



Remarks of the Chair

Although the turmoil associated with the economic crisis of 2008/09 is largely behind us – certainly investment markets have rebounded, and our housing markets and employment statistics are stable – that crisis has fundamentally changed the regulatory environment in which companies, especially those in the financial sector, operate.

Today, banks and insurance companies such as LAWPRO are under increased scrutiny from their regulators: Solvency tests are more stringent, the benchmarks against which we are measured higher, and disclosure requirements more extensive – and growing. The bottom line: Robust financial results are in order.

The most important of our benchmarks – the Minimum Capital Test (“MCT”) as set by LAWPRO’s principal regulator, the Financial Services Commission of Ontario – is a case in point. At December 31, 2010, the company’s MCT ratio was 226 per cent compared to 206 per cent a year earlier. However, a pending change to the way the MCT is calculated could result in a significant drop in all insurers’ MCTs, without the companies themselves making any changes to their underlying business. So, the better a company’s MCT is today, the better it will be able to cushion itself against the fallout from the new MCT calculation when it comes.

Equally challenging are the evolving new financial reporting standards being adopted by the accounting profession in many parts of the world. These new International Financial Reporting Standards (“IFRS”) not only require significantly more disclosure (the Notes that accompany our financial statements could be twice as long next year), but could also dramatically affect how we treat funds held in reserve to pay for claims in the future.

Stacked up against these pressures, LAWPRO’s solid and stable financial results for 2010 are reassuring and just what the doctor ordered. They put the company in a better position to weather the coming changes that may adversely affect our financial results and will fundamentally change the way this Board reports those results publicly.

Certainly a net income of \$15.2 million looks good at first blush.

But this solid result does not mean lawyers are reporting fewer claims. Instead, it is largely the result of a revision to the actuarial models LAWPRO uses to project ultimate claims costs. Initiated two years ago and developed with the assistance of external actuaries, this revision addresses the need for an actuarial tool that provides more robust predictions in ultimate claims costs for the insurance program. The revision relies heavily on the fact that LAWPRO now has more than 10 years of claims experience to draw on since the original models were adopted in 2001, and was vetted by members of the LAWPRO Board with extensive experience in the insurance industry.

Under the new models, LAWPRO was able to release more than \$20 million of gross claims reserves, contributing to overall claims costs in the 2010 financial statements of just under \$80 million. This release of reserve funds had a positive effect on both net income of \$15.2 million compared to a loss of \$6.5 million in 2009, and on shareholder’s equity which grew to more than \$159 million from \$141 million in 2009.

Despite this favourable result, all signs point to fact that we have truly arrived at a new era in claims. In 2010, the number of claims reported again topped the 2,000 mark. Based on current trends, LAWPRO is projecting total claims costs in the order of \$80 to \$90 million for the 2010 program, once all claims received in 2010 are eventually resolved. This compares unfavourably to the earlier part of this decade when claims costs arising from operating the program for a year were in the \$55 to \$65 million range annually.

Although strong, investment income at just over \$19 million is not at a level that completely offsets this significant increase in claims costs which, as we have said in the past, continues to put pressure on the level of the insurance premium. For 2011, the base premium is \$3,350 – which is about the average level of the premium paid by lawyers over the past 15 years.

To conclude, the Board and management are dealing with extensive new regulatory issues from both our primary regulator and other provincial authorities, the new and as yet poorly defined IFRS accounting rules for insurers, and disturbingly increased claims costs.

The Board is working closely with LAWPRO management to monitor these challenges and others as they evolve. The positive results of 2010 reflect well on the leadership and expertise of the management team. On behalf of the members of the Board, I thank them for their extraordinary efforts and commitment.

I am also indebted to my fellow Board members for the rigor, commitment and insights that they brought to the table as we addressed many difficult issues in 2010.

We live in interesting times.

Ian D. Croft
Chair