LawPRO

2007 Annual Report

Cover image:

The lobby of LAWPRO's new premises at 250 Yonge Street.

Planning for our move in early 2008 involved all areas of the company as we re-engineered processes and streamlined operations to minimize the costs of relocating employees and infrastructure.

Contents

About LAWPRO®

Lawyers' Professional Indemnity Company (LAWPRO) is licensed to provide professional liability insurance and title insurance in numerous jurisdictions across Canada.

In 2007, LAWPRO provided liability insurance to about 21,100 members of the Law Society of Upper Canada. Through our TitlePLUS® operation, LAWPRO also provides comprehensive title insurance and legal services coverage for residential and commercial purchase and mortgage-only/refinance transactions handled by lawyers.

Our mission

To be an innovative provider of insurance products and services that enhance the viability and competitive position of the legal profession.

Remarks of the Chairman

Recent events have again demonstrated that LAWPRO is well positioned to anticipate – and respond to – the changing environment.

In early 2008, Kim Carpenter-Gunn, Chairman of the LAWPRO Board since 2002, was appointed to the Superior Court of Ontario, leaving the Board without a Chairman. As Vice-Chairman of the LAWPRO Board since 1996, I am honoured that members of our Board have asked me to fill this vacancy.

In 2007 President and Chief Executive Officer Michelle Strom informed the Board that she intended to retire within the year. Michelle has been an integral part of LAWPRO's success since 1995 and has been its President and CEO for the last seven years. After an extensive search both within and outside of the company, a Search Committee of the Board recommended, and the Board approved, the appointment of Kathleen Waters, formerly Vice-President, TitlePLUS, as President and CEO, effective March 31st, 2008. She provides both continuity and a fresh new perspective as LAWPRO embarks on the next phase of its evolution.

In their respective roles, Kim and Michelle have each contributed to the success and strength of the company. On behalf of the Board of Directors, I thank them for their hard work, vision and commitment. We all wish them the very best in their new endeavours.

As Chairman of the LAWPRO Board, I am pleased to report that prudent fiscal management and sound investment strategies over the years have again led to excellent financial results at LAWPRO – and provided the Board with the manoeuvring room to reduce insurance premiums for 2008 without losing sight of the need for caution on the emerging claims scenario.

Solid claims handling, a reduction in reserves for previous years' claims, as well as a $7.2 million increase in investment income to $25.9 million, led to a healthy net income of $17.6 million for 2007. As well, the company has assets of $481.5 million and shareholder's equity of $135.8 million at December 31, 2007. LAWPRO's solid financial position was again confirmed by A.M. Best, a leading insurance company rating agency, which awarded the company an "A" rating for the eighth consecutive year.

This sound footing and favourable results of the past few years enabled the Board to approve a $300 reduction in insurance premiums for 2008; at $2,300, the base premium is now the lowest it has been since 1995. LAWPRO's ability to lower premiums in a prudent manner in 2007 speaks to the company's financial soundness, its commitment to the profession and its long-term planning horizon which includes diligent monitoring of changes in the economic climate and assessment of the emerging claims environment. However, higher claims numbers reported for the second consecutive fund year in 2007 coupled with predictions of economic slowdown will be important factors to consider while managing premium levels going forward.

Much has changed at LAWPRO in the past year: It relocated its offices, consolidating staff on one floor; it introduced process improvements to streamline operations in anticipation of the move; and it is led by a new president with new plans and priorities. LAWPRO is well positioned to continue delivering on its mission: To be an innovative provider of insurance products and services that enhance the viability and competitive position of the legal profession.

Ian D. Croft
Chairman

Remarks of the Retiring President & CEO

This, my last annual report as LAWPRO President and CEO, finds me in a reflective mood. Over the past seven years, I have been privileged to lead an exceptional organization and a team of talented, dedicated professionals. Together, we have strengthened the company, developed its potential, weathered a storm or two and innovated for the benefit of our many stakeholders.

The LPIC of 2001 is different from the LAWPRO of today in more than name. Back then, we were just coming out of what I would call our "entrepreneurial" stage: We had built the infrastructure – the people, processes, procedures – needed for a brand-new insurance company. We wrestled claims under control, retired a sizeable deficit in the previous insurance program, and launched two exciting new risk management ventures – the practicePRO and TitlePLUS programs. It was time to reflect, to refocus and guide the company into maturity.

The rebranding of LPIC into LAWPRO in 2002 was an important first step – and one that reflected a new way of thinking. Our decision to hold all risk within our program, rather than to reinsure in what had become an increasingly difficult reinsurance market post 9/11, signaled our coming of age: The company had both the capital and confidence to go it alone. This decision alone has saved the bar tens of millions of dollars over the past five years. The strength and stability of our insurance operations, and our expert claims management have earned LAWPRO consistent "A" ratings from a leading rating agency.

The complexity of LAWPRO's products and programs has evolved to meet the evolving needs of the bar. Modifications to the insurance program supported pro bono practice, mobility, regulatory changes to real estate practice and more. The TitlePLUS program expanded from a small regional base to being a significant player on the national title insurance stage; it is the only Canadian title insurer with membership in a North American organization of title insurers committed to advancing the role of the real estate bar. Our practicePRO risk management program is now an acknowledged leader in its field; its materials are reproduced around the world, and its expertise sought at conferences and seminars across North America.

We also have taken the lead in representing the interests of the bar. For example, we not only educated lawyers about business continuity/disaster planning, but also led by example, developing robust plans and procedures that would ensure LAWPRO operations can continue no matter what. Today, we head a multi-stakeholder group working to fight fraud. We are regularly consulted on legislative changes affecting Ontario lawyers; and we lend our expertise to task forces and groups studying practice-related changes.

LAWPRO's move into new premises in early 2008, and the appointment of Kathleen Waters, formerly Vice-President of TitlePLUS, as my successor signals the start of a new era. With this transition, I feel satisfied that LAWPRO can continue to serve the needs of the bar without losing any momentum. I am extremely proud of the entire LAWPRO team, of our accomplishments and of the direction in which we have steered the company – and thank each and every member of the LAWPRO team for their dedication and commitment to our common vision over the past seven years.

Michelle L.M. Strom
Retiring President & CEO

Remarks of the Incoming President and CEO

The opportunity to lead an insurance organization such as LAWPRO is both an honour and a tremendous responsibility.

As has been documented elsewhere in this annual report, the company is a role model for lawyers' malpractice insurers. We provide a competitively-priced, flexible, adaptable insurance program that aims to support lawyers' competitiveness in an increasingly challenging practice climate. Our comprehensive websites, proactive risk management ventures – practicePRO and the TitlePLUS program – demonstrate LAWPRO 's client service focus. Expert claims handling and sound financial management have contributed to profitable bottom lines, providing us with the flexibility to maintain stability in insurance premiums. Most importantly, the team responsible for this impressive track record is committed to building an even stronger insurance organization.

We do not have to look far for new challenges. Weaker investment markets, a slowdown in the real estate sector, a larger and more difficult claims portfolio, and a very competitive title insurance market are among the issues we'll be tracking closely in the next 12 months. But they are not unexpected. And we are well positioned to address these new challenges. Prudent financial management strategies will stand us in good stead as we look to minimize the impact of the changing economy on the insurance program. Principled claims management has helped us keep claims costs in check – and will be even more important if the economy weakens and clients seek to recover losses by criticizing the past services of their lawyers.

What will we do differently? Expect us to be more visible, proactive and innovative. You'll see practicePRO initiatives being promoted by more of our staff in more venues in the coming year. You'll hear more about the benefits of Excess and Innocent Party insurance as we focus on helping lawyers evaluate their exposure to claims. We'll grow the TitlePLUS presence on the national stage, capitalizing on our unique position as the only Canadian Bar-related® title insurer. Our experience in working with many stakeholders on anti-fraud initiatives and implementing new real estate fraud coverage reinforces the need to have a presence in many forums. Expect us to be more proactive in representing the interests of all members of the bar – whether it's at the association, government or media level.

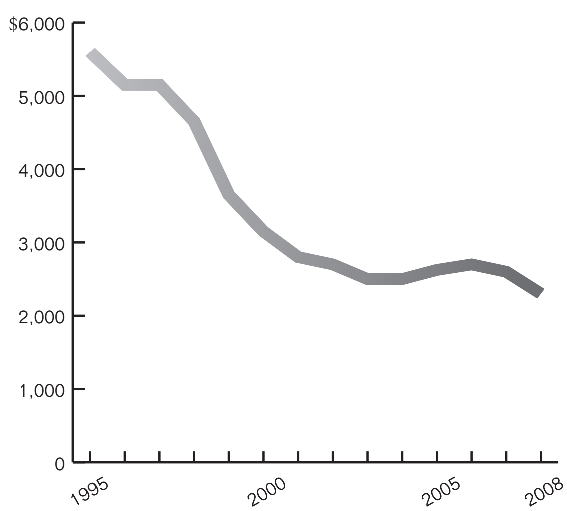
A personal priority is to find the time to interact with all sectors of the bar. One of the most enjoyable aspects of my years in private practice was the exposure to various sectors of practice provided by my repair work in lawyers' liability files. I look forward to widening my horizons again. As Vice-President of TitlePLUS for the past decade, I have become well versed on the needs and concerns of the real estate bar. I've also had the opportunity to develop important contacts with national and international bar-related associations and regulatory bodies, as well as government officials in the financial and legal ministries. I'll be drawing on these experiences and contacts as I travel the province to hear first-hand the views, concerns and insights of as many LAWPRO insureds as possible – and to in turn represent these concerns back to the appropriate bodies, for the benefit of the bar.

Kathleen A. Waters
President & CEO

Although not without its challenges, 2007 was a year of significant accomplishments for LawPRO.

The number of lawyers insured under the LawPRO program now stands at about 21,100, an increase of just under two per cent from 2006. The base insurance premium lawyers pay has dropped significantly over the last two years – from $2,700 in 2006 to $2,300 in 2008. Strong investment results from recent years and favourable claims development relating to prior years enabled us to implement a $300 premium reduction for 2008 without compromising on the need for caution on emerging claims.

Base premium per lawyer



The base premium paid by most Ontario lawyers has remained relatively stable for the past eight years, ranging between $2,300 and $2,800.

A major focus – and consistent with our mandate to evolve the program to meet the bar's needs – was the introduction of a new Real Estate Practice Coverage option for the 2008 program. This coverage responds to the Ontario government's requirement that lawyers who access the province's electronic registration system have in place a prescribed form of insurance coverage to protect against certain types of fraud, and is but one aspect of a fraud prevention initiative launched by the government more than a year ago.

In 2007, LawPRO worked closely with both government and Law Society representatives to provide input to the legislative and procedural changes being considered as part of this anti-fraud initiative. While supporting the general direction of the initiatives, we also advocated for criteria that reflect our commitment to manage the program's exposure to fraud.

Implementation of this new coverage option also involved the development and integration of new technology-based processes and information-sharing protocols – all of them in record time.

By year-end, 6,700 lawyers had purchased this optional Real Estate Practice Coverage as part of their annual LawPRO application filing – a strong endorsement by the bar of this consumer protection measure. The annual $500 premium for this coverage for 2008 was pro-rated to $375 per lawyer in anticipation of a March 31 start date for when this coverage would first be required by the Ontario government.

Lawyers also responded positively to LawPRO's ongoing drive to deliver more programs and services online, via our website and other electronic media. A record 19,462 lawyers – 92 per cent of the practicing bar – filed their 2008 LawPRO insurance application online, the majority of them in time to qualify for the $50 per lawyer e-file discount.

We also attribute a decrease in call volumes in 2007 – despite the introduction of the new Real Estate Coverage – to lawyers' willingness to turn first to our website for information. The easy navigation of our revamped site and volume of information available at lawyers' fingertips enable lawyers to be more self-sufficient in finding information for themselves and completing filings electronically rather than resorting to paper and the mail.

As is discussed later, significant new content was added to both the practicePRO and TitlePLUS websites in 2007. Traffic to our websites (www.lawpro.ca, www.titleplus.ca and www.practicepro.ca) increased 11 per cent in 2007 – evidence that lawyers are not only integrating technology into their practices but also are increasingly turning to LawPRO as an information resource.

LawPRO provides lawyers with many options to customize the insurance program to their specific needs, as indicated in the chart on the following page.

Our own Excess Insurance program continues to grow. Targeted at law firms of up to 50 lawyers, the program in 2008 will insure 1,362 law firms representing 3,578 lawyers – a slight increase from 1,306 firms and 3,507 lawyers in 2007. Of these, 76 firms opted for our new $9 million limit option introduced in 2007 – significantly more than 42 firms in 2007. Our continuing efforts to educate the bar about

Coverage option	Feature	No of lawyers participating (as of Jan. 31, 2008)
New call discount	10-40% base premium discount for those called 1-4 years	3,466
Part-time practice	40% base premium discount for eligible lawyers	1,377
Restricted area of practice option	40% base premium discount for immigration/criminal law practitioners	1,183
Innocent Party Buy-Up	Increase in Innocent Party limits up to $1 million per claim/$1 million aggregate	3,191 (based on $249/lawyer)
Run-Off Buy Up	Increase limits for past services from $250,000 per claim/aggregate up to $1 million per claim/ $2 million aggregate	735
Excess Insurance	Add additional layer of protection of up to $9 million above primary limits of $1 million per claim/ $2 million in the aggregate	3,578 lawyers (1,362 firms)

liability, exposure and the benefits of excess insurance also are successful: Of the 71 new firms insured under LAWPRO's Excess Coverage in 2008, 98 per cent had no previous excess coverage; and 97 per cent of those firms which bought LAWPRO Excess Insurance coverage in 2007 renewed their coverage with LAWPRO for 2008.

Claims trend upwards

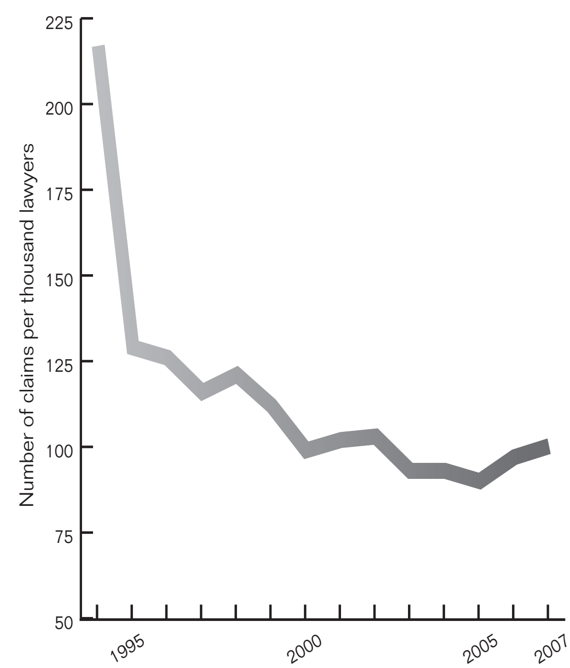
The more demanding business environment in which lawyers operate; the increase in complex and often protracted litigation; and fast-rising property values coupled with an increase in real estate claims are among many factors that are adversely affecting the insurance program. In 2007, for the second consecutive year, claims numbers have increased resulting in higher estimates of overall claims costs.

Lawyers reported 2,153 claims in 2007, a nine per cent increase from the previous year and the highest number of claims reported in a single year since 1995. Although we were able to close more files than the previous year, the number of files open at the end of the year also stands at 2,934 – its highest level in the last 6 years.

It is currently estimated to cost $91 million to resolve all claims (including TitlePLUS claims) arising out of the 2007 fund year. This is largely because we see more claims reported.

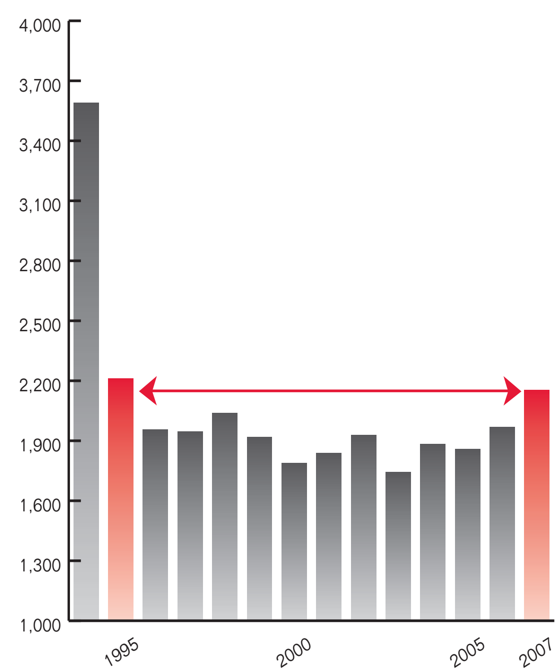
Fraud also continues to be a significant factor in our claims portfolio: The 80 or so claims reported in 2007 that have a fraud component are expected to cost the program between $9 and $10 million – about 10 per cent of our claims costs for the year. Real estate-related fraud continues to represent a major portion of our fraud portfolio, accounting for 63 per cent of fraud-related claims reported and 56 per cent of fraud-

Claims frequency



In 2007, claims frequency (the number of claims per 1,000 lawyers) increased for the second consecutive year. In 2007, 100.2 claims/1,000 lawyers were reported, compared to 97/1,000 lawyers in 2006 and 90/1,000 in 2005.

Number of claims reported



In 2007, 2,153 claims were reported – the highest number of claims reported in a single year since 1995.

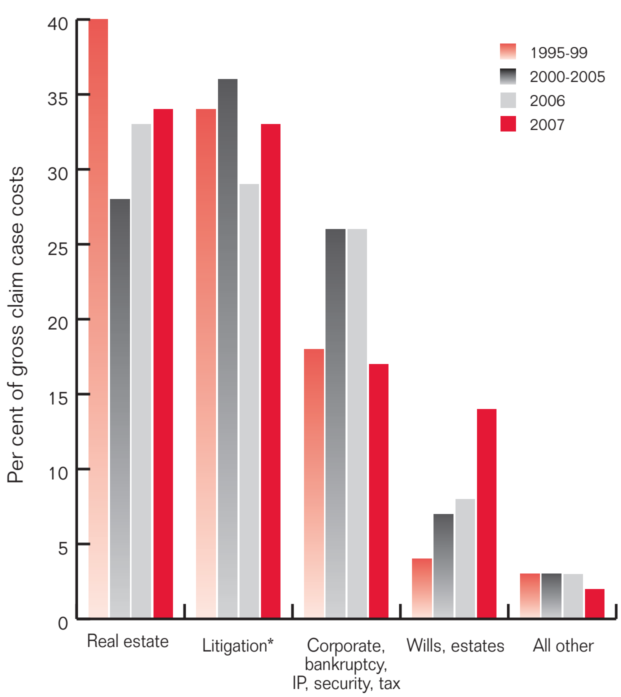
related costs in 2007. Schemes run the gamut from fraud by employees and clients, to fraud where lawyers are complicit.

Despite these challenges, the LAWPRO claims team continues to post impressive results: Of the 1,940 claims closed in 2007, 45 per cent were closed without any payment and 85 per cent without indemnity payment. Our enviable track record at trial too is intact: we won all 11 matters that went to trial, and were successful on five of seven matters that went to the Court of Appeal. As well we were successful on 12 of 16 actions to have matters summarily dismissed.

Our principled approach to claims management which will see us defend claims without merit all the way to trial, also continues to meet with success. We were able to settle 20 matters on the courtroom steps; however these matters are often expensive to defend because all of the preceding steps of litigation have been completed. Defending these files costs us, on average, three times as much as the average defence cost on files closed in 2007.

Two initiatives reflect the claims group's commitment to cost effectiveness. A new best practices protocol assists defence counsel and LAWPRO claims counsel in managing claims involving unrepresented litigants.

Distribution of claims by area of practice
(as at February 29,2008)



*Includes defence and plaintiff litigation, family law and criminal law.

Real estate claims have trended upwards in the past few years, accounting in 2007 for about 34 per cent of claim case costs. Litigation claims too have increased to about 33 per cent of claim case costs compared to 29 per cent in 2006.

Our ongoing recovery/subrogation initiative generated about $950,000 in indemnity and cost recoveries, principally from situations where LAWPRO was successful at trial or on motion, and costs were awarded. A similar initiative for claims made against TitlePLUS policies has a 91 per cent recovery rate track record.

practicePRO takes the lead

LAWPRO's practicePRO program, which in 2008 marks its 10th anniversary, continues to set the tone for risk and practice management initiatives in the legal arena, nationally and internationally.

practicePRO staff are regularly invited to lead or contribute to conference programs, law-related association committees, and special issue Task Forces. For example, in 2007 practicePRO chaired the American Bar Association's TECHSHOW, recognized as the premier legal technology show. We played an active role on the committee developing The Sedona Canada E-discovery Principles, new national guidelines that provide lawyers with practical advice on handling electronic discoveries. practicPRO participated on the Canadian Bar Association's Task Force on Conflicts of Interest, and participated in numerous programs of the Ontario Bar Association, the Canadian Bar Association, the Law Society and other organizations. Jurisdictions from as far away as Malaysia and Hong Kong have adapted practicePRO risk management materials for their own use.

Locally, our efforts to encourage lawyer participation in Continuing Legal Education (CLE) programs through our CLE premium credit program (lawyers taking practicePRO-approved CLE programs receive a $50 per course credit on their insurance premium, to a maximum of $100 per lawyer) continue to be successful. In 2007, we accredited 116 CLE programs attended by 14,300 lawyers. This initiative has fundamentally changed the face of CLE programming in Ontario, ensuring that claims prevention content is an integral aspect of many CLE programs.

A principal focus for practicePRO is to take its message directly to the legal community. In 2007 we delivered 36 presentations on risk management-related topics to various law associations, law firms and CLE programs across North America. LAWPRO magazine, our principal risk management vehicle, tackled topics such as the implication of the aging baby boom for law practice, and how delegation, effective hiring and retention strategies help practices "make their mark." A streamlined practicePRO website that makes it easy to access the wealth of practicePRO resources recorded a 73 per cent increase in traffic with close to 80,000 unique visitors downloading 120,000 copies of various practicePRO publications and materials.

TitlePLUS program ten years later

Ten years after its launch in 1997, our TitlePLUS program has matured into a unique and significant player on the national title insurance stage.

TitlePLUS policy volumes in 2007 increased just over 11 per cent, reflecting significant growth in western Canadian markets as well as sustained growth in Ontario. As well, TitlePLUS growth nationally outpaced growth in the title insurance industry in 2007. We may be a relative newcomer on the national stage, but national TitlePLUS market share in Canada matches that of Bar-related® title insurers in the United States who have been in business for many more years than the TitlePLUS program. These successes indicate that our many efforts to educate the bar about our program, and educate consumers about the benefits of TitlePLUS insurance, are striking a chord.

In 2007, the TitlePLUS subscriber base grew 14 per cent to 4,200 lawyers nationally: 466 lawyers used TitlePLUS for the first time. We strengthened our presence in the commercial, over-$1 million residential and new home/bulk commercial sectors, and added seven new confirmed lenders to our extensive lender roster.

As well, we prepared for the launch of our TitlePLUS program in Quebec in 2008; as we did in western Canada, we have adapted our application, claims management and underwriting approaches to accommodate the special needs and requirements of the Quebec marketplace. We also strengthened our French-language capabilities to ensure that we can address the bilingual needs of the Quebec environment.

Sustained growth requires a sustained effort on the part of our TitlePLUS team to get the message to lawyers, lenders and consumers.

To this end, our TitlePLUS consultants made more than 4,300 visits to law firms and lawyers to demonstrate TitlePLUS technology at work; they also presented to more than 120 groups, hosted 65 "lunch and learn" sessions for lawyers, and organized 20 regional lender awareness events. As well, our TitlePLUS group sponsored or participated at about 190 trade shows, conferences, symposia and other events frequented by our target lawyer and lender stakeholder groups.

These profile-building activities were supported at the consumer level in 2007 by a major public awareness and education campaign that positions the lawyer as integral to real estate practice. This campaign, launched in 2006 but expanded in 2007, aims to educate homebuyers and borrowers about how working with a lawyer in different types of real estate transactions – from buying a home to refinancing a mortgage to investing in rental property – can make for a more successful result.

Two media pitches – one on mortgage refinance issues, a second on rental properties – complemented by a series of 20 articles on a variety of real estate/lawyer topics and made available for free to national media, generated extensive national print, broadcast and web coverage. The campaign reached an estimated eight million consumers via print media, as well as about six million consumers via coverage on the Internet.

To further support this campaign, the TitlePLUS Real Simple Real Estate Guide – an online resource that includes checklists, financial calculators and information on the role of a real estate lawyer – has expanded to reflect the awareness campaign's focus. The site recorded more than 115,000 hits over the past 18 months.

To mark its 10th anniversary, the TitlePLUS program released a book chronicling the evolution of the program and its impact on title insurance and the Canadian real estate market. The 30-page book covers a wide range of topics, such as: why working with a Bar-related title insurer (such as TitlePLUS insurance) is in the long-term best interests of lawyers; how the TitlePLUS program has been adapted to the conveyancing and underwriting practices of the various jurisdictions; and how the program has empowered lawyers and consumers alike through its education efforts. The book also explains the TitlePLUS program's innovative use of technology.

TitlePLUS claims

Stringent underwriting and other control measures set TitlePLUS insurance apart.

The continued presence of fraud – which accounts for about three per cent of claims but almost one-third of claims costs – prompted the introduction of additional risk identification processes in 2007. As a result, we declined 14 transactions because of suspected fraud or grow house activity. As well, we declined 36 applications to become TitlePLUS subscribers or applications for TitlePLUS coverage because of risk issues.

Municipal issues such as realty tax arrears, building deficiency work orders and building code violations account for most claims reported. Claims are settled for an average of $3,600 per claim, and consistently about 90 per cent are closed for less than $5,000.

2007

Financial Report

Management Discussion and Analysis

Accounting changes effective January 1, 2007

The Company adopted accounting standards changes under Canadian generally accepted accounting principles effective January 1, 2007 that impact its 2007 financial statements. These changes have been discussed in detail in the Company's financial statements. In summary, the Company is required to account for its investments at fair market value under the new standards rather than at cost or amortized cost as had previously been the case. As a result, at December 31, 2007 unrealized gains and losses on the investment portfolio are accounted on the balance sheet and reflected in shareholder's equity. In prior years, unrealized gains and losses on the investment portfolio were disclosed in the notes to the financial statements but not recorded in the accounts.

Due to the accounting changes, the December 31, 2006 and December 31, 2007 balance sheets are not directly comparable and should be read in conjunction with the notes to the financial statements. The Company's new accounting policy choices have however substantially retained the comparability of its net income reported in 2006 and 2007.

Income Statement

In 2007, the Company generated net income of $17.6 million, an increase of $8.2 million over 2006. Income before taxes increased by $13.6 million to $28.1 million. Underwriting income increased by $6.4 million, and investment income increased by $7.2 million.

Net premiums earned

Premiums earned, net of reinsurance ceded, increased by $9.8 million to $91.9 million in 2007. Both the optional excess and title insurance programs experienced growth in the year and premiums from the mandatory Ontario professional liability insurance program exceeded budgeted levels as a result of additional premium transferred from the Law Society's Premium Stabilization Fund.

Net claims and adjustment expenses

Incurred claims and adjustment expenses, net of reinsurance recoveries increased by $1.0 million. During 2007, there was favourable development of prior years' claims in the amount of $13.1 million, which partly offset the higher claims incurred in respect of the 2007 insurance program year.

Reinsurance

The Company purchased excess of loss clash reinsurance coverage for 2007, which limits its exposure to large aggregation of multiple claims arising from the same proximate cause. The optional Excess program continued to be fully reinsured, removing exposure to the Company from claims in this program.

Prior to January 1, 2003, the Company had quota share reinsurance arrangements on the mandatory Ontario professional liability insurance program.

General expenses

The general expenses in 2007 were substantially as anticipated and at the same level as 2006.

Reinsurance commissions earned

The Company earned commissions on premium ceded in respect of reinsurance of its 2007 Optional Excess insurance program of $1.1 million, similar to 2006. In addition, the Company also earned profit commissions for favourable claims development on the quota share reinsurance arrangements that it had prior to January 1, 2003. As claims estimates become more certain with time, there is less potential for favourable development on claims relating to older fund years, resulting in lower profit commissions.

Investment income

Income generated from investments increased by $7.2 million in 2007. Investment income includes net capital gains of $11.3 million realized on disposition of assets ($3.7 million in 2006). At December 31, 2007 the cost of the investment portfolio exceeded its market value by $0.6 million (2006 – market value exceeded cost by $16.7 million).

Balance Sheet

Shareholder's equity increased by $16.8 million, substantially being the net income earned during the year, offset by accumulated other comprehensive loss at December 31, 2007.

Investments

Investment assets, inclusive of cash and cash equivalents, increased by $31.7 million to $399.9 million at December 31, 2007. The increase was primarily the result of cash provided by operations and investment income generated by the portfolio. As explained in the financial statements, with the introduction of new accounting standards in 2007, investments are measured at fair market value on the balance sheet at December 31, 2007 but were measured at cost at December 31, 2006. The investment portfolio is managed in accordance with investment policy approved by the Company's Board of Directors in diversified, high quality assets. A portion of the investment portfolio, which is primarily composed of fixed income securities, is invested in a manner that is expected to substantially match in maturity to the payment of claims liabilities in future.

The portion of the Company's investment portfolio, which is considered surplus to the requirements of settling claims liabilities, is managed separately and includes fixed income securities and equity investments in publicly traded companies, the values of which are subject to market volatility.

Provision for unpaid claims and adjustment expenses and reinsurers' share thereof

The provision for unpaid claims represents the amount required to satisfy all of the Company's obligations to claimants prior to reinsurance recoveries. This has increased by $11.7 million. Reinsurance recoveries have declined by $10.6 million and accordingly the net increase in the provision is $22.3 million. This increase is attributable to higher estimates of claims for the 2007 insurance program year and the impact of changes in reinsurance arrangements made since 2002. The percentage ceded under quota share reinsurance in respect of the Ontario mandatory professional liability insurance program declined from 57% in 1995 to nil effective January 1, 2003.

The determination of the provision of unpaid claims and adjustment expenses involves significant estimation. The process of determination of the provision is based on known facts currently available, interpretations and judgments and is influenced by factors that are inherently variable.

Management Statement on Responsibility for Financial Information

The preparation of the annual financial statements, Management's Discussion and Analysis (MD&A) and all other information in the Company's Annual Report is the responsibility of the Company's management and has been approved by the Board of Directors.

The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Financial statements, by their very nature, include amounts and disclosures based on estimates and judgments. Where alternative methods or interpretations exist, management has chosen those it deems most appropriate in the circumstances, including appropriate consideration to relevance and materiality. Actual results in the future may differ materially from management's current assessment given the inherent variability of future events and circumstances. Financial information appearing elsewhere in the Company's Annual Report is consistent with the financial statements.

Management maintains the necessary system of internal controls over financial reporting to meet its responsibility for the reliability of the financial statements. These controls are designed to provide management with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, assets are safeguarded against unauthorized use or disposition and liabilities are recognized.

The Board of Directors is responsible to ensure that management fulfils its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board carries out its responsibility, primarily through its Audit Committee, which is independent of management. The Audit Committee reviews the financial statements and recommends them to the Board for approval. The Audit Committee also reviews and monitors the Company's system of internal controls over financial reporting in the context of reports made by management or the external auditors.

Role of the Auditor

The external auditors, Deloitte and Touche LLP, have been appointed by the shareholder. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and to report thereon to the Company's shareholder. In carrying out their audit, the auditors make use of the work of the appointed actuary and their report on the policy liabilities of the Company. The external auditors have full and unrestricted access to the Audit Committee and the Board of Directors to discuss audit, financial reporting and related findings. The auditors' report outlines the scope of their audit and their opinion.

Role of the Appointed Actuary

The actuary is appointed by the Board of Directors of the Company. With respect to the preparation of these financial statements, the appointed actuary is required to carry out a valuation of the policy liabilities and to report thereon to the Company's shareholder. The valuation is carried out in accordance with accepted actuarial practice and regulatory requirements. The scope of the valuation encompasses the policy liabilities as well as any other matter specified in any direction that may be made by the regulators. The policy liabilities consist of a provision for unpaid claims and adjustment expenses on the expired portion of policies, a provision for future obligations on the unexpired portion of policies, and other policy liabilities that may be applicable to the specific circumstances of the Company.

In performing the valuation of the policy liabilities, which are by their very nature inherently variable, the appointed actuary makes assumptions as to the future rates of claims severity, inflation, reinsurance recoveries, expenses and other matters, taking into consideration the circumstances of the Company and the nature of the insurance coverage being offered. The valuation is necessarily based on estimates; consequently, the final values may vary significantly from those estimates. The appointed actuary also makes use of management information provided by the Company, and uses the work of the auditor with respect to the verification of the underlying data used in the valuation.

Toronto, Ontario
February 8, 2008

Michelle Strom
President and CEO

Akhil J. Wagh
Vice-President, Finance and Treasurer

Auditors' Report

Deloitte.

To the Shareholder of Lawyers' Professional Indemnity Company

We have audited the balance sheet of Lawyers' Professional Indemnity Company as at December 31, 2007 and the statements of income, of comprehensive income, of changes in shareholder's equity and of cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Toronto, Ontario
February 8, 2008

Chartered Accountants
Licensed Public Accountants

Appointed Actuary's Report

Eckler Ltd.
Consultants and Actuaries

To the Shareholder of Lawyers' Professional Indemnity Company

I have valued the policy liabilities of Lawyers' Professional Indemnity Company for its balance sheet as at 31 December 2007, and their changes in its statement of income for the year then ended, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of the policy liabilities makes appropriate provision for all policyholder obligations, and the financial statements fairly present the results of the valuation.

Toronto, Ontario
February 8, 2008

Brian G. Pelly
Fellow, Canadian Institute of Actuaries

Balance Sheet

Stated in thousands of Canadian dollars **As at December 31**	**2007**	**2006**
Assets		
Cash and cash equivalents	6,849	1,634
Investments (note 2)	393,059	366,513
Investment income due and accrued	2,210	2,637
Due from reinsurers	4,045	7,224
Due from insureds	2,162	2,312
Due from the Law Society of Upper Canada (note 5)	11,396	731
Reinsurers' share of provisions for:		
Unpaid claims and adjustment expenses (note 4)	55,443	66,008
Other receivable	436	665
Other assets	1,014	343
Capital assets (note 3)	729	432
Income taxes recoverable	1,278	–
Future income taxes (note 7)	2,931	7,750
Total assets	**481,552**	**456,249**
Liabilities		
Provision for unpaid claims and adjustment expenses (note 4)	339,621	327,911
Unearned premiums	787	787
Due to reinsurers	482	495
Due to insureds	1,254	1,637
Expenses due and accrued	2,493	2,735
Income taxes due and accrued	–	2,587
Other taxes payable	1,095	1,078
	345,732	**337,230**
Shareholder's equity (note 8)		
Capital stock issued and paid	5,000	5,000
Contributed surplus	30,645	30,645
Retained earnings	101,392	83,374
Accumulated other comprehensive income (loss)	(1,217)	–
	135,820	**119,019**
Total liabilities and shareholder's equity	**481,552**	**456,249**

See accompanying notes to financial statements

On behalf of the Board

Ian D. Croft
Director

Michelle L.M. Strom
Director

Statement of Income

Stated in thousands of Canadian dollars

For the year ended December 31	**2007**	**2006**
Premiums earned – gross	97,276	86,972
Premiums earned – ceded	(5,388)	(4,886)
Net premiums earned	**91,888**	**82,086**
Net claims and adjustment expenses (note 4)	73,313	72,319
Premium taxes	2,919	2,610
General expenses	15,027	15,132
Reinsurance commissions earned	(1,473)	(3,727)
	89,786	**86,334**
Underwriting income (loss)	**2,102**	**(4,248)**
Investment income	25,948	18,734
Other income	47	50
Income before income taxes	**28,097**	**14,536**
Income tax expense (recovery) (note 7)		
Current	9,971	6,711
Future	516	(1,573)
Net income for the year	**17,610**	**9,398**

See accompanying notes to financial statements

Statement of Comprehensive Income

Stated in thousands of Canadian dollars		
For the year ended December 31		**2007**
Net income		**17,610**
Other comprehensive income (loss), net of income tax:		
Net changes in unrealized gains and losses on available for sale financial assets (net of taxes of $1,636)	(2,883)	
Reclassification adjustment for gains and losses included in net income (net of taxes of $4,071)	(7,201)	
Other comprehensive income (loss)		**(10,084)**
Comprehensive income		**7,526**

See accompanying notes to financial statements

Statement of Changes in Shareholder's Equity

Stated in thousands of Canadian dollars

	Capital stock	Contributed surplus	Retained earnings	Accumulated other comprehensive income (loss)	Shareholder's equity
Balance at December 31, 2006	**5,000**	**30,645**	**83,374**	**–**	**119,019**
Transitional adjustments on adoption of new accounting standards:					
Investments – net unrealized gains (net of taxes of $5,883)	–	–	1,942	8,867	10,809
Provision for unpaid claims and adjustment expenses (net of taxes of $1,105)	–	–	(1,534)	–	(1,534)
Balance at January 1, 2007	**5,000**	**30,645**	**83,782**	**8,867**	**128,294**
Net income for the year	–	–	17,610	–	17,610
Other comprehensive income (loss) for the year	–	–	–	(10,084)	(10,084)
Balance at December 31, 2007	**5,000**	**30,645**	**101,392**	**(1,217)**	**135,820**

The aggregate of retained earnings and accumulated other comprehensive income (loss) as at December 31, 2007 is $100,175 (January 1, 2007 – $92,649).
See accompanying notes to financial statements

Statement of Cash Flows

Stated in thousands of Canadian dollars **For the year ended December 31**	**2007**	**2006**
Operating Activities		
Net income	17,610	9,398
Items not affecting cash:		
Future income taxes	516	(1,573)
Amortization of capital assets	440	311
Realized gains	(11,306)	(3,779)
Amortization of premiums and discounts on bonds	(1,786)	(1,521)
Changes in unrealized gains and losses	1,457	–
	6,931	**2,836**
Change in other non-cash balances:		
Other taxes payable	17	124
Income taxes due and accrued	1,367	2,523
Due to/from reinsurers and insureds	2,933	292
Provision for unpaid claims and adjustment expenses	8,501	6,222
Reinsurers' share of provision for unpaid claims and adjustment expenses	11,135	13,642
Unearned premiums	–	123
Expenses due and accrued	(242)	(704)
Investment income due and accrued	427	419
Other receivable	229	367
Other assets	(671)	(36)
Due to/from the Law Society of Upper Canada	(10,665)	(6,439)
Net cash inflow from operating activities	**19,962**	**19,369**
Investing Activities		
Purchase of capital assets	(736)	(154)
Purchase of investments	(258,722)	(231,398)
Proceeds from sale of investments	244,711	211,997
Net cash outflow from investing activities	**(14,747)**	**(19,555)**
Net increase (decrease) in cash and cash equivalents during the year	5,215	(186)
Cash and cash equivalents, beginning of the year	1,634	1,820
Cash and cash equivalents, end of the year	**6,849**	**1,634**
Cash and cash equivalents at end of the year consists of:		
Cash	3,823	1,381
Cash equivalents	3,026	253
	6,849	**1,634**

See accompanying notes to financial statements

Notes to Financial Statements

As at December 31, 2007

Amounts stated in thousands of Canadian dollars (except per share amounts)

Lawyers' Professional Indemnity Company (the "Company") is an insurance company, incorporated in Ontario and licensed to provide lawyers' professional liability insurance and title insurance. The Company is a wholly-owned subsidiary of the Law Society of Upper Canada ("LSUC"), which is the regulator of legal services in Ontario.

1. Significant Accounting Policies

These financial statements have been prepared under the *Insurance Act of Ontario* (the "Act") and related regulations which require that except as otherwise specified by the Company's regulator, the Financial Services Commission of Ontario ("FSCO"), the financial statements of the Company are to be prepared in accordance with Canadian generally accepted accounting principles. The significant accounting policies used in the preparation of these financial statements are summarized below. These accounting policies conform, in all material respects, to Canadian generally accepted accounting principles.

Changes in accounting policies

Effective January 1, 2007, the Company adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"): CICA Handbook Section 1506, *Accounting Changes*; 3855, *Financial Instruments – Recognition and Measurement*; Section 3861, *Financial Instruments – Disclosure and Presentation*; Section 3865, *Hedges*; Section 1530, *Comprehensive Income* and Section 3251, *Equity*.

The adoption of these new accounting standards resulted in changes in the accounting for financial instruments, the cumulative effects of which have been recorded as transitional adjustments to opening retained earnings or opening accumulated other comprehensive income as described below. The Company adopted these standards at the beginning of the year and in accordance with the transitional provisions prior period balances were not restated. The adoption of these new accounting standards had no significant impact on net income for the year ended December 31, 2007.

Prior to the adoption of the new accounting standards, the Company measured its investments in fixed income securities at amortized cost and its investments in equities at cost. Under the previous accounting standards, the Company valued its provision for unpaid claims and adjustment expenses based on a discount rate at which the present value of future cash flows from assets backing its provision for unpaid claims and adjustment expenses was equal to the sum of the amortized cost and accrued investment income of those assets at the valuation date.

Financial instruments – recognition and measurement

In accordance with the new standards, financial assets are classified as held for trading, available for sale, held to maturity or loans and receivables. Financial liabilities are classified as held for trading or as other financial liabilities. These classifications are determined based on the characteristics of the financial assets and liabilities, the Company's choice and/or the Company's intent and ability. As permitted under the standards, the Company has the ability to designate any financial instrument irrevocably on initial recognition or adoption of the standards, as held for trading under the fair value option ("FVO") as long as its fair value can be reliably measured. The Company's financial assets and liabilities are measured on the balance sheet at fair value on initial recognition and are subsequently measured at fair value or amortized cost depending on their classification as indicated below.

Held for trading financial assets

Financial assets classified as held for trading are measured at fair value on the balance sheet with realized gains and losses and net changes in unrealized gains and losses recorded in investment income along with dividends and interest earned.

As at January 1, 2007, financial assets in the Company's cash-flow matched investment portfolio totaling $248,840 (fair value $251,653), previously accounted for at cost or amortized cost, were designated as held for trading under the FVO. The cash-flow matched portfolio consists of fixed income investment securities and is intended to substantially match the expected timing and magnitude of future payments from the provision for unpaid claims and adjustment expenses. The cash-flow matched portfolio represents a significant component of the Company's risk management strategy to meet its claims obligations. The designation of the financial assets in the cash-flow matched investment portfolio as held for trading is intended to significantly reduce the measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognizing gains and losses thereon under different bases.

Financial assets purchased for short term investment objectives are classified as held for trading. At January 1, 2007, cash and cash equivalents totaling $1,634 (fair value $1,634), previously accounted for at cost and amortized cost were classified as held for trading. Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments with maturities of three months or less at the time of acquisition.

Available for sale financial assets

Financial assets classified as available for sale are measured at fair value on the balance sheet. Net changes in unrealized gains and losses are recorded in other comprehensive income

Notes to Financial Statements

As at December 31, 2007

Amounts stated in thousands of Canadian dollars (except per share amounts)

until realized, at which time the cumulative gain or loss is reclassified to investment income in the statement of income. When unrealized losses on available for sale securities are determined to be other than temporary, the unrealized loss previously recorded in other comprehensive income is reclassified to investment income in the statement of income. Previously, such securities were written down to net realizable value. Investments in equity securities classified as available for sale that do not have quoted market prices in an active market are measured at cost. Dividends and interest income from available for sale securities, including amortization of premiums and the accretion of discounts, are recorded in investment income in the statement of income.

Financial assets in the Company's surplus portfolio (consisting of all investments outside the cash-flow matched portfolio) including fixed income securities, equities and pooled funds, totaling $117,673 (fair value $131,552), previously accounted for at cost or amortized cost were classified as available for sale on January 1, 2007.

Provision for unpaid claims and adjustment expenses

Under the new accounting standards, the valuation of the provision for unpaid claims and adjustment expenses is based on a discount rate that is determined on a fair value basis rather than an amortized cost basis used previously. As a result of changes to the discount rate used in the actuarial valuation, the provision for unpaid claims and adjustment expenses increased by $1,534 (net of taxes $1,105) with a corresponding reduction in opening retained earnings at January 1, 2007.

Other financial assets and liabilities

The Company has not designated any financial assets as held to maturity. Loans and receivables and other financial liabilities are carried at amortized cost. Given the short term nature of other financial assets and other financial liabilities, amortized cost approximates fair value.

Comprehensive income

Comprehensive income consists of net income and other comprehensive income. Net changes in unrealized gains and losses on financial assets classified as available for sale are not recognized in net income, but are included as part of other comprehensive income and remain in accumulated other comprehensive income until recognized in the statement of income. Accumulated other comprehensive income is recorded on the balance sheet as a separate component of shareholder's equity (net of income taxes).

Fair values of financial instruments are based on quoted market prices in active markets and are determined using bid prices for financial assets and ask prices for financial liabilities. Fair values of third party pooled funds are based on the net asset values as advised by the funds.

Transaction costs related to financial assets and liabilities are expensed as incurred. The Company accounts for the purchase and sale of securities using trade date accounting.

Transitional adjustments

On January 1, 2007, the company recognized all of its financial assets and liabilities on the balance sheet according to their classification. Any adjustment made to a previous carrying amount was recognized as an adjustment to opening retained earnings or opening accumulated other comprehensive income, net of income taxes. A summary of the impact on the balance sheet of adopting the new standards is as follows:

	As at December 31, 2006	Adjustment on adoption of new standards	As at January 1, 2007
Investments	366,513	16,692	383,205
Provision for unpaid claims and adjustment expenses	327,911	3,209	331,120
Reinsurers' share of provision for unpaid claims	66,008	570	66,578
Future income taxes	7,750	(4,778)	2,972
Retained earnings	83,374	408	83,782
Accumulated other comprehensive income	–	8,867	8,867

There was no impact on reported net income for the year ended December 31, 2006.

Capital assets

Capital assets are carried at amortized cost. Amortization is charged to expense on a straight-line basis over the estimated useful lives of the assets as follows:

Leasehold improvements	Term of lease
Furniture and fixtures	3 to 5 years
Computer equipment and software	1 to 3 years

Premium related balances

Insurance policies under the professional liability insurance program are effective on a calendar year basis. Professional liability insurance premium income is earned on a pro rata basis over the term of coverage of the underlying insurance policies; generally one year, except for policies for retired lawyers, which have terms of up to five years. The portion of

Notes to Financial Statements

As at December 31, 2007

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premiums related to the unexpired term of coverage at the balance sheet date is recorded as unearned premiums.

Title insurance premiums are earned at the inception date of policies.

Premiums receivable are recorded as amounts due from insureds in the balance sheet, net of any required provision for doubtful amounts. Premiums received from insureds in advance of the effective date of the insurance policy are recorded as amounts due to insureds in the balance sheet.

The Company defers policy acquisition expenses, primarily premium taxes on its written professional liability insurance premiums to the extent these costs are considered recoverable. These costs are expensed on the same basis that the related premiums are earned. The method to determine recoverability of deferred policy acquisition expenses takes into consideration future claims and adjustment expenses to be incurred as premiums are earned and anticipated investment income. Deferred policy acquisition expenses are not material at year-end.

Other income

Other income is miscellaneous income other than premium income or investment income and is recognized when it is earned.

Claims related balances

a) Provision for unpaid claims and adjustment expenses

The provision for unpaid claims and adjustment expenses is an estimate of the ultimate cost of all insurance claims not paid as at the balance sheet date and is determined using case-basis evaluations and an amount for the expected future development of claims incurred as at the balance sheet date. The provision takes into account the time value of money.

b) Deductibles

The lawyers' professional liability insurance policy requires insureds to pay deductibles to the maximum extent of $25 each on individual claims. Expected deductible recoveries on paid and unpaid claims are recognized net of any required provision for uncollectible accounts at the same time as the related claim liabilities.

Reinsurance

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers in the statement of income. Amounts relating to reinsurance in respect of the premiums and claims related balances in the balance sheet are recorded separately. Amounts recoverable from reinsurers are estimated and recognized in a manner consistent with the Company's method of determining the related policy liability associated with the reinsurance policy.

Employee future benefits

The Company maintains a defined contribution pension plan for its employees as well as a supplemental defined benefit pension plan for certain designated employees, which provides benefits to those employees in excess of the benefits provided by the Company's defined contribution pension plan. The benefit liability under the supplemental defined benefit pension plan is actuarially determined using the projected benefit method pro-rated on service and management's assumptions about discount rates, expected plan assets' performance, salary growth and retirement ages of employees. The discount rate is determined on the basis of market conditions at year-end and other assumptions are based on long term expectations.

Adjustments for plan amendments are recognized fully into income in the year to which they relate. Changes in assumptions and actuarial gains and losses are recognized into income in the year following the actuarial valuation of the benefit liability to which they relate.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income tax assets and liabilities are determined based on the differences between the financial reporting and tax basis of assets and liabilities, and are measured using the tax rates and laws that are expected to be in effect in the periods in which the future income tax assets or liabilities are expected to be settled or realized, where those tax rates and laws have been substantively enacted.

Use of estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates and changes in estimates are recorded in the year in which they are determined. The most significant assets and liabilities which require estimation in their determination are the provision for unpaid claims and adjustment expenses and reinsurers' share thereof (note 4).

2. Investments

Investment summary

The Company holds a diversified portfolio consisting of equities and fixed income securities with investment grades of "BBB" or better. Effective January 1, 2007, fixed income securities and equities are carried on the balance sheet at fair value as indicated in note 1 to the financial statements. At December

Notes to Financial Statements

As at December 31, 2007

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31, 2006, fixed income securities and equities were carried at amortized cost and cost respectively on the balance sheet. The estimated fair values of fixed income securities, common and preferred equities are based on quoted market values that approximate bid prices.

	December 31, 2007			
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available for sale				
Fixed income securities	$ 86,721	1,049	(492)	87,278
Common equities	38,808	2,979	(5,447)	36,340
	125,529	4,028	(5,939)	123,618
Held for trading under FVO				
Fixed income securities	266,481	2,072	(735)	267,818
Preferred equities	1,605	22	(4)	1,623
	268,086	2,094	(739)	269,441
Total	**$393,615**	**6,122**	**(6,678)**	**393,059**
Reconciled in aggregate to asset classes as follows:				
Fixed income securities	$353,202	3,121	(1,227)	355,096
Equities	40,413	3,001	(5,451)	37,963
Total	**$393,615**	**6,122**	**(6,678)**	**393,059**

	December 31, 2006			
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Fixed income securities	$ 316,959	4,700	(616)	321,043
Common equities	46,955	13,248	(805)	59,398
Preferred equities	2,599	165	–	2,764
Total	**$366,513**	**18,113**	**(1,421)**	**383,205**

Realized gains and losses

The realized capital gains (losses) and increase (decrease) in the unrealized gains and losses of the Company's available for sale investments for the year ended December 31, 2007 are as follows:

	Net realized gains (losses)			Increase (decrease) in unrealized gains and losses		
	Gross	Tax	Net	Gross	Tax	Net
Fixed income securities	$ 840	(303)	537	(879)	320	(559)
Equities	10,432	(3,768)	6,664	(14,912)	5,387	(9,525)
	$11,272	(4,071)	7,201	(15,791)	5,707	(10,084)

Investment income

Investment income arising from investments classified as held for trading under FVO and from investments classified as available for sale recorded in net income for the year is as follows:

	2007			2006
	Held for trading under FVO	Available for sale	Total	Total
Interest	$11,253	4,243	15,496	14,233
Dividends	106	1,123	1,229	1,328
Net realized gains	34	11,272	11,306	3,778
Change in net unrealized gains and losses	(1,457)	–	(1,457)	–
	9,936	16,638	26,574	19,339
Less: Investment expenses	(276)	(350)	(626)	(605)
Investment income	$ 9,660	16,288	25,948	18,734

Financial risk management objectives and policies

Investments represent the most significant component of financial assets held by the Company and are subject to a variety of risks including market risk, interest rate risk, currency risk, credit risk, liquidity risk and cash flow risks. A significant portion of the investment portfolio is invested with the primary objective of matching the investment asset cash flows with the expected future payments on the Company's claim liabilities. This portion, referred to as the cash flow matched investment portfolio consists of fixed income securities that are intended to address the liquidity and cash flow needs of the Company as claim payments crystallize in future. The cash flow matched portfolio has been designated as held for trading under the FVO. The remainder of the Company's overall investment portfolio is categorized as available for sale. The available for sale portfolio substantially backs shareholder's equity and is invested in fixed income securities and equities with the objective of preserving capital and achieving an appropriate return consistent with the objectives of the Company.

Notes to Financial Statements

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Governance processes around investments include oversight by the Investment Committee of the Company's Board of Directors. The oversight includes reviews of the Company's third party investment managers, investment performance and adherence to the Company's investment policy. The Company's investment policy statement is reviewed at least on an annual basis and addresses various matters including investment objectives, risks and management. Guidelines and limits have been established in respect of asset classes, issuers of securities and the nature of securities to address matters such as quality and concentration of risks in the context of the investment portfolio of the Company.

Market risk relates to changes in the market price of securities caused by a variety of factors that may be specific to individual securities or that may have a broader impact on the portfolio. At December 31, 2007, unrealized losses in the portfolio were considered to be temporary. Less than 20% of the investment portfolio is invested in equities. Approximately half of the equities portfolio is subject to currency risk exposure on the portion of holdings that are invested outside Canada. This risk is borne by the Company and forms part of its overall investment income.

The maturity profile of fixed income securities as at December 31, 2007 and its analysis by type of issuer is as follows:

	Within 1 Year	1 to 5 Years	Over 5 Years	Fair Value
Available for sale				
Issued or guaranteed by:				
Canadian federal government	$ 282	30,255	15,100	45,637
Canadian provincial and municipal government	–	–	1,501	1,501
NHA mortgage backed securities	–	–	9,993	9,993
Corporate debt	–	2,862	27,285	30,147
	$ 282	33,117	53,879	87,278
Held for trading under FVO				
Issued or guaranteed by:				
Canadian federal government	$ 39,281	66,663	–	105,944
Canadian provincial and municipal government	–	11,232	51,009	62,241
Other government	–	5,078	–	5,078
NHA mortgage backed securities	895	–	–	895
Corporate debt	15,925	55,880	21,855	93,660
	$ 56,101	138,853	72,864	267,818
Fixed income securities	**$56,383**	**171,970**	**126,743**	**355,096**
Percent of total	16%	48%	36%	

The weighted average duration of fixed income securities at December 31, 2007 is 4.44 years (2006: 5.18 years). The effective yield on fixed income securities as at December 31, 2007 is 3.95% (2006: 3.82%).

3. Capital Assets

	2007			2006
	Cost	Accumulated amortization	Carrying value	Carrying value
Furniture & Fixtures	$1,172	(1,140)	32	56
Computer Equipment	3,014	(2,475)	539	229
Computer Software	2,410	(2,252)	158	111
Leasehold Improvements	935	(935)	–	36
Total	**$7,531**	**(6,802)**	**729**	**432**

4. Provision for Unpaid Claims and Adjustment Expenses

The determination of the provision for unpaid claims and adjustment expenses is a complex process based on known facts, interpretations and judgment and is influenced by a variety of factors. Consequently, the measurement of the ultimate settlement costs of claims made to date that underlies the provision for unpaid claims and adjustment expenses and any related recoveries for reinsurance and deductibles, involves estimates and measurement uncertainty. The amounts are based on estimates of future trends in claim severity and other factors, which could vary as claims are settled.

Variability can be caused by several factors including the emergence of additional information on claims, changes in judicial interpretation and significant changes in severity or frequency of claims from historical trends. Ultimate costs incurred could vary from current estimates. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the methods of estimation that have been used will produce reasonable results given the current information. An actuary performs a valuation of claim liabilities at least annually. As adjustments to estimated claim liabilities become necessary, they are reflected in current operations.

To limit losses through the spreading of risks, the Company cedes reinsurance to other insurers. In the event that a reinsurer is unable to meet obligations assumed under reinsurance agreements, the Company is liable for such amounts. The Company has guidelines and a review process in place to

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ascertain the credit worthiness of the companies to which it cedes. Based on current information of the financial health of the reinsurers, no provision for doubtful debts has been made in the financial statements in respect of reinsurers.

Changes in provisions for unpaid claims and adjustment expenses recorded in the balance sheet comprise the following:

	2007	2006
Provision for unpaid claims and adjustment expenses – beginning of year – net	$261,903	242,039
Transitional adjustment on adoption of new accounting standards	2,639	–
	264,542	242,039
Change in net provision for claims and adjustment expenses due to:		
Prior years' incurred claims	(13,143)	(11,866)
Current year's incurred claims	91,045	83,989
Net claims and adjustment expenses paid in relation to:		
Prior years	(47,184)	(45,534)
Current year	(6,810)	(6,921)
Impact of discounting	(4,272)	196
Provision for unpaid claims and adjustment expenses – end of period – net	284,178	261,903
Reinsurers' share of provisions for unpaid claims and adjustment expenses	55,443	66,008
Provision for unpaid claims and adjustment expenses – end of period – gross	$339,621	327,911

As the provision for unpaid claims and adjustment expenses is recorded on a discounted basis and reflects the time value of money, its carrying value is expected to provide a reasonable basis for the determination of fair value. However, determination of fair value also requires the practical context of a buyer and seller, both of whom are willing and able to enter into an arm's length transaction. In the absence of such a practical context, the fair value is not readily determinable.

5. Related Party Transactions

Pursuant to a service agreement effective January 1, 1995, the Company administers the Errors and Omissions Insurance Fund (the "Fund") of the LSUC and provides all services directly related to the operations and general administration of the Fund in consideration for the LSUC insuring its mandatory professional liability insurance program with the Company.

The insurance policy under the mandatory professional liability insurance program of the LSUC is written by the Company and is effective on a calendar year basis. The insurance policy is renewed effective January 1 each year subject to the LSUC's acceptance of the terms of renewal submitted by the Company.

For the year ended December 31, 2007, 87% of the premiums written related to mandatory insurance coverage provided to the LSUC and to the lawyers that are within the scope of its regulation. Under the insurance policy that was in force between July 1, 1990 and December 31, 1994, the Company was responsible for claims in excess of the LSUC and lawyers' deductibles. The provision for unpaid claims and adjustment expenses is net of amounts relating to policies for years prior to 1995 that are payable by the LSUC.

Commencing January 1, 1995, there was no longer the LSUC deductible and 100% of the risk over the individual lawyer deductible was insured through the Company. The annual policy limits for each of the years effective January 1, 1995 to December 31, 2007 are $1,000 per claim and $2,000 in aggregate per lawyer.

For 2007, the Company has estimated an additional premium of $2,276 (2006: $172 refund of premium due to the Fund) is due from the Fund pursuant to the retrospective premium rating provisions of its insurance policy. This premium is receivable from the LSUC and forms part of the net inter-company balance due from the LSUC of $11,396 (2006: $731).

6. Employee Future Benefits

The Company has a defined contribution pension plan which is mandatory for all its employees upon meeting the eligibility requirements. Each employee is required to contribute 4.5% of yearly maximum pensionable earnings and 6% in excess thereof, of an employee's annual base earnings. Under the plan, the Company matches all employee contributions. The Company made payments of $447 in 2007 (2006: $421) and recorded pension expense of $453 (2006: $424). The Company also has a supplemental defined benefit pension plan. Funding for the supplemental plan commenced in 2005. Funding requirements are reviewed annually with an actuarial valuation for funding purposes effective as at December 31. The most recent actuarial valuation for funding purposes was performed effective December 31, 2006. For reporting purposes, all assets and liabilities associated with pension benefits have been measured using values as at December 31, 2007.

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	2007	2006
Accrued benefit obligation		
Balance, beginning of the year	$2,164	1,705
Current service cost	145	134
Interest cost	115	94
Actuarial loss (gain)	(76)	139
Special termination benefit	373	–
Curtailment	(409)	–
Plan amendment	–	92
Balance, end of year	$2,312	2,164

	2007	2006
Fair value of plan assets		
Market value of plan assets – beginning of year	$1,560	644
Actual return on plan assets, net of expenses	(37)	83
Employer contribution	823	833
Market value of plan assets – end of year	$2,346	1,560

The defined benefit plan assets arise primarily from employer contributions that are originally allocated equally between deposits with the Government of Canada and investments in the units of a balanced pooled fund, representing a portfolio mix of equities and debt securities.

Reconciliation of funded status surplus (deficit) of the benefit plan to the amounts recorded in the financial statements:

	2007	2006
Fair value of plan assets	$2,346	1,560
Accrued benefit obligation	(2,312)	(2,164)
Funded status surplus (deficit)	34	(604)
Unamortized net actuarial loss	25	45
Accrued benefit asset (liability)	$ 59	(559)

The accrued benefit asset is included in other assets while the accrued benefit liability is included in expenses due and accrued in the balance sheet.

Components of defined benefit costs recognized in the year:

	2007	2006
Current service cost	$145	134
Interest cost	115	94
Actual return on assets	37	(83)
Actuarial loss (gain)	(76)	138
Special termination benefit	373	–
Curtailment	(409)	–
Plan amendment	–	92
Difference between actual and recognized actuarial losses	121	168
Difference between actual and expected return on assets	(100)	47
Defined benefit costs recognized in the statement of income	$206	590

The defined benefit plan was amended in 2007 to reflect retirement arrangements for a senior executive effective in 2008. The pending retirement triggered a plan curtailment due to the member's expected years of future service being reduced and it also triggered a special termination benefit. The curtailment reduced the benefit obligation by $409; the special termination benefit increased the benefit obligation by $373.

The significant assumptions used by the Company are as follows (weighted average):

	2007	2006
Discount rate	5.25%	5.00%
Expected long term rate of return on plan assets	6.00%	6.00%
Rate of compensation increase	3.50%	3.50%

7. Income Taxes

The Company's effective tax rate does not differ significantly from the applicable Canadian statutory income tax rate of 36.12%.

The Company's future income tax asset is the result of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The sources of these temporary differences and the tax effects for each year are as follows:

Notes to Financial Statements

As at December 31, 2007

Amounts stated in thousands of Canadian dollars (except per share amounts)

	2007	2006
Investments	$(1,668)	2,832
Net provision for unpaid claims and adjustment expenses	4,505	4,599
Other	94	319
Total	$ 2,931	7,750

During the year the Company made payments of $9,019 and received refunds of $415 from tax authorities.

8. Shareholder's Equity

Capital stock of the Company represents:

30,000 Common Shares of par value of $100 each – authorized, issued and paid.

20,000 6% non-cumulative, redeemable, non-voting Preferred Shares of par value of $100 each – authorized, issued and paid.

9. Statutory Insurance Information

The Company is the beneficiary of trust accounts in the amount of $7,697 (2006: $7,423) which are held as security for reinsurance ceded to unregistered reinsurers. This trust balance is not reflected in these financial statements but is considered in determining statutory capital requirements.

In accordance with licensing requirements, the Company has deposited securities with the regulatory authorities having a market value of $51 (2006: $54).

10. Operating Lease Commitments

During 2007, the Company had commitments for monthly lease payments in respect of the premises at 1 Dundas Street West from which it operated as at December 31, 2007. The lease expired on January 31, 2008 and remaining lease obligation payable in respect of this lease in 2008 of $114 was paid subsequent to year end.

The Company entered into a lease effective February 1, 2008 for new premises at 250 Yonge Street and moved its operations to the new location subsequent to year end.

At December 31, 2007, lease obligations on office premises were as follows:

2008	$ 1,222
2009	1,220
2010	1,220
2011	1,220
2012	1,220
Thereafter	6,608
	$12,710

The Company has commitments arising from the change in location towards capital expenditures of approximately $4,000 relating primarily to leasehold improvements and furniture and fixtures of which $677 was paid by December 31, 2007 and is included within Other Assets on the balance sheet. The balance is expected to be paid in 2008.

11. Comparative Figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

12. Future Accounting Changes

On January 1, 2008 the Company will adopt CICA Handbook Section 1535, Capital Disclosures; Section 3862, Financial Instruments – Disclosures and Section 3863, Financial Instruments – Presentation.

Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

Section 3862 on financial instruments disclosures, requires the disclosure of information about: (i) the significance of financial instruments for the entity's financial position and performance and (ii) the nature and extent of risks arising from financial instrument to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. Section 3863 on the presentation of financial instruments is unchanged from the presentation requirements included in Section 3861.

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Lawyers' Professional Indemnity Company

250 Yonge Street, Suite 3101
P.O. Box 3, Toronto, Ontario M5B 2L7

Telephone: (416) 598-5800 or 1-800-410-1013
Facsimile: (416) 599-8341 or 1-800-286-7639

e-mail: service@lawpro.ca
www.lawpro.ca

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250 Yonge Street
Suite 3101, P.O. Box 3
Toronto, Ontario M5B 2L7
www.lawpro.ca