INDEPENDENT CITIES
RISK MANAGEMENT
AUTHORITY

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ICRMA
Net Asset Policy

August 12, 2021

Change Record

Date	Description
10/19/2011	Initial approval of the policy by the ICRMA Board
03/01/2018	As part of the Governing Documents project, ICRMA worked to align its various policy documents and ensure that the right content was in the right place without unnecessary repetition. The original Net Asset policy did not contain the calculation language but rather referred to the bylaws for this detail. The change approved March 1, 2018 placed the calculation details into the policy document. At the same time, the bylaws approved that day removed the provisions providing details re calculation of dividends and bylaws. The revised net asset policy went into immediate effect following approval.
08/12/2021	The Net Asset Policy was amended to account for the Property and Auto Physical Damage Programs and to address other technical corrections.

A. Introduction

This policy and procedure document shall be treated as one of **ICRMA's Governing Documents** and, as such, shall have the same effect as the **Joint Exercise of Powers Agreement for Insurance and Risk Management Purposes (Agreement)**, the **ICRMA Bylaws (Bylaws), the Program Underwriting & Policy Manual (Policy Manual)** and **Memoranda of Coverage (MOC's) relating to ICRMA's pooled programs for liability, workers' compensation, property, and auto physical damage**.

If any provision of this document conflicts with the **Agreement**, the **Bylaws, the Policy Manual,** or **MOC's,** the then current version of those documents govern whenever approved.

B. Purpose

1. The purpose of this policy statement is to give guidance to the Board in making annual funding, dividend and assessment decisions for the ICRMA pooled liability, workers' compensation, property, and auto physical damage programs. By adoption of this policy statement, the Board acknowledges the long-term financial strength of the ICRMA pooled program is paramount.

2. The Board relies heavily on actuarial estimates when making financial decisions. Such estimates, though professionally developed, contain uncertainty due to the random nature of claims, ICRMA's significant "Self-Insured Retention" levels, possible data errors, inaccurate case reserves, and other unknowns. Accordingly, the Board desires to fund the ICRMA pooled programs in a cautious and prudent manner and return ""Equity"" to its Members in an equally cautious and prudent manner. ICRMA seeks to conservatively fund the outstanding liabilities of its pooled programs and maintain "Net Assets" sufficient to absorb substantial fluctuations in actuarial estimates.

3. To fund future program years in a fiscally prudent manner, ICRMA collects contributions at an actuarially determined "Probability Level" as determined by the Board, annually. The Board strives to annually collect at the 70% "Probability Level" or higher for the **liability program,** the 80% "Probability Level" or higher for the **workers compensation program**, and the 70% "Probability Level" or higher for the **auto physical damage program** as determined by the actuary. The Board strives to annually fully-fund the aggregate stop loss attachment point in the **property program** or collect at the 70% "Probability Level" or higher for program years in which no aggregate stop loss is purchased.

4. In addition, as provided in the ICRMA governing documents, dividends may be declared and paid solely at the discretion of the Board provided that the "Net Assets" of the program plus the reserves for unpaid losses, after dividend, equals or exceeds a 90% "Probability Level" (discounted for the liability program and undiscounted for the workers' compensation, property, and auto physical damage programs).

5. Nothing in this policy statement shall be applied or construed to require or mandate the Board to return "Equity" to the members in any particular year. Rather, the Board retains sole discretion and authority to determine from year-to-year whether to return "Equity" as set forth in this policy statement and **ICRMA's Governing Documents,** as well as how much "Equity" to return.

C. Definitions

1. "**Claims Paid to Date**" is the amount actually paid on reported claims at the date of valuation. "Claims Paid to Date" includes those amounts paid for both defense and indemnity of claims.

2. "**Equity**" or "**Net Assets**" is the amount of assets remaining, after deducting all liabilities, including liabilities for unpaid losses discounted for investment income and estimated at the actuarially determined "Expected" or "Central Estimate" ""Probability Level"".

3. "**Expected**" by industry standard translates roughly to the 50% to 56% ""Probability Level"" as determined by the independent actuary.

4. "**Expected Liabilities**" is the total of all "Outstanding Reserves", "IBNR", discounted, at the "Expected" ""Probability Level"" and "ULAE".

5. "**Incurred But Not Reported (IBNR)**" is the estimate of the funds needed to pay for covered losses that have occurred but have

not yet been reported to the member and/or ICRMA. “IBNR” includes (a) known and unknown loss events that are expected to be claims; and (b) expected future development on claims already reported.

6. “**Net Contribution**” includes the total contributions from Members less the excess insurance cost.

7. “**Net Present Value**” is the discounting of future cash flows to current values by taking into account the time-value of money.

8. “**Probability Level**” is a statistical term used to express the degree to which an actuarial projection (usually “Ultimate Net Loss”) will be sufficient in predicting the dollar losses ultimately paid for a given program year or combination of years. The higher a “Probability Level” the greater certainty the actuary has that losses will not exceed the dollar value used to attain that “Probability Level.”

9. “**Self-Insured Retention**” is the maximum amount of exposure to a single loss retained by ICRMA.

10. “**Outstanding Reserves**” are the sum total of unpaid case reserves in the “Self Insured Retention” as determined by the ICRMA Claims Manager.

11. “**Ultimate Net Loss**” is the sum of “Claims Paid to Date”, “Outstanding Reserves”, and “IBNR”, all within ICRMA’s “Self Insured Retention”. It is the estimate of the total value of all claims that will ultimately be made against Members for which ICRMA is responsible.

12. “**Unallocated Loss Adjustment Expenses (ULAE)**” are settlement expenses that cannot be attributed to the processing of a specific claim.

D. Important Net Asset Ratios

Annually, the Board shall review calculations tied to a variety of net asset ratios to assist in evaluating the fiscal strength of ICRMA’s programs, by program year or a combination of program years. The financial ratio targets shown below, generally establish the baselines from which ICRMA’s pooled programs should operate. Ratios falling outside of a target range do not necessarily indicate that a program, a program year or combination of program years is in financial trouble. It should also be noted that net asset ratio targets may reasonably vary by program, depending upon the length of the tail of liability characterized by each.

Among the ratios/targets that the Board shall review annually and may consider prior to authorizing a return of “Equity” or imposing an assessment for the liability and workers’ compensation programs are the following:

1. **“Net Contributions” to “Net Assets” ratio: Target ≤ 2:1.** This ratio is a measure of how “Net Assets” compare to the rate at which the pool is taking on risk (or growing), measured by the current annual volume of contributions, less contributions passed through to reinsurers or insurers. A low ratio is desirable.

2. **“Outstanding Reserves” to “Net Assets” ratio: Target ≤ 3:1.** This ratio is a measure of how “Net Assets” are leveraged against possible reserve inadequacies. A low ratio is desirable.

3. **“Net Assets” to “Self Insured Retention” ratio: Target ≥ 5:1.** This ratio measures how conservative the “Net Asset” position is by virtue of how many retained occurrences the “Net Asset” amount could absorb. A high ratio is desirable.

4. **Reserve Development: Target ≤ 20%.** This is a measure of the change in aggregate ultimate losses from one valuation period to the prior valuation(s). Generally, the one-year and two-year reserve development to “Equity” threshold should be less than 20%. A low ratio is desirable.

5. **Change in “Net Assets”: Target ≥ -10%.** This ratio measures the stability “Net Assets,” from recent events. A decline in excess of 10% may signal a new adverse trend and warrant consideration of more conservative financial decisions in the near term. A positive or low-negative ratio is desirable.

E. Calculating Dividends & Assessments

1. **Criteria** – After annual review of the “Net Asset” position of the pooled programs, the program years to be adjusted and the net asset ratios, the Board will determine whether it is desirable to increase, decrease, or stabilize “Net Assets” for each pooled program If the Board desires to decrease “Net Assets,” by returning “Equity” to the Members, it will not return funds from any given program year that will cause the funding of the program as a whole to fall below the 90% “”Probability Level””.

2. **Definition & Limitations** – Dividends and assessments are defined and their limits spelled out in **ICRMA's Bylaws Article XIII.H and Article XIII.I, respectively**.

3. **Dividends**
   a. ***Availability –*** The Board may declare dividends **ONLY** when funds available to a specific program exceed those available to pay for "Outstanding Reserves," "IBNR," "ULAE" and unrestricted surplus. Specifically, dividends are available to be declared **ONLY** at such time as the program has "Equity", with liabilities actuarially stated on an undiscounted basis for workers' compensation, property and auto physical damage and on a discounted basis for liability and at a 90% "Probability Level".

   With regard to the property and auto physical damage programs, for any program (or program year) that does not have an actuarially-determined funding basis, the Board may declare a dividend, if:
      i. The program year's coverage period incepted not less than thirty-six (36) months previously; AND
      ii. An accountant, auditor or other financial services provider advises that the "Net Assets" of a program year, or the program as a whole, far exceed the expected undiscounted incurred losses; **OR**
      iii. Facts or circumstances appear such that the Board concludes that failure to declare a dividend would be fiscally imprudent.

   b. ***Calculation –*** The first dividend calculation for the liability and workers' compensation programs may be performed five (5) years after the end of the program year. Additional calculations may be made each year thereafter until such time as the program year is closed. The first dividend calculation for the property and auto physical damage programs may be performed two (2) years after the end of the program year. Additional calculations may be made each year thereafter until such time as the program year is closed.
      i. The calculated amount represents the maximum dividend available to be declared.
      ii. This amount shall be reduced if the two (2) succeeding years (after the fifth program year for liability and workers' compensation and after the second program year for property and auto physical damage reaches eligibility) have negative "Equity", with liabilities actuarially stated at an "Expected" "Probability Level".
      iii. Each Member's share of any dividends shall be allocated based upon the method by which the contributions were collected, beginning with the oldest program year.
      iv. However, until the last claim of a program year has been paid and the program year has been closed, the program year must maintain sufficient funds to satisfy the 90% "Probability Level" funding requirement (discounted for the liability program and undiscounted for the workers' compensation, property, and auto physical damage programs).

   c. ***Distribution*** – Each Member's share of any dividends shall be allocated based upon the method by which the deposit contributions were originally collected. However, until the last claim of a program year has been paid and the program year has been closed, the program year must maintain sufficient funds to satisfy the 90% "Probability Level" funding requirement (discounted for the liability program and undiscounted for the workers' compensation, property, and auto physical damage programs).

   "Equity" from the risk-sharing layer may be exchanged between eligible program years if sufficient funds are available. The transfer of "Equity" will be performed so that the individual Member's share of "Equity" is separately applied so as to maintain the integrity of each Member's balance.

4. **Assessments**
   a. **Availability** – The Board may assess amounts deemed necessary and approved by the Board as sufficient to ensure that the claims payment obligations of the pool are consistently met. The Board may levy assessments on the participants of any program year(s) when:
      i. It is determined by the actuary that any program year or the program as a whole is no longer actuarially sound; **OR**
      ii. An accountant, auditor and/or other financial services provider advises that the assets of a program year, or the program as a whole, do not meet the "Expected" discounted/undiscounted losses; **OR**
      iii. Facts or circumstances appear such that the Board concludes that levying an assessment would be fiscally prudent.

   In addition, the Board reserves the right to assess the Members of any program an amount determined by the Board to be necessary for the soundness of the program and to allocate such assessment to the Members in a fair and equitable manner.

   b. ***Calculation*** – There is no requirement that the program year be closed prior to making an assessment.
      i. Each Member's share of the assessment shall be allocated based upon the method by which the annual contributions were collected for the risk-sharing layer of each program year being assessed.
      ii. If such assessment is not sufficient to relieve the pool of its deficit, in the year of the assessment, as determined by section E.4.a. above, such assessment shall be levied each subsequent year until the deficit is resolved.

c. ***Implementation*** – The Board determines the timing of the payment at the time the assessment is levied. The calculation of interest and/or penalties to be assessed on late payments is defined by **ICRMA's Bylaws**.

F. Amendment

Unless otherwise specified all financial policies**,** approved by the Board**,** shall be reviewed and reaffirmed or modified <u>at least once every three (3) years.</u>