

Pool Finance, Tigers and Bears...Oh My!

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Pool Finance

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Topics

BUDGETING

It all starts with a plan, or budget. What are the key components of a Pool budget?

PREMIUM & REINSURANCE

Every Pool's primary source of revenue is insurance premiums, or member contributions. Know the difference between "gross" and "net" premiums, and how reinsurance plays a role.

CLAIMS EXPENSE

The largest – and most uncertain – Pool expense is Claims Expense. Pretty straight forward? Not quite – enter actuarial science.

INVESTMENTS

Investment income is a crucial component of a Pool's finances. Understand how investment income can make or break your financial year.

SURPLUS & FINANCIAL STRATEGY

Surplus, or net position, is the historical accumulation of how much revenues have exceeded expenses. How each Pool uses surplus is part of financial strategy.

FINANCIAL STATEMENTS

How did we do? Financial statements answer this key question. Learn how to read the key components and understand results.

KEY TERMS

CLAIMS RESERVES

The unpaid amount (or liability) of the Pool's claims. While it is a liability, it is also an asset as it is included in the Pool's investments.

DIVIDEND

Return of premium to members.

NET INCOME

Total Revenues (both Operating and Non-Operating) less Total Expenses.

PREMIUM

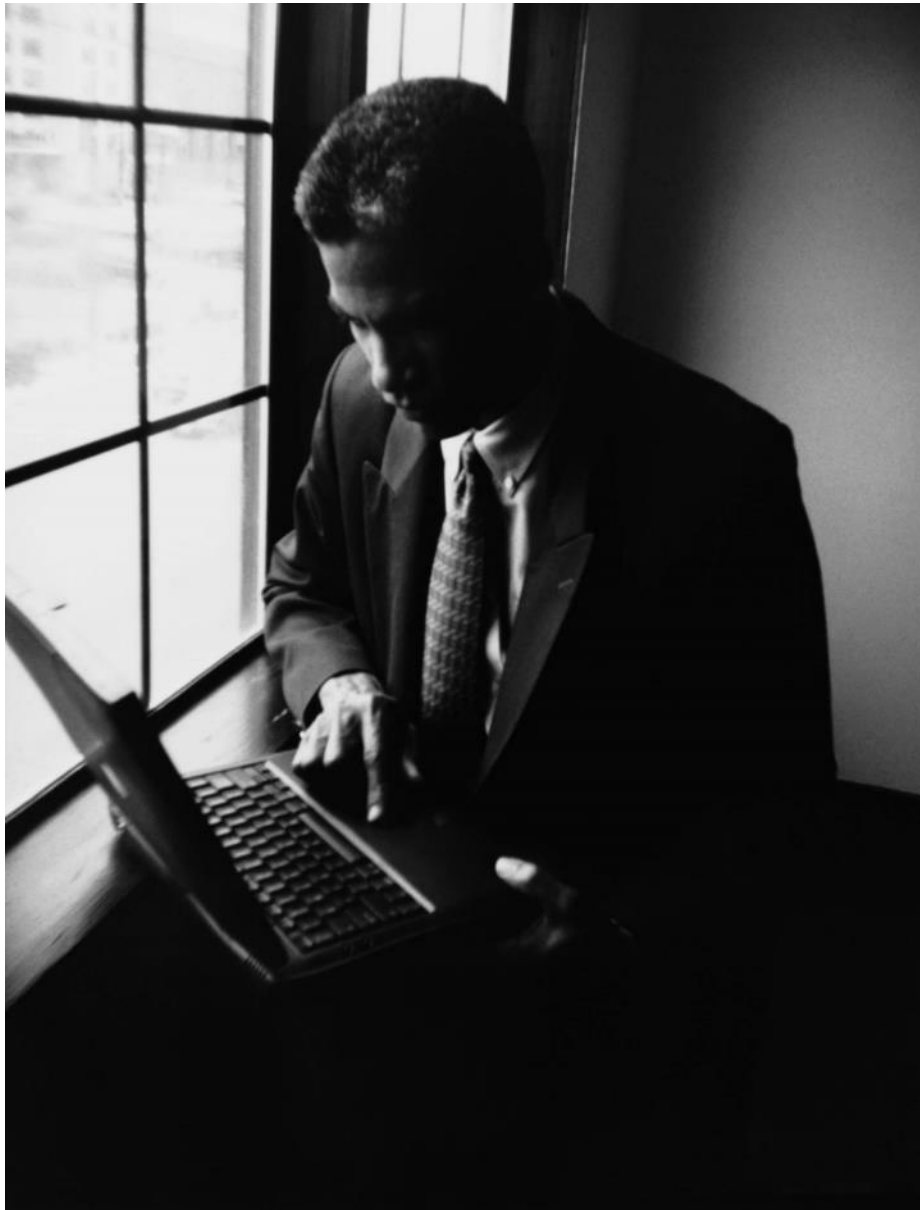
“Gross” premium is the total amount of premium (or “contributions”) collected from members. “Net” premium is the amount of premium retained by the Pool. $\text{Net premium} = \text{Gross premium} - \text{Ceded Reinsurance premium}$, or the amount of premium the Pool pays to its reinsurers to transfer risk.

REINSURANCE

Insurance for insurance companies. Used to transfer risk.

SURPLUS

Also known as Net Position, it is the accumulation of Net Income over time. It can also be calculated as $\text{Total Assets} - \text{Total Liabilities}$.



BUDGETING

DIFFERENT FROM MUNICIPAL BUDGETS

Unlike many municipal budgets, many Pool budgets are not balanced. It is common for budgeted income to be negative or positive.

BASED ON RATES YOU SET

The Pool's budgeted revenues will largely depend on the insurance rates established by the Board of Trustees.

WHAT'S THE STRATEGY

The budget tells you what the Pool's strategy is. Is the Surplus more/less than adequate? How important is Investment Income to year-end results?

BUDGET EXAMPLES

	Positive Net Income	Negative Net Income	Percent of Total
Revenues:			
Gross Premium (Contributions)	100,000,000	90,000,000	
Investment Income	5,000,000	5,000,000	
Total Revenues	105,000,000	95,000,000	
Expenses:			
Claims Expense	60,000,000	60,000,000	60%
Reinsurance	10,000,000	10,000,000	10%
Administration	20,000,000	20,000,000	20%
Other	10,000,000	10,000,000	10%
Total Expenses	100,000,000	100,000,000	
Net Income	5,000,000	(5,000,000)	

Claims Expense +
Reinsurance expenses =
70-75% of total expenses

Administration and Other
expenses typically =
25-30% of total expenses

Strategy: Premiums to cover expenses.
Investment Income is “gravy” and surplus
growth strategy.

Strategy: Spending surplus to offset rates,
improve services, or member dividends.

BUDGET EXAMPLES

Positive Net Income	
Revenues:	
Gross Premium (Contributions)	100,000,000
Investment Income	5,000,000
Total Revenues	105,000,000
Expenses:	
Claims Expense	60,000,000
Ceded Reinsurance	10,000,000
Administration	20,000,000
Other	10,000,000
Total Expenses	100,000,000
Net Income	5,000,000

Gross Premium	100,000,000
Ceded Reinsurance	<u>(10,000,000)</u>
Net Premium	90,000,000

Gross Premium is the total premiums anticipated to be collected from members, which is based on insurance rates.

Ceded Reinsurance is the insurance expense purchased to protect the Pool from catastrophic losses. The more risk the Pool retains, the lower the reinsurance (and vice-versa).

Net Premium is the Pool's retained premium after paying reinsurance.

MORE ON REINSURANCE

LIABILITY

\$1,000,000

Member's Per-Claim Limit

Reinsurer's Share =
\$750,000 xs \$250,000

Pool's Share (or Retention)
\$250,000

REINSURANCE

Reinsurance, put simply, is insurance for insurance companies.

Designed to protect Pools from catastrophic loss.

Also referred to as Excess of Loss Insurance or Stoploss Insurance.

Can be 100% pass-through, like Cyber reinsurance.

RETENTION

A Pool's retention is the dollar threshold amount, usually per claim, where the Pool transfers the risk to a reinsurer.

The selection of the retention largely depends on the line of coverage (Workers Compensation vs. Liability vs. Health), as well as the Pool's surplus position.

Retentions should increase over time due to inflation, especially for Health insurance.

BUDGET EXAMPLES

	Positive Net Income	Negative Net Income	Percent of Total
Revenues:			
Gross Premium (Contributions)	100,000,000		
Investment Income	5,000,000		
Total Revenues	105,000,000		
Expenses:			
Claims Expense	60,000,000		
Ceded Reinsurance	10,000,000		
Administration	20,000,000		
Other	10,000,000		
Total Expenses	100,000,000		
Net Income	5,000,000		

Pools are in the insurance business, so naturally the largest expense is Claims Expense.

Claims Expense represents only the portion of losses retained by the Pool.

Losses that impact the Pool's reinsurers are not captured on the Pool's financials. Rather, these losses are captured on the reinsurer's financials.

HOW IS CLAIMS EXPENSE CALCULATED?

Short Answer: by the Pool's Actuary (usually independent)

Full Story:

The Actuary analyses historical claim estimates by the Pool's claims adjusters and compares those estimates to the final claim payments. The Actuary then “develops” the known losses using a factor based on the historical analyses. Finally, the Actuary adds in an IBNR (Incurred But Not Reported) estimate for claims that have not yet been reported to the Pool.

CLAIMS DEVELOP OVER TIME

WORKERS COMPENSATION

On December 15, 2024, a Police Officer injurs his knee during foot pursuit of a suspect while jumping over a fence. Medical costs for knee surgery are anticipated to be \$15,000 and the officer is anticipated to be out of work for six weeks.

Initial Claim Estimate of \$22,000:

Medical Costs	\$15,000
Lost Time Wages	7,000

The officer begins experiencing back pain in early January 2025, which was not present before the incident. Additionally, the first knee surgery did not correct the injury and another knee injury becomes necessary in February.

The second knee surgery is more complex and will cost \$25,000 in medical costs. Back pain treatment for 6 weeks will cost \$3,000. Now, the officer is not expected to return to work until March 31, 2025.

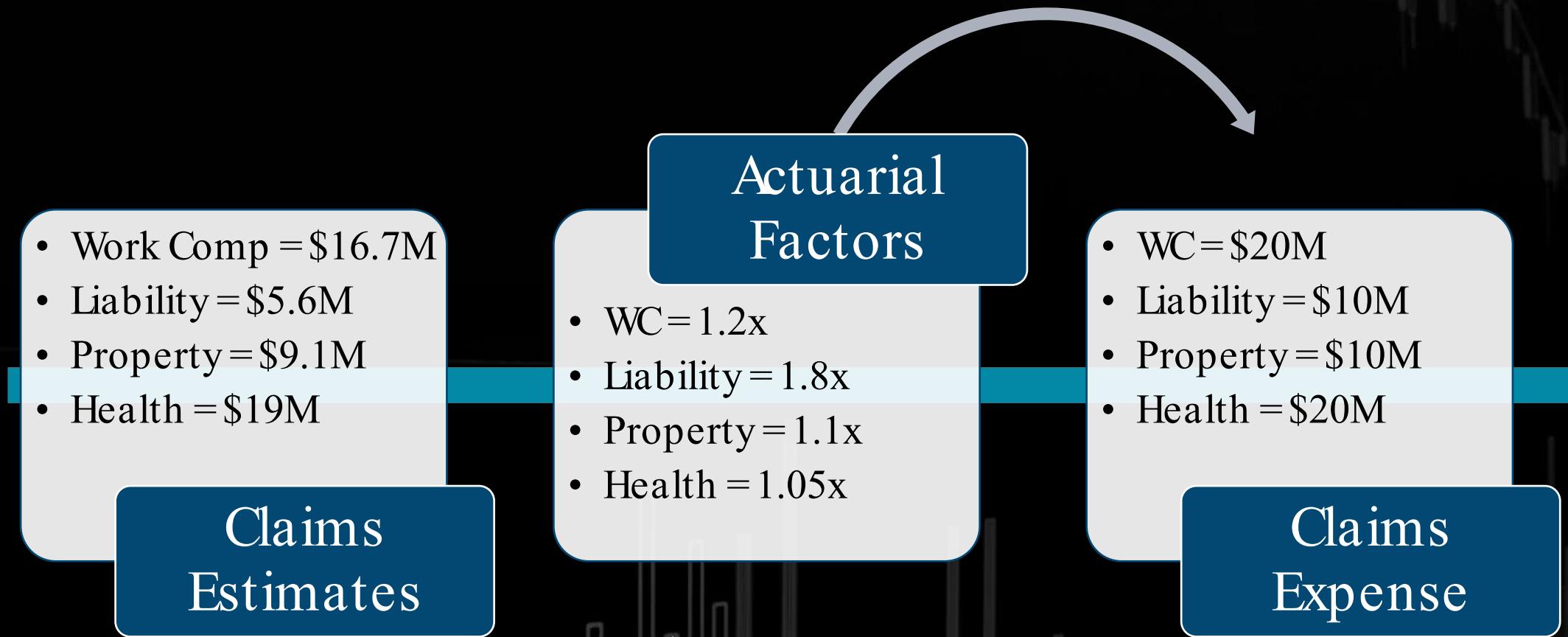
Revised Claim Estimate of \$58,000:

Medical Costs	\$40,000
Lost Time Wages	18,000

The Pool's policy and financial year is Jan 1 – Dec 31 (calendar year).

The claim estimate for the 2024 year of \$22,000, while accurate at year-end, is now going to cost 264% more.

This type of **claim development is natural** and inherent to the nature of injuries.



\$50,400,000 of Claims Estimates becomes \$60,000,000



INVESTMENTS

INVESTMENT POLICY

Set by the Board, the policy governs the Pool in allowable investments and allocation thresholds. Some Pools only invest in Fixed Income (Bonds), and others further diversify to Equities (Stocks).

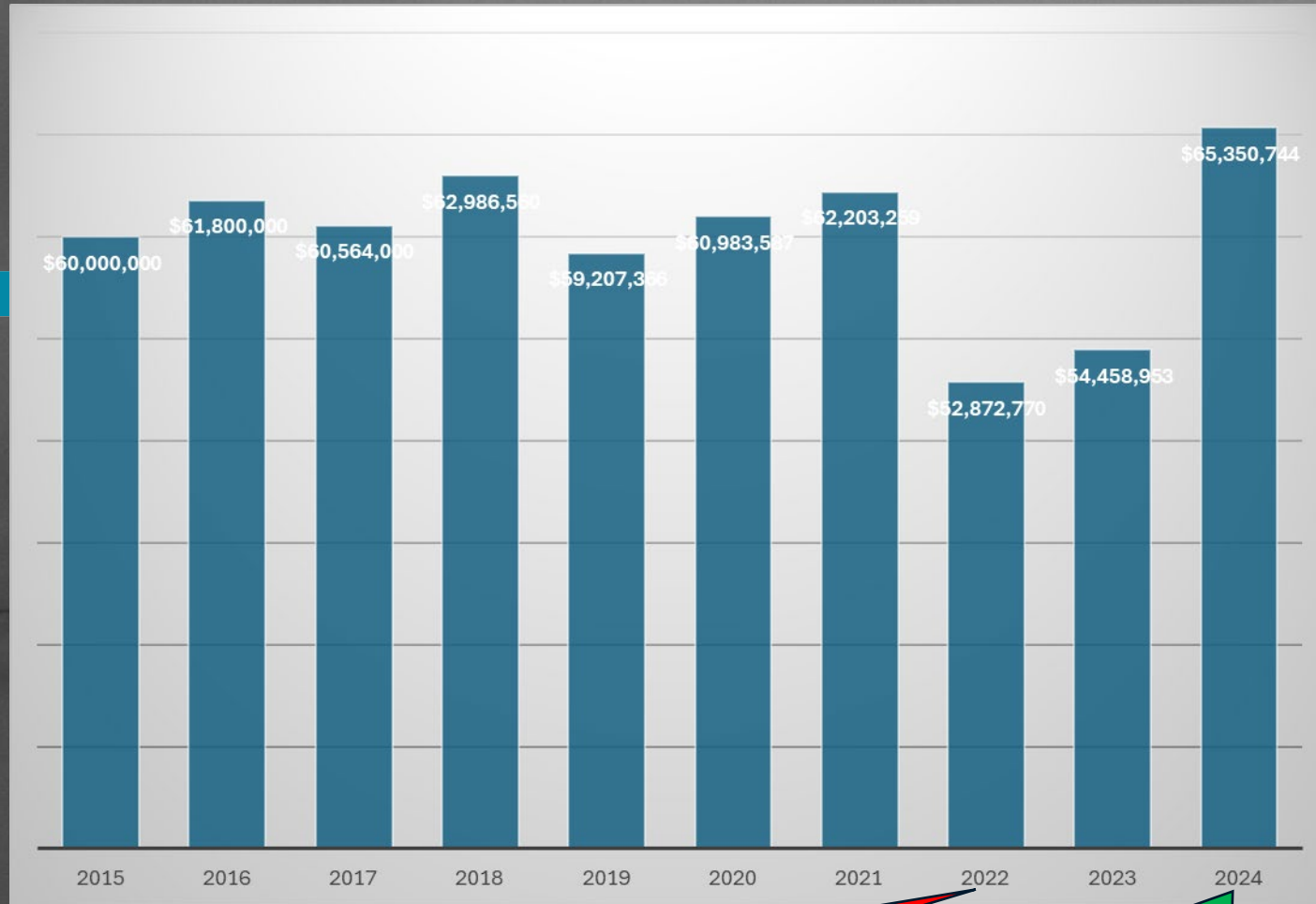
WHAT'S BEING INVESTED

Because of claims development, premiums collected in one year will not be needed immediately to pay the full amount of claims for many years to come. This “float” on premiums, along with the Pool’s surplus, is invested in markets and yields a return.

MAKE OR BREAK THE YEAR

Many Pools factor in a conservative rate of return for investments when contemplating rates and, in turn, premiums. This means that Premiums + Investment Income are anticipated to cover claims expenses. A good (or bad) investment market can make (or break) your financial year. Think of 2022 versus 2024.

SURPLUS



Surplus is also known as “net position” and is the accumulation of revenues in excess of expenses (or net income).

Surplus will be volatile over time. Claims activity and investment markets cannot be predicted with certainty.

Unfavorable investment year, primarily due to rising interest rates impacting Fixed Income market.

Strong investment year for both Fixed Income and Equity markets.

SURPLUS STRATEGY

Using Membership Capital to Help Members

OFFSET RATES

Using surplus to offset rate increases to members. Can be dangerous in the long-term, as “catching up” to actuarially sound rates compounds each year.

IMPROVE SERVICES

Add or enhance member programs and services, including loss prevention; additional coverages; safety grants; higher limits; etc.

INCREASE RETENTIONS

With surplus growth, a Pool may re-consider the risk it retains vs. passes to reinsurers. Over time, retaining risk leads to further surplus growth.

Surplus may also be used to support Dividend programs, where a designated amount of premium is returned to members.

A black and white photograph of a person's hands typing on a laptop keyboard. The person is wearing a dark long-sleeved shirt. A white cup is visible in the background. The laptop is on a wooden surface.

FINANCIAL STATEMENTS

Pool financial statements not only show you how well the Pool performed against the budget, but also can inform you on the financial strategy of the Pool.

Let's take a look...

BALANCE SHEET

	2023	2024	\$ Change
Assets:			
Investments	19,500,000	23,500,000	4,000,000
Other Assets	1,500,000	2,500,000	
Total Assets	21,000,000	26,000,000	
Liabilities:			
Claims Reserves (<u>Current</u>)	3,800,000	4,600,000	
Claims Reserves (<u>Noncurrent</u>)	8,100,000	8,500,000	
Other	800,000	1,300,000	
Total Liabilities	12,700,000	14,400,000	
Total Net Position (Surplus)	8,300,000	11,600,000	3,300,000

Here, Investments growth drove Surplus growth. Without it, Surplus would have decreased from year-to-year.

Current Claim Reserves is the portion of reserves expected to be paid in one year. Noncurrent reserves is greater than one year. The two numbers combined is the Pool's total claim liability.

[Total Assets] – [Total Liabilities] = Net Position (“Surplus”)

If the Pool were to shut down operations at FYE 2024, there would be \$11.6m remaining after paying out claims

INCOME STATEMENT

		2023	2024	\$ Change
Operating	Operating Revenues:			
	Gross Premium (Contributions)	7,700,000	8,900,000	1,200,000
	Other	10,000	10,000	
	Total Operating Revenues	7,710,000	8,910,000	1,200,000
	Operating Expenses:			
	Claims Expense	4,300,000	4,500,000	200,000
	Reinsurance	1,200,000	1,400,000	200,000
	Administration	2,400,000	2,600,000	200,000
	Other	100,000	100,000	-
	Total Operating Expenses	8,000,000	8,600,000	600,000
Non-Operating	Operating Income / (Loss)	(290,000)	310,000	
	Total Non-Operating Revenues (Investment Income)	1,000,000	3,100,000	2,100,000
	Net Income (Surplus Change)	710,000	3,410,000	

The Income Statement is organized like the Budget, except it is organized into “Operating” (< 1 yr) vs. “Nonoperating” (> 1 yr).

Operating Income shows how well the Pool performed without reliance on Investment Income.

Non-Operating Revenues (or Investment Income) can be significant to overall Net Income results. Here, Investment Income represented 141% and 91% of Net Income for 2023 and 2024, respectively.

Imagine if Net Income was (3,100,000) for 2024. Net Income = (2,790,000).

Summary

BUDGETING

Demonstrates your Pool's plan and strategy for the upcoming fiscal / policy year, and the reliance on Investment Income for overall results.

PREMIUM & REINSURANCE

Setting rates and premium adequacy are crucial to operating results. Reinsurance spend, and corresponding retentions, are also key to balancing risk transfer and surplus utilization.

CLAIMS EXPENSE

Claims expense cannot be predicted with certainty. Claim development is normal. Some years, your Pool's expected loss experience will be better than forecasted; other times, it will be worse than forecasted.

INVESTMENTS

Investment earnings on your Surplus and Claims Reserves, known as Non-Operating Income, is key to your overall results. Investment income can make or break your financial year.

SURPLUS

Overall, Surplus will be volatile each year but should grow over time. Surplus can be used to increase retentions, enhance member services, offer dividends, and offset rates (carefully).

FINANCIAL STATEMENTS

Understanding your financial statements can help you (a) identify the Pool's Operating vs. Non-Operating performance and (b) compare actual results to your budget.