1,500,000)	-	(1,500,000)
Balance December 31, 2017	50,000	11,518,960	(21,769)	11,547,191

Accompanying notes are an integral part of the financial statements.

Canadian Lawyers Liability Assurance Society**Statement of cash flows**

Years ended December 31

	2017	2016
	\$	\$
Operating activities		
Net (loss) income for the year	(1,321,269)	330,190
Changes in non-cash items:		
Interest income due and accrued	2,589	(1,185)
Premiums receivable	737,746	1,539,211
Reinsurers' share of unearned premiums	1,640,928	802,666
Deferred policy acquisition costs	50,911	18,992
Reinsurance receivable	219,858	759,678
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	(1,774,000)	1,326,000
Provision for unpaid claims and adjustment expenses	3,252,000	(1,261,000)
Premium deficiency liability		
Unearned premiums	(865,023)	(923,721)
Due to reinsurers	(1,721,693)	1,004,716
Accounts payable and accrued charges	(130,292)	(266,784)
Amortization of bond premium	(40,908)	(26,740)
Amortization of bond discount	8,885	8,408
Cash (used in) provided by operating activities	59,732	3,310,431
Financing activities		
Refund of premium surplus	(1,500,000)	0
Investing activities		
Purchase of bonds	(559,485)	(1,227,445)
Disposal of bonds	530,000	800,000
Purchase of short term investments	(70,356,401)	(60,702,487)
Disposal of short term investments	70,234,870	57,542,744
Cash provided by (used in) investing activities	(151,016)	(3,587,188)
Net (decrease) increase in cash	(1,591,284)	(276,757)
Cash balance, beginning of year	4,731,655	5,008,412
Cash balance, end of year	3,140,371	4,731,655
Cash balance comprises		
Cash at bank	3,140,371	4,731,655
Interest received	171,976	150,763

Accompanying notes are an integral part of the financial statements.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

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 RBC Centre, 155 Wellington Street West, 40th Floor, Toronto, Ontario, M5V 3J7.

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 (2016 - \$150,000) 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 revaluation 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.

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, 2021:

- 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, 2021.

The Society intends to adopt the temporary exemption, and adopt amendments to IFRS 4 in its financial statements for the annual period beginning on January 1, 2018. The Society does not expect the amendments to have a material impact on the financial statements.

3. Significant accounting policies (continued)

Future accounting changes (continued)

(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 intends to adopt the temporary exemption described previously, and will adopt the amendments to IFRS 9 in its financial statements for the annual period beginning on January 1, 2021. 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, 2021. 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 January 1, 2021. The extent of the impact of adoption of the standard has not yet been determined.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

4. Investments

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

	December 31, 2017		December 31, 2016	
	Fair value and carrying value	Amortized cost	Fair value and carrying value	Amortized cost
	\$	\$	\$	\$
Short term investments	11,745,460	11,757,685	11,587,109	11,595,247
Bonds	5,091,893	5,101,437	5,150,585	5,080,837
	16,837,353	16,859,122	16,737,694	16,676,084

The difference between amortized cost and market value of the AFS investments consists of gross unrealized gains of \$ 39,896 (2016: \$98,851) and gross unrealized losses of \$ 61,665 (2016: \$37,241).

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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

4. Investments (continued)

b) Maturity profile of investments as at December 31:

2017	Term to maturity			Total
	Within 1	1 - 5	Over	
	year	years	5 years	
	\$	\$	\$	\$
Short-term investments	11,745,460			11,745,460
Government of Canada bonds	250,531	453,264	499,246	1,203,041
Canadian public authorities bonds	351,463	521,034	1,106,356	1,978,853
Canadian corporate bonds	200,316	1,357,907	351,776	1,909,999
Total fair value	12,547,770	2,332,205	1,957,378	16,837,353

2016	Term to maturity			Total
	Within 1	1 - 5	Over	
	year	years	5 years	
	\$	\$	\$	\$
Short-term investments	11,587,109			11,587,109
Government of Canada bonds	-	509,035	716,642	1,225,677
Canadian public authorities bonds	332,638	625,574	1,020,583	1,978,795
Canadian corporate bonds	201,684	1,188,386	556,043	1,946,113
Total fair value	12,121,431	2,322,995	2,293,268	16,737,694

c) Net investment income has the following components:

	2017	2016
	\$	\$
Interest income		
Bonds	84,177	114,354
Cash, cash equivalents and short term investments	85,209	37,594
	169,386	151,948
Amortization of discount (premium) on investments	32,023	18,332
Realised gain (loss) on disposal	-	-
Total net investment income	201,409	170,280

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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

4. Investments (continued)

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

December 31, 2017	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
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

December 31, 2016	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Cash at bank	4,731,655	-	-	4,731,655
Investments - available-for-sale				
Short term investments	-	11,587,109	-	11,587,109
Bonds	-	5,150,585	-	5,150,585
	4,731,655	16,737,694	-	21,469,349

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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

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, 2015	102,508,000	96,120,000	6,388,000
Incurring claims and claim adjustment expenses			
Provision for current year claims	7,315,000	6,730,000	585,000
Increase (decrease) in provision for claims of prior years	(6,037,231)	(5,363,998)	(673,233)
Increase (decrease) in provision due to discount rate change	(1,036,000)	(969,000)	(67,000)
Total incurred	241,769	397,002	(155,233)
Payments and recoveries attributable to			
Current year claims	-	-	-
Prior years claims	(1,502,769)	(1,723,002)	220,233
	(1,502,769)	(1,723,002)	220,233
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

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, 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

December 31, 2016

	Undiscounted \$	Discounted at 1.75% \$	Provisions for adverse deviation \$	Value per accepted actuarial practice \$
Provision for unpaid claims and adjustment expenses				
Gross	99,825,000	92,907,000	8,340,000	101,247,000
Recoverable from reinsurers	96,644,000	89,961,000	4,833,000	94,794,000
Net	3,181,000	2,946,000	3,507,000	6,453,000

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

5. Unpaid claims and adjustment expenses (continued)

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 2.15% (2016: 1.75%) 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.

Changes in the assumptions used in the December 31, 2017 actuarial valuation resulted in a total decrease in net liabilities of \$745,000 (2016: decrease of \$70,000), which is due to the change in loss development factors used in the Bornhuetter-Ferguson method and unallocated loss adjustment expense load increased from 1.95% to 2.60% (2016: Remained at 1.95%). The change in the discount rate led to a further increase in the net liabilities of \$134,000 (2016: increase of \$67,000).

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, 2018.

7. Expenses by nature

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

	2017	2016
	\$	\$
Management services	997,006	992,220
Legal and professional	843,829	686,964
Other expenses	232,086	286,424
Total	2,072,921	1,965,608

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

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, 2017 (July 1, 2016: \$975,000) 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, 2017, Colchester received from the Society premiums of \$209,798 (July 1, 2016: \$1,594,237).

Colchester provides aggregate stop-loss reinsurance protection for a portion of the Society's retained risk. On July 1, 2017 this reinsurance had an attachment point of \$5,000,000 (July 1, 2016: \$5,000,000), and an annual aggregate limit of \$10,000,000 (July 1, 2016: \$10,000,000). 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.

- 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, 2017, the total reserves held and recoverable on the Society's financial statements relating to LPT was \$17,961,185 (2016 - \$18,872,183). 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, 2017 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.

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:

Canadian Lawyers Liability Assurance Society

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For the year ended December 31, 2017

11. Risk management (continued)

Analysis of claims development - net and gross

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Estimate of ultimate (by underwriting year):											
End of year	8,150,000	8,797,000	8,322,000	4,665,000	463,000	411,000	440,000	424,000	444,000	192,000	
One year later	7,626,000	9,329,000	9,795,000	107,000	423,000	380,000	413,000	392,000	1,062,000		
Two years later	5,524,000	8,299,000	2,073,000	107,000	334,000	269,000	308,000	281,000			
Three years later	4,419,000	20,000	2,073,000	107,000	435,000	197,000	284,000				
Four years later	5,000	20,000	2,073,000	107,000	362,000	131,000					
Five years later	5,000	20,000	2,073,000	107,000	281,000						
Six years later	5,000	20,000	2,073,000	107,000							
Seven years later	5,000	20,000	2,073,000								
Eight years later	5,000	20,000									
Nine years later	5,000										
Current estimate of ultimate	5,000	20,000	2,073,000	107,000	281,000	131,000	284,000	281,000	1,062,000	192,000	4,436,000
Cumulative payments	(5,000)	(20,000)	(2,073,000)	(107,000)	(203,000)	-	(17,000)	-	(29,000)	-	(2,454,000)
Net liability	-	-	-	-	78,000	131,000	267,000	281,000	1,033,000	192,000	1,982,000

Provision for unpaid claims and adjusting expenses recoverable from insurers

Nine year net liability	1,982,000
Effect of discounting and PFAD	3,299,000
Unallocated loss adjustment expense	2,650,000
Provision for unpaid claims and adjusting expenses recoverable	96,568,000
Gross liability in statement of financial position	104,499,000

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, 2017.

	Net income for the year	Equity	Net income for the year	Equity
	\$	\$	\$	\$
5% increase in expected losses	141,000	141,000	130,000	130,000
5% decrease in expected losses	(92,000)	(92,000)	(133,000)	(133,000)
0.5% increase in discount rate	(161,000)	(161,000)	(131,000)	(131,000)
0.5% decrease in discount rate	168,000	168,000	136,000	136,000

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, 2017 is \$62,034,333 (2016 - \$66,799,000).

Canadian Lawyers Liability Assurance Society**Notes to the financial statements**

For the year ended December 31, 2017

11. 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.

	<u>2017</u>	<u>2016</u>
	\$	\$
Cash	3,140,371	4,731,655
Short term investments	11,745,460	11,587,109
Bonds	5,091,893	5,150,585
Interest income due and accrued	18,532	21,121
Premiums receivable	1,782,634	2,520,380
Reinsurance recoverable	617,756	837,614
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	96,568,000	94,794,000
Total credit exposure	118,964,646	119,642,464

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:

	<u>2017</u>	<u>2016</u>
R-1 (high)	70%	70%
AAA	7%	7%
AA	23%	23%
	100%	100%

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:

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

11. Risk management (continued)

b) Liquidity risk (continued)

	December 31, 2017			
	Due within 1 year	1 to 5 years	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
Total	3,321,643	3,918,000	2,854,000	10,093,643

	December 31, 2016			
	Due within 1 year	1 to 5 years	Over 5 years	Total
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses (net)	1,097,000	3,014,000	2,342,000	6,453,000
Due to reinsurers	2,514,054	-	-	2,514,054
Accounts payable and accrued charges	643,905	-	-	643,905
Total	4,254,959	3,014,000	2,342,000	9,610,959

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.

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 \$301,584 (2016: \$291,878) which would be recorded in OCI. This impact would be more than offset on an economic basis by a decrease in the estimated unpaid claims and adjustment expense of \$317,000 (2016: \$258,000) 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 \$232,419 (2016: \$250,135) 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 \$342,000 (2016: \$278,000) recorded through net income.

11. Risk management (continued)

c) Market risk (continued)

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, 2017, the equity was \$11,547,191 (2016: \$14,451,839). 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, 2017, the Society's MCT was 451.27% (2016: 464.23%). 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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2017

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, 2017 the total reserve and guarantee funds required are as follows:

	2017	2016
	\$	\$
Reserve fund		
Net premiums written during the period	7,138,000	10,610,000
Less: Amounts paid to licensed reinsurers	5,075,000	8,347,000
	2,063,000	2,263,000
Requirement	50%	50%
	1,031,500	1,131,500
Guarantee fund		
Total liabilities	110,202,000	109,667,000
Less: Unearned premiums	3,540,000	5,262,000
Recoverable from licensed reinsurers	95,515,000	93,713,000
Add: Statutory margin	50,000	50,000
	11,197,000	10,742,000
Total of reserve and guarantee fund	12,228,500	11,873,500
Cash and approved securities	19,978,000	21,469,000
Excess of cash and securities over reserve and guarantee fund	7,749,500	9,595,500

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 recoverable
- 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. In 2017, the Society paid the Departing Subscriber \$1,500,000 by means of refund of premium surplus. 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.

Another 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 22, 2018.