



ALBERTA LAWYERS
INSURANCE ASSOCIATION

ALBERTA LAWYERS INSURANCE EXCHANGE
and
ALBERTA LAWYERS INSURANCE ASSOCIATION

2018 BUDGETS AND COMMENTARY
FOR THE FISCAL YEAR ENDING DECEMBER 31, 2018

Approved by the ALIEX Advisory Board

November 28, 2017



ALBERTA LAWYERS
INSURANCE EXCHANGE

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BACKGROUND

The *Legal Profession Act* requires the Law Society of Alberta to establish and maintain an insurance program for lawyers. Generally, every Alberta lawyer in private practice must purchase a base level of professional liability insurance coverage, with the purchase of excess coverage being voluntary.

In 1988, the Law Society of Alberta established a subsidiary corporation, Alberta Lawyers Insurance Association (“ALIA”), to manage the professional liability insurance program for insured Alberta lawyers. ALIA handles all claims against Alberta lawyers. It provides protection to those lawyers and compensation to members of the public who have suffered insured losses due to the actions of insured lawyers. ALIA operates as a separate financial entity.

In 2014, Alberta Lawyers Insurance Exchange (“ALIEX”) was established and licensed by the Superintendent of Insurance (Alberta) as an insurance reciprocal. ALIEX provides lawyers professional liability (“Part A”) and trust safety (“Part B”) insurance, funding claims in excess of the ALIA’s \$500,000 group deductible. ALIA purchases reinsurance and excess insurance to provide additional protection.

With ALIEX in place, effective July 1, 2014, ALIA withdrew as a subscriber from the Canadian Lawyers Insurance Association (“CLIA”), a reciprocal insurance exchange that provides professional liability insurance for practicing lawyers in some other provinces and territories. Claims pre-July 1, 2014 continue to be run off under the CLIA reciprocal. ALIA remains a subscriber to CLIA for the purposes of the voluntary excess insurance program.

An insurance reciprocal is not a legal entity and requires a principal attorney to act on its behalf. ALIA acts as the principal attorney for ALIEX and manages ALIEX pursuant to a Management Agreement. The Superintendent of Insurance regulates reciprocals as if they were provincial companies and requires the operations of the reciprocal to be overseen by an Advisory Board which must conduct itself as if it were a corporate board.

Despite the interconnection between the operations and strategic plans of ALIA and ALIEX, separate budgets are prepared, as set out in the pages that follow.

COMMENTARY ON THE BUDGETS AND FINANCIAL MODEL

In keeping with standard practice, the ALIA and ALIEX budgets are broken out into revenue and expenses. Although budget forecasts are necessarily speculative, there are particular challenges in preparing a budget where the major contributing revenues and expenses will, of necessity, remain undetermined for many months. ALIA/ALIEX’s major sources of revenue are its investment income and, more significantly, the premiums received by ALIA/ALIEX for both Part A and Part B which will not be determined until the spring of 2018, when the actuary’s report is received. Similarly, the losses and expenses that will have to be paid by ALIEX for both Part A and Part B are being estimated more than a year in advance.

Further, given the lack of history in the operation of ALIEX and its ongoing growth and evolution, reliance on previous experience may not significantly enhance the forecasts.

Accordingly, the figures used in the budgets for the significant line items may be seen as “placeholders” that are based on the best information available at this time, as set out in the detailed commentary below.

The following pages provide the respective 2018 budgets for ALIA and ALIEX accompanied by explanations of the elements of each budget.

ALIA 2018 BUDGET

	2018 Budget	2017 Forecast	2017 Budget	Variance 2018 Budget to 2017 Budget	Variance 2017 Forecast to 2017 Budget
Revenue					
Premium - Professional liability	\$ 28,472,000	\$ 25,881,000	\$ 23,832,000	\$ 4,640,000	\$ 2,049,000
Premium - Trust safety	3,517,000	3,360,000	3,272,000	245,000	88,000
Premium ceded - Professional liability	(744,000)	(767,250)	(767,250)	23,250	-
Premium ceded - Trust safety	(362,800)	(374,200)	(385,150)	22,350	10,950
Net premium	30,882,200	28,099,550	25,951,600	4,930,600	2,147,950
Investment income	6,370,000	6,350,000	6,800,000	(430,000)	(450,000)
Unrealized gain (loss) on Investments	-	1,000,000	-	-	1,000,000
Management Fee - ALIEX	472,600	308,000	308,000	164,600	-
Voluntary Excess Admin Fee	135,000	132,000	140,000	(5,000)	(8,000)
	<u>37,859,800</u>	<u>35,889,550</u>	<u>33,199,600</u>	<u>4,660,200</u>	<u>2,689,950</u>
Expenses					
Provision for claims and related costs - Professional liability	19,000,000	18,000,000	18,000,000	1,000,000	-
Provision for claims and related costs - Trust safety	1,200,000	1,850,000	1,850,000	(650,000)	-
Premium paid to ALIEX - Professional liability	4,884,000	4,200,000	3,600,000	1,284,000	600,000
Premium paid to ALIEX - Trust safety	631,000	560,000	500,000	131,000	60,000
Salaries and benefits	3,115,300	2,398,600	2,564,000	551,300	(165,400)
Management fee - LSA	3,696,000	3,341,000	3,348,000	348,000	(7,000)
CLIA retroassessment	635,500	635,500	635,500	-	-
Provision for input tax credits	600,000	600,000	600,000	-	-
Contractors	557,000	310,000	302,500	254,500	7,500
Investment fees	290,000	305,000	305,000	(15,000)	-
Bank and credit card charges	392,000	376,000	325,000	67,000	51,000
Professional fees	451,500	220,000	206,500	245,000	13,500
Risk Management	130,000	40,000	100,000	30,000	(60,000)
Administration	170,500	70,100	123,400	47,100	(53,300)
CLIA Wind Up	-	-	35,000	(35,000)	(35,000)
Amortization	-	180	180	(180)	-
	<u>35,752,800</u>	<u>32,906,380</u>	<u>32,495,080</u>	<u>3,257,720</u>	<u>411,300</u>
Surplus	<u>\$ 2,107,000</u>	<u>\$ 2,983,170</u>	<u>\$ 704,520</u>	<u>\$ 1,402,480</u>	<u>\$ 2,278,650</u>

Revenue:

Premiums – Part A (Professional liability) and Part B (Trust Safety Insurance);

An analysis of Part A and Part B premium revenue is provided in Appendix 1. The levies used in the draft budget assume a 3.5% increase from the levies that were approved for the 2017/18 policy year. The actual levies for 2018/19 will be determined in the spring of 2018 by the ALIEX Advisory Board.

The estimated number of insured lawyers used in the budget is based on an estimated growth of 1.5% from 2017 levels. This growth rate was derived from actual increases over the last three years.

Premiums ceded – Part A and Part B

Premiums ceded for both Part A and Part B represents the premium paid to third party reinsurers for reinsurance. Within the 2018 budget, we allocated 80% of the reinsurance premiums to ALIA and 20% to ALIEX. This allocation is consistent with the recommendation of our actuary.

The budget for Part A reinsurance assumes no increase from what we paid in the second half of 2017. As the reinsurance year is six months out of sync with our fiscal year, the reinsurance that we purchased in mid-2017 takes us through to mid-2018.

The Part B reinsurance has two layers of coverage providing an aggregate of up to \$25 million – layer 1 is with AIG and provides coverage in excess of \$3 million up to \$13 million. Layer 2 is with CHUBB and provides coverage in excess of \$13 million up to \$25 million. In preparation of our budget, we are anticipating a 10% increase on the AIG portion Part B reinsurance, as was experienced for the 2016/17 policy year premium, due to recent claims against the bond for Assurance Fund claims. No increase is expected in layer 2 as the recent claims only affected layer 1 of the coverage.

Investment income

The budget for investment income is conservative and based on our average investment income for the past three years and consists of interest, dividends and realized gains or losses on sales of investments within the ALIA investment portfolio. The actual amount of investment income can vary considerably from budget depending on investment market conditions and the extent to which we are required to liquidate investments to pay claims.

Unrealized gain (loss) on investments

Current accounting convention requires that we record the changes in the market value of our investments from one reporting period to another. We do not budget for these unrealized gains or losses on the investment portfolio as it is inherently difficult to predict investment markets.

Management fee – ALIEX

ALIA charges ALIEX a management fee to recover costs related to the claims management, governance, financial and other administrative support provided by ALIA to ALIEX.

Voluntary excess administration fee

ALIA administers the voluntary excess insurance program provided by CLIA to Alberta insured lawyers. ALIA charges a fee to CLIA of 10% of the excess insurance premium purchased by insured lawyers.

Expenses:

Provision for claims and related costs – Part A and Part B

The claims provision budget is based on ALIA's average claims expense over the past nine years. The actual provision for claims and related costs is determined annually at year end based on the actuary's valuation of ALIA's claims liability. The claims provision includes both indemnity payments and legal costs. The legal costs, considered to be general expenditures, include coverage counsel opinions, repair counsel costs and defence counsel costs.

ALIEX premiums – Part A and Part B

ALIEX charges ALIA a premium for Part A and Part B coverage in excess of ALIA's deductible of \$500,000 for both parts of the insurance program. The premium is determined annually by the Advisory Board and is determined when the levy is set. An analysis of this premium is provided in Appendix 2.

Salaries and benefits

This budget line item includes the cost of ALIA's full time staff, consisting of the Chief Operating Officer, Senior Manager of Operations, Claims Supervisor, Claims Specialist, eight claims examiners and 10 other staff members for a total of 22 full time equivalents (FTE's) in 2018 relative to 19 FTE in 2017. This staff team supports the operations of both ALIA and ALIEX (ALIEX has no employees).

Management fee

The Law Society charges ALIA an annual management fee to recover ALIA's proportionate share of costs incurred by the Law Society that support the operations of the insurance program. Support is provided to ALIA by various departments within the Law Society including Human Resources, Accounting, Administration, Communications, Membership, Business Technology, Trust Safety, Governance, Professionalism and Policy (loss prevention services), and Secretariat.

The management fee calculation also includes an annual credit to ALIA for an estimate of the ALIA staff time dedicated to the management of legacy Assurance Fund claims. As the Assurance Fund winds down, the amount of ALIA staff time required to deal with these claims will decline as is reflected in the draft budget.

CLIA retroactive assessment

In 2014, CLIA assessed ALIA with a retroactive assessment of \$5,084,000 was being declared based on Alberta's declining subscriber account surplus with CLIA. The first half of this assessment was paid in fiscal 2014 with the balance paid in four equal annual installments of \$635,500 ending in 2018.

Provision for input tax credits

ALIA is contesting a ruling by Canada Revenue Agency ("CRA") that has disallowed ALIA's ability to claim input tax credits on expenses. The budget assumes that no decision will be made in 2018 which is also reflected in the 2017 forecast.

Contractors

The 2018 budget includes contract funding for the business plan initiatives referred to above; assistance with business analysis and report writing to analyze trends and develop required reports; assistance with drafting ALIA ORSA; staff recruitment costs; contract resources to develop an ALIA /ALIEX website; claims auditor, and governance enhancements.

Investment fees

Our investment manager (Mawer) charges investment management fees quarterly calculated on a tiered percentage schedule based on the market value of ALIA's investment portfolio. The 2018 budget is based on estimates of the market value of the ALIA portfolio in 2018. Investment fees are lower in 2018 as we conducted a review of our investment structure in 2017 through Mercer.

Bank and credit card fees

In addition to bank service charges, this budget includes fees charged by our credit card payment services provider (Moneris) for levies collected from insured lawyers through our on-line payment system. The budget is based on our estimate of the percent of insured lawyers who will pay the annual levy on-line.

Professional fees

This budget includes audit, actuarial and legal fees.

Risk management

In addition to the loss prevention services provided by the Law Society charged to ALIA through the management fee, the ALIA budget incorporates funding for several loss prevention initiatives planned in 2018.

Administration

This budget item includes estimated costs for recruiting, staff travel, training and professional dues.

ALIEX 2018 BUDGET

	<u>2018 Budget</u>	<u>2017 Forecast</u>	<u>2017 Budget</u>	<u>Variance 2018 Budget to 2017 Budget</u>	<u>Variance 2017 Forecast to 2017 Budget</u>
Revenue					
Premium - Professional liability	\$ 4,884,000	\$ 4,200,000	\$ 3,600,000	\$ 1,284,000	\$ 600,000
Premium - Trust safety	631,000	560,000	500,000	131,000	\$ 60,000
Premium ceded - Professional liability	(186,000)	(163,000)	(163,000)	(23,000)	\$ -
Premium ceded - Trust safety	(90,700)	(80,000)	(71,000)	(19,700)	(9,000)
Net premium	<u>5,238,300</u>	<u>4,517,000</u>	<u>3,866,000</u>	<u>1,372,300</u>	<u>651,000</u>
Investment income	<u>374,000</u>	<u>339,000</u>	<u>340,000</u>	<u>34,000</u>	<u>(1,000)</u>
	<u>5,612,300</u>	<u>4,856,000</u>	<u>4,206,000</u>	<u>1,406,300</u>	<u>650,000</u>
Expenses					
Provision for claims and related costs - Professional liability	2,500,000	2,500,000	2,500,000	-	-
Provision for claims and related costs - Trust safety	200,000	200,000	400,000	(200,000)	(200,000)
Management fee	472,600	308,000	308,000	164,600	-
Premium taxes	219,000	98,200	164,000	55,000	(65,800)
Professional fees	303,000	155,000	180,000	123,000	(25,000)
Contractors	34,000	40,000	192,640	(158,640)	(152,640)
Board expenses	133,000	100,000	91,000	42,000	9,000
Investment fees	40,000	38,000	36,000	4,000	2,000
Administration	15,500	16,000	15,300	200	700
	<u>3,917,100</u>	<u>3,455,200</u>	<u>3,886,940</u>	<u>30,160</u>	<u>(431,740)</u>
Surplus	<u>\$ 1,695,200</u>	<u>\$ 1,400,800</u>	<u>\$ 319,060</u>	<u>\$ 1,376,140</u>	<u>\$ 1,081,740</u>

Revenue:

Premium – Part A and Part B

ALIEX charges ALIA a levy for the insurance coverage the reciprocal provides in excess of ALIA's deductible of \$500,000 for both parts. The actual premium is determined annually by the Advisory Board when the levy is set. An analysis of this revenue budget is provided in Appendix 2.

Premium ceded – Part A and Part B

Please see the related explanation for this budget item in ALIA above.

Investment income

Please see the related explanation for this budget item in ALIA above.

Expenses:

Provision for claims and related costs – Part A and Part B

The actual provision for claims and related costs is determined annually at year end based on the actuarial report. With no experience with claims in the ALIEX layer, the budget for the provision is unchanged from 2017 for Part A and reduced from \$400,000 to \$200,000 for Part B.

Management fee

ALIA charges ALIEX a management fee to recover costs related to the claims management, governance, financial, and other administrative support provided by ALIA to ALIEX. Please see the related explanation for this budget item in ALIA above and refer to Appendix 4 for the details of the management fee calculation.

Premium taxes

The Alberta Government charges insurance reciprocals an annual tax of 4% on premiums collected net of reinsurance premiums paid (or ceded).

Professional fees

This budget item includes audit, actuarial and legal fees.

Contractors

The 2018 contractor budget provides funding for work related to an enterprise risk project, recruitment of new directors and consulting help to renew our reinsurance and excess insurance coverage.

Board expenses

Board expenses includes funding for board honorariums, the annual premium for Directors and Officers insurance and board meal and travel expenses.

Investment fees

Our investment manager (Mawer) charges investment management fees quarterly calculated on a tiered percentage schedule based on the market value of ALIEX's investment portfolio. The 2018 budget is based on estimates of the market value of the ALIEX portfolio in 2018.

Administration

Administration costs consist primarily of investment custodian fees, bank service charges and general administrative expenses.

ACCUMULATED SURPLUS ANALYSIS

The following table provides a projection of the combined accumulated surplus of the indemnity program based on the 2018 budget and financial forecast to the end of 2017.

	<u>ALIA</u>	<u>ALIEX</u>	<u>Combined</u>
Actual balance at December 31, 2016	\$27,260,525	\$ 5,668,431	\$ 32,928,956
Forecast net income to Decmeber 31, 2017	<u>2,983,170</u>	<u>1,400,800</u>	<u>4,383,970</u>
Forecast balance at December 31, 2017	30,243,695	7,069,231	37,312,926
Budget net income to December 31, 2018	<u>2,107,000</u>	<u>1,695,200</u>	<u>3,802,200</u>
Projected balance at December 31, 2018	32,350,695	8,764,431	41,115,126
Estimated ALIA surplus in CLIA at December 31, 2016	<u>10,193,000</u>	<u>-</u>	<u>10,193,000</u>
Projected combined surplus at December 31, 2018	<u>\$42,543,695</u>	<u>\$ 8,764,431</u>	<u>\$ 51,308,126</u>

APPENDIX 1 - ALIA 2018 PREMIUM REVENUE ANALYSIS

Insurance policy year - July 1 to June 30 (12 months)	Budget Fiscal 2018 - Jan 1, 2018 to Dec 31, 2018			Budget Fiscal 2017 - Jan 1, 2017 to Dec 31, 2017			Difference
	Jan 1, 2018 to Jun 30, 2018 (6 months)	Jul 1, 2018 to Dec 31, 2018 (6 months)	Jan 1, 2018 to Dec 31, 2018 (12 months)	Jan 1, 2017 to Jun 30, 2017 (6 months)	Jul 1, 2017 to Dec 31, 2017 (6 months)	Jan 1, 2017 to Dec 31, 2017 (12 months)	2018 to 2017 (12 months)
PART A:							
Part A Premium	\$ 4,038	\$ 4,180		\$ 3,483	\$ 3,483		
Number of insured lawyers	6,750	6,750		6,650	6,650		
Sub-total Part A premium revenue	\$ 13,628,500	\$ 14,107,500	\$ 27,736,000	\$ 11,581,000	\$ 11,581,000	\$ 23,162,000	\$ 4,574,000
Surcharge revenue	290,000	300,000	590,000	265,000	265,000	530,000	60,000
Administration fees			146,000			140,000	6,000
Total premium revenue (Part A)	\$ 13,918,500	\$ 14,407,500	\$ 28,472,000	\$ 11,846,000	\$ 11,846,000	\$ 23,832,000	\$ 4,640,000
PART B:							
Part B Premium	\$ 512	\$ 530		\$ 492	\$ 492		
Number of insured lawyers	6,750	6,750		6,650	6,650		
Total premium revenue (Part B)	\$ 1,728,000	\$ 1,789,000	\$ 3,517,000	\$ 1,636,000	\$ 1,636,000	\$ 3,272,000	\$ 245,000

APPENDIX 2 - ALIEX 2018 PREMIUM REVENUE ANALYSIS

Insurance policy year - July 1 to June 30 (12 months)	Budget 2018 - Jan 1, 2018 to Dec 31, 2018			Forecast 2017 - Jan 1, 2017 to Dec 31, 2017			Budget 2017 - Jan 1, 2017 to Dec 31, 2017		
	Jan 1, 2018 to Jun 30, 2018* (6 months)	Jul 1, 2018 to Dec 31, 2018 (6 months)	Jan 1, 2018 to Dec 31, 2018 (12 months)	Jan 1, 2017 to Jun 30, 2017 (6 months)	Jul 1, 2017 to Dec 31, 2017* (6 months)	Jan 1, 2017 to Dec 31, 2017 (12 months)	Jan 1, 2017 to Jun 30, 2017 (6 months)	Jul 1, 2017 to Dec 31, 2017 (6 months)	Jan 1, 2017 to Dec 31, 2017 (12 months)
PART A:	2,400,000	2,484,000	4,884,000	1,800,000	2,400,000	4,200,000	1,800,000	1,800,000	3,600,000
PART B:	310,000	321,000	631,000	250,000	310,000	560,000	250,000	250,000	500,000
Total ALIEX Premium			\$ 5,515,000			\$ 4,760,000			\$ 4,100,000

* Advisory Board approved \$4.8 million for the Part A premium from July 1, 2017 to June 30, 2018. Therefore, \$2,400,000 is from July 1, 2017 to December 31, 2017 and \$2,400,000 from January 1, 2018 to June 30, 2018. Advisory Board approved \$620,000 for the Part B premium from July 1, 2017 to June 30, 2018. Therefore, \$310,000 is from July 1, 2017 to December 31, 2017 and \$310,000 from January 1, 2018 to June 30, 2018. 2018 assumes a 3.5% increase.