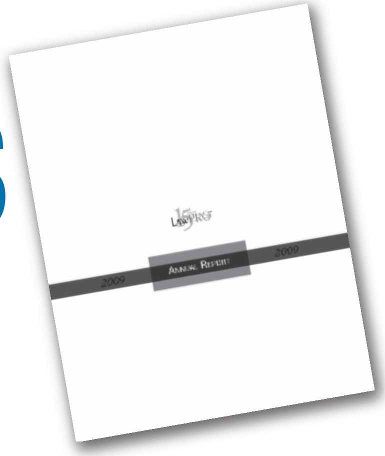
2009 Annual Report highlights

Financial results explained



A – Net premiums: $101.4 million

Net LAWPRO revenues in 2009 stood at about $101.4 million, about $16 million higher than in 2008 for two principal reasons:

- A small increase in the number of insured lawyers and a $150/lawyer increase in the base premium to $2,450 in 2009;
- A special transfer from an E&O/premium stabilization fund to cover the additional claims costs that the introduction of the Harmonized Sales Tax (HST) represents (see Net claims below for further explanation).

Revenue from transaction levies was down by about $2 million to just under $18 million, the result of a stagnant real estate market and the widespread use of title insurance (title-insured transactions generally are not subject to a real estate transaction levy surcharge).

Unstable real estate markets of late 2008 and 2009 also kept title insurers' premium revenues below earlier record levels, but the TitlePLUS program posted a small $300,000 increase in revenues, driven in part by strong sales outside Ontario.

B – Net claims: $108.7 million

Claims costs in 2009 were up significantly compared to 2008 for several reasons:

1. Resolving prior years' claims is costing us more – not less – than we had expected, in both the E&O and TitlePLUS programs.
2. In the E&O program, more claims were reported in 2009 than in any year since 1995 and the cost of resolving those claims is estimated at a more than $85 million.
3. In 2009 we took two unusual "hits" to the claims bottom line:
   a. Accounting rules require that we recognize in our 2009 financial statements the impact the HST will have on our unresolved claims. LAWPRO has had to estimate the legal costs on our unresolved claims files – which at year end stood at about $384 million – and increase our claims costs by the additional eight per cent that HST will add to our legal fee and other consulting costs when it is enacted on July 1, 2010. This alone added $10.7 million to our claims costs for 2009.
   b. The other factor affecting claims costs is what is known as the discount rate or the time value of money. The funds we have set aside to pay our outstanding claims are invested in conservative investments – which on renewal pay less when it comes to rate of return than when they were first invested, two or three years ago. Each quarter LAWPRO's actuaries calculate how much money our investments are earning and how much money we will need to be able to pay off those outstanding claims some time in the future. If interest rates are low, we likely need to set aside more money simply because the lower investment rates are, the more money we will need to be able to pay off those claims. In 2009, the decrease in the discount rate added $7 million in additional expense to our claims costs.

C – General expenses: $15.4 million

The cost to operate the company was not only lower in 2009 than in 2008 by $400,000, but also lower than budget – the result of strong internal controls and a concerted effort by our employees to control costs where possible.

D – Investment income: $11.9 million

In mid-2009, LAWPRO's Investment Committee made a bold move – to transfer management of a portion of LAWPRO's investments to a new investment manager – a move that required the company to realize a loss of about $9 million in the investment portfolio. This loss is reflected in lower investment income of $11.9 million in 2009, compared to $20.7 the previous year.

Under new management and with a new strategy, LAWPRO's total investment portfolio rebounded strongly in the second half of the year, posting total (after tax) gains of about $13.7 million. These gains have not been "realized" – in other words, the market value of the investments has gone up but as the investments have not been cashed in, the gains (a) do not show up in our investment income line, and (b) do not form part of the net income.

LAWPRO ended 2009 with its managers exceeding their benchmarks for the year by 4.6 per cent (the benchmark was 3 per cent and LAWPRO total fund performance, net of fees, was 7.6 per cent).

E – Net (loss) income

As a result of two unusual developments – the $7 million in additional claims liabilities resulting from a decrease in the discount rate (see B above) and the $9 million loss in investment income (see D), the program reported a net loss of $6.5 million in 2009.

F – Comprehensive income: $7.2 million

The investment gains noted in D above show up in an important financial yardstick: a company's comprehensive income, which is an important measure of the company's worth and stability.

LAWPRO's comprehensive income at the end of 2009 stood at $7. 2 million – the result of strong gains in its investment portfolio.

This positive result also shows up in another important measure – the equity that our shareholder has in the company. This figure increased by $7.2 million to $141.1 million at year end – 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 benchmark set by our regulators: In fact, our MCT at the end of 2009 stood at 206 per cent – well above our target of 175 per cent and the FSCO minimum target of 150 per cent. This MCT level allows LAWPRO to absorb a degree of financial adversity.

However, to maintain its Minimum Capital Test (which requires LAWPRO to have a proportionate amount of capital beyond what is 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.

* As of the end of 2009, the cost of current and previous year claims that are not yet resolved was up 10 per cent to $384 million from $349 million in 2008.

STATEMENT OF (LOSS)/INCOME

Stated in thousands of Canadian dollars

For the year ended December 31		2009	2008
Premiums earned – gross		107,453	90,739
Premiums earned – ceded		(5,960)	(5,683)
Net premiums earned	A	**101,493**	**85,056**
Net claims and adjustment expenses (note 4)	B	108,686	81,880
Premium taxes		3,225	2,724
General expenses	C	15,434	15,809
Reinsurance commissions earned		(3,252)	(4,913)
		124,093	**95,500**
Underwriting loss		**(22,600)**	**(10,444)**
Investment income (note 2)	D	11,873	20,658
Other income		83	31
(Loss) / Income before income taxes		**(10,644)**	**10,245**
Income tax (recovery) / expense (note 7)			
Current		(3,268)	2,877
Future		(899)	343
		(4,167)	**3,220**
Net (loss) / income	E	**(6,477)**	**7,025**

See accompanying notes to financial statements

STATEMENT OF COMPREHENSIVE INCOME/(LOSS)

Stated in thousands of Canadian dollars

For the year ended December 31		2009	2008
Net (loss) / income		**(6,477)**	**7,025**
Other comprehensive income / (loss), net of income tax:			
Net changes in unrealized gains and losses on available for sale financial assets, net of taxes of ($3,256) (2008: $3,815)		6,669	(7,574)
Reclassification adjustment for (gains) and losses included in net income, net of taxes of ($3,446) (2008: $701)	D	6,996	(1,392)
Other comprehensive income / (loss)		**13,665**	**(8,966)**
Comprehensive income / (loss)	F	**7,188**	**(1,941)**

See accompanying notes to 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, 2007	**5,000**	**30,645**	**101,392**	**(1,217)**	**135,820**	
Net income	—	—	7,025	—	7,025	
Other comprehensive loss for the year	—	—	—	(8,966)	(8,966)	
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**	F

The aggregate of retained earnings and accumulated other comprehensive income (loss) as at December 31, 2009 is $105,422 (December 31, 2008 – $98,234).