



The operating ratio:

$$\frac{(\text{Net Incurred Losses} + \text{Non-Loss Expenses} - \text{Investment Income})}{(\text{Net Contributions})}$$

Like the [combined ratio](#), a pool's operating ratio is a rudimentary measure of financial stability and solvency. The benefit of using an operating ratio measure rather than combined ratio is that it takes investment income into consideration. This is an important factor to consider, in particular for workers' compensation where a claim can continue to be paid for 20, 30 or even 40+ years.

Imagine your pool has \$100 in contributions, \$80 in incurred losses, \$20 in overhead expenses, and \$5 of investment income. Your operating ratio is 95 percent. A low operating ratio implies loss and expense costs that are less than contributions and investment income, so decisions such as whether to offer member dividends or lowered annual contributions could reasonably be considered. Of course, neither of these decisions should be made on the basis of one year's results.

A loss ratio in excess of 100 percent may be the result greater-than-expected losses, unfavorable loss development or reserve strengthening, changes in expenses, or unfavorable investment results.

The components of the operating ratio can be managed to some degree. Expenses might be lowered with more efficient operations and contributions can be adjusted to closer align with expected losses and expense costs. Some pools have modest flexibility to shift investment practices in order to maximize income, but that decision is very much a product of your pool's investment goals (whether long-term stability or short-term gains) and state statute. Many pools seek to change the cost curve for members in terms of loss control and risk management tools to prevent or mitigate loss costs - although any pool can have a bad loss year.

It is more important to understand the factors behind your pool's operating ratio and any changes that have occurred, than to know the operating ratio itself. And, paying attention

to changes in your pool's operating ratio over time can be an important bellwether of overall financial health. No single financial measure is a reliable indicator of a pool's overall solvency or financial well-being, so pools are encouraged to evaluate multiple measures and to evaluate year-over-year performance to watch for important indications and manage pool operations.