

Claims numbers, costs trend upward putting pressure on premiums

Claims-related costs account for more than 85 per cent of LAWPRO's annual budget. Costs to administer the LAWPRO program are minimal, accounting for about 15 per cent of our budgeted annual costs (compared to 25 to 30 per cent for most commercial insurers). In other words, no matter how much we reduce program administration costs (which already are at a minimal level), we cannot achieve the savings needed to cover consistent increases in claims numbers and costs. Claims costs – over which we have little if any control – simply account for too much of our budget.

This reality, coupled with the consistent decline in revenues from transaction levies and a declining balance in the Premium Stabilization Fund, mean base premium revenues figure more importantly than ever. Also important is the need to find new ways to contain claims costs, through more proactive risk management, to avoid having to consider restricting the scope of coverage provided under the insurance policy.

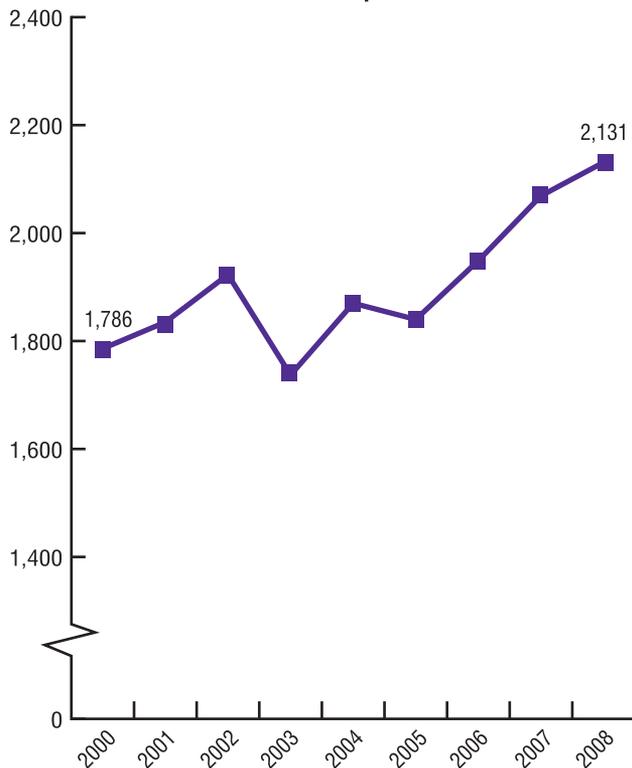
More lawyers are reporting claims (graphs 3 & 4)

The number of claims reported annually has been steadily increasing, topping the 2,000 mark for each of the last two years. Results to date for 2009 indicate the number of claims reported this year may be at the highest levels we have seen since 1995.

Moreover, the rate of increase in the number of claims being reported to LAWPRO has been exceeding the rate at which new lawyers are coming into practice each year. As a result, the claims frequency (the number of claims per 1,000 lawyers) has increased almost 10 per cent in the last four years, from a low of 90 in 2005 to 99 in 2008. In other words, for every 1,000 lawyers we insure, we are now seeing nine additional claims reported.

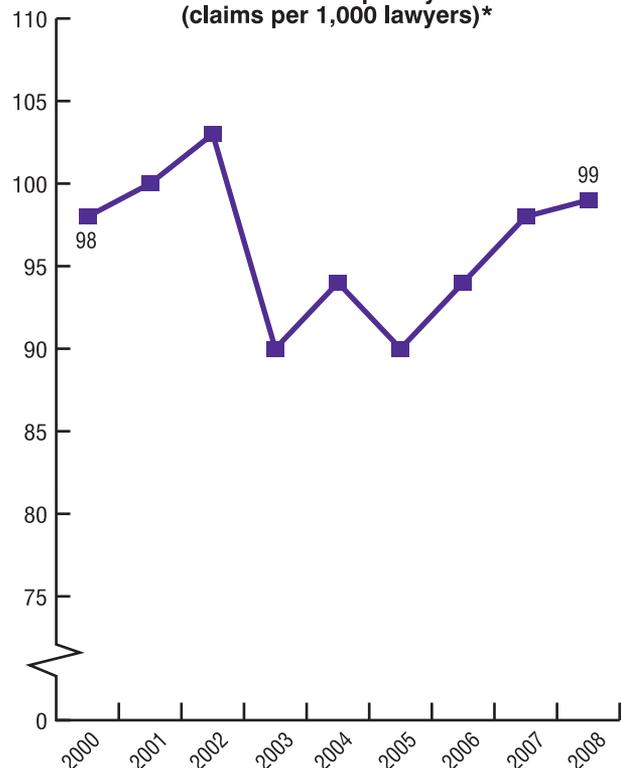
This increase in claims frequency is particularly pronounced in the 2004 to 2008 period – during which premiums generally trended downwards.

GRAPH 3
Claims reported*



* Based on claim reports as of June 30, 2009

GRAPH 4
Claims frequency
(claims per 1,000 lawyers)*



* Based on claim reports as of June 30, 2009

Claims costs rising sharply (graphs 5 to 7)

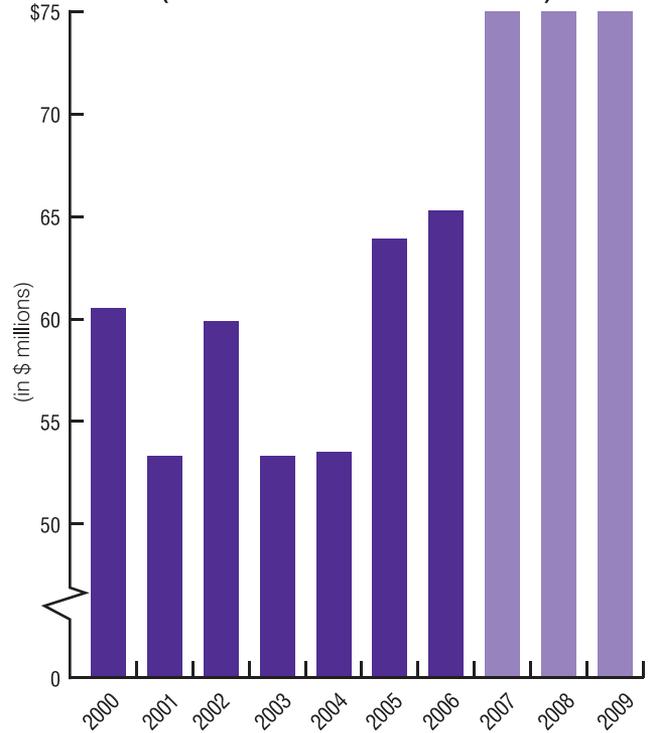
As graph 5 illustrates, claims costs also have been trending upwards, especially in the last three years. Between 2000 and 2004, the average cost of claims reported annually stood at about \$56 million per year; in the 2005 to 2006 period, that average climbed to almost \$65 million. Of real concern are the numbers that we are forecasting for the 2007 to 2009 fund years, as case incurred claims costs for each of those years is trending to be close to or even exceed \$75 million annually.

This same trend is evident when we look at claims severity (graph 6). To ensure we have an apples-to-apples comparison, we looked at claims at the same point in time – in this case, at 30 months after the start of the year in which the claim was reported. It takes on average 24 to 36 months to resolve or adequately assess and reserve a specific year's claims portfolio, so looking at each year's claims 30 months out provides some measure of certainty.

On a per claim basis, the cost per claim file rose from an average of about \$25,500 in the 2000 to 2004 period, to \$29,000 for 2005 and 2006, and to more than \$35,000 for 2007 to 2009. (Severity for these latter three years is a management projection based on current trends.) In other words, in the nine years between 2000 and 2009, the average cost per claim may end up rising close to 40 per cent.

Another measure of what is happening in our claims portfolio is the number of large claims that cost the program \$100,000 or more (graph 7). That number too has been steadily rising – from about 133 per year in the 1999-2001 period, to 146 per year in the 2002 to 2004 period, to 189 per year in the 2005 to 2007 period.

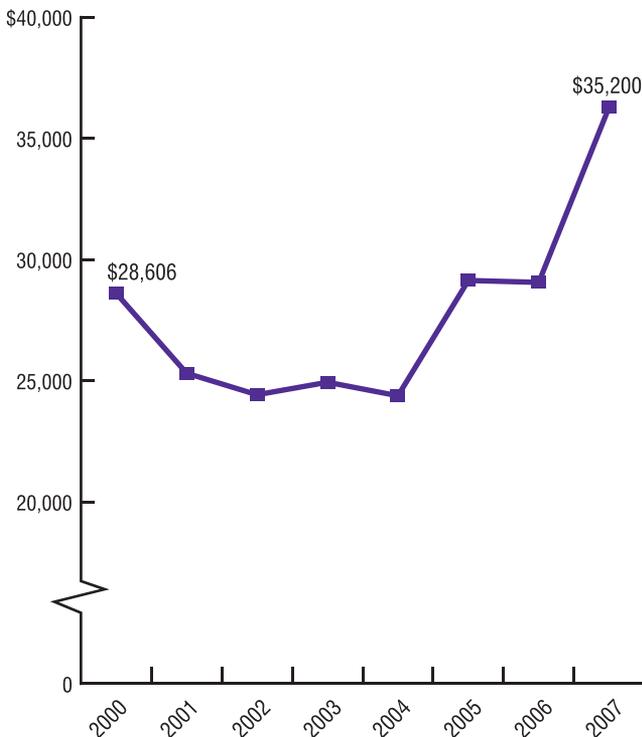
GRAPH 5
Claims cost
(case incurred actual & estimated)*



* For 2000 to 2006, costs above include claims paid plus reserves assigned to unresolved claims for that fund year, but exclude costs for general program administration.

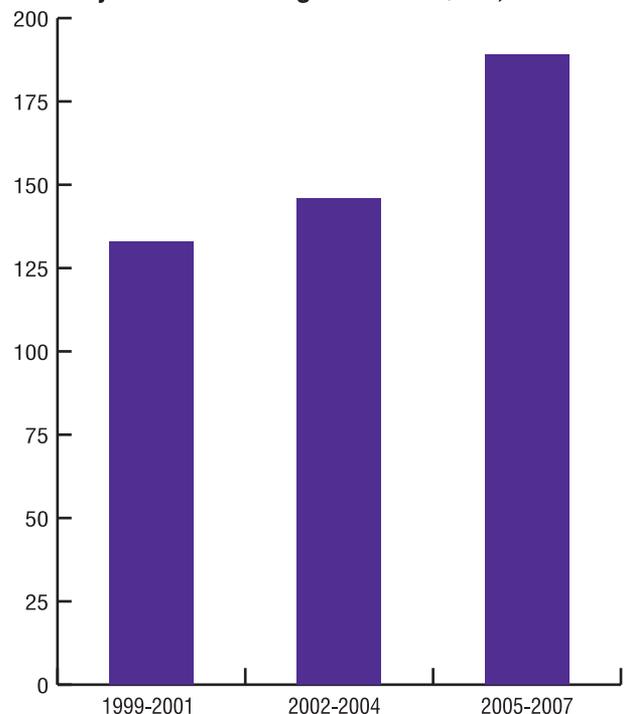
For 2007 to 2009, costs are management projections based on claim reports as of June 30, 2009. More than 25 per cent of claims reported in 2007 are still open, more than 40 per cent of claims reported in 2008 are still unresolved, and only six-month estimates are available for 2009.

GRAPH 6
Average cost per claim at 30 months after
start of year in which claim was reported*



* Based on claim reports as of June 30, 2009

GRAPH 7
Average number of claims reported each
year with a value greater than \$100,000*



* Based on claims reported as of June 30, 2009

Sharp increase in real estate costs (graph 8)

The LAWPRO claims portfolio contains a mix of claims from many areas of law. By numbers of claims, the mix of malpractice claims that LAWPRO sees is roughly in proportion to the amount of work done in all the areas of law in which Ontario lawyers practise.

Although the number of claims in any given area of law changes from year to year (as does the cost to resolve those claims), graph 8 demonstrates some overall cost trends. The majority of LAWPRO's claim costs arise from real estate, litigation and corporate work. Between 2000 and 2007, the costs for real estate, corporate, wills/estates, and family claims have all trended upwards. Over the same period of time, litigation claim costs have fluctuated between \$15 and \$20 million.

While we are seeing more claims involving intellectual property, employment/labour and criminal law, there are no clear trends in the costs of the claims in these areas of law.

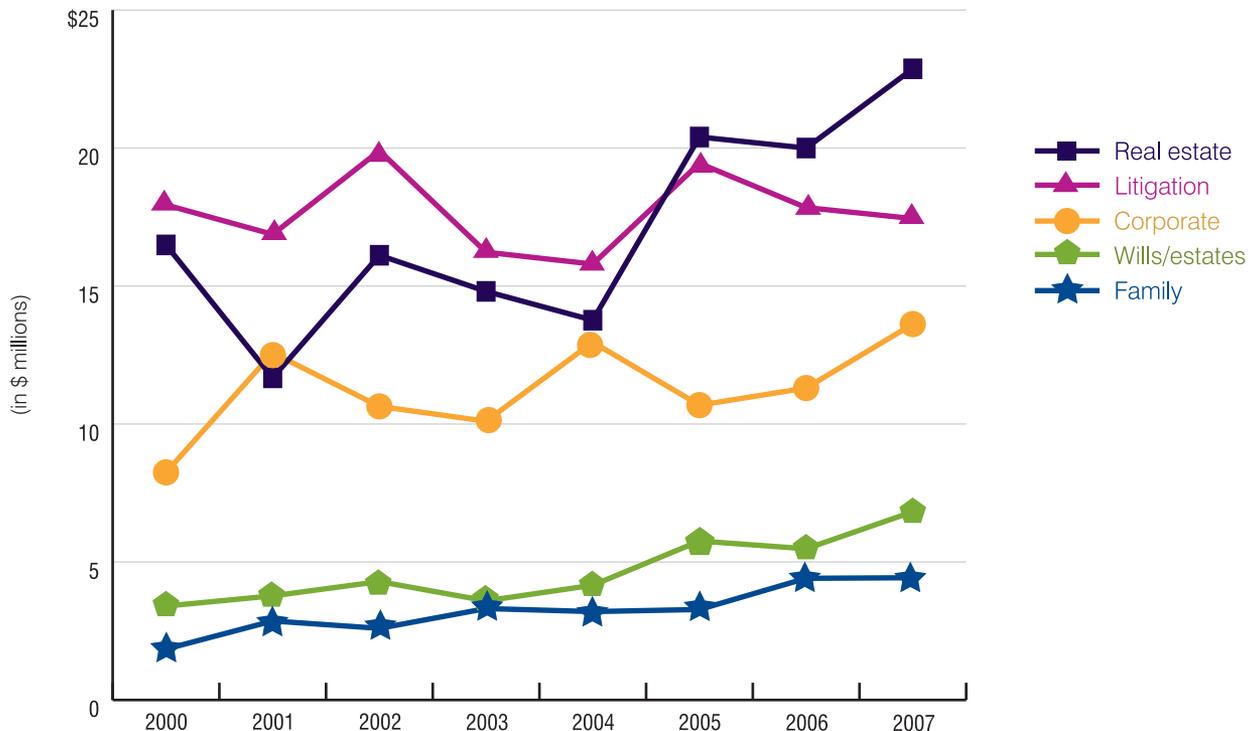
The state of the economy will change the relative amount and types of work that lawyers undertake, which will in turn change the mix of claims. In tough economic times there will be fewer

commercial and real estate deals, and potentially fewer claims arising from this type of work in coming years. However, in tough times there will be more work in the collections, bankruptcy, employment, power of sale and foreclosure areas. Given the current state of the economy, LAWPRO expects to see more claims in these areas in future years.

Rising costs in step with a booming economy

The trends we are seeing in our claims portfolio are not totally unexpected. Over the same 2000 to 2009 period, inflation stood at about 20 per cent. Canada's Gross Domestic Product grew about 26 per cent. Average house prices in Ontario rose 20 per cent between 2005 and 2009 – a factor that no doubt contributed to the fact that real estate consistently accounts for one-third or more of all claims costs incurred. In a robust economy, such as we have seen for much of the past decade, it is not surprising that damages for claims would be rising. Add to that the increased complexity of law practice which results in more complex claims files in our portfolio and you have a claims portfolio that includes more claims that cost more to resolve.

GRAPH 8
Claims costs (case incurred) by area of law*



* Based on claim reports as of June 30, 2009