

From crisis to innovation: 20 years of LAWPRO professional liability insurance

20 YEARS

Twenty years ago, an investigative task force appointed by the Law Society of Upper Canada¹ made a sobering discovery: the fund established to pay for professional indemnity claims against Ontario lawyers was underfunded by over \$200 million dollars. The resulting crisis presented the bar in Ontario with one of the most serious challenges in its history. It also prompted the delegation of the primary professional liability program to the organization you have come to know as LAWPRO, a highly specialized, innovative, and solvent licensed insurance company owned by the Law Society.

As of the fall of 2014, LAWPRO insured about 25,000 Ontario lawyers, managed over \$600 million in cash and investments, and had shareholder's equity of \$200 million. Out of the insurance crisis of the 1990s has arisen a professional liability powerhouse, committed to values of professionalism, innovation, integrity, service and leadership. And its main business (90 per cent of its gross revenue) continues to be providing the Ontario private practice bar with its primary layer of professional liability insurance protection. The timeline on the next page highlights some of the major innovations LAWPRO has delivered to the profession over the last 20 years.

Early approaches

Compulsory professional indemnity insurance has a 40 year history in the province. Since 1972, Ontario lawyers have been required, as a condition of licensing, to maintain coverage for malpractice claims. The *Law Society Act* empowers the Law Society of Upper Canada to “make arrangements” for professional indemnity coverage for its members and to own shares in a provider company.²

Early “arrangements” included the negotiation of coverage from Gestas Corporation Limited, then American Home, and then Lloyd's.³

Adjusting services were provided by Maltman's International. In 1990, the Law Society first arranged its own E&O policy through Lawyers' Professional Indemnity Company (then known as LPIC) and began handling the administration and funding of coverage for smaller claims. LPIC was useful to enable the reinsurance of larger claims. Though separately incorporated, LPIC was not operationally separate from the Law Society. Via a “layering” structure common to many insurance programs, the Law Society (through a group deductible), LPIC, and the chosen reinsurers bore responsibility for respective “layers” of claims losses.

¹ “Report to Convocation of the Insurance Task Force and the Insurance Committee,” the Law Society of Upper Canada, October 28, 1994 (amended November 15, 1994).

² Section 61 of the *Law Society of Upper Canada Act*, R.S.O. 1990 c. L.8 permits the Law Society to make insurance arrangements, and section 5(4) permits it to own shares in a provider company.

³ *Supra* note 1 at page 83, para. 265

Transaction and claims history
levy surcharges introduced
1995

No charge run-off
coverage offered

Options to tailor coverage
introduced, choice of deductible
amounts and types, premium
discount introduced for new
practitioners
1996

Discounts introduced
for restricted area of
practice lawyers (criminal
and/or immigration)
1997

Innocent party coverage
for sole practitioners
1998

Introduction of e-filing discount
1999

The funding crisis

In the spring of 1994, evidence began to emerge that the value of the insurance fund managed by the Law Society was at least \$122 million short of estimated claims liabilities. The Law Society appointed actuary Brian Pelly of Eckler Partners Ltd. and accounting specialist David Ross of Deloitte & Touche to investigate further. They determined that the convergence of multiple factors – including a misunderstanding about capital requirements, inaccurate estimation of deductible receivables, and computer and other errors – had led, by June 30, 1994, to a deficit of \$154 million.⁴

Because of the time value of money, and because the Law Society was also required by regulators to raise an additional \$50 million to capitalize LPIC, the amount required to retire the deficit and place LPIC in a position to continue to offer insurance was estimated, in October 1994, at \$240 million over the course of four years (1995-1998).⁵

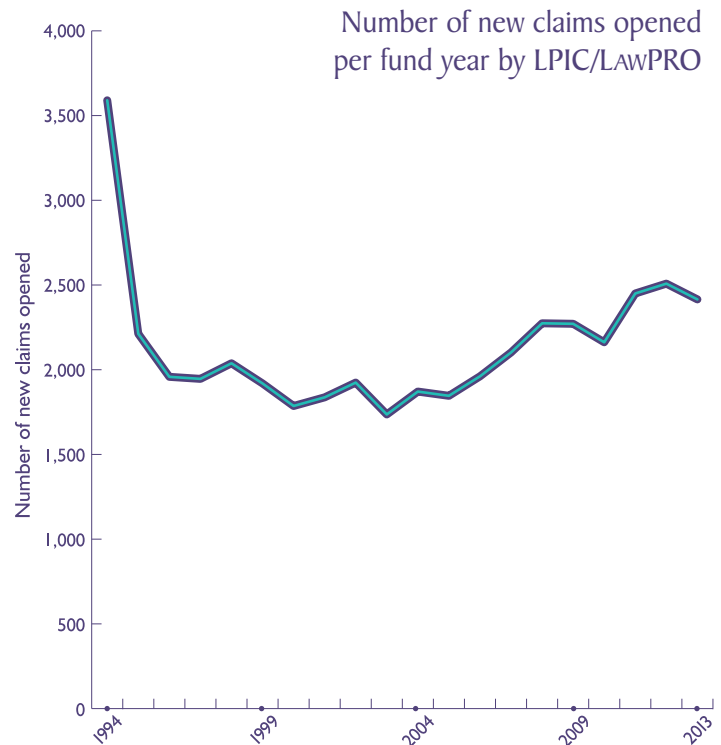
The Task Force

This discovery sent a shockwave of panic through the bar. To come to terms with the monumental challenge before it, the Insurance Committee of the Law Society acted quickly to appoint members of an Insurance Task Force. Established by Convocation on June 27, 1994, the Task Force, chaired by Harvey Strosberg, was comprised of Thomas Bastedo, Susan Elliott, Abraham Feinstein, Neil Finkelstein, and Ross Murray. With the assistance of a team of experts including Brian Pelly and David Ross, the Task Force members spent the summer and early fall of 1994 grappling with the deficit's implications for the future of lawyers' professional indemnity coverage in Ontario.

On October 28, 1994, the Insurance Task Force and the Insurance Committee (hereafter Task Force) released a report recommending that the requirement that Ontario lawyers carry professional indemnity insurance be maintained, but that significant changes be made to the terms and administration of that coverage. In particular, the Task Force recommended that the insurance fund be operated in a commercially reasonable manner, that risk-rating be employed, and that coverage not be extended on a no-fault basis – and some lawyers could be denied coverage in certain circumstances. (See the box on page 7 for the principles underlying the Task Force's recommendations.)

⁴ Ibid., at page 2, para. 4

⁵ Ibid., at page 21, para. 65



The Task Force report made it clear, however, that LPIC as it was being operated in 1994 was poorly positioned to put these recommendations into action. At that time, LPIC did not collect the data necessary for risk rating⁶, did not keep its own records, did not track its own denial of coverage statistics or reasons⁷, had no guidelines for the expenditure of legal fees⁸, and outsourced key functions (such as the development of coverage opinions) that, if managed internally, would have provided the information needed to risk-rate premiums and accurately set levies. The management structure of the company was also a barrier to success: there were “no identifiable channels for decision-making and no clear lines of authority.”⁹

To overcome these barriers, the Task Force recommended that LPIC immediately put in place a dedicated CEO/President responsible for the company's operations, including underwriting; that an active and informed board of directors be appointed; and that the company hire a vice-president of claims, a vice-president of finance, and a vice-president of operations.

⁶ Ibid., at page 84, para. 271

⁷ Ibid., at page 85, para. 275

⁸ Ibid., at page 98, para. 319

⁹ Ibid., at page 84, para. 269

Risk Management Credit launched	Addition of provisions to facilitate lawyer mobility in Canada		Program amended to address <i>locum</i> work		Sublimit coverage for eligible cybercrime losses
Program expanded to include multi-disciplinary partnerships (MDPs)	Addition of defence cost protection for certain statutory penalties	Addition of real estate practice coverage option (REPCO)	Addition of limited trust account protection for counterfeit certified cheques/bank drafts	Increase in discounts for part-time, new and restricted area of practice lawyers	Policy adapts to lawyer/paralegal partnership structure
2002	2003	2008	2009	2012	2014

The result: an independent insurance company



Malcolm Heins was the company's first CEO and he had a clear vision for what the company could become. He was a lawyer with a background in professional indemnity insurance and 12 years of experience as a senior insurance company executive. When asked about LPIC's toughest challenge, he references not just its finances, but communications:

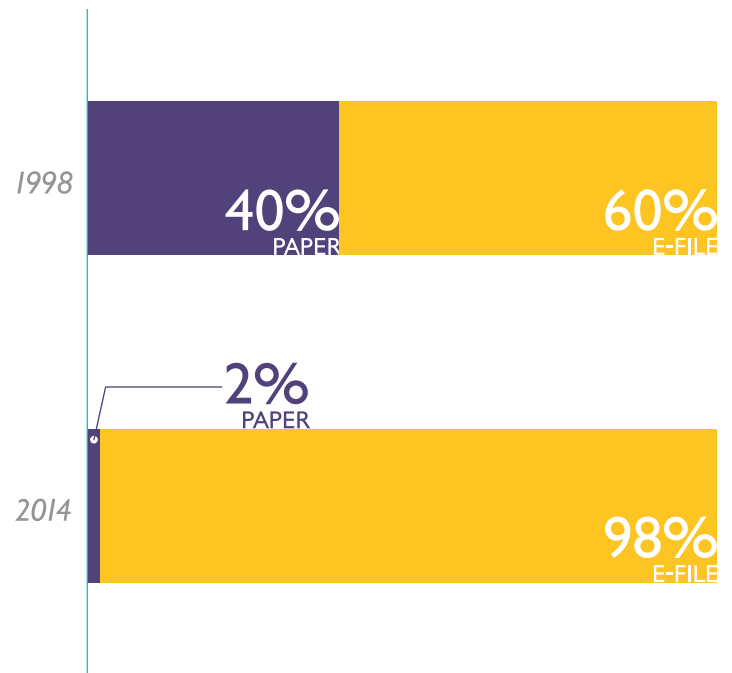
"we knew we needed to create a real understanding by Ontario's lawyers as to what caused their claims. We needed to encourage them to make changes in their law practices." Educating lawyers about claims prevention remains a key priority for the company today.



Michelle Strom, President and CEO at LAWPRO from 2001 to 2008, joined the company in January 1995 as Chief Financial Officer, and remembers the very practical challenges of the company's first several months: "Something people tend to forget is that when LPIC separated itself from the Law Society in 1995, the new company had no separate

computer systems. We started building them right away, but the company's operations had to go on while that was happening. We sent out about 16,000 insurance applications that year – on paper – and each one had to be reviewed and the data manually entered. Everyone who could review applications did. This allowed us to develop what ultimately became a very robust set of data to better

manage the program, but that first year, from a data perspective, we were in the dark, building everything from scratch." (For some perspective on how times have changed, 98 per cent now e-file.)



The Insurance Task Force principles

The Insurance Task Force and the Law Society's Insurance Committee expressed the following principles as the foundation of the recommendations contained in their October 28, 1994 Report to Convocation:

- a) that the [Law] Society intends to continue the E&O program;
- b) that LPIC will be operated in a commercially reasonable manner;
- c) that LPIC will not be operated on a "no-fault" compensation basis;
- d) that LPIC must limit some coverage and eliminate other coverage;
- e) that LPIC will move toward a system in which the cost of insurance generally reflects risks;
- f) that LPIC's mandate will be to settle claims fairly and expeditiously;
- g) that LPIC may deny coverage in appropriate circumstances or cancel coverage if deductibles, surcharges, premiums or levies are not paid; and
- h) that some solicitors who have been repeatedly negligent may not be able to afford to practise because they will not be able to afford the cost of insurance.

Convocation accepted the Task Force's recommendations, and acted quickly to appoint Malcolm Heins as the CEO of LPIC. "Having those detailed guidelines and a specific mandate from the Task Force was key to moving forward," said Heins. Under his direction, changes to the company's management structure were implemented within a few months of his arrival. (For governance details, see "What does operational and board independence look like?" on page 9.) "In addition," noted Heins, "we had to persuade the reinsurance market to provide financial support, but before going out to the reinsurers, we needed to redesign and clarify the insurance coverage and be able to demonstrate to reinsurers that we had the ability to make the insurance program financially sustainable." Heins rewrote the policy and put on a road show in early 1995 for all of the reinsurers who could potentially support LPIC. The result: the reinsurers got on board and LPIC was ready for operation as an independent insurance company, governed by commercial insurance industry principles, within six months of Convocation's acceptance of the Task Force's report.

The primary insurance program is planned each year to generate only those profits required for present and future compliance with regulatory requirements and prudent solvency planning. The company's focus for the program remains consistent with the Task Force's vision of a commercially responsible insurance initiative: premiums charged in a particular policy year are intended to match, to the closest extent possible, the projected defence, indemnity and administrative costs, plus meeting regulatory capital requirements. (For details about what it means to operate the primary insurance program in a commercially reasonable manner, see the sidebar on page 10.)

A well-defined scope of coverage

As recommended by the Task Force, LAWPRO takes a principled approach to defining the appropriate scope of coverage for the mandatory professional indemnity policy. For example, the LAWPRO policy covers lawyer errors and omissions, but does NOT generally cover criminal acts or fraud (other than through its specifically defined and priced innocent party coverage) – compensation for losses related to these is more commonly available from the Law Society's victim compensation fund.

The primary program policy also does not cover losses that are remote from the delivery of professional legal services. Where a lawyer offers non-legal services (for example, by acting as a real estate broker or a financial advisor), there is no coverage for claims that result. Coverage of losses related to trust account overdrafts resulting from counterfeit cheques and instruments is available only in circumstances where the lawyer has taken steps required by LAWPRO to verify the validity of instruments. Finally, in 2014 LAWPRO introduced a sublimit of coverage for losses related to cybercrime, recognizing that prevention of these losses is more closely dependent on the appropriate use of information technology, and not on the application of legal skill.

Board committees then and now

LPIC

board committees in 1995

Audit Committee

Executive Committee

Investment Committee

LAWPRO

board committees in 2014

Audit Committee

Executive Committee

Investment Committee

Conduct Review Committee

Governance Committee

Risk Committee

What does operational and board independence look like?

Prior to the release of the Task Force report, LPIC, although separately incorporated, remained integrated with the Law Society. The company shared both elements of its management structure and operating systems (such as data management) with the Law Society. The primary insurance program was effectively being run as a department of the Law Society.

Re-designing the primary program on a commercially reasonable basis required some profound changes in structure and operations. As recommended by the Task Force, the company moved quickly in the final months of 1994 to establish an independent governance structure for LPIC. Malcolm Heins took on the role of CEO, and within a few months, the Law Society as shareholder appointed to the board a number of directors with insurance and/or financial industry backgrounds: William Holbrook would serve on the board from 1995 to 2009, and Robert McCormick until 2004. Directors Douglas Cutbush, Ian Croft, and Rita Hoff (who was appointed in 1996) remain members of LAWPRO's board today.

LAWPRO's governance separation from the Law Society, its sole shareholder, is evidenced by the following:

- While the current chair of LAWPRO's board, Susan T. McGrath, is a Law Society benchler, the majority of the board members are neither benchers nor Law Society employees, and many of them have backgrounds in the financial services and insurance industries. None of the committee chairs are benchers of the Law Society.
- LAWPRO management is completely separate from the Law Society. The board appoints the CEO, and the CEO staffs and manages the company.
- LAWPRO maintains records separate from those of the Law Society and performs its own data analysis. Financial management of the company is also separate.
- LAWPRO does not have the power to pay dividends to the Law Society; instead, any profit is reinvested into LAWPRO itself.

Explains Strom: "Our success can be traced back to the creation of that first executive team. Everyone brought a unique perspective, everyone was working very hard, but we had a common goal. We were building the framework that would allow the company to succeed."

In the months and years that followed, LPIC – and then LAWPRO – implemented safeguards and created the policies required of a regulated financial institution. The obligation to keep up with evolving regulatory compliance requirements continues to shape the way LAWPRO governs itself, makes decisions, and does business. Here are a few of the characteristics of an Ontario licensed insurance company:

- There are limits on the permissible numbers of (Law Society) "affiliated" directors on the board and/or on certain board committees.
- Directors and officers are subject to rules under insurance legislation with respect to solvency requirements and market conduct (including appropriate claims handling). Failure to comply can result in prosecution, fines, and, depending on the allegation, civil liability on a personal basis. In some areas, there are self-reporting obligations.
- LAWPRO is subject to the "related party" rules of the Ontario insurance regulation regime. Strict rules govern transactions with a parent organization, and apply to LAWPRO's annual sale of the primary professional liability program to the Law Society. LAWPRO General Counsel is charged with ensuring compliance with the related party regime. As a safeguard, the General Counsel meets four times annually with the board's Conduct Review Committee.

The benefits for lawyers:

Operational and governance separation from the Law Society ensures that the insurance company is more able to set its own priorities for the provision of a secure and appropriately priced professional liability program, without being unduly influenced by the issues, goals, and agenda of the bar's regulator. While LAWPRO maintains an intimate understanding of the role of and challenges faced by the bar, separation from the Law Society's management allows it to focus more directly on the broader insurance industry issues affecting the primary program, including solvency and effective claims management.

The evolution of today's LAWPRO: expertise prompts innovation

The story has a very happy ending: not only did the reorganized LPIC succeed in retiring the 1994 deficit, it did so slightly ahead of schedule. Credit for this achievement must be shared with the bar, who paid levies to the Law Society to permit it to fund the higher LPIC capital requirement, and to insured lawyers who paid higher levies in 1995-1998.¹⁰

Lawyers' willingness to accept responsibility for the deficit and for the creation of an independent, solvent insurance program was an important show of faith in what the company could achieve. Says Michelle Strom, "in 2002, we changed the company's name to LAWPRO

to reflect our emergence as a *professional* and *proactive* insurance company. Re-launching and rebranding the company was our way of saying that, while the problems of LPIC had shaped the program, LAWPRO represented the future and all that it has become."

We hope lawyers licensed in 2015 and beyond who aren't familiar with the insurance crisis will not take for granted the result of these efforts: an innovative, legally compliant, and financially stable primary professional liability insurance program that offers coverage carefully tailored to claims risk. (For more on risk-rating, see the sidebar on page 12.) Today's LAWPRO is celebrating five years of premium stability in the primary program despite annual claims costs of approximately \$100 million, once internal claims handling costs are considered.

Operating in a commercially reasonable manner

Perhaps the most fundamental of the Insurance Task Force's recommendations was that LPIC and the primary program be operated "in a commercially reasonable manner." What does this mean in practical terms?

A company that operates in a commercially reasonable manner strives to earn at least enough income to cover its expenses, taking into account contingencies and the time value of money. Because financial industry regulation requires companies to pass solvency tests like the Minimum Capital Test (MCT)¹¹, corporations in the industry must also acquire and maintain assets sufficient to satisfy these tests. This means LAWPRO must strive to earn a modest margin of profit on the primary program, which it then reinvests in itself, as a hedge against contingencies (such as an unexpected increase in claims costs). Because LAWPRO purchases reinsurance for a small portion of the risks it covers¹², the company must also demonstrate that it is financially stable enough to be offered this reinsurance at an acceptable cost.

Maintaining stability and solvency means making prudent investments, accurately forecasting expenses, controlling operating costs, and carefully managing claims. To achieve these ends, LAWPRO relies on the expertise of professional investment managers and advisors. Internally, the company employs a controller, auditor and actuary. Its results are

also subject to review by external auditor Deloitte, LLP and external actuary Eckler Ltd. Eckler actuary Brian Pelly conducted the review that formed the basis of the findings in the 1994 Task Force report and is still providing actuarial services to the company today.

To assess whether or not the company is achieving its goal of commercially reasonable operation, our experts compare LAWPRO's general expenses, return on equity (ROE), and return on investments (ROI) to industry benchmarks. When planning the primary program each year, LAWPRO's Audit Committee is intensely aware of the possible impact on the MCT. LAWPRO has a track record of lower operating expenses compared to the industry average, and the company's success in achieving a modest profit as measured by ROE allows it to maintain solvency while charging a lower premium today than in 1994.

The benefits for lawyers:

Operating with a view to minimizing costs means offering a base premium for the primary program that reflects the greatest possible savings that the size of the premium pool and solvency requirements will permit.

¹⁰ The premiums were set to pay the then-current operating and claims expenses, and the levies (volume, real estate and civil litigation) went to retire the deficit. Once the deficit was retired, the real estate and civil litigation levies were then used as a source of premium which allowed the base premiums to decrease after 1998.

¹¹ More information about the MCT test as it relates to LAWPRO can be found in: "MCT + IFRS: More than the sum of its parts" from the January 2012 issue of *LAWPRO Magazine*; and "Insurance Biz 101: Why profit is not always a bad word" from the September 2010 issue of *LAWPRO Magazine*.

¹² When LPIC was first created, the company reinsured a substantial proportion of the risks it covered in the primary program. Today, because of improved capitalization and greater experience with claims management, LAWPRO purchases reinsurance to protect the primary program only for a narrow category of risk: "one or more large aggregations of multiple claims arising from the same proximate cause," (large cluster claims).

The chart below illustrates both the growth in the number of lawyers in private practice and the reduction in the proportion of lawyers who chose to go into private practice in the last 20 years. Despite these demographic shifts, LAWPRO has stabilized premiums – the 2015 premium of \$3,350 represents a 40 per cent decrease from the premium charged in 1995.

With each passing year, the company develops a deeper understanding of claims trends, and is well positioned to identify and cope with emerging risks including sophisticated mortgage frauds and cybercrime. (See page 13 for an overview of our claims handling successes.) “Today’s LAWPRO,” notes Heins, “provides one of the best– if not the best – professional indemnity programs for lawyers in the world. Ontario lawyers need only observe what’s happening

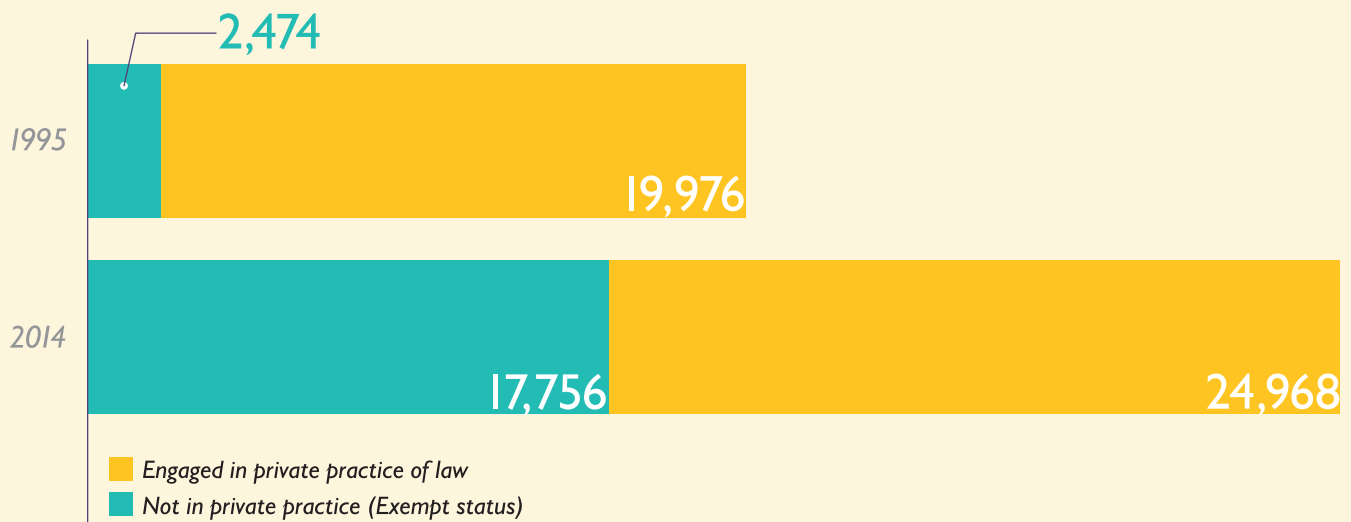
in other jurisdictions to see that they enjoy a more favourable insurance market than their peers.”

Just how innovative is LAWPRO’s primary professional indemnity program?

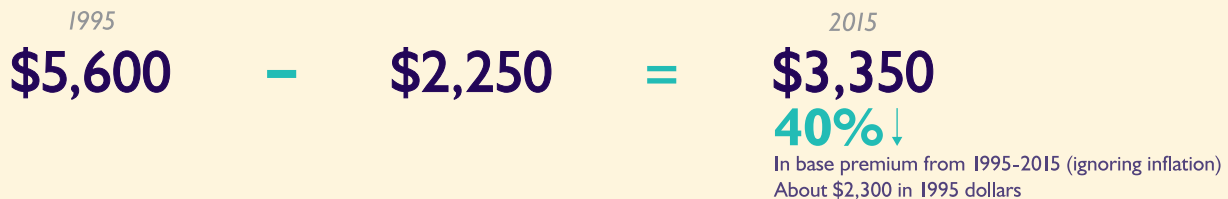
The Law Society of Upper Canada’s mandatory professional indemnity program, underwritten by LAWPRO, is the largest of its kind in Canada. While professional indemnity insurance for lawyers is mandatory across the country, the Ontario program is distinctive in being offered by a licensed insurance company with such a long history of operational and governance independence.

Moving from 1995 to 2014

Number of Ontario lawyers:



Ontario lawyers have seen a 40% decrease in premiums in the same time period:



Because malpractice insurance for lawyers is not mandatory in the U.S. (except in the state of Oregon), LAWPRO has been at the forefront of research into coverage models, claims trend analysis, premium setting, and many other aspects of insurance administration. For a more in-depth look into how LAWPRO determines coverage and sets premiums, you may want to explore these resources:

- “A desire for deluxe services at a compact price: What is LAWPRO to do?” (*LAWPRO Magazine* May 2013)
- “InsuranceBiz: Why the LAWPRO base premium is only part of the story” (*LAWPRO Magazine* May 2013)
- “Balancing risk and fairness: How LAWPRO considers new insurance program coverages” (*LAWPRO Magazine* Fall 2011)

- “Insurance Biz 101: Why profit is not always a bad word” (*LAWPRO Magazine* September 2010)

For insight into the LAWPRO program in a global context, see:

- “Malpractice insurance in foreign jurisdictions: An update” (*LAWPRO Magazine* June 2014)
- “Mandatory professional liability and a mandatory insurer: A global perspective” (*LAWPRO Magazine* Fall 2011) ■

Kathleen Waters is President & CEO at LAWPRO.

What is risk rating, and how does LAWPRO accomplish it?

If you ever had to pay for car insurance as a teenage driver, you’ve seen risk rating at work. The reality, in insurance, is that the individuals who make up a pool of insureds are not all at equal risk of a claim. When it comes to car insurance, for example, insurers have long since learned from claims patterns that teenage drivers have more accidents than adults.

Professional indemnity claims follow patterns as well: claims are higher in certain areas of law, at certain stages in a lawyer’s career, and under certain other circumstances (for example, the more claims a lawyer has had in the past, the more likely he or she will have claims in the future).

Fairness and commercial reasonableness demand that lawyers at greater risk of a claim (based either on their own individual history or on general claims patterns, or both) ought to bear a greater responsibility for supporting the premium pool than lawyers at low risk of a claim. In its 1994 report, the Insurance Task Force recommended that LPIC/LAWPRO should employ risk-rating in the primary program, and that some practitioners who have been repeatedly negligent may not be able to afford to practise because they will not be able to afford the cost of insurance.

Every year LAWPRO reports to Convocation on its risk-rating analysis, including the following factors: area of practice, geographic region, firm size, years since call to the bar, and part-time status. After 20 years of collecting data, LAWPRO has a wealth of knowledge about what makes a lawyer’s practice more or less risky. Today’s policy employs a wide range of risk-rating customizations, including:

- Declining discounts for lawyers in their first four years of practice – because the claims rate for new lawyers is low, and increases with each year; the discounts also help new practitioners get “on their feet” financially;
- A discount for lawyers who practise law part-time;
- A discount for lawyers who practise exclusively criminal and/or immigration law – areas of low claims risk;
- Per-transaction levies for real estate transfers and commencement of litigation, (because these are areas of high claims risk); and
- Claims history surcharges for lawyers who have had a claim that required a payment as defined by endorsement.¹³

While risk rating promotes fairness and helps to protect the primary program from the impact of the highest-risk practitioners, it can never be exact. LAWPRO recognizes that serving the profession means balancing affordability concerns with the goal of insuring lawyers in the broader public interest.

The benefits for lawyers:

Risk rating promotes fairness by allocating premium responsibility based on risk, and deters claims by apportioning higher costs to riskier practitioners.

¹³ See Endorsement 4 of the 2015 LAWPRO policy.

Efficient and fair claims handling

In its 1994 report, the Insurance Task Force expressed concerns about pre-1995 LPIC's lack of control over claims resolution costs. The company was spending thousands of dollars on coverage opinions, but had not established an "opinion bank" to avoid duplicating opinions. While the Task Force found that fees being charged by outside counsel were fair and results were good, LPIC had few procedures in place to manage litigation costs. Individual claim budgeting was not being done, and there was no procedure in place to audit the value of legal services as compared to results.

The Task Force also made it clear that if LPIC was to be responsible to the public by acting in good faith to settle claims fairly and expeditiously, then lawyers should be required to act with good faith in their dealings with LPIC; for example, by complying with policy conditions – like the requirement to report potential claims promptly and to provide full disclosure of claims circumstances. LPIC ought, the Task Force held, to be allowed to deny coverage in appropriate circumstances, because "financial realities" would not permit the company to continue to try to offer "a Rolls Royce insurance policy for the price of a Ford." In other words, LPIC was not to operate the primary program on a "no fault" compensation basis.

Today's LAWPRO carefully manages claims:

85 per cent of files closed without indemnity payment

In 2013, 44 per cent of files were closed with no payment required; 41 per cent required payment of defence costs only; and just 15 per cent required defence costs and an indemnity payment.

Highly satisfied insureds

Annual surveys of insureds who have had claims handled by LAWPRO typically reveal a high degree of satisfaction. In 2013, 97 per cent of LAWPRO insureds reported being satisfied with how their claims were handled, 92 per cent were satisfied with the counsel assigned, 89 per cent said they would have the same defence counsel firm represent them again, and 87 per cent said LAWPRO received good value for money spent on defence.

Experienced internal counsel

LAWPRO employs more than 30 internal counsel who together provide an impressive range of practice experience. Several members of the claims departments have decades of practice experience, and a few have been with LPIC/LAWPRO since inception. In 2013, LAWPRO internal counsel managed over 3,000 open claims files in the primary program. Not all of those claims are ultimately assigned to external counsel; in many cases, the file is closed after resolution by internal counsel, or in some cases the insured is encouraged to resolve the claim himself or herself with LAWPRO's support. LAWPRO counsel also handle most of the company's efforts to recover costs from third parties.



Michelle Strom notes that special mention should be made of Caron Wishart, who led the claims department until her death in 2010:

“Caron was the face of the claims department. She held herself and the claims counsel to the highest of standards. She was firm, but she had a way of seeing individual strengths and of getting the best out of counsel.”