



CANADIAN LAWYERS LIABILITY ASSURANCE SOCIETY

Enterprise Risk Management Policy

Last Updated
December 7, 2022

ENTERPRISE RISK MANAGEMENT POLICY

Effective date: September 7, 2016

1. Purpose and Scope

Enterprise Risk Management (“ERM”) is the process through which CLLAS proactively manages risk by identifying, assessing, monitoring and mitigating risks from all sources that may impact short- and long-term financial sustainability. ERM is intended to enhance decision-making by integrating strategic planning with a focused evaluation of the risk exposures stemming from CLLAS’ operations and the environment in which it operates. The purpose of this policy is to document the practices and responsibilities with respect to ERM.

The ERM policy, together with CLLAS’ risk appetite assessment, constitutes the foundation for CLLAS’ Own Risk and Solvency Assessment (“ORSA”) and most governance policies, including the surplus target and surplus policy, the investment policy, the reinsurance security policy and the outsourcing policy.

2. Objectives

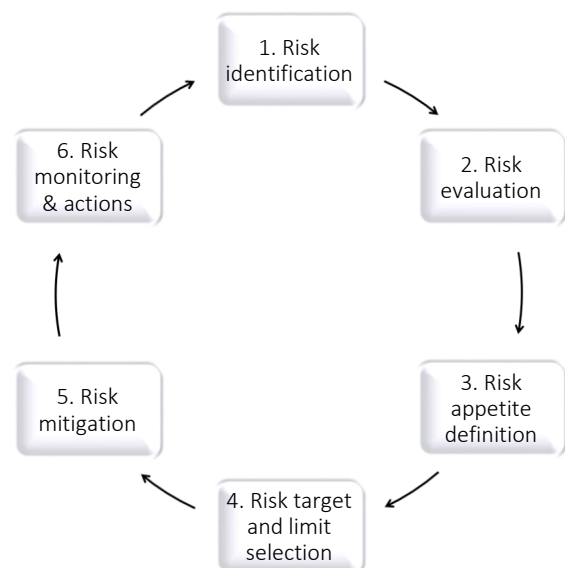
ERM has multiple objectives, including the following:

- Avoid or mitigate risks that could materially impair the financial position or condition of CLLAS;
- Accept risks that contribute to CLLAS’ strategy;
- Manage risks in accordance with best practices and enhance strategic decision-making; and
- Promote a better understanding of the interrelationships between CLLAS’ risk profile and capital needs.

3. ERM Cycle

ERM is a cycle where risks are periodically identified and measured, where risk targets and limits are set, and where CLLAS’ financial condition and material risks are regularly monitored and compared to its risk targets and limits. Risk appetite is fluid and would reflect any improvement or deterioration in risk tolerance, changes in the business strategy and changes in economic conditions.

The diagram on the right illustrates the steps of the ERM cycle. CLLAS’ approach to the various steps is outlined in the next sections.





4. Identification and Evaluation of Material Risks

The Office of the General Manager identifies, defines and assesses the materiality of known, reasonably foreseeable or emerging risks that may have an impact on CLLAS' ability to continue operations, both under normal and stressed conditions. The materiality of the risks CLLAS is exposed to will change over time as the risks are, in part, dependent on CLLAS' business strategy (e.g. amount of net retention, subscriber base, reinsurers selected for reinsurance placement) and on its business environment (e.g. stage of the insurance/reinsurance cycle, outlook for investment market).

The risks which are considered to be material are reviewed in more detail and their potential impact on CLLAS' financial position and continued ability to meet minimum regulatory requirements is quantified.

5. Risk Appetite

Risk appetite is the high-level direction for the amounts and types of risks CLLAS wants to pursue based on its risk profile, vision and overall strategy. CLLAS currently considers the following risk appetite statements to be appropriate:

- CLLAS has an overall low to medium risk appetite;
- CLLAS wants to balance the likelihood of retroassessment against the efficiency of operating with as little capital as is prudent and appropriate;
- CLLAS does not want to engage in risk-taking activities that could be detrimental to its reputation or the reputation of its subscribers;
- CLLAS wants protection against extreme events that could compromise its solvency;
- CLLAS strives to maintain excellent long-term relationships with its reinsurance partners in order to continue accessing reinsurance markets at a reasonable cost;
- CLLAS strives to protect itself from strategic risk by having knowledgeable and stable Advisory Board and senior management;
- CLLAS reduces its operational risk by outsourcing operational functions to experts (accounting, claims management, actuarial, investments, etc.).

6. Risk Targets and Limits

CLLAS' surplus target is based on an MCT of 210%.

Risk targets and limits are determined in the context of applying risk appetite statements to specific risk categories or business units. Risk targets and limits should be mindful of regulatory requirements or constraints, such as AMRGF requirements, MCT requirements and statutory limits on investment.

The following table presents risk categories that can be monitored. As these risks may challenge the Reciprocal's ability to meet strategic objectives, the following risk targets and limits are recommended, above which management action could be considered:



Risk Category	Risk Metric	Frequency	Green Zone (Meets Target)	Yellow Zone	Red Zone (Limit Exceeded)
General	AMRGF – Excess of Cash and Approved Securities Over Regulatory Requirement	Quarterly	\$5,000,000 and above	\$2,500,000 to \$5,000,000	Less than \$2,500,000
	MCT Ratio	Quarterly	210% and above	n/a	Less than 210%
	Status of Governance Policies	Annually	Up to date	Items Outstanding	Materially behind schedule
Insurance	Gross Loss Ratio (Liability and Cyber separately)	Quarterly	Less than 150%	150% to 300%	Over 300%
	Net Loss Ratio (Liability and Cyber separately)	Quarterly	Less than 50%	50% to 100%	Over 100%
	Risk of Systemic Loss	Annually	Nothing on horizon	Some concerns raised	Adverse experience anticipated
Premium & Strategy	Actual Expenses vs. Budget	Quarterly	Less than 105%	105% to 120%	Over 120%
	State of the Market Outlook	Annually	Nothing on horizon	Some concerns raised	Adverse experience anticipated
Reinsurance	Reinsurer credit rating	Annually	A or above	A-	B+ and below
	Maximum concentration with a single reinsurer excluding Colchester	Quarterly	Less than 10%	10% to 15%	Over 15%
Operational	Board Discussion of Prior Quarter Risk Metrics	Quarterly	Discussed corrective measures	Received but no discussion	Not received
	Resiliency Capacity – People	Annually	Score of 4 or 5 out of 5	Score of 3 out of 5	Score of 1 or 2 out of 5
	Resiliency Capacity – Data/systems	Annually	Score of 4 or 5 out of 5	Score of 3 out of 5	Score of 1 or 2 out of 5
	Advisory Board Turnover in the Last 12 Months	Quarterly	0 to 2 members	3 to 4 members	5 or more members
	Key Management/Advisor Turnover in the Last 36 Months	Quarterly	0 to 1 person	2 to 3 people	4 or more people
Investments	Investment Manager Compliance Statement	Quarterly	In compliance	Temporarily or slightly not in compliance	Consistently or materially not in compliance
Regulatory Compliance	Regulatory Outlook Report	Annually	No significant issues noted	Issues being addressed	Significant issues outstanding



A description of each risk metric is presented below.

General

(1) AMRGF – Excess Cash and Approved Securities over Reserve and Guarantee Fund – key requirement under the Alberta Insurance Act.

(2) MCT Ratio – primary solvency test applicable to insurers in Canada.

(3) Status of Governance Policies – the General Manager will provide a report to the Board once a year in September documenting the status of CLLAS’s governance policies and the proposed cycle for preparing/reviewing/confirming the policies (a matrix or set schedule of review would be set for each policy and communicated). The list of policies should generally follow OSFI’s requirements as adopted by the Alberta Superintendent, and would likely include:

- Defence Counsel Rates Policy
- Enterprise Risk Management Policy
- Investment Policy
- Outsourcing Policy
- Rate Setting Policy
- Reinsurance Risk Management Policy
- Surplus Management Policy
- Related Party Transactions Policy

Insurance Risk

(4a) Gross Loss Ratio – Liability - ratio of claims to premiums without the application of any reinsurance.

(4b) Gross Loss Ratio – Cyber - ratio of claims to premiums without the application of any reinsurance.

(5a) Net Loss Ratio – Liability - loss ratio after the application of reinsurance.

(5b) Net Loss Ratio – Cyber - loss ratio after the application of reinsurance.

(6) Risk of Systemic Loss – Systemic risk arises from dynamics which produce shocks or uncertainty faced by all (or in any event multiple) insureds. Examples could include an economic recession or an adverse court ruling on a limitations issue. The risk of systemic loss is a difficult matter to assess. A focused discussion would take place once per year in December and summarized in a memo from the General Manager to the Board, which could be as simple as “no issues noted”.

Premium & Strategy Risk

(7) Actual Expenses vs. Budget – the variation of expenses from the budget as compiled in the quarterly management financial statements.



(8) State of the Market Outlook – annual report from General Manager in December with objective to identify any industry trends that could put pressure on CLLAS premium rates, such as predatory pricing.

Reinsurance Risk

(9) Reinsurer Credit Rating – The credit rating is based on A.M. Best and S&P.

(10) Maximum Concentration with a Single Reinsurer Excl. Colchester – This is monitored to assess concentration risk. It is measured based on a reinsurer's proportion of current claims liability exposure (i.e. case reserves and IBNR) for all policy years. Lloyd's syndicates are assessed separately.

Operational Risk

(11) Board Discussion of Prior Quarter Risk Metrics – This metric ensures that the Board holds regular discussions on its key material risks. The General Manager would prepare a short accompanying memo to highlight any metrics in “yellow” and “red” zones. Such metrics as well relevant corrective measures, if necessary, should be discussed with the Board.

(12) Resiliency Capacity - People (redundancy, succession) –The General Manager would report once per year in December on business continuity/crisis management. CLLAS' status would be assessed by the Board on a five-point satisfaction scale.

(13) Resiliency Capacity – Data/Systems –The General Manager would report once per year in December on IT systems and data management. CLLAS' status would be assessed by the Board on a five-point satisfaction scale.

(14) Board Turnover in Last 12 Months – Board member turnover head count.

(15) Senior Management/Key Advisor Turnover in Last 36 Months – Senior Management Turnover head count over 36 months.

Investment Risk

(16) Investment Manager Compliance Statement –Identifies whether the portfolio is in or out of compliance, with the latter case leading to Board disclosure and discussion.

Regulatory Risk

(17) Regulatory Outlook Report – The General Manager would provide a report, once per year in December, identifying regulatory changes on the horizon and CLLAS's ability to effectively deal with current and anticipated future regulatory requirements.



7. Risk Mitigation

Risk mitigation measures are implemented by the Advisory Board and the Office of the General Manager, with the support of its standing committees, in order to mitigate the frequency or severity of risks. Risk mitigation strategies should be considered for all material risk categories (as outlined in Appendix A) and should be periodically reviewed.

8. Risk Monitoring and Actions

Risks are monitored and compared against targets and limits on a quarterly basis by the Office of the General Manager. Results are presented to the Advisory Board along with management financial statements, which also include aggregate solvency measures such as the AMRGF, MCT and other financial performance ratios.

The Advisory Board and Office of the General Manager would consider implementing appropriate actions when a risk exceeds the established limit. Corrective actions would be discussed with the Advisory Board before being implemented by the Office of the General Manager.

9. ORSA and Stress Testing

CLLAS performs a full ORSA at its discretion but at a minimum every five years. The ORSA is a comprehensive assessment of CLLAS' risks and is intended to assist the Advisory Board in determining the internal MCT ratio target to support the reciprocal's strategy. The ORSA process should:

- Strive to identify and quantify all risks material to CLLAS' operations;
- Be the basis for the selection of the overall internal target;
- Be the basis for the selection of targets and limits by risk category;
- Be used to identify current and potential mitigation strategies;
- Be used to review Advisory Board, Principal Attorney and management responsibilities;
- Be documented in a summary report; and
- Be approved by the Advisory Board.

CLLAS performs stress testing in the context of its ORSA and in accordance with OSFI Guideline E-18. Stress testing involves evaluating the impact of a set of specified assumptions on CLLAS' financial condition. CLLAS' stress testing should:

- Include plausible but severe scenarios that could materially impact its operations or financial condition;
- Cover a range of scenarios, including non-historical scenarios;
- Take into account the effectiveness of risk mitigation techniques such as reinsurance in stressed conditions; and
- Be documented in the ORSA summary report.



10. Responsibility for ERM

The Advisory Board is ultimately responsible for overseeing ERM and risk-taking activities. The Advisory Board is responsible for the following:

- Review/approval of risk appetite statements;
- Review/approval of risk targets and limits;
- Review/approval of the ERM policy; and
- Review/approval of the internal capital target and the ORSA.

The Principal Attorney is responsible for the following:

- Reporting to the Advisory Board on the effectiveness of and compliance with the ERM policy.

The Office of the General Manager is responsible for the implementation of the Board-approved strategy and overall business performance, specifically:

- Ensuring compliance with the ERM policy;
- Identifying, assessing and monitoring risks;
- Assessing the effectiveness of operations against risk appetite statements and risk limits;
- Recommending appropriate risk mitigation strategies;
- Developing appropriate action plans and ensuring timely communication with the Advisory Board or a committee thereof when risk limits are exceeded;
- Reporting to the Principal Attorney and Board on the risk profile and capital needs, including ORSA;
- Recommending improvements in policies, processes and procedures;
- Developing and reporting on internal controls with respect to risk-taking activities;
- Filing appropriate documentation and communication with the regulator with respect to the ERM policy and ORSA.

11. Authority

The Advisory Board has the authority to make revisions to this policy.

12. History of Modifications

This policy was first approved by the Advisory Board on September 7, 2016.

This policy was updated to amend the key metrics with respect to maximum allocation to a single non-governmental security and confirmed by the Advisory Board on December 6, 2017.



This policy was updated to reflect risk descriptions, risk metrics, targets and limits to reflect changes adopted in the 2019 ORSA report. The changes were confirmed by the Advisory Board on December 10, 2019.

This policy was updated to reflect the results of the 2022 ORSA report and the addition of the Cyber Program. The changes were confirmed by the Advisory Board on December 7, 2022.



APPENDIX A – MATERIAL RISKS

Pursuant to its ERM policy, CLLAS periodically identifies, assesses and monitors material risks. The following are CLLAS' exposure to material risks:

- 1. Insurance risk:** CLLAS provides Canadian law firms with up to \$139,975,000 of professional liability insurance coverage per occurrence. CLLAS also has a 5% subscription participation in up to \$140 million of optional excess layers purchased by the law firms. Coverage is provided on a claims-made basis. Coverage is provided excess of the mandatory law society coverage (or \$25,000 in the case of drop-down coverage).

CLLAS also started offering cyber coverage up to \$10,000,000 per claim and per firm aggregate.

CLLAS is exposed to low frequency, high severity losses. There is significant uncertainty around the timing, frequency and severity of these insurance losses.

Insurance risk includes the risk of unfavorable changes in claim behavior driven by new legal precedents as well as changes in social attitudes and expectations. Social inflation could be exacerbated by the fact that information is readily available through global news, social media and the internet.

Further, CLLAS only has two lines of business Liability and Cyber. However, CLLAS has a geographical diversification benefit as it insures lawyers in multiple Canadian provinces.

- 2. Premium & Strategy risk:** Strategic risk arises from the potential inability to implement appropriate business plans and strategies, make decisions, allocate resources, or adapt to changes in the business environment¹.

CLLAS operates on the basis of five-year underwriting periods, and can expect significant competitive pressure from insurance brokers during the lead up to a new underwriting period. In order for CLLAS' premium rates to remain competitive, there must be a sufficiently large subscriber base to share the administrative costs necessary to maintain the self-insurance structure. If the subscriber base decreased significantly as a result of, for example, uncompetitive rates, the viability of the reciprocal may be compromised.

¹ OSFI Own Risk and Solvency Assessment Guideline, January 2014.



- 3. Reinsurance risk:** Given the loss portfolio transfer at June 30, 2012 and the low net claim retention since July 1, 2012, CLLAS retains only a small proportion of its insurance exposure and cedes the remaining exposure to reinsurers. A reinsurer default or dispute on claims presents a material risk as CLLAS has the ultimate responsibility for the payment of claims.

CLLAS places reinsurance with multiple reinsurers, the largest placement being with Colchester Reinsurance Limited (Colchester) due to the loss portfolio transfer. Colchester also has an important participation on the proportional treaty since July 1, 2012.

Deposits held in Canada for unregistered reinsurance amounts recoverable from Colchester do not present a material off-balance sheet risk exposure for CLLAS given that amounts are secured under a security agreement and are held in cash or government bonds in Canadian denomination.

- 4. Operational risk:** Operational risk is defined as the risk of loss resulting from people, inadequate or failed internal processes and systems, or from external events. This includes legal risk but excludes strategic and reputational risk. The risk of loss resulting from people includes, for example, operational risk events relating specifically to internal or external fraud, non-adherence to internal procedures/values/objectives, or unethical behaviour more broadly. Risk exposure relating to external events and that stems from coverage sold by insurers to third parties is excluded, while risk on an insurer's own operations is considered within scope¹.

- 5. Investment Risk:** Investment risk comprises interest rate, inflation, asset default and liquidity risks.

Interest rate risk:

CLLAS' fixed income investments are classified as available-for-sale and are therefore reported at fair market value in the financial statements. Claim liabilities are also reported on a fair value basis (i.e. liabilities are discounted using market rates).

¹ OSFI Operational Risk Management Guideline E-21



Interest rate risk exists when there is a mismatch between expected payments from assets and expected payments from liabilities. For example, when interest rates increase, both fixed income assets and claim liabilities would decrease. If they were perfectly matched, the impact on surplus would be nil. If not, one would decrease more than the other, creating a non-zero impact on surplus. The converse would also be true when interest rates decrease.

Inflation risk:

Sudden and sustained increases in the inflation rate would most likely lead to higher-than-anticipated claim payments and general expenses as well as disruptions in fixed income and capital markets.

Asset default risk:

CLLAS is exposed to asset default risk as it has investments in fixed income instruments. CLLAS' investment policy allows for long-term investments in federal and provincial government bonds as well as corporate bonds rated BBB or better.

The riskiest class of fixed income in CLLAS' portfolio is corporate bonds. Although provincial and federal government bonds present some default risk, it is not considered material at this moment.

CLLAS has minimal exposure to default risk on other assets, for example receivables or cash held in bank accounts.

Liquidity risk:

Liquidity risk is the potential for losses due to holding insufficient funds in liquid assets such as cash. An example of a situation leading to liquidity risk is needing to realize a loss on the sale of invested assets when insufficient liquid assets are available to pay for losses.

Other investment risks:

Based on its Investment Policy, CLLAS holds all its assets in cash and Canadian fixed income and is therefore not directly exposed to equity or foreign exchange risks.



- 6. Regulatory compliance risk:** Regulatory compliance risk arises from losses due to failure to comply with regulatory requirements. Examples include costs associated with the need to restate financial statements if they are not in compliance with professional standards, or fines and penalties if legislative requirements are not fulfilled.
- 7. Reputation risk:** Reputation risk arises when the confidence of insured members, creditors, reinsurers and other business partners leads to a negative impact on earnings, liquidity or capital position.

For example:

- Reputation with subscribers could be negatively impacted by unstable or noncompetitive premium rates or failure to pay claims in a timely manner;
- Reputation with reinsurers could be negatively impacted by a lack of risk management efforts or failure to report claims information in a timely manner;
- Reputation with various business partners could be negatively impacted by failure to provide timely payments;
- Reputation with regulators could be negatively impacted by failure to communicate in a timely manner.

Concentration risk arises from failure to diversify risk. It is a risk category that is closely tied with other risk categories, most notably with risks involving insurance, reinsurance and invested assets.

It is also important to keep in mind that risk mitigation measures – such as the use of reinsurance to reduce the net insurance exposure or the use of collateral or letters of credit to secure reinsurance recoverables – may not be functioning as usual under stressed market conditions. For example, if there were a property catastrophe and multiple insurers were seeking recoveries from reinsurers, CLLAS' communications and recoveries on professional liability losses with these same reinsurers may be delayed or compromised.