5. (3.5 points)

An insurer writes personal lines business in multiple states. Its underwriting guidelines indicate that it does not insure homes worth less than $100,000. It will only insure personal property for renters if they also buy their auto insurance from the company.

The following excerpts have been provided from the insurer's 2013 Annual Statement:

	Current Year Net Admitted Assets (000s)	Prior Year Net Admitted Assets (000s)
Bonds	$30,000	$55,000
Common stocks	40,000	15,000
Real estate held for production of income	12,000	3,000
Cash and cash equivalents	20,000	5,000
TOTALS	$102,000	$78,000

Gross written premium	$ 45,000	$ 32,000
Net written premium	$ 40,000	$ 27,000

a. (0.5 point)

Briefly describe two concerns about the company's underwriting guidelines that a regulator might raise during a market conduct exam.

b. (1 point)

Evaluate the financial health of the company by identifying and briefly describing two areas that a regulator might investigate.

c. (1 point)

Given the findings in parts a. and b. above, briefly describe four actions that a regulator may take.

d. (1 point)

Fully describe how the NAIC might also be involved in this investigation. Include a description of the NAIC's duties and interaction with the domestic state regulator.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 5	
TOTAL POINT VALUE: 3.5	**LEARNING OBJECTIVE: A1, A2, C2**
SAMPLE ANSWERS	

Part a: 0.5 point

Concern 1:

- Not insuring homes less than 100K is unfairly discriminatory- may have disparate impact on racial, ethnic groups.
- Not insuring homes worth less than $100,000 may be unfairly discriminatory against protected classes or low income groups.
- The floor on home values (possible red-lining)

Concern 2:

- Forcing renters to buy auto is a tie-in sale. This is illegal under Clayton Antitrust Act and under most state laws.
- Tying Auto and Renters: it is likely a lot of renters are young and may have poor driving experience. You may be exposing yourself to a lot of young auto drivers with this requirement.
- The tying of auto insurance with the property insurance is illegal under Robinson-Patman Act.

Part b: 1 point

Regulatory investigation 1:

- Large growth in NWP 40/27-1 = 48%, outside IRIS 3 range.
- NWP grew significantly (40/27)-1 = 48% > 33% IRIS 3.
- The large growth in NWP from the previous year. Rapid growth is a common cause of insolvency & may indicate lessening UW standards.

Regulatory investigation 2:

- Company investment portfolio has shifted significantly towards stocks and real estate and away from bonds.
- Invested Assets have been shifted over to much riskier investments (drop in Bonds, increase in Stocks). Based on the increase in cash and shift to risky investments, this company appears to be in financial distress & is trying to raise money to pay claims.
- This insurer has significantly increased the % of real estate & stocks of its admitted portion: Stocks from 19.2% to 39.2% and RE from 3.8% to 11.8%. Stocks and real estate have less certain value in the event of liquidation & therefore less suitable to pay PH claims.
- Change in investments: Bond Holdings - $25 K, Stock holdings + 25 K, Cash +15 K, RE for production + 9k. It is abnormal for insurer to have more stocks than bonds.
- Has large % of assets in cash – could be investing some of these funds and earning a return
- The holding of stocks increased significantly from 15 M (or 19% of assets) to 40M (39% of assets). Stocks are volatile. Additionally, they are common stock, not preferred.
- An increase in assets held in stocks. Stocks can be very volatile.
- Real Estate for income also went up a lot as a % of assets. Real Estate for investment can be difficult to redeem in a need for cash. Why did this go up so much?

Part c: 1 point

- Any combination of 4 unique actions would work. For example:
  This company definitely needs looking into. The improper market conduct could trigger

supervision even if the RBC ratio is good. Actions may include: (1) Restrict new business (Premiums) (2) Require permission before making investment decisions. (3) May order them to discontinue UW restrictions discriminating against lower value homes. (4) Require property coverage even without auto.

Other actions:

- Require insurer to provide coverage for homes<100 k.
- May prohibit product bundling.
- Immediately cease tie-in sale of auto.
- Restrict growth to 33% or less.
- The regulator could restrict writing new business.
- Require them to rewrite underwriting guidelines and limit their new and renewal business until they do so.
- May restrict purchase of stocks.
- Force them to change investment allocation.
- Restrict the investment in stocks & RE and increase in bonds.
- Prohibit certain investments.
- The regulator could mandate shifting back to investing mainly in bonds.
- Monitor investment activities & transactions, or require the insurer to alter its portfolio mix.
- May begin off-site examination of the company's books.
- Further review the financial health of the insurer through on-site financial exams to identify problem areas.
- On-site exam – regulator may go to the company to develop a better view of the company's risk
- May begin a market conduct exam.
- File for receivership
- Mandatory Corrective Action – If regulator believes PH could be impacted adversely by financial health of company, regulator can make company take certain actions (i.e., limit business, reduce expenses, reinsurance coverage).
- Administrative Supervision – Given hazardous condition, regulator could seek court approval to formally take control of company. All manager decisions need commissioner approval (reinsurance, mgmt. changes).

Part d: 1 point

- NAIC may coordinate efforts and communication between different states as this insurer operates in multiple states. NAIC could also conduct analysis using tools like FAST or through FAWG and give recommendations to regulators on corrective actions.
- Analyst team will review financial statements and IRIS ratios to determine whether immediate regulatory attention is warranted if fact finding reveals significant areas of concern. May be recommended to the FAWG for review if this insurer is nationally significant. FAWG may provide advice on appropriate regulatory strategies and methods. NAIC also maintains databases that include consumer complaints against insurance companies and will provide that info to the regulator.
- The Analyst Team System might have reviewed this insurer, looking at IRIS ratios and using FAST tools. They would have noted the problems mentioned above and forwarded to

FAWG for review. FAWG would advise the state regulator on how to fix the situations and would act as check to ensure that proper action is taken.

- NAIC would provide data to the regulator as needed (asset valuations, insurer past history, state of insurer in the auto/ homeowner market in general, etc.) NAIC's FAD could perform independent review of the insurer and share findings with domiciliary regulator. If insurer was nationally significant, FAD identifies areas of concern, refers to FAWG for further review and the FAWG may question the domiciliary regulator/ provide forum for discussion. NAIC also maintains database of consumer complaints.
- NAIC SVO values insurer's investments. May determine insurer's investments in riskier asset classes (i.e., real estate, stocks) is too great. NAIC is a source of guidance for regulator. Performs research for regulator's benefit, provides statistical databases for insurer to easily monitor solvency of insurers in its states, provides info on Congressional initiatives regarding insurance.

EXAMINER'S REPORT

The candidates drew on their knowledge about how regulators investigated companies that might be in trouble and what actions the regulator could take to bring a company out of trouble. The question was somewhat challenging since it asked candidates to draw some conclusions about probable actions of the regulators, based on actions of the company. The candidates generally did well in noting concerns about the company's behavior, but had more difficulty in describing the involvement of the NAIC.

Part a

Common error: When discussing the limitation of insurance to those homes valued over $100,000, some candidates stated that the company had a higher risk of CAT losses, etc. due to insuring higher value homes. However, this answer does not address market conduct.

Part b

Common error: Repeating essentially the same issue (for example, stating that the increase in stocks and the decrease in bonds were two separate issues).

Part c

Common errors included:

- Discussing an action to be taken about a specific concern not described in a. or b.
- Not describing an action to be taken, but rather, indicating that the regulator should check or review other areas such as other IRIS ratios, reserves, etc.
- Discussing increasing surplus or capital. Nothing was mentioned about capital or surplus or the amount of the reserves in the question, so no conclusion can be drawn about these issues.

Part d

A common error was to state that the NAIC can require actions. The NAIC can suggest actions, but only regulators can require actions.