ABAG PLAN Corporation
Funding Policy
Adopted May 22, 2002
Revised May 19, 2004
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1.0 Policy

It is the policy of the ABAG PLAN Corporation (PLAN) to prudently fund its programs to maintain sufficient assets to pay all losses, avoid substantial fluctuations in assets or deposits, and provide risk management services tailored to each member. We will achieve this through the most efficient mix of insurance, self-insurance and risk management resources.

2.0 Scope

This funding policy applies to activities of the PLAN with regard to funding the financial assets of the Liability Program. Terms with special meaning are defined in the “Definitions” section of this policy.

3.0 Objectives

It is the objective of this policy to provide a system which will accurately monitor and forecast losses and funding levels so that the PLAN can maintain sufficient assets to meet its obligations. Funding of the programs will be in accordance with sound actuarial methods and management principles with the following priorities:

1. Sufficient assets to pay expected losses
2. Stability of funding to avoid substantial fluctuations in deposits or assets
3. Support risk management programs to benefit all members

3.1 Sufficient Assets

The PLAN shall utilize Expected Liabilities, projected discounted liabilities at an actuarially determined Confidence Level (CL) of approximately 50%, when reporting liabilities for purposes of audited financial statements.

The PLAN calculates reserves for Unallocated Loss Adjustment Expenses (ULAE) at 10% of undiscounted Expected Liabilities.

The PLAN maintains a Risk Margin Fund with assets equal to the difference between Expected Liabilities plus ULAE and discounted liabilities at a 90% CL.

The PLAN may return Net Assets to members only to the extent assets will remain at least equal to discounted liabilities at a 90% CL.

Upon termination of the PLAN, any remaining assets or liabilities per member shall be calculated using the Termination Formula attached as Exhibit A.

The PLAN shall calculate its initial Program Year deposits at a minimum of Expected Losses (50% CL) for that year.

The initial Program Year deposit shall include amount needed, if any, to maintain total assets at least equal to Expected Liabilities.

With respect to initial Program Year Deposits, assessments, or returns, the Executive Committee is granted the authority to utilize an actuarial degree of confidence other than that noted above when it is appropriate to do so based upon evaluation of the following criteria:

- Favorable or unfavorable program funding issues that need to be addressed
- Insurance market conditions
- Legislative issues expected to impact the liability environment or pool management, and
- Risk exposures that impact the viability of the program

3.2 Stability of Funding

The PLAN maintains a Self-Insured Retention (SIR) Fund consisting of assets greater than discounted liabilities at a 90% CL. This fund enables the PLAN to prudently raise or lower the program's SIR &/or total Deposits depending on market conditions and loss experience. It's also used as a catastrophe reserve and to fund risk management programs.

The PLAN shall maintain a Net Asset to SIR ratio of at least 3:1

The PLAN shall maintain an SIR Fund Balance to SIR ratio of at least 2:1.

The PLAN shall maintain a Net Program Year Deposit to Net Asset Ratio of 1:1 or less.

The PLAN shall maintain an Expected Liabilities to Net Asset ratio of 1.5:1 or less

The PLAN shall consider transferring risk through insurance or other alternatives to protect assets from falling below the recommended ratios or Expected Liabilities at a 70% CL.

3.3 Support Risk Management Programs

The PLAN shall allow the use of funds to provide risk management services for the members.

4.0 <u>Delegation of Authority</u>

ABAG is designated as funding manager of the PLAN and is responsible for ensuring all funding activities are within the guidelines of these policies. ABAG shall develop and maintain administrative procedures for the operation of the funding program, with resources allocated to analyze and recommend a funding strategy for each Program Year.

5.0 <u>Reporting</u>

The Risk Manager will submit a yearly report which summarizes Ultimate Net Losses, funding levels, funding options for the upcoming Program Year, and how well the PLAN is achieving its funding goals and benchmarks.

6.0 Funding Program Benchmarks:

The PLAN shall seek to maintain the following benchmarks in choosing funding options:

- Yearly Deposits at least equal to Expected Losses (50% CL), with goal of 70% CL
- Net Assets to SIR ratio at least 3:1, with goal of 5:1.
- SIR Fund to SIR ratio at least 2:1, with goal of 3:1.
- Expected Liabilities to Net Asset ratio of 1.5:1, with goal of 1:1 or less.
- Net Deposit to Net Asset ratio of 1:1, with goal of 0.5:1 or less.
- Maintain Risk Margin Fund at 90% CL

7.0 Policy Adoption

The PLAN's funding policy shall be adopted by resolution of the Board of Directors. The policy shall be reviewed annually by the Actuary Committee and any modification made thereto must be approved by the Board.

8.0 Definitions

Claim Reserves: estimate of the funds needed to pay for known claims against a member that have been reported to the PLAN. The PLAN will establish a reserve for each open claim.

Confidence Level (CL): 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 CL the greater surety the actuary has that losses will not exceed the dollar value used to attain that CL.

Deposit: the amount charged either individually or collectively to the pool members to cover the loss expenses of a given Program Year.

Expected Liabilities: Claim Reserves + IBNR, discounted, at an actuarially determined Confidence (CL) level of approximately 55% to 60%, for all Program Years. Same as Reserves for Claims and Claims Adjustment Expenses on Statement of Net Assets.

Expected Losses: actuarial projection of Ultimate Net Loss for a Program Year, discounted, at a Confidence (CL) level of approximately 55% to 60%.

Incurred But Not Reported (IBNR) Claims: estimate of the funds needed to pay for covered losses that have occurred but have not yet been reported to the member and/or PLAN. IBNR claims include (a) known loss events that are expected to become claims, (b) unknown loss events that are expected to become claims, and (c) expected future development on claims already reported.

Loss Adjustment Expenses: expenses incurred in the course of investigating and settling claims.
• **Allocated loss adjustment expenses (ALAE)** include costs or expected costs directly attributable to a specific claim, such as attorney, expert, or damage appraisal fees.
• **Unallocated loss adjustment expenses (ULAE)** include costs or expected costs that are not directly attributable to a specific claim but are related to claims settlement, such as salaries, supplies, and other costs of the PLAN's claims administrator.

Net Assets: total assets less total liabilities. Refer to audited financials Statement of Net Assets.

Ultimate Net Loss: the sum of claims paid to date, Claim Reserves and IBNR, all within the program's pooled layer or SIR. Estimate of the total value of all claims that will ultimately be made against members for which the PLAN is responsible.

EXHIBIT A

TERMINATION FORMULA

Upon termination of the PLAN, Net Assets per member shall be calculated by historical program year as follows:

NA = P + I - WPL - XS - LP - D + FI - WCR - IBNR - ULAE
where WPL = (PL250 x CF) + PLP x %P
and WCR = (CR250 x CF) + PCR x %P

The total of Net Assets for all historical program years is the member's total Net Assets.

Terms and Methodology Defined:

(NA) Net Assets - The amount of assets remaining after all liabilities are subtracted.

(P) Premium - These are the actual amounts collected from individual members for loss premium only, which are summed up to arrive at the fiscal year totals.

(I) Investment Income - These are fiscal year totals, which are allocated to each individual member based upon a pro-rata percentage of premiums paid (%P).

WPL Calculation Terms:

(PL) Paid Losses - These are the actual loss amounts for individual members paid from the ABAG layer (i.e. above deductible). This amount includes claim settlement amounts and associated legal expenses. Claims administration is not included.

(PL250) $250K Capped Paid Losses - These are the actual loss amounts for individual members paid from the ABAG layer (i.e. above deductible), but with paid losses on each claim capped at $250,000 before applying the deductible. This amount includes claim settlement amounts and associated legal expenses. Claims administration is not included.

(CF) Credibility Factor - An actuarially determined measure of weight to be given to an individual member's loss experience, based upon its relative size compared to other members, based on payroll. The credibility factor for each historical year is the factor used for calculating the loss premium for each historical year.

(PLC) Capped Paid Losses - This is the product of $250K Capped Paid Losses (PL250) and the credibility factor (CF) for each member.

(PLP) Pooled Paid Losses - This is the difference between the total of paid losses (PL) for all members, and the total of capped paid losses (PLC) for all members, which is allocated to each individual member based upon a pro-rata percentage of premiums paid (%P).

(WPL) Weighted Paid Losses - This is the sum of capped paid losses (PLC) and pooled paid losses (PLP).

(XS) Excess Insurance - These are fiscal year totals, which are allocated to each individual member based upon a pro-rata percentage of premiums paid (%P) for fiscal years 2004-05 and prior; and based upon population for 2005-06 and later fiscal years. Population figures are those utilized in the annual premium calculation.

(LP) Loss Prevention Expenses - These are fiscal year totals, which are allocated to each individual member based upon a pro-rata percentage of premiums paid (%P).

(D) Dividends - These are the actual amounts distributed to individual members, which are summed up to arrive at the fiscal year totals.

(FI) Future Investment Income - These are estimated fiscal year totals anticipated based upon the actuarial reserve discount assumptions, which are allocated to each individual member based upon a pro-rata percentage of premiums paid (%P).

WCR Calculation Terms:

(CR) Case Reserves - These are the actual loss amounts for individual members reserved in the ABAG layer (i.e. above deductible). This amount includes claim settlement amounts and associated legal expenses. Claims administration is not included.

(CR250) $250K Capped Case Reserves - These are the actual loss amounts for individual members reserved in the ABAG layer (i.e. above deductible), but with paid and incurred losses on each claim capped at $250,000 before applying the deductible. The $250K capped case reserve is the difference between the capped incurred and capped paid.

(CF) Credibility Factor - An actuarially determined measure of weight to be given to an individual member's loss experience, based upon its relative size compared to other members, based on payroll. The credibility factor for each historical year is the factor used for calculating the loss premium for each historical year.

(CRC) Capped Case Reserves - This is the product of $250K Capped Case Reserves (CR250) and the credibility factor (CF) for each member.

(CRP) Pooled Case Reserves - This is the difference between the totals of case reserves (CR) for all members, and the total of capped case reserves (CRC) for all members, which is allocated to each individual member based upon a pro-rata percentage of premiums paid (%P).

(WCR) Weighted Case Reserves - This is the sum of capped case reserves (CRC) and pooled case reserves (CRP).

(WIL) Weighted Incurred Losses - This is the sum of weighted paid losses (WPL) and weighted case reserves (WCR) for each member.

(IBNR) Incurred But Not Reported Reserves - This is the bulk total actuarial reserve, which is allocated to each individual member based upon a pro-rata percentage of weighted incurred losses (%WIL).

(WR) Weighted Reserves - This is the sum of weighted case reserves (WCR) and incurred but not reported reserves (IBNR) for each member.

(ULAE) Unallocated Loss Adjustment Expense Reserves - This is calculated in total as 10% of the total of weighted case reserves (WCR) and incurred but not reported reserves (IBNR), which is allocated to each individual member based upon a pro-rata percentage of weighted reserves (%WR).