3. (3 points)

   An efficient regulatory system should meet the following criteria:

   - It should have benefits that exceed its costs.
   - It should respond to changes in the economy.

   a. (0.5 point)

      Briefly describe one provision of the Gramm-Leach-Bliley Act and how it meets one of the above criteria.

   b. (0.5 point)

      Briefly describe one provision of the Dodd-Frank Act and how it meets one of the above criteria.

   c. (1 point)

      Describe two specific examples of duplication of effort in solvency regulation.

   d. (1 point)

      Describe one challenge in solvency regulation and describe one possible solution.

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<table>
<tr><td colspan="2">QUESTION 3</td></tr>
<tr><td>TOTAL POINT VALUE: 3</td><td>LEARNING OBJECTIVE: A2, A4</td></tr>
<tr><td colspan="2">SAMPLE ANSWERS</td></tr>
<tr><td colspan="2">Part a: 0.5 point</td></tr>
<tr><td colspan="2">
States must make it easier for insurance producers to operate in multiple jurisdictions. Reflects increasing need for insurance products that span multiple regions since the economy is more interconnected now than ever.
The Gramm-Leach-Bliley (GLB) Act identified who would regulate companies that had both banking and insurance sectors. States continue to regulate insurance while federal government regulates banking. It responds to changes in the economy since entities with both banking and insurance didn't exist in the earlier part of the 20th century.
The Gramm-Leach-Bliley Act has responded to changes in the economy as one holding company could have an investment, banking, and insurance company. With the current economy filled with mergers and acquisitions, this is a good response.
Provision to disclose information sharing practices between banks and insurers; this responds to the needs of changes to the economy because of increasing privacy concerns of consumers.
</td></tr>
<tr><td colspan="2">Part b: 0.5 point</td></tr>
<tr><td colspan="2">
The Dodd-Frank act responded to changes in the economy by establishing the FIO and allowing it to negotiate covered agreements with alien insurers. This was driven by the increasing global economy and the inability of state regulators to a function on a global level.
Makes it easier for non-admitted insurer to get business. Remove diligent search criteria of admitted market. Costs of admitted market search plus needing specially licensed producer in each state in order to place business with non-admitted insurer outweighed. Benefits of unique products offering/additional capacity they bring to the market, so Dodd-Frank recognized this and now the costs of regulating non-admitted insurer are low and benefits of system are much higher.
Premium tax is collected by domicile state only for non-admitted insurers --> the benefit that exceeds the cost is that it simplifies business for non-admitted insurers
Companies receive credit for reinsurance in each jurisdiction so long as regulator in home state gives credit and is NAIC accredited (or comparable). Increases efficiency and reduces cost of regulation. Jurisdictions rely on judgment of home state; less work.
Reinsurance only regulated by domiciliary state regulator of reinsurer, which reduces costs of regulation as reinsurers normally operate in multiple states
</td></tr>
<tr><td colspan="2">Part c: 1 point</td></tr>
<tr><td colspan="2">Any two of the following:
Insurer must be licensed in each state where they do business -> Each state DOI can perform exams on the company meaning that multiple states will be independently reviewing their financial strength => more likely any potential issues will be found.
NAIC Financial Analysis Division -> performs quarterly reviews of nationally significant insurer -> this is independent from and in addition to review performed by the state DOIs => increases likelihood that large insurers in financial trouble will be found in time to take action and prevent insolvency.
NAIC FAWG monitors nationally significant insurers and individual states monitor these
</td></tr>
</table>

insurers as well.

- Duplication occurs when multiple rating agencies provide a rating for the same company
- Federal Insurance Office (FIO) reviews nationally significant insurers which may overlap with state regulation.
- Publicly-traded insurers must file 10-K with federal government (SEC) and file annual statements in every state it operates in. Again multiple eyes help spot troubling financial situations.
- NAIC's Analyst Team System evaluates insurers' financial strength to detect those that are in immediate need of regulatory attention and has regulators analyze them again.
- US insurer that also operates in Europe may need to fulfill state solvency requirements as well as Solvency II requirements.

Part d: 1 point

- Challenge: Regulatory forbearance: Regulators may fail to take prompt actions when needed. Solution: Peer review/pressure can help solve this. Each individual state can take actions if necessary – this puts pressure on regulators to act.
- Challenge: RBC factor-based capital requirement does not explicitly include important elements such as catastrophe risk and Asbestos & Environmental reserve risk and these are important solvency risks for companies. Solution: Develop catastrophe and Asbestos and Environmental components of RBC utilizing experts.
- Challenge: State regulators may be aligned with a special interest instead of public interest. Solution: Other states can pressure domiciliary state to act if special interest is causing problems for public or take their own action.
- Challenge: Solvency regulation in the US is based on the RBC ratio which is a formulaic factor-based model. This approach does not take into account the unique risks of specific insurers. Solution: Changing this system to something like an ORSA would allow companies to factor in their unique risks and better account for their solvency.
- Challenge: Human Fallibility - people make mistakes and can miss warning signs. Solution: Duplication, where other regulators can also review same company, which makes it more likely for troubled companies to be detected.
- Challenge: One challenge of solvency regulation is the lack of uniformity across states in terms of rates, forms and regulations. The NAIC attempts to account for this with its accreditation standards. Solution: Move to a national regulatory body to reduce cost and increase uniformity.

EXAMINER'S REPORT

Most candidates performed very well on this question, being able to demonstrate their understanding of regulatory systems and the Gramm-Leach-Bliley Act and Dodd-Frank Act.

Part a

Common errors included:

- Incorrect provision (e.g., Banks are allowed to directly own insurance subsidiaries or Banks are allowed to underwrite insurance directly)
- Vague language while describing a provision (e.g., Banks are regulated by federal government, with no mention of insurance company regulation)
- Listing what criteria was met without describing how it was met
- Forgetting to address how the provision met the criteria.

Part b

Common errors included: • Incorrect provision (e.g., Mixing up reinsurer regulation and non-admitted insurer licensing) • Vague language while describing a provision (e.g., Premium tax being paid to the home state, without describing what type of insurance and whose home state) • Listing what criteria was met without describing how it was met. • Forgetting to address how the provision met the criteria.
Part c
Common errors included: • Listing but not describing the example. • Repeating essentially the same form of duplication for the second example. • Not mentioning the entities involved in duplication of solvency regulation.
Part d
Common errors included: • Listing but not describing challenge and/or solution • Describing a challenge but not proposing a solution • Describing a challenge but the solution does not explain how the challenge is resolved.