2. (2.5 points)

   a. (1.5 points)

      For each of the following lines of insurance, briefly describe the degree of regulatory scrutiny and provide a rationale for it.

      - Inland marine
      - Private passenger auto
      - Commercial general liability

   b. (1 point)

      Describe how political influence could explain the difference in regulatory scrutiny between ocean marine insurance and workers compensation insurance.

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a.

Inland Marine is regulated very little.
Inland Marine has low/minimal regulation.
IM is the least scrutinized of the three lines
-The risks are highly individualized.
-There is no statistical information to justify rates.
-Diverse coverages and classifications
-The buyers are sophisticated and knowledgeable

CGL has only general regulation (except during tight markets).
CGL has medium regulation
General Liability is moderately regulated
CGL is not as highly scrutinized as PPA but more than IM
-The buyers are sophisticated and knowledgeable

PPA typically requires regulatory review of overall rates and details of the rating plan.
Auto is heavily regulated
PPA has the most regulation of the three lines
-Coverage is legally required
-Consumers tend to be uninformed
-The statistical plan is highly uniform with credible data for analysis
-Rates and classification systems involved are complicated

b. Political Theory of regulation explains that regulatory attention can be greatest for issues that attract substantial voter interest and are easy for policymakers to understand.

Ocean Marine insurance attracts little regulatory interest since it:
-directly affects few voters
-coverage can be difficult for policymakers to understand.

Workers' Compensation attracts much regulatory interest since it:
-affects thousands of employers and employees
-affects a large population of the people
-mandatory coverage- political influence needs to make sure that coverage is avail and affordable
-a large expense for most businesses
-has a well-defined experience rating system that policymakers can understand
-social benefit

2. <u>Examiner's Report</u>

This question tests basic knowledge of the current state of rate regulation.

a. Most candidates did very well on this part. Common errors included:
   - Vague descriptions of the degree of regulatory scrutiny (Sort of, Not a little, Not a lot, Not Heavily…)
   - Talked about the number of people impacted by the line of insurance, but the number of people affected by the insurance is not always representative of the degree of regulatory scrutiny.

b. The most common errors were not addressing the impact of political influence in the response and not mentioning the different degrees of regulatory scrutiny between Ocean Marine and

Workers Comp. Several candidates described the Workers Comp environment in detail, but made no mention of Ocean Marine. Some candidates did not focus on political pressure or regulatory environment and rather focused on comparing what each line of business is.

3. Sample Answers

a. Any three of the following:
   - Promote the financial stability of insurers/mitigate disruptive market failures
   - Prevent collusion/monopolistic pricing amongst insurers
   - Reduce unfair price differences between insurance products
   - Ensure affordable coverage
   - Protect consumers from purchasing high-priced insurance
   - Protect public interest by controlling what insurers charge
   - Risk classification achieves greater equity/fairness
   - Prevent excessive insurer profits (when insurance is mandatory)
   - Encourage some parties to buy insurance who otherwise would engage in risky activity without insurance (when insurance is mandatory)
   - Promote price information disclosure

   OR

   Any one of the following:
   - Rate regulation seeks to remedy issues of fairness, equity, or affordability in insurance
   - 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

b. Any three of the following:
   - Due to complexity of insurance industry, consumers have an inability to evaluate an insurer's financial condition and long-term viability, hence the need for solvency regulation
   - Protects policyholders/claimants/beneficiaries by ensuring ability of insurers to fulfill their contractual obligations (claims, unearned premium)
   - Facilitates an effective and efficient marketplace for insurance products
   - Promotes market stability
   - Protects public interest
   - Insurer insolvency affects consumer, who must absorb the resulting costs / can decrease consumer access to insurance (availability) / can affect the rates consumers pay for insurance (affordability)
   - Insurers have incentives to take risk because of guaranty fund (moral hazard)
   - Guaranty funds pay for insolvent insurers and solvency regulation prevents this cost from getting out of control
   - Compared to other business transactions, insurance transactions involve a considerable amount of risk (The potential future loss amount is unknown, yet the insurance policy is sold for a specific premium amount).
   - Large cash flow up front. Regulators must monitor loss reserves to assure future claim payment.
   - Concern that policyholder surplus is inadequate
   - Purpose of policyholder surplus (regulation ensures it's adequate):