Vector Control Joint Powers Agency (VCJPA)
Target Equity/Return of Equity Policy Statement

I. PURPOSE.

The purpose of this policy statement is to give guidance to the Board of Directors in making annual funding, dividend, and assessment decisions for the VCJPA program. By adoption of this policy statement, the Board of Directors acknowledges the long-term financial strength of the VCJPA program is of utmost importance.

The Board of Directors acknowledges there is a high degree of uncertainty in the annual actuarial estimates due to the possibility of occasional catastrophic claims and inconsistent or inaccurate case reserving; therefore, the Board of Directors desires to fund the VCJPA program in a cautious and prudent manner and return equity to its members in an equally cautious and prudent manner. It is the policy of VCJPA to conservatively fund its programs to maintain sufficient assets to pay all losses and avoid substantial fluctuations to contributions.

In order to fund program years in a fiscally prudent manner, the VCJPA Board of Directors collects contributions at an actuarially determined confidence level as determined by the Board annually. The VCJPA Board of Directors strives to annually collect at the 80 percent (80%) confidence level or higher as determined by the actuary.

In addition, as provided in the VCJPA governing documents, dividends may be declared and paid solely at the discretion of the Board after a program year is at least four (4) years old for the Pooled Liability Program (PLP) and funded at least at the 90 percent (90%) "Confidence Level"; and at least five (5) years old for the Pooled Workers' Compensation Program (PWCP) and funded at least at the 90% "Confidence Level".

Nothing in this Policy Statement shall be applied or construed to require or mandate the Agency Board of Directors to return Equity to the members in any particular year. Rather, the Board of Directors retains the discretion and authority to determine from year-to-year whether to return Equity based on the principles and policies in this Policy Statement and Agency governing documents. If there is any conflict between a provision in this Policy Statement and a provision in the Agency governing documents (i.e., Joint Powers Agreement, Bylaws, Master Plan Documents, Memoranda of Coverage), the governing documents shall prevail.

II. DEFINITIONS.

- "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.

- "Confidence Level" is a statistical term used to express the degree to which an actuarial projection (usually "Ultimate Net Loss" or "IBNR") 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 has that losses will not exceed the dollar value used to attain the expected "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".

- "Expected Liabilities" is the total of all "Outstanding Reserves" and "IBNR", discounted, at the "expected" confidence level, which by industry standard translates roughly to the 50% to 56% "Confidence Level" as determined by the independent actuary.

- "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 VCJPA. "IBNR" includes (a) known and unknown loss events that are expected to be claims; and (b) expected future development on claims already reported.

- "Net Contribution" includes the total contributions from members less the excess insurance cost.

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

- "Outstanding Reserves" are the sum total of unpaid case reserves in the "Self Insured Retention" as determined by the VCJPA Litigation Manager.

- "Self Insured Retention" is the maximum amount of exposure to a single loss retained by VCJPA.

- "Ultimate Net Loss" is the sum of "Claims Paid to Date", "Outstanding Reserves" and "IBNR" all within VCJPA's "Self Insured Retention". It is the estimate of the total value of all claims that will ultimately be made against members for which VCJPA is responsible.

III. IMPORTANT EQUITY RATIOS.

The VCJPA Board of Directors will evaluate and consider whether the following ratios remain appropriate for the group prior to and following any potential return of "Equity":

“Net Contribution” to “Equity” ratio: Target ≤ 2:1
This ratio is a measure of how “Equity” is leveraged against possible pricing inaccuracies. A low ratio is desirable.

“Outstanding Reserves” to “Equity” ratio: Target ≤ 3:1
This ratio is a measure of how “Equity” is leveraged against possible reserve inaccuracies. A low ratio is desirable.

“Equity” to “Self Insured Retention” ratio: Target ≥ 5:1
This ratio is a measure of the maximum amount that “Equity” could decline due to a single loss. A high ratio is desirable.

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%. NOTE: This factor will not be evaluated until the group has at least six (6) years of actual loss experience.

Change in Equity: Target ≥ -10%
This ratio measures if a decline in equity in excess of 10 percent (10%) warrants an increase in annual contribution or an assessment.

IV. ANNUAL ACTUARIAL STUDY. VCJPA will conduct an annual actuarial analysis to assist the Board of Directors in making funding decisions on a prospective and retrospective basis.

V. RETROSPECTIVE RETURN OF EQUITY CRITERIA. After annual review of the “Equity” position of the program as a whole, the program years to be adjusted and the important ratios, the Board of Directors will determine whether it is desirable to increase, decrease, or stabilize “Equity”. If the Board desires to decrease “Equity”, by returning “Equity” to the members, it will not return funds from any given program year that will cause the given PLP or PWCP program year to fall below a 90% “Confidence Level”

Return of “Equity” may be available from the “closing” of a year in accordance with the Bylaws.

VI. AMENDMENT. This policy statement approved by the Board on March 9, 2012, shall be reviewed and reaffirmed or modified at least once every three years.

Appendix A
Applicable VCJPA Governing Documents Sections

The VCJPA Pooled Liability Program Master Program document, Article III, Sections D & E state the following:

D. ACTION REQUIRED WHEN A **PROGRAM YEAR** IS FOUND TO BE ACTUARIALLY UNSOUND

1. ACTIONS

(a) The Administrator shall determine the actuarial condition of each **program year**.

(b) If the PLP, as a whole, is found not to be **actuarially sound**:

i. Each participating **Member District** in the unsound **program year**(s) shall be assessed its pro rata share of the total funding necessary to make the PLP, as a whole, **actuarially sound**.

ii. Each **Member District's** share shall be calculated as that percentage of the amount needed to make the **program year actuarially sound** which is equal to the **Member District's deposit premium** for the **program year** as it relates to the total **deposit premiums** for the **program year**.

iii. Each **Member District** shall have the amount of its assessment added to its **deposit premium** amount for the **program year** that is being augmented. Future retrospective adjustments to this **program year** shall use the combined contributions by the **Member Districts** affected as the amount of **deposit premium** from which such reconciliations are calculated.

(c) If the PLP, as a whole, is **actuarially sound**, the **Board of Directors** may assess any **program year** that is found to be actuarially unsound. If the **Board of Directors** does not assess an actuarially unsound **program year**, the Administrator shall determine the amount of interest that would have been earned on the funds of the other **program years** had the deficient **program year** been adequately funded. The difference between the amount of interest actually earned and the amount that could have been earned shall then be charged against the deficient **program year** and allocated to the other **program years**.

E. PRIMARY POOL RETROSPECTIVE ADJUSTMENT

1. TIMING

(a) Four years after the end of the **program year**, the first retrospective adjustment shall be performed. Each year thereafter, there shall be an additional retrospective adjustment made until such time that the **program year** is closed.

2. CALCULATION

(a) Account balances for each **Member District** for the **program year** are calculated as follows:

i. Each **Member District** is credited for the PLP **deposit premium** paid for that **program year**; assessments paid, if any, for that **program year**; and any previous retrospective adjustments paid by the **Member District** for that **program year;** plus the interest earned on the account balance during the period since the **deposit premium** was made. This amount constitutes the total amount credited to the **Member District's** account.

ii. The **Member District's losses** incurred within the **Member District's retained limit** and the **Member District's** portion of the **losses** shared with other **Member Districts** in the primary pooling portion of the PLP are then determined. The shared **losses** are allocated to each participant in the same proportion as each **Member District's** relative risk distribution is to the total relative risk distribution of all the **Member Districts** participating in that layer. At the discretion of the **Board of Directors**, the relative risk distribution formula may be adjusted for experience.

iii. Once the incurred **losses** for the **Member District** and the **Member District's** shared **losses** have been calculated for each of the pool layers, the total is subtracted from the **Member District's** account.

iv. Next, the **Member District's** share of the **administrative expenses**, including excess coverage and **claims** handling expenses, and the **deposit premiums** for the Mid-Layer and Aggregate Pools are subtracted from the account. The claims handling fees for each **program year** shall be distributed to the **Member Districts** on a pro rata basis allocated on the basis of deposit premium.

v. Finally, an allowance for Incurred But Not Reported (IBNR) Reserve is subtracted from the account based on the amount determined by the actuarial study.

(b) Upon completion of the calculation described above, if there is a negative balance in a **Member District's** individual account, the **Member District** shall be billed for that deficiency. Any positive balance will be refunded to the **Member District** except as stated in Article VIII, Section C.3.

The VCJPA Pooled Workers' Compensation Program Master Program document, Article I, Section K states the following:

1. <u>PREMIUMS, ASSESSMENTS, AND RETROSPECTIVE ADJUSTMENTS</u>

a. **Deposit premiums** shall be established and charged to the individual **Member Districts** such that, with the addition of funds raised from other sources, there shall be sufficient funds to meet expected losses and other expenses.

b. Bonds or other debt instruments may be used by the **Agency** to fund, in whole or in part, the expected losses and expenses for one or more **Program Years**.

c. The **deposit premiums** may be used to fund or pay premiums in connection with any coverage component of the PWCP or may be applied as contributions of the **Member Districts** to pay principal of, premium on, and interest on one or more series of bonds issued by the **Agency** to fund, in whole or in part, any coverage component of the PWCP to pay administrative costs of the PWCP and to purchase excess workers' compensation and employer's liability coverage. The application of any portion of the **deposit premiums** to pay debt service on bonds issued by the **Agency**, as provided in this paragraph (c), shall be determined by Resolution of the membership at a regular or special membership meeting, upon not less than two-thirds (2/3) vote of the individual representatives present and voting.

d. There shall be annual retrospective adjustments beginning the fifth year after the **end of the Program Year**, and ending when all **claims** are closed and new **claims** are highly improbable.

e. Assessments shall be made when the PWCP as a whole is found to be actuarially unsound. Assessments, at the discretion of the **Board of Directors**, may be made against actuarially unsound **Program Years** even though the PWCP as a whole is **actuarially sound**. Each **Member District** participating in a deficient **Program Year** shall be assessed in the same relationship as their **deposit premiums** for the year relating to the total premiums for that year.