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Why be concerned about what's happening with claims?

For the past several years, we have been sounding warning bells about consistent increases in claims numbers and costs. This year, those bells are ringing more loudly than ever.

In articles, presentations, our annual report and our Report to Convocation we have been reinforcing with the profession that a worsening claims picture puts pressure on the whole insurance program, and especially on premium stability.

But that message has often been lost (or only slightly heard) during exceedingly good times when the economy boomed and, for reasons unrelated to claims experience, we were able to keep premiums at near-record low levels. After all, as long as the principal barometer (premiums) is holding steady, why worry about what is happening in the background?

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We at LAWPRO were and are concerned. And you should be too. This special issue of LAWPRO Magazine has been prepared to remind you of the fundamentals of the insurance program: the relationship between claims reported by lawyers and the money we need to raise to pay those claims, what the claims trends are, and what you can do to help keep claims numbers and costs down as much as possible.

There is no silver bullet here. As you will learn from this publication, the "wiggle room" that a buoyant economy provided both LAWPRO (in the form of healthy investment returns) and lawyers (in that clients were less likely to allege malpractice in a rising economy) is no more. Good risk management is more important than ever. And good risk management is largely a matter of hammering away at the fundamentals, such as good communication with clients, good client intake/identification practices, and diligent time and practice management.

Remember this simple fact: Every additional $1million in expense to LAWPRO adds about another $50 per year to the base premium for each lawyer. So, for example, it only takes a single $1 million loss or two $500,000 losses for you to notice the impact. In a world where we see 2000 plus claims per year and the number of large losses is increasing, it doesn't take long to figure out the potential impact on the base premium.

Two mitigating factors have enabled LAWPRO to maintain stable premiums (ranging from a high of $3,150 to a low of $2,300 over the past nine years) despite a worsening claims picture:

- our ability to tap into a Premium Stabilization Fund (PSF) which, as its name suggests, we were able to access for a number of years to help stabilize premiums, thus effectively offsetting significant claims cost increases; and
- healthy investment returns over the last five years and especially in 2007. The exceptional returns of 2007 made it possible to reduce premiums to their lowest levels ever (at least, for LAWPRO premiums) in 2008, and to increase the base premium a modest $150 in 2009. The LAWPRO Board and Executive team felt it only right that lawyers should realize the benefit of this investment income through a reduced base premium.

All good things, it is said, must come to an end. In 2008 and 2009 we see a convergence of several adverse trends that have a major effect on the insurance program and our ability to provide premium stability going forward on the same basis as in recent years.

First – and as is more fully explained on the following pages – the balance in the Premium Stabilization Fund stood at about $16 million at the end of 2008. One of its functions is to cover shortfalls in transaction levy premiums needed to finance the insurance program; the continuing decline in premium revenues from transaction levies (a trend exacerbated by the economic slowdown in real estate in late 2008 and 2009) means we have had to draw on the PSF more than originally anticipated for 2009 – leaving even less in the fund that we can access in future years to mitigate continued increases in claims costs.

Second, investment income for LAWPRO fell sharply in late 2008 and in the first months of 2009, as it has for everyone with equity investments. The $26 million in investment income in 2007 played a major factor in helping us keep our bottom line in the black. We do not expect to see this kind of return again for some time. In general, interest rates are at an all-time low, and as our existing bonds mature, the new ones available for purchase often have lower interest rates.

Third – and as mentioned by Board Chair Ian Croft in the 2008 LAWPRO Annual Report – we are also coming to grips with the Ontario government's announcement of a harmonized sales tax (HST) regime. The legal costs we pay to lawyers to defend insureds with claims will attract HST (being a financial institution, LAWPRO neither charges GST/HST on our premiums nor are we allowed to deduct GST/HST paid). This will result in an immediate eight per cent increase to our annual legal bill as well as to other operating expenses.

The good news on this front is that, to date, the claims portfolio continues to be fully backed by our asset-liability matched portfolio of fixed income securities. So it is not that we see any existing shortfall in the money needed to pay claims right now, but we are analyzing the impact of HST on the future resolution of existing claims and on the reserves that we have assigned to these reported but still unresolved claims files.

Where does this leave us all? We at LAWPRO are studying the situation and the options available to us extremely carefully as we prepare our Report to Convocation for the 2010 program. We also encourage you to take some time to inform yourself about the issues as described on the following pages, and to work with us in helping keep increases in claims numbers and costs in check.

Kathleen Waters
President and CEO

Transaction levy revenues, Premium Stabilization Fund contribute to premium stability

Premium revenues to meet LAWPRO's fiscal requirements each year come from three principal sources: E&O base premiums, levy surcharges and the Premium Stabilization Fund.

The base premium: The E&O base premium is the company's principal source of revenue. The process of assessing what the premium likely should be starts about six months before the premium is to come into effect. It is based on several factors including: best estimates of revenues from transaction levies, the number of lawyers in practice in the year in which the premium is to be in effect, an actuarial projection of claims costs for the coming year and estimates of the company's operating costs. Although most lawyers pay the base amount of premium, many pay less, depending on the coverages and options selected. For example, a lawyer qualifying for part-time practice or the Restricted Area of Practice Option would be eligible for a discount of 40 per cent off the base premium.

Transaction levies/Claim history levy surcharges: Lawyers practising real estate or civil litigation in 2009 pay a transaction levy surcharge of $50 per real estate or civil litigation transaction, reflecting the added exposure that these areas of practice represent to the program (see also graph 8). Lawyers with claims on which damages have been paid pay a claims history levy surcharge ranging from $2,500 to $35,000 and more, depending on the number of claims reported that attract this surcharge.

Premium Stabilization Fund (PSF): Created in 1999, this fund helps guard against any future shortfall in levy receipts in a given year (forecasting transaction levy revenues in a changing legal and economic landscape is difficult). It has also acted as a buffer against the need for sudden increases in base premiums.

Monies in this fund come from two sources: 1) revenues from transaction levies and claims history surcharges that are in