



# RESERVE POLICY

## Purpose and Definition

Operating reserves (Reserves) represent unrestricted net assets of NAIFA that are set aside by the Board of Trustees. The purposes or objectives of the Reserves include the following:

1. Provide emergency funds to meet unforeseen budget shortfalls attributable to economic downturns, major restructuring, or other significant events
2. Provide seed money for new initiatives or programs that are important to the mission of NAIFA but cannot be funded initially from operating cash flows
3. Establish a reserve for special emergency legislative initiatives to enable NAIFA to respond appropriately and timely to legislative challenges facing its members
4. Provide a means for funding future debt service requirements
5. Provide a funding mechanism for the replacement of capital assets

## Reserve Funding

While no single calculation or methodology is definitive in determining the appropriate level of reserves, the calculation of the overall operating reserve for NAIFA shall include each of the reserve components as outlined below. To the extent that the net asset reserve is not funded by current assets, NAIFA will need to systematically fund the reserve using operating cash flows until such time as the net asset reserve can be supported by current assets. For purposes of defining current assets for the reserve calculation, NAIFA will consider all investments current assets regardless of the intended holding period. The target reserve will be achieved by contributing cash flows from operations until such time as the net asset reserve is fully supported by current assets.

The Finance Committee may recommend to the Executive Committee contributions in excess of the minimum. The Finance Committee may also make recommendations to the Executive Committee to revise the target reserve amounts and/or the annual target contribution rate as deemed necessary. The Executive Committee will report such recommendations to the Board of Trustees for approval.

Based upon NAIFA's financial position as of August 31, 2003, the substantial debt principal payments totaling \$1.1 million due during the year ending August 31, 2004, and the fiscal year 2004 operating cashflow projection, NAIFA's contribution to the funding of each reserve component will begin in fiscal year 2005. However, should actual financial results for fiscal year 2004 significantly exceed projections, the Finance Committee may recommend to the Executive Committee to begin funding a portion of the overall reserve in fiscal year 2004. The Executive Committee will report such recommendations to the Board of Trustees for approval.

The annual funding contribution will involve setting aside actual dollars in a separate investment account rather than merely segregating a portion of the net asset balance for financial reporting.

### **Target Asset Allocation**

The Finance Committee will recommend the investment policy, including investment instruments and asset allocation for the Reserve Fund, to the Executive Committee who will report to the Board of Trustees. The Board of Trustees will approve both the investment policy and asset allocation of the Reserve Fund.

### **Use of Reserve Funds**

The Reserve Fund, including investment earnings on such funds, will only be utilized by NAIFA if a situation as defined in the Purpose and Definition section above occurs and only upon the approval of the Board of Trustees. Management of NAIFA would be required to report back to the Board on the use of such funds in a manner acceptable to, and prescribed by, the Board.

### **Components of the Reserve:**

NAIFA's operating reserve will consist of the following components:

#### **1. General Reserves**

NAIFA has established a general reserve for the purpose of helping to ensure the Association is prepared to successfully weather the effects of an economic downturn, a financial shortfall, major restructuring, or some other significant event. The general reserve is designed to cover fixed operating expenses for a specific time period. Fixed operating expenses are defined as those business operating expenses which will be incurred regardless of sudden changes in revenue sources, the cancellation of a specific convention or program activity, etc.

Associations typically target 3 to 6 months of budgeted operating expenses to set aside for this purpose, with the average target reserve being approximately 50% of annual operating expenses based on recent studies. NAIFA's general reserve will be equal to four months (33%) of operating expenses. Four months rather than six months is targeted since additional reserve components are separately identified in items #2 through #5 below. Refer to [Attachment A](#) for the target reserve fund annual contribution. Budgeted 2004 operating expenses have been used as the base in determining both the overall target reserve and the annual increase. As the Association grows, reserves must grow at a similar pace and the goals must be adjusted accordingly. Based upon the size of NAIFA's current operations as well as its current financial position, it is planned that NAIFA will contribute 7% of the target reserve base in fiscal year 2005 with a contribution in future years equal to 7% of the target reserve base plus the increase in the target reserve as based upon the increase in annual operating expenses. In this manner, NAIFA will fully fund its general reserve within approximately 15 years.

## **2. Capital Asset Replacement Reserves**

NAIFA has established a capital asset replacement reserve for unanticipated, nonrecurring expenditures for the maintenance and repair of the building and the replacement of obsolete property and equipment. The purpose of the capital asset replacement reserve fund is to help ensure sufficient funds are available to enable the routine replacement of property and equipment over an adequate replacement cycle and to pay for emergency repairs and maintenance costs not included in the annual operating budget. The reserve fund is designed to provide a funding source for the standard replacement of existing property and equipment and to cover the cost of any necessary emergency maintenance and repairs. The amount of this reserve is based on a projection of the office furniture and equipment that will need to be replaced as well as an estimated reserve for unforeseen building maintenance and repairs. Additionally, the reserve includes an estimate for the costs of a tenant allowance and lease commission which will be involved in securing the renewal of NAIFA's existing building tenants or finding replacement tenants. While a portion of the tenant allowance and lease commission would likely be recouped through future lease rental income, for purposes of determining the reserve funding needs, future tenant income has not been included.

The target reserve fund annual contribution is detailed in [Attachment B](#). NAIFA's budgeted depreciation expense in most years will more than cover the projected asset replacement and building repairs. However, in order to ensure actual cash is available for capital asset replacement needs, NAIFA will contribute to the capital asset replacement reserve an amount equal to the annual budgeted depreciation expense. The cumulative reserve balance will be reduced as assets are acquired and capitalized. The finance committee will periodically review the balance of the capital asset replacement reserve along with future projections of capital additions and building improvements to determine the point at which annual contributions to the capital asset replacement reserve should be adjusted.

## **3. Debt Service Reserve**

NAIFA has established a debt service reserve to help ensure the ability to meet its various long-term loan principal repayment obligations. As of August 31, 2003, NAIFA has principal loan obligations totaling \$11,331,253 due in varying amounts and times over the next seven years. The purpose of the debt service reserve is to help ensure sufficient funds are available to meet all principal debt repayment obligations when due and to minimize the impact on the operating budget and programs in years of significant repayment obligations.

The debt maturity of NAIFA's various loans payable as of August 31, 2003 is outlined in [Attachment C](#). All principal payments due in fiscal year 2004, including the balloon principal payments due for the notes payable due to Million Dollar Roundtable and LIFE, have been included in NAIFA's operating cashflow budget projection for 2004. At this time, it is NAIFA's intention to continue to include all annual interest and principal payments due under the various debt obligations in the annual operating budget. Additionally, prior to the due date of the balloon payment on the National Life note of nearly \$9 million presently due in 2010, it is management's intention to refinance this note for a period of seventeen years, the balance remaining on the original amortization schedule of twenty-seven years. As such,

no funds have been set aside at this time to establish the debt service reserve fund and no annual contribution amount has been planned.

Periodically, the Finance Committee will re-evaluate NAIFA's overall financial position, budget and total operating reserves and consider the possibility of funding the debt service reserve to facilitate an accelerated payment schedule of the National Life debt.

#### **4. Pension Benefit Cost Reserve**

NAIFA has established a pension benefit cost reserve to accumulate the funds which will be needed to fund the termination costs of NAIFA's defined benefit pension plan. NAIFA's defined benefit pension plan was frozen March 31, 2001. As the Association has no current intent to reach a settlement date for terminating the plan, no funds have been set aside at this time to establish the pension benefit cost reserve fund and no annual contribution amount has been planned. In addition, it is assumed that some of the liability will be offset in the future by investment gains. At least annually the Board of Trustees will consider whether or not NAIFA's financial position and current economic conditions necessitate a change in the policy regarding the pension benefit cost reserve.

NAIFA's annual contribution requirement to the defined benefit plan under ERISA will continue to be paid out of the operating cashflow budget.

#### **5. Reserve for Special Emergency Legislative Initiatives**

NAIFA has established a reserve for special emergency legislative initiatives. While NAIFA's annual operating budget includes funds for various planned lobbying initiatives, NAIFA is at times presented with additional unanticipated opportunities to possibly effectuate a change or outcome on a significant legislative vote, election, etc. which would be advantageous to NAIFA and its members. The purpose of the legislative reserve is to help ensure funds are available for worthy emergency lobbying initiatives, as determined by the Board of Trustees.

NAIFA's conference, The Association of Health Insurance Advisors (AHIA), previously established a war chest specifically for use at the discretion of the board of AHIA. NAIFA's legislative reserve will be considered separate from the war chest of AHIA.

NAIFA's target legislative initiative reserve fund will be equal to 25% of total annual law and legislative expenses. The annual target funding requirement is detailed in [Attachment D](#) and assumes an annual contribution beginning in fiscal year 2005 equal to 5% of the total annual budgeted law and legislative expenses with such budgeted costs projected to increase by 2% each year. Each year's annual target funding contribution will also include any amount of the special emergency legislative reserve spent in the prior year on board approved initiatives. In this manner, NAIFA's special emergency legislative initiative reserve will be fully funded in approximately five years.

## Summary

The overall targeted reserve at the end of fiscal year 2008 is 21% of the projected annual operating expenses as shown in [Attachments E and F](#). The funding targets described above should be reevaluated on a periodic basis taking into consideration NAIFA's financial results and future plans.