



# **BUDGET 2021**

Approved by the ALIA Board

December 1, 2020

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## INTRODUCTION

The budget contained in this document represents management's funding proposal to carry out the activities and initiatives of the Alberta Lawyers Indemnity Association ("ALIA") in 2021.

While the budget and forecast 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's major sources of revenue are its investment income and, more significantly, the levies received for both Part A and Part B which will not be determined until the spring of 2021, when the Board sets the levies based on the actuary's levy report.

Accordingly, the figures used in the budget for the significant line items are based on the best information available at this time, as set out in the detailed commentary below.

In addition, while the Business Plan identifies the initiative of undertaking the opportunity to align ALIA's policy year end and fiscal year end, the budget assumes a fiscal year of January 1 to December 31 and a policy year of July 1 to June 30. Management anticipates that the fiscal year will change in 2021, and is currently awaiting approval from the Canada Revenue Agency. Once the request is approved management will be seeking a new budget based on the new fiscal year.

The following pages highlight the 2021 budget for ALIA accompanied by explanations.

## BUDGET STRUCTURE

In discussing the budget, we refer to:

- **Budget 2021** - which means the fiscal year beginning January 1, 2021 and ending December 31, 2021;
- **Budget 2020** - which means the fiscal year beginning January 1, 2020 and ending December 31, 2020; and
- **Forecast 2020** - which is our forecast of revenue and expenses for the fiscal year beginning January 1, 2020 and ending December 31, 2020 based on management's current estimate of anticipated results to December 31, 2020.

## ALIA 2021 BUDGET

	<u>2021 Budget</u>	<u>2020 Forecast</u>	<u>2020 Budget</u>	<u>Variance 2021 Budget to 2020 Budget</u>	<u>Variance 2020 Forecast to 2020 Budget</u>
<b>Revenue</b>					
Premium - Professional liability	\$ 17,820,000	\$21,148,000	\$22,383,500	\$ (4,563,500)	\$ (1,235,500)
Premium - Misappropriation indemnity	2,770,000	2,900,000	2,900,000	(130,000)	-
Civil Litigation Filing Levy	1,900,000	-	-	1,900,000	
Net premium	<u>22,490,000</u>	<u>24,048,000</u>	<u>25,283,500</u>	<u>(2,793,500)</u>	<u>(1,235,500)</u>
Investment income	7,400,000	4,300,000	7,450,000	(50,000)	(3,150,000)
Unrealized gain (loss) on Investments	-	10,000,000	-	-	10,000,000
Voluntary excess insurance administration fee	160,000	160,000	145,000	15,000	15,000
	<u>30,050,000</u>	<u>38,508,000</u>	<u>32,878,500</u>	<u>(2,828,500)</u>	<u>5,629,500</u>
<b>Expenses</b>					
Provision for claims and related costs - Professional liability	23,316,000	23,000,000	17,500,000	5,816,000	5,500,000
Provision for claims and related costs - Misappropriation indemnity	476,000	1,700,000	50,000	426,000	1,650,000
Premium deficiency	5,100,000	5,100,000	3,000,000	2,100,000	2,100,000
Insurance	1,907,000	1,786,000	1,835,700	71,300	(49,700)
Salaries and benefits	3,273,500	3,043,000	3,458,400	(184,900)	(415,400)
Management fee - Law Society	2,923,200	3,070,000	3,151,200	(228,000)	(81,200)
Contractors	162,600	195,400	235,000	(72,400)	(39,600)
Investment fees	420,000	420,000	420,000	-	-
Banking fees	114,000	113,700	126,000	(12,000)	(12,300)
Professional fees	250,500	333,500	378,500	(128,000)	(45,000)
Board expenses	100,000	87,500	100,000	-	(12,500)
Administration	224,200	132,200	259,500	(35,300)	(127,300)
	<u>38,267,000</u>	<u>38,981,300</u>	<u>30,514,300</u>	<u>7,752,700</u>	<u>8,467,000</u>
<b>Net income</b>	<u>\$ (8,217,000)</u>	<u>\$ (473,300)</u>	<u>\$ 2,364,200</u>	<u>\$ (10,581,200)</u>	<u>\$ (2,837,500)</u>

## REVENUE

### *Premiums – Professional liability and Misappropriation Indemnity*

The budget includes the current levy of \$2,921 for the first six months of 2021 (second half of the 2020/2021 policy year) and a projected levy for July 1, 2021 to December 31, 2021 (first half of the 2021/2022 policy year). The budget assumes a \$2,297 Professional Liability levy for the 2021/2022 policy year, which is a decrease of \$236 decrease compared to the current 2020/2021 levy of \$2,533. The budget also assumes a \$382 Misappropriation Indemnity levy for the 2021/2022 policy year, which is a decrease of \$6 compared to the current 2020/2021 levy.

The assumption is that based on the Civil Litigation Filing Levy (“CLFL”) the base Part A levy will decrease by \$500 adding back the one-time economic relief of \$316 from the current levy, net of surplus distribution, estimates a Part A levy of \$2,297. The assumptions were discussed with ALIA’s actuary who forecasted both the Professional Liability and Misappropriation Indemnity levy for the 2021/2022 policy year based on the current information available.

At the end of 2020, the forecasted surplus is estimated at approximately \$62.3 million (\$64.3 million including the projected surplus in CLIA) and at the end of 2021 the projected surplus is projected at \$50 million (\$56 million including the projected surplus in CLIA). Considering that ALIA’s surplus is estimated at approximately 99.7 percentile by the end of 2020 the assumption is that the levy will decrease for the 2021/2022 policy year. An analysis of Part A and Part B levy revenue is provided in Appendix 1. Actual levies for the 2021/2022 policy will be approved by the Board in the spring of 2021 upon receipt of the actuary’s levy setting report.

The number of lawyers who participate in Alberta’s mandatory indemnity program (“Subscribers”) estimated within the budget is based on an estimated growth of 2% from 2020 levels. This growth rate was derived from actual increase over the last three years and an assessment of future trends.

### *Civil Litigation Filing Levy*

Recently ALIA’s Board provided approval to proceed with the the Civil Litigation Filing Levy on a two-year pilot project commencing with the 2021/2022 policy year. Therefore, the budget assumes six months of CLFL revenue based on a current estimate of 51,000 civil litigation actions in the Court of Queen’s Bench of Alberta and a per filing fee of \$75, for total revenue of \$1.9 million in 2021 (6 months in 2021).

### *Investment Income*

The budget for investment income is conservative and consists of interest, dividends and realized gains or losses on sales of investments. The actual amount of investment income can vary considerably from budget depending on investment market conditions and the extent to which ALIA is required to liquidate investments to pay claims.

In 2020 the portfolio experienced a significant decline in Q1 (8%) and has continued to recover dramatically since then however as per ALIA's Investment Manager ("Mawer") there continues to be market volatility and conservatism is the best approach. As at the end of Q3 2020 ALIA's portfolio has rebounded and experienced an overall 6.9% return in 2020. However, based on continued economic volatility and in consultation with Mawer, an estimated return of 4% is reflected in the 2021 budget.

### *Unrealized Gain (Loss) on Investments*

Accounting convention requires that we record to income the changes in the market value of our investments from one reporting period to another. As it is inherently difficult to predict investment markets, and as recommended by our investment manager, we do not budget for unrealized gains or losses on the investment portfolio.

### *Voluntary Excess Insurance Administration Fee*

ALIA administers the voluntary excess insurance program provided by the Canadian Lawyers Insurance Association (CLIA) to Subscribers. ALIA charges a fee to CLIA of 10% of the excess insurance premium purchased by Subscribers.

## EXPENSES

### *Provision for claims and related costs – Professional Liability and Misappropriation Indemnity*

The professional liability claims provision budget is based on ALIA's actuary, Willis Towers Watson ("WTW"), review of the 2020 claims data which is updated within the 2020 forecast and the anticipated trend for 2021. The budgets for both Professional Liability and Misappropriation Indemnity are based on the evaluation completed during the most recent levy setting as well as anticipated trends for the second half of 2021.

### *Premium deficiency*

As the policy and fiscal years do not align, the premium deficiency represents the difference between the projected costs of the program as it relates to the second half of the 2021/2022 policy year and unearned premiums recorded at the end of the fiscal year (December 31, 2021), as determined by ALIA's actuary.

### *Insurance – Professional Liability and Misappropriation Indemnity*

Insurance for Professional Liability and Misappropriation Indemnity represents the premium paid to third parties for insurance (formerly called "reinsurance").

Currently the Professional Liability coverage is \$10 million in excess of \$27 million annual aggregate. It is purchased from Allianz Global Risk Insurance (33.33%), Continental Casualty (25%) and AXA/XL (25%) and Liberty Mutual (16.67%). The budget for the Professional Liability insurance assumes a 10% increase of the premium paid for the 2020/2021 policy year which was \$1,370,000.

The Misappropriation Indemnity excess insurance 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. The budget for Misappropriation Indemnity excess insurance assumes a 10% increase of the premium paid for the 2020/2021 policy year which was \$447,000.

### *Salaries and Benefits*

This budget line item includes the cost of ALIA's full time staff consisting of 25 full time equivalents (FTE's) in 2021. The decrease in the salary budget of \$184,900 relates to the decision to not increase staff compensation levels in 2021, which aligns with the position of the Law Society.

### *Management Fee*

The Law Society provides several services and facilities to ALIA, including office space, Accounting, Information Technology, Customer Service, Information Management, Human Resources and Governance support. The cost of these facilities and services are recovered through the management fee. The fee also includes a provision for loss prevention services provided to ALIA through the Law Society's proactive Early Intervention and Practice Management programs. The ALIA management fee has decreased from the 2020 budget by \$228,000 (7%) due to a decrease in Law Society expenses and a further refinement in analysis of services provided.

### *Contractors*

The 2021 budget includes estimated contractor funding for initiatives described in the Business Plan document including:

- Contractor resources for Lean, CLFL, Survey of the Profession, Loss Prevention, Board Compensation Review, Year End Change and Coding projects;
- Regular external review of claim files; and
- Other projects that management expects will proceed in 2021.

### *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 2021 budget is based on estimates of the market value of the ALIA portfolio.

### *Banking Fees*

These fees include regular fees from ALIA's financial institutions including custodial fees charged by RBC Investor Services as well as fees charged by ATB for wire transfers, electronic funds transfers (EFTs), etc.

### *Professional Fees*

Professional fees include audit, actuarial, insurance consultant and legal fees. The 2021 budget has decreased by \$128,000 from 2020 and is mainly due to a reduction in legal fees as a result of completing more legal services internally.

### *Board Expenses*

Board expenses includes funding for honoraria, the annual premium for Directors and Officers insurance, Board training (such as Institute of Corporate Directors) and Board travel expenses.

### *Administration*

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

# ACCUMULATED SURPLUS ANALYSIS

The Board revised the Equity Management policy in June 2019 to provide for monitoring of program capital based on capital targets set under the surplus target guideline (the “Surplus Guideline”) developed by ALIA’s actuary. The Surplus Guideline is based on the actuary’s stochastic model for ALIA and is also used to determine the “zone” in which the surplus falls.

The following table provides a projection of the accumulated surplus of the indemnity program based on the 2021 budget and forecast to the end of 2020:

<b>Actual accumulated surplus at December 31, 2019</b>	\$62,762,285
Forecast net income for the year ending December 31, 2020	<u>(473,300)</u>
<b>Forecast accumulated surplus at December 31, 2020</b>	62,288,985
Budgeted net income for the year ending December 31, 2021	<u>(8,217,000)</u>
<b>Projected accumulated surplus at December 31, 2021</b>	<b>\$54,071,985</b>
Projected Surplus in CLIA at December 31, 2019	\$5,607,471
<b>Total Projected Surplus (including CLIA)</b>	<b><u>\$59,679,456</u></b>

Based on the projected accumulated surplus at December 31, 2020, compared to the Surplus Guideline, ALIA’s surplus is estimated to be at the 99.65 percentile at the end of 2020 (excluding CLIA) and at the 99<sup>th</sup> percentile at the end of 2021 (excluding CLIA) which is within the blue zone:

Levy Action	Levy = Expected Costs + Special Capital Contribution	Levy = Expected Costs + Capital Contribution (amortized over 3 years)	Levy = Expected Costs + Capital Contribution (amortized over 5 years)	Levy = Expected Costs (no adjustment to the levy)	Levy = Expected Costs - Capital Distribution (amortized over 5 years)
Trigger	35% <= Probability	25% <= Probability < 35%	10% <= Probability < 25%	5% <= Probability < 10%	Probability < 5%
Surplus Level	Surplus <= 65th VaR	50th VaR < Surplus <= 75th VaR	75th VaR < Surplus <= 90th VaR	90th VaR < Surplus <= 95th VaR	Surplus > 95th VaR

As indicated earlier there are a number of uncertainties within the budget (i.e. levy, claims liability and expense, investment income) which impacts the surplus.

## APPENDIX 1 - ALIA 2021 VERSUS 2020 LEVY BUDGET REVENUE ANALYSIS

Insurance policy year - July 1 to June 30 (12 months)	Budget Fiscal 2021 - Jan 1, 2021 to Dec 31, 2021			Budget Fiscal 2020 - Jan 1, 2020 to Dec 31, 2020			Difference
	Jan 1, 2021 to Jun 30, 2021 (6 months)	Jul 1, 2021 to Dec 31, 2021 (6 months)	Jan 1, 2021 to Dec 31, 2021 (12 months)	Jan 1, 2020 to Jun 30, 2020 (6 months)	Jul 1, 2020 to Dec 31, 2020 (6 months)	Jan 1, 2020 to Dec 31, 2020 (12 months)	2021 to 2020 (12 months)
<b>PART A:</b>							
Part A Premium	\$ 2,533	\$ 2,297		\$ 3,344	\$ 3,000		
Number of insured lawyers	7,100	7,250		6,820	6,850		
Sub-total Part A premium revenue	\$ 9,000,000	\$ 8,350,000	\$ 17,350,000	\$ 11,403,100	\$ 10,275,400	\$ 21,678,500	\$ (4,328,500)
Surcharge revenue	150,000	160,000	310,000	235,000	325,000	560,000	(250,000)
Administration fees			160,000			145,000	15,000
<b>Total levy revenue (Part A)</b>	<b>\$ 9,150,000</b>	<b>\$ 8,510,000</b>	<b>\$ 17,820,000</b>	<b>\$ 11,638,100</b>	<b>\$ 10,600,400</b>	<b>\$ 22,383,500</b>	<b>\$ (4,563,500)</b>
<b>PART B:</b>							
Part B Premium	\$ 388	\$ 382		\$ 448	\$ 400		
Number of insured lawyers	7,100	7,250		6,820	6,850		
<b>Total levy revenue (Part B)</b>	<b>\$ 1,380,000</b>	<b>\$ 1,390,000</b>	<b>\$ 2,770,000</b>	<b>\$ 1,530,000</b>	<b>\$ 1,370,000</b>	<b>\$ 2,900,000</b>	<b>\$ (130,000)</b>