# Financial results explained

## INCOME STATEMENTS

### A Net premiums: $109.7 million

Net LAWPRO revenues in 2011 stood at about $109.7 million, about $9 million more than in 2010.

An increase in the 2011 base premium to $3,350 per lawyer, and in the number of lawyers insured under the program are major factors affecting the net premium figure for 2011. Excess premium revenues were on budget while TitlePLUS premiums were slightly lower than forecast.

### B Net claims: $101 million

Net claims appear at first glance to be up significantly from 2010. But a refinement of LAWPRO's actuarial model in 2010 contributed significantly to the release of more than $18 million of claims reserves (pre-tax) that year, making the net claims number lower than it would otherwise have been.

Factors affecting the net claims expense in 2011 included a decrease in the discount rate (the rate applied to funds set aside to pay for unresolved claims that takes into account rates of return in investment markets) that added more than $10 million to claims costs; a higher claims count in 2011 (2,468 claims compared to 2,231 in 2010); and increased costs associated with resolving claims. Offsetting these increases was a decrease in the funds needed to pay prior years' claims as some unresolved claims from previous years are closing for less than projected, including TitlePLUS claims.

A Net premiums

D Net investment income

B Net claims

C Operating expense

E Net income

Stated in thousands of Canadian dollars

### STATEMENTS OF INCOME

| For the year ended December 31 | 2011 | 2010 |
|---|---|---|
| **Revenue** | | |
| Gross written premiums | $ 115,729 | 106,673 |
| Reinsurers' share of written premiums | (5,945) | (6,358) |
| Net written premiums | 109,784 | 100,315 |
| (Increase) decrease in unearned premiums | (93) | 123 |
| Net premiums earned | **109,691** | **100,438** |
| Net investment income (note 5) | 21,899 | 19,254 |
| Ceded commissions | 2,449 | 1,704 |
| | **$ 134,039** | **121,396** |
| **Expenses** | | |
| Gross claims and adjustment expenses (note 8) | 105,020 | 76,614 |
| Reinsurers' share of claims and adjustment expenses | (4,031) | 3,262 |
| Net claims and adjustment expenses | 100,989 | 79,876 |
| Operating expenses (note 14) | 17,461 | 16,240 |
| Premium taxes | 3,473 | 3,205 |
| | **121,923** | **99,321** |
| **Income before income taxes** | **$ 12,116** | **22,075** |
| Income tax expense (recovery) (note 13) | | |
| Current | 3,616 | 6,917 |
| Deferred | (206) | (55) |
| | 3,410 | 6,862 |
| **Net income** | **$ 8,706** | **15,213** |

*Accompanying notes are an integral part of the financial statements.*

F Comprehensive income

### STATEMENTS OF COMPREHENSIVE INCOME

Stated in thousands of Canadian dollars

| For the year ended December 31 | 2011 | 2010 |
|---|---|---|
| **Net income** | **$ 8,706** | **15,213** |
| Other comprehensive income, net of income tax: | | |
| Net changes in unrealized gains (losses) on available-for-sale financial assets, net of income tax expense (recovery) of ($576) [2010: $1,797] | (1,467) | 4,000 |
| Reclassification adjustment for (gains) losses included in net income, net of income tax (expense) recovery of ($247) [2010: ($437)] | (626) | (973) |
| Reclassification adjustment for impairments on available-for-sale assets, included in net income, net of income tax recovery of $770 [2010: $0] (note 5) | 1,956 | - |
| **Other comprehensive income** | **(137)** | **3,027** |
| **Comprehensive income** | **$ 8,569** | **18,240** |

*Accompanying notes are an integral part of the financial statements.*

## C General expenses: $17.5 million

Expenses to operate LAWPRO came in $1.5 million less than expected and represent only about 19 per cent of overall costs compared to industry averages of closer to 30 per cent.

Year-over-year general expenses are up $1.2 million or six per cent. Effective internal controls and a concerted effort by our employees to control costs where possible contributed to bringing expenses in under budget.

## D Investment income: $21.9 million

Investment income was up only $2.7 million compared to 2010. Difficult and often unpredictable investment markets, the need to reinvest maturing investments at lower rates and the need to take a write-down of about $2.7 million on some securities (because of a change in the way new accounting rules under IFRS treat even a temporary investment loss) resulted in a relatively flat result for investment income.

## E Net (loss) income: $8.7 million

Net income of $8.7 million is above budget of $5.5 million; higher claims costs, offset by stable investment returns and lower-than-budgeted expenses contributed to this result.

## F Comprehensive income: $8.6 million

A positive net income result of $8.7 million helped offset a slight loss of $0.1 million in other comprehensive income resulting from small losses in investments in our surplus portfolio as of year end 2011.

Total comprehensive income – an important barometer of a company's stability – was $8.6 million for 2011. As a result, the equity that our shareholder has in the company increased by that amount to just under $168 million – tangible proof of the viability and financial strength of the investment that Ontario lawyers have in LAWPRO.

## 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 2011 stood at 220 per cent, down slightly from 226 per cent at the end of 2010. This MCT level helps LAWPRO to absorb a degree of financial adversity and weather coming changes in accounting and regulatory rules that could adversely affect our financial results going forward. Although well above the 185 per cent minimum MCT set by LAWPRO's regulator (FSCO), the 2011 MCT of 220 per cent is at the lower end of the preferred 220 to 230 per cent range that LAWPRO Board and management believe is appropriate going forward.

A number of factors will continue to affect LAWPRO's ability to meet Board-set MCT targets:

1. planned changes in the way the MCT is calculated could result in a significant decline in the MCTs of all insurers – without the companies themselves making any changes to their underlying business. LAWPRO expects this new method of calculating MCT will put significant pressure on the company's ability to meet its MCT targets in the coming years;
2. new international financial reporting standards are expected to have a major impact on how insurance companies treat funds held in reserve to pay for claims in the future.*

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 investment (ROE) in 2011 was five per cent compared to 10 per cent for the previous year. Since 1995, LAWPRO's average ROE has been 9.07 per cent. ■

* As of the end of 2011 the cost of current and previous year claims that are not yet resolved stood at just under $408.7 million.