L|PIC

2001 annual report

About Lawyers' Professional Indemnity Company

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

Incorporated in 1990 by the Law Society of Upper Canada, LPIC operates independently with its own management and Board of Directors.

LPIC operates in a commercially viable and responsible manner in accordance with the regulations of the Ontario Insurance Act, the Ontario Corporations Act, and other applicable legislation.

In 2001, LPIC provided liability insurance to more than 18,000 members of the Law Society of Upper Canada, and managed the liability insurance program of the Law Society of Newfoundland and Labrador. Through TitlePLUS®, LPIC also provides comprehensive title insurance and legal services coverage for residential purchase and mortgage-only/refinance transactions handled by lawyers.

Our Mission Statement

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

contents

remarks of the chairman

In early 1995, as LPIC first became an independent insurance company, I outlined my expectations for this new organization: LPIC should be operated independently of the Law Society; it should represent the interests of the profession; and it should be run as an economically viable insurance company, vigorously defending claims, and charging premiums that are determined in a commercially reasonable manner reflecting risk experience. I also spoke in favour of the insurance program model recommended by the Insurance Task Force. Since then, having been on the LPIC Board since 1994, and its Chair since 1997, I find that my view has not changed. I believe that this model should be continued, mainly because it is in the interests of all the members of the profession.

I take pleasure in confirming that LPIC continues to enjoy great success. We have received an "A" (Excellent) rating for the second year in a row from a premier rating organization, the A.M. Best Company. For 2001, LPIC had $399 million in assets, $72.3 million in equity, and an after-tax profit of $8.7 million. The number of open claims files continued to decline, and stood at 3,056 at year end compared to 6,681 in 1994. TitlePLUS and practicePRO®, as well as sound management of the claims portfolio, speak to LPIC's strong service commitment to the profession.

LPIC's ability to lower premiums is another sign of success. At $2,800 per lawyer, premiums in 2001 were half of what they were in 1995, when LPIC assumed responsibility for managing the Law Society's Errors and Omissions Program. Premiums for 2002 are lower still at $2,700 per lawyer. In addition, nearly 40% of lawyers pay even less than that because of the various risk-rated premium discounts available.

This year I have decided to step down as a Director and Chair of LPIC, and I would like to thank everyone who has been involved in making LPIC a success. In particular, I would like to thank the Insurance Task Force for steering us in the right direction; my fellow Board members for their active contributions; the profession itself for keeping the claims down and incorporating LPIC's numerous risk management initiatives into legal practice; and the management team and staff at LPIC for their continued outstanding efforts and commitment to serving the lawyers in Ontario.

I intend to continue as an active Bencher of the Law Society of Upper Canada and a sole practitioner in Thunder Bay.

LPIC is in very capable hands, and I wish everyone the best. It has been an honour and a privilege to serve as Chair of LPIC for the past five years.

Ross W. Murray

Ross W. Murray, Q.C.

remarks of the president

This time last year, I said that we would not have to look far to find challenges in 2001. But I could never have envisaged the complexity and impact of forces that would challenge the insurance industry, the legal profession and LPIC, this past year.

An economic downturn brought falling equity markets, and lower bond interest rates drastically reduced investment income – a significant portion of LPIC's revenues. The events of September 11 shook the very foundations of the insurance industry, causing significant loss of capacity in the reinsurance marketplace that we rely on to share our risk with. Some reinsurers opted not to continue underwriting certain lines of business – professional liability included.

In light of all this, our excellent results are all the more gratifying. The strong footing we have built through the past seven years enabled us to weather this tumultuous year without incident.

Our financial position is strong and secure, as confirmed by our "A" rating from A.M. Best Co. The claims portfolio is well managed. Most importantly, we have built a highly motivated, knowledgeable and creative team who capably rise to the challenge of making LPIC a leader in anticipating and meeting lawyers' needs.

Although liability insurance remains a core focus, we are evolving in the interests of the profession. Our expanded mandate is to provide you with a range of products and services that enhance the competitive position of the legal profession; TitlePLUS, our title insurance program, and practicePRO®, our risk and change management initiative, are examples of this mandate in action. In 2001, we took the evolution of LPIC to a new level, launching new technology initiatives and several new Web-based TitlePLUS programs that support the introduction of TitlePLUS in other jurisdictions across Canada.

The time has come for LAWyers' PROfessional Indemnity Company (LPIC) to be reborn as LAWPRO.

LAWPRO will become the umbrella for our insurance-related initiatives, starting with our new LAWPRO publication. By this time next year, LPIC will be LAWPRO – the new hallmark for the profession. LAWPRO: It's who we are, and what we do.

My first full year as LPIC's president has strengthened my conviction in our future as a leader of the profession, and my confidence in the management team and employees, who thrive on challenge. My special thanks go to the members of our Board of Directors, whose support and guidance proved especially valuable in these most interesting of times.

Michelle L.M. Strom

liability insurance

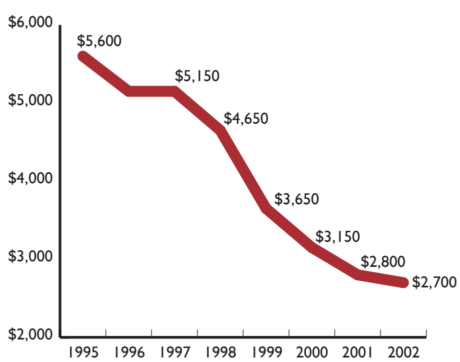
As the insurer to the legal profession in Ontario, LPIC is focused on providing lawyers with financially sound, well-managed insurance programs that respond to both our customer's needs and the changing environment in which lawyers practise. The strength and viability of these programs enhances our ability to grow and to innovate.

Our success in managing these core insurance operations was affirmed again by A.M Best Co. In 2001, this leading insurance rating agency awarded LPIC an "A" (Excellent) rating, commenting favourably on our prudent underwriting, focus on customer service, sophisticated claims handling, effective reinsurance program, proactive risk management and TitlePLUS, our title insurance program.

growth

In 2001, LPIC provided liability insurance coverage to a record 18,018 Ontario lawyers, compared to 17,800 the previous year. A history of sound management of the program enabled us to reduce premiums to the lowest levels paid by lawyers in close to a decade. In 2001, base premiums fell $350 to $2,800 per lawyer – half of the $5,600 that lawyers paid in 1995 when LPIC assumed responsibility for managing the insurance program. An additional $100 reduction for 2002 brings base premiums to a new low of $2,700 per lawyer.

LPIC base premium per lawyer (1995-2002)



LPIC's ongoing efforts to better inform lawyers about the appropriate levels of liability insurance, and how they can tailor their coverage to meet their specific needs also bore fruit in 2001. In each of the last two years, more Ontario lawyers purchased optional coverages, such as increased innocent party protection and lower deductibles, ensuring their coverage better reflects the risk associated with their specific law practice.

As well, about 40 per cent of lawyers benefited from premium reductions available to those who are new to law practice, practise part-time, restrict their practice to criminal and/or immigration law, or opt for non-standard insurance deductibles.

More than 11,200 lawyers – about 64 per cent of the practising bar – took advantage of the $50 e-filing premium discount, while close to 40 per cent reduced premiums an additional $150 per lawyer by opting to pay premiums early and in a lump sum.

LPIC Excess Program: Rapid Growth

Our success at highlighting the need for adequate liability insurance coverage is most apparent in the significant growth in the LPIC Excess Liability Insurance program. Launched in 1998, the Excess program now insures more than 1,800 lawyers in just under 800 law firms, about 15 per cent of lawyers practising in small and mid-size law firms. In the last two years alone, we have grown this business, which competes with the private marketplace, by more than 50 per cent.

In 2001, 165 new firms, most of whom had never previously secured excess coverage, opted to place their excess coverage with

LPIC, a 30 per cent increase from the previous year. Despite an increase in the excess premium, prompted by significant increases in reinsurance costs as a result of the events of September 11th, 97 per cent of firms opted to renew coverage with LPIC for 2002. This program's ability to attract and retain business speaks volumes about the quality of our excess program and the need it fills for Ontario lawyers.

Serving Lawyers Via The Web

The profession's increased use of the Web to transact business with LPIC was apparent in both an increase in the number of lawyers who e-filed their insurance application, and a decrease in the volume of telephone inquiries that came in to our Customer Service department.

Over the last two years, the number of lawyers who e-filed increased by more than 20 per cent; in 2001, a record 12,700 lawyers filed applications electronically for their 2002 insurance coverage. As well, about one-third of new applications for Excess Insurance came in via the Web site, while an increasing number of lawyers are opting to file their quarterly transaction levy forms electronically.

In 2001, the volume of inquiries handled by our Customer Service team decreased for the first time in six years. Call volumes were down almost 15 per cent to 48,000 calls from 56,000 in 2000, due in large part to an enhanced Web site, improved e-filing processes, and active promotion of Web-based tools and resources. Today, e-mail accounts for about one-third of all contact between LPIC and lawyers seeking liability insurance information.

Building on this trend to electronic communication, we focused on delivering more of our products and services via our Web site. We chose, for example, to distribute the 2002 insurance policy and forms books electronically rather than in print form, at an estimated savings of over $25,000. We transformed our principal communication vehicle – the LPIC News – into an electronic newsletter distributed periodically via e-mail. Fast-breaking news, key deadline reminders and the like will be communicated to lawyers electronically, ensuring timely and streamlined access to information.

Professional liability claims

A Reduced File Load

Claims reported in 2001 were roughly consistent, both in average severity (cost per claim) and in number, with those reported a year earlier.

Number of claims reported per thousand lawyers insured by LPIC

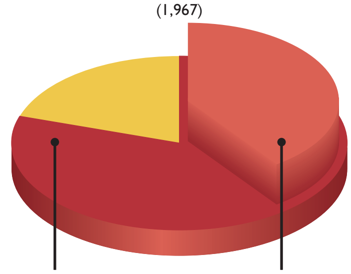
Although the number of lawyers insured under the LPIC program has increased by more than 1,700 since 1995, the number of new claims reported annually has fallen consistently until just this past year when the number of new claims reported increased slightly to 1,836 from 1,780 in 2000.

In 2001, 1,836 new claims were reported, while 1,967 claims were closed. Accordingly, the number of open files continued to decline: At December 2001, we had 3,056 open files – a new low, and down from 3,187 in 2000. This compares to a peak of 6,681 open files in 1994, when LPIC assumed responsibility for management of the Law Society's professional liability insurance program.

Another measure of success is our consistent ability to close new claims quickly, and often at no or minimal cost to the program. Of the 1,967 claims that we closed in 2001, close to 40 per cent (780) were closed without any payment for either expenses or indemnity. Moreover, we closed 80 per cent of these files (1,580) without any indemnity payment made. This track record speaks to our proactive claims management philosophy. We establish a resolution strategy early in the life of each file;

where there is liability, claims are resolved expeditiously and cost effectively; and LPIC will not pay out frivolous claims to make them go away.

Claims closed in 2001
(1,967)



A claims management strategy that emphasizes resolving claims quickly and cost-effectively, combined with our ability to draw on in-house claims expertise, enables LPIC to consistently close approximately 40 per cent of claims without making any payment for defence or indemnity.

A Decrease In Large File Inventory

Claims payments at $63.2 million were in line with payments in 1998 and 1999, but about $10 million higher than in 2000, due in large part to a tripling in the number of large files closed with indemnity payments of between $500,000 and $1 million.

This increase is the result of a convergence of several developments:

- increased use of case management which significantly shortens the litigation process;
- LPIC's own strategy of resolving claims expeditiously, which has significantly shortened the time it takes to close files; and
- an increase in the number of older, complex files that were resolved in the past year, either at court or through other resolution strategies.

As a result, claims payments on large files accounted for more than one-third of the $38.9 million that we paid in indemnity in 2001.

The overall impact on the program however, is negligible, as we had appropriately reserved for these more complex and costly files.

Moreover, the increase in activity on these files has significantly decreased our inventory of large files. This, combined with a decrease in the number of new large claims reported in the past year, bodes well for the future of the insurance program.

Managing Defence Costs

Prudent claims management ensured that we were able to control the cost of defending these larger claims, as well as others in our portfolio, in 2001. Overall defence costs increased only two per cent to $20.9 million from $20.6 million, led largely by an increase in fees for expert reports, appraisals, mediation and arbitration. These increases reflect the increased cost associated with resolving larger claims, as well as a trend to early mediation on newer files – a trend which itself ultimately helps us reduce the overall cost of the claim. Costs for these "other" payments increased to $2.8 from $2.2 million, while adjusting fees fell to $0.5 million from $0.6 million a year earlier.

LPIC is always seeking new ways to manage its claims portfolio and defence costs. To help us resolve more complex files, we draw on the experience and expertise of a group of seasoned counsel.

But not all claims files require senior-level counsel. To address this reality, and the need to develop the next generation of expertise, we recently introduced two initiatives aimed at furthering the ability of more junior lawyers to manage claims files.

One was a pilot project in which a firm seconded a junior lawyer to LPIC for one year; the junior did only our defence work. The success of this project prompted us to launch a mentoring initiative in 2001, which has junior lawyers in a number of defence firms mentored by both LPIC claims examiners and a senior lawyer in their firm. The juniors handle all aspects of several of LPIC's smaller, less complex claims, thus gaining exposure to all stages of litigation and insight into claims handling from a client perspective. Moreover, files are resolved in a cost-effective fashion by a lawyer with the appropriate level of experience and expertise. We expect this program will yield a group of junior lawyers who can expertly deal with our claims.

Success At Trial

LPIC's continued proactive position on claims matters also continued to pay off in 2001, resulting in wins on 24 of the 28 matters that we took to trial and/or the Court of Appeal. As well, we were successful in 18 summary judgment applications, thus minimizing costs to all parties by taking claims which we feel have no merit off the costly litigation track.

The overall success of our claims handling was also corroborated by a key client group – lawyers whose claims files we closed. Last year we expanded the scope of a survey given to lawyers, asking them to evaluate both our claims handling and the work of defence counsel. The results were a strong endorsement for the work of both: 93 per cent said they were satisfied with the way LPIC handled the claim; 85 per cent felt LPIC received value for defence monies spent; and 87 per cent were satisfied with defence counsel services overall, and would ask the firm to represent them again, if needed.

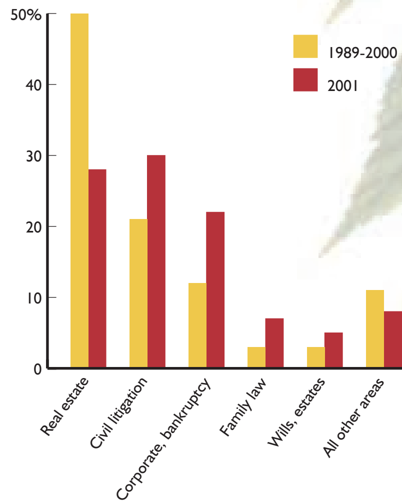
Litigation Claims Outpace Real Estate Losses

The impact of title insurance on real estate claims, first apparent in 2000, was even more pronounced in 2001. As the frequency and cost of real estate claims declined, litigation assumed top spot as the area of practice generating the most claims and claims costs.

In 2001, the broad category of litigation claims (civil litigation, family law and criminal law) accounted for more than 38 per cent of claims costs and 45 per cent of claims reported, consistent with numbers reported in 2000.

Distribution of claims by area of practice

(% of gross claims costs)



Moreover, civil litigation (defence and plaintiff litigation) claims alone outpaced real estate claims in 2001. Civil litigation claims accounted for 30 per cent of claims costs and 36 per cent of claims reported. This compares to real estate claims, which in 2001 represented only 28 per cent of claims costs and 26 per cent of reported claims. The decline in real estate claims represents a significant savings to the claims portfolio.

practicePRO

The launch of our practicePRO initiative three years ago recognized the integral role that risk and change management play in a strong, responsive insurance program, and in the legal profession's ability to thrive and compete in a changing practice environment.

Expanding the scope of risk management

A significant initiative for practicePRO in 2001 was to ensure lawyers understand their obligations under the *Proceeds of Crime (Money Laundering) and Terrorism Financing Act*, new federal legislation designed to curb money laundering. To help lawyers prepare to comply with the Act, practicePRO developed a number of tools that were cited as leading resources in legal circles, and used by several law societies across Canada.

Principal among these tools were: a 50-page guide to the Act, to help firms comply with this legislation; a Model Compliance Manual, which was prepared in conjunction with the Law Society of British Columbia and is designed to be used by firms as a template for their own compliance manual and staff training; and a PowerPoint presentation for law firms to use in their in-house professional development programs on the new money laundering legislation.

A Focus On Electronic Tools

To encourage the use of technology in law practices, practicePRO delivered the majority of these new tools in electronic format, through our Web site. The frequency with which many of these tools were downloaded puts to rest any concerns about the profession's ability to adopt technology. The Guide, in its various versions, was downloaded 4,250 times, the Manual 1,131 times and the PowerPoint presentation just over 800 times.

Another technology-based initiative, our practicePRO online COACHING CENTRE (OCC), was equally successful. This online, self-coaching tool lets lawyers coach themselves on the "soft skills" such as inter-personal communication, delegation, and avoiding procrastination, that are as important to a lawyer's success as sound legal skills. A $50 premium incentive offered to each lawyer who used the OCC in 2001 prompted lawyers and law students to download more than 20,000 OCC modules and workshops; just over 1,900 lawyers completed an online survey form to qualify for the premium credit.

Building on the success of this initiative, we have developed a Continuing Legal Education (CLE) premium credit program for 2002 that will enable lawyers to save up to $100 on their insurance premiums if they participate in at least two LPIC-approved CLE programs during the year. We will be working closely with the Law Society of Upper Canada, The Advocates' Society, the Ontario Bar Association, the County and District Law Presidents' Association and local law associations, on this initiative.

To ensure the practising bar hears its message, practicePRO partnered with the legal community in sponsoring major legal events such as LegalTech Toronto and the Ontario Bar Association's Annual Institute. As well, we presented at more than 60 events across the province in 2001, addressing approximately 1,800 members and Bar Admission Program students on money laundering and a variety of other risk management topics.

strength

Building on the success of two special reports that dealt in depth with litigation claims and real estate fraud, we will launch a new risk and practice management publication in 2002. LAWPRO magazine will examine current developments affecting the legal profession and the risk and change management issues that these developments raise.

TitlePLUS

Innovation today is a necessity. New technologies, rising costs and competitive pressures dictate that we must find new ways to deliver products and services. We must also help the profession strike out in new directions as it adapts to the changing face of law practice. TitlePLUS exemplifies this need to innovate.

Developing the next generation of conveyancing systems

On the eve of its fifth anniversary and building on its previous successes, TitlePLUS posted record results in 2001, increasing the number of policies sold by more than 40 per cent over the previous year. We estimate that one in 10 residential purchases in Ontario now is insured by TitlePLUS, a statistic that speaks to the impact that TitlePLUS has had on both title insurance and conveyancing generally.

2001 also marked a turning point in the evolution of TitlePLUS: Our launch of two new Web-based products signaled a focus on automated delivery systems as the principal method of delivering TitlePLUS policies as we introduce the TitlePLUS option across Canada.

Moving to the Web

The first of these new Web-based systems, LawyerMortgage.com, has helped lawyers recapture a significant share of the refinance market. LawyerMortgage.com streamlines these kinds of transactions by allowing lawyers to apply online for TitlePLUS coverage for mortgage-only or refinance transactions.

The second innovation, LawyerDoneDeal.com, expands the market for our successful TitlePLUS New Home/GoodStart® program, an all-inclusive package targeted at the new development market.

What makes this latter initiative unique is its ability to share centralized due diligence information over the Web; underwriting "intelligence" built into the Web-based system also results in a fully automated, online process, and instant approval for title insurance coverage in most cases.

Supporting these innovative new programs were a number of marketing initiatives that helped solidify the position of TitlePLUS as a market leader in 2001:

- A new marketing campaign in major trade publications emphasized how easy it is to use TitlePLUS;
- A concerted personal contact program saw TitlePLUS consultants contact, visit and/or train close to 800 real estate lawyers and their staff;
- The introduction of a new Farms program helped to attract business from rural Ontario;
- We added 13 new financial institutions to our roster of banks and credit unions who use TitlePLUS, broadening our penetration in the lending community;
- We doubled the number of firms using RealtiPLUS®, a pay-per-use software product which provides lawyers with a single platform that integrates key conveyancing processes, including a TitlePLUS application, into one comprehensive package.

Paving The Way For National Expansion

The resulting increase in TitlePLUS users and sales is significant. More than 1,600 lawyers are now registered to use TitlePLUS; 600 have signed up to transact business with us over the Web. An additional 700 lawyers made use of TitlePLUS through our Dial-In program in 2001.

Even more telling is the number of lawyers who purchased a TitlePLUS policy for the first time. In 2001, TitlePLUS did business with more than 350 lawyers who had not previously used our title insurance product. Many of these are lawyers who were attracted to TitlePLUS by our new Web-based programs. By year end, LawyerMortgage.com and LawyerDoneDeal .com were generating 20 per cent of TitlePLUS policy sales.

These trends bode well for another major TitlePLUS initiative announced in 2001: a planned national expansion of TitlePLUS commencing with its launch in Atlantic Canada in early 2002. TitlePLUS plans to continue partnering with other parties to develop new products and services that further streamline the conveyancing process for the real estate bar, and improve access to TitlePLUS for lawyers in other jurisdictions across Canada.

innovation

An Agent For Change

Numbers, however, only tell part of the story. What makes TitlePLUS unique among insurers is our commitment to partner with the real estate bar in developing opportunities that support the future of this bar. RealtiPLUS, the one-stop real estate desktop; our team of consultants who provide in-office training to help lawyers and their staff integrate TitlePLUS into their individual practices; the personalized service and advice provided by our team answering the phone lines; and the launch of new Web-based products that facilitate access to TitlePLUS, all have established TitlePLUS as a leading agent of change in real estate conveyancing.

TitlePLUS claims

Prudent underwriting and personalized service have ensured that TitlePLUS continues to benefit from a relatively low incidence of claims. Since we launched TitlePLUS in 1997, just over 200 claims have been reported, the majority of them arising out of minor problems such as survey, building permit, utility arrears and search-related issues. Most are resolved within two weeks, due in large part to an emphasis on repairing claims wherever possible, and the ability to draw on LPIC's in-house legal expertise for resolving claims.

® TitlePLUS, practicePRO, LawPRO, GoodStart, and RealtiPLUS are registered trademarks of Lawyers' Professional Indemnity Company.

results

management discussion and analysis

LAWYERS' PROFESSIONAL INDEMNITY COMPANY

In 2001, the Company generated net income of $8.7 million, an increase of $4.8 million over 2000. Income before income taxes increased by $6.9 million to $15.4 million. Underwriting income increased by $11.0 million to $3.0 million, more than offsetting a $4.1 million decrease in investment income.

Income Statement

Premiums Earned

Premiums increased by $13.5 million to $81.8 million in 2001. This increase is primarily due to a reduced retrospective premium rate adjustment under the insurance agreement between the Company and the Law Society of Upper Canada. Growth in TitlePLUS premiums also contributed to the higher premiums.

Reinsurance Ceded

The Company continues to partner with Canadian-licensed reinsurers in 2001, and consistent with the reinsurance strategy first introduced in 1995, shares risk proportionately from first dollar of loss in both its Ontario professional liability and title insurance lines of business. The reduced reinsurance costs in 2001 reflect that the percentage ceded dropped to 35% for professional liability in 2001, down from 50% in 2000.

The Newfoundland & Labrador, and excess professional liability programs, continue to be reinsured 100%, removing all exposure to the Company from claims in these programs.

Net Claims and Adjustment Expenses

Incurred claims increased by $8.4 million in 2001 from 2000. This increase, was consistent with the Company ceding less of its claims to reinsurers. Offsetting the increase as a result of reinsurance changes is the recovery of $3.0 million, a product of prior years claims improvements.

The number of claims reported in 2001 was roughly consistent both in average severity and in number with those reported a year earlier.

Commissions Earned

The Company earns base commissions on that portion of premiums ceded to reinsurers, plus additional commission for profitable results. While profit commissions are comparable between the 2001 and 2000 years, base commission earnings decreased by $1.3 million, due to the reduced share of the Ontario program ceded to reinsurers.

General Expenses

Expenses in 2001 increased $0.5 million from levels expended in 2000, mostly stemming from increased personnel and technology costs.

Investment Income

In 2001, $12.4 million of investment income was generated, a decrease of $4.1 million from the previous year. Gains from sales of investments were $1.5 million in 2001, down from $5.9 million in 2000. Investment income is net of a $4.1 million write-down for equity holdings. At December 2001 the market value of the portfolio exceeds book value by $3.6 million (2000 - $3.3 million).

Balance Sheet

Investments

Investment assets, inclusive of cash and short term deposits, increased by $18.0 million to $227.2 million at December 31, 2001. This increase roughly mirrors the increase in the Company's net provision for unpaid claims and adjustment expenses which totals $15.6 million. Investment assets are invested in accordance with investment policy approved by the Company's Board of Directors in a diversified, high quality portfolio.

Provision for Unpaid Claims and Adjustment Expenses and Reinsurers' Share of Provision

The provision for unpaid claims represents the amount required to satisfy all of the Company's obligations to claimants without offset for reinsurance. This has increased by $7.0 million. Reinsurance recoveries have declined by $8.6 million and accordingly the net change in provision is $15.6 million. These changes are the result of the addition of claims for the 2001 year, net of payments, during the year. The decline in the reinsurance recoveries is due to the reduction of the share of the Ontario program ceded, from 50% to 35%.

The estimation of claims liabilities introduces processes that generate measurement uncertainty and are subject to variation. The Company attempts to ensure these estimates are prudently conservative.

Shareholder's Equity

Equity has increased by $8.7 million, the amount of net income generated in the year. The Company has assets well in excess of liabilities, as measured by regulatory tests.

auditors' report

Deloitte & Touche

To the Shareholder of Lawyers' Professional Indemnity Company

We have audited the balance sheet of Lawyers' Professional Indemnity Company as at December 31, 2001, and the statements of income and 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, 2001, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles including the accounting requirements of the Financial Services Commission of Ontario.

Toronto, Ontario
February 1, 2002

Deloitte & Touche LLP
Chartered Accountants

actuary's report

Eckler Partners Ltd.
Internationally MILLIMAN GLOBAL
Report for Financial Statements at December 31, 2001

Role of the Valuation Actuary

The valuation actuary is appointed by the Audit Committee of the company. With respect to the preparation of these financial statements, the actuary is required to carry out a valuation of the policy liabilities and to report thereon to the company's shareholders. The valuation is carried out in accordance with accepted actuarial practice, except as specifically disclosed to the contrary, 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 and a provision for future obligations on the unexpired portion of policies.

In performing the valuation of the liabilities for these future events, which are by their very nature inherently variable, the actuary makes assumptions as to 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 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.

Valuation Actuary's Report

I have valued the policy liabilities of the Lawyers' Professional Indemnity Company for its balance sheet as at 31 December 2001, and their changes in its statement of income for the year then ended, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods, except as described in the following paragraph.

In accepted actuarial practice, the valuation of policy liabilities reflects the time value of money. Pursuant to the authority granted by the Insurance Act for the Province of Ontario, the Superintendent of Financial Services has directed that the valuation of some policy liabilities not reflect the time value of money. My valuation complies with that directive.

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

Toronto, Ontario
February 13, 2002

Brian G. Pelly
Fellow, Canadian Institute of Actuaries

balance sheet

LAWYERS' PROFESSIONAL INDEMNITY COMPANY

Stated in thousands of dollars

	As at December 31	2001	2000
Assets			
	Investments (note 3)	223,437	206,706
	Cash and cash equivalents	3,736	2,496
	Investment income due and accrued	2,337	2,284
	Due from reinsurers	12,529	11,397
	Due from insureds	1,033	651
	Reinsurers' share of provisions for:		
	Unpaid claims and adjustment expenses (note 2)	150,583	159,139
	Unearned premiums	224	184
	Income taxes recoverable	–	5,473
	Other assets	1,279	529
	Fixed assets	622	798
	Future income taxes (note 7)	3,355	4,733
	Total assets	**399,135**	**394,390**
Liabilities			
	Provision for unpaid claims and adjustment expenses (note 2)	310,900	303,915
	Due to reinsurers	5,965	7,916
	Due to insureds	763	637
	Due to the Law Society of Upper Canada	2,726	15,454
	Expenses due and accrued	2,317	2,126
	Income taxes due and accrued	3,342	–
	Premium taxes payable	106	177
	Unearned premiums and commissions	679	558
		326,798	330,783
Shareholder's Equity (note 6)	Capital stock issued and paid	5,000	5,000
	Contributed surplus	30,645	30,645
	Earned surplus	32,460	22,074
	Statutory appropriations	4,232	5,888
		72,337	63,607
	Total liabilities and shareholder's equity	**399,135**	**394,390**

See accompanying notes

On behalf of the Board

Ross W. Murray
Director

Director

statement of income

LAWYERS' PROFESSIONAL INDEMNITY COMPANY

Stated in thousands of dollars

Year ending December 31	2001	2000
Premiums earned	81,770	68,277
Reinsurance ceded	29,558	37,714
Net premiums earned	**52,212**	**30,563**
Net claims and adjustment expenses (note 2)	44,327	35,924
Premium taxes	2,468	2,068
General expenses	9,841	9,370
Reinsurance commissions earned	(7,389)	(8,717)
	49,247	**38,645**
Underwriting income	**2,965**	**(8,082)**
Investment and other income	12,395	16,478
Income before income taxes	**15,360**	**8,396**
Provision for income taxes — current (note 7)	5,252	2,603
— future (note 7)	1,378	1,874
Net income	**8,730**	**3,919**

See accompanying notes

statement of cash flows

LAWYERS' PROFESSIONAL INDEMNITY COMPANY

Stated in thousands of dollars

	Year ending December 31	2001	2000
OPERATING ACTIVITIES	Net income	8,730	3,919
	Items not affecting cash:		
	Future income taxes	1,378	1,874
	Depreciation	494	551
	Realized gains	(1,474)	(5,873)
	Amortization of (discount) premium on bonds	(32)	330
		9,096	**801**
	Changes in non-cash working capital balances:		
	Premium taxes payable	(71)	(397)
	Income taxes due and accrued	3,342	(12,016)
	Due from reinsurers and insureds	(3,339)	(2,560)
	Provision for unpaid claims and adjustment expenses	6,985	17,874
	Reinsurers' share of provisions	8,516	(3,679)
	Unearned premiums and commissions	121	82
	Expenses due and accrued	191	271
	Investment income due and accrued	(53)	(432)
	Income taxes recoverable	5,473	–
	Other assets	(750)	(258)
	Due to/(from) the Law Society of Upper Canada	(12,728)	16,551
	Total funds provided by operating activities	**16,783**	**16,237**
INVESTING ACTIVITIES	Fixed assets:		
	Purchases of fixed assets	(318)	(265)
	Investments:		
	Purchases of investments	(280,441)	(275,504)
	Proceeds of sale of investments	265,216	254,864
	Investment purchases, net	(15,225)	(20,640)
	Net change in cash and cash equivalents	1,240	(4,668)
	Cash and cash equivalents, beginning of year	2,496	7,164
	Cash and cash equivalents, end of year	**3,736**	**2,496**

See accompanying notes

notes to the financial statements

LAWYERS' PROFESSIONAL INDEMNITY COMPANY

Stated in thousands of dollars

As at December 31, 2001

Lawyers' Professional Indemnity Company ["the Company"] is an insurance company licensed to provide lawyers' professional liability and title insurance.

1. Significant Accounting Policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, including the accounting requirements of the Financial Services Commission of Ontario. The most significant accounting policies are as follows:

Investments

The Company records its investments in debt securities at amortized cost. Premiums and discounts from par value are amortized on a straight-line basis over the term to maturity. Investments in term deposits and common and preferred shares are carried at cost.

Gains and losses on investments are included in investment income when realized, or in the event an asset's value becomes impaired.

Fixed assets

Fixed assets are presented at cost, net of accumulated depreciation and amortization. Depreciation and amortization are 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 equipment	3 to 5 years
Software	1 to 3 years

Premium related balances

Professional liability premium income is earned evenly over the term of the insurance policy, generally one year except for policies for retiring members. Most policies are written to follow the calendar year, the portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums.

The reinsurers' share of unearned premiums is recognized as an asset at the same time using principles consistent with the Company's method for determining the unearned premium liability.

Title insurance premium is earned at the inception date of the policy.

Premiums receivable are recorded at amounts due less any required provision for doubtful amounts.

Claims related balances

a) Provision for unpaid claims and adjustment expenses

The insurance program covers claims made against insureds in the policy period.

The provision is determined using case-basis evaluations plus an amount for future development and delayed reporting and is an estimation of the ultimate cost of all insurance claims to December 31, 2001. The estimates are regularly reviewed and updated and any resulting adjustments are included in current income.

Claims liabilities are carried on an undiscounted basis.

b) Reinsurers' share of provisions for unpaid claims and adjustment expenses

Expected reinsurance recoveries on unpaid claims and adjustment expenses are recognized as assets at the same time and using principles consistent with the Company's method for establishing the related liability.

c) Members' deductibles

The insurance policy calls for insured members to pay deductibles ranging from nil up to twenty-five thousand dollars. Expected deductible recoveries on paid and unpaid claims are recognized net of any required provision for uncollectible accounts using principles consistent with the Company's method for establishing the related claims liability.

Income taxes

Effective January 1, 2000, the company changed its method of accounting for income taxes from the accrual method to the asset and liability method with the adoption of the Canadian Institute of Chartered Accountants' Handbook "Income Taxes."

Under the asset and liability 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 substantively enacted 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.

2. Measurement Uncertainty

The settlement of professional liability claims involves processes the outcome of which is inherently uncertain. Consequently, the estimation 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 or deductibles, involves estimates and measurement uncertainty. The amounts are necessarily based on estimates of future trends in claim severity and other factors which could vary as the claims are settled. Variability can be caused by receipt of additional claim information, changes in judicial interpretation, or significant changes in severity or frequency of claims from historical trends. Ultimate costs incurred will inevitably vary from current estimates, to some extent. 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. Estimates are reviewed at least annually by an actuary and, as adjustments to these 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 credit worthiness of the companies to which it cedes. Based on current information of the financial health of the reinsurers, no provision has been made in the accounts for doubtful collection.

The Company has in a few instances purchased annuities from life insurers. No provision for credit risk related to these insurers is required at December 31, 2001 (2000 – nil).

Changes in prior year loss estimates

Changes in claim liabilities for prior year claims recorded in the balance sheet and their impact on net claims and adjustment expenses amounted to an improvement of $3,000 in the year ended December 31, 2001 (2000 – $1,320).

Fair value

Under accepted actuarial practice, the amount calculated to be equal to the cost of settling claims takes into consideration the time value of money and provisions for adverse deviations.

As at December 31, 2001, the Superintendent of Financial Services does not recognize that these actuarially determined liabilities represent the appropriate amount at which policy liabilities should be stated. The following discussion is based on the evaluation of policy liabilities valued under accepted actuarial practice.

The basic assumptions made in establishing actuarial liabilities are best estimates of possible outcomes. To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience and to provide greater comfort that the actuarial liabilities are adequate to pay future benefits, actuaries are required to include margins in some assumptions. A range of allowable margins is prescribed by the Canadian Institute of Actuaries relating to claim development, reinsurance recoveries and investment income variables.

Below, is a comparison between policy liabilities as recorded in the Company's financial statements and policy liabilities computed in accordance with accepted actuarial practice. Management believes that policy liabilities computed in accordance with accepted actuarial practice provide a reasonable measurement of the fair value of such liabilities.

December 31		Recorded in the accounts	According to accepted actuarial practice
2001	Unpaid Claims	310,900	297,400
	Reinsurers' share of unpaid claims	(150,583)	(142,124)
2000	Unpaid claims	303,915	288,802
	Reinsurers' share of unpaid claims	(159,139)	(148,971)

3. Investment Information

The company holds a diversified portfolio consisting of equities and securities with investment grades of "A" or better.

Estimated fair values and unrealized gains and losses

The book values, estimated fair values and unrealized gains (losses) on investments as at December 31 were as follows:

2001

	Book Value	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Yield %
Debt Securities	190,387	3,806	(759)	193,434	4.3
Common Shares	25,421	2,598	(1,987)	26,032	
Preferred Shares	7,629	36	(48)	7,617	
	223,437	6,440	(2,794)	227,083	

2000

	Book Value	Unrealized Gain	Unrealized Loss	Estimated Fair Value	Yield %
Debt Securities	181,702	2,416	(214)	183,904	5.5
Common Shares	23,892	3,795	(2,598)	25,089	
Preferred Shares	1,112	–	(52)	1,060	
	206,706	6,211	(2,864)	210,053	

The estimated fair values of debt securities, common and preferred shares are based on quoted market values. The book value of common shares noted above is net of a write-down of $4,169 (2000 – $nil).

Liquidity and interest rate risk

The maturity profile of debt securities as at December 31, 2001 is as follows:

	Within 1 Year	1 to 5 Years	Over 5 Years	Book Value
Debt securities	1,478	166,677	22,232	190,387
Percent of total	1%	88%	11%	

The average duration of the portfolio at December 31, 2001, is 3.3 years, limiting the Company's exposure to changing interest rates. The Company's reinvestment risk is insignificant. Equities have no specific maturities.

4. Statutory Insurance Information

a) The Company is the beneficiary of a trust account in the amount of $7,158 (2000 – $14,642) for reinsurance ceded to unregistered reinsurers. This trust balance is not reflected in these financial statements but is considered in determining statutory reserve requirements.

b) The Ontario Insurance Act restricts amounts available for shareholder dividends to unappropriated surplus, subject to minimum capital requirements.

c) The Company has deposited securities with the regulatory authorities having a market value of $295 (2000 – $289).

Stated in thousands of dollars
As at December 31, 2001

5. Related Party Transactions

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

For the year ended December 31, 2001, 95% of the premiums written related to insurance coverage provided to the Law Society and its members. Under the insurance policy in force between July 1, 1990 and December 31, 1994, the Company is responsible for claims in excess of Law Society 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 Law Society. This amount is currently estimated to be $26,786 (2000 – $37,909).

Commencing January 1, 1995, there is no longer a Law Society deductible and 100% of the risk over the individual member deductible is insured through the Company. The annual policy limits for the period January 1, 1995 to December 31, 2001, are $1 million per claim and $2 million per member in aggregate.

In 2001, the Company refunded $2.9 million (2000 – $14.7 million) in premiums to the Society pursuant to a retrospective premium rating adjustment in the insurance contract. These funds are held in trust by the Errors & Omissions Fund of the Society for future insurance purposes.

6. Shareholder's Equity

a) Common Shares: Par value of $100 each, authorized, issued and outstanding	30,000
Preferred Shares: Par value of $100 each, 6% non-cumulative, redeemable, non-voting, authorized, issued and outstanding	20,000

b) Reconciliation of earned surplus	2001	2000
Beginning of year	**22,074**	**16,120**
Net income for the year	8,730	3,919
Decrease/(increase) in statutory appropriations		
Fixed and other assets	278	87
Future income taxes	1,378	1,874
Reinsurance ceded to unregistered reinsurers	–	74
End of year	**32,460**	**22,074**

7. Income Taxes

The Company's effective tax rate does not differ significantly from the applicable Canadian statutory income tax rate of 41.75%.

The Company's income tax expense has the following components:

	2001	2000
Current	5,252	2,603
Future	1,378	1,874
Total income tax expense	6,630	4,477

Reconciliation to Statutory Tax Rate

	2001	2000
Income taxes at Canadian statutory tax rate	6,412	3,691
Increase/(decrease) resulting from:		
Changes in tax rate applicable to future income taxes	513	802
Other	(295)	(16)
Income tax provision	6,630	4,477

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:

	2001	2000
Investments	(880)	263
Actuarial liabilities	4,271	4,586
Other	(36)	(116)
Total	3,355	4,733

8. Commitments

The Company is committed to monthly lease payments in effect until January 31, 2008. Lease obligations are are follows:

2002	$1,300
2003	$1,300
2004	$1,362
2005	$1,362
Thereafter	$2,838

9. Comparative Financial Statements

Certain amounts in the comparative financial statements have been reclassified to conform to the presentation used in the 2000 financial statements.

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