

Financial statements of

**Canadian Lawyers Liability
Assurance Society**

December 31, 2015

Canadian Lawyers Liability Assurance Society

December 31, 2015

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Independent Auditor's Report

To the Advisory Board of Canadian Lawyers Liability Assurance Society

We have audited the accompanying financial statements of Canadian Lawyers Liability Assurance Society, which comprise the statement of financial position as at December 31, 2015, and the statements of comprehensive income (loss), changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Canadian Lawyers Liability Assurance Society as at December 31, 2015, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

A handwritten signature in black ink that reads "Deloitte LLP". The signature is written in a cursive, flowing style.

Chartered Professional Accountants
Licensed Public Accountants
February 24, 2016

Canadian Lawyers Liability Assurance Society

Statement of financial position

as at December 31

	2015	2014
	\$	\$
Assets		
Cash at bank	5,008,412	6,498,867
Short term investments (Note 4)	8,404,974	9,010,686
Bonds (Note 4)	4,793,017	4,030,005
Interest income due and accrued	19,936	18,437
Premiums receivable (Note 6)	4,059,591	4,354,998
Prepaid expenses	139,500	139,500
Deferred policy acquisition costs	173,213	89,149
Reinsurers' share of unearned premiums	4,984,847	5,168,601
Reinsurance receivable	1,597,292	371,647
Provision for unpaid claims and adjustment expenses recoverable from reinsurers (Note 5)	96,120,000	68,964,000
Total assets	125,300,782	98,645,890
Liabilities		
Accounts payable and accrued charges	910,689	1,571,240
Unearned premiums	6,185,289	6,382,095
Due to reinsurers	1,509,338	1,682,942
Provision for unpaid claims and adjustment expenses (Note 5)	102,508,000	75,357,000
Total liabilities	111,113,316	84,993,277
Equity		
Minimum surplus (Note 12)	50,000	50,000
Additional surplus (Note 12)	14,010,039	13,527,896
Accumulated other comprehensive income	127,427	74,717
Total equity	14,187,466	13,652,613
Total liabilities and equity	125,300,782	98,645,890

On behalf of the Advisory Board

Chair of the Audit Committee

Director

Canadian Lawyers Liability Assurance Society

Statement of comprehensive income (loss)

years ended December 31

	2015	2014
	\$	\$
Premiums		
Written premiums	12,438,547	13,080,403
Reinsurance ceded	10,024,473	10,582,777
Net written premiums	2,414,074	2,497,626
Change in unearned premiums	13,051	328,383
Earned premiums	2,427,125	2,826,009
Expenses		
Claims (Note 5)	(47,792)	327,878
Premium deficiency adjustment	-	-
Operating expenses (Note 7)	1,897,159	1,848,042
Premium taxes	262,362	468,101
	2,111,729	2,644,021
Underwriting income (loss) for the year	315,396	181,988
Investment income (Note 4)	166,747	184,221
Net income (loss) for the year	482,143	366,209
Change in unrealized gains (losses) on available-for-sale financial assets arising during the year	52,710	100,944
Other comprehensive income (loss)	52,710	100,944
Comprehensive income (loss)	534,853	467,153

Canadian Lawyers Liability Assurance Society

Statement of changes in equity years ended December 31

	Minimum surplus	Additional surplus	Accumulated other comprehensiv e income	Total equity
	\$	\$	\$	\$
Balance December 31, 2013	50,000	13,161,687	(26,227)	13,185,460
Net income (loss)	-	366,209	-	366,209
Other comprehensive income (loss)	-	-	100,944	100,944
Balance December 31, 2014	50,000	13,527,896	74,717	13,652,613
Net income (loss)	-	482,143	-	482,143
Other comprehensive income (loss)	-	-	52,710	52,710
Balance December 31, 2015	50,000	14,010,039	127,427	14,187,466

Canadian Lawyers Liability Assurance Society

Statement of cash flows years ended December 31

	2015	2014
	\$	\$
Operating activities		
Net income (loss) for the year	482,143	366,209
Changes in non-cash items:		
Interest income due and accrued	(1,499)	(3,522)
Premiums receivable	295,407	167,410
Unearned reinsurance premiums ceded	183,754	123,671
Deferred policy acquisition costs	(84,064)	103,820
Reinsurance receivable	(1,225,645)	(251,626)
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	(27,156,000)	(1,872,000)
Provision for unpaid claims and adjustment expenses	27,151,000	2,276,000
Premium deficiency liability		
Unearned premiums	(196,806)	(452,053)
Due to reinsurers	(173,604)	158,838
Accounts payable and accrued charges	(660,551)	1,158,502
Amortization of bond premium	(19,648)	(36,738)
Amortization of bond discount	9,310	4,309
Cash (used in) provided by operating activities	(1,396,203)	1,742,820
Investing activities		
Purchase of bonds	(723,040)	(1,160,101)
Purchase of short term investments	(64,855,784)	(61,281,593)
Disposal of short term investments	65,484,572	62,848,279
Cash provided by (used in) investing activities	(94,252)	406,585
Net (decrease) increase in cash	(1,490,455)	2,149,405
Cash balance, beginning of year	6,498,867	4,349,462
Cash balance, end of year	5,008,412	6,498,867
Cash balance comprises		
Cash at bank	5,008,412	6,498,867
Interest received	154,910	148,269

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

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 RBC Centre, 155 Wellington Street West, 40th Floor, Toronto, Ontario, M5V 3J7.

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 \$75,000 (2014 - \$75,000) 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 revaluation of financial instruments which are measured at fair value.

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 and 8: Reinsurance (regarding insurance contract premium related to additional premium liability).

Notes 5: Provision for unpaid claims and adjustment expenses

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.

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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

3. Significant accounting policies (continued)

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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

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.

Future accounting changes

(i) IFRS 4 – Insurance contracts

The International Accounting Standards Board ("IASB") issued a revised exposure draft ED/2013/7, Insurance Contracts (the "revised ED") on June 20, 2013. The revised ED represents the first comprehensive IFRS accounting model for insurance contracts and aims to provide a consistent basis for accounting for insurance contracts. The final standard is expected in 2016, and although the effective date has not yet been decided by the IASB it is not expected to be effective before 2019.

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

The final version of IFRS 9 "Financial Instruments" issued in July 2014 is the IASB's replacement of IAS 39 "Financial Instruments: Recognition and Measurement". The Standard includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting.

However, the IASB has recently issued an exposure draft to allow insurers (i.e. entities whose predominant activity is issuing insurance contracts within the scope of IFRS 4) to defer the implementation of IFRS 9 to as late as January 1, 2021, which may allow insurers to align the implementation of IFRS 9 with the forthcoming IFRS 4, Phase II Insurance Contracts standard. The Society is currently evaluating the impact of IFRS 9.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

4. Investments

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

	December 31, 2015		December 31, 2014	
	Fair value and carrying value	Amortized cost	Fair value and carrying value	Amortized cost
	\$	\$	\$	\$
Short term investments	8,404,974	8,408,764	9,010,686	9,008,354
Bonds	4,793,017	4,661,800	4,030,005	3,948,070
	13,197,991	13,070,564	13,040,691	12,956,424

The difference between amortized cost and market value of the AFS investments consists of gross unrealized gains of \$133,763 (2014: \$81,935) and gross unrealized losses of \$6,336 (2014: \$7,218).

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:

	Term to maturity			
	Within 1 year	1 - 5 years	Over 5 years	Total
2015	\$	\$	\$	\$
Short-term investments	8,404,974			8,404,974
Government of Canada bonds	303,504	513,911	418,885	1,236,300
Canadian public authorities bonds	302,438	696,831	799,335	1,798,604
Canadian corporate bonds	201,656	1,184,703	371,754	1,758,113
Total fair value	9,212,572	2,395,445	1,589,974	13,197,991

	Term to maturity			
	Within 1 year	1 - 5 years	Over 5 years	Total
2014	\$	\$	\$	\$
Short-term investments	9,010,686	-	-	9,010,686
Government of Canada bonds	-	810,792	204,523	1,015,315
Canadian public authorities bonds	-	995,098	533,108	1,528,206
Canadian corporate bonds	-	812,456	674,028	1,486,484
Total fair value	9,010,686	2,618,346	1,411,659	13,040,691

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

4. Investments (continued)

c) Net investment income has the following components:

	2015	2014
	\$	\$
Interest income		
Bonds	105,896	80,626
Cash, cash equivalents and short term investments	50,513	71,167
	156,409	151,793
Amortization of discount (premium) on investments	10,338	32,428
Realised gain (loss) on disposal	-	-
Total net investment income	166,747	184,221

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.

December 31, 2015	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Cash at bank	5,008,412	-	-	5,008,412
Investments - available-for-sale				
Short term investments	-	8,404,974	-	8,404,974
Bonds	-	4,793,017	-	4,793,017
	-	13,197,991	-	13,197,991
	5,008,412	13,197,991	-	18,206,403

December 31, 2014	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Cash at bank	6,498,867	-	-	6,498,867
Investments - available-for-sale				
Short term investments	-	9,010,686	-	9,010,686
Bonds	-	4,030,005	-	4,030,005
	-	13,040,691	-	13,040,691
	6,498,867	13,040,691	-	19,539,558

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

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

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.

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, January 1, 2014	73,081,000	67,092,000	5,989,000
Incurring claims and claim adjustment expenses			
Provision for current year claims	7,154,000	6,428,000	726,000
Increase (decrease) in provision for claims of prior years	2,185,699	2,731,821	(546,122)
Increase (decrease) in provision due to discount rate change	1,719,000	1,571,000	148,000
Total incurred	11,058,699	10,730,821	327,878
Payments and recoveries attributable to			
Current year claims	-	-	-
Prior years claims	(8,782,699)	(8,858,821)	76,122
	(8,782,699)	(8,858,821)	76,122
Provision for unpaid claims and adjustment expenses, December 31, 2014	75,357,000	68,964,000	6,393,000
Incurring claims and claim adjustment expenses			
Provision for current year claims	6,974,000	6,420,000	554,000
Increase (decrease) in provision for claims of prior years	24,035,001	24,728,793	(693,792)
Increase (decrease) in provision due to discount rate change	1,445,000	1,353,000	92,000
Total incurred	32,454,001	32,501,793	(47,792)
Payments and recoveries attributable to			
Current year claims	-	-	-
Prior years claims	(5,303,001)	(5,345,793)	42,792
	(5,303,001)	(5,345,793)	42,792
Provision for unpaid claims and adjustment expenses, December 31, 2015	102,508,000	96,120,000	6,388,000

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

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").

December 31, 2015

	Undiscounted	Discounted at 1.50%	Provisions for adverse deviation	Value per accepted actuarial practice
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses				
Gross	100,072,000	94,085,000	8,423,000	102,508,000
Recoverable from reinsurers	97,030,000	91,238,000	4,882,000	96,120,000
Net	3,042,000	2,847,000	3,541,000	6,388,000

December 31, 2014

	Undiscounted	Discounted at 1.85%	Provisions for adverse deviation	Value per accepted actuarial practice
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses				
Gross	72,791,000	67,208,000	8,149,000	75,357,000
Recoverable from reinsurers	69,715,000	64,380,000	4,584,000	68,964,000
Net	3,076,000	2,828,000	3,565,000	6,393,000

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 1.50% (2014: 1.85%) 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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

5. Unpaid claims and adjustment expenses (continued)

d) Key assumptions (continued)

Changes in the assumptions used in the December 31, 2015 actuarial valuation resulted in a total decrease in net liabilities of \$31,000 (2014: \$153,000), which is due to the change in loss development factors used in the Bornhuetter-Ferguson method and change in unallocated loss adjustment expense load from 3.05% to 1.95% (2014: 3.15% to 3.05%). The change in the discount rate and provisions for adverse deviation assumptions led to a further increase in the net liabilities of \$1,258,000 (2014: increase of \$148,000).

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, 2016.

7. Expenses by nature

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

	2015	2014
	\$	\$
Management services	1,072,402	1,062,253
Legal and professional	663,666	603,982
Other expenses	161,091	181,807
Total	1,897,159	1,848,042

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, 2015 (July 1, 2014: \$975,000) 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 eleven 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, 2015, Colchester received from the Society premiums of \$1,841,076 (July 1, 2014: \$1,913,596).

Colchester provides aggregate stop-loss reinsurance protection for a portion of the Society's retained risk. On July 1, 2015 this reinsurance had an attachment point of \$5,000,000 (July 1, 2014: \$5,000,000), and an annual aggregate limit of \$10,000,000 (July 1, 2014: \$10,000,000). 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.

- 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, 2015, the total reserves held and recoverable on the Society's financial statements relating to LPT was \$23,043,514 (2014 - \$25,364,000). 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, 2015 the value of the security deposits exceeds the required amount.

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

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

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, a payment to that Subscriber may be due subsequent to June 30, 2017. The Society would consider whether as of June 30, 2017 there are no further liabilities relating to the underwriting periods prior to the date of the Subscriber's withdrawal in determining whether the distribution should be determined as of June 30, 2017 or a later date. Depending on the amount of such payment and the amount of the Society's surplus at that time, such payment may have a material effect on the equity position of the Society.

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.

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.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

11. Risk management (continued)

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 9 year period, on both a gross and net of reinsurance basis:

Analysis of claims development - net and gross

	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Estimate of ultimate (by underwriting year):										
End of year	8,441,000	8,150,000	8,797,000	8,322,000	4,665,000	463,000	411,000	220,000	212,000	
One year later	7,819,000	7,626,000	9,329,000	9,795,000	107,000	423,000	380,000	413,000		
Two years later	10,237,000	5,524,000	8,299,000	2,073,000	107,000	334,000	269,000			
Three years later	11,100,000	4,419,000	20,000	2,073,000	107,000	435,000				
Four years later	12,535,000	5,000	20,000	2,073,000	107,000					
Five years later	8,525,000	5,000	20,000	2,073,000						
Six years later	8,525,000	5,000	20,000							
Seven years later	8,437,000	5,000								
Eight years later	8,206,000									
Current estimate of ultimate	8,206,000	5,000	20,000	2,073,000	107,000	435,000	269,000	413,000	212,000	11,740,000
Cumulative payments	(8,206,000)	(5,000)	(20,000)	(2,073,000)	(107,000)	(200,000)	-	-		(10,611,000)
Net liability	-	-	-	-	-	235,000	269,000	413,000		1,129,000

Provision for unpaid claims and adjusting expenses recoverable from insurers (total all years):

Nine year net liability	1,129,000
Effect of discounting and PFAD	3,345,000
Unallocated loss adjustment expense	1,914,000
Provision for unpaid claims and adjusting expenses recoverable from reinsurers	96,120,000

Gross liability in statement of financial position

102,508,000

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

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, 2015.

	2015		2014	
	Net income for the year	Equity	Net income for the year	Equity
	\$	\$	\$	\$
5% increase in expected losses	126,000	126,000	(228,000)	(228,000)
5% decrease in expected losses	(128,000)	(128,000)	228,000	228,000
0.5% increase in discount rate	(131,000)	(131,000)	135,000	135,000
0.5% decrease in discount rate	136,000	136,000	(140,000)	(140,000)

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, 2015 is \$66,067,491 (2014 - \$68,840,000).

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

11. 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.

	2015	2014
	\$	\$
Cash	5,008,412	6,498,867
Short term investments	8,404,974	9,010,686
Bonds	4,793,017	4,030,005
Interest income due and accrued	19,936	18,437
Premiums receivable	4,059,591	4,354,998
Reinsurance recoverable	1,597,292	371,647
Provision for unpaid claims and adjustment expenses recoverable from reinsurers	96,120,000	68,964,000
Total credit exposure	120,003,222	93,248,640

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:

	2015	2014
	%	%
Bonds, treasury bills and cash (< 1 year)	70.0	69.0
Government of Canada (> 1 year)	7.0	8.0
Canadian provincials (> 1 year)	11.0	12.0
Corporates (> 1 year)	12.0	11.0
Total portfolio	100.0	100.0

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:

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

11. Risk management (continued)

b) Liquidity risk (continued)

December 31, 2015				
	Due within 1 year	1 to 5 years	Over 5 years	Total
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses (net)	1,098,000	2,981,000	2,309,000	6,388,000
Due to reinsurers	1,509,338	-	-	1,509,338
Accounts payable and accrued charges	910,690	-	-	910,690
Total	3,518,028	2,981,000	2,309,000	8,808,028

December 31, 2014				
	Due within 1 year	1 to 5 years	Over 5 years	Total
	\$	\$	\$	\$
Provision for unpaid claims and adjustment expenses (net)	933,000	3,130,000	2,330,000	6,393,000
Due to reinsurers	1,682,942	-	-	1,682,942
Accounts payable and accrued charges	1,571,240	-	-	1,571,240
Total	4,187,182	3,130,000	2,330,000	9,647,182

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.

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 \$228,390 (2014: \$237,998) which would be recorded in OCI. This impact would be more than offset on an economic basis by a decrease in the estimated unpaid claims and adjustment expense of \$257,000 (2014: \$265,000) 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 \$201,485 (2014: \$188,709) 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 \$278,000 (2014: \$286,000) recorded through net income.

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

11. Risk management (continued)

c) Market risk (continued)

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, 2015, the equity was \$14,187,466 (2014: \$13,652,613). 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, 2015, the Society's MCT was 359.61% (2014: 346%). 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.

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, 2015 the total reserve and guarantee funds required are as follows:

	2015	2014
	\$	\$
Reserve fund		
Net premiums written during the period	12,439,000	13,080,000
Less: Amounts paid to licensed reinsurers	9,919,000	10,471,000
	2,520,000	2,609,000
Requirement	50%	50%
	1,260,000	1,305,000
Guarantee fund		
Total liabilities	111,113,000	84,993,000
Less: Unearned premiums	6,185,000	6,382,000
Recoverable from licensed reinsurers	94,966,000	68,446,000
Add: Statutory margin	50,000	50,000
	10,012,000	10,215,000
Total of reserve and guarantee fund	11,272,000	11,520,000
Cash and approved securities	18,206,000	19,540,000
Excess of cash and securities over reserve and guarantee fund	6,934,000	8,020,000

Canadian Lawyers Liability Assurance Society

Notes to the financial statements

For the year ended December 31, 2015

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 recoverable
- f) Due to reinsurers
- g) Accounts payable and accrued charges

14. Date of authorization for issue

The financial statements were authorized for issue by the Advisory Board on February 24, 2016.