AMERICAN ACADEMY *of* ACTUARIES

July 11, 2006

Honorable Kevin McCarty
Attn: NAIC Property and Casualty Committee
C/o: Davin Cermak
2301 McGee Street
Suite 800
Kansas City, MO 64108

Re: NAIC/NCOIL National Catastrophe Plan Discussion Paper

Dear Commissioner McCarty:

The Natural Catastrophe Subcommittee (Subcommittee) of the American Academy of Actuaries (Academy) welcomes the opportunity to provide input regarding the production of estimates related to the level of catastrophic disaster and its effects on insurance capacity, as cited in the Discussion Paper on the Current National Catastrophe Plan Proposal prepared by the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL).

The Subcommittee is currently preparing a monograph (working title, "Catastrophic Hazards – The Worst Is Yet To Come") on the issue of insuring the risk of catastrophes. The substance of the draft monograph is synopsized below:

The monograph, as developed thus far, identifies extreme natural catastrophes that have the potential to cause disastrous accumulations of economic losses in various regions throughout the United States. However, terrorist events, which may be more geographically spread, may have an equally great or greater impact than natural catastrophes. The Academy's Terrorism Risk Insurance Subgroup is in the process of preparing a separate monograph addressing terrorism risk insurance issues.

With the assistance of catastrophic computer modeling services, provided to the Subcommittee by AIR Worldwide Corporation, several scenarios are being modeled to determine the estimated financial impact on the insurance industry – for both property lines and the workers' compensation line of business. Additionally, estimates are being produced for non-insured losses, such as government buildings and infrastructure. In some scenarios, losses for actual historical events, such as Hurricane Andrew, are projected in terms of today's dollars. In other cases, actual historical events are modified to illustrate more severe but plausible scenarios – for example, the financial impact of a Hurricane Andrew-type storm directly hitting the Miami area.

The draft monograph concludes that, despite the record-setting losses experienced by the insurance industry over the last two hurricane seasons, the potential exists for far more severe devastation and financial losses.

The Subcommittee offers the following comments specific to the NAIC/NCOIL Discussion Paper:

- Engineering studies as well as recent experience in Florida illustrate the ability of strong building codes to significantly reduce losses over what would otherwise occur. A National Catastrophe Plan should include measures to promote appropriate levels of loss mitigation. We are encouraged by the guiding principle underlying the discussions with regard to support for reasonable building codes, development plans, and other mitigation tools.

- While residential flood insurance is available through the National Flood Insurance Program, there is significant insured and uninsured risk due to damage resulting from the flooding of commercially insured buildings. Ensuring adequate commercial flood insurance capacity may significantly reduce estimates of future catastrophic financial effects, as time-element losses like unemployment compensation may be mitigated. The ability of people to return to work quickly, in part depends upon businesses being up and running.

- Private market capital is leveraged to support multiple lines of insurance, and, if exhausted, would impede the ability of the insurance industry to continue writing all lines of insurance. The threshold for public involvement must be at a level below that which would exhaust private market capacity and yet not compete with the private industry.

- The recommended level of trigger should be appropriately selected in recognition of the industry’s capacity. Recent history provides ample evidence related to the industry's ability to withstand $25 billion and $40 billion of annual insured losses and total catastrophic losses in excess of $65 billion over a two-year period.

- If underlying catastrophe premium rates are at adequate levels, an adjustment could be required to eliminate a federal plan’s contribution to the overall average annual loss, resulting in lower premiums for the consumer. Thus, a federal layer might result in lower premiums to consumers, greater availability of coverage at existing rates, or a combination of these outcomes.

We hope that you will find these comments helpful. The Subcommittee remains ready to assist the NAIC and NCOIL in the preparation of a National Catastrophe Plan and intends to provide NAIC and NCOIL with the results of its research when it is completed later this year.

If you have any questions regarding these comments, please feel free to contact me or Lauren Pachman, Casualty Policy Analyst at pachman@actuary.org.

Sincerely,

Shawna Ackerman
Co-Chair
Natural Catastrophe Subcommittee
American Academy of Actuaries