3. (4 points)

   a. (3 points)

      Construct and justify a framework for insurance regulation for primary insurance companies that addresses each of the following elements:

      - Regulatory jurisdiction
      - Duties of regulators
      - Rate regulation
      - Solvency regulation

   b. (0.5 point)

      Discuss how the regulatory system described in part a. above would function in an increasingly globalized insurance industry.

   c. (0.5 point)

      Justify whether or not the system described in part a. above would require variations for reinsurers.

CONTINUED ON NEXT PAGE

QUESTION 3	
TOTAL POINT VALUE: 4	LEARNING OBJECTIVE: A1,A2,A4
SAMPLE/ACCEPTED ANSWERS	
Part a: 3 points	

Regulatory Jurisdiction

- I would have regulation remain at the state level. The primary reason is that there are benefits to the duplication, peer review, and diversity of perspectives that are realized by each state having authority. These benefits include the reduction of fallibility capture and forbearance.
- Should be regulated by the states by the states. This gives states the power to enact laws and regulate based on each states unique characteristics- population, type of risks, regulatory/political environment, types of insurance companies that operate in the state, etc.
- I'm assuming regulation is currently at the state level. States; if it isn't broke, don't fix it. Substantial cost to move regulation to federal level.
- States have jurisdiction over business of insurance. The current state based system did better than the fed regulation of banks during financial crisis.
- Federal with congressional oversight. Insurance should be regulated by the federal government, subject to regulations as deemed necessary or desirable by acts of congress. A Federal Dept. of Insurance shall be created to regulate the insurance market. Federal oversight has many benefits: one voice in international debate/discussion, reduce cost and complexity of compliance, quickly react to changes in insurance market.
- I would use a federal jurisdiction for the primary regulatory authority of insurance. This would help centralize regulatory power and deliver uniform laws and regulations for all insureds

Duties of Regulators

- License insurers, financial reporting review of insurers, and periodic examinations. The constant monitoring of insurers, from their formation to their on-going operation, will ensure adequate risk management is in place.
- Regulators must first protect the consumer's benefit, promote competitive market, and cooperate and streamline regulation among other states. A few examples include: ensure coverage is available and affordable, rates are adequate, monitor consumer complaints, and ensure accreditation of state department of insurance.

Rate Regulation

- A use and file system would be best. Competition is best regulator of insurance so we don't want too much regulation of rates. However, we should make sure they are not discriminatory, thus use and file to check that. Still, admin costs shouldn't be too high for this.
- Rate regulation would be competitive file and use system. This would allow regulators to monitor filings, but allow competition to be prime regulator.
- Open competition with No File laws will be the rate regulation method. Open competition provides incentives for companies to charge the actuarially fair rate and provide efficient services due to competition. Prior approval increases administrative costs and negatively effects coverage availability.

- Should differentiate by LOB. Certain lines like Ocean Marine have diversified risks and knowledgeable consumers. Should have minimal rate regulation and rely on competition. While some other lines such as WC, can have a closer rate monitoring as insurance is compulsory, rating classifications are complicated, and affects most workers and employers.
- Prior approval. The insurers may charge high rate to gain excess profits, especially when the purchase of insurance is compulsory.

Solvency Regulation

- Companies should have internal models that dictate solvency requirements. Regulators can check these models. Companies understand their own risks best, and this creates culture of risk management. However, there should be IRIS ratios as well, just to ensure possible solvencies are recognized early.
- ORSA – the company is in the best position to assess its own risk and manage their risk. The regulators can review the ORSA report and take necessary actions if required. The companies have strong incentives to control their risk and stay solvent.
- Each state would need to be accredited to monitor the solvency of each insurer. The accreditation program would ensure that the solvency of insurers was being monitored consistently among the states and would help detect financially troubled insurers before it became too late for the regulators to jump in and help out.
- Solvency regulation will be a combination of US system and Solvency II. US system has advantage of rules based and prudent person but Solvency II has internal models which promote culture of risk management and better align with firm's risks. Combination can take best of both systems.
- The RBC method seems like a good method. It evaluates many different risks that the insurers are subject to and provides clear instructions on how regulators should act based on the result. Perhaps it would be best to add in a catastrophe provision which RBC does not currently have.
- We would stick with SAP accounting as it provides a conservative view of companies financial which is very important as we don't want them going insolvent thus harming our citizen.
- Use multiple procedures involving financial examination, IRIS test and RBC ratio to ensure detection of problems insurers as early as possible and make sure companies are complying to minimum capital requirements.
- Approach similar to Solvency II where oversight is based both as a formulaic approach and a principles-based approach. This structure would consider both held reserves and capital, as well as management and risk mitigation culture.
- IRIS type ratios that monitor certain aspects of a company's solvency. These allow a consistent, objective view of a company's solvency. Regulator action can be approved after failing a certain number of ratios.
- Minimum capital requirements will be put into place to ensure the company has funds to pay claims. Also, reserves will be reviewed so that each company is prepared to pay future claims.

Part b: 0.5 point

- Companies should have internal models that dictate solvency requirements. Regulators can check these models. Companies understand their own risks best, and this creates culture of risk management. However, there should be IRIS ratios as well, just to ensure possible solvencies are recognized early.
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Part c: 0.5 point

- It will need some variations due to the capital structure and risk natures of reinsurers. For instance, capital requirement may be higher for reinsurer due to the exposure to CAT events
- Yes. Reinsurer usually present in multiple state. Need a more uniform control on reinsurers. State-based regulation may need to be modified.
- Yes, because regulators are primarily located outside the US, there would need to be a framework established to regulate them.
- It would not need to. Reinsurers could play by the same rules. One could rationalize that

"unauthorized" reinsurers aren't as safe so shouldn't be used, or "our" regulated reinsurers are with the cost.

- Many reinsurers are overseas, so framework needs to address lack of information and difference in solvency standards to the RBC as well as accounting differences
- (Federal jurisdiction selected in part a) No. I think it works equally well for reinsurers.1 regulator to get approval from, easy interface internationally helps reinsurers as many are multinational.
- No. There would be only one uniform law for all reinsurers (internationally & domestic). This would allow insurers to obtain reinsurance in an easier fashion and not require collateral for unauthorized reinsurers, since it is costly.
- Would require less emphasis on rate regulation as we have sophisticated buyers who can determine how fair the rate being charged is. Also somewhat less emphasis on solvency regulation as the sophisticated buyers will consider the financial strength of its reinsure
- No, reinsurers are also insurance companies and should fall under similar regulatory requirements. They should not have any less stringent requirements because reinsurance defaults and insolvencies have led to many primary insurance company insolvencies.

EXAMINER'S REPORT

Overall the candidates performed well on this question. The candidate was expected to generally know the various forms of regulation and the reasons for each. The expectation of creating a new system from scratch seemed to challenge some candidates. Some candidates started with the current system of US regulation without making the assumption explicit. Others, it seems, were looking to simply regurgitate parts of the syllabus without thought to what was really being asked. That said, most who attempted the question did quite well.

Part a

The candidates generally did well on the creation part and poorly on the justifications. Many papers did not supply justifications for any parts. As mentioned above the candidates were expected not only to know the forms but the reasons. Another common error, as mentioned above, was the unwritten assumption that the question was asking the candidate to change the current US system. For example under the duties of regulators we had many candidates answer "the same as they are today." This fails to display knowledge of the material.

Part b

Candidates did generally well on this section. Most were able to synthesize their system with the global perspective or recognize why there system would come up short. Some candidates just put a judgment (good or bad) without a discussion.

Part c

Candidates generally did well on this section, but not quite as well as section b. Again, many candidates missed the justification part of this question. An answer of "it would not require changes" or "it would work equally well for reinsurers" was insufficient without further reasoning.