3. (3.25 points)

   a. (0.75 point)

      Briefly describe three arguments that support the need for insurance rate regulation.

   b. (0.75 point)

      Briefly describe three arguments that support the need for insurance solvency regulation.

   c. (0.75 point)

      Identify an area of overlap and an area of conflict between the goals of rate regulation and solvency regulation.

   d. (1 point)

      Describe one advantage and one disadvantage to insurance companies of having numerous state and federal agencies involved in solvency regulation.

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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. <u>Sample Answers</u>

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 <u>fairness</u>, <u>equity</u>, or <u>affordability</u> in insurance
   - A rate is reasonable and <u>not excessive</u>, <u>inadequate</u>, or <u>unfairly discriminatory</u> 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):

-provides financial capacity
-supports growth
-supports underwriting activities
-buffer against business risk to ensure company can meet debt obligations
-buffer against insurance risk (price inadequacy, reserve error, underwriting risk)
-ensures investments are compliant

- Prevents "betting the farm" when insurers are on the brink of insolvency
- Obviates need for costly rate regulation
- Protects reputation of the insurance industry (extension of efficient/effective market argument)
- Encourages a risk management culture where insurers are aware of their own specific risks

c. Any one of the following areas of overlap:

- Protecting the policyholder
- Protecting public interest
- Ensuring an effective insurance marketplace
- Solvency concerns are somewhat encompassed in rate regulation
- Rate adequacy
- Solvency regulation obviates rate regulation's role in preventing insolvencies
- Both protect uninformed buyers
- Both interested in keeping insolvency costs low
- Solvency regulation increases transparency in industry which leads to decreased information risk and decreased rates

Any one of the following areas of conflict (need to address both rate and solvency):

- Affordability/availability concerns of rate filings vs. adequacy/solvency concerns of solvency regulation
- Adequacy concerns of solvency regulation vs. rate equity concerns of rate regulation. Rate equity leads to adverse selection which can impact solvency
- Facilitating an efficient marketplace vs. restrictions on rate/risk classification
- Encouraging some risky parties to buy subsidized insurance vs. insurer solvency
- Preventing excessive profits to insurers vs. insurer solvency
- Fairness/no discrimination vs. adequate rates
- Costs related to keeping up with solvency regulations passed on to policyholders and can increase rates or impact solvency
- Regulator costs for doing rate regulation may interfere with solvency regulation
- Rate regulation can limit competition but solvency regulation promotes it

d.

Any one of the following advantages:

- Having numerous agencies working in coordination reduces the risk of regulatory forbearance
- Having numerous agencies working in coordination reduces the risk of regulatory capture
- Having a system of peer review and peer pressure provides incentive for the domestic regulator to be responsive to the concerns of other states
- Having some duplication and overlap can be advantageous in detecting warning signs more easily

- Having a diversity of perspectives tends to produce centrist solutions, making it unlikely that excessive deregulation or over-regulation could occur
- Having a state regulatory system reduces moral hazard problems that accompany a market expectation of bailouts due to the difficulty of accessing federal government funds

Any one of the following disadvantages:

- Having a single regulator would increase national uniformity
- Reinsurers operating in a global market can compete better with uniform federal regulation and capital requirements per Dodd Frank
- Higher costs associated with duplicative and overlapping regulation (multiple rate filings, delays)
- Inefficiencies associated with duplicative and overlapping regulation / need to keep track of regulations for multiple states
- Uniform regulation can stifle innovation
- Tendency for states to rely on rating agencies in their RBC system
- States ignore unregulated affiliates within an insurance group in a practice known as "ring-fencing". A rating downgrade of these affiliates can negatively impact the regulated parts of an insurance group.

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

Parts a and b of this question were not difficult and there were many possible correct answers. Parts c and d are slightly more difficult in that they require synthesizing the basic concepts.

a. Candidates generally performed very well on this part. Common errors included:
   - Giving arguments to support solvency regulation instead of rate regulation.
   - Providing duplicate arguments (eg stating that one goal was affordability and another that there should be a limit to what one should pay for insurance)
   - Stating that rate regulation helps ensure availability (rather than "ensure coverage is available and affordable" or "ensure coverage is affordable")
   - Stating that rates should not be discriminatory (rates can and should be discriminatory, it is when they are unfairly discriminatory that problems arise)

b. Candidates performed well on this part. Common errors included:
   - Giving arguments to support rate regulation instead of solvency regulation.
   - Providing duplicate arguments (eg stating that guaranty fund assessments hurt insurers for one answer and that guaranty funds hurt policyholders in another answer)
   - Providing too general of an answer (eg "there have been many cases of insurers becoming insolvent")
   - Stating that taxpayers pay for insurer insolvencies (guaranty funds are designed to pay for insolvencies, which are funded by insurer assessments)
   - Stating that solvency regulation obviates the need for rate regulation (solvency regulation obviates the need for rate regulation's role in preventing insolvencies)
   - Stating that solvency regulation protects investor funds (no evidence of solvency regulation being concerned with investor funds)
   - Stating that solvency regulation protects employees of company from losing their jobs (no evidence of solvency regulation being concerned with company employees)

c. Candidates did fairly well on this part. However, there were many candidates who lost some credit by providing only a partial answer (eg only describing an overlap or only describing a conflict). Other common errors included:
   - Stating that ensuring availability was an overlap
   - Stating that ensuring policyholder obligations are met was an overlap (this is a solvency goal)
   - Stating that an area of conflict was: rate regulation wants to ensure rates not excessive while solvency regulation wants to ensure high rates (regulators want rates to be adequate, not necessarily high, to meet all costs and provide a reasonable profit)

d. Candidates generally scored very well on this part. Some candidates lost credit by providing incomplete or partial answers.

4. Sample Answers

a.
   - Clayton Anti-Trust made illegal activities that lessened competition or created monopoly power.
   - Clayton Anti-Trust made illegal activities that created monopoly power, including tying, exclusive dealing, and mergers between competitors.
   - Cooperative arrangements (rate making in concert) is not allowed under Clayton Anti-Trust, which are necessary and incidental to establishing adequate coverages, and related concerns.
   - Robinson-Patman Act (Clayton Anti-Trust amendment) prohibits price discrimination with the exception of price differentials.
   - Clayton Act is a federal law and didn't apply to the insurance industry before the SEUA case.

b. Boycotting: Not explicitly addressed by Clayton Act. Explicitly prohibited by the Sherman Act. Requiring purchase of both homeowners & auto policies: Tying of purchases explicitly prohibited by Clayton Act.

c. Any two of the following:
   - Returned insurance to the states.
   - Federal regulations still apply in boycotting, intimidation and coercion per Sherman Act.
   - Bureau ratemaking is allowed
   - Federal regulation still takes precedent in any law specifically regarding insurance and to the extent not regulated by the states.

d. Boycotting: Explicitly prohibited by Sherman Act which is still applicable per McCarran-Ferguson Act.
   Requiring purchase of both homeowners & auto policies: Not explicitly addressed by Sherman Act. It is addressed by the Clayton Act or would be handled by state insurance law/statutes.

4. Examiner's Report

Parts a and c of this question are very straightforward. Parts b and d are slightly more difficult in that they require applying the Acts in a specific example.

a. Most candidates knew the definition of the Clayton Act. However, some candidates were confused by the difference between the Clayton Act and Sherman Act.