14. (2.5 points)

a. (1.5 points)

Briefly describe how guaranty funds both positively and negatively affect the following stakeholders:

- Large corporate insureds
- Small individual insureds
- Insurance companies

b. (1 point)

Briefly describe one advantage and one disadvantage for each of the following approaches to funding guaranty funds:

- Post-insolvency assessment
- Pre-funded assessment

CONTINUED ON NEXT PAGE

- For Principle 3, stating that non-subsidized risks satisfy this principle.
- For Principle 3, saying that NFIP meets this requirement because it is difficult for private insurers to meet. This does not mean that the NFIP meets it.
- For Principle 3, confusion over how low-risk properties pay for high-risk properties. This is due to wide risk classes, not grandfathering (where low risks are not subsidizing high risks, the government subsidizes).

b. Common errors included:

- Many candidates provided improvements but no justifications for them.
- Some candidates supplied an improvement with an inappropriately matched justification.
- Some candidates stated that increased rates would be an improvement, but the goal should be actuarially sound rates and therefore not all rates may need to be increased.
- Eliminating coverage was not an acceptable improvement. Per pg 16 of the AAA paper "The NFIP is not allowed to refuse to cover an "eligible" property, regardless of the property's loss history. Ineligible structures are few and are prescribed by the federal program." Refusing coverage without reference to potential loss mitigation strategies goes against the goals of the NFIP.

14. Sample Answers

a.

Small individual insureds –
Positive (any one of the following):

- get the total value of most claims paid promptly rather than waiting to receive a fraction of the claim under federal bankruptcy laws
- receive payment promptly
- provides temporary coverage
- allows them to collect unearned premiums
- Don't have to do own analysis or be as concerned w/ insurer strength since they are covered (partially) in case insolvency
- Insurers will be more aggressive, lower price for insured
- Duty to Defend claim

Negative (any one of the following):

- willing to tolerate risky insurer underwriting;
- Increases the cost of insurance
- higher costs through assessments being passed onto consumers
- Small claim deductible may limit small claims & they won't get all of unearned premium back most likely
- There may be delays/decreases in outstanding claim payment
- Maximum limit in addition to policy limit applies

Large corporate insureds -
Positive (any one of the following):

- receive payment promptly
- allows them to collect unearned premiums
- Protected by Guaranty Fund if they purchase from admitted market
- provides temporary coverage

- Duty to Defend claim
- Workers comp unlimited claim benefit

Negative (any one of the following):
- Are subject to large net worth deductibles
- Increases the cost of insurance
- higher costs through assessments being passed onto consumers
- may not benefit from GF as it excludes marine, excess, etc.
- Unlikely they will see benefits if guaranty fund is required because they have financial capacity to cover own losses.
- if they participate in RRGs or non-admitted market
- There may be delays/decreases in outstanding claim payment
- Maximum limit in addition to policy limit applies

Insurance companies -
Positive (any one of the following):
- They benefit however from the ability of GF to intervene and attempt to assist in rehabilitation prior to insolvency, which makes the market more stable for customers/investors
- Gives their policyholders reassurance that they are protected if they go insolvent
- Help promote financial soundness and integrity of the industry as insured won't be left high and dry from insolvencies
- Allows financially weak insurers to compete at same level as strong ones
- Amt paid is known + will be enough to cover cost of insolvency

Negative (any one of the following):
- Insurers have to pay operating expenses for the fund, increasing costs of doing business.
- Increases the cost of insurance
- They are directly assessed to fund guaranty fund
- Competition is distorted, as insurers can be lax in their underwriting standards.
- Allows financially weak insurers to compete at same level as strong ones

b.

Post-Insolvency Assessment -
Advantages
- Assessments offset by recoveries from insolvent insurers' estates
- Tax credits may allow insurers to avoid part of the cost of their assessments
- More accurate assessment.
- Company retains asset to earn investment income
- If no one goes bankrupt, no payment is required, so rates and/or expens are kept down and there is less interference in the market

Disadvantages
- Assessment on all solvent insurers currently operating in the state
- Could be a large amount at once, not expected
- Maximum assessment may not cover insolvencies due to catastrophes
- Can be costly and adversely impact financial results abruptly (cause erratic financial results)

Pre-Funded Assessment -

Advantages

- Assessment on all insurers operating in the state
- Pre-funding can build a catastrophe fund
- GF can invest funds so smaller assessments
- Even, small and regular payments will need to put in. This allows for insurers to plan for assessments
- Motivates insures to accurately make rates to avoid insolvency
- Less delay in paying claims affected insureds because funds available
- Insured's (Public) peace of mind that fund is present

Disadvantages

- Requires ins cos to fund when there may not be a need. They could be investing those funds.
- Assessments may be passed on to policyholders and the fund might never be used.
- If not enough funds, may be exhausted and still have to assess more.
- It is difficult to estimate cost ahead of time so could be over/under assessing

14. Examiner's Report

Part a is straightforward, while Part b is somewhat less straightforward especially since the pre-funded approach is discussed only briefly in the syllabus readings. Nevertheless, candidates could provide logical responses that evaluated the advantages and disadvantages.

Common errors included:

- In part a, some candidates didn't list both the positive and negative effects and only opined on whether it was positive or negative overall.
- In part b, some candidates confused the pre and post funding attributes and answered the parts in reverse.
- Some confused the effects of insureds with insurers and vice versa.
- Some candidates incorrectly mentioned that guaranty funds apply to reinsurers.
- Some candidates repeated answers, for example, reporting the same answer for all stakeholders in part a, "Increases the cost of insurance." For part b, some candidates stated that an advantage of pre-funded assessment was the speed of claims payments (quicker) while a disadvantage of the post-insolvency assessment was the speed of claims payments (slower).

15. Sample Answers

a.

Sample 1

Surplus is allocated according to following formula:
total mean surplus x (mean loss reserve + mean UPR + EP during the year of the line of business) / (total mean loss reserve + total mean UPR + total EP during the year)

Sample 2

avg PHS / Total[avg L&LAE RSV + avg UEPR + cur EP] * LOB[avg L&LAE RSV + avg UEPR + cur EP]

Sample 3

allocated by the lines proportion of the insurers "A: mean net loss and LAE reserves, mean net unearned premium reserves, and calendar year earned premium" where net means net of