



FEMA

W-10008

February 4, 2010

MEMORANDUM FOR: Write Your Own (WYO) Company Principal Coordinators,  
NFIP Servicing Agent, and Selected Adjusting Firms

FROM:

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

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

SUBJECT: Update - NFIP Case Loss Reserving Procedures

This is an update to Bulletin W-08095 dated December 22, 2008, and makes minor revisions that clarify the reserving process to be used going forward.

Each year, the Department of Homeland Security (DHS) conducts an independent, external review of internal control processes within various Agencies that are under the DHS umbrella. For 2008 and 2009, this review was performed by KPMG. Their review included the National Flood Insurance Program (NFIP) claims and policy files of several WYO Companies and the NFIP Servicing Agent.

The KPMG 2008 findings indicated that some insurers were not complying with the NFIP case-reserving procedures. That finding was not material and, in our opinion, has no effect on the operations of the NFIP. However, in reviewing that finding, FEMA's Claims & Appeals Branch determined that the *NFIP Adjuster Claims Manual*, which KPMG cited as the source of the requirement, incorrectly characterized case reserves and the reserving process that is common throughout the insurance industry. Since it is, and always has been, the intention of the NFIP to follow that industry practice, we are therefore issuing this revision. The Manual is currently being updated and will include this revision.

In addition, reserving practices has been an area of interest during Operation Reviews beginning with the FY 2009 cycle. Case loss reserves have no direct effect on the NFIP's balance sheet, therefore, any findings will not be considered critical. Also, we will review other NFIP publications and plans to determine if any reference to case reserving can be clarified to provide future auditors of the NFIP with the correct case reserve procedure.

Beginning with the FY 2011 Claims Operation Review cycle, reserving issues will be considered non-critical errors at the discretion of the reviewer.

### **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 reserves do not include reserves for Allocated Loss Adjustment Expenses (ALAE), Unallocated Loss Adjustment Expenses (ULAE), or reserves for losses that have been Incurred But Not Reported (IBNR). The initial case reserve may be a system-generated amount based on criteria established by the Company or it may be an individually set case reserve based on the best knowledge of the loss at the time the initial reserve is set. Subsequent adjuster reports should refine the case 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 reduced as payments are made. Bulk reserving for catastrophe losses 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 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.

cc: Vendors, IBHS, FIPNC, Government Technical Representative

Suggested Routing: Accounting, Claims, Data Processing