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AMERICAN ACADEMY *of* ACTUARIES

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July 11, 2011

The Honorable Tim Johnson  
Chairman, U.S. Senate Banking, Housing & Urban Affairs Committee  
136 Hart Senate Office Building  
Washington, DC 20510

The Honorable Richard Shelby  
Ranking Member, U.S. Senate Banking, Housing & Urban Affairs Committee  
304 Russell Senate Office Building  
Washington, DC 20510

Re: S. 1091

Dear Sens. Johnson and Shelby:

As you prepare to consider S. 1091, “The Consumer Option for an Alternative System to Allocate Losses (COASTAL) Act,” the American Academy of Actuaries’<sup>1</sup> Flood Insurance Subcommittee appreciates the opportunity to share an actuarial perspective on the legislation and its possible effect on the National Flood Insurance Program (NFIP).

First, we support the reauthorization of the NFIP for at least five years. We believe that reauthorization will help to support the market for flood insurance as the program regains stability.

In addition, we strongly support efforts to provide a better financial base for the NFIP. We are encouraged, therefore, by the provisions of this bill that move the program toward full-risk rates. These provisions include requiring new or reinstated policies to be charged those full-risk rates and phasing in full-risk rates over a five-year period at the rate of 20 percent per year for existing policies in areas in which maps have been updated.

The process of transitioning from the NFIP’s existing rate structure to one that employs more full-risk rates necessarily will involve addressing the program’s existing \$17.75 billion Treasury debt, which was incurred following the catastrophic losses suffered in the 2005 Gulf Coast hurricanes. Resolving the issue of the outstanding debt is critical to the program becoming financially sound. The bill, however, does not address this issue. A significant portion of the NFIP premium currently goes to paying off the debt and interest on the debt. At this rate, it will be decades until the debt is paid off, during which time the NFIP’s ability to accumulate reserves for future catastrophes will remain

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<sup>1</sup> The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

compromised. Improving the NFIP's financial stability may require either a specific load to the premiums for annual debt service or waiver of the debt. It is critical that this issue be addressed in this legislation.

The creation of a procedure to allocate claims between wind and water losses attempts to address a critical issue in adjusting claims following a major hurricane. This bill provides an intriguing solution to that problem, but it may be overly simplistic to believe that there is a mathematical formula that can determine the appropriate allocation of losses in all cases. Each claim is unique and may include complicating factors that fall outside even the best-built models. From an actuarial viewpoint, it would be valuable if more data could be collected that would help to determine the actual costs for each peril with additional accuracy. This is particularly important in situations in which different entities provide the separate coverages, as is usually the case when wind and water losses arise from the same event. We applaud this proposal's provisions for the gathering of such additional data.

We do, however, have significant concerns about the challenges of implementation of some of this legislation's provisions:

- Before rolling out such a large-scale program nationwide, we recommend conducting a limited pilot program to determine whether the proposed procedure is practical and whether it is, in fact, a cost-effective answer to the problem that this bill seeks to address.
- In addition, by our reading, Section 103(b)(3), "Allocation of Indeterminate Claims," appears to make this provision mandatory for most of the personal lines insurers that currently write the wind business—all of the write-your-own (WYO) carriers plus all those insurers with agents who "work exclusively or predominately for that insurer." That would mean that this program is not optional, as is represented in the language of the legislation, for the vast majority of NFIP policyholders. Furthermore, the opt-out provision appears to allow a consumer to opt out of the program only if the insurer agrees.
- On a technical point, the bill requires that the model developed for this purpose be "90 percent accurate" for every individual indeterminate loss. While high levels of accuracy are desirable in any such model, it is unclear how accuracy will be measured for the purpose of establishing compliance with the statute. Any model can only provide estimates of possible or probable results; the accuracy of insurance models can be challenging to measure, and this bill contains no objective criteria upon which to base a determination of the accuracy of any model developed pursuant to its provisions. It seems unlikely that any model could develop better answers for individual claims than would be arrived at based on an expert examination of the unique facts of each claim.

The American Academy of Actuaries' Flood Insurance Subcommittee hopes that you will find these comments helpful. We would be pleased to assist you in your efforts to

reauthorize the NFIP. If you have any questions, please feel free to contact Lauren Pachman, the Academy's casualty policy analyst, at [pachman@actuary.org](mailto:pachman@actuary.org). Again, thank you for this opportunity to comment on the proposed legislation.

Sincerely,

Stuart B. Mathewson, FCAS, MAAA  
Chair, Flood Insurance Subcommittee  
American Academy of Actuaries

CC: The Honorable Roger Wicker  
U.S. Senate Banking, Housing & Urban Affairs Committee  
555 Dirksen Senate Office Building  
Washington, DC 20510