



Canadian Lawyers Insurance Association

**CLIA / AAJC**

**l'Association d'Assurance des Juristes Canadiens**

**2010 Annual Report**

[www.clia.ca](http://www.clia.ca) | [info@clia.ca](mailto:info@clia.ca)

## CLIA FINANCIAL HIGHLIGHTS

	<u>2010</u>	<u>2009</u>
<b>Balance Sheet</b>		
Total Assets	93,806,161	83,381,228
Subscriber's Equity	27,809,365	25,046,357
Statutory Surplus	23,487,526	20,427,133
<b>Operating Data</b>		
Gross Direct Written Premium	11,566,800	10,767,988
Gross Direct Premium Earned	11,314,284	10,872,969
Net Direct Premium Earned	7,477,263	6,946,772
Net Investment Income	5,203,203	1,907,798
Net Income	3,451,622	(347,177)
Distribution of Premium Surplus	(431,819)	(246,767)
Contribution (Distribution) of Surplus	40,590	-
Compulsory Premiums Written (CLIA)	7,836,182	7,243,062
Premiums Written (Comp Fund)	699,390	683,136
Excess Premiums Written (CLIA & CBELA)	3,031,228	3,957,576
Total Written Premiums	<u>11,566,800</u>	<u>11,883,774</u>

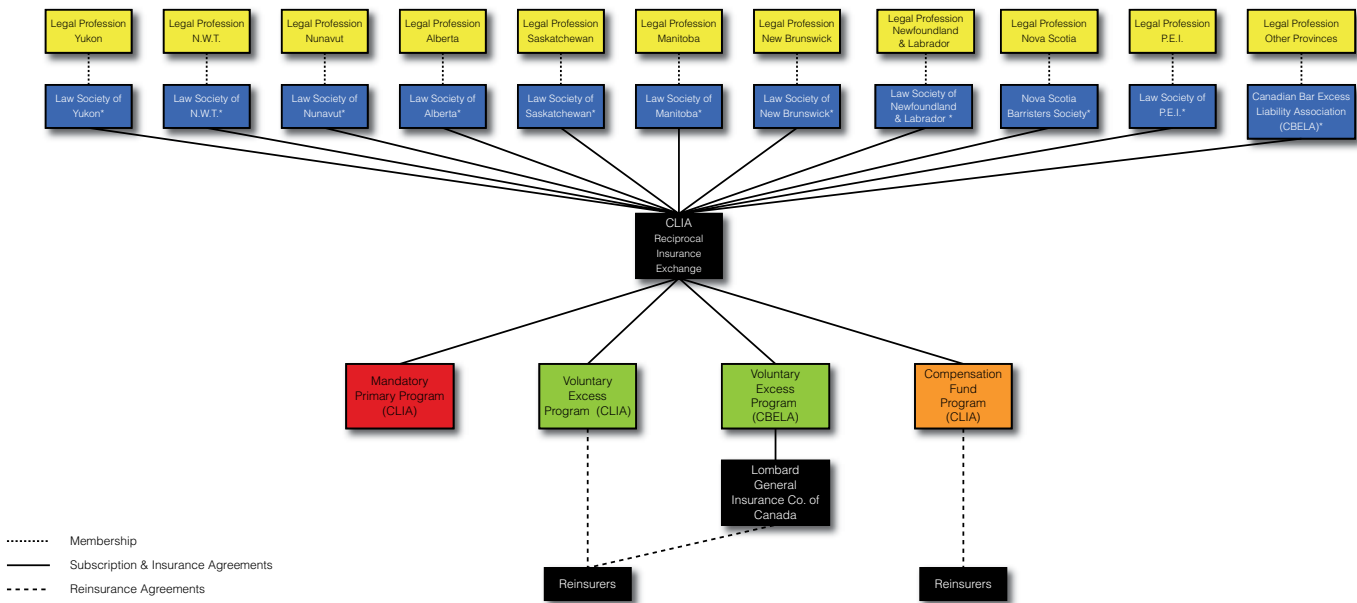
# Reciprocal Insurance Exchange Profile

CLIA was established in 1988 as a reciprocal insurance exchange for the purpose of insuring the professional liability risks of the legal profession in Canada. Its subscribers now include the law societies of Alberta, Manitoba, Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, Saskatchewan, the Yukon, Northwest Territories and Nunavut, each of which provides its members with a mandatory insurance program of \$1,000,000 per occurrence, \$2,000,000 in the annual aggregate. CLIA also offers a voluntary excess program to lawyers and law firms in these provinces through its subscriber law societies, and manages a program for lawyers and law firms in the provinces of British Columbia, and Ontario, through its subscriber, the Canadian Bar Excess Liability Association (CBELA), a not-for-profit corporation affiliated with the Canadian Bar Insurance Association. The voluntary excess program offers limits ranging from \$1,000,000 to \$9,000,000 excess of the underlying mandatory limit.

Membership by law societies in CLIA is accomplished by subscribing to the reciprocal insurance exchange agreement. Membership in CLIA as a subscriber involves a minimum commitment to a five-year underwriting period, which enables the risk to be spread or pooled among subscribers according to actuarial advice and the objectives of the individual law societies. Each subscriber carries one vote on CLIA's Advisory Board, which has the responsibility of overseeing the affairs of CLIA, including the appointment of an Attorney-in-Fact, a General Manager, and other advisors, and the delegation of responsibilities as it considers appropriate. The General Manager's Office is facilitated through the Insurance Management Unit of Dion, Durrell + Associates Inc. The Office of the General Manager provides on-going insurance management services in the areas of underwriting, reinsurance, claims administration, financial reporting, regulatory matters, subscriber/insured liaison and board/committee support services.

The structure of CLIA is as follows:

Schematic of CLIA Structure



\* Actual subscription to CLIA may be effected through not-for-profit corporations established by the respective entities.

## Chair's Message to Subscribers and Insureds

### Introductory Remarks

CLIA continues to demonstrate financial strength in the face of a difficult environment. In addition to ongoing uncertainty in the markets, CLIA has faced increased claims activity in many jurisdictions across the country. In spite of these challenges, CLIA has continued to provide a secure program of insurance for its subscriber law societies and for lawyers.

CLIA's financial position remained very strong through 2010, as it has throughout the economic rollercoaster of the last few years. As the economy continues its recovery and shows signs of stabilizing, external factors remain worrisome. Nevertheless, CLIA's results demonstrate that the conservative investment policy adopted by CLIA some years ago can both protect assets and provide reasonable returns.

One of the key tenets that has guided CLIA for more than twenty years is its dedication to fiscal responsibility and prudent management of its resources. The program distributed \$431,819 in premium surplus to its members in 2010, an increase from the \$246,767 distributed in 2009. The subscriber's equity position of the program increased by \$2,763,008 in 2010, and now stands at \$27,809,365. Over the past ten years, CLIA has returned to its members more than \$42 million in premium payments that ultimately were not needed to support the program and close to \$4 million in premium credits to law firms insured under the Voluntary Excess Program.

The following is a report of the CLIA program over the last 12 months.

### 2010: The Year in Review


The most recent financial statements point to CLIA's continued financial strength. Although claims activity varies from year to year, it tends to move in cycles with the economy. Not surprisingly, the last two years has produced an increased level of claims activity. CLIA and its law society partners have continued to provide excellent management of these claims, thereby ensuring protection to both lawyers and the public. These short-term variations in the economy and levels of claims activity have always been taken into consideration as CLIA has pursued its objective to provide a program that is both strong and sustainable. CLIA's investment policy is focused on ensuring that it is defensively positioned with assets matched to liabilities. Additionally, CLIA aims to invest its surplus in a way that diversifies the investment portfolio and enhances expected returns.

CLIA continued to achieve strong results in its investment portfolio. Rates of return realized by CLIA's investment managers have generally placed them in the top quartile in comparison to other managers, in spite of restrictions placed on them by regulatory requirements and CLIA's own investment policy.

CLIA's website, which is located at [www.clia.ca](http://www.clia.ca), serves as a valuable source of information for CLIA members, in particular in the area of loss prevention. I encourage all lawyers to take full advantage of the many loss prevention resources made available through the website. CLIA also welcomes any feedback or advice you may have, and asks that you let us know if there is more that we can be doing in this area.

The CLIA program could not succeed without the support and active participation of its subscribing law societies. Further, at the local level, many of our subscribing law societies provide claims management. These staff are the front line in claims handling in the CLIA program, bringing high levels of professionalism and commitment to their jobs. They also assist the volunteer members of CLIA's Advisory Board in their effort to provide a strong sustainable insurance program. I would like to thank the staff and volunteers for their combined efforts, all of which have allowed CLIA to succeed for over twenty years. In addition, I wish to acknowledge the commitment of CLIA's actuaries and the General Manager's office. CLIA's unique structure could not be sustained without the insightful advice and diligent work we have received from both.

Due to the work of those mentioned above, CLIA remains well-positioned to carry out its mandate. I look forward to seeing CLIA do so for many years.

  
Charles D. Whelley, Q.C.  
Chair of the Advisory Board

## Manager's Message and Analysis of Operating Results

The following provides an overview of the annual financial position of the Canadian Lawyers Insurance Association (CLIA) for the year ended December 31, 2010. This analysis should be read in combination with the audited financial statements and the related notes for the twelve-month periods ending December 31, 2009 and 2010. The audited financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP).

### Premiums

Direct Earned Premium increased by 4% from \$10,872,969 (2009) to \$11,314,284 (2010).

At the same time, reinsurance costs on the Voluntary Excess Program (VEP) decreased slightly from \$3,926,197 (2009) to \$3,837,021 (2010).

### Claims

Net Claims and Adjustment Expenses Incurred decreased from \$9,701,930 (2009) to \$8,205,219 (2010).

### Expenses (Income)

Operating Expenses decreased slightly from \$1,751,122 (2009) to \$1,730,959 (2010).

CLIA earned commissions on reinsurance premiums ceded to reinsurers on its voluntary excess program of \$1,078,473 (2010). This amount is net of any change in the provisions CLIA carries for receipt of profit sharing payments from its reinsurers and for the possible repayment of reinsurance commissions due to adverse claims experience, as provided for in its reinsurance contracts.

The Administrative fee income from other business decreased from \$99,694 (2009) to \$0 (2010). This is the result of the decision to terminate of the CBELA VEP, which had been managed by CLIA, effective January 1, 2010.

### Underwriting Gain (Loss)

CLIA's underwriting performance (i.e. premiums less claims and expenses) improved from 2009 to 2010. CLIA recorded an Underwriting Loss of \$1,751,581 in 2010, as compared with an Underwriting Loss of \$2,254,975 in 2009.

### Investment Income

Investment Income was \$5,203,203 (2010), up from the previous year's level of \$1,907,798 (2009). This is an increase of 172.7%, due to the net realized gain on disposal of investments of \$3,176,960. CLIA restructured its equity investment portfolio during 2010 and this transition resulted in the majority of the \$3,176,960 in gains realized in 2010 (compared with realized losses of \$130,387 in 2009).

CLIA maintains a conservative investment strategy. Assets are matched with liabilities in a "core" portfolio, and CLIA's surplus is invested in a mix of fixed income and equity investments with a view to diversification and generating reasonable returns over the long run. This conservative approach was instrumental in the preservation of capital during

the economic instability of the last several years, and is consistent with CLIA's long-term objectives.

### Net Income

CLIA's Net Income for the 2010 year was \$3,451,622 as compared to a Net Loss of \$347,177 in 2009. Net Income increased in large part because of the significant increase in realized investment gains.

### Subscriber's Equity

CLIA returned \$431,819 to its members in 2010 in the form of return of excess surplus. This is an increase in the distribution of premium surplus from \$246,767 in 2009. In 2010, CLIA also received a contribution of surplus in the amount of \$40,590 from a Subscriber which joined the Compensation Fund Program during the year.

After taking into account the underwriting Income and the return of surplus to its members, CLIA's surplus increased from \$21,007,133 (2009) to \$24,067,526 (2010) and its Subscribers Equity increased from \$25,046,357 (2009) to \$27,809,365 (2010). CLIA continues to maintain a reasonable balance between a healthy and stable Subscribers' Equity position and operating on a long-term break-even basis.

### Cash and Investments

Cash and Investments increased by 10.6% from \$69,984,855 (2009) to \$77,414,471 (2010).

### Unpaid Claims and Adjustment Expenses

Unpaid Claims and Adjustment Expenses increased 14.8% from \$47,903,368 (2009) to \$54,982,724 (2010).

### Conclusion

Notwithstanding the environment of global political and economic uncertainty, CLIA remains in a solid financial condition and is well-positioned for whatever the future may bring. CLIA's remains focused on its primary objective of providing stable, predictable, and affordable insurance to Canadian lawyers. It continues to achieve this through the significant efforts of the volunteer members of CLIA's Advisory Board, staff of CLIA's participating Law Societies, and CLIA's strategic partners.

The knowledge and capability of these various individuals has created CLIA's continued success and, consequently, the financial strength that the program enjoys today. The leadership that is currently in place is well positioned to continue directing CLIA down a path of long-term growth and stability.



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Patrick Mahoney  
General Manager

## REPORT OF THE ACTUARY

### Role of Actuary

The actuary is appointed by the Advisory Board of the Canadian Lawyers Insurance Association (“CLIA”) pursuant to the Alberta Insurance Act. The actuary is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives. The actuary is also required to provide an opinion regarding the appropriateness of the policy liabilities at the balance sheet date to meet all policyholder obligations of CLIA. Examination of supporting data for accuracy and completeness and consideration of CLIA assets are important elements of the work required to form this opinion.

Policy liabilities include unearned premiums, unpaid claims and adjustment expenses, the reinsurers’ share of unearned premiums and unpaid claims and adjustment expenses, deferred premium acquisition costs, premium deficiency and retrospective adjustments. The actuary uses the work of the external and internal auditors in verifying data used for valuation purposes.

### Appointed Actuary’s Report

To the Subscribers of the  
**Canadian Lawyers Insurance Association**

I have valued the policy liabilities of the Canadian Lawyers Insurance Association for its balance sheet at December 31, 2010 and their change 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 policy liabilities makes appropriate provision for all policyholder obligations, and the financial statements fairly present the results of the valuation.

Toronto, Ontario  
February 24, 2011



Julie-Linda Laforce  
Fellow, Canadian Institute of Actuaries



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## INDEPENDENT AUDITORS' REPORT

To the Subscribers of the Canadian Lawyers Insurance Association

We have audited the accompanying financial statements of the Canadian Lawyers Insurance Association, which comprise the balance sheet as at December 31, 2010, the statements of income and surplus, comprehensive income and accumulated other comprehensive income and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### *Opinion*

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Canadian Lawyers Insurance Association as at December 31, 2010, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants, Licensed Public Accountants

February 24, 2011  
Toronto, Canada

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Balance Sheet

December 31, 2010, with comparative figures for 2009

	2010	2009
<b>Assets</b>		
Cash	\$ 5,433,070	\$ 6,613,268
Investments (note 3):		
Short-term securities	4,703,489	6,398,553
Bonds and debentures	49,839,677	37,956,883
Pooled fund units	17,438,235	19,016,351
Accrued investment income	356,233	313,247
Premiums receivable from subscribers	1,120,483	893,339
Unearned reinsurance premium	1,884,554	1,904,090
Due from other insurance companies (note 10)	3,199,937	3,101,722
Deferred policy acquisition costs	188,865	180,082
Unpaid claims and adjustment expenses recoverable from reinsurers (note 4)	9,641,618	7,003,893
	\$ 93,806,161	\$ 83,381,228

### Liabilities and Subscribers' Equity

<b>Liabilities:</b>		
Unpaid claims and adjustment expenses (note 4)	\$ 54,982,724	\$ 47,903,368
Unearned premium	6,426,582	6,174,066
Due to other insurance companies	3,730,415	3,323,960
Accrued expenses and other liabilities	423,137	496,722
Unearned reinsurance commissions	433,938	436,755
	65,996,796	58,334,871
<b>Subscribers' equity:</b>		
Surplus	24,067,526	21,007,133
Accumulated other comprehensive income	3,741,839	4,039,224
	27,809,365	25,046,357
	\$ 93,806,161	\$ 83,381,228

See accompanying notes to financial statements.

On behalf of the Board:

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Statement of Comprehensive Income and Accumulated Other Comprehensive Income

Year ended December 31, 2010, with comparative figures for 2009

	2010	2009
Net income (loss)	\$ 3,451,622	\$ (347,177)
Other comprehensive income (loss):		
Change in unrealized gain on available-for-sale assets	2,879,575	5,431,646
Recognition of realized (gain) loss on available-for-sale assets	(3,176,960)	130,387
	(297,385)	5,562,033
<b>Comprehensive income</b>	<b>\$ 3,154,237</b>	<b>\$ 5,214,856</b>
Accumulated other comprehensive income (loss), beginning of year	\$ 4,039,224	\$ (1,522,809)
Other comprehensive income (loss)	(297,385)	5,562,033
Accumulated other comprehensive income, end of year	\$ 3,741,839	\$ 4,039,224

See accompanying notes to financial statements.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Statement of Income and Surplus

Year ended December 31, 2010, with comparative figures for 2009

	2010	2009
Direct premiums earned	\$ 11,314,284	\$ 10,872,969
Reinsurance ceded	(3,837,021)	(3,926,197)
<b>Net premiums earned</b>	<b>7,477,263</b>	<b>6,946,772</b>
Net claims and claim adjustment expenses incurred (note 4)	8,205,219	9,701,930
	(727,966)	(2,755,158)
<b>Expenses (income):</b>		
Acquisition	371,139	495,349
Operating	1,730,959	1,751,122
Commission on reinsurance premiums (note 10)	(1,078,473)	(2,646,960)
Administrative fee on other business	-	(99,694)
	1,023,625	(500,183)
Underwriting loss	(1,751,581)	(2,254,975)
Investment income (expenses):		
Interest	1,777,682	1,747,915
Pooled fund distributions, net of return of capital	475,704	493,007
Net realized gain (loss) on disposal of investments	3,176,960	(130,387)
Investment expenses	(227,143)	(202,737)
Net investment income	5,203,203	1,907,798
<b>Net income (loss)</b>	<b>3,451,622</b>	<b>(347,177)</b>
Surplus, beginning of year	21,007,133	21,601,077
Distribution of premium surplus (note 7)	(431,819)	(246,767)
Contribution of surplus (note 6)	40,590	-
<b>Surplus, end of year</b>	<b>\$ 24,067,526</b>	<b>\$ 21,007,133</b>

See accompanying notes to financial statements.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Statement of Cash Flows

Year ended December 31, 2010, with comparative figures for 2009

	2010	2009
<b>Cash provided by (used in):</b>		
<b>Operating activities:</b>		
Net income (loss)	\$ 3,451,622	\$ (347,177)
Items not affecting cash:		
Amortization of premium/discount on bonds and debentures	435,210	264,705
Net realized loss (gain) on disposal of investments	(3,176,960)	130,387
Change in non-cash operating items:		
Increase in receivables	(368,345)	(1,015,914)
Decrease in unearned reinsurance premium	19,536	102,074
Decrease (increase) in deferred policy acquisition costs	(8,783)	560
Decrease (increase) in unpaid claims and adjustment expenses recoverable from reinsurers	(2,637,725)	88,857
Increase in unpaid claims and adjustment expenses	7,079,356	3,714,401
Increase (decrease) in unearned premium	252,516	(104,380)
Increase in due to other insurance companies	406,455	401,547
Decrease in accrued expenses and other liabilities	(73,585)	(61,842)
Decrease in unearned reinsurance commissions	(2,817)	(27,389)
	5,376,480	3,145,229
<b>Financing activities:</b>		
Distribution of premium surplus	(431,819)	(246,767)
Contribution of surplus	40,590	-
	(391,229)	(246,767)
<b>Investing activities:</b>		
Proceeds from sale of investments:		
Bonds and debentures	15,722,665	25,423,835
Pooled fund and income trust units	17,700,000	5,220,932
Purchase of investments:		
Bonds and debentures	(27,466,365)	(22,990,194)
Pooled funds	(13,816,813)	(9,817,727)
	(7,860,513)	(2,163,154)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(2,875,262)</b>	<b>735,308</b>
Cash and cash equivalents, beginning of year	13,011,821	12,276,513
<b>Cash and cash equivalents, end of year</b>	<b>\$ 10,136,559</b>	<b>\$ 13,011,821</b>
Cash and cash equivalents comprise the following with original maturities under 90 days:		
Cash	\$ 5,433,070	\$ 6,613,268
Short-term securities	4,703,489	6,398,553
	\$ 10,136,559	\$ 13,011,821
<b>Supplemental cash flow information:</b>		
Interest and distributions received	\$ 2,660,061	\$ 2,502,921

See accompanying notes to financial statements.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements

Year ended December 31, 2010

The Canadian Lawyers Insurance Association (the "Association"), a reciprocal insurance exchange, was formed in 1988 by an agreement among its subscribers dated June 22, 1988. The subscribers consist of ten provincial and territorial law societies and the Canadian Bar Excess Liability Association ("CBELA"), a not-for-profit corporation affiliated with the Canadian Bar Insurance Association. The Association is a single-purpose insurer dedicated to the underwriting of lawyers' primary ("mandatory layer") and excess ("voluntary excess layer") professional liability coverages.

Underwriting commenced on June 30, 1988. The Association is licensed in all provinces and territories, except British Columbia, Ontario and Québec. In those provinces where the Association does not underwrite the mandatory layer coverage, the subscriber CBELA offered the voluntary excess layer coverage to interested law firms through a licensed insurance company utilizing the Association's excess layer reinsurance arrangements. This offering was suspended in 2010.

The Association amended its policy with effect from March 31, 2006 to provide coverage to certain subscribing Law Societies for losses paid by the Law Society as a result of misappropriation by lawyers of client funds ("Compensation Fund Program"). The Association insures the subscribing Law Societies for these losses, which are explicitly excluded from the coverage provided directly to lawyers.

### 1. Significant accounting policies:

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles and comply with the requirements for filing with the Superintendents of Insurance of the various provinces in which the Association is licensed.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 1. Significant accounting policies (continued):

#### (b) Premium income:

Income is recognized on premiums written, net of reinsurance ceded, on a pro rata basis over the term of the related policies. Unearned premium represents the portion of premiums written related to the unexpired risk portion of the policy at year end.

The reinsurers' share of unearned premiums is recognized as amounts recoverable using principles consistent with the Association's method for determining the unearned premium liability.

#### (c) Deferred policy acquisition costs:

Costs that vary with, and are directly related to, the production of new and renewal business are deferred and amortized as the related premiums and commissions are earned. These costs include premium taxes and certain other underwriting costs. The policy acquisition costs are deferred to the extent that they can be recovered from unearned premiums and unearned commissions, respectively, as well as from anticipated investment income.

#### (d) Unpaid claims and adjustment expenses:

The provision for unpaid claims and adjustment expenses represents an estimate of the ultimate net cost of all such amounts, including investigation and the projected final settlement of claims incurred prior to the balance sheet date. Estimated recoveries of these costs from reinsurance ceded are included in assets. The computation of these provisions takes into account the time value of money using discount rates based on projected investment income from the assets supporting the provisions. The estimates of loss activity are, by necessity, subject to uncertainty and are derived from a wide range of possible outcomes. These estimates are continually reviewed as additional information affecting the estimated quantum of claims settlement is obtained. All changes in estimated claim amounts are recorded as incurred claims in the year in which the change in estimate is determined.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 1. Significant accounting policies (continued):

The Association's significant accounting policies are as follows:

#### (a) Financial instruments:

All financial instruments other than insurance contracts, including derivatives, are measured in the balance sheet at fair value, except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. All investments have been designated as available-for-sale ("AFS") securities. AFS securities are carried at fair value, whereby the unrealized gains and losses are included in other comprehensive income ("OCI") until sale or other-than-temporary impairment is recognized, at which point, cumulative unrealized gains or losses are included in investment income. Realized gains and losses on sale and write-downs to reflect other-than-temporary impairments in value are included in net realized gain (loss) on disposal of investments.

The Association uses a fair value hierarchy for classification of fair value measurements that reflects the significance of the inputs used in making the fair value measurements (Level 1, Level 2 and Level 3).

Transaction costs related to the purchase of bonds are recorded as part of the carrying value of the bond at the date of purchase and are recognized using the straight-line method, which has been determined to approximate the effective interest method.

Investment income is recorded as it is earned. Gains and losses on disposal of investments are calculated using average cost and are determined and recorded on the settlement date.

Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable are classified as other financial liabilities, which are measured at amortized cost.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 1. Significant accounting policies (continued):

#### (e) Reinsurance ceded:

Reinsurance premiums ceded and reinsurance recoveries on losses incurred are recorded as reductions of the respective income and expense accounts. Estimates of amounts recoverable from reinsurers on unpaid claims are recorded separately from estimated amounts payable to policyholders. Unearned premiums are also reported before reduction for business ceded to reinsurers and the reinsurers' portion is shown separately. Amounts recoverable from reinsurers are estimated in a manner consistent with the policy liabilities associated with the reinsured policy.

#### (f) Income taxes:

No provision for income taxes has been made in these financial statements as the Association is not subject to such taxes.

#### (g) Future changes in accounting policies:

In February 2008, the Canadian Accounting Standards Board ("AcSB") confirmed that a publicly accountable enterprise will be required to adopt International Financial Reporting Standards ("IFRS"). IFRS will replace current Canadian generally accepted accounting principles for those enterprises. The Office of the Superintendent of Financial Institutions and other provincial insurance regulators have confirmed that the Association is considered a publicly accountable enterprise and is expected to adopt IFRS in accordance with the AcSB requirements. For the Association, IFRS will be effective for the annual period commencing January 1, 2011, including the preparation and reporting of one year of comparative figures. The Association is in the process of converting to IFRS and will adopt IFRS in its quarterly and annual financial reports starting with the first quarter of 2011 and will provide corresponding comparative financial information for 2010.

The IFRS accounting standard for insurance contracts, IFRS 4 - Phase II which deals with recognition and measurement is still under development. A discussion paper was published in May 2007 and the exposure draft circulated for comment in July 2010. The final standard is expected in 2011, with implementation not expected before 2013.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 2. Role of the actuary and auditors:

The actuary has been appointed by the Advisory Board of the Association. With respect to the preparation of financial statements, the actuary is required to carry out a valuation of the Association's policy liabilities and report thereon to the subscribers. Policy liabilities consist of the provisions for, and reinsurance recovery of, unpaid claims and adjustment expenses on insurance policies in force, including provisions for salvage and subrogation, and future obligations on the unearned portion of insurance policies in force, including deferred policy acquisition costs. The valuation is made in accordance with accepted actuarial practice, as well as any other matter specified in any direction that may be made by regulatory authorities. In performing the valuation of the liabilities, which are by their nature inherently variable, assumptions are made as to the future loss ratios, trends, rates of claims frequency and severity, inflation, reinsurance recoveries, investment rates of return, and both internal and external adjustment expenses, taking into consideration the circumstances of the Association and the nature of the insurance policies in force. The provisions do not include estimates for extraordinary future emergence of either new classes of claims or claims categories not sufficiently recognized in the claims database. The actuary, in verifying the management information provided by the Association used in the valuation, also makes use of the work of the external auditors. The actuary's report outlines the scope of the work and opinion provided.

The external auditors have been appointed by the subscribers pursuant to the Alberta Insurance Act (the "Act") to conduct an independent and objective audit of the financial statements of the Association in accordance with Canadian generally accepted auditing standards and to report thereon to the subscribers. In carrying out their audit, the auditors also make use of the work of the actuary and the report on the Association's policy liabilities. The auditors' report outlines the scope of their audit and their opinion.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 3. Investments:

The fair values, yield and terms to maturity of investments are as follows:

	Term to maturity				2010	2009
	Within 1 year	Over 1 - 6 years	Over 6 years	No specific maturity	Total	Total
Short-term securities:						
Fair value	\$ 4,703,489	\$ -	\$ -	\$ -	\$ 4,703,489	\$ 6,398,553
Yield	1.93%	-	-	-	1.93%	0.39%
Government of Canada:						
Fair value	3,658,679	4,744,128	1,543,234	-	9,946,041	8,073,173
Yield	1.48%	2.12%	3.11%	-	2.57%	2.46%
Canadian public authorities:						
Fair value	2,486,336	7,438,455	6,156,630	-	18,081,421	10,496,975
Yield	1.55%	2.44%	3.95%	-	3.40%	3.90%
Canadian corporate:						
Fair value	2,677,274	11,716,835	9,418,106	-	23,812,215	19,386,535
Yield	2.24%	3.12%	4.81%	-	4.17%	4.54%
Pooled fund units:						
Fair value	-	-	-	17,438,235	17,438,235	19,016,351
Yield	-	-	-	1.50%	1.50%	1.80%
<b>Total fair value</b>	<b>\$ 13,525,778</b>	<b>\$ 23,899,418</b>	<b>\$ 17,117,970</b>	<b>\$ 17,438,235</b>	<b>\$ 71,981,401</b>	<b>\$ 63,371,587</b>

The investment portfolio, consisting of bonds, short-term investments and pooled fund units, are classified as AFS and their fair value is determined using quoted market bid prices. The Association does not have investments in bonds or other investments for which the fair value is determined using a valuation technique based on assumptions that are not supported by observable market prices or rates.

Fair value hierarchy:

The Association uses a fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value. The extent of the Association's use of quoted market prices (Level 1), models using observable market information as inputs (Level 2) and models without observable market information as inputs (Level 3) in the valuation of bond and equity investments, were as follows:

	AFS	Total
2010		
Level 2:		
Valued using models with observable inputs	\$ 71,981,401	\$ 71,981,401

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 3. Investments (continued):

2009	AFS	Total
Level 2:		
Valued using models with observable inputs	\$ 63,371,587	\$ 63,371,587

The Association did not have any transfers between Level 1 and Level 2 in the fair value hierarchy.

The Association limits its total investment concentration, taken at market value at the time of purchase, in any single issuer (other than the Government of Canada or any of its provinces rated A or higher) to 10% of the Association's total investment portfolio; 15% of the market value of the Association's equity investments in any single industry; or 8% of the Association's equity investments in any single corporation.

The Association also limits investment concentration, taken at market value, to the greater of \$500,000 or 2% of assets of each debt instrument in any single entity or connected group and the greater of \$500,000 or 5% of assets for each equity investment in any single fund, entity or connected group.

The minimum investment quality requirement of the Association's investment policy for bonds is "BBB-" at the time of purchase.

The Association makes investments only in permitted investments, as identified in the investment provisions of the regulations under the Act.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 4. Unpaid claims and adjustment expenses:

(a) Nature of unpaid claims and adjustment expenses:

The establishment of the provision for unpaid claims and adjustment expenses is based on known facts and interpretation of circumstances and is, therefore, a complex and dynamic process influenced by a large variety of factors. These factors include the Association's experience with similar cases and historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims, claims' severity and claim frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Association's claim department personnel and independent adjusters retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices, including claims handling and settlement practices, future investment returns, the effect of inflationary trends on future claims settlement costs, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination, since the longer the span between the incidence of a loss and the payment or settlement of the claims, the more variable the ultimate settlement amount can be.

Consequently, the establishment of the process to determine the provision for unpaid claims and adjustment expenses relies on the judgment and opinions of a large number of individuals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining the provisions necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimates made. These provisions are monitored and recalculated annually.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 4. Unpaid claims and adjustment expenses (continued):

(b) Activity in the provision for unpaid claims and adjustment expenses is summarized as follows:

	2010	2009
Provision for unpaid claims and adjustment expenses, beginning of year:		
Gross	\$ 47,903,368	\$ 44,188,967
Reinsurance ceded	(7,003,893)	(7,092,750)
<b>Net provision, beginning of year</b>	<b>\$ 40,899,475</b>	<b>\$ 37,096,217</b>
Net incurred claims and adjustment expenses:		
Provision for insured events of current year	\$ 9,467,810	\$ 10,419,208
Decrease in provision for insured events of prior years	(1,937,659)	(329,078)
Increase (decrease) due to change in discounting	675,068	(388,200)
<b>Total net incurred</b>	<b>\$ 8,205,219</b>	<b>\$ 9,701,930</b>
Net payments attributable to:		
Current year events	\$ (39,894)	\$ (82,930)
Prior year events	(3,723,694)	(5,815,743)
<b>Total net payments</b>	<b>\$ (3,763,588)</b>	<b>\$ (5,898,673)</b>
Gross provision for unpaid claims and adjustment expenses, end of year	\$ 54,982,724	\$ 47,903,368
Reinsurance ceded, end of year	(9,641,618)	(7,003,893)
<b>Net provision for unpaid claims and adjustment expenses, end of year</b>	<b>\$ 45,341,106</b>	<b>\$ 40,899,475</b>

(c) Discounting of the provision for unpaid claims and adjustment expenses and related reinsurance recoveries:

The provision for unpaid claims and adjustment expenses and related reinsurance recoveries are discounted using rates based on the projected investment income from the assets supporting the provisions and reflecting the estimated timing of payments and recoveries. The discount rate used is 3.60% as of December 31, 2010 (2009 - 4.00%).

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 6. Results of the Compensation Fund Program:

The Compensation Fund Program forms a separate underwriting group within the Association. Contributions during the year were \$40,590 (2009 - nil). The results of this program, which are included in the statement of income and surplus, are as follows:

	2010	2009
Net premiums earned	\$ 384,732	\$ 390,394
Expenses:		
Net incurred claims	(117,516)	302,513
Administrative costs	174,952	108,689
	57,436	411,202
<b>Excess of revenue over expenses (expenses over revenue)</b>	<b>\$ 327,296</b>	<b>\$ (20,808)</b>

### 7. Distribution of premium surplus:

On April 10, 2010, the Advisory Board approved a distribution of premium surplus totalling \$431,819 to subscribers effective July 1, 2010.

On April 4, 2009, the Advisory Board approved a distribution of premium surplus totalling \$246,767 to subscribers effective July 1, 2009.

On April 12, 2008, the Advisory Board approved a distribution of premium surplus totalling \$5,166,720 to subscribers effective July 1, 2008.

On April 14, 2007, the Advisory Board approved a distribution of premium surplus totalling \$989,683 to subscribers effective July 1, 2007.

On April 8, 2006, the Advisory Board approved a distribution of premium surplus totalling \$4,049,146 to subscribers effective July 1, 2006.

On September 24, 2005, the Advisory Board approved a distribution of premium surplus totalling \$489,577 to subscribers effective July 1, 2005.

On April 17, 2004, the Advisory Board approved a distribution of premium surplus totalling \$4,926,590 to subscribers effective July 1, 2004.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 4. Unpaid claims and adjustment expenses (continued):

The resulting carrying amount is considered to be an indicator of fair value as there is no ready market for trading of insurance policy liabilities.

### 5. Underwriting policy and reinsurance:

The limit on the mandatory layer coverage is \$1,000,000 per occurrence, \$2,000,000 in the annual aggregate, inclusive of group deductibles ranging from nil to \$300,000. The Association provides coverage in excess of the group deductible up to the \$1,000,000 per occurrence limit. The mandatory layer coverage also includes a stop-loss component, whereby the losses within the group deductible retained by the various subscribers are capped. The Association's stop-loss exposure is not reinsured.

The limits on the voluntary excess layer coverage range from a minimum of \$1,000,000 to a maximum of \$9,000,000 per occurrence, with an annual aggregate equal to the applicable per-occurrence limit. This coverage is reinsured in both the licensed and unlicensed reinsurance markets.

The Compensation Fund Program provides maximum limits to each participating Law Society of \$10,000,000 per occurrence and in the annual aggregate, inclusive of group deductibles of \$100,000 per occurrence and \$500,000 in the annual aggregate. The Association has arranged reinsurance protection for losses in excess of \$1,000,000 per occurrence (inclusive of a group deduction of \$100,000 per occurrence) and \$2,000,000 in the Association-wide annual aggregate.

Reinsurance does not discharge the primary liability of the Association. The Association evaluates the financial condition of its reinsurers and monitors concentrations of credit risk of the reinsurers to minimize its exposure to significant losses from their insolvency. The Association believes no material credit risk exists and, therefore, no provisions have been recorded other than in the actuarial provision for adverse deviation related to reinsurance risk.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 8. Financial instrument risk management:

The Association has policies related to the identification, monitoring and mitigation of risks associated with financial instruments. The key risks related to financial instruments are credit risk, liquidity risk and market risk (interest rate, equity and currency). The following describes how the Association manages each of these risks:

#### (a) Credit risk:

Credit risk is the risk of loss due to the failure of debtors to make payments when due. Credit risk is primarily associated with invested assets and amounts due from policyholders and reinsurance counterparties. The investment portfolio's exposure to credit risk is managed through policies and procedures, including a credit evaluation by the investment manager and investment guidelines which specify investment quality and exposure limits. The portfolio is monitored and reviewed regularly by the Investment Committee and Board of Directors. Premiums due from policyholders present minimal risk due to the short-term nature of the receivable, the financial strength of the policyholders and the historic and financial relationship with the Association as a reciprocal insurance exchange. Reinsurance is placed with counterparties with good credit ratings which is reviewed on an annual basis and concentration of credit risk is managed by utilizing an appropriate mix of reinsurers.

#### (i) Exposure to credit risk:

The following table summarizes the exposure to credit risk related to financial instruments and certain insurance assets at carrying value:

	2010	2009
Investments	\$ 71,961,401	\$ 63,371,587
Accrued investment income	356,233	313,247
Premiums receivable from subscribers	1,120,483	893,339
Due from other insurance companies	3,199,937	3,101,722
Unpaid claims and adjustment expenses recoverable from reinsurers	9,641,618	7,003,893
<b>Total balance sheet credit exposure</b>	<b>\$ 86,299,672</b>	<b>\$ 74,683,788</b>

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 8. Financial instrument risk management (continued):

#### (ii) Concentration of credit risk:

The Association utilizes an investment policy to minimize the concentration of credit risk by ensuring diversification across asset classes. A summary of the carrying value of investments by asset class and maximum and minimum quantity requirements is disclosed in note 3. The investment manager provides a quarterly compliance certificate confirmation that the investments are in compliance with the investment policy.

The following table summarizes the credit quality of the fixed income portion of the investment portfolio as at December 31:

Rating	2010	2009
	% of bonds	
AAA	31.6	31.9
AA+ to AA-	26.0	28.2
A+ to A-	28.8	27.1
BBB+ to BBB-	13.6	12.8
Total	100.0	100.0

#### (b) Liquidity risk:

Liquidity risk is the risk that the reciprocal will not be able to meet all cash outflow obligations as they come due.

The primary cash outflow is the payment of insurance claims and is represented by the unpaid claims and adjustment expenses liability on the balance sheet. In order to manage the liquidity risk associated with this liability, an investment policy is in place to match the duration of invested assets with the actuarial estimation of the timing of unpaid claims by year. A summary of the invested assets by term to maturity is disclosed in note 3.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 8. Financial instrument risk management (continued):

#### (c) Market risk:

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity markets and foreign currency rates. The primary market risk exposures are discussed below.

#### (i) Interest rate risk:

Interest rate risk is the risk of financial loss arising from changes in interest rates. Fluctuations in interest rates will impact the market value of the fixed income portion of the investment portfolio. Interest rate fluctuations may create unrealized gains or losses which are recorded as OCI; however, these assets are ordinarily held to maturity which would reduce this exposure. A portion of these assets supports the estimated actuarial liabilities represented by the unpaid claims and adjustment expenses on the balance sheet which is calculated, in part, using a discount factor based on the market value rate of return of the investment portfolio.

The Association is exposed to interest rate risk if the cash flows from the investments are not matched to the liabilities that they support. This risk is mitigated partially by the investment policy to match the duration of invested assets with the actuarial estimation of the timing of the settlement of unpaid claims.

A 1% increase in interest rates would have an estimated decreased in the fair value of the fixed income portion of the investment portfolio of \$1,949,836 (2009 - \$1,447,087) which would be partially offset on an economic basis by a decrease in the estimated unpaid claims and adjustment expense of \$1,650,397 (2009 - \$1,482,737) through net income. Conversely, a 1% decrease in interest rates would increase the market value of the fixed income portion of the investment portfolio by \$2,351,709 (2009 - \$1,816,505), which would be partially offset on an economic basis by an increase in the estimated unpaid claims and adjustment expense of \$1,780,865 (2009 - \$1,597,786) through net income.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 8. Financial instrument risk management (continued):

#### (ii) Equity risk:

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. To mitigate this risk, the Association's investment policy specifies limits to the exposure from equity markets. Equities held in the investment portfolio as at December 31, 2010 consist of pooled funds which are designated as AFS with changes in fair value recorded as OCI.

The estimated impact of a 10% increase in equity markets would increase OCI by \$1,743,824 (2009 - \$1,901,634). A 10% decrease in equity markets would have the corresponding opposite effect decreasing OCI by the same amount.

#### (iii) Currency risk:

As at December 31, 2010, the Association did not have any material exposure to foreign currency risk.

### 9. Surplus management:

Subscribers' equity comprises surplus and accumulated other comprehensive income. At December 31, 2010, the subscribers' equity was \$27,809,365 (2009 - \$25,046,357). The Association's objectives for the management of surplus are for the prudent operation of the reciprocal and to provide relatively predictable premium costs for its members over time. A surplus management policy is approved by the Advisory Board, which oversees the surplus management process.

As a reciprocal insurance exchange, the requirement for surplus is lower than that of an incorporated insurance company. A reciprocal may rely on the contractual agreement among its members to contribute to the losses incurred by other members and to make assessments for additional contributions to surplus if required and, accordingly, can rely on the creditworthiness of its subscribers.

## CANADIAN LAWYERS INSURANCE ASSOCIATION

Notes to Financial Statements (continued)

Year ended December 31, 2010

### 9. Surplus management (continued):

The Association is regulated by the Superintendent of Insurance, Alberta and a number of other provinces where licenses are held, all of which expect incorporated insurance companies to meet a Minimum Capital Test ("MCT") ratio of capital available to capital required of at least 150%. As of December 31, 2010, the Association's MCT was 266% (2009 - 255%). However, the minimum regulatory standard for reciprocals in Alberta is adjusted equity exceeding \$50,000. The Association's practice is to maintain a surplus level which is significantly higher than the regulatory minimum. The Association's surplus adequacy is evaluated regularly and this evaluation takes into account the gross exposure to risk, the level and nature of reinsurance purchased and the resulting net exposure to members. Input from the appointed actuary, which includes an assessment of loss volatility, is factored into this evaluation.

### 10. Profit-sharing with reinsurers:

According to the provisions of an Automatic Facultative Reinsurance Agreement between the Association and certain reinsurance companies, a profit-sharing arrangement has been agreed following a five-year run-off from the end of the policy period, whereby the Association and the reinsurers will share equally in any surplus as at the calendar year end following the run-off period. The profit-sharing is payable December 31, 2011.

At December 31, 2010, the Association's share is estimated to be \$1,810,725 (2009 - \$1,835,498), which has been recorded as a receivable from other insurers less a 20% provision of \$362,145 (2009 - \$367,100), for a net receivable of \$1,448,580 (2009 - \$1,468,398).

## **ADVISORY BOARD (DECEMBER 2010)**

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Charles D. Whelley, Q.C. \*  
Cox & Palmer  
Saint John, New Brunswick

### **Nova Scotia (Vice-Chair)**

Sandra MacPherson Duncan, Q.C.\*  
Beveridge, MacPherson & Duncan  
Halifax, Nova Scotia

### **Saskatchewan (Secretary-Treasurer)**

Michael W. Milani, Q.C.\*  
McDougall Gauley LLP  
Regina, Saskatchewan

### **Past-Chair**

Phyllis A. Smith, Q.C.\*  
Emery Jamieson LLP  
Edmonton, Alberta

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Vivian R. Stevenson, Q.C.  
Duncan & Craig LLP  
Edmonton, Alberta

### **Manitoba**

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Gange, Goodman & French  
Winnipeg, Manitoba

### **New Brunswick**

Franklin O. Leger, Q.C.\*\*  
Cox & Palmer  
Saint John, New Brunswick

### **Newfoundland & Labrador**

Stephen May  
Cox & Palmer  
St. Johns, Newfoundland

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Field LLP  
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### **Nunavut**

Susanne Boucher  
Justice Canada  
Iqaluit, Nunavut

### **Prince Edward Island**

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Key, McKnight & Maynard  
Summerside, Prince Edward Island

### **Yukon**

Mark A. Radke \*\*  
Whitehorse, Yukon

### **CBELA Representative**

Virginia A. Engel, Q.C.  
Peacock Linder & Halt LLP  
Calgary, Alberta

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#### **Consulting Actuaries**

Dion, Durrell Risk Financing Services  
Toronto, Ontario

#### **Auditors**

KPMG LLP  
Toronto, Ontario

\* Denotes Member of Executive &  
Finance Committee

\*\* Denotes Member of Audit  
Committee





