# Center for Insurance Policy and Research Summit:
# Flood Insurance Reform

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**Chair, Flood Subcommittee**

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AMERICAN ACADEMY of ACTUARIES

# Background—Actuarial Rates

- Basic principle—an actuarial rate should reflect the hazard of the insured risk.
- Casualty Actuarial Society (CAS) Statement of Principles Regarding Property and Casualty Insurance Ratemaking
- Actuarial Standards Board (ASB)—Actuarial Standard of Practice No. 12—Risk Classification

# CAS Statement of Principles Regarding Property and Casualty Insurance Ratemaking

- "Principle 1: A rate is an estimate of the expected value of future costs."
- "Principle 2: A rate provides for all costs associated with the transfer of risk."
- "Principle 3: A rate provides for the costs associated with an individual risk transfer."
- "Principle 4: A rate is reasonable and not excessive, inadequate, or unfairly discriminatory if it is an actuarially sound estimate of the expected value of all future costs associated with an individual risk transfer."

# ASOP No. 12—Risk Classification

- "A relationship between a risk characteristic and an expected outcome, such as cost, is demonstrated if it can be shown that the variation in actual or reasonably anticipated experience correlates to the risk characteristic."

# Actuarial Perspective on Flood Insurance Reform Act of 2012

- Premium rate structure reforms
  - The Flood Insurance Subcommittee support efforts to create more adequate rates by reducing subsidies for selected properties.
- Premium adjustment
  - To be consistent with actuarial principles, premiums should accurately reflect the hazard in the rates, as reflected in updated maps.
- Minimum deductibles
  - Increasing minimum deductibles helps to mitigate the losses to the program.

# Actuarial Perspective on Flood Insurance Reform Act of 2012

- Considerations in determining chargeable premium rates
  - We support using actuarial principles in determining rates. However, including catastrophe years in determination of "average historical loss year" may actually violate those principles.
- Reserve fund/repaying flood insurance debt
  - In theory, setting the reserve fund is a good idea. But if the debt is to be paid off first, this may not be practical.
  - There could be a need for significantly more premium.
- Reinsurance initiative
  - While private reinsurance could be a significant help in stabilizing the program, at current rates, there may not be enough NFIP premium to purchase a significant amount of reinsurance.

# Wharton Paper:
# A Methodological Approach for Pricing Flood Insurance and Evaluating Loss Reduction Measures: Application to Texas

- Areas of agreement
  - It might be beneficial to have a private market to complement the NFIP.
  - There are certainly significant differences in the expected losses for areas that have similar NFIP rates. Private insurers develop considerably more detailed classification systems to better match hazard and rates.
    - See discussion of risk classification in Academy Public Policy Monograph, *The National Flood Insurance Program: Past, Present… and Future?*

# Wharton Paper:
# A Methodological Approach for Pricing Flood Insurance and Evaluating Loss Reduction Measures: Application to Texas

- Questions and Concerns
  - As noted in the paper, private insurers require much higher loadings. Given that, are there enough areas in which:
    - private insurers could charge lower premiums, and
    - homeowners would purchase it?
  - The U.S. insurance market is robust; insurers will offer products to fulfill consumers' needs. Given that, why have companies not developed programs to take advantage of this?

# Recommendations

- Program needs wider participation.
  - Better publicity?
  - Better agent training?
  - Better differentiated rates?
- Address the NFIP debt.
- Continue toward more adequate rates.

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