



FEMA

W-10100

December 17, 2010

MEMORANDUM FOR: Write Your Own (WYO) Principal Coordinators and the National Flood Insurance Program (NFIP) Servicing Agent

A handwritten signature in black ink, appearing to read "James A. Sadler".

FROM: James A. Sadler, CPCU, AIC
Director of Claims
National Flood Insurance Program

SUBJECT: Second Update – NFIP Case Loss Reserving Procedures

This is an update of two bulletins – W-08095, dated December 22, 2008, and W-10008, dated February 4, 2010 – and addresses issues identified during the latest DHS Financial Audit conducted by KPMG.

Each year, the Department of Homeland Security (DHS) conducts an independent, external review of internal financial control processes within various agencies under the DHS umbrella. For claims with a Fiscal Year (FY) 2009 date of loss, this review was once again performed by KPMG. Their review included National Flood Insurance Program (NFIP) claims and policy files of selected WYO Companies and the NFIP Direct Servicing Agent.

The latest KPMG findings indicate that some insurers do not comply with the NFIP case-reserving procedures as amended. That finding was not material and, in our opinion, has no effect on the operations of the NFIP. In Bulletin W-10008, dated February 4, 2010, FEMA's Claims & Appeals Branch notified all WYO Companies and the NFIP Direct Servicing Agent that during the upcoming FY 2011 Operation Review cycle any reserving errors would be considered non-critical errors.

Based on the latest DHS Financial Audit results, the Claims & Appeals Branch will escalate its treatment of reserve errors. **Such errors will be critical errors for the FY 2012 Operation Review cycle (beginning after September 30, 2011).** These findings will be consistent with the Case Loss Reserves description below.

The Operation Review team will expect the reserve history information to be available at the time of the review. If this information is not usually found in the claim file, the information confirming reserve history for each selected file may be provided separately at the start of the review. The *NFIP Adjuster Claims Manual* was issued online in June 2010, and is subject to perpetual review. Any changes will be announced by bulletin. This bulletin will be included in the upcoming revision.

Case Loss Reserves

The case loss reserve (case reserve) is the company's estimate of the value of future payments for an individual claim. The incurred loss is the sum of all payments plus any outstanding case reserve.

NFIP case loss reserves do not include reserves for Allocated Loss Adjustment Expenses (ALAE), Unallocated Loss Adjustment Expenses (ULAE), Special Allocated Loss Adjustment Expenses (SALAE), or reserves for losses that have been Incurred But Not Reported (IBNR). The initial case loss reserve may be a system-generated amount based on criteria established by the Company or it may be an individually set case loss reserve based on the best knowledge of the loss at the time the initial reserve is set. Subsequent adjuster reports and other information should be used to refine the case loss reserve amount (increase or decrease) as the company becomes aware of additional facts, inspections, and estimates of damage.

Following a catastrophe, instead of case loss reserves for individual claims, a company may bulk reserve for catastrophe losses. The bulk reserve is typically reduced as payments are made. Bulk reserving for catastrophe or other loss types is an accepted industry option.

Advance payments and other partial payments will normally decrease the case loss reserve. However, at the time an advance payment or other partial payment is made, the company's estimate of the value of future payments should be reevaluated and the case loss reserve revised. The goal is that the company's knowledge of the claim along with any advance or other partial payments will result in a case loss reserve that closely reflects the value of future payments. For example, when the final payment is made it should be in an amount close to the outstanding case reserve just before payment.

It is understood that reserving is not an exact science. Consistency is more important than target accuracy. WYO Companies and the NFIP Servicing Agent should have established procedures that enable this consistency.

Another reserve issue pointed out during audits is the merging of policies from one company or vendor to another. The procedures for transferring policies and claims from one to another vendor or company should include guidance regarding the preservation of reserves during the transfer.

An additional issue raised in the latest DHS Financial Audit, is the timing of the case reserve change. Regardless of the timing of the receipt of information upon which a case reserve change is to be

based, the case reserve is typically not adjusted until the payment is made or after any additional verification of facts is complete. It is the judgment of the examiner that FEMA will depend upon. The receipt of such information may be in one Month, one Fiscal Year, or one Calendar Year, but the payment or reserve adjustment may be made in the next period. The important factor is that the reserve remains up until payment is made (typically a systemic reduction) or until the reported facts are verified. The insurance industry typically considers some reserve redundancy as healthy. Again, reserving is not an exact science.

cc: Vendors, IBHS, FIPNC, Government Technical Representative

Suggested Routing: Accounting, Claims, Data Processing