
Financial statements of Canadian Lawyers Liability Assurance Society

December 31, 2019

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Independent Auditor's Report

To the Advisory Board of
Canadian Lawyers Liability Assurance Society

Opinion

We have audited the financial statements of Canadian Lawyers Liability Assurance Society (the "Society"), which comprise the statements of financial position as at December 31, 2019, and the statements of comprehensive income (loss), changes in equity and cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Society as at December 31, 2019, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards ("Canadian GAAS"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Society or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Society's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian GAAS will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Society's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Society's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Society to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Chartered Professional Accountants
Licensed Public Accountants
[DATE]
Toronto, ON

Canadian Lawyers Liability Assurance Society

Statement of financial position

As at December 31, 2019

		2019	2018
	Notes	\$	\$
Assets			
Cash at bank		3,784,745	5,081,001
Short term investments	4	12,342,761	7,128,611
Bonds	4	6,015,184	5,911,332
Interest income due and accrued		20,531	20,988
Premiums receivable	6	1,254,203	1,635,998
Prepaid expenses		144,413	140,827
Deferred policy acquisition costs		134,134	106,582
Reinsurers' share of unearned premiums		3,626,526	2,736,021
Reinsurance receivable		351,056	2,996,041
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	5	59,504,000	87,941,000
		87,177,553	113,698,401
Liabilities			
Accounts payable and accrued charges		330,424	335,152
Unearned premiums		4,618,813	3,664,920
Due to reinsurers		2,111,955	1,935,175
Provision for unpaid claims and adjustment expenses	5	66,388,000	95,430,000
		73,449,192	101,365,247
Equity			
Minimum surplus	12	50,000	50,000
Additional surplus	12	13,630,931	12,317,745
Accumulated other comprehensive (loss) income		47,430	(34,591)
Total equity		13,728,361	12,333,154
		87,177,553	113,698,401

The accompanying notes are an integral part of the financial statements.

On behalf of the Advisory Board

_____, Chair of the Audit Committee

_____, Director

Canadian Lawyers Liability Assurance Society

Statement of comprehensive income (loss)

Year ended December 31, 2019

	Notes	2019 \$	2018 \$
Premiums			
Written premiums		9,288,383	7,390,585
Reinsurance ceded		7,292,904	5,517,391
Net written premiums		1,995,479	1,873,194
Change in unearned premiums		(63,389)	69,723
Earned premiums		1,932,090	1,942,917
Expenses			
Claims	5	(958,063)	(586,867)
Premium deficiency adjustment		—	—
Operating expenses	7	1,714,487	1,836,345
Premium taxes		240,716	209,892
		997,140	1,459,370
Underwriting income (loss) for the year		934,950	483,547
Investment income	4	378,237	315,238
Net income (loss) for the year		1,313,187	798,785
Change in unrealized losses on available-for-sale financial assets arising during the year		82,020	(12,822)
Other comprehensive loss		82,020	(12,822)
Comprehensive income (loss)		1,395,207	785,963

The accompanying notes are an integral part of the financial statements.

Canadian Lawyers Liability Assurance Society

Statement of changes in equity

Year ended December 31, 2019

	Minimum surplus \$	Additional surplus \$	Accumulated other comprehensive income \$	Total equity \$
Balance December 31, 2017	50,000	11,518,960	(21,769)	11,547,191
Net income (loss)	—	798,785	—	798,785
Other comprehensive income (loss)	—	—	(12,822)	(12,822)
Distribution of premium surplus	—	—	—	—
Balance December 31, 2018	50,000	12,317,745	(34,591)	12,333,154
Net income (loss)	—	1,313,187	—	1,313,187
Other comprehensive income (loss)	—	—	82,020	82,020
Distribution of premium surplus	—	—	—	—
Balance December 31, 2019	50,000	13,630,932	47,429	13,728,361

The accompanying notes are an integral part of the financial statements.

Canadian Lawyers Liability Assurance Society

Statement of cash flows

Year ended December 31, 2019

	2019 \$	2018 \$
Operating activities		
Net income (loss) for the year	1,313,187	798,785
Changes in non-cash items		
Interest income due and accrued	457	(2,456)
Premiums receivable	381,795	146,636
Reinsurers' share of unearned premiums	(890,505)	(194,768)
Prepaid expenses	(3,586)	(1,327)
Deferred policy acquisition costs	(27,552)	(3,272)
Reinsurance receivable	2,644,985	(2,378,285)
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	28,437,000	8,627,000
Provision for unpaid claims and adjustment expense	(29,042,000)	(9,069,000)
Premium deficiency liability		
Unearned premiums	953,893	125,045
Due to reinsurers	176,780	286,144
Accounts payable and accrued charges	(4,728)	(178,460)
Amortization of bond premium	(53,402)	(45,764)
Amortization of bond discount	10,000	10,496
	3,896,324	(1,879,226)
Financing activity		
Refund of premium surplus	—	—
Investing activities		
Purchase of bonds	(464,200)	(1,648,590)
Disposal of bonds	450,000	800,000
Purchase of short term investments	(55,103,380)	(65,426,955)
Disposal of short term investments	49,925,000	70,095,401
	(5,192,580)	3,819,856
Net (decrease) increase in cash	(1,296,256)	1,940,630
Cash balance, beginning of year	5,081,001	3,140,371
Cash beginning, end of year	3,784,745	5,081,001
Cash balance comprises		
Cash at bank	3,784,745	5,081,001
Interest received	335,292	277,514

The accompanying notes are an integral part of the financial statements.

1. Description of business

The Canadian Lawyers Liability Assurance Society (the "Society") was formed under the Reciprocal Insurance Exchange Agreement for select Canadian Law Firms dated December 22, 1986 ("Subscription Agreement"). The Society is licensed by the Superintendent of Insurance, Alberta and other provinces in Canada to provide lawyers professional liability insurance to its subscribers. The Society commenced operations on June 30, 1987.

The address and registered office is Bay Adelaide Centre - West Tower, 333 Bay Street, Suite 3400, Toronto, Ontario, M5H 2S7.

The Society does not have any employees and is managed by an independent third party that reports to the Advisory Board. The Advisory Board has the authority and responsibility for planning, directing and controlling the activities of the entity. The Chair of the Advisory Board receives an annual honorarium of \$150,000 (\$150,000 in 2018) and the other members of the Advisory Board receive no compensation.

2. Basis of preparation

Statement of compliance

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as defined by the International Accounting Standards Board ("IASB").

These financial statements have been prepared on the historical cost basis, except for the valuation of financial instruments which are measured at fair value and outstanding claims and reinsurance are measured at discounted amounts.

3. Significant accounting policies

These financial statements reflect the following policies:

Use of estimates and judgments

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions about the reported amounts of revenues, expenses, assets, and liabilities and the disclosure of contingent liabilities, at the reporting date. These estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and any future periods affected. Information about judgments, estimates and assumptions that have the most significant effect on the amounts reflected in the financial statements are reflected in the following notes:

Notes 5: Provision for unpaid claims and adjustment expenses

Notes 8: Reinsurance Program

Insurance premiums and deferred acquisition costs

Insurance premiums are recorded as written at the inception date of the policies and deferred as unearned premiums to be taken into income as earned on a pro-rata basis over the terms of the underlying policies. Retro-assessment calls are recorded as written and earned at the date of approval by the Society's Advisory Board. Premium taxes are recorded as deferred policy acquisition costs and expensed in the periods in which related premiums are earned.

3. Significant accounting policies (continued)

Insurance premiums and deferred acquisition costs (continued)

At each reporting period, liability adequacy tests are performed to ensure that the unearned premiums are sufficient to pay expected claims and expenses. If not, a premium deficiency will occur. Premium deficiencies are recognized initially by reducing the deferred acquisition cost asset and, if necessary, establishing an additional provision.

Reinsurance

The Society participates in, and enters into, reinsurance contracts in the normal course of business in order to limit the potential for losses arising from certain exposures. Reinsurance premiums are recognized in the same period as the related insurance premiums that are earned as described above.

Reinsurance assets include balances due from reinsurance companies for paid and unpaid losses. Amounts recoverable from reinsurers are estimated and recognized in a manner consistent with the reserve for losses associated with the related reinsurance contract. The Society reflects reinsurance balances on a gross basis in the statement of financial position to reflect the credit risk related to reinsurance.

Certain of the Society's reinsurance contracts contain additional premium liability clauses which require that the Society pay additional premiums if paid claims and case reserves exceed certain pre-determined levels. The Society accrues such additional premiums based upon current actuarial estimates of ultimate loss experience.

Provision for unpaid claims and adjustment expenses

The provision for unpaid claims and adjustment expenses represents an estimate of the ultimate gross amounts payable for all claims, including investigation costs and the projected final settlement of claims incurred prior to the statement of financial position date. The provision for unpaid claims and adjustment expenses is calculated in accordance with accepted actuarial practice in Canada taking into consideration the time value of money and explicit provisions for adverse deviation ("PFAD"). The estimates of loss activity are, by necessity, subject to uncertainty and are derived from a wide range of possible outcomes. These estimates are continually reviewed as additional information affecting the estimated quantum of claims settlement is obtained. All changes in estimated claim amounts are recorded as incurred claims in the period in which the change in estimate is determined.

The amounts recoverable from reinsurers are calculated based upon the same principles as the gross liability and are reflected as an asset in the statement of financial position.

Investments

The investment portfolio is comprised of bonds and short term investments which are classified as available-for-sale ("AFS") and their fair value is determined using quoted market bid prices. The Society does not have investments in bonds or other investments for which the fair value is determined using a valuation technique based on assumptions that are not supported by observable market prices or rates.

AFS investments are recorded at fair value with changes in the fair value recorded as unrealized gains and losses, which is included in other comprehensive income ("OCI"). Realized gains and losses on sale, as well as losses from impairment are recorded in net investment income in the statement of comprehensive income.

The Society accounts for the purchase and sale of investments using trade date accounting. Realized gains or losses on sale of investments are determined on a first in first out basis. Transaction costs related to the purchase of these bonds are recorded as part of the carrying value of the bond at the date of purchase. Discounts or premiums on the purchase of bonds are deferred and amortized over the remaining term of the bonds using the effective interest method and recorded in investment income in the statement of comprehensive income.

3. Significant accounting policies (continued)

Impairments

AFS bonds are assessed for impairment on at least a quarterly basis. Objective evidence of impairment includes financial difficulty of the issuer, bankruptcy or defaults and delinquency in payments of interest or principal. When an investment is impaired it is written down to its fair value and associated unrealized gains or losses accumulated in OCI are reclassified to net investment income in the statement of comprehensive income. Once an impairment loss is recorded to income, the loss can only be reversed for fixed income securities to the extent a subsequent increase in fair value can be objectively correlated to an event occurring after the loss was recognized. Recovery in the fair value of a previously impaired AFS fixed income security up to the original amortized cost is recognized in net income. Following the impairment loss recognition, these assets will continue to be recorded at fair value with changes in fair value recorded to OCI, and tested for further impairment quarterly.

Insurance and reinsurance assets are reviewed for impairment on a quarterly basis. If objective evidence arises indicating a receivable from a policyholder or reinsurer is uncollectible, the carrying amount of the asset is reduced to its expected recoverable amount. The impairment loss is recognized as an expense in the net income.

Accounting changes

(i) Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)

On September 12, 2016, the IASB issued amendments to IFRS 4 to address accounting mismatches and volatility that may arise in profit or loss in the period between the effective date of IFRS 9, Financial Instruments ("IFRS 9") and the new insurance contracts standard, IFRS 17 Insurance Contracts, issued May 2017. The amendments apply in the same period in which an insurer adopts IFRS 9.

The amendments introduce two approaches that may be adopted by insurers in the period between the effective date of IFRS 9 and IFRS 17, effective January 1, 2021 (however, the IASB has tentatively decided to propose deferring the effective date to January 1, 2022):

- overlay approach – an option for all issuers of insurance contracts to reclassify amounts between profit or loss and other comprehensive income for eligible financial assets by removing any additional accounting volatility that may arise from applying IFRS 9; and
- temporary exemption – an optional temporary exemption from IFRS 9 for entities whose activities are predominately connected with insurance. This exemption allows an entity to continue to apply existing financial instrument requirements in International Accounting Standards ("IAS") 39, Financial Instruments: Recognition and Measurement ("IAS 39") to all financial assets until the earlier of the application of IFRS 17 or January 1, 2022.

The Society has adopted the temporary exemption, and adopted amendments to IFRS 4 in its financial statements for the current year.

An entity is permitted to continue applying IAS 39 if the following conditions are met:

- it has not applied IFRS 9 before; and
- its activities are predominantly connected with insurance on its annual reporting date immediately before April 1, 2016

3. Significant accounting policies (continued)

Accounting changes (continued)

(i) Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4) (continued)

An entity's activities are predominantly connected with insurance if:

- its liabilities arising from contracts in scope of IFRS 4 are significant compared with the total liabilities
- the ratio of its liabilities connected with insurance compared with its total liabilities is:
 - greater than 90 percent; or
 - greater than 80 percent but less than or equal to 90 percent, and the entity does not engage in a significant activity unconnected with insurance

The Society's total liabilities as at December 31, 2015 were \$111,113,316 of which \$110,202,627 pertain to insurance liabilities. Since the Society's predominance ratio is greater than 90%, it qualifies for the temporary exemption.

(ii) IFRS 9, Financial Instruments ("IFRS 9")

On July 24, 2014 the IASB issued the complete IFRS 9 standard. The mandatory effective date of IFRS 9 is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The restatement of prior periods is not required and is only permitted if information is available without the use of hindsight.

IFRS 9 introduces new requirements for the classification and measurement of financial assets. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows.

The standard introduces additional changes relating to financial liabilities. It also amends the impairment model by introducing a new 'expected credit loss' model for calculating impairment.

IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. This new standard does not fundamentally change the types of hedging relationships or the requirement to measure and recognize ineffectiveness, however it will provide more hedging strategies that are used for risk management to qualify for hedge accounting and introduce more judgment to assess the effectiveness of a hedging relationship. Special transitional requirements have been set for the application of the new general hedging model.

The Society has adopted the temporary exemption described previously, and will adopt the amendments to IFRS 9 in its financial statements for the annual period in which the Society adopts IFRS 17, Insurance Contracts. The Society continues to assess the impact of these changes on the financial statements.

(iii) IFRS 17, Insurance Contracts ("IFRS 17")

On May 18, 2017 the IASB issued IFRS 17 Insurance Contracts. The new standard is effective for annual periods beginning on or after January 1, 2021 (however, the IASB has proposed deferring the effective date to January 1, 2022). IFRS 17 will replace IFRS 4 Insurance Contracts.

This standard introduces consistent accounting for all insurance contracts. The standard requires a company to measure insurance contracts using updated estimates and assumptions that reflect the timing of cash flows and any uncertainty relating to insurance contracts. Additionally, IFRS 17 requires a company to recognize profits as it delivers insurance services, rather than when it receives premiums.

The Society intends to adopt IFRS 17 in its financial statements for the annual period beginning on its effective date. On November 14, 2018 the IASB voted to propose a one-year deferral of the effective date for IFRS 17, the new insurance contracts Standard, to 2022. The IASB also decided to propose extending to 2022 the temporary exemption for insurers to apply the financial instruments Standard, IFRS 9, so that both IFRS 9 and IFRS 17 can be applied at the same time. The extent of the impact of adoption of the standard has not yet been determined.

4. Investments

(a) The Society's investments consist of the following:

	Fair value and carrying value	2019 Amortized cost	Fair value and carrying value	2018 Amortized cost
	\$	\$	\$	\$
Short term investments	12,342,761	12,366,783	7,128,611	7,135,002
Bonds	6,015,184	5,943,731	5,911,332	5,939,531
	18,357,945	18,310,515	13,039,943	13,074,533

The difference between amortized cost and market value of the AFS investments consists of gross unrealized gains of \$90,238 (\$31,215 in 2018) and gross unrealized losses of \$42,808 (\$65,806 in 2018).

The Society limits its bonds to securities issued or guaranteed by the Government of Canada, any province of Canada or Canadian corporations having a rating of A or better. Short term investments are invested in securities issued by the Government of Canada or a Canadian Province having a rating of A or better, or a Canadian Chartered Bank having a rating of R-1 or better. These securities have a maturity of less than 1 year from the purchase date.

(b) Maturity profile of investments as at December 31:

	Within 1 year	1 - 5 years	Over 5 years	2019 Total
	\$	\$	\$	\$
Short-term investments	12,342,761			12,342,761
Government of Canada bonds	—	914,030	558,934	1,472,964
Canadian public authorities bonds	—	1,183,647	1,122,606	2,306,253
Canadian corporate bonds	551,815	1,018,035	666,117	2,235,967
Total fair value	12,894,576	3,115,712	2,347,657	18,357,945

	Within 1 year	1 - 5 years	Over 5 years	2018 Total
	\$	\$	\$	\$
Short-term investments	7,128,611	—	—	7,128,611
Government of Canada bonds	250,154	647,036	553,910	1,451,100
Canadian public authorities bonds	—	1,176,097	1,086,670	2,262,767
Canadian corporate bonds	200,605	1,297,309	699,551	2,197,465
Total fair value	7,579,370	3,120,442	2,340,131	13,039,943

4. Investments (continued)

(c) Net investment income has the following components:

	2019 \$	2018 \$
Interest income		
Bonds	104,436	91,976
Cash, cash equivalents and short term investments	230,399	187,994
	334,835	279,970
Amortization of discount (premium) on investments	43,402	35,268
Realised gain (loss) on disposal	—	—
Total net investment income	378,237	315,238

(d) Fair value measurements

The Society measures certain assets and liabilities using fair value. Fair value is a market-based measurement and not an entity-specific measurement, and requires the use of a fair value hierarchy with the highest priority given to quoted prices in active markets. Investments measured and reported at fair value are classified and disclosed in one of the following categories:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table presents the Society's financial instruments that have been measured at fair value, on a recurring basis, as at December 31.

	Level 1 \$	Level 2 \$	Level 3 \$	2019 Total \$
Cash at bank	3,784,745	—	—	3,784,745
Investments – available-for-sale				
Short term investments	—	12,342,761	—	12,342,761
Bonds	—	6,015,184	—	6,015,184
	3,784,745	18,357,945	—	22,142,690
	Level 1 \$	Level 2 \$	Level 3 \$	2018 Total \$
Cash at bank	5,081,001	—	—	5,081,001
Investments – available-for-sale				
Short term investments	—	7,128,611	—	7,128,611
Bonds	—	5,911,332	—	5,911,332
	5,081,001	13,039,943	—	18,120,944

The Society did not have any transfers between any levels during the year.

5. Unpaid claims and adjustment expenses

(a) Nature of unpaid claims and adjustments expenses

The establishment of the provision for unpaid claims and adjustment expenses is based on known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. These factors include the Society's experience with similar cases and historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims, claims severity and claim frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Society's consultants retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices including claims handling and settlement practices, the effect of inflationary trends on future claims settlement costs, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination. The longer the span between the incidence of a loss and the payment or settlement of the claims, the more variable the ultimate settlement amount can be.

Consequently, the establishment of the provision for unpaid claims and adjustment expenses process relies on the judgment and opinions of a large number of individuals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining the provisions necessarily involves risks that the actual results will deviate, perhaps materially, from the best estimates made.

5. Unpaid claims and adjustment expenses (continued)

- (b) Activity in the provision for unpaid claims and adjustment expenses is summarized as follows:

	Gross \$	Ceded \$	Net \$
Provision for unpaid claims and adjustment expenses, December 31, 2017	104,499,000	96,568,000	7,931,000
Incurring claims and claim adjustment expenses			
Provision for current year claims	6,723,000	6,125,000	598,000
Increase (decrease) in provision for claims of prior years	23,656,088	24,763,955	(1,107,867)
Increase (decrease) in provision due to discount rate change	(965,000)	(888,000)	(77,000)
Total incurred	29,414,088	30,000,955	(586,867)
Payments and recoveries attributable to			
Current year claims	—	—	—
Prior years claims	(38,483,088)	(38,627,955)	144,867
	(38,483,088)	(38,627,955)	144,867
Provision for unpaid claims and adjustment expenses, December 31, 2018	95,430,000	87,941,000	7,489,000
Incurring claims and claim adjustment expenses			
Provision for current year claims	9,442,837	8,103,000	1,339,837
Increase (decrease) in provision for claims of prior years	(7,076,969)	(4,628,068)	(2,448,901)
Increase (decrease) in provision due to discount rate change	1,426,000	1,275,000	151,000
Total incurred	3,791,868	4,749,932	(958,064)
Payments and recoveries attributable to			
Current year claims	(292,837)	—	(292,837)
Prior years claims	(32,541,031)	(33,186,932)	645,901
	(32,833,868)	(33,186,932)	353,064
Provision for unpaid claims and adjustment expenses, December 31, 2019	66,388,000	59,504,000	6,884,000

5. Unpaid claims and adjustment expenses (continued)

(c) Provision for unpaid claims and adjustment expenses

Under accepted actuarial practice in Canada, the appropriate value of the claims liabilities is the discounted value of such liabilities plus the provision for adverse deviation ("PFAD").

	Undiscounted	Discounted at 1.90%	Provisions for adverse deviation	2019 Value per accepted actuarial practice
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses				
Gross	64,408,000	59,170,000	7,218,000	66,388,000
Recoverable from reinsurers	60,412,000	55,512,000	3,992,000	59,504,000
Net	3,996,000	3,658,000	3,226,000	6,884,000

	Undiscounted	Discounted at 2.40%	Provisions for adverse deviation	2018 Value per accepted actuarial practice
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses				
Gross	94,037,000	85,197,000	10,233,000	95,430,000
Recoverable from reinsurers	89,434,000	81,048,000	6,893,000	87,941,000
Net	4,603,000	4,149,000	3,340,000	7,489,000

(d) Key assumptions

The best estimate of the provision for unpaid claims and adjustment expenses as reported in these financial statements has been determined by the Society's appointed actuary in accordance with accepted actuarial practice as determined by the Standards of Practice of the Canadian Institute of Actuaries ("CIA"), including the selection of appropriate assumptions and methods.

The Incurred But Not Reported ("IBNR") liabilities have been estimated for each coverage period using the Bornhuetter-Ferguson Method which is based on expected claims development patterns and expected losses.

The estimated undiscounted outstanding liabilities are discounted to reflect the time value of money using a selected discount rate of 1.90% (2.40% in 2018) which is based on the expected market yield of the Society's investment portfolio of bonds and short term assets.

Based on the recommended margin for adverse deviation ranges prescribed by the CIA, a provision for adverse deviation is selected for the following variables: claims development, reinsurance recovery and interest rate.

5. Unpaid claims and adjustment expenses (continued)

(d) Key assumptions (continued)

Changes in the assumptions used in the December 31, 2019 actuarial valuation resulted in a total increase in net liabilities of \$ 780,819 (increase of \$517,738 in 2018), which is due to the change in loss development factors used in the Bornhuetter-Ferguson method and unallocated loss adjustment expense load increased from 2.95% to 3.95% (increased from 2.60% to 2.95% in 2018). The change in the discount rate and provisions for adverse deviation assumptions led to a further increase in the net liabilities of \$150,590 (decrease of \$77,000 in 2018).

Sensitivities regarding these assumptions are provided in Note 11 Insurance Risk Management.

6. Premiums receivable

All subscribers are large reputable Canadian law firms, and no significant credit risk is expected. All amounts are due by January 1, 2020.

7. Expenses by nature

The following table presents the Society's expenses by nature:

	2019	2018
	\$	\$
Management services	852,705	967,759
Legal and professional	592,779	629,380
Other expenses	269,003	239,206
Total	1,714,487	1,836,345

8. Reinsurance program

(a) The Society has obtained proportional reinsurance coverage which limits its net liability to a maximum amount of \$ 975,000 effective for the annual coverage period beginning on July 1, 2019 (\$975,000 in July 1, 2018) on any one loss.

(b) Colchester Reinsurance Limited (Colchester) is an off-shore captive reinsurer domiciled in Barbados. The shareholders of Colchester are twelve Toronto based legal firms or their related service corporations. Those twelve shareholders are unrelated to each other. However, each of Colchester's shareholders is, or is related to the Society's current and past subscribers. For the annual coverage period beginning on July 1, 2019, Colchester received from the Society premiums of \$ 1,330,072 (\$428,716 in July 1, 2018).

Colchester provides aggregate stop-loss reinsurance protection for a portion of the Society's retained risk. On July 1, 2019 this reinsurance had an attachment point of \$5,000,000 (\$5,000,000 on July 1, 2018), and an annual aggregate limit of \$ 10,000,000 (\$10,000,000 on July 1, 2018). Starting July 1, 2011, the attachment point and limit were determined with reference to the combined net claim liabilities of the Society and Colchester. Starting on July 1, 2012 the attachment point and limit are solely determined with reference to the net claim liabilities of the Society.

8. Reinsurance program (continued)

- (c) In 2012, the Society initiated a Loss Portfolio Transfer (LPT) with Colchester to transfer the outstanding net retained liabilities for the policy year periods from inception to the period ended June 30, 2012 for a premium of \$44,260,000. The net retained liability was estimated as \$33,103,000 at the time of LPT.

As at December 31, 2019, the total reserves held and recoverable on the Society's financial statements relating to LPT was \$ 4,566,102 (\$12,779,738 in 2018). A Reinsurance Security Agreement (RSA) is in place which requires Colchester to set up on behalf of the Society deposits equal to 115% of Colchester's share of claim liabilities. At December 31, 2019 the value of the security deposits exceeds the required amount.

- (d) Reinsurance does not discharge the primary liability of the Society.

9. Income taxes

The Society is a reciprocal as defined under Part 1 of the Alberta Insurance Act, RSA 2000, c I- 3. Accordingly, no provision for income taxes is made in these financial statements.

10. Equity

In accordance with the Reciprocal Insurance Exchange Agreement, subscribers were not obliged to contribute any amounts to the Society in the form of a capital contribution. The subscribers' surplus therefore represents cumulative surplus and may be used to cover potential future catastrophe claims or reduce future premiums, if appropriate. The Agreement provides that additional assessments may be made to cover the actual loss, claims and costs experienced by the Society.

Under the terms of the Society's Reciprocal Insurance Exchange Agreement, the Society is obligated to return a share of the Society's surplus (if any) to a departed Subscriber subsequent to the fifth anniversary of its departure, based on that Subscriber's participation in the Society. A Subscriber withdrew from the Society on June 30, 2012. As a result, an initial refund of premium surplus of \$1,500,000 was made to that Subscriber at December 31, 2017. There were no withdrawals during the year.

11. Risk management

Insurance risk management

The Society accepts insurance risks through its insurance contracts where it assumes the risk of loss from persons or organizations subject to the underlying loss. The Society is exposed to uncertainty surrounding the timing, frequency and severity of claims under these contracts and the principal risk that the actual claims payments exceed the carrying amount of the insurance liabilities or that claims are under-reserved.

The Society manages insurance risk via its underwriting and reinsurance strategy within an overall risk management framework. Pricing is based on assumptions which have regard to trends and past experience. Exposures are managed by having documented underwriting limits and rating criteria. Reinsurance is purchased to mitigate the effect of potential loss to the Society from individual large events. Reinsurance policies are written with approved reinsurers (two of the current reinsurers are unlicensed) on either a proportional, aggregate or excess of loss treaty basis.

11. Risk management (continued)

Insurance risk management (continued)

There is some concentration of risk since all coverage is related to professional liability and the underlying insured's are a homogeneous group since all are engaged in the practice of law in Canada. There is some risk of increased claim activity due to the occurrence of events that could increase the number of or value of legal actions against lawyers. Examples could be changes in legislation or a severe economic downturn. This risk is mitigated to some extent by the use of aggregate and excess of loss reinsurance. Concentration risk regarding reinsurance is mitigated by the use of multiple reinsurers with varying participations and an annual assessment of the financial strength of all reinsurers.

Claim development

Uncertainty exists on reported claims in that all information may not be available at the reporting date; therefore, the claim cost may rise or fall at some date in the future when the information is obtained. In addition, claims may not be reported to the Society immediately; therefore, estimates are made as to the value of claims incurred but not yet reported, a value which may take some months to finally determine. In order to determine the liability, assumptions are developed considering the characteristics of the line of business, the historical pattern of payments, the amount of data available and any other pertinent factors. In general, the longer the term required for the settlement of a group of claims, the more variable the estimates. Short settlement term claims are those which are expected to be substantially paid within a year of being reported. The following table shows the development of claims over a 10 year period, on both a gross and net of reinsurance basis:

11. Risk management (continued)

Claim development (continued)

Analysis of claims development – net and gross

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Estimate of ultimate (by underwriting year)											
End of year	8,322,000	4,665,000	463,000	411,000	440,000	424,000	444,000	387,000	419,000	622,000	
One year later	9,795,000	107,000	423,000	380,000	413,000	392,000	1,062,000	360,000	390,000		
Two years later	2,073,000	107,000	334,000	269,000	308,000	281,000	950,000	263,000			
Three years later	2,073,000	107,000	435,000	197,000	284,000	218,000	891,000				
Four years later	2,073,000	107,000	362,000	131,000	222,000	162,000					
Five years later	2,073,000	107,000	281,000	59,000	164,000						
Six years later	2,073,000	107,000	227,000	22,000							
Seven years later	2,073,000	107,000	225,000								
Eight years later	2,073,000	107,000									
Nine years later	2,073,000										
Current estimate of ultimate	2,073,000	107,000	225,000	22,000	164,000	162,000	891,000	263,000	390,000	622,000	4,919,000
Cumulative payments	(2,073,000)	(107,000)	(203,000)	—	(43,000)	—	(650,000)	—	—	(293,000)	(3,369,000)
Net liability	—	—	22,000	22,000	121,000	162,000	241,000	263,000	390,000	329,000	1,550,000
Provision for unpaid claims and adjusting expenses											
recoverable from insurers											
Ten year net liability											1,550,000
Effect of discounting and PFAD											2,886,000
Unallocated loss adjustment expense											2,448,000
Provision for unpaid claims and adjusting expenses recoverable											59,504,000
Gross liability in statement of financial position											66,388,000

11. Risk management (continued)

Sensitivities

The insurance claim liabilities are sensitive to the key assumptions that follow. It has not been possible to quantify the sensitivity of certain assumptions such as legislative changes or uncertainty in the estimation process.

The table below shows the effect on net income and equity of a +/- 5% change in the expected losses and the effect of a +/- 0.5% change in the discount rate applied to claims provisions for the year ended December 31, 2019

	2019		2018	
	Net income for the year	Equity	Net income for the year	Equity
	\$	\$	\$	\$
5% increase in expected losses	(169,000)	(169,000)	(106,000)	(106,000)
5% decrease in expected losses	177,000	177,000	157,000	157,000
0.5% increase in discount rate	151,000	151,000	151,000	151,000
0.5% decrease in discount rate	(156,000)	(156,000)	(156,000)	(156,000)

Financial risk management

The Society has policies related to the identification, monitoring and mitigation of risks associated with financial instruments. The key risks related to financial instruments are credit risk, liquidity risk and market risk (interest rate, equity and currency). The following describes how the Society manages each of these risks.

(a) Credit risk

Credit risk is the risk of loss due to the failure of debtors to make payments when due. Credit risks are primarily associated with invested assets and amounts due from policyholders and reinsurance counterparties. The investment portfolio's exposure to credit risk is managed through policies and procedures including a credit evaluation by the investment manager and investment guidelines which specify investment quality and exposure limits. The portfolio is monitored and reviewed regularly by the Board. Premiums due from policyholders present minimal risk due to the short term nature of the receivable and the historic/financial relationship with the Society as a Reciprocal Insurance Exchange. The Society evaluates the financial condition of its reinsurers and monitors concentrations of credit risk of the reinsurers to minimize its exposure to significant losses from their insolvency. The Society believes that it has taken appropriate steps to manage credit risk and has made appropriate provision for any such exposures. One of the primary reinsurers is Colchester Reinsurance Limited as discussed in Note 8. The credit risk related to Colchester is managed by maintaining a security account pursuant to the RSA and a quarterly review of Colchester's financial condition. The balance held in the account at December 31, 2019 is \$38,454,437 (\$49,017,698 in 2018).

11. Risk management (continued)

Financial risk management (continued)

(a) Credit risk (continued)

(i) Exposure to credit risk

The following table summarizes the exposure to credit risk related to financial instruments and certain insurance assets at carrying value.

	2019	2018
	\$	\$
Cash	3,784,745	5,081,001
Short term investments	12,342,761	7,128,611
Bonds	6,015,184	5,911,332
Interest income due and accrued	20,531	20,988
Premiums receivable	1,254,203	1,635,998
Reinsurance recoverable	351,056	2,996,041
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	59,504,000	87,941,000
Total credit exposure	83,272,480	110,714,971

(ii) Concentration of credit risk

The Society utilizes an investment policy to minimize the concentration of credit risk by ensuring diversification across asset classes. The following table summarizes the distribution of investments by credit risk:

	2019	2018
	%	%
R-1 (high)	67%	55
AAA	8%	11
AA	25%	34
	100%	100

11. Risk management (continued)

Financial risk management (continued)

(b) Liquidity risk

Liquidity risk is the risk that the Society will not be able to meet all cash outflow obligations as they come due. The primary potential cash outflow is the payment of insurance claims and is represented by the provision for unpaid claims and adjustment expenses liability on the statement of financial position. In order to manage the liquidity risk associated with this liability, an investment policy is in place. A summary of the invested assets by term to maturity is provided in Note 4. The following table summarizes the exposure to liquidity risk:

				2019
	Due within 1 year	1 to 5 year	Over 5 years	Total
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses (net)	924,000	3,299,000	2,661,000	6,884,000
Due to reinsurers	2,111,955	—	—	2,111,955
Accounts payable and accrued charges	330,424	—	—	330,424
	3,366,379	3,299,000	2,661,000	9,326,379
	Due within 1 year	1 to 5 year	Over 5 years	Total
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses (net)	1,079,000	3,786,000	2,624,000	7,489,000
Due to reinsurers	1,935,175	—	—	1,935,175
Accounts payable and accrued charges	335,152	—	—	335,152
	3,349,327	3,786,000	2,624,000	9,759,327

(c) Market risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity markets and foreign currency rates. The primary market risk exposures are discussed below.

(i) Interest rate risk

Interest rate risk is the risk of financial loss arising from changes in interest rates. Fluctuations in interest rates will impact the market value of the fixed income portion of the investment portfolio. Interest rate fluctuations may create unrealized gains or losses which are recorded as OCI, however, these assets are ordinarily held until maturity which would result in a recovery of par value. A portion of these assets support the net provision for unpaid claims and adjustment expenses which is calculated, in part, using a discount factor based on the market rate of return of the investment portfolio.

11. Risk management (continued)

Financial risk management (continued)

(c) Market risk (continued)

(i) Interest rate risk (continued)

The Society is exposed to interest rate risk if the cash flows from the investments are not matched to the liabilities that they support. This risk is partially mitigated by the investment policy which specifies that the timing of the settlement of unpaid claims be considered when selecting the duration of invested assets.

The estimated impact of a 1% increase in interest rates would decrease the market value of the fixed income portion of the investment portfolio by \$346,756 (\$326,288 in 2018) which would be recorded in OCI. This impact would be offset on an economic basis by a decrease in the estimated unpaid claims and adjustment expense of \$295,000 (\$297,000 in 2018) recorded through income. Conversely, a 1% decrease in interest rates would increase the market value of the fixed income portion of the investment portfolio by \$243,198 (\$241,045 in 2018) which would be recorded in OCI. This impact would be more than offset on an economic basis by an increase in the estimated unpaid claims and adjustment expense of \$319,000 (\$319,000 in 2018) recorded through net income.

(ii) Equity risk

Equity risk is the uncertainty associated with the valuation of assets arising from changes in equity markets. To mitigate this risk, the Society's investment policy does not allow exposure to equity markets.

(iii) Currency risk

The Society does not have any material exposure to foreign currency.

12. Surplus management and adequacy

Equity is comprised of minimum and additional surplus and AOCI. At December 31, 2019, the equity was \$13,728,361 (\$12,333,154 in 2018). The Society's objectives for the management of surplus are for the prudent operation of the reciprocal and to provide relatively predictable premium costs for its members over time. A surplus management policy is approved by the Advisory Board which oversees the surplus management process.

As a reciprocal insurance exchange, the requirement for surplus is lower than that of an incorporated insurance company. A reciprocal may rely on the contractual agreement among its members to contribute to the losses incurred by other members and to make assessments for additional contributions to surplus if required and accordingly, can rely on the credit worthiness of its subscribers.

The Society is regulated by the Superintendent of Insurance, Alberta and in British Columbia, Ontario and Nova Scotia where licenses are held, all of which expect incorporated insurance companies to meet a Minimum Capital Test ("MCT") ratio of capital available to capital required of at least 150%. As of December 31, 2019, the Society's MCT was 718.07% (496.27% in 2018). However, the minimum regulatory standard for reciprocals in Alberta is adjusted equity exceeding \$50,000. The Society's practice is to maintain a surplus level which is significantly higher than the regulatory minimum. The Society's surplus adequacy is evaluated regularly and this evaluation takes into account the gross exposure to risk, the level and nature of reinsurance purchased and the resulting net exposure to members. Input from the appointed actuary, which includes an assessment of loss volatility, is factored into this evaluation.

12. Surplus management and adequacy (continued)

In accordance with sections 99 and 100 of the Alberta Insurance Act, the Society is required to maintain a reserve and guarantee fund. At December 31, 2019 the total reserve and guarantee funds required are as follows:

	2019 \$	2018 \$
Reserve fund		
Net premiums written during the period	9,288,000	7,391,000
Less: amounts paid to licensed reinsurers	7,233,000	5,465,000
	2,055,000	1,926,000
Requirement	50%	50%
	1,027,500	963,000
Guarantee fund		
Total liabilities	73,449,000	101,365,000
Less: unearned premiums	4,619,000	3,665,000
recoverable from licensed reinsurers	59,435,000	87,357,000
Add: statutory margin	50,000	50,000
	9,445,000	10,393,000
Total of reserve and guarantee fund	10,472,500	11,356,000
Cash and approved securities	22,143,000	18,121,000
Excess of cash and securities over reserve and guarantee fund	11,670,500	6,765,000

13. Fair value disclosure

The fair value of the following classes of financial instruments is deemed to approximate carrying value due to the immediate or short term maturity of the financial instruments.

- (a) Cash at bank
- (b) Interest income due and accrued
- (c) Premiums receivable
- (d) Premium taxes receivable
- (e) Reinsurance receivable
- (f) Due to reinsurers
- (g) Accounts payable and accrued charges

14. Contingent liability

The Society's Reciprocal Insurance Exchange Agreement (the "Agreement") contains provisions addressing the rights and liabilities of a Subscriber (a "Departing Subscriber") which elects to withdraw from the Society at the end of an Underwriting Period. These include the obligation of the Society to pay to the Departing Subscriber the amount of declared credits or the obligation of the Departing Subscriber to pay to the Society the amount of declared assessments, in each case, based on the Departing Subscriber's participation in the Society. Any such payment obligation to or by a Departing Subscriber is to be determined and paid subsequent to the fifth anniversary of the date of departure of the Departing Subscriber.

A Subscriber elected to withdraw from the Society on June 30, 2012 and, accordingly, a determination of a payment obligation to or by such Departing Subscriber was made subsequent to June 30, 2017. The obligations of the Society and the Departing Subscriber under the Agreement continue to apply, and a determination of any further payment obligation to or by the Departing Subscriber will be made subsequent to June 30, 2022. In the event that it is determined that the Society has a payment obligation to such Departing Subscriber, then depending on the amount of such payment obligation and the amount of the Society's equity at that time, such payment obligation may have a material effect on the equity position of the Society.

A Subscriber elected to withdraw from the Society on June 30, 2017 and, accordingly, a determination of any payment obligation to or by such Departing Subscriber will be made subsequent to June 30, 2022. In the event that it is determined that the Society has a payment obligation to such Departing Subscriber, then depending on the amount of such payment obligation and the amount of the Society's equity at that time, such payment obligation may have a material effect on the equity position of the Society.

15. Date of authorization for issue

The financial statements were authorized for issue by the Advisory Board on February 25, 2020.