

EXAM 6 – UNITED STATES, FALL 2012

12. (3 points)

The following are goals of government insurance programs:

- i. To fill insurance needs unmet by private insurers
- ii. To compel people to buy a particular type of insurance
- iii. To achieve collateral social purposes

a. (1.5 points)

Identify and briefly describe a government insurance program that was initially created to achieve each goal. Choose a different program for each goal.

b. (1.5 points)

Evaluate the effectiveness of each program identified in part a. above, in achieving the goal.

CONTINUED ON NEXT PAGE

12) Sample Answer

Need unmet by private insurers

- **Terrorism Insurance**

- Part A- Terrorism risk insurance program was designed to fill an unmet need. After 9/11 it was evident that private insurance companies may not have the capacity to provide terrorism insurance. Therefore government stepped in to fulfill this need.
- Part B- The terrorism risk insurance program, even though it fulfills an unmet need, it is not effective since the demand is not as large as expected. It may be feasible for private insurers to provide this insurance backed by CAT bonds.

- **Unemployment Insurance**

- Part A- unemployment insurance – due to the catastrophic nature of coverage it was considered uninsurable by private insurance. This therefore fills an unmet need.
- Part B- unemployment insurance has provided temporary financial assistance but only replaces about 1/3 of income and only about 2/3 apply.

- **Fair PLANS**

- Part A- FAIR plans – provide unmet need by providing coverage on higher risk properties that were considered uninsurable by private market.
- Part B- Effective – partners w/private insurers and fills unmet need in market; higher costs shared by all insurers in state.

- **NFIP**

- Part A- National flood insurance program – provides insurance in catastrophe prone area that private market hesitates to cover.
- Part B- the NFIP covers high risk properties, but often must borrow from the treasury to do so. It will need to change more adequate rates and increase participation to lower costs moving forward.

Compel people to buy a particular type of insurance

- **Workers' Compensation**

- Part A- WC funds: since WC insurance is compulsory, state WC funds help to address both affordability and availability issues
- Part B- WC funds are effective. However, private insurers are able to provide WC insurance with as much expertise and efficiency. Government involvement is definitely effective in markets where there is an exclusive WC state fund; since the alternative private option may have had availability/affordability issues.

- **NFIP**

- **NFIP – flood insurance**

- This is required by people who have federally backed mortgage loans and live in flood zones. It is available to communities who meet certain regulations standards and offer protection to homeowners that were not offered in insurance market.
- Not particularly effective – a large proportion of houses are not insured even though mandated by law. Government actually ends up paying disaster relief anyways which leads to large losses.

- **Residual AL**
 - Part A- Residual auto market – auto insurance is mandatory, but high risk drivers may not be able to get coverage from private insurers, so residual market is created to address availability and affordability issues.
 - Part B- The program enables high-risk drivers to obtain insurance who may otherwise go without, so this is good for society. Also insurers share the prem and loss which seems to be a fair way to address the problem.

Collateral social purpose

- **National Flood Insurance Program**
 - Part A- Flood insurance achieves a collateral social purpose by enforcing building codes and limiting new construction in flood zones.
 - Part B- While mostly ineffective due to the rates being not actuarially sound and lack participation, the social purpose is partially achieved since communities adopt flood plain management plans and provide funds to mitigate before flood damage.
- **Social Security (OASDI)**
 - Part A- create a minimum savings for retirement and healthcare for all qualified workers, comprising of most of all workers.
 - Part B- effective in creating savings for all participants. Criticism exists in that it is currently underfunded for a long-term view and needs to be tweaked. However, provides a mix of individual equity and social adequacy, while promoting earned right and universality.
- **Unemployment Insurance**
 - Part A- Unemployment Insurance is a government funded program used to help certain people who lose their job due to no fault of their own but as a result of economic recession
 - Part B- Unemployment insurance is effective because currently it provides millions with income they would not otherwise be able to have. It might not be as efficient as we would like considering it only replaces 1/3 of the wages, prolongs unemployment and only 2/3 of eligible people can collect.
- **TRIA**
 - Part A- government provides terrorism insurance so that there is no market disruption when a catastrophic attack occurs (esp. for certain industries like airlines).
 - Part B- also moderate program; has been used to alleviate terrorism risks, but participation lower than originally expected.
- **WC**
 - Part A- employers are legally required to provide workers compensation. This is a positive externality because it encourages injury prevention and safety practices while containing the costs of coverage
 - Part B- Program is effective, injured workers are compensated without the need to sue due to no-fault law. Coverage is available at a reasonable cost and residual market is very small.

Examiner's Report

Many candidates offered a reasonable listing for question A. However there were two common ways to lose credit. First, an acceptable program was mentioned but the program's description didn't provide adequate detail on why it was created to achieve a certain goal. Second, certain programs were not accepted for many goals for example, social security and unemployment were not accepted for goal II because the insured is normally not the buyer for these products and has little or no say as to whether those coverages are purchased.

For question B, we were looking for a good half point thought out answer to pair with their response in A. Some candidates did not receive credit for B because their evaluation of the effectiveness was the same as their answer in A which didn't demonstrate mastery of the material. In addition, some answers received partial credit for mentioning a correct point, but not enough for a full credit answer.

The graders looked at each part A and B together for each program so points that received credit for A that were mentioned in their answer for B were accepted and vice versa. Some candidates even combined A and B for each program into a few sentences. The majority of candidates received over half of the credit for this question.