



LOSS RATIO ADJUSTMENTS

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Drafted March 26, 2026

Background

A modification to the annual cost allocation formula has been implemented—specifically, the addition of loss ratio adjustments at the end of the calculation. Loss ratio adjustments take the form of either a credit of up to 15%, reducing a member's annual contribution, or a surcharge of up to 15% increasing it based on each members' cumulative contributions paid into the pool relative to their actual loss history.

On Feb 19, 2026, this report and accompanying exhibits were reviewed and discussed by a Focus Group consisting of 16 member agencies of different sizes and geographic locations. The Focus Group was supportive of the concept of loss ratio adjustments, however, it recommended that implementation be delayed until 2027, in order to allow more time for outreach and communication, especially as it relates to those members who are scheduled to receive a surcharge.

Subsequent to the Focus Group discussion, a determination was made by staff that there was a way to comply with the intent of the Focus Group, while also not delaying the issuance of loss ratio credits to those members who are scheduled to receive them this year. Accordingly, loss ratio credits were applied to the 2026–27 annual contribution calculation (credits only), while surcharges were negated with a one-time offset, effectively delaying their implementation until 2027.

This report was also reviewed and discussed by the Finance Officers Committee at its meeting on March 12, 2026. The Finance Officers Committee recommended that the Executive Committee review and approve the addition of loss ratio adjustments to the annual contribution formulas of the Primary and Excess Liability Programs.

Introduction

In practice, most members are not expected to receive a loss ratio adjustment in any given year. This is because most members typically fall within a normal range of variation when it comes to annual contributions paid into the pool vs. liability losses paid out on a member's behalf.

The calculation is based on a simple idea: inputs vs. outputs. If contributions relative to losses are “normal,” on average, over a long period of time, then no adjustment is necessary. However, if ceded losses are unusually low or unusually high, consistently, over a long period of time, relative to contributions, then loss ratio adjustments provide a mechanism to address outliers on both ends of the spectrum. Loss ratio adjustments only apply to the Primary and Excess Liability Programs. By comparison, the claims experience of the workers' compensation programs tend to

be more stable due to the nature of the exposure type, which makes a mechanism like loss ratio adjustments somewhat less necessary for workers' compensation.

Underwriting Philosophy

The Authority's cost allocation formula is guided by 3 principles:

- Solvency
- Fairness
- Simplicity

True Up Mechanism

In years past, the Authority's true-up mechanism, based on developed losses, was the annual retrospective adjustment, which was discontinued in 2023. That process had both strengths and weaknesses. Loss ratio adjustments are an effective way to re-introduce an element of true-up without many of the challenges associated with the old methodology. This is desirable because liability claims are difficult to predict and any underwriting activity conducted at the beginning of a coverage year is merely an estimate of future costs. Some type of subsequent true up, after the fact is generally a good idea, to the extent that it can be (a) calculated simply, and (b) limited in scope so that individual members are only moderately impacted.

Loss ratio adjustments are aimed at providing more equitable outcomes as it relates to each member's long-term financial performance within the program; more specifically, as it relates to circumstances in which the cost allocation formula has unintentionally produced underwriting outcomes that are outside the normal range of variation. One way in which this can be achieved is by adding a retrospective element to the prospective formula, which considers (1) how much individual members have paid into the pool over a 10-year period compared to (2) the amount of ceded losses each member has generated. From there, incremental adjustments gradually bring outliers back within the normal range.

What is a Loss Ratio?

Loss Ratio = (Net Incurred Losses ÷ Contributions)

Over a 10-year period, contributions should exceed net incurred losses. Loss ratios are a key metric for the insurance industry and public entity risk pools, useful both in the aggregate to assess long term financial performance and at the individual member level. In the Authority's primary and excess liability programs the average loss ratio, pool-wide since 2013, has typically ranged from 60%–75%.

This means that for every \$1 of annual contributions collected from members, the Authority pays out 60¢–75¢ in claims. The remaining funds are used to purchase

excess and reinsurance, and pay for claims administration, risk management programs, member training, actuarial services, and general overhead expenses. Investment earnings also help to pay for a portion of the Authority's operating costs.

Loss ratios are informative because they provide a simple comparison of member contributions against their direct cost of claims. The average loss ratio of the Authority's liability programs can be used as a baseline expectation around which individual member loss ratios should tend to fall. Of course, there will be a significant amount of variability from year to year at the individual member level, due to the volatile nature of liability claims. However, on average, over the course of a 10-year period, individual member loss ratios should fall within 25%–75% after adjustment for skewing.

Normal Long-Term Range of Variation = 25%–75%

When a member's loss ratio falls within the normal long-term range of variation, no loss ratio adjustment will be applied because the adjustment is intended to address outliers on both ends of the spectrum. The current cost allocation formula reliably produces equitable underwriting outcomes for the majority of members, most of the time.

The goal is for the formula to neither undercharge nor overcharge any single member, especially as measured over a 10-year period. When a member's long-term loss ratio falls within the 25%–75% range, this is considered to be a normal underwriting outcome. When a member's long-term loss ratio is below 25% or above 75%, a mechanism would be helpful to move those members inside the normal range of variation.

Loss Ratio Adjustments

The maximum allowable Loss Ratio Adjustment is $\pm 15\%$ applied as a supplemental, and separate, calculation at the end of the annual contribution formula of the primary and excess liability programs. Favorable adjustments are referred to as credits; unfavorable adjustments are referred to as surcharges. Loss ratio adjustments will not be restricted by the volatility bands in the annual contribution formula.

- Loss Ratio Credit
- Loss Ratio Surcharge

Loss Data Sample Size for Statistical Credibility

Members with payroll below \$1M will not receive loss ratio adjustments because their loss data is too sparse and lacks actuarial predictive value.

Sliding Scale for the Application of Loss Ratio Credits and Surcharges

Members with loss ratios of 25% or lower will receive a credit applied to their annual contribution. The amount of the credit ranges from 1% to 15% on a sliding scale. The scale slides from loss ratios of 25% down to 10%. Members with a loss ratio of 10% or less will receive the maximum possible loss ratio credit of 15%.

Conversely, members with loss ratios of 75% or higher will receive a surcharge applied to their annual contribution. The amount of the surcharge ranges from 1% to 15% on a sliding scale. The scale slides from loss ratios of 75% up to 90%. Any member with a loss ratio of 90% or more will receive the maximum possible surcharge of 15%.

These parameters apply to the 2026–27 annual contribution calculation and are subject to modification in future years, as necessary to ensure that they are properly coordinated with the underlying volatility bands in the basic formula.

Loss Ratio Calculation

For the 2026–27 annual contribution calculation the following data set was used to calculate individual member loss ratios:

10-year data set = 2023–24 and the preceding 9 years 2014–25 and 2015–26 have been excluded due to their undeveloped status.

High and low years removed

The year with the highest loss ratio and the year with the lowest loss ratio within the 10-year sample are removed to prevent skewing and to help establish more stable outcomes.

The remaining 8 years are averaged together to produce a rolling long-term loss ratio which serves as the percentage that determines whether or not a loss ratio adjustment is applied in the formula. If a member's loss ratio is 25% or lower a credit will be applied. If a member's loss ratio is 75% or higher a surcharge will be applied.

Members with Less Than 5 Years of Tenure

Members need at least 5 years of tenure with the Authority for loss ratio adjustments to be applied. This is necessary because loss ratios lack actuarial meaning without a substantive volume of developed claims data.

Members with 5–10 Years of Tenure

Members who have 5–10 years of tenure will have a partial data set in their loss

ratio calculation, meaning, their 8-year average could be based on 7 years of data or even 1 year of data. This will be addressed by applying the principle of using the best available data at the time of the calculation. Meaning, based on the defined parameters, if a member has 1 year of data available to calculate their loss ratio, that single year's loss ratio will substitute for what would have otherwise been an 8-year average. As member tenure increases, this limitation will resolve naturally. Other constraints in the formula, by design, will help to mitigate the impact of this issue on the few rare cases to which it applies.

Volatility Bands

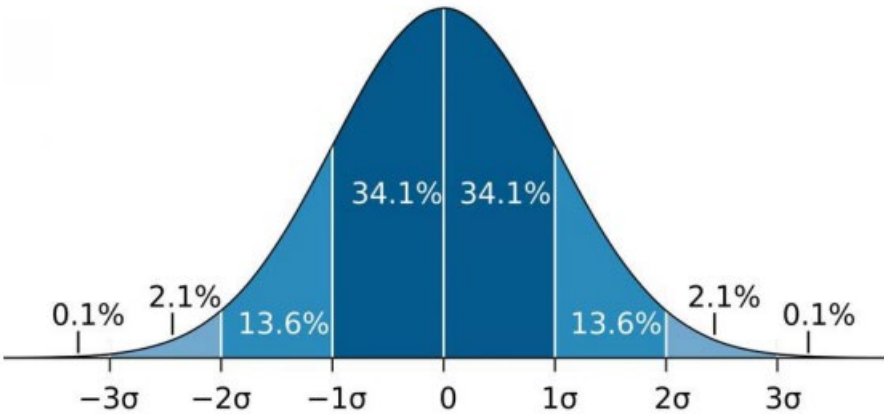
Volatility bands are a longstanding part of the Authority's annual contribution formula. They help to stabilize changes in member contributions by providing a floor and a ceiling beyond which the percentage change (year-over-year) is limited, regardless of individual member claim development. Below is a table showing current volatility band limitations.

Rather than expanding the volatility bands to allow for greater variability in pricing for all members, loss ratio adjustments will be applied in a way that only impacts edge cases on either end of the spectrum (at least in a material way). In other words, loss ratio adjustments are intended to gradually, over several years, move the outliers on both ends to fall within the normal range of variation, which is defined as loss ratios between 25% and 75%.

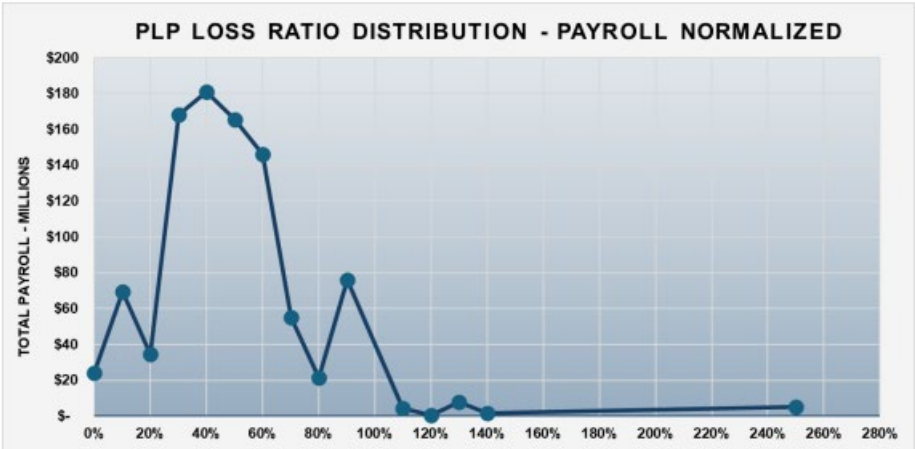
That said, after loss ratio adjustments are applied, it will become possible for a primary liability program member who is an outlier on the high end to receive a 45% annual contribution increase: first, up to 30% as a result of volatility bands, and secondly, up to another 15% in loss ratio surcharge. The same applies to the excess liability program, where the maximum allowable annual contribution increase would now become 45%.

In practice, this would affect only edge cases, which are a subset of members who consistently have unusually high loss ratios, over an extended period. In these cases, it could be reasonably argued that the 45% increase is warranted in order to correct unintentional underwriting outcomes. The same logic applies on the low end: members who consistently have unusually low loss ratios, over an extended period would receive a credit as a corrective measure.

Standard Bell Curve Distribution



Primary Liability Program — Actual Loss Ratio Distribution



Payroll Normalized Mean Loss Ratio: **48%**
 Payroll Normalized Standard Deviation: **± 28%**
 Lower Limit of 1σ: **20%** (the selected lower limit of the normal range is 25%)
 Upper Limit of 1σ: **76%** (the selected upper limit of the normal range is 75%)