



The Liability Leverage ratio:

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

The [Reserve Leverage](#) financial benchmark measures one element of a pool's liabilities, namely the unknown portion of ultimate losses (case reserve and IBNR). But a pool's total liabilities, as shown on its balance sheet, also includes such items as unearned contributions, accrued expenses, long- and short-term debentures, reinsurance recoverables, etc. The Liability Leverage ratio measures the proportion of total liabilities as compared to net position. In other words, the Liability Leverage ratio is very similar to the Reserve Leverage ratio, but with additional liabilities. The Liability Leverage ratio should typically be higher than the Reserve Leverage ratio.

One of the fundamental equations of accounting found on the balance sheet is Net Assets = Net Liabilities + Net Position. Therefore, the Liability Leverage ratio is basically a measure of how much of a pool's net position can support its total liabilities. The smaller the ratio, the more financially secure the pool.

For a pool with a net position of \$6 million and net liabilities of \$10 million, the Liability Leverage is 1.67. The pool's current net position can support a variation in net liabilities of up to 67 percent. Within the pooling industry, a typical range is anywhere from .5 - 2.0. Although a pool cannot decrease the amount of liabilities it has, it can make an effort to bolster net position to lower its ratio.

If your pool has multiple lines of business, consider reviewing this ratio on a consolidated basis. By consolidating lines of business, a degree of group leverage can be measured. Those pools with a greater portion of their overall book in longer-tail lines of business will have higher ratios (given their higher level of reserves). Shorter-tailed lines concentrated pools will have lower Liability Leverage ratios.

Once again, as with all ratios in the FBI, the Liability Leverage is done net of reinsurance. Pools should be cognizant of the amount of reinsurance recoverables from their risk transfer contracts.