



**2008  
Annual Report**



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## About LAWPRO®

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

In 2008, LAWPRO provided liability insurance to about 21,500 members of the Law Society of Upper Canada. We also insured more than 1,400 law firms (representing about 3,700 lawyers) under our optional Excess Insurance program.

Through our TitlePLUS® operation, LAWPRO also provides comprehensive title insurance to property owners and lenders throughout Canada. LAWPRO's practicePRO® risk management program assists lawyers in managing their potential exposure to professional liability claims.

## 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

By any measure, 2008 was an eventful – at times volatile – year that left its mark on most organizations.

I am pleased to report that LAWPRO weathered the economic storm of 2008 quite well. Thanks to the direction set for this company by current and previous Boards and Convocation, as well as the expertise, leadership and dedication of LAWPRO management and staff, LAWPRO continues to provide lawyers with a financially sound, professional and customer-focused insurance program.

In 2008, LAWPRO posted net income of \$7 million, attributed in part to a reduction in costs of claims from previous years. The company has assets of \$488.6 million, up from \$481.6 the previous year. Return on Equity – an important measure of the investment that the Ontario bar (through the Law Society) has in the company – stood at five per cent. This is a solid rate of return compared to the returns generally seen in investment markets in 2008. Once again, the company's sound financial position has been confirmed by A.M. Best, which has awarded the company an "A" rating for the ninth consecutive year.

This is not to say that LAWPRO emerged unscathed by the economic turmoil of the past months. Our investment portfolio reported mixed results. The majority of our investment portfolio is invested conservatively in bonds, as these are funds set aside to fund anticipated total costs for claims currently open or expected; this portion of the portfolio performed relatively well. LAWPRO's very small position in the equity market (only about 10 per cent of the total portfolio) was, of course, subject to the ups and downs of the investment market. Overall, investment income for the company fell about \$5 million to \$20.7 million in 2008 from \$25.9 million the previous year.

Premium income was also down about \$6.8 million, due largely to a \$300 decrease in the 2008 base premium (to \$2,300 per insured lawyer in 2008 from \$2,600 in 2007) and, to a lesser extent, declining TitlePLUS revenues due to the slowdown in the real estate market.

At the same time, claims numbers and costs continued to increase. As is more fully discussed in the Operations Report on the following pages, lawyers reported more claims in 2008 than in any year since 1995, and TitlePLUS claims continue to grow as the portfolio of TitlePLUS policies

grows. So the cost of resolving claims is on the increase – to approximately \$82 million in 2008 from just over \$73 million in 2007.

After taking into account a \$9 million after-tax effect of recording in equity the decline in the value of investments, there was a slight decrease in shareholder's equity to \$133.8 million from \$135.8 million a year earlier.

The LAWPRO Board is monitoring these and other developments closely. The Audit and Investment Committees have been expanded and receive frequent reports from the company's investment advisors and LAWPRO management. We are also gearing up for a new era of accounting and governance requirements that could fundamentally change companies' disclosure requirements and the presentation of its financial statements. Some of these initiatives could affect the determination of the amount of the company's net income as early as next year.

We also know that after being able to hold the line on professional liability insurance premiums for many years and, in fact, deliver a significantly low premium in 2008, base premium increases may be unavoidable. For 2009 mandatory insurance premiums have been set at \$2,450 per lawyer – an increase of \$150. However, the current economic climate will continue to put pressure on premiums in the future. In addition, the Ontario plan announced in early 2009 to introduce a Harmonized Sales Tax with the federal Goods and Services Tax will add an eight percent tax to certain LAWPRO costs, thus making premium increases even more likely.

The Board congratulates President and CEO Kathleen Waters and her team for successfully navigating the company during a year of change, both internal and external. I would like to thank the members of the Board for the confidence they have invested in me as Chairman, and for their support and guidance through these very "interesting" times.

Ian D. Croft  
Chairman

# Remarks of the President and CEO



“When the times get tough, the tough get going.”\* That saying could have been penned for the LAWPRO team.

The past year was a year of challenge and change. But the 130 people who stand behind the LAWPRO name tackled those challenges with a renewed focus, energy and enthusiasm, and a commitment to continue delivering excellence in every aspect of our insurance products and operations.

There was much about 2008 that we could not control: the number of claims that our insureds report; the complexity of those claims; the economy and its effect on our bottom line, among others.

But those things that could be managed, we managed well, for the benefit of the Ontario lawyers and our TitlePLUS insureds.

Our continued success at managing claims costs is a good example. Although they were higher than the previous year, claims costs in 2008 were lower than we had budgeted. Excellent management of our growing claims portfolio, and success at resolving several claims from previous years for less cost than we had projected, contributed to this positive result. Another measure of our success in managing claims costs is our continued ability to close files without any payment made: In 2008, close to 50 per cent of the more than 2,000 errors and omissions claims closed were resolved without any defence or indemnity payment and 87 per cent without any indemnity payment being made.

Our stellar track record in defending lawyers in our professional liability programs also speaks to our commitment to the profession: In 2008 we won 18 of 19 matters that we took to trial and saw claimants capitulate on 12 other matters on the courthouse steps; we were successful on all 11 earlier decisions appealed by claimants and won all 11 summary judgment applications that we initiated.

This commitment to manage effectively and efficiently infuses all parts of our organization.

We cannot prevent claims from happening – but we can ensure lawyers fully understand their exposure and better

protect their practices. In 2008 more lawyers than ever before bought Run-Off Coverage (to protect themselves against claims arising out of past practice) and /or opted to join our Excess Insurance program.

We may not be able to prevent fraud – but we are giving lawyers every possible tool to recognize and avoid fraud scams through our magazine, special brochures, seminars and presentations.

The soft housing market affected TitlePLUS sales volumes – but our continued emphasis on stringent underwriting helped keep our claims ratio (ratio of claims paid to premium revenue) at a reasonable level. TitlePLUS claims are resolved expeditiously whenever possible; for example, 77 per cent of claims received in 2008 are already closed, with the average claim being resolved in less than three months. These results reflect our commitment to servicing efficiently the needs of our homeowner and lender clients.

Our “green” initiative to implement more environmentally sensitive practices and processes in our operations not only helped reduce paper use but also saved an estimated \$40,000 in production and mailing costs. And that’s only the beginning: We continue to explore opportunities for more sustainable and cost-effective ways to deliver excellence in our insurance programs.

Our collective focus on managing for excellence has stood the bar in good stead. Unlike many legal practitioners in the United Kingdom who have been faced with premium increases of 40 to 60 per cent (prompting some of them to close their doors) or have not been able to secure any liability insurance in conventional markets (prompting a flood to a “last resort” pool), Ontario lawyers continue to reap the benefits of an insurance program that is sound, secure and relatively affordable.

Our focus in 2009 is to ensure that these benefits continue to accrue to the profession and all of our insureds.

Kathleen A. Waters  
President & CEO

\* This saying was first penned by Joseph P. Kennedy, father of U.S. President John F. Kennedy and popularized in a song by Billy Ocean in 1986.

# Report on LAWPRO OPERATIONS

LAWPRO is an insurance company with three product lines: A standard errors and omissions (E&O) insurance program (as required by the Law Society of Upper Canada for all its lawyer members); an optional excess insurance program that enables Ontario law firms to increase their insurance coverage beyond the \$1 million per claim/\$2 million aggregate levels provided by the standard E&O program; and an optional TitlePLUS title insurance product that real estate practitioners across Canada can make available to their clients.

## The standard E&O insurance program

In each of the last two years, the number of lawyers insured under the LAWPRO program has increased about two per cent: In 2008, we provided the E&O coverage to just over 21,500 lawyers, up from about 21,100 in 2007. As of this report's publication date, about 21,900 lawyers have applied for this E&O insurance coverage for 2009.

At \$2,300 per insured lawyer, the 2008 E&O base premium was the lowest since we assumed responsibility for the Law Society's insurance operations in 1995. Superior investment results and some initial improvements in claims costs from earlier years enabled us to reduce premiums significantly for 2008. The past year, however, has seen a reversal in these and other factors: A continued deterioration in our claims experience, and increased economic uncertainty associated with the investment markets are among the factors that prompted a modest increase in the base premium for 2009 to \$2,450 per lawyer.

One of the hallmarks of the LAWPRO insurance program is its flexibility. Lawyers have a number of options to tailor their insurance coverage to their specific needs – often with the added benefit of reducing the actual premium payable below the base premium level. As indicated on the chart to the right, the number of lawyers availing themselves of these options continues to increase, often at a greater rate than the increase in the number of lawyers insured in the program.

We attribute this in part to our concerted efforts to educate lawyers about their risk exposure and how they can better protect their practices. For example, the number of lawyers on exemption opting to better protect themselves for claims arising out of their past practice by increasing their

Coverage option	Feature	No. of lawyers participating (as of Jan. 31, 2008)	No. of lawyers participating (as of Jan. 31, 2009)
New call discount	10-40% base premium discount for those called 1-4 years	3,466	3,502
Part-time practice	40% base premium discount for eligible lawyers	1,377	1,465
Restricted area of practice option	40% base premium discount for immigration/criminal law practitioners	1,183	1,230
Innocent Party Buy-Up	Increase in Innocent Party sublimits up to as much as \$1 million per claim/\$1 million aggregate	3,191 (based on \$249/lawyer)	3,155 (based on \$249/lawyer)
Run-Off Buy-Up	Increase limits for past services from \$250,000 per claim/aggregate up to as much as \$1 million per claim/\$2 million aggregate	735	895
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)	3,724 lawyers (1,422 firms)
Real Estate Practice Coverage	Required for all lawyers practising real estate law. Sublimit coverage of \$250,000 per claim/\$1 million aggregate	6,966 (as of April 1, 2008)	7,102

Run-Off Buy-Up coverage jumped 22 per cent between 2008 and 2009.

Similarly, the number of firms choosing LAWPRO's Excess Insurance coverage grew four per cent to 1,422 firms.

Fewer lawyers opted to buy up their Innocent Party Coverage for 2008, partly because they had decided to secure excess insurance from other insurers and incorporate Innocent Party coverage as a drop-down to their excess coverage.

The launch of a LAWPRO "green" initiative added impetus to our commitment to use online technologies to deliver our insurance programs and services. Our multi-faceted program to make our operations more environmentally sensitive examines opportunities in all of our operations. For the annual insurance application/renewal process, we significantly reduced the amount of paper information provided to lawyers; they were instead encouraged to use our comprehensive website to access information and complete insurance-related filings.

This campaign clearly struck a chord: A record 95 per cent of lawyers – 20,600 – filed their insurance applications online; 85 per cent of them did so in time to qualify for the \$50 per

lawyer e-filing discount. Overall, traffic to our websites increased just over 10 per cent to more than 440,000 visits in 2008 – an indication of how important the Internet has become as a resource and productivity tool for lawyers.

We estimate this emphasis on delivering the insurance program online saved LawPRO \$40,000 in production and mailing costs in 2008.

## **E&O claims**

### **The numbers**

A trend we have discussed in recent annual reports continues to adversely affect the insurance program: Claims numbers and costs are continuing to increase.

In 2008, for the fourth consecutive year, the number of claims reported to LawPRO increased and now stands at the highest it has been since 1995.

Lawyers last year reported 2,175 claims, a three per cent increase from the 2,115 claims reported in 2007. Despite a concerted and successful effort on the part of our claims group to close more files than the previous year, the number of open files managed by our claims team now stands at over 3,100 – the highest it has been since 2000. Our claims expenses increased to close to \$73 million in 2008, a four per cent increase from just under \$70 million the previous year.

Another important measure is to compare the average cost of claims for each policy year at a specific point in time: As graph 4 on page 11 shows, that trend too is consistently upward.

Fraud-related claims continue to be a concern. The number of claims with a fraud component increased to 135 in 2008 with an initial estimated cost of \$7.8 million. That dollar amount will likely increase as these claims are investigated and reserved accordingly. Comparable numbers in 2007 were 84 fraud claims costing \$3.8 million. As in past years, the majority of fraud claims in 2008 were related to real estate, accounting for 64 per cent of fraud-related claims reported and 56 per cent of costs so far. Fraud schemes in 2008 ran the gamut from mortgage refinancings with fraudulent appraisals to misappropriation of funds by law firm partners (often lawyers with unblemished records and solid reputations), or by long-term, trusted staff.

Although the estimated costs attached to our 2008 claims are at this point still relatively new, some trends are evident. As in the past, real estate and litigation claims continue to account for the bulk of our claims costs. The cost of claims arising out of corporate/bankruptcy/security practices is up – a reflection of the more complex practice environment and the high underlying values associated with alleged errors in these areas. (For more see graph 5 on page 11)

### **Managing costs**

Our claims team's focused claims management philosophy is one important tool in LawPRO's goal of managing claims costs.

That philosophy is built on three principles:

- First, we do not make economic settlements, in general.
- Second, we expeditiously and cost-effectively resolve claims for which there is liability on the part of the lawyer, thus protecting the insureds' coverage limits to the extent possible. The success of these first two principles is reflected in our file closing numbers: Of the 2,006 files that we closed in 2008, 48 per cent were closed without any payment made for defence or indemnity, and 87 per cent were closed without any indemnity payment being made.
- Third, we vigorously defend lawyers on matters that have no merit, all the way to trial if necessary. And on precedent-setting matters, we will defend lawyers in the interests of the bar.

This approach continues to yield impressive results that benefit Ontario lawyers. In 2008, LawPRO won 18 of 19 matters that we took to trial. On 12 other matters that were headed to trial, claimants capitulated on the eve of the trial. We won all 11 matters on which claimants had appealed earlier decisions. And we were successful on all 11 summary judgment applications which we initiated.

Another important tool – and a measure of success – is feedback we receive from lawyers. Surveys conducted of insured lawyers with a closed claims file demonstrate that we are meeting their needs and expectations.

Our 41 per cent survey response rate in 2008 was higher than in many years. Of those who responded:

# A SELECTION OF WINNING LAWPRO CASES

## WINNING CASES WHERE COSTS WERE AWARDED

In *Richmond v. James*, 2008 CanLII 73705 (ON.S.C.), a claimant with a poor credit rating who was unable to obtain traditional financing to purchase a house, was referred to a mortgage broker by her lawyer. The broker in turn found the claimant a private lender. The lawyer advised the claimant of the terms of the loan which had a high interest rate and mortgage-lending fee. The claimant opted to close the deal.

Unable to make mortgage payments, the claimant was sued by the lender; she in turn sued the lawyer, alleging that he deliberately sabotaged the claimant's ability to finance via traditional lenders and that he received a kick-back. A one-day mediation attempt failed: the claimant was adamant about staying in the house, regardless of costs.

The trial judge dismissed the claim against the lawyer. Moreover the judge awarded costs on a substantial indemnity basis in the amount of \$110,000 to LAWPRO.

The judge was not kind to the claimant for alleging breach of fiduciary duty against the lawyer, and stated "these types of allegations go to the basic foundation of the duties of a solicitor and can rock if not destroy his career. We are talking about the integrity of individuals and how they make their living and support their families to put themselves in the position they are today." (The costs endorsement is unreported, but available from LAWPRO). The claimant's appeal was dismissed for delay on March 23, 2009. Additional costs of \$750 were awarded against her.

*Ontario (Transportation) and Kansa v. Miller Thompson and Canadian Surety Company*, 2008 CanLII 60337 (ON. S.C.). is another decision that demonstrates that LAWPRO will stand behind its insureds, not capitulate and take matters to trial where a strong defence position exists.

The Ministry of Transportation and its insurer, A, were assessed 50 per cent liable in a bodily injury lawsuit along with a construction company and its insurer, B. The Ministry and A paid the claim and then sued insurer B, plus their own trial lawyer and his law firm to recover the damages paid to the plaintiff in the underlying litigation, claiming that the Ministry of Transportation was covered under insurer B's policy, and that the Ministry's lawyer was negligent in failing to recognize it.

The trial judge dismissed insurer A's action, holding that the treatment accorded to the Ministry's lawyer at the hands of insurer A and its counsel in this litigation was troublesome. The lawyer was older, and until his retirement had carried on a pre-eminent insurance defence practice involving many different insurers under the road liability policy of the M.T.O. Serious allegations impugning the lawyer's professional competence and reputation were advanced and maintained without proof. This action, which started two years after the lawyer's retirement from the practice of law, was not concluded against him until after he had endured four years of litigation, had personally attended a week long trial, testified, and expert evidence had been presented affirming that his actions met the appropriate standard of practice. This lawsuit hung over the head of this well-regarded professional for an unduly protracted period of time.

While the judge initially awarded partial indemnity costs to the law firm, on further submissions, these were increased to the substantial indemnity scale.

## DEFENDING CLAIMS AGAINST TRIAL COUNSEL

*Heald v. Campbell*, 2008 ON. C.A. 59 demonstrates that LAWPRO continues to successfully defend malpractice actions against trial counsel.

The lawyer represented an individual in a claim against a school board. The action was dismissed. The individual then sued the lawyer, alleging that the lawyer was negligent in failing to bring a motion at the outset of trial regarding the production of certain documents; call certain witnesses; challenge the evidence of certain parties and witnesses; cross-examine diligently enough; object sufficiently to the trial judge's interventions in the trial; exclude one defence counsel from settlement discussion correspondence; and produce certain letters.

The Court of Appeal dismissed the action. Even if the lawyer had done everything that the claimant alleged ought to have been done, the outcome in the underlying action would have been no different. The underlying claim was statute barred, and the claimant could prove no damages against the school board. Further, the lawyer's alleged failures did not constitute a breach of a solicitor's standard of care – they were, at most, errors in judgment.

## TAKING A STAND ON TITLE INSURER INDEMNIFICATION OF LAWYERS

In 2005, the Law Society of Upper Canada negotiated an indemnity agreement on behalf of its lawyer members with all of the title insurers operating in Ontario. Under the terms of the agreement, title insurers agree to indemnify and save harmless any lawyer who has obtained a title insurance policy on behalf of his or her clients for any claims arising under that title insurance policy.

This indemnification has been put to the test on numerous occasions. Recently, a lawyer acquired a title insurance policy for his clients. Later the clients sued the lawyer alleging, among other things, that the insured transaction violated the *Planning Act*. The lawyer asked the title insurer to cover his on-going costs of defending the action. The insurer refused.

In *Stewart Title Guarantee Co. v. Zeppieri*, 2009 CanLII 2329 (O.N.S.C.), the title insurer launched an application for an interpretation of the indemnity agreement. LAWPRO counsel, acting on behalf of the lawyer, obtained an order that, under the indemnity agreement, the title insurer was required to pay the lawyer's defence costs.

The judge rejected the title insurer's argument that it was only obligated to pay defence costs once the action was disposed of by judicial determination. The judge accepted the lawyer's (LAWPRO's) submission that a Law Society lawyer member should never have to "put his hand in his pocket" in respect of a claim covered by the terms of the indemnity agreement.

This is an important decision for LAWPRO insureds. It clarifies and ensures consistency among title insurers on when the indemnity agreement is triggered, and how it is to be applied. We have over the years been diligent in pursuing indemnity from the title insurers for LAWPRO insured lawyers. This decision corroborates the position we have taken that the indemnification is triggered by the pleadings, and that it includes the title insurer funding a defence for the LAWPRO insured lawyer.

- 97 per cent said that they were satisfied with how LAWPRO handled the claim;
- 87 per cent said they would have the defence counsel firm represent them again; and
- 84 per cent said LAWPRO received good value for defence monies spent.

### practicePRO: helping lawyers avoid claims

As well as working with lawyers to help manage claims when they do arise, we also strive to help lawyers avoid claims in the first place.

Through our practicePRO program, we provide lawyers with many tools and resources to help them identify practice risks and take steps to minimize their claims exposure. For example, we publish a series of *managing* booklets on topics ranging from practice interruptions to law firm finances to client service. We completed a major overhaul of the practicePRO website in 2008, including adding more risk management content to the many resources and information already there. In 2008, 85,000 unique visitors to the site downloaded more than 213,000 LAWPRO articles and resources – almost double the traffic of 2007. The practicePRO Lending Library, which makes practice management texts available to Ontario lawyers, continues to grow in popularity. All of these, and many more, resources were featured in a special issue of LAWPRO Magazine to mark practicePRO's 10<sup>th</sup> anniversary in 2008.

LAWPRO insureds regularly tell us that one of the most useful resources we provide is our quarterly publication, *LAWPRO Magazine*. Last year it tackled topics such as the relationship between lawyer personality and malpractice; how to manage multi-generational workplaces; 10 critical practice risks and how to avoid them; and how firms can cushion the effects of the economic downturn.

Fraud was the focus of numerous education efforts in 2008. We created a central page on the practicePRO website that puts fraud-prevention tips and resources at lawyers' fingertips. We tackled topics in our magazine such as employee fraud, emerging fraud scams and how the Canadian payments system works, so that lawyers can work with it to avoid being defrauded. At numerous conferences and presentations, we spoke of fraud and

how to avoid being duped. LawPRO also produced a special fraud alert handout that summarizes the characteristics of the most common frauds and provides tips on how to avoid them. This brochure aims to educate law firm staff and lawyers about fraud avoidance.

LawPRO also works behind the scenes to ensure the risk management message is getting heard. As a result of our CLE Credit program, through which lawyers taking LawPRO-approved CLE programs receive a \$50 per course credit on their insurance premium (to a maximum of \$100), we have ensured CLE providers include in their programs a significant risk management component. In 2008 the number of approved CLE programs increased more than 50 per cent to 181 programs attended by more than 15,500 lawyers. LawPRO and practicePRO content was included in the materials for many of these programs.

Our active participation in law-related associations and on task forces is yet another way that we spread the risk management message. In 2008, for example, we contributed to the Canadian Bar Association's Conflicts of Interest Task Force, and were largely responsible for creating the Conflicts Toolkit, a collection of checklists and sample letters and retainers to help lawyers avoid conflicts claims. We delivered 35 presentations on risk management related topics to various law associations, law firms and CLE programs. practicePRO's director co-chaired the Law Society/Ontario Bar Association's annual Solo and Small Firm Conference, and will co-chair the 2010 CBA Annual Conference and Meeting. And we regularly contribute articles to print and online publications north and south of the border, as well as allowing organizations around the world to use our materials in their own education and risk management efforts.

### **The LawPRO Excess program**

Since it was established in 1997, our Excess Insurance program has grown on average four per cent annually. A record 1,422 firms representing 3,724 lawyers elected LawPRO as their excess insurance provider for 2009; 103 firms chose the maximum \$9 million limit option. Of the 65 new firms that opted for LawPRO's Excess Coverage for

2009, 95 per cent had not carried this type of insurance in the past. Our retention rate on our Excess business was 97 per cent, a clear indication that this program meets the needs of the market it is aimed at – small and medium-sized firms of fewer than 50 lawyers.

### **Excess claims**

To date, we have not paid any indemnity amount under our Excess program, a reflection of our ability to carefully manage costs within the insurance program's primary limits. Prudent underwriting and solid claims management have helped ensure that our Excess program is a profitable line of business for LawPRO.

### **The TitlePLUS program**

Despite a difficult real estate market that saw all major title insurers report reduced premium revenues in 2008, our TitlePLUS title insurance program continued to post better-than-average year-over-year results.

Our national market share held steady, and although our Ontario market penetration fell slightly overall, a strong rebound in the fourth quarter bodes well for 2009. Particularly strong results in our new home/bulk commercial program support our plans to continue to promote this part of our TitlePLUS program.

The slowdown in real estate activity appears to have generated renewed interest in our program from both lawyers and lenders. Our subscriber base in 2008 increased six per cent to more than 4,400 lawyers; and we issued TitlePLUS policies for just under 1,000 lenders across Canada. These results indicate that our vision of real estate practice is gaining traction: The higher level of legal expertise and professionalism we expect from both our users and our TitlePLUS staff sets us apart from other providers.

Efforts to grow the TitlePLUS program continued on many fronts in 2008.

An important focus was our move into the Quebec market. We established important relationships with local notaries, in keeping with our commitment to work closely with

front-line service providers in the various jurisdictions in which we offer TitlePLUS insurance. In 2009 we will participate in a 16-city road show to educate notaries on title insurance. We also created a separate French-language section of the TitlePLUS website to facilitate our launch into the Quebec market.

Our consultants in 2008 made close to 5,000 visits to law firms to demonstrate TitlePLUS technology and assist clerks in using the online application system. We presented to 150 groups of law firms, lenders and realtors on the benefits of the TitlePLUS program. We also hosted four conferences for subscribers across Canada, and visited dozens of communities on road shows that provided lawyers with mini-seminars on topics ranging from TitlePLUS updates to technology tips to data on LAWPRO claims trends. As well, we sponsored, exhibited or participated in more than 120 trade shows, conferences and other events attended by our lawyer, notary, lender and realtor stakeholder groups.

At the consumer level, profile-building efforts focused on expanding the success of our two-year campaign to educate the consumer public about the importance of lawyers in all types of real estate transactions. Three media pitches – one on rental units, one on recreational properties and a third on how buying and selling has changed in the last decade (aimed primarily at the seniors' audience) – generated coverage in more than 40 newspapers, websites and broadcast outlets that reached 3.5 million consumers. A separate series of articles explaining how to work with a lawyer and how using a lawyer helps consumers reached an estimated 38 million consumers through close to 130 newspapers, magazines and online media.

In 2008 we also reached out to the younger buyer market by establishing a new type of presence on the Internet. Other ventures to engage consumers through social media networks are contemplated for 2009, including the launch of a TitlePLUS Facebook page.

### **TitlePLUS claims**

The legal expertise and experience of our TitlePLUS team referenced earlier not only help alert lawyers to potential claims issues, but also strengthen our stringent underwriting measures. The result: Close to 84 per cent of TitlePLUS claims are minor with payments of less than \$10,000, and the average cost of a TitlePLUS claim is just under \$4,500.

It should be noted that over the history of the TitlePLUS program, our claims paid ratio (the ratio of claims paid to premiums) stands at only 30 per cent.

But in 2008, five major fraud claims and two significant building department-related claims took their toll, resulting in losses of several million dollars. Fraud claims account for only two per cent of claims reported but 36 per cent of payments made to date – an indication of how a few claims can have a major affect on claims costs in any one year.

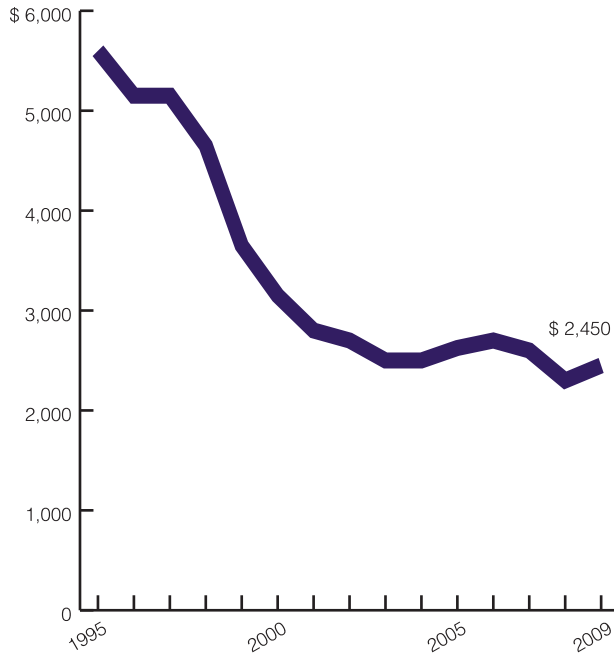
To mitigate the impact on fraud on our portfolio, we have further strengthened our underwriting criteria to alert us to transactions that could involve fraud. We regularly identify situations that warrant manual intervention and often alert lawyers to possible indicia of fraud in these files. In a 12-month period ending in 2008, we rejected more than 100 applications for TitlePLUS coverage because of fraud-related concerns and estimate that these files would have triggered losses of between \$6 million and \$8 million.

We also refused several applications because the properties involved contained grow houses. Several were identified by our underwriting group based on publicly-available databases that we monitor. We not only prevented losses, but also were able to help educate the lawyers involved on grow house risks, enabling these lawyers to appropriately advise their clients and avoid potential problems in the future.

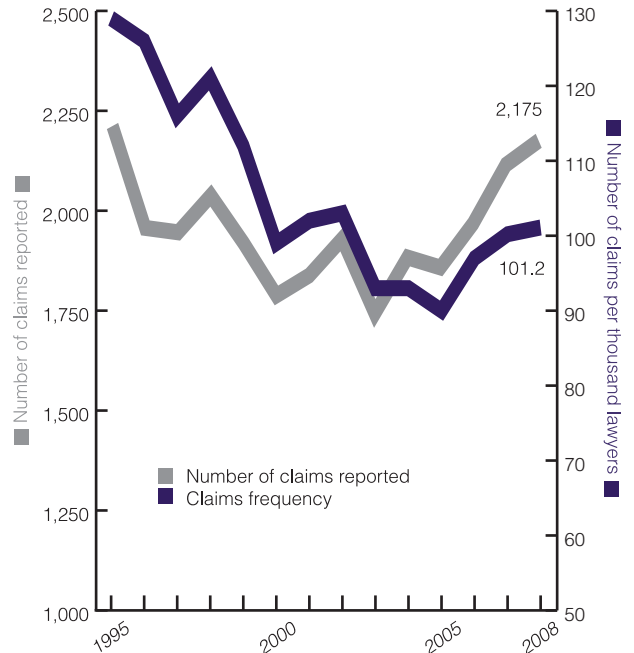
# Highlights

## LAWPRO E&O and Excess insurance programs

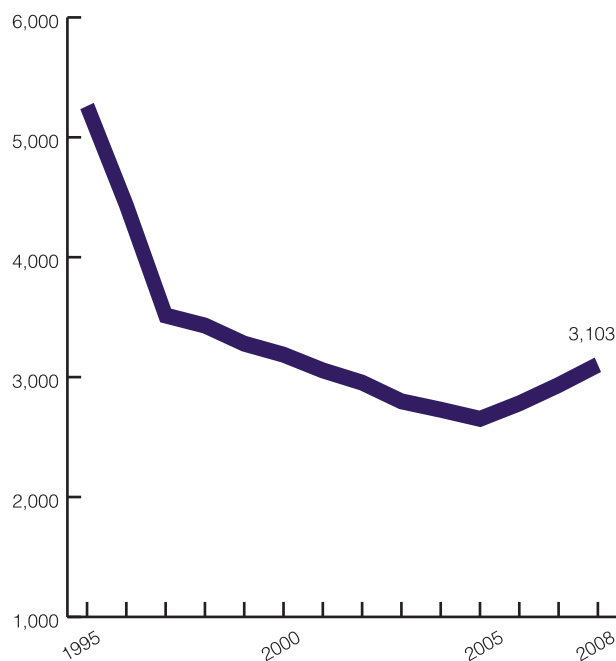
### 1. Base premium per lawyer



### 2. Number of claims reported & frequency



### 3. Number of open claims files



#### Graph 1

For nine consecutive years, the base premium paid by most Ontario lawyers has ranged in the \$2,300 to \$2,800 range. At \$2,450 per lawyer, the 2009 base premium is the second lowest it has been in 15 years.

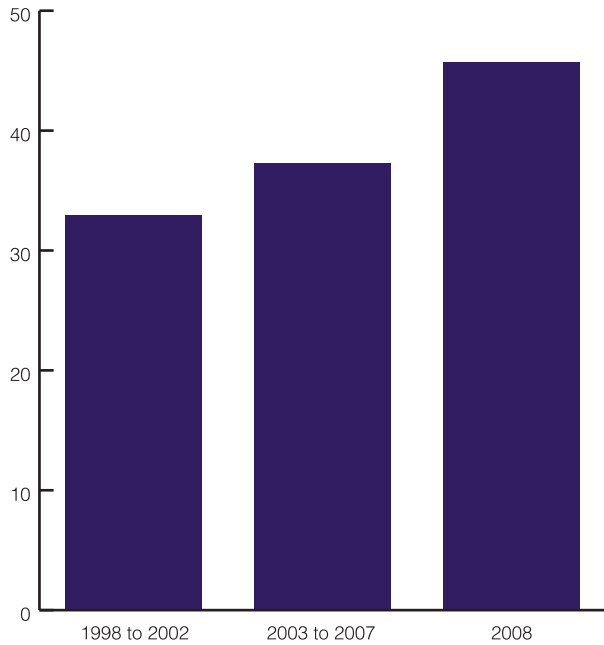
#### Graphs 2 & 3

Ontario lawyers are reporting more claims, and the increase in the number of claims reported is exceeding the number of new lawyers coming into practice each year. In 2008 the number of claims reported to LAWPRO increased to 2,175, the highest it has been since 1995 and the fourth consecutive year in which claims have increased. Moreover, claims frequency – the number of claims per 1,000 lawyers – has increased from a low of 90 in 2005 to 100.2 in 2008. Although we closed 2,006 claims files in 2008, the number of open claims files that we are managing has climbed from a low of 2,652 in 2005 to 3,103 in 2008.

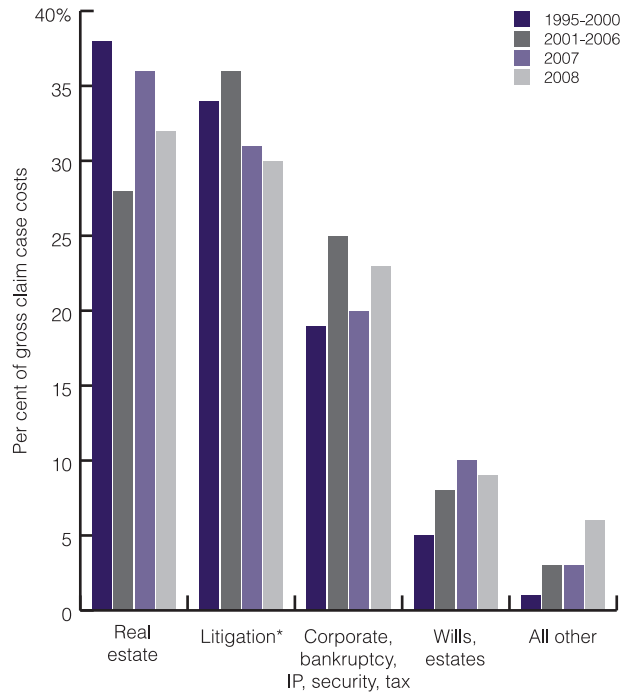
# Correction to 2008 LawPRO Annual Report - Page 11

Graph 4 contained a typographical error. The label on the center bar should have read 2003 to 2007.

## 4. Average claim cost totals as of February 20 following fund year (in \$millions)

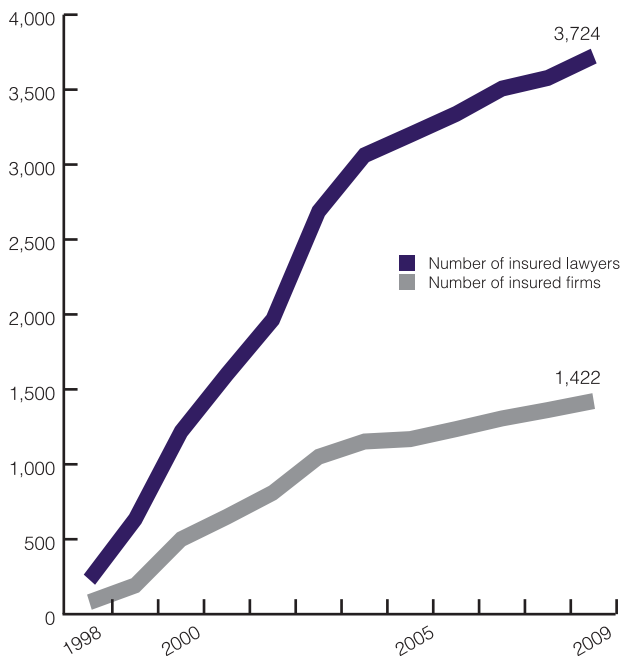


## 5. Distribution of claims costs by area of practice (as at February 28, 2009)



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

## 6. Growth in LawPRO Excess Insurance program



### Graph 4

Not only are claims numbers increasing, but so are the average costs of these files. Based on an analysis of the previous year's estimated claims costs on February 20 of the following year, one sees that the average cost of all claims has gone from about \$32 million in the 1998-2002 period to about \$45 million for 2008 claims costs – a 40 per cent increase.

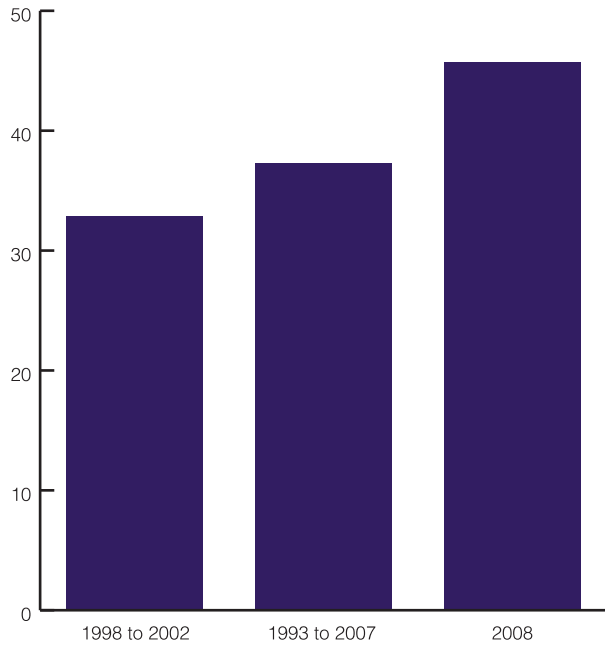
### Graph 5

Real estate and civil litigation claims continue to account for upwards of 60 per cent of claims case costs in 2008. The jump in claims costs from 2007 to 2008 arising out of corporate/bankruptcy/intellectual property/securities and tax areas of practice reflects the complexity and higher financial stakes of claims in these areas.

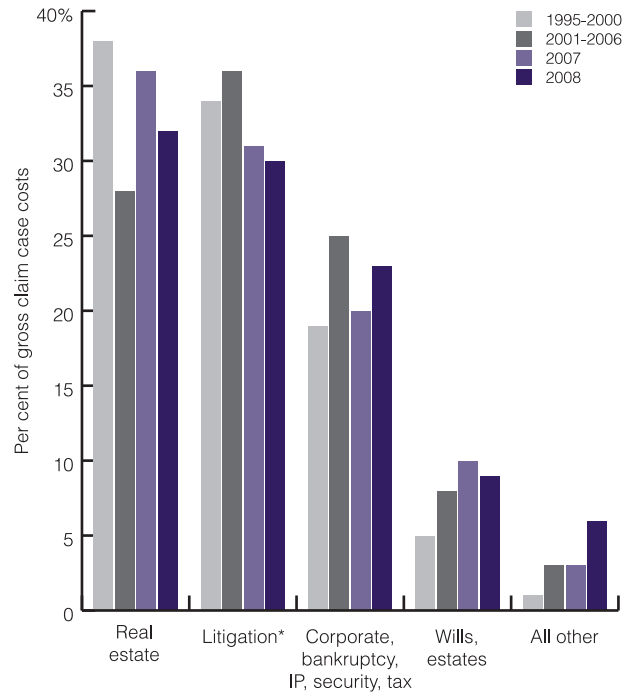
### Graph 6

Ongoing efforts by LawPRO to educate lawyers about their potential exposure to claims and the options available to better protect their law practices have contributed to steady growth in our Excess Insurance program.

**4. Average claim cost totals as of February 20 following fund year (in \$millions)**

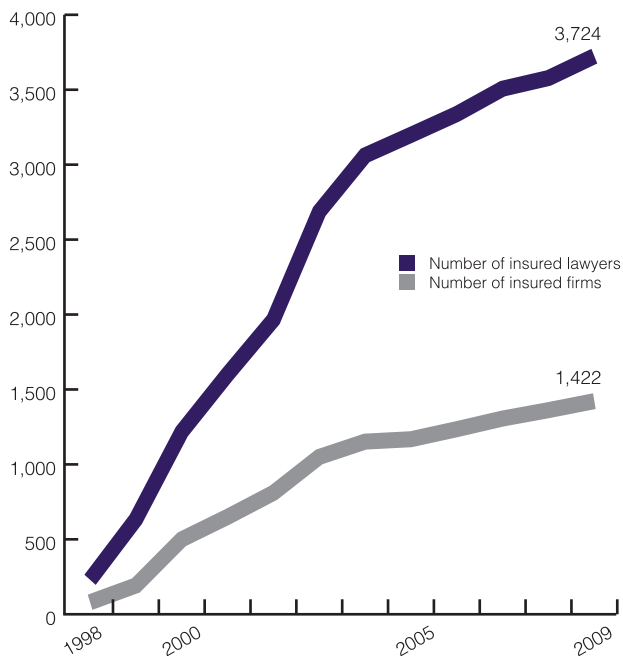


**5. Distribution of claims costs by area of practice (as at February 28, 2009)**



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

**6. Growth in LawPRO Excess Insurance program**



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**Graph 5**

Real estate and civil litigation claims continue to account for upwards of 60 per cent of claims case costs in 2008. The jump in claims costs from 2007 to 2008 arising out of corporate/bankruptcy/intellectual property/securities and tax areas of practice reflects the complexity and higher financial stakes of claims in these areas.

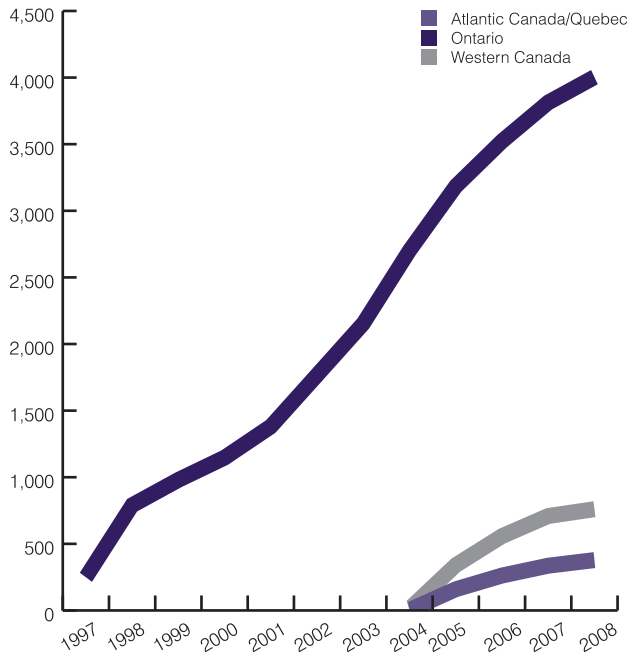
**Graph 6**

Ongoing efforts by LawPRO to educate lawyers about their potential exposure to claims and the options available to better protect their law practices have contributed to steady growth in our Excess Insurance program.

# Highlights

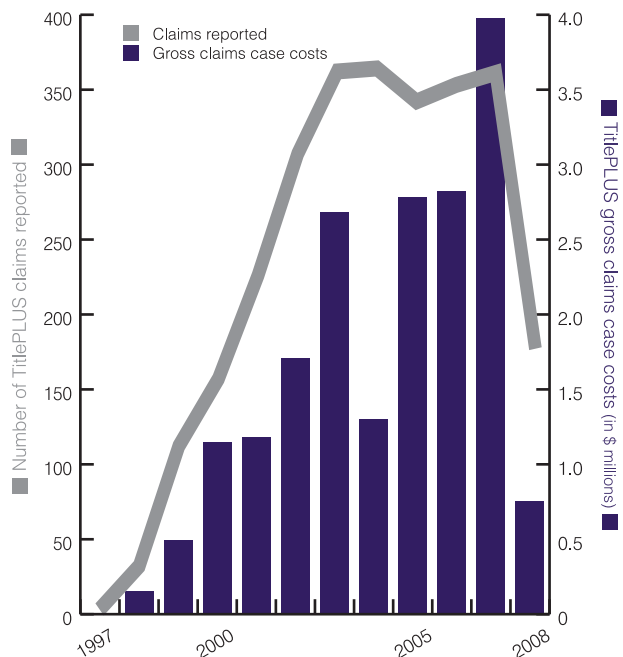
## TitlePLUS program

### 7. Number of TitlePLUS eligible lawyers



Note: TitlePLUS title insurance was made available in Atlantic Canada and Western Canada in 2004, and launched in Quebec in 2009.

### 8. TitlePLUS claims (by policy year)



### Graph 7

As TitlePLUS insurance has become more established and well-known across the country, we have seen a steady increase in the number of TitlePLUS-eligible lawyers. With the launch of the TitlePLUS program in Quebec we expect to see the number of notaries in that province eligible to assist their clients in obtaining a TitlePLUS policy also increase.

### Graph 8

As this graph illustrates, our TitlePLUS program has seen a fairly consistent increase in the number of claims reported by TitlePLUS policyholders – as one would expect as more TitlePLUS policies are sold. But the costs for resolving those claims have increased less dramatically – a reflection of sound claims management and the fact that more than 85 per cent of claims reported are relatively minor and have an average cost of under \$4,500. The exception was the 2007 policy year which saw a number of costly building permit and fraud-related claims reported.

The apparent decrease in the number of claims and gross claim case costs for 2008 is due to the fact that statistics for claims arising out of 2008 policies are still incomplete. As is to be expected, as of February 20, 2009, when the numbers for this graph were generated, relatively few claims had been reported on TitlePLUS policies issued in 2008. We anticipate these very “young” numbers will increase over time.

Title insurance claims are generally reported at two key points in time: Shortly after a transaction closes when immediate risks (such as utility and tax arrears) are identified; and when the property changes hands (on average every three to five years) and previously unknown issues (such as old building department work orders or a prior owner’s mortgage that had not been discharged from title) are identified. Both scenarios will continue to generate claims that will affect the 2008 statistics for some time to come.

# **2008 Financial Report**

# Management Discussion and Analysis

## Accounting changes effective January 1, 2008

The Company adopted accounting standards changes under Canadian generally accepted accounting principles effective January 1, 2008 that impact its 2008 financial statements. These changes have been discussed in detail in the Company's financial statements. In summary, the Company is required to provide additional disclosures in the notes to its financial statements regarding risk and capital management, including the objectives, policies, processes and methods used to measure and manage certain risks. There are no quantitative changes to the balance sheet or income statement as a result of the adoption of these standards.

## Income Statement

In 2008, the Company generated net income of \$7.0 million, a decrease of \$10.6 million over 2007. Income before taxes decreased by \$17.9 million to \$10.2 million. Underwriting income decreased by \$12.5 million, while investment income decreased by \$5.2 million.

## Net premiums earned

Premiums earned, net of reinsurance ceded, decreased by \$6.8 million to \$85.1 million in 2008. The optional excess insurance program experienced growth of \$0.3 million in the year while the title insurance program experienced a decline of \$0.7 million during the same period. Premiums from the mandatory Ontario professional liability insurance program came in under budgeted levels as a result of a premium refund due to the Law Society's Premium Stabilization Fund under the provisions of its insurance contract.

## Net claims and adjustment expenses

Incurred claims and adjustment expenses, net of reinsurance recoveries, increased by \$8.6 million. During 2008, there was favorable development of the E&O program's prior years' claims in the amount of \$24.5 million, which partly offset the higher claims incurred in respect of both the 2008 insurance program year and the title insurance program.

## Reinsurance

The Company purchased excess of loss clash reinsurance coverage for 2008, 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 2008 were \$0.8 million higher than 2007, however were \$0.5 million lower than anticipated.

## Commissions earned

The Company earned reinsurance commissions of \$1.2 million on premium ceded in respect of its 2008 Optional Excess insurance program, similar to 2007. In addition, the Company also earned \$3.3 million of profit commissions for favourable claims development on the quota share reinsurance arrangements that it had prior to January 1, 2003, and an additional \$0.4 million relating to the excess program. 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 decreased by \$5.2 million in 2008. Investment income includes net capital gains of \$2.4 million realized on disposition of assets (\$11.3 million in 2007). At December 31, 2008 the cost of the investment portfolio exceeded its market value by \$13.0 million (2007 – cost exceeded market value by \$0.6 million).

### **Balance Sheet**

Shareholder's equity decreased by \$1.9 million, being the net income earned during the year, offset by the other comprehensive losses incurred during the same period.

### **Investments**

Investment assets, inclusive of cash and cash equivalents, increased by \$9.5 million to \$411.6 million at December 31, 2008. The increase was primarily the result of cash provided by operations and investment income generated by the portfolio. 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 \$9.0 million. Reinsurance recoveries have declined by \$9.2 million and accordingly the net increase in the provision is \$18.2 million. This increase is attributable to higher estimates of claims for the 2008 insurance program year, the impact of changes in reinsurance arrangements made since 2002, and higher estimates of claims in the title insurance program. 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 the annual financial statements have 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 4, 2009



Kathleen A. Waters  
President and CEO



Steven W. Jorgensen  
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, 2008 and the statements of income, of comprehensive (loss)/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, 2008 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*

Chartered Accountants  
Licensed Public Accountants  
February 5, 2009  
Toronto, Canada

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# Appointed Actuary's Report Expression of Opinion



**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 December 31, 2008, and their changes in the 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  
11 February 2009

*B. G. Pelly*

Brian G. Pelly  
Fellow, Canadian Institute of Actuaries

# Balance Sheet

Stated in thousands of Canadian dollars

As at December 31

## Assets

	2008	2007
Cash and cash equivalents	3,039	6,849
Investments (note 2)	406,385	393,059
Investment income due and accrued	2,165	2,210
Due from reinsurers	6,308	4,045
Due from insureds	2,216	2,162
Due from the Law Society of Upper Canada (note 5)	8,719	11,396
Reinsurers' share of provisions for unpaid claims and adjustment expenses (note 4)	46,186	55,443
Other receivables	680	436
Other assets	355	1,014
Capital assets (note 3)	3,993	729
Income taxes recoverable	5,925	1,278
Future income taxes (note 7)	2,645	2,931
<b>Total assets</b>	<b>488,616</b>	<b>481,552</b>

## Liabilities

Provision for unpaid claims and adjustment expenses (note 4)	348,646	339,621
Unearned premiums	811	787
Due to reinsurers	527	482
Due to insureds	1,332	1,254
Expenses due and accrued	2,783	2,493
Other taxes payable	638	1,095
	<b>354,737</b>	<b>345,732</b>

## Shareholder's equity (note 8)

Capital stock issued and paid	5,000	5,000
Contributed surplus	30,645	30,645
Retained earnings	108,417	101,392
Accumulated other comprehensive loss	(10,183)	(1,217)
	<b>133,879</b>	<b>135,820</b>
<b>Total liabilities and shareholder's equity</b>	<b>488,616</b>	<b>481,552</b>

See accompanying notes to financial statements

On behalf of the Board



Kathleen A. Waters  
Director



Ian D. Croft  
Director

## Correction to 2008 LawPRO Annual Report - Page 20

The words Net income were incorrectly placed, and should align with the numbers 7,025 and 17,610.

### Statement of Income

Stated in thousands of Canadian dollars

#### For the year ended December 31

	2008	2007
Premiums earned – gross	90,739	97,276
Premiums earned – ceded	(5,683)	(5,388)
<b>Net premiums earned</b>	<b>85,056</b>	<b>91,888</b>
Net claims and adjustment expenses (note 4)	81,880	73,313
Premium taxes	2,724	2,919
General expenses	15,809	15,027
Reinsurance commissions earned	(4,913)	(1,473)
	<b>95,500</b>	<b>89,786</b>
<b>Underwriting (loss)/ income</b>	<b>(10,444)</b>	<b>2,102</b>
Investment income (note 2)	20,658	25,948
Other income	31	47
<b>Income before income taxes</b>	<b>10,245</b>	<b>28,097</b>
Income tax expense (note 7)		
Current	2,877	9,971
Future	343	516
	<b>3,220</b>	<b>10,487</b>
<b>Net income</b>	<b>7,025</b>	<b>17,610</b>

See accompanying notes to financial statements

### Statement of Comprehensive (Loss)/Income

Stated in thousands of Canadian dollars

#### For the year ended December 31

	2008	2007
<b>Net income</b>	<b>7,025</b>	<b>17,610</b>
Other comprehensive loss, net of income tax:		
Net changes in unrealized gains and losses on available for sale financial assets, net of taxes of \$3,815 (2007: \$1,636)	(7,574)	(2,883)
Reclassification adjustment for gains and losses included in net income, net of taxes of \$701 (2007: \$4,071)	(1,392)	(7,201)
<b>Other comprehensive loss</b>	<b>(8,966)</b>	<b>(10,084)</b>
<b>Comprehensive (loss)/income</b>	<b>(1,941)</b>	<b>7,526</b>

See accompanying notes to financial statements

# Statement of Income

Stated in thousands of Canadian dollars

## For the year ended December 31

	2008	2007
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See accompanying notes to financial statements

# Statement of Comprehensive (Loss)/Income

Stated in thousands of Canadian dollars

## For the year ended December 31

	2008	2007
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<b>Other comprehensive loss</b>	<b>(8,966)</b>	<b>(10,084)</b>
<b>Comprehensive (loss)/income</b>	<b>(1,941)</b>	<b>7,526</b>

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
<b>Balance at December 31, 2006</b>	<b>5,000</b>	<b>30,645</b>	<b>83,374</b>	<b>–</b>	<b>119,019</b>
Transitional adjustments on adoption of new accounting standards:					
Investments – net unrealized gains (net of \$5,883 income tax)	–	–	1,942	8,867	10,809
Provision for unpaid claims and adjustment expenses (net of \$1,105 income tax)	–	–	(1,534)	–	(1,534)
Net income	–	–	17,610	–	17,610
Other comprehensive income (loss) for the year	–	–	–	(10,084)	(10,084)
<b>Balance at December 31, 2007</b>	<b>5,000</b>	<b>30,645</b>	<b>101,392</b>	<b>(1,217)</b>	<b>135,820</b>
Net income	–	–	7,025	–	7,025
Other comprehensive income (loss) for the year	–	–	–	(8,966)	(8,966)
<b>Balance at December 31, 2008</b>	<b>5,000</b>	<b>30,645</b>	<b>108,417</b>	<b>(10,183)</b>	<b>133,879</b>

The aggregate of retained earnings and accumulated other comprehensive income (loss) as at December 31, 2008 is \$98,234 (December 31, 2007 – \$100,175).

# Statement of Cash Flows

Stated in thousands of Canadian dollars

For the year ended December 31

## Operating Activities

	2008	2007
Net income	7,025	17,610
Items not affecting cash:		
Future income taxes	343	516
Amortization of capital assets	875	440
Realized gains	(2,443)	(11,306)
Amortization of premiums and discounts on bonds	(1,603)	(1,786)
Changes in unrealized gains and losses	(1,028)	1,457
	<b>3,169</b>	<b>6,931</b>

Changes in non-cash working capital balances:

Other taxes payable	(457)	17
Income taxes recoverable	(188)	1,367
Due from reinsurers	(2,218)	3,166
Due from insureds	24	(233)
Provision for unpaid claims and adjustment expenses	9,025	8,501
Reinsurers' share of provisions for unpaid claims and adjustment expenses	9,257	11,135
Unearned premiums	24	–
Expenses due and accrued	290	(242)
Investment income due and accrued	45	427
Other receivables	(244)	229
Other assets	659	(671)
Due from the Law Society of Upper Canada	2,677	(10,665)
<b>Net cash inflow from operating activities</b>	<b>22,063</b>	<b>19,962</b>

## Investing Activities

Purchases of capital assets	(4,141)	(736)
Purchases of investments	(286,316)	(258,722)
Proceeds from sales and maturities of investments	264,584	244,711
<b>Net cash outflow from investing activities</b>	<b>(25,873)</b>	<b>(14,747)</b>

Net change in cash and cash equivalents during the year

	(3,810)	5,215
Cash and cash equivalents, beginning of year	6,849	1,634
<b>Cash and cash equivalents, end of year</b>	<b>3,039</b>	<b>6,849</b>

Cash and cash equivalents at end of year consists of:

Cash	2,721	3,823
Cash equivalents	318	3,026
	<b>3,039</b>	<b>6,849</b>

See accompanying notes to financial statements

# Notes to Financial Statements

As at December 31, 2008

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 governing body for lawyers 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 primary insurance 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

#### a) Adopted during the year

Effective January 1, 2008, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Sections 1535 "Capital Disclosures", 3862 "Financial Instruments – Disclosures" and 3863 "Financial Instruments – Presentation". Section 1535 requires disclosure of an entity's objectives, policies and processes for managing capital; information about what the entity regards as capital; whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance. Sections 3862 and 3863 replace Handbook Section 3861 "Financial Instruments – Disclosure and Presentation". Section 3863 carries forward unchanged the presentation requirements of Section 3861 while Section 3862 requires additional disclosures of the nature and extent of risks arising from financial instruments, including the objectives, policies, processes and methods used to measure and manage key risks. These new disclosures are included in notes 11 and 12.

On October 17, 2008, the CICA announced amendments to Section 3855 "Financial Instruments – Recognition and Measurement" and Section 3862 "Financial Instruments – Disclosures". These amendments permit companies to move certain financial assets out of categories that require fair value changes to be recognized immediately in net income. No such transfers have been effected by the Company.

#### b) Future accounting changes

In February 2008, the CICA issued Section 3064 "Goodwill and Intangible Assets", replacing Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs". Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Provisions concerning goodwill are unchanged from the previous Section 3062. Section 3064 will be effective on a prospective basis for the Company's fiscal year beginning January 1, 2009. The new

section is not expected to have a material impact on the Company's financial statements.

The Accounting Standards Board ("AcSB") has issued an exposure draft proposing to incorporate International Financial Reporting Standards ("IFRS") into the CICA Handbook over the period ending December 31, 2010. After this transitional period, the Company will cease to use Canadian GAAP and will adopt IFRS on January 1, 2011. The Company monitors this transition to IFRS and is analyzing the impact that the adoption of the IFRS will have on its financial statements.

### Financial instruments – recognition and measurement

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.

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 fund administrators. 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. The effective interest method is used to calculate amortization/accretion of premiums or discounts on fixed income securities.

### 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.

The Company maintains a cash-flow matched investment portfolio which was designated as held for trading under the FVO. The cash-flow matched portfolio consists of fixed income investment securities the amounts and terms of which match the expected timing and magnitude of future payments of claims and adjustment expenses. The cash-flow matched portfolio represents a significant component of the Company's risk management strategy for meeting 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

# Notes to Financial Statements

As at December 31, 2008

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

otherwise arise from measuring assets, liabilities, and gains and losses under different accounting methods. Interest rate movements cause changes in the values of the investment portfolio and of discounted estimated future claims liabilities. As the changes in values of the matched portfolio and of the discounted estimated future claims liabilities flow through the income statement, the result is an offset of at least a significant portion of these changes.

Cash and cash equivalents are also classified as held for trading. Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments that mature in three months or less from the date of acquisition.

## Available for sale financial assets

Financial assets classified as available for sale are measured at fair value on the balance sheet. 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. Net changes in unrealized gains and losses are recorded in other comprehensive income ("OCI") until realized, at which time the cumulative gain or loss is reclassified to investment income in the statement of income. Also, unrealized losses that are determined to be other than temporary are reclassified to investment income. Investments in equity securities classified as available for sale that do not have quoted market prices in an active market would be measured at cost.

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, are designated as available for sale.

## 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.

## Impairment

Available for sale assets are tested for impairment on a quarterly basis. Objective evidence of impairment for bonds includes financial difficulty of the issuer, bankruptcy or defaults and delinquency in payments of interest or principal. Objective evidence of impairment for stocks includes a significant or prolonged decline in fair value of the stock below cost or changes with adverse effects that have taken place in the technological, market, economic or legal environment in which the issuer operates that may indicate that the carrying value will not recover.

Where there is objective evidence that an available for sale asset is impaired and the decline in value is considered other than temporary,

the loss accumulated in OCI is reclassified to net investment income. Once an impairment loss is recorded to income, it is not reversed. Following 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. Interest is no longer accrued and previous interest accruals are reversed.

## 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. The balance sheet adjustments relating to investments and the provision for unpaid claims and adjustment expenses (net of reinsurance) have been summarized in the statement of changes in shareholder's equity.

Although the provision for unpaid claims and adjustment expenses is not a financial instrument, its valuation is based on a discount rate that is determined on a fair value basis, under the new accounting standards, 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 \$1,105 income tax) with a corresponding reduction in opening retained earnings at January 1, 2007.

Also effective January 1, 2007, as a result of measuring investments at fair value instead of amortized cost, the cash-flow matched investment portfolio increased by \$1,942 (net of \$871 income tax) with a corresponding increase in opening retained earnings, while the surplus investment portfolio increased by \$8,867 (net of \$5,012 income tax) with a corresponding increase in accumulated other comprehensive income ("AOCI").

## 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 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.

# Notes to Financial Statements

As at December 31, 2008

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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, and therefore the Company's policy is to not recognize an asset on the balance sheet.

## 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 calculated based on accepted actuarial practice developed by the Canadian Institute of Actuaries. The provision consists of case estimates prepared by claims adjusters and a provision for incurred but not reported claims ("IBNR"). The estimates include related investigation, settlement and adjustment expenses. The estimates are regularly reviewed and updated, and any resulting adjustments are included in current income. The provision is recorded net of anticipated salvage and subrogation recoveries.

Claim liabilities are carried on a discounted basis using the yield of the underlying assets backing the claim liabilities, with a provision for adverse deviations, in accordance with accepted actuarial practice. Since the underlying assets are carried at fair value, the discount rate is the market yield.

### b) Deductibles

The 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 claims liability.

## 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 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 in income in the year to which they relate. Changes in assumptions and actuarial gains and losses are recognized in 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 adjustments and reinsurers' share thereof (note 4).

## Notes to Financial Statements

As at December 31, 2008

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

### 2. Investments

#### a) Summary

	December 31, 2008			
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available for sale				
Fixed income securities	\$ 77,962	2,035	(2,113)	77,884
Common equities	49,191	300	(15,615)	33,876
	127,153	2,335	(17,728)	111,760
Held for trading under FVO				
Fixed income securities	290,637	7,117	(4,467)	293,287
Preferred equities	1,605	10	(277)	1,338
	292,242	7,127	(4,744)	294,625
<b>Total</b>	<b>\$ 419,395</b>	<b>9,462</b>	<b>(22,472)</b>	<b>406,385</b>
Reconciled in aggregate to asset classes as follows:				
Fixed income securities	\$ 368,599	9,152	(6,580)	371,171
Equities	50,796	310	(15,892)	35,214
<b>Total</b>	<b>\$ 419,395</b>	<b>9,462</b>	<b>(22,472)</b>	<b>406,385</b>

	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
<b>Total</b>	<b>\$ 393,615</b>	<b>6,122</b>	<b>(6,678)</b>	<b>393,059</b>
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
<b>Total</b>	<b>\$ 393,615</b>	<b>6,122</b>	<b>(6,678)</b>	<b>393,059</b>

The available for sale assets disclosed in the preceding tables exhibit evidence of impairment; however, no impairment loss has been recognized in net income because it is not considered other than temporary, due to factors such as a lack of prolonged decline and/or the existence of good prospects for future recovery.

#### b) Realized/change in unrealized 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 are as follows:

	2008					
	Net realized gains (losses)			Increase (decrease) in unrealized gains and losses		
	Gross	Tax	Net	Gross	Tax	Net
Fixed income securities	\$ 931	(312)	619	(635)	212	(423)
Equities	1,162	(389)	773	(12,847)	4,304	(8,543)
<b>Total</b>	<b>\$ 2,093</b>	<b>(701)</b>	<b>1,392</b>	<b>(13,482)</b>	<b>4,516</b>	<b>(8,966)</b>

	2007					
	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	(14,911)	5,386	(9,525)
<b>Total</b>	<b>\$ 11,272</b>	<b>(4,071)</b>	<b>7,201</b>	<b>(15,790)</b>	<b>5,706</b>	<b>(10,084)</b>

#### c) 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:

	2008			2007		
	Held for trading under FVO	Available for sale	Total	Held for trading under FVO	Available for sale	Total
Interest	\$ 12,444	4,141	16,585	\$ 11,246	4,192	15,438
Dividends	77	1,152	1,229	113	1,174	1,287
Net realized gains	350	2,093	2,443	35	11,272	11,307
Change in net unrealized gains and losses	1,028	–	1,028	(1,457)	–	(1,457)
	13,899	7,386	21,285	9,937	16,638	26,575
Less: Investment expenses	(321)	(306)	(627)	(276)	(351)	(627)
Investment income	\$ 13,578	7,080	20,658	\$ 9,661	16,287	25,948

## Notes to Financial Statements

As at December 31, 2008

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### d) Maturity profile of fixed income securities

The maturity profile of fixed income securities and its analysis by type of issuer is as follows:

December 31, 2008	Within 1 Year	1 to 5 Years	Over 5 Years	Total
<b>Available for sale</b>				
Issued or guaranteed by:				
Canadian federal government	\$ –	23,177	1,131	24,308
Canadian provincial and municipal government	–	1,203	2,969	4,172
Other government	–	–	–	–
Mortgage backed securities	–	1,350	18,071	19,421
Corporate debt	–	3,944	26,039	29,983
	\$ –	29,674	48,210	77,884
<b>Held for trading under FVO</b>				
Issued or guaranteed by:				
Canadian federal government	\$ 39,474	63,594	17,355	120,423
Canadian provincial and municipal government	7,455	18,038	48,712	74,205
Other government	–	5,371	2,496	7,867
Mortgage backed securities	–	1,248	1,351	2,599
Corporate debt	16,138	54,364	17,691	88,193
	\$ 63,067	142,615	87,605	293,287
<b>Fixed income securities</b>	<b>\$ 63,067</b>	<b>172,289</b>	<b>135,815</b>	<b>371,171</b>
Percent of total	17%	46%	37%	100%

December 31, 2007	Within 1 Year	1 to 5 Years	Over 5 Years	Total
<b>Available for sale</b>				
Issued or guaranteed by:				
Canadian federal government	\$ 282	30,255	15,100	45,637
Canadian provincial and municipal government	–	–	1,501	1,501
Other government	–	–	–	–
Mortgage backed securities	–	1,122	16,607	17,729
Corporate debt	–	1,740	20,671	22,411
	\$ 282	33,117	53,879	87,278
<b>Held for trading under FVO</b>				
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
Mortgage backed securities	895	–	–	895
Corporate debt	15,925	55,880	21,855	93,660
	\$ 56,101	138,853	72,864	267,818
<b>Fixed income securities</b>	<b>\$ 56,383</b>	<b>171,970</b>	<b>126,743</b>	<b>355,096</b>
Percent of total	16%	48%	36%	100%

The weighted average duration of fixed income securities at December 31, 2008 is 4.32 years (2007: 4.44 years). The effective yield on fixed income securities as at December 31, 2008 is 3.96% (2007: 3.95%).

### 3. Capital Assets

	2008			2007
	Cost	Accumulated amortization	Carrying value	Carrying value
Furniture & Fixtures	\$ 1,320	(242)	1,078	32
Computer Equipment	979	(543)	436	539
Computer Software	216	(128)	88	158
Leasehold Improvements	2,600	(209)	2,391	–
<b>Total</b>	<b>\$ 5,115</b>	<b>(1,122)</b>	<b>3,993</b>	<b>729</b>

### 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 claims liabilities at least annually. As adjustments to estimated claims 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 ascertain the creditworthiness of the companies to which it cedes. Based on current information of the financial

## Notes to Financial Statements

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health of the reinsurers, no provision for doubtful debts has been made in the financial statements in respect of reinsurers.

Details of the provision for unpaid claims and adjustment expenses, by line of business, is summarized as follows:

December 31, 2008	Gross	Ceded	Net
Liability	\$ 337,185	(46,019)	291,166
Title	11,461	(167)	11,294
<b>Total</b>	<b>\$ 348,646</b>	<b>(46,186)</b>	<b>302,460</b>

December 31, 2007	Gross	Ceded	Net
Liability	\$ 332,602	(55,208)	277,394
Title	7,019	(235)	6,784
<b>Total</b>	<b>\$ 339,621</b>	<b>(55,443)</b>	<b>284,178</b>

Changes in the provision for unpaid claims and adjustment expenses recorded in the balance sheet comprised of the following:

	2008	2007
Provision for unpaid claims and adjustment expenses – beginning of year – net	\$ 284,178	261,903
Transitional adjustment on adoption of new accounting standards	–	2,639
	284,178	264,542
Change in net provision for claims and adjustment expenses due to:		
Prior years' incurred claims	(15,143)	(13,143)
Current year's incurred claims	94,470	91,046
Net claims and adjustment expenses paid in relation to:		
Prior years	(55,099)	(47,184)
Current year	(8,499)	(6,811)
Impact of discounting	2,553	(4,272)
Provision for unpaid claims and adjustment expenses – end of period – net	302,460	284,178
Reinsurers' share of provisions for unpaid claims and adjustment expenses	46,186	55,443
Provision for unpaid claims and adjustment expenses – end of period – gross	<b>\$ 348,646</b>	<b>339,621</b>

Details of the net claims and adjustment expenses for the year ended December 31 are as follows:

	2008			2007		
	Gross	Ceded	Net	Gross	Ceded	Net
Claims & adjustment expenses paid	\$64,653	6,527	58,126	57,734	9,299	48,435
Change in case reserves	10,517	(7,490)	18,007	17,264	(11,136)	28,400
Change in IBNR	(6,175)	(3,367)	(2,808)	(5,215)	(505)	(4,710)
Discount expense/(income)	3,350	797	2,553	(3,294)	978	(4,272)
Unallocated loss adjustment expenses paid	5,472	–	5,472	5,143	–	5,143
Change in ULAE	530	–	530	317	–	317
	<b>\$78,347</b>	<b>(3,533)</b>	<b>81,880</b>	<b>71,949</b>	<b>(1,364)</b>	<b>73,313</b>

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 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.

Commencing January 1, 1995, there was no longer the LSUC deductible and 100% of the risk over the individual member deductible was insured through the Company. The annual policy limits for each of the years effective January 1, 1995 to December 31, 2008, are \$1,000 per claim and \$2,000 in aggregate per member.

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For the year ended December 31, 2008, 87% of the premiums written related to mandatory insurance coverage provided to LSUC and its members (2007: 87%). 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 LSUC and member 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. For 2008, the Company has estimated a refund of premium of \$1,415 (2007: \$2,276 additional premium) to the Fund pursuant to the retrospective premium rating provisions of its insurance policy. This retrospective premium forms part of the net inter-company balance due from LSUC of \$8,719 (2007: \$11,396).

### 6. Employee Future Benefits

The Company has a defined contribution pension plan which is available to 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 \$468 in 2008 (2007: \$447) and recorded pension expense of \$470 (2007: \$453).

The Company also has a supplemental defined benefit pension plan. Funding for the supplemental plan commenced in 2005, with payments of \$756 in 2008 (2007: \$823) and recorded pension expenses of \$1,026 in 2008 (2007: \$206). 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, 2008. For reporting purposes, all assets and liabilities associated with pension benefits have been measured using values as at December 31, 2008.

Accrued benefit obligation	2008	2007
Balance, beginning of the year	\$ 2,312	2,164
Current service cost	191	145
Interest cost	162	115
Actuarial loss (gain)	(461)	(76)
Special termination benefit	–	373
Curtailement	–	(409)
Plan amendment	734	–
Balance, end of year	<b>\$ 2,938</b>	<b>2,312</b>

Fair value of plan assets	2008	2007
Market value of plan assets – beginning of year	\$ 2,346	1,560
Actual return on plan assets, net of expenses	(240)	(37)
Employer contribution	756	823
Market value of plan assets – end of year	<b>\$ 2,862</b>	<b>2,346</b>

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 plans to the amounts recorded in the financial statements:*

	2008	2007
Fair value of plan assets	\$ 2,862	2,346
Accrued benefit obligation	(2,938)	(2,312)
Funded status surplus (deficit)	(76)	34
Unamortized net actuarial loss	(135)	25
Accrued benefit asset (liability)	<b>\$ (211)</b>	<b>59</b>

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:*

	2008	2007
Current service cost	\$ 190	145
Interest cost	162	115
Actual return on assets	240	37
Actuarial losses	(461)	(75)
Special termination benefit	–	373
Curtailement	–	(409)
Past service cost	734	–
Difference between actual and recognized actuarial losses	486	120
Difference between actual and expected return on assets	(325)	(100)
Defined benefit costs recognized in the statement of income	<b>\$ 1,026</b>	<b>206</b>

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

	2008	2007
Discount rate	6.50%	5.25%
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 following table reconciles the difference between the income taxes that would result solely by applying statutory tax rates to pre-tax income and the income taxes actually provided in the financial statements.

## Notes to Financial Statements

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	2008	2007
Net income before taxes	\$ 10,245	28,097
Provision for income taxes at statutory rates	3,432	10,149
Increase/(decrease) resulting from:		
Unpaid claims	221	1,447
Investments	(466)	(632)
Other	33	(477)
Provision for income taxes	<b>\$ 3,220</b>	<b>10,487</b>

The Company's statutory income tax rate for the year ended December 31, 2008 is 33.50% (2007: 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:

	2008	2007
Investments	\$ (2,100)	(1,668)
Net provision for unpaid claims and adjustment expenses	4,591	4,505
Other	154	94
Total	<b>\$ 2,645</b>	<b>2,931</b>

During the year the Company made payments of \$4,438 and received refunds of \$1,374 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 \$7,866 (2007: \$7,697) 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 \$50 (2007: \$51).

### 10. Operating Lease Commitments

The Company entered into a lease effective February 1, 2008, for new premises at 250 Yonge Street.

At December 31, 2008, lease obligations on office premises were as follows:

2009	\$ 1,220
2010	1,220
2011	1,220
2012	1,220
2013	1,220
Thereafter	5,388

### 11. Risk Management

The Company employs an enterprise-wide risk management framework which establishes practices for risk management and includes policies, processes to identify, assess, manage and monitor risks and risk tolerance limits. It provides governance and supervision of risk management activities across the Company's business units, promoting the discipline and consistency applied to the practice of risk management.

The Company's risk framework is designed to minimize risks that could materially adversely affect the value or stature of the Company, to contribute to stable and sustainable returns, to identify risks that the Company can manage in order to increase earnings, and to provide transparency of the Company's risks through internal and external reporting. The Company's risk philosophy involves undertaking risks for appropriate return and accepting those risks that meet its objectives. The Company's risk management program is aligned with its long term vision and its culture supports an effective risk management program. The key components of the risk culture include acting with fairness, appreciating the impact of risk on all major stakeholders, embedding risk management into day to day business activities, fostering full and transparent communications, cooperation, and aligning of objectives and incentives.

#### a) Insurance risk

Insurance risk is the risk of loss due to actual experience differing from the experience assumed when a product was designed and priced with respect to claims, policyholder behaviour and expenses. A variety of assumptions are made related to the future level of claims, policyholder behaviour, expenses and sales levels when products are designed and priced as well as in the determination of actuarial liabilities. The development of assumptions for future claims are based on Company and industry experience; assumptions for policyholder behaviour are based on Company experience and predictive models. Such assumptions require a significant amount of professional judgment and therefore, actual experience may be materially different than the assumptions made by the Company. The Company has policies and procedures in place in order to monitor and control these risks.

## Notes to Financial Statements

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### b) Credit risk

Credit risk is the risk of loss due to the inability or unwillingness of a borrower or counterparty to fulfill its payment obligation to the Company. Credit risks arise from investments in fixed income securities and preferred shares, and its balances due from insureds and reinsurers.

Management monitors credit risk and any mitigating controls. The Company has established a credit review process where the credit quality of all exposures is continually monitored so that appropriate prompt action can be taken when there is a change which may have material impact.

Governance processes around investments include oversight by the Board of Directors' Investment Committee. 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.

With respect to credit risk arising from balances due from reinsurers, the Company's exposure is measured as both current exposure and potential future exposure reflecting the level of ceded liabilities. Reinsurance and insurance counterparties must also meet minimum risk rating criteria. The Company's Board of Directors has approved a reinsurance policy, which is monitored by the Company's Audit Committee.

The credit risk profile of the Company's investments in fixed income securities and term deposits as at December 31, 2008, is provided below.

Credit rating	Market value	% of Total holdings
AAA	\$ 165,287	45%
AA	75,259	20%
A	97,887	26%
BBB	17,465	5%
BB or lower	–	0%
Not rated	15,273	4%
<b>Total</b>	<b>\$ 371,171</b>	<b>100%</b>

### c) Liquidity risk

Liquidity risk is the risk that the Company will not have enough funds available to meet all expected and unexpected cash outflow commitments as they fall due. Under stressed conditions, unexpected cash demands could arise primarily from a significant increase in the level of claim payment demands.

To manage its cash flow requirements, the Company has arranged diversified funding sources and maintains a significant portion of its

invested assets in highly liquid securities such as cash and cash equivalents and government bonds (see note 2d). In addition, the Company has established counterparty exposure limits that aim to ensure that exposures are not so large that they may impact the ability to liquidate investments in their market value.

Claims liabilities account for the majority of the Company's liquidity risk. 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 these claims 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 claims are settled. The remainder of the Company's overall investment portfolio, the available for sale portfolio, 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.

The following table summarizes carrying amounts of financial instruments and insurance assets and liabilities as at December 31, 2008 by contractual maturity or expected cash flow dates (the actual repricing dates may differ from contractual maturity because certain securities and debentures have the right to call or prepay obligations with or without call or prepayment penalties).

	Within 1 year	1 to 5 years	5 to 10 years	More than 10 years	No fixed Maturity	Total
<b>Assets</b>						
Cash and cash equivalents	\$ 3,039	–	–	–	–	3,039
Investments – held for trading under FVO	63,067	142,615	59,582	28,023	1,338	294,625
Investments – available for sale	–	29,674	21,035	27,175	33,876	111,760
Investment income due and accrued	2,165	–	–	–	–	2,165
Due from reinsurers	6,308	–	–	–	–	6,308
Due from insureds	2,216	–	–	–	–	2,216
Due from LSUC	8,719	–	–	–	–	8,719
Reinsurers' share of unpaid claims	12,201	25,593	7,098	1,294	–	46,186
Other receivable	680	–	–	–	–	680
Other assets	330	25	–	–	–	355
Income taxes recoverable	5,925	–	–	–	–	5,925
<b>Total</b>	<b>\$104,650</b>	<b>197,907</b>	<b>87,715</b>	<b>56,492</b>	<b>35,214</b>	<b>481,978</b>
<b>Liabilities</b>						
Provision for unpaid claims	\$ 72,006	196,354	61,564	18,722	–	348,646
Due to reinsurers	527	–	–	–	–	527
Due to insureds	1,332	–	–	–	–	1,332
Expenses due and accrued	2,783	–	–	–	–	2,783
<b>Total</b>	<b>\$ 76,648</b>	<b>196,354</b>	<b>61,564</b>	<b>18,722</b>	<b>–</b>	<b>353,288</b>

## Notes to Financial Statements

As at December 31, 2008

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

### d) Market and interest rate risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rate, foreign exchange rates, and equity prices. Due to the nature of the Company's business, invested assets and insurance liabilities as well as revenues and expenses are impacted by movements in capital markets, interest rates, and to a lesser extent, foreign currency exchange rates. Accordingly, the Company considers these risks together in managing its asset and liability positions and ensuring that risks are properly addressed. These risks are referred to collectively as market price and interest rate risk – the risk of loss resulting from movements in market price, interest rate, credit spreads and foreign currency rates.

Interest rate risk is the potential for financial loss arising from changes in interest rates. The Company is exposed to interest rate price risk on monetary financial assets and liabilities that have a fixed interest rate and is exposed to interest rate cash flow risk on monetary financial assets and liabilities with floating interest rates that are reset as market rates change.

For held for trading assets and other financial assets supporting actuarial liabilities, the Company is exposed to interest rate risk when the cash flows from assets and the policy obligations they support are significantly mismatched, as this may result in the need to either sell assets to meet policy payments and expenses or reinvest excess asset cash flows under unfavourable interest environments. The estimated impact on the Company of an immediate parallel increase of 1% in interest rates as at December 31, 2008, across the yield curve in all markets, would be a decrease in net investment income of \$9,903 and a decrease in net claims and adjustment expenses of \$9,975, and conversely, an immediate 1% parallel decrease in interest rates would result in an estimated increase in net investment income of \$10,621 and an increase in net claims and adjustment expenses of \$10,701.

Bonds designated as available for sale generally do not support actuarial liabilities. Changes in fair value of available for sale fixed income securities are recorded to OCI. For the Company's available for sale fixed income securities, an immediate 1% parallel increase in interest rates at December 31, 2008, across the entire yield curve, would result in an estimated after-tax decrease in OCI of \$3,269. Conversely, an immediate 1% parallel decrease in interest rates would result in an estimated after-tax increase in OCI of \$3,766.

Market price and interest rate risk is managed through established policies and standards of practice that limit market price and interest rate risk exposure. Company-wide market price and interest rate risk limits are established and actual positions are monitored against limits. Target asset mixes, term profiles, and risk limits are updated regularly

and communicated to portfolio managers. Actual asset positions are periodically rebalanced to within established limits.

Equity price risk is the risk that the fair values of equities decrease as the result of changes in the levels of equity indices and the value of individual stocks. The Company's equities are designated as available for sale and generally do not support actuarial liabilities. Assuming all other variables held constant, an immediate 10% increase in stock prices at December 31, 2008, would result in an estimated after-tax increase in OCI of \$2,250, and conversely, an immediate 10% decrease in stock prices would result in an estimated after-tax decrease in OCI of \$2,250.

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates, in particular when an asset and liability mismatch exists in a different currency than the currency in which they are measured. While a substantial majority of the investment portfolio is invested in Canadian dollar denominated fixed income securities, during the year ended December 31, 2008 less than 10% of the portfolio was invested in equities (2007: 10%), with approximately half of the equities portfolio held in foreign denominated securities (2007: 60%). As the Company does not hold significant liabilities in foreign currencies, the resulting currency risk is borne by the Company and forms part of its overall investment income.

The Company also manages possible excessive concentration of risk. Excessive concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political and other conditions. Concentrations indicate the relative sensitivity of the Company's performance to developments affecting a particular industry or geographic location. In order to avoid excessive concentrations of risk, the Company applies specific policies on maintaining a diversified portfolio. Identified risk concentrations are managed accordingly.

The following table summarizes the carrying amounts of financial instruments as at December 31, 2008, by geographical location of the issuer:

	Fixed Income Securities	Equities	Total	% of Total
Canada	\$ 371,171	15,398	386,569	95.1%
USA	–	8,275	8,275	2.0%
Japan	–	2,548	2,548	0.6%
United Kingdom	–	1,445	1,445	0.4%
Others	–	7,548	7,548	1.9%
<b>Total</b>	<b>\$ 371,171</b>	<b>35,214</b>	<b>406,385</b>	<b>100.0%</b>

## Notes to Financial Statements

As at December 31, 2008

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

### 12. Capital Management

Capital is comprised of the Company's shareholder's equity. As at December 31, 2008 the Company's shareholder's equity was \$133,879 (2007: \$135,820). The Company's objectives when managing capital are to maintain financial strength and protect its claims paying abilities, to maintain creditworthiness and to maximize returns for shareholders over the long term. Senior management develops the capital strategy and oversees the capital management processes of the Company. Capital is managed using both regulatory capital measures and internal metrics.

FSCO, the Company's primary insurance regulator, along with other provincial insurance regulators, regulate the capital required in the Company using two key measures, i.e., Minimum Capital Test ("MCT") and the Dynamic Capital Adequacy Test ("DCAT"). The minimum solvency ratio targeted by the Company is 175%, which is higher than the regulatory MCT requirement of 150%. To monitor current

and future capital requirements, the Company's appointed actuary models the Company's expected financial position under various adverse scenarios. The appointed actuary must present both an annual report and the DCAT report to management and the Audit Committee. During the year ended December 31, 2008, the Company complied with the various provincial regulators' guidelines and as at December 31, 2008, the Company has a MCT ratio of 219% (2007: 238%).

A common measure of capital adequacy in the property and casualty industry used by management is the ratio of net premiums to surplus (or shareholder's equity). The higher the ratio, the greater is the potential risk borne by the Company in relation to the surplus available to absorb loss variations. The net premiums written to surplus ratio at December 31, 2008, was 0.64 (2007: 0.68).

The Company may use reinsurance to manage its capital position.

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