

8. (3.25 points)

a. (0.75 point)

Identify three advantages of reinsurance facilities over other residual market mechanisms.

b. (0.25 point)

Briefly describe one similarity between Joint Underwriting Associations (JUAs) and reinsurance facilities.

c. (0.25 point)

Briefly describe one similarity between JUAs and assigned risk plans.

d. (0.5 point)

From the perspective of a high-risk policyholder, describe which of the following residual market mechanism might be the least preferred:

- JUAs
- Reinsurance facilities
- Assigned risk plans

e. (0.5 point)

State A imposes minimal restrictions on risk classification for private passenger automobile insurance, while State B imposes significant restrictions. Compare the likely size of the residual market in each of these states.

f. (1 point)

Identify two courses of action that insurers might pursue due to the restrictions imposed by State B, and briefly describe the resulting impact on the size of the residual market for each of these actions.

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 8	
TOTAL POINT VALUE: 3.25	LEARNING OBJECTIVE: B2, B3
SAMPLE ANSWERS (BY PART, AS APPLICABLE)	
Part a: 0.75 point	
<p>The following provide examples of thorough responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any three of the following were accepted:</p> <ul style="list-style-type: none"> • “Provides improved service” or “Better claims practice; insure may treat assigned risk differently in ARP” • “Charges more socially equitable rates” or “To allow insurers charging their own fair rates.” • “Removes the stigma of knowing you’re in a residual market.” • “Policy holder doesn’t have to get rejected to participate, so it’s less trouble for consumers.” • “Convenience for policy holders, they do not need to apply to ARP” • “Insurers have more control over rates than in traditional residual markets.” • “Stabilizes UW results as pool share experience compared to Assigned Risks” • “Actuarial fair rates can be charged to high risk drivers rather than the prescribed rates” or “Insurers have more control over rates than in traditional residual markets.” • “More efficient – consumers only apply to reg. market, ins company handle claims, billing, etc.” • “Losses and operating expenses are apportioned among the insurers on a formula basis.” 	
Part b: 0.25 point	
<p>The following provide examples of thorough responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any one of the following was accepted:</p> <ul style="list-style-type: none"> • “Both share profit and loss among all insurers in market.” • “JUAs & Reinsurance Facilities both spread the risks based on the insurer’s market share.” • “Both JUAS and RF receive risks after they applied to private insurers who do not wish to retain risk.” • “In both the insured may not be aware of placement.” • “Both have voluntary insurer that writes business then cedes/forwards business to residual market.” • “Both provide insurance for those unwanted in voluntary market” • “Insurer has the choice to write the policy or submit policy to the residual market” 	
Part c: 0.25 point	
<p>The following provide examples of thorough responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any one of the following was accepted:</p> <ul style="list-style-type: none"> • “Both have uniform rates for all insureds.” • “Constant rate charged to insured regardless of servicing carrier” • “Both allow coverage to be obtained for otherwise uninsurable risks” 	

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<ul style="list-style-type: none"> • “Both assign high risk insured to specific insurers.” • “Both do not use Private Insurer’s premium rates.” • “the insurer/JUA to which the risk is assigned is responsible for issuing policies, collecting premiums, handling claims and providing other service to the assigned risk”
Part d: 0.5 point <p>The following provide examples of thorough responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any one of the following was accepted:</p> <ul style="list-style-type: none"> • “Assigned Risk Plan is the least preferred because the high risk policyholder has the stigma of being allocated to residual market,” • “Assigned Risk plan might be least preferred since insureds must first be actively denied in the voluntary market before applying to the assigned risk plan.” • “JUA would be least preferred for a high risk policyholder because rates are set based on the performance of the pool, so this will likely result in the highest of rates.” • “Assigned Risk Plan because they will first be rejected by an insurer and then will have to apply to the plan, so there is a stigma of knowing that they are in the residual market.
Part e: 0.5 point <p>The following provide examples of thorough responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any one of the following was accepted:</p> <ul style="list-style-type: none"> • “State A would likely have a smaller residual market than State B.” • “State B is higher. Insurers will reject certain classes on voluntary market”
Part f: 1 point <p>The following provide examples of thorough responses having the necessary components to demonstrate knowledge of the topic and obtain full credit; any two of the following were accepted:</p> <p>Exit market strategy:</p> <ul style="list-style-type: none"> • “Insurers may opt to not write business for that line and leave the state entirely which reduces competition and increases the size of residual market.” • “Exit market → likely increase residual market size due to some customers not being able to find a new insurer.” <p>Underwriting Strategy:</p> <ul style="list-style-type: none"> • “Tighten underwriting standards: increase residual market due to reduced availability.” • Write fewer policies that have unprofitable characteristics- more insureds move to residual market & increase the residual market size. • “Insurer may implement stricter underwriting standards to only target low risk insureds, which would increase size of residual market.” • “Insurers may increase u/w standards to focus on the better risks and not write the high-risk policies (b/c they can’t rate properly) which shrinks the voluntary market and increases the residual market.” • “Implement Underwriting Guidelines to avoid writing High-Risk insureds → ↑Residual market due to private unwillingness to insure.” <p>Marketing Strategy:</p> <ul style="list-style-type: none"> • “Use restricted variable in its marketing strategy – Target only low –risk groups – High risks are not informed of the coverage available to them, and thus unable to find

SAMPLE ANSWERS AND EXAMINER'S REPORT

insurance, increasing residual market size.”

- “May change marketing strategy to market only to low risk drivers. This will also increase the size of the residual market.”
- “Reduce expenses: Impact: decrease the size as the insurer may be able to write more risk and still retain profits due to the reduced expenses.”

Shift Insurer Profile:

- “An insurer may decide to become a high risk only insured and raise rates to the level appropriate for high risks. This would decrease the size of RM.”
- “Insurers may have different tiers of companies, with one focusing on high-risk customers. Residual market may become smaller then.”
- “They may put offices in certain low-risk areas, so that consumers will not even apply with their company →larger residual market if consumer cannot find insurer.”

In order to receive full credit, candidates needed to provide responses from two of the three categories listed above.

EXAMINER'S REPORT (BY PART, AS APPLICABLE)

Part a

The candidate was expected to know for Private Passenger auto plan for reinsurance facilities the funding mechanisms, allocation of exposures/ expenses and general operations and be able to describe the advantages of this plan in comparison to other plans. Most candidates were able to answer with at least two advantages.

Candidates were expected to respond with advantages to the insured as delineated in the text, but a number of candidates received full credit by identifying advantages to the insurance company as well.

Common errors made included wrong descriptions of how the program worked. The program's expenses were lower than other plans, losses were not spread among the entire group; losses were shared by market share.

Part b

Candidates performed well on this section. The candidate was expected to know the operations and risk transfer mechanisms of the various programs and be able to compare them.

The candidate was expected to respond that JUA's and Reinsurance Facilities both do something the same. Candidates generally scored well.

- Candidates did not receive credit where they provided similar, but not identical, functions (e.g. RF cedes a risk and JUA assigns a risk).
- Common errors were stating that both plans did something while only one plan did this action.
- Candidates were unsure sometimes on how insureds were placed in the plans.

Part c

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Candidates performed well on this section. The candidate was expected to know the operations and risk transfer mechanisms of the various programs and be able to compare them. The candidate was expected to respond that JUA's and Assigned Risk Plans both do something the same. Candidates generally scored well.

- Candidates did not receive credit where they provided similar, but not identical, functions.
- Common errors often involved identifying a feature that only one of the two programs has

Part d

The candidate was expected to know the relative advantages and disadvantage of the various programs and be able to compare them and determine which one an insured would least like to be in with one reason why.

Candidates received full credit for identifying the least preferable residual market mechanism, along with at least one plausible argument for that consumer preference

Common incorrect responses involved identifying reinsurance facility pricing as a negative, or failing to explain why the selected residual market mechanism would be least preferred.

Part e

The candidate was expected to know how restrictions by regulators on auto insurance rates would affect the residual market.

The candidate was expected to respond that the more restrictions on rating set by the regulator the less likely the insurers would want to write in the state and therefore the residual market would be larger in State B. Candidates generally performed well on this section

Candidates receiving no credit typically claimed the opposite effect: that less restrictions and better pricing would lower availability.

Part f

Overall, candidates did not perform as well on this section.

- Candidates frequently would describe an action, but then not describe **how** it would impact the residual market
- Candidates sometimes described two actions that were more or the less the same action, so only received credit for one action.
- Other actions described would be irrational market actions for the insurer, and often lead to bankruptcy. Only reasonable actions were credited.
- Others proposed actions that would have not been allowed by the state's restrictions on rating such as finding other rating classes.