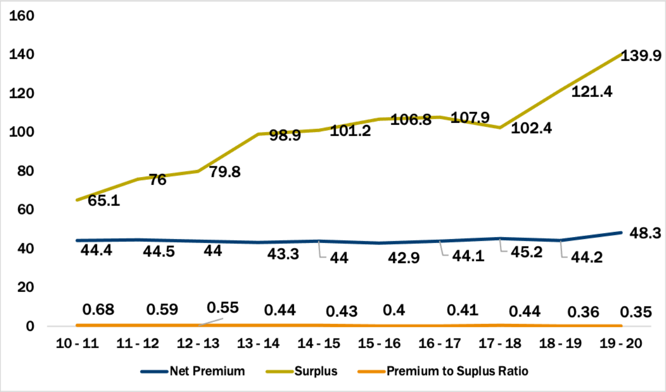
Virginia Risk Sharing Association

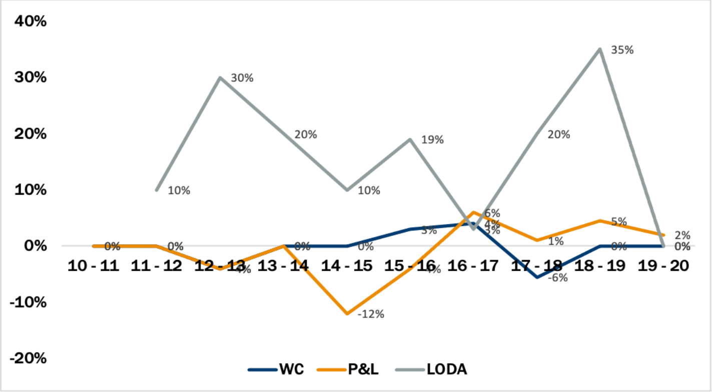
Financial Strength Equals Financial Stability

As the following graphs illustrate, the Virginia Risk Sharing Association (VRSA) has been fortunate to experience substantial growth in members' equity over the past 10 years. This has allowed the pool to provide members with remarkable rate stability – a VRSA strategic goal. Our various underwriting, investment, claims and loss prevention strategies are all built around this fundamental concept, with our members' budgeting in mind.

Premium to Equity



Rate Change



VRSA members have been fortunate to experience a remarkable decade period of rate stability. Expected changes arising out of the 2020 Virginia General Assembly included public sector collective bargaining, significantly expanded workers' compensation benefits, and a variety of measures that will increase local government liability. These will present new challenges for members and will lead to rate increases as our claims experience develops. The good news is that VRSA is in a strong financial position, which affords VRSA the opportunity to respond in measured fashion to any changes that may come our way.

Members' equity provides protection against:

- Adverse claims development;
- Continued liberalization of the Virginia Workers' Compensation Commission and Courts;
- Continued expansion of Workers' Compensation presumptions and LODA benefits by the Virginia General Assembly;
- Reinsurance market instability;
- Investment losses; and
- Catastrophic claims such as hurricanes, tornados, or a reinsurer failure.

Members' Equity Also Provides:

- Investment income to offset a substantial portion of operational costs;
- The ability to add and expand coverages at little additional costs to members; and
- The ability for the pool to take on additional risk.

Target Equity Study

The VRSA Members' Supervisory Board recently engaged Price Waterhouse Coopers to conduct a target equity range study utilizing an enterprise risk management process, which enabled the board and staff to consider the appropriate level of risk tolerance and the corresponding range of members' equity to hold appropriate for that risk. There are two main parameters in determining adequate funding levels:

1. **Board's risk appetite/tolerance** - The board's desired level of protection helps define its target funding strategy.
2. **Risk profile of the program** – Utilization of an economic capital modeling approach that reflects the pool's own risk profile and includes:
   - *Underwriting Risk,* also known as pricing risk, which represents risk that the actual outcome for the next year will deviate from the budgeted amount. Typical sources of this are volatility in the frequency or severity of claims and unexpected levels of catastrophic claims. Since the overhead expense items are rather predictable, the majority of risk lies within the claims cost. The model incorporates future claims and claims expenses, and the volatility around them, to measure underwriting risk.
   - *Reserving Risk*, which measures the potential for actual claims settlement costs deviating unfavorably from the current booked reserves. Typical sources of potential unfavorable reserve development include excessive inflation, emergence of latent or new types of claims and a change in the judicial environment affecting claim settlements.
   - *Asset and Credit Default Risk,* which reflects the risk that the value of investment and credit assets may deteriorate due to changes in macroeconomic financial conditions or a decline in the financial strength of debtors.
   - *Operational Risk* captures potential for fund deterioration arising from off-balance sheet or unplanned items.

Result - As a result, the board adopted a members' equity policy that establishes a current target equity range of **1 x 1-in-200 year event** and **2 x 1-in-200-year event**. This translates to a current range of $72M - $144M with current members' equity at approximately $139M.

Maintaining surplus adequacy to handle a 1-in-200 year event is fast becoming a global standard for insurance companies.

As a comparatively small, single state risk-sharing pool, the board feels strongly that a more conservative posture is advisable when compared to large insurance companies. The board briefly discussed a return of equity, but agreed that continued maintenance of stable rates for the foreseeable future was preferred. The board will continue to monitor members' equity and evaluate the appropriate level to hold on behalf of members.