The Alberta Lawyers Insurance Exchange

Financial Statements
December 31, 2014

February 26 2015

Independent Auditor's Report

To the Directors, of Alberta Lawyers Insurance Exchange

We have audited the accompanying financial statements of Alberta Lawyers Insurance Exchange, which comprise the statement of financial position as at December 31, 2014 and the statements of net and comprehensive income and changes in equity, and cash flows for the period from July 1, 2014 to December 31, 2014 and the related notes, which comprise 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 Alberta Lawyers Insurance Exchange as at December 31, 2014 and its financial performance and its cash flows for the period from July 1, 2014 to December 31, 2014 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Accountants

PricewaterhouseCoopers LLP
111 5th Avenue SW, Suite 3100, Calgary, Alberta, Canada T2P 5L3
T: +1 403 509 7500, F: +1 403 781 1825

The Alberta Lawyers Insurance Exchange
Statement of financial position

	December 31, 2014 $	July 1, 2014 $
Assets		
Cash	865,196	5,000,000
Investments	7,890,251	-
Prepaid expenses	120,000	-
Accrued interest receivable	19,403	-
Accounts receivable	69	-
Total assets	8,894,919	5,000,000
Liabilities and Equity		
Accounts payable and accrued liabilities	101,548	-
Unearned premiums	1,984,925	-
Reserve for claims and related costs (note 6)	1,190,000	-
	3,276,473	-
Equity		
Contributed Capital (note 4)	5,000,000	5,000,000
Retained earnings	618,446	-
Total equity	5,618,446	5,000,000
Total liabilities and equity	8,894,919	5,000,000

Approved by the Advisory Board

_______________________________ Director _______________________________ Director

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

The Alberta Lawyers Insurance Exchange

Statement of net and comprehensive income and changes in equity

For the period from July 1, 2014 to December 31, 2014

	July 1, 2014 to December 31, 2014 $
Revenue	
Premium	1,984,925
Premium ceded	(120,000)
Net premium	1,864,925
Investment income	104,620
Unrealized gain on the fair market value of investments	42,071
	2,011,616
Expenses	
Provision for claims and related costs (note 6)	1,190,000
Management fee (note 7)	100,000
Administration	61,170
Professional fees	40,000
Investment counsel fee	2,000
	1,393,170
Net and comprehensive income	618,446
Retained earnings – beginning of period	5,000,000
Retained earnings – end of period	5,618,446

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

The Alberta Lawyers Insurance Exchange

Statement of Cash Flows

For the period ended December 31, 2014

	December 2014 $
Cash provided by (used in)	
Operating activities	
Net income for the period	618,446
Items not affecting cash	
Unrealized gain on fair market value of investments	(42,071)
Provision for claims and related costs (note 6)	1,190,000
	1,766,375
Changes in non-cash working capital items	1,947,000
	3,713,375
Investing activities	
Purchase of investments	(13,371,021)
Sale of investments	5,522,842
	(7,848,179)
Financing activities	
Capital contribution	5,000,000
Increase (decrease) in cash	865,196
Cash – beginning of period	-
Cash – end of period	865,196
Interest received	23,010

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

1 General

The Alberta Lawyers Insurance Exchange (the "Exchange") is a reciprocal insurance exchange pursuant to the Insurance Act formed in accordance with a Subscribers Agreement dated May 14, 2014 among the Law Society of Alberta (the "Society"), the Alberta Lawyers Insurance Association (the "Association"), and the members of the Society to provide insurance products to the members of the Society. The Exchange commenced operations on July 1, 2014.

The Exchange is licensed in Alberta and regulated by the Superintendent of Insurance of Alberta and subject to the regulations in Alberta's Insurance Act. The Exchange is an entity domiciled in Canada and the address of its registered office is Suite 500, 919 11th avenue, SW, Calgary, Alberta, T2R 1P3.

The financial statements were authorized for issue by the Advisory Board of the Exchange on February 26, 2015.

2 Summary of significant accounting policies

The principal accounting policies applied in the presentation of these financial statements are set out below. These policies have been consistently applied to the period presented.

(a) Basis of preparation

These financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS). These are the first annual financial statements prepared in accordance with IFRS and as such, IFRS 1, First Time Adoption of International Reporting Standards ("IFRS 1") has been applied. The financial statements have been prepared under the historical cost convention, except for the valuation of certain financial instruments at fair value through profit and loss.

As a financial services company, the balance sheet is presented on a non-classified basis. Assets expected to be realized and liabilities expected to be settled within the Exchange's normal operating cycle of one year would typically be considered as current, including the following balances: cash and cash equivalents, treasury bills included in investments, prepaid expenses, accrued interest receivable, accounts receivable, accounts payable and accrued liabilities, and unearned premiums.

The following balances are generally comprised of current and non-current amounts: bonds and debentures included in investments, and the reserve for claims and related costs. The current and non-current portions of such balances are disclosed, where applicable, throughout the notes to the financial statements.

(b) Use of estimates and judgment

The preparation of the financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities as at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

Information about judgments, estimates and assumptions that have the most significant effect on the amounts reflected in the financial statements is included in note 6 – Reserve for claims and related costs.

(c) Functional and presentation currency

The financial statements are presented in Canadian dollars, which is also the Exchange's functional currency.

(d) Financial instruments

The Exchange initially measures financial assets and financial liabilities at fair value. It subsequently measures its investments at fair value. The financial assets subsequently measured at amortized cost include cash and cash equivalents, accounts receivable and accrued interest receivable. The financial liabilities subsequently recorded at amortized cost include accounts payable and accrued liabilities.

The Exchange's investments consist of equity securities, corporate bonds, provincial government bonds and federal government bonds. The investment in equity securities which are traded on active markets are recorded at fair value. The Exchange has elected to record the investments in corporate bonds, provincial government bonds and federal government bonds at fair value. Changes in fair value of the investments are recorded in the statement of net and comprehensive income and changes in equity. The investments which are not traded on active markets are recorded at fair value.

Financial assets are tested for impairment at the end of each reporting period when there are indications that the assets may be impaired.

(e) Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Exchange and it can be reliably measured.

(f) Premium income

Premiums are determined annually prior to July 1st, the commencement of the policy year, and amounts are due from insured lawyers prior to that date. Premium revenue is recorded evenly throughout the fiscal year as the services are rendered. Premiums are billed and collected by the Association on the Exchange's behalf.

(g) Investment income

Investment income comprises of interest, dividends, fund distributions, and gains and losses realized on the disposal of investments. Interest and dividends earned on investments are included as revenue on an accrual basis. The change in fair value of investments is recorded in the statement of net and comprehensive income and changes in equity as an unrealized gain (loss).

(h) Reserve and Provision for claims and related costs

The reserve for claims and related costs includes provisions for claims incurred but not reported and a provision for adverse deviations. The reserve for claims and related costs represents an estimate of the ultimate net cost of all amounts related to the settlement of claims incurred prior to the date of the statement of financial position.

The provision for claims and related costs is based upon the change from the period in the reserve for claims and related costs. The reserve amount is the actuarially determined discounted cost of possible claims and related costs as at the end of the fiscal period.

The estimates of loss activity are subject to a high level of uncertainty, and are derived from a wide range of possible outcomes. These estimates are continually reviewed as additional information affecting settlement is obtained.

The Exchange has engaged a third party actuary to provide an annual valuation of the reserve for claims and related costs in accordance with the standards of practice adopted by the Canadian Institute of Actuaries. For the purpose of the actuarial valuation, the actuary uses information contained in the Exchange's financial records.

(i) Insurance contracts

Contracts entered into by the Exchange meet the definition of an insurance contract and are accounted for in accordance with IFRS 4, Insurance Contracts ("IFRS 4"). Insurance contracts are those contracts where the association has accepted significant insurance risk. A contract is considered to have significant insurance risk if, and only if, an insured event could cause an insurer to make significant additional payments in any scenario at the inception of the contract.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire.

(j) Reinsurance ceded

The Exchange enters into reinsurance treaties for contracts with coverage in excess of certain maximum amounts. Estimates of any amounts recoverable from reinsurers on unpaid claims will be recorded separately from other estimated amounts payable. Amounts recoverable from reinsurers are estimated in a manner consistent with the liabilities associated with the reinsured policy.

Ceded reinsurance arrangements do not relieve the Exchange from its obligations to policyholders.

Reinsurance assets and liabilities are derecognized when the contractual rights are extinguished or expire, or when the contract is transferred to another party.

As of December 31, 2014, no reinsurance assets have been recorded.

(k) Recoveries

Recoveries for claims and related costs from insurers and other third parties are recorded when they can be reasonably estimated and collectability is reasonably assured. Otherwise, the recovery is recorded when received.

(l) Cash

Cash includes cash on deposit with banks and other highly liquid short-term investment comprised of treasury bills with original maturity dates of three months or less.

(m) Donated services

A portion of the Exchange's work is dependent on the services of volunteers, in particular the significant contribution of members of the Advisory Board and committees of the Advisory Board. These services are not normally purchased by the Exchange and, due to the difficulty in determining their fair value, donated services are not recognized in these financial statements.

(n) Unearned premiums

Insurance levies for each fiscal year are billed in advance and recognized as revenue on a monthly basis during the fiscal year. Unearned premiums represent the portion of premiums remaining to be earned at the reporting date.

(o) Income taxes

No provision for income taxes has been made in these financial statements as the Exchange is not subject to such taxes.

(p) New accounting standards issued but not yet adopted

IFRS 15, "Revenue from Contracts with Customers"

IFRS 15 was issued in May 2014, and introduces a single, comprehensive revenue recognition model for all contracts with customers other than those that are within the scope of other standards, such as insurance contracts and financial instruments. IFRS 15 therefore supercedes the two main revenue recognition standards, IAS 18, Revenue, and IAS 11, Construction Contracts, as well as related interpretations. The core principal of this new standard is that revenue recognition should depict the transfer of goods or services in an amount that reflects the consideration received or expected to be received in exchange for these goods or services. The new standard also provides more guidance on certain types of transactions and will result in an increase in the disclosures related to revenue. The Exchange is still in the process of assessing the impact of this standard, which is effective for annual periods beginning on or after January 1, 2017.

IFRS 9, "Financial Instruments"

IFRS 9, published in November 2009 and amended in October 2010 and November 2013, replaces Financial Instruments Recognition and Measurement ("IAS 39"). IFRS 9 deals with the classification and measurement of financial instruments, impairment of financial assets and hedge accounting. The requirements of this standard represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortized cost and fair value. A financial asset would be measured at amortized cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets would be measured at fair value. The standard eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivables. The classification and measurement for financial liabilities remain largely unchanged. The effective date for IFRS 9 is January 1, 2018, with early adoption permitted. The Exchange is still in the process of assessing the impact of these changes.

3 Investments

The Exchange's investments are governed by a Statement of Investment Policies and Goals as approved by the Advisory Board and managed under contract with an external investment manager. The Exchange's investments are carried at fair market value, subject to normal market fluctuations, and the statement of revenue, expenses, and net assets reports both realized and unrealized gains and losses on investments. The Exchange's investments consist of treasury bills, bonds and equity investments.

Investments are as follows:

	December 31, 2014 $
T-Bills denominated in Canadian dollars	1,943,000
Bonds denominated in Canadian dollars:	
Corporate	1,581,462
Provincial government	1,397,258
Federal government	1,498,583
	4,477,302
Equities denominated in Canadian dollars	1,469,949
	7,890,251

4 Equity and Contributed capital

Prior to the commencement of operations on July 1, 2014, the Association contributed $5 million to the Exchange.

5 Surplus and surplus management

Equity comprises the surplus and accumulated comprehensive income. As at December 31, 2014, the Exchange's equity was $5,618,446. The Exchange's objectives for managing the surplus are for the prudent operation of the reciprocal and to provide relatively predictable premiums costs for insured lawyers over time.

The Exchange was in compliance with all regulatory requirements as of December 31, 2014.

Under the requirements of Section 99 and 100 of The Act, the Exchange must maintain, as a reserve fund, a sum of cash or approved securities to 50% of the subscribers' annual premiums. In addition, the Exchange is required to maintain in a guarantee fund a sum of cash or approved securities of at least $50,000 plus the sum of all liabilities excluding unearned premiums. If, at any time, the reserve fund or the guarantee fund is less than the required amount, the subscribers are required to make up the deficiency.

The total reserve and guarantee funds required are as follows:

	2014 $
Reserve fund	
Premiums written	3,969,850
	x 50%
Reserve fund required reserve	1,984,925
Guarantee fund required reserve	1,341,548
Cash and marketable securities required	3,326,473
Cash and marketable securities maintained	8,755,447
Cash and marketable securities maintained in excess of required amounts	5,428,974

6 Reserve for claims and related costs

The change in the reserve for claims and related costs is summarized as follows:

	December 31, 2014 $
Reserve for claims and related costs – beginning of period	-
Claims paid and accrued	-
Related costs paid and accrued	-
Recoveries	-
	-
Increase due to claims experience	1,190,000
Reserve for claims and related costs – end of period	1,190,000
Provision for adverse deviations	198,000
Provision for incurred but unreported claims	992,000
Reserve for claims and related costs	1,190,000

Included in the Provision for claims and related costs in the statement of net and comprehensive income and changes in equity is the increase due to claims experience of $1,190,000.

The discount rate applied by the actuary at December 31, 2014 is 2.11%, which is based on the expected market yield of the Exchange's portfolio of bonds. The undiscounted reserve balance at December 31, 2014 is $1,090,000.

Actuarial analysis

The process of determining actuarial liabilities necessarily involves the risk that actual results may vary from assumed results. The risk varies in proportion to the length of period covered by each assumption and the potential volatility of the actual results.

The provision for incurred but unreported claims has been estimated for the period using actuarial methods and is based on expected claims development patterns and expected losses.

Sensitivity analysis

The sensitivity analysis below is based on a change in assumption while holding all other conditions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The table below provides the impact on net income of the most significant assumption changes.

Assumption	Income impact December 31, 2014	Equity
5% increase in expected claim losses	$(61,148)	$(61,148)
5% decrease in expected claim losses	$57,327	$57,327
1% increase in discount rate	$(202,022)	$(202,022)
1% decrease in discount rate	$223,193	$223,193

7 Related party transactions

During the period, the Exchange paid the Association $100,000 for management fees. The Association provides and performs certain management, claims management and administrative duties and services to the Exchange as outlined within a Management Agreement and as delegated by the Advisory Board of the Exchange.

The members of the Advisory Board include lawyers drawn from law firms across the province. These law firms may at times be engaged by the Exchange in the normal course of business. During the period ended December 31, 2014, expenses of $0 were incurred with these law firms. The Advisory Board members are not involved in retaining these firms.

All related party transactions occurred in the normal course of operations and have been measured at the agreed to exchange amount, which is the amount of consideration established and agreed to by the related parties.

8 Financial instruments

The Exchange recognizes financial instruments at fair value upon initial recognition, plus transaction costs in the case of financial instruments measured at amortized cost. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Exchange has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation is discharged, cancelled, or has expired.

The Exchange's investments are measured at fair value through profit or loss (FVTPL) and are classified as held for trading or designated at FVTPL at inception. A financial asset or financial liability is classified as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the short term; or if, on initial recognition, it is part of a portfolio of identifiable financial investments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking.

Gains and losses arising from changes in the fair value of FVTPL financial instruments are presented in the statement of net and comprehensive income and changes in equity as net changes in unrealized appreciation (depreciation) of investments in the period in which they arise.

All other financial assets and liabilities are measured at amortized cost. Under this method, financial assets and liabilities reflect the amount required to be received or paid, discounted, when appropriate, at the contract's effective interest rate.

Fair value hierarchy

A fair value hierarchy is presented below that distinguishes the significance and objectivity of the inputs used in determining the fair value measurements of financial instruments. The hierarchy contains the following levels based on the nature of the pricing inputs:

Level 1 – Inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities that are publicly available at the measurement date.

Level 2 – Inputs other than quoted prices that are observable for the assets or liabilities either directly or indirectly, including inputs in markets that are not considered to be active.

Level 3 – Inputs that are largely unobservable. Fair value requires significant management estimate and judgment.

The following table illustrates the fair value classification of the Exchange's financial instruments within the fair value hierarchy.

As at December 31, 2014

	Estimated fair value			Total
	Level 1	Level 2	Level 3	
T-Bills	$1,943,000	-	-	$1,943,000
Bonds	$4,477,302	-	-	$4,477,302
Equities		$1,469,949	-	$1,469,949
Total Investments	$6,420,302	$1,469,949	-	$7,890,251

9 Underwriting Policy and Reinsurance

The Association provides coverage for claims incurred up to $500,000. After July 1, 2014, the Exchange provides coverage for claims in excess of $500,000 up to a maximum of $1,000,000 per occurrence and $2,000,000 in the annual aggregate.

The Association and the Exchange have entered into a stop loss reinsurance contract for coverage of liability arising from a single claim up to $5,000,000 over the Exchange's deductible level of $1,000,000, and up to $26,000,000 in the annual aggregate.

As of December 31, 2014, there were no claims above the Exchange's coverage of $1,000,000 and no claims above this level considered to be incurred but not reported as determined by the appointed actuary. As such, no asset for the reinsurance contract has been recognized in the statement of financial position.

10 Insurance and financial risk management

In the normal course of business, the Exchange enters into contracts that transfer insurance risk or financial risk or both. The Exchange monitors and manages these risks relating to the operations of the Exchange through internal risk reports which analyze exposures by degree and magnitude of risk.

Insurance risk

The insurance risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable. The key risk related to insurance is that the actual claims payment amounts or timing are different from expectations.

The Exchange manages insurance risk rating within an overall risk management framework that includes a focus on rating, use of reinsurance and surplus management. Reinsurance is purchased to mitigate the effect of potential loss to the Exchange from individual large events. Reinsurance policies are written with reinsurers who meet the Exchange's standards for financial strength. Reinsurers and reinsurer security is monitored on a continuous basis.

Financial risk

The Exchange is exposed to a range of financial risks. The key financial risk is that in the long term its investment proceeds are not sufficient to fund the obligations arising from its insurance contracts. The most important components of this financial risk are market risk (including foreign exchange risk, interest rate risk and other price risk), credit risk and liquidity risk.

Market risk

Market risk is the risk that the fair value of financial instruments will fluctuate due to changes in market prices. The Exchange separates market risk into three categories: foreign exchange risk, price risk, and interest rate risk.

Foreign exchange risk

Foreign exchange risk arises from the possibility that changes in the price of foreign currencies will result in losses. The Exchange holds assets and liabilities, including cash and investments, that are in Canadian dollars, so foreign exchange risk is considered to be insignificant.

Price risk

The investments of the Exchange are subject to price risk because changing interest rates impact the market value of the fixed rate investments, general economic conditions affect the market value of equity investments and currency exchange rates impact the market value of the investments denominated in currencies other than the Canadian dollar. The risk is mitigated by engaging an investment manager for the long term portfolio investments and by investing other funds in short term fixed rate products with high credit ratings.

The following table summarizes the effect on net and comprehensive income as a result of a fair value change in the investment portfolio. The analysis assumes all other variables remains constant.

As at December 31, 2014

	Carrying value	Effect of a 10% increase in the fair value on net and comprehensive income	Effect of a 10% decrease in the fair value on net and comprehensive income
Investments	$7,890,251	$789,025	($789,025)

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. The Exchange is exposed to interest rate risk if the cash flows from investments are not matched to the liabilities they support. The Exchange manages the interest rate risk on fixed income bonds by engaging an investment manager who operates subject to investment parameters designed to mitigate this risk.

The approximate impact of an increase in interest rates of 1% would decrease the provision for claims and related expenses and the market value of fixed income securities for a net decrease to comprehensive income for the period ended December 31, 2014 of $202,022. The approximate impact of a decrease in interest rates of 1% would increase the provision for claims and related expenses and the market value of fixed income securities for a net increase to comprehensive income for the period ended December 31, 2014 of $223,193.

Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The Exchange's financial assets that are exposed to credit risk consist of investments in bonds, accrued interest receivable and accounts receivable. The maximum exposure of the Exchange to credit risk is the carrying amount of these financial instruments as disclosed in the financial statements at December 31, 2014.

The Exchange manages credit risk by maintaining bank accounts with reputable financial institutions, only investing in securities that are liquid, highly rated and traded in active markets, by placing limits on its exposure to a single counterparty and by ensuring accounts receivable are from reputable, credit-worthy members/organizations.

The credit quality of the Exchange's investment in bonds is described in the following table:

Securities:	December 31, 2014 $
Bonds – AAA rating	1,498,583
Bonds – AA rating	1,560,210
Bonds – A rating	1,134,562
Not rated	283,947
Total	4,477,302

Liquidity risk

Liquidity risk is the risk that the Exchange will be unable to meet its obligations when they fall due, or that it may be required to settle its obligations on terms that are disadvantageous. The Exchange engages an investment manager to administer the investments it plans to hold for a long period of time. These investments are subject to liquidity risk if the Exchange is required to sell at a time that the market for these investments is unfavourable or the investments are illiquid.

Included in investments are fixed income bonds in the amount of $4,477,302. The maturity dates and interest rate ranges are as follows:

Maturity dates (from balance sheet date)	Interest rate range	Market value $
Within five years	2.00 – 3.66%	1,436,566
Greater than five years but less than ten years	2.50 – 3.94%	2,554,338
Greater than ten years	3.45%	486,398
		4,477,302

The following table presents the contractual terms to maturity of the financial liabilities owed by the Exchange. As at December 31, 2014:

Financial liability	Carrying value	Contractual term to maturity
Accounts payable and accrued liabilities	$101,548	Less than one year