

2010 financial results explained

A Net premiums (\$100.4 million)

Net LAWPRO revenues in 2010 stood at about \$100.4 million, about \$1 million lower than in 2009.

Premium revenues declined despite the increase in the base premium to \$2,950 and the \$15 increase in the real estate transaction levy surcharge to \$65 per transaction from \$50 for several reasons, key of which are:

- the 2009 income figure included a significant amount of retroactive premium under LAWPRO's arrangement with the Law Society to cover the accrual of the impact of the harmonized sales tax on the existing claims reserves as of December 31, 2009. In other words, the income line in 2009 was higher than usual for that "one-time" reason;
- continued flux in real estate markets resulted in lower TitlePLUS premium revenues.

B Net claims (\$79.9 million)

The decline in net claims costs in 2010 is not the result of fewer claims being reported, or because the cost of resolving claims has gone down. In fact the opposite is true – in 2010 lawyers again reported more than 2,200 claims which are expected to ultimately cost the program in excess of \$85 million.

Instead, the decrease in the net claims and adjustment expense line of our income statement is largely the result of a revision to the actuarial model LAWPRO uses to project ultimate claims costs, resulting in a reduction of loss reserves for older policy years.

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Statement of Income (Loss)

Stated in thousands of Canadian dollars | For the year ended December 31

	2010	2009
Insurance premiums earned	\$ 106,796	107,453
Reinsurance premiums ceded	(6,358)	(5,960)
Net premiums earned	\$ 100,438	101,493
Net claims and adjustment expenses (note 4)	\$ 79,876	108,686
Premium taxes	3,205	3,225
General expenses	16,239	15,434
Reinsurance commissions earned	(1,704)	(3,252)
	\$ 97,616	124,093
Underwriting income (loss)	\$ 2,822	(22,600)
Investment income (note 2)	19,254	11,873
Other (expense) income	(1)	83
Income (loss) before income taxes	\$ 22,075	(10,644)
Income tax expense (recovery) (note 7)		
Current	\$ 6,917	(3,268)
Future	(5)	(899)
	\$ 6,862	(4,167)
Net income (loss)	\$ 15,213	(6,477)

Accompanying notes are an integral part of the financial statements.

This model was implemented in 2001 – 10 years ago. Two years ago, our actuaries (LAWPRO has three actuaries providing input, directly or indirectly, on the mandatory program: our internal actuary, our external appointed actuary, and the consulting actuary who advises our auditor) decided that the model being used would benefit from a revision that would build on the 10 years of data available, and would bring additional clarity to premium-setting and reserving in the future.

Their work came together in a way that allowed the new refined model to be applied to the 2010 year end results. This review could easily have resulted in a very different result, requiring LAWPRO to increase reserves for unpaid claims.

As it was, LAWPRO was able to release more than \$18 million of claims reserves (pre-tax), contributing to overall claims costs in the 2010 financial statements of just under \$80 million.

C General expenses (\$16.2 million)

Despite the fact that LAWPRO – like individual lawyers and law firms – now has to pay HST on many items not previously subject to this level of taxation, the expenses for running LAWPRO increased only five per cent between 2009 and 2010 to \$16.2 million. Strong internal controls and a concerted effort by our employees to control costs where possible contributed to bringing expenses in under budget.

D Investment income (\$19.3 million)

A rebound in investment markets contributed to a solid performance for LAWPRO's portfolio of investments in 2010. Investment income was up by close to \$8 million to \$19.3 million from \$11.9 million in 2009.

The investment portfolio posted total (after tax) gains (realized and unrealized) of about

\$3 million. Returns of five per cent (after fees) exceeded LAWPRO's budget projection of four per cent.

E Net (loss) income (\$15.2 million)

Net income of \$15.2 million is largely the result of the release of reserve funds of about \$18 million (pre-tax) explained in B above and a solid performance by LAWPRO's investment portfolio as described in D above.

F Comprehensive income (\$18.2 million)

The strong net income result, combined with continued growth in the investment portfolio, contributed to solid growth in comprehensive income – an important financial yardstick that is a measure of the company's worth and stability.

LAWPRO's comprehensive income at the end of 2010 stood at \$18.2 million. In other words, the equity that our shareholder has in the company increased by \$18.2 million to just over \$159 million at the end of 2010 – tangible proof of the viability and financial strength of the investment that Ontario lawyers have in LAWPRO.

Statement of Comprehensive Income

Stated in thousands of Canadian dollars | For the year ended December 31

	2010	2009
Net income (loss)	\$ 15,213	(6,477)
Other comprehensive income, net of income tax:		
Net changes in unrealized gains on available-for-sale financial assets, net of taxes of \$1,797 (2009: \$3,256)	4,000	6,669
Reclassification adjustment for (gains) and losses included in net income, net of taxes of (\$437) (2009: \$3,446)	(973)	6,996
Other comprehensive income	\$ 3,027	13,665
Comprehensive income	\$ 18,240	7,188

Accompanying notes are an integral part of the financial statements.

Statement Of Changes In Shareholder's Equity

Stated in thousands of Canadian dollars

	Capital stock	Contributed Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Shareholder's Equity
Balance at December 31, 2008	\$ 5,000	30,645	108,417	(10,183)	133,879
Net loss	—	—	(6,477)	—	(6,477)
Other comprehensive income for the year	—	—	—	13,665	13,665
Balance at December 31, 2009	\$ 5,000	30,645	101,940	3,482	141,067
Net income	—	—	15,213	—	15,213
Other comprehensive income for the year	—	—	—	3,027	3,027
Balance at December 31, 2010	\$ 5,000	30,645	117,153	6,509	159,307

The aggregate of retained earnings and accumulated other comprehensive income (loss) as at December 31, 2010, is \$123,662 (December 31, 2009 – \$105,422).

Accompanying notes are an integral part of the financial statements.

Key benchmarks

As a result of these solid financial results, LAWPRO continues to meet or exceed the Minimum Capital Test (MCT) benchmarks set by our regulators. The company's MCT for 2010 stood at 226 per cent – well within the preferred 220 to 230 per cent range set by the LAWPRO Board and management. This MCT level allows LAWPRO to absorb a degree of financial adversity going forward – and puts the company in a stronger position to weather coming changes that could well adversely affect our financial results.

Key among these headwinds are the following:

1. a pending change to the way the MCT is calculated that could result in a significant decline in the MCTs of all insurers – without the companies

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2. evolving new financial reporting standards that are being adopted by the accounting profession in many parts of the world. The new International Financial Reporting Standards (IFRS) could dramatically affect how insurance companies treat funds held in reserve to pay for claims in the future.*

At the same time, to maintain its MCT (which requires LAWPRO to have a proportionate amount of capital beyond what is just needed to pay the year's claims), LAWPRO needs to add about \$5 to \$7 million to its equity every year. In other

words, as each year's claims are added to our claims liabilities our capital also has to grow by the relevant proportionate amount.

There are two ways to do this: By having net income on the Income Statement or Other Comprehensive income through unrealized gains. It is very difficult to predict the latter. Therefore, it is important that in most years, LAWPRO budget to expect a net income in the millions of dollars.

The company's return on equity (ROE) in 2010 was 10 per cent – similar to that of previous years. Since 1995, LAWPRO's average ROE has been 9.26 per cent.

* As of the end of 2010 the cost of current and previous year claims that are not yet resolved stood at just under \$382 million.