



The contribution leverage ratio:

$$\frac{\text{Net Contributions}}{\text{Net Position}}$$

Net contributions are a pool's primary revenue, and net position (which might also be called "member equity" or "surplus") is a pool's cushion for absorbing losses greater than expected. The contribution leverage ratio measures the degree of protection the pool's net position provides relative to contributions it expects to write. This is one way to measure changes or challenges if pool contributions change dramatically from one year to the next against a fairly stable net position, which is generally much slower to change. Imagine a pool growing very fast with new members, but with surplus that is relatively low based upon historical membership. The surplus could be at risk if new members' risk profiles turn out to be different than historical trends, or if there's a dramatic shift in loss expectations for any other reason.

In general within the insurance industry, a range of 0 to 3.0 is acceptable, meaning the insurer can write up to \$3 of contribution for every \$1 of surplus it has. Because pools tend to grow slowly and methodically, generally want to provide long-term stability for their members, and tend to price-to-risk, most pools operate with contribution leverage ratios that are very low by insurance industry standards. There is no currently identified acceptable pooling range for a contribution leverage ratio - which is part of the reason the FBI will be so valuable within the AGRiP membership.

As a simple example of this ratio, imagine a pool had \$4 million in contributions last year, with member equity of \$2.5 million. The pool's contribution leverage ratio is 1.6, which means it is writing 60% more contributions as it has protective surplus. This ratio implies a low risk to the pool's net position. Some pools have member equity that is greater than their annual contributions, which makes for a very low contribution leverage ratio (less than 1.0).

The contribution leverage ratio is calculated net of excess insurance or reinsurance, so pools should be cognizant of receivables and the quality of their reinsurers. Inadequate or insufficient reinsurance could adversely affect a pool's solvency, even if the contribution leverage ratio appears reasonable.