

# Authority for California Cities Excess Liability

## Target Equity Ratios

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# Target Equity Policy

- Purpose
  - Provide guidance to the Board for development of annual funding, dividends and assessment decisions
  - Develop set of benchmarks to measure the pools financial stability
    - Compared to industry standards and past experience
  - Assist in evaluation and implementation of prudent funding levels
  - Expose deteriorating experience before it can have an adverse impact on the pool

# Definitions

- “Confidence Level” is a statistical term used to express the degree to which an actuarial projection will be an accurate prediction of the dollar losses ultimately paid for a given program year or combination of years. The higher a “Confidence Level” the greater certainty the actuary had that losses will not exceed the dollar value used to attain “Confidence Level”
- “Equity” is the amount of funds remaining, after deducting all administrative and excess insurance costs, available to pay claims in excess of actuarial expected losses discounted for investment income at the actuarially determined “Expected” “Confidence Level” <sup>(1)</sup>
- “Net Contribution” includes the total contributions from members less the excess insurance costs
- “Self Insured Retention” is the maximum amount of exposure to a single loss retained by ACCEL

<sup>(1)</sup> See Discussion on Page 4

# CAJPA “Equity” vs. “Net Position”

- CAJPA’s definition of “Equity” is:
  - The amount of funds remaining, after deducting all administrative and excess insurance costs and the amount available to pay claims in excess of the actuarial expected losses discounted for investment income at the actuarially determined “Expected” “Confidence Level”
- Net Position is defined as your Assets subtract all Liabilities
  - For ACCEL the Retrospective Refunds Available are a Liability to the POOL
- Under CAJPA’s definition, ACCEL has been evaluated as an Equity pool and we hope this continues

# Assets - Liabilities = Net Position

- ACCEL is a Non-Equity pool
- However, under the CAJPA definition of Equity, we can evaluate the pool as an Equity pool
- “Restriction” does not effect this definition of Equity
- ACCEL’s Equity according to the CAJPA definition is \$22,006,565
- Last year this figure was \$20,366,791

# Change in Equity Ratio

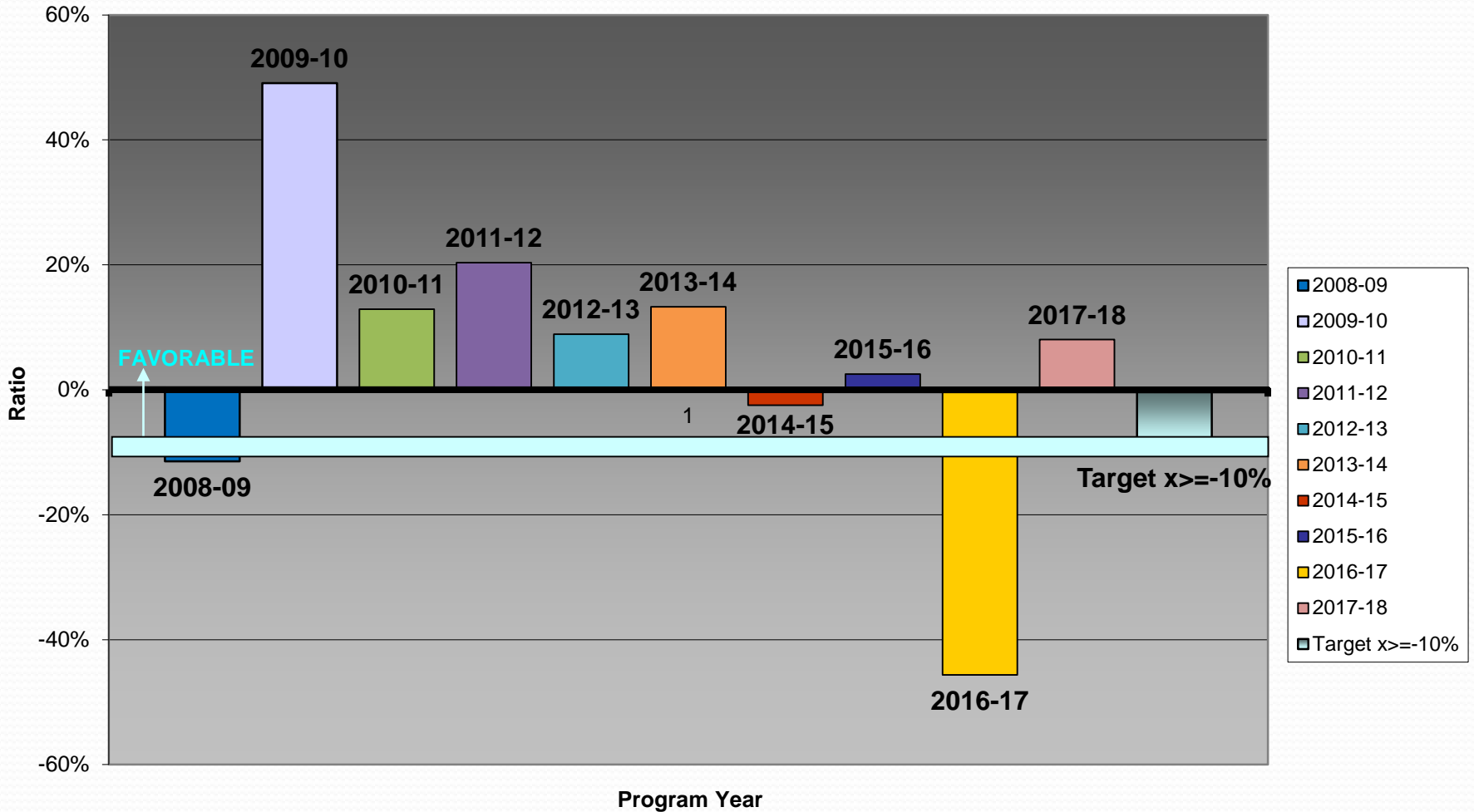
**Target  $\geq -10\%$**

- This ratio measures if a decline in equity in excess of 10% warrants an increase in annual contribution or an assessment.
- Large fluctuations in equity indicate the program is experiencing change.
- *Takeaway: ACCEL's equity has decreased significantly due to a large increase in claims reserves. Because of this, the Board took action to restrict the retro available to withdraw, which is a prudent step to take given the 'test year' of the retro (\$-8.6M).*

**Example: 2017-18**

$$\frac{(2017-18 \text{ Equity}) - (2016-17 \text{ Equity})}{2016-17 \text{ Equity}} \geq -10\%$$
$$\frac{\$22,006,565 - \$20,366,791}{\$20,366,791} = 8\%$$

# ACCEL Target Equity Ratios Change In Equity



# “Equity” to “Self Insured Retention” ratio

**Target  $\geq 5:1$**

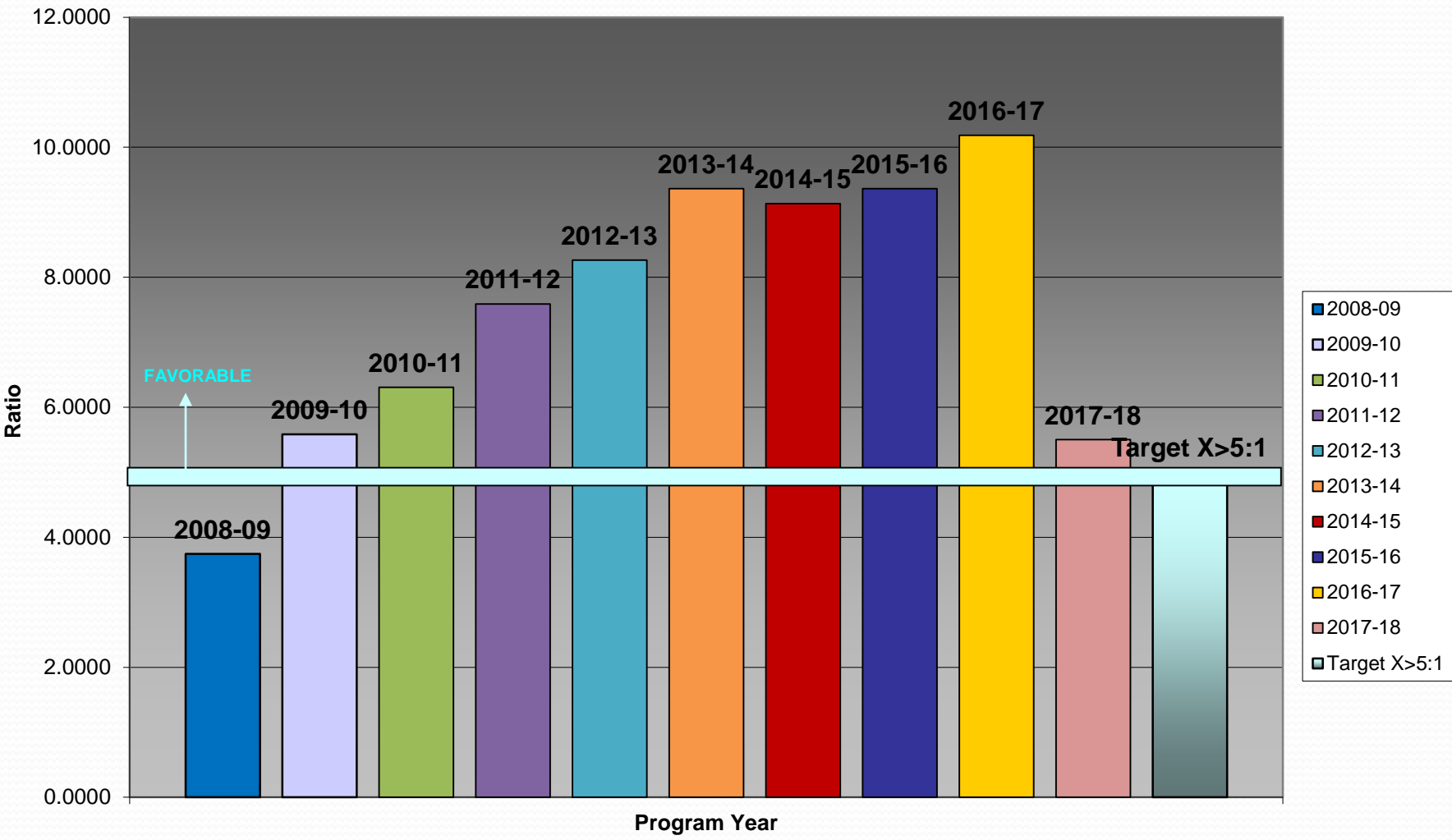
- This ratio is a measure of the maximum amount that equity could decline due to a single loss.
- Assists in determining the feasibility of increasing the pool SIR (currently \$4,000,000).
- Protects against possibility of assessment.
- A high ratio is desirable.
- *Takeaway: ACCEL continues to be sufficiently funded to withstand several limit losses. Last year's ratio did not deteriorate due to the reduced retention by purchasing reinsurance excess of \$3,000,000. This year ACCEL returned to a \$4,000,000 shared risk layer, and equity remained appropriate. This means members should consider not taking retro payments, and look for increased rates to improve position.*

**Example: 2017-18**

$$\frac{\text{Equity}}{\text{Insured Retention}} \geq 5:1$$

$$\frac{\$22,006,565}{\$4,000,000} = 5.50$$

# ACCEL Target Equity Ratios Equity to Self Insured Retention



# Ultimate Reserve Development Ratio

**Target  $\leq 20\%$**

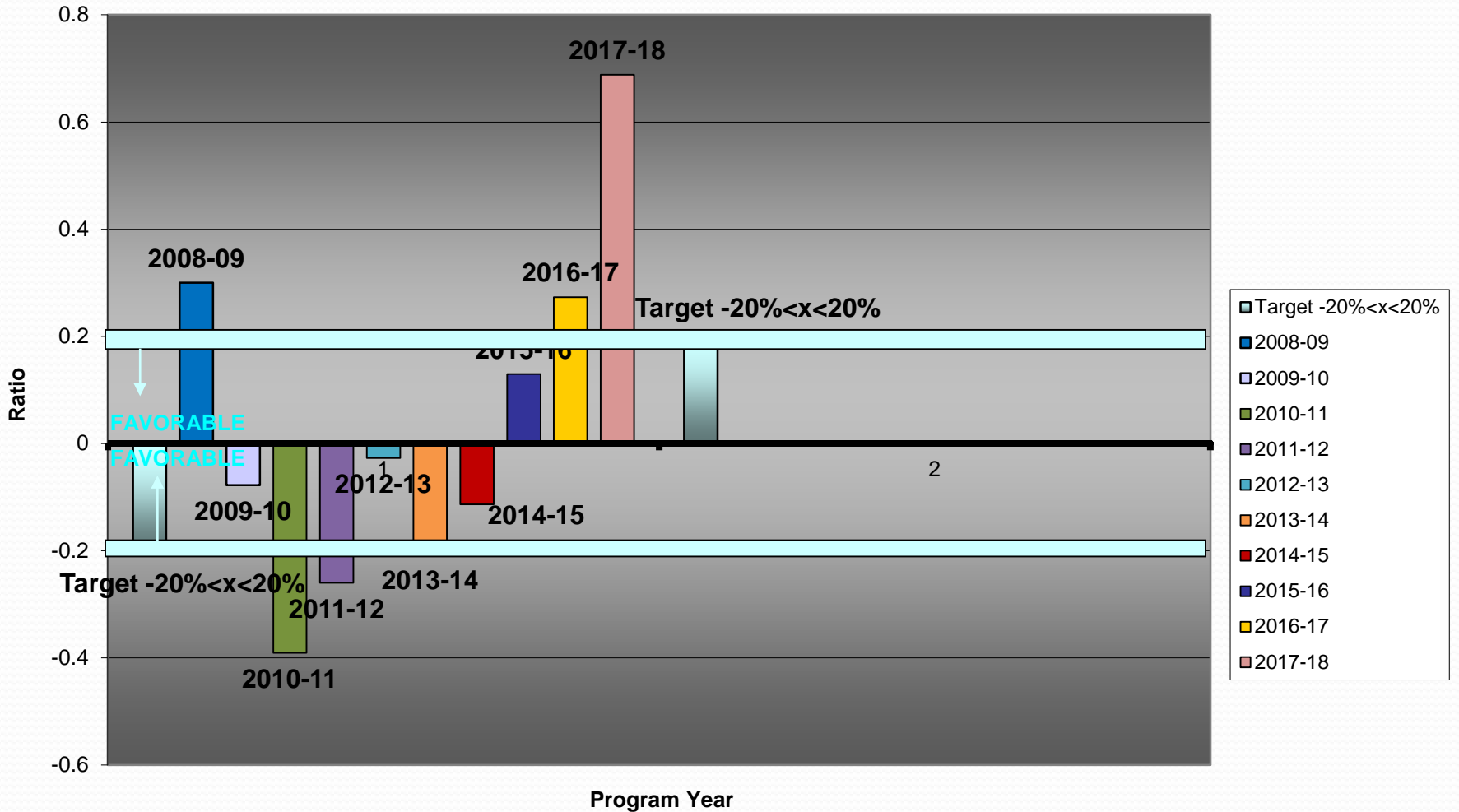
- This is a measure of the change in aggregate ultimate losses from one valuation period to the prior valuation period.
- Generally, the one year and two year reserve development to equity threshold should be less than 20%.

*Takeaway: The ultimate incurred losses have increased outside of the desirable range. This is an indication of claims reserves increasing more than expected by the actuary. ACCEL has seen a considerable increase in excess claims activity, Mike Harrington has been increasing rates, and this is consistent with industry trends.*

## Example: 2017-18

$$-20\% < \frac{(\text{Ultimate Liabilities for Years more that 2 years old}) - (\text{FY2015} - 16 \text{ Ultimate Liabilities})}{\text{FY2015} - 16 \text{ Equity}} < 20\%$$
$$\frac{\$91,039,611 - \$62,431,042}{\$37,454,927} = 76\%$$

# ACCEL Target Equity Ratios Reserve Development Ratio



# “Outstanding Reserves” to “Equity” ratio

**Target  $\leq 3:1$**

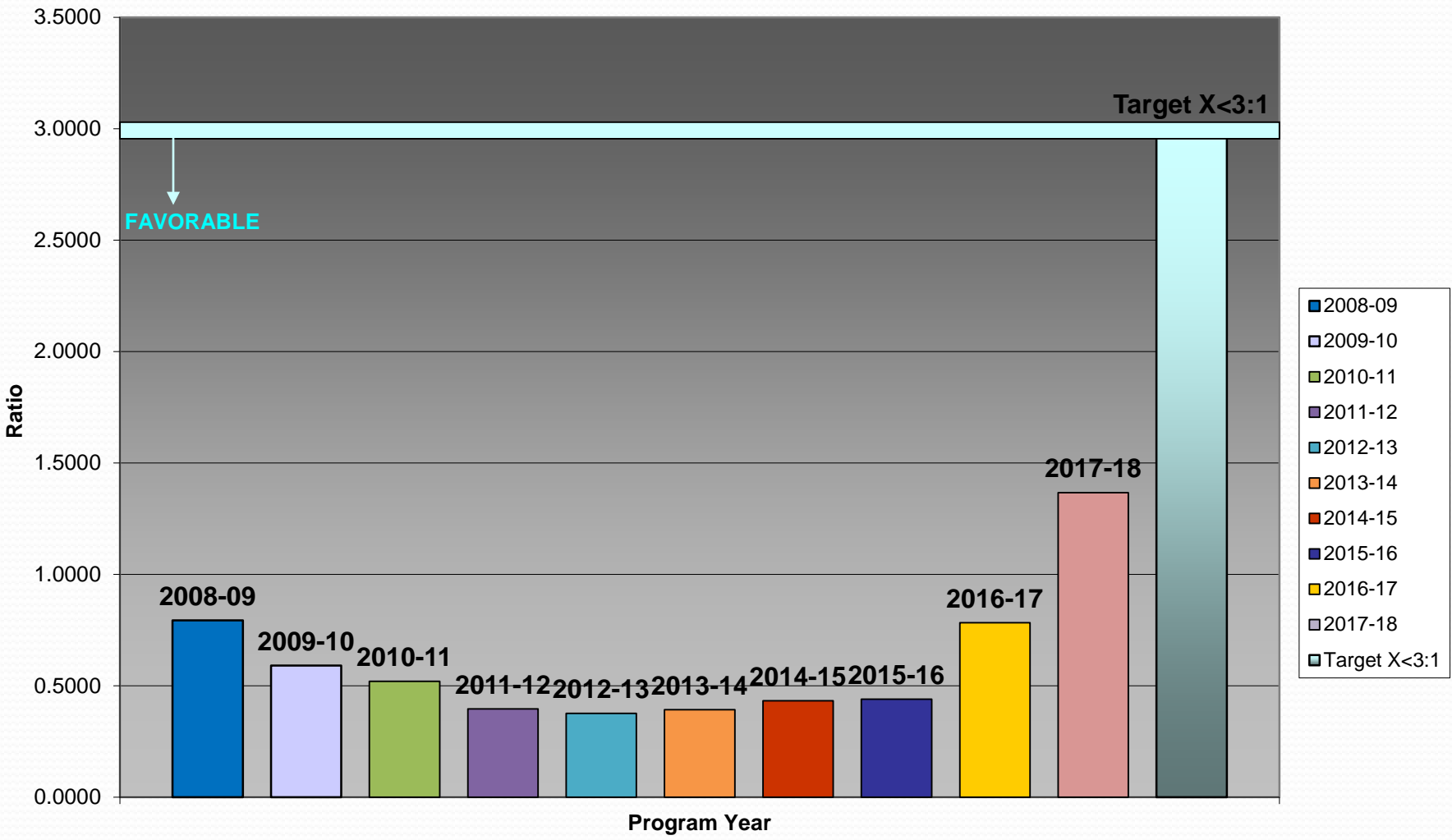
- Comparison of net equity to current potential losses, including IBNR.
- Over time this ratio could indicate changing loss exposures.
- A low ratio is desirable.

*Takeaway: ACCEL continue to comply with this guideline, but our position has deteriorated. If our equity is reduced further, we would see a strong impact, but because members have not taken their retro payments, ACCEL still has sufficient funding. Now is a good time to let retro funds sit at ACCEL (restrict).*

**Example: 2017-18**

$$\frac{\text{Outstanding Reserve}}{\text{Equity}} \leq 3:1$$
$$\frac{\$30,086,000}{\$22,006,565} = 1.37$$

# ACCEL Target Equity Ratio Outstanding Reserves to Equity



# “Net Contribution” to “Equity” ratio

**Target  $\leq 2:1$**

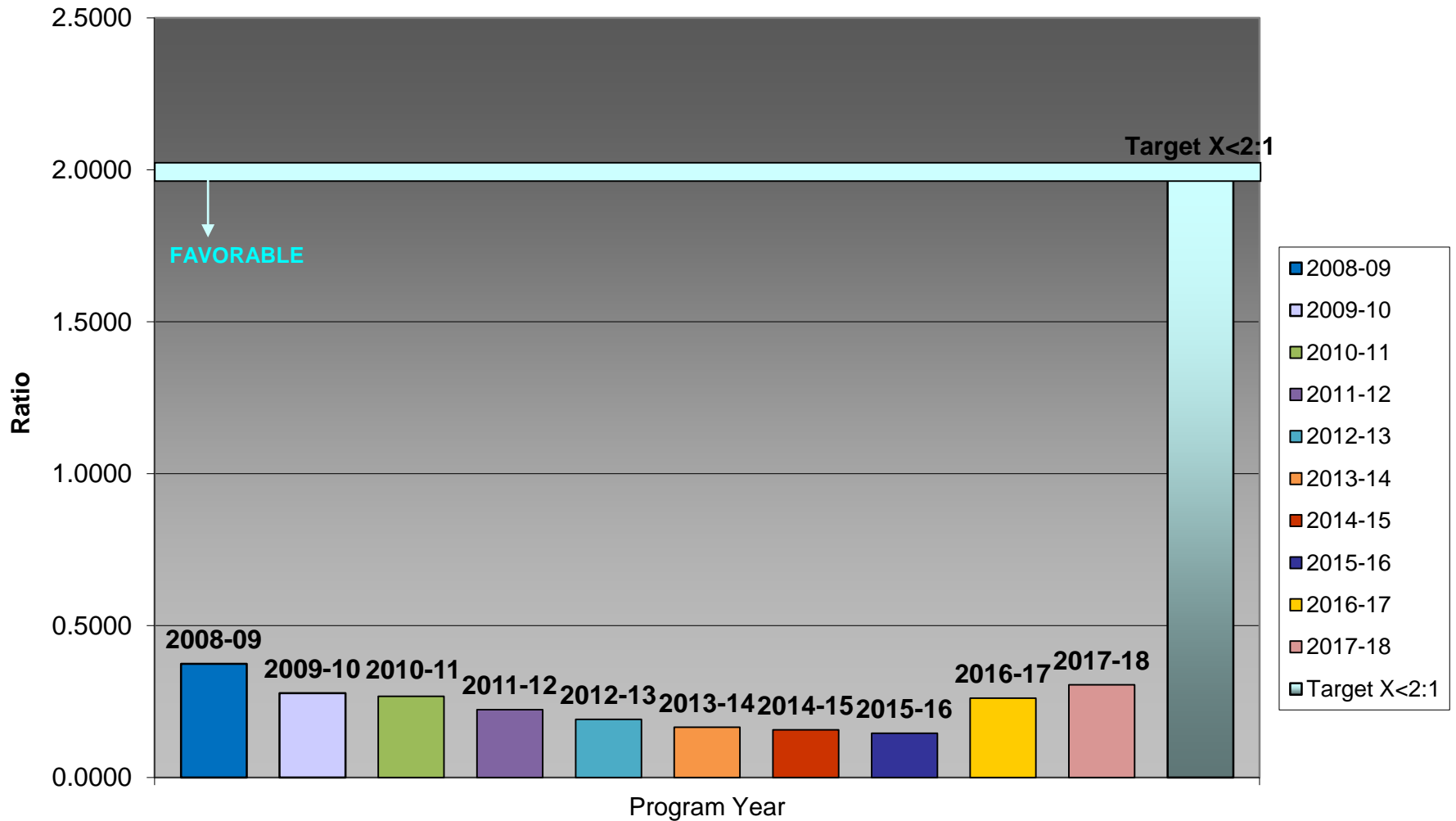
- This ratio is a measure of how equity is leveraged against possible pricing inaccuracies.
- Relationship between *annual deposits* and equity.
  - Note: Equity discussion on page 4.
- Illustrates exposure compared to current risk.
- The net contribution or annual deposit is the amount of funding members pays towards funding the pooled layer – this does not include investment income.
- A low ratio is desirable.

*Takeaway: ACCEL has many years of prudent funding that lead to a strong overall financial position. While that has been impacted, we are not at a stage where our annual funding is a large portion of the overall program’s financial position. This is valuable for new pools, and pools in poor financial condition.*

**Example: 2017-18**

$$\frac{\text{Net Contributions}}{\text{Equity}} \leq 2:1$$
$$\frac{\$6,725,863}{\$22,006,565} = 0.31$$

## ACCEL Target Equity Ratio Net Contribution to Equity



# 2017-18 Program Year Trends

- In 2016-17 ACCEL has reached all of its Equity Goals except for
  - Retained \$2,000,000
  - Reserves which has increased to 27%
  - Change in Equity which has decreased by 46%

## 2017-18

- ACCEL retained \$4,000,000 for this year of the study. We now see the impacts of claims trends, and to maintain prudent funding levels, Members should try to maintain retro funds in ACCEL.
- ACCEL's financial standing took a considerable step back, and we now need to monitor funding guidelines, retro payments and watch 'Test Year' (-8.6M) fall into the available retro funds, and monitor recent years loss trends (*years not in retro results*).
- Met all goals except increase in reserves greater than 20% (76%).

- Any Questions?

