

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

excess of what LAWPRO had forecasted during the planning process; and 2) a “refund of premium” provision that sees any surplus in funds resulting from claims costs from prior fund years being **lower** than budgeted transferred to the fund for future insurance purposes.

Similarly, if levy revenues fall below projections and/or claims costs are higher than budgeted, monies are drawn from the PSF to offset the shortfall.

Premiums, premium revenues stable over nine years (graphs 1&2)

The insurance premium paid by lawyers over the past 10 years has trended downwards – despite an upward trend in E&O claims numbers, costs and frequency as graphs 3 to 7 on the following pages illustrate.

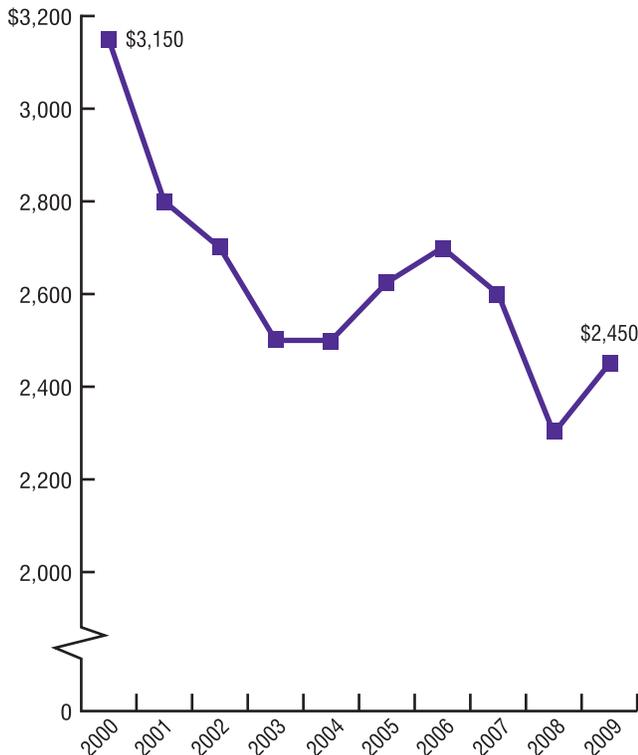
Revenues from base premiums have generally tracked variations in the per lawyer base premium – that is, years in which the per lawyer base premium fell also saw a decline in total revenues from

base premiums. Transaction levies also have trended downwards, largely the result of widespread use of title insurance in real estate transactions (title-insured transactions usually do not attract the \$50 real estate levy surcharge when acting for the purchaser and lender), and more recently of declined economic activity.

As graph 2 illustrates, years in which base premium and transaction levy revenues declined significantly while claims costs also increased (see graph 5) required LAWPRO to draw funds from the PSF.

Between 2000 and 2008, we drew close to \$30 million from the fund, leaving a balance in the fund as of December 31, 2008, of about \$16 million. For the first six months of 2009, revenues from transaction levies were about \$2 million less than projected – a trend that may require us to dip further into the PSF before the current year is out. We forecast that the PSF balance will be significantly lower at the end of this year than it was at the beginning – leaving us with even less in the fund that we can access in future years to mitigate continued increases in claims costs.

GRAPH 1
Base premium (per lawyer)



GRAPH 2
Premium revenues (by source)

