

EXAM 6 – UNITED STATES, FALL 2012

13. (3 points)

Three types of residual market auto insurance programs are:

- Automobile insurance plans (AIP)
- Reinsurance facilities (RF)
- Joint underwriting associations (JUA)

a. (1.5 points)

Compare the following for AIPs and JUAs:

- i. How drivers are assigned to an insurer
- ii. How rates are set once a driver is assigned to an insurer
- iii. How profit and loss are allocated to participants

b. (0.75 point)

An insurer prefers low-risk drivers because its rating plan does not charge an adequate premium for high-risk drivers. Justify which type of residual market auto program the insurer would prefer. The justification should include two supporting reasons.

c. (0.75 point)

An insurer has a large market share across an entire state. The insurer has good claims handling practices that help reduce the average loss payment per claim. The insurer also has lower claims-handling expenses than the industry average in the state. Justify which type of residual market auto program the insurer would prefer. The justification should include two supporting reasons.

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### 13) Sample Answer

#### Part A

##### Answer 1

- I) In AIP drivers apply to plan and assigned to insurer based on voluntary market share. In JUA drivers apply to insurer; insurer forwards application to JUA.
- II) In AIP rates are set by regulators and uniform. In JUA, rates are set based on pool experience and uniform.
- III) In AIP, insurer retains the profits/losses. In JUA, profits/losses shared among participants based on voluntary market share.

#### Part B

##### Answer 1

JUA – the rates would be set by JUA, so they could probably be highest and more responsive to experience. This increases revenues and chance of making profit. The risk could be stored by all insurers, unlike an AIP which would make insurer solely responsible for profit/loss; this increases risk.

##### Answer 2

This insurer would favor a reinsurance facility because it can retain all the profits from its low risk drivers and it can still choose whether to accept high risk drivers. If it does accept high risks it can always code them to the facility.

##### Answer 3

RF would not be preferred because it would use insurer's inadequate rates. AIP would not be preferred because insurer may not have experience handling high risk policies and claims handling and would be required to do so under AIP; would prefer a JUA.

#### Part C

##### Answer 1

RF – the insurers could elect to retain the best of the high risk insured's and make a profit because of their better than average claims practices and expenses. Those insured's who would still be unprofitable can be ceded to the RF. In essence the insurance company could leverage adverse selection to maximize results.

##### Answer 2

Insurer will prefer AIP because:

- It retains the loss/profit; good claim handling practice that reduces average payment per claim and low claim handling expense benefit the insure itself.
- It has large market share, so would probably not interested in losses shared based on voluntary market share.

##### Answer 3

The insurer would prefer a JUA and would prefer to be the main service carrier for it. With lower claims handling expenses they can handle the high risk claims cheaper than other carriers. The JUA also has the advantage of charging high risk rates based on the pool

experience, so the low risks will not have to subsidize the high risks as much as they do in other programs.

### Examiner's Report

Part A asked to compare AIPs and JUAs. A number of candidates also included the characteristics of RFs.

Another common mistake in Part A was that the question asked "How drivers are assigned to an insurer" and for AIP a number of candidates did not write that they are assigned by market share.

Part B & C a number of candidates lost points by not tying the answer back to the situation mentioned in the question. In Part B, several candidates mentioned that a low average premium implies a lower market share. A low average premium is not a function of market share. When candidates said this they were not able to receive full credit for the question.