3. (2.5 points)

   a. (1 point)

      Briefly describe one distinct rationale for each of the following elements in a state insurance solvency regulatory system:

      - Minimum capital requirements
      - A state guaranty fund
      - Reinsurance transactions require regulatory approval
      - Insurers must submit annual financial statements

   b. (0.5 point)

      Briefly describe two reasons for the development of the Reinsurance Regulatory Modernization Framework of 2008.

   c. (1 point)

      Describe two provisions of the Nonadmitted and Reinsurance Reform Act of 2010.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 3	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: A2 / A3**
SAMPLE ANSWERS	
Part a: 1 point	
Any one of the following bullets for each element: Minimum capital requirements • Ensure that company has enough surplus to remain solvent • Ensure that adequate capital is on hand to fulfill policyholder obligations • Barrier to entry into state for prospective insurance companies, keeps riskier undercapitalized carriers from entering market • Allows regulators to take regulatory action against troubled insurers • Helps identify troubled insurers by seeing which insurers are below or near their minimum capital levels • Reduce insurer's incentive to engage in risky behavior State guaranty fund • Protect policyholders when an insurer goes insolvent by paying the claims and/or a portion of the unearned premium of the policyholder; may be subject to limitations/caps Reinsurance transactions require regulatory approval • Certain actions are risky and require prior approval to ensure the financial stability of the insurer is maintained • A way of monitoring practices to make sure they are not damaging the interest of the policyholders • Most reinsurers are outside of the U.S and they are not regulated by the U.S. regulatory system • Review to ensure insurer is not using reinsurance to artificially inflate surplus / mask financial issues • To verify there is risk transfer in the reinsurance contract • Reinsurance coverage may be covering or exposed to large losses or catastrophic risks. This requires regulatory attention • Allows regulator to review reinsurance transaction and require and/or assess the collectability of collateral • Protects insurers and policyholders since many insurer insolvencies have resulted from reinsurers becoming insolvent Insurers must submit annual financial statements • These financial statements allow the regulator to continually monitor insurers • Statements are used by regulators to assess the insurer's risk and financial condition • Enable regulators to detect as early as possible those insurers in financial trouble • Reports feed into offsite monitoring analysis / tools such as RBC and IRIS • Encourage market discipline / competition since publically available • Allows evaluation of reserve adequacy • Standardized format allows regulators to compare companies	
Part b: 0.5 point	
Any two of the following:	

- Needed to reduce penalties associated with unauthorized but strong reinsurers
- Better reflect the globalization of insurance by recognizing foreign reinsurers
- Allow reinsurers to receive collateral reductions when they meet certain standards
- Promote competition in the reinsurance market
- Standardize treatment/streamline regulation for domestic and alien reinsurers

Part c: 1 point

Any two of the following bullets:
Non-admitted

- Premium taxes for non-admitted insurance transactions are only paid in the home state of the insured
- States need to develop uniform rules and procedures for the payment, collection, reporting and allocation of premium taxes for non-admitted insurance transactions
- States cannot prohibit placement of an insured with a non-admitted insurer outside the US as long as insurer was on the NAIC quarterly listing
- If a commercial lines purchaser meets the definition of an "exempt commercial purchaser" and the broker has notified them that coverage may be available in the admitted market, and the purchaser has requested coverage in writing from the surplus lines insurer, the broker does not need to do a diligent search of the admitted market.
- Eliminates the diligent search requirement for commercial purchasers. If you have a risk manager and are a large company, don't have to get declined in admitted market first to obtain non-admitted coverage
- Placement of non-admitted insurance is only to be regulated by the home state of insured
- Non-admitted /Surplus line brokers only need to be licensed in home state of the insured

Reinsurance

- If the insurer's domiciled state is NAIC accredited and the domiciled state recognized the reinsurance credit, other states cannot deny credit
- Allow states to continue reinsurance collateral reform on individual basis if they are accredited by NAIC
- The reinsurer's domiciliary state has sole responsibility of the financial solvency of reinsurer

EXAMINER'S REPORT

Part a

Candidates were expected to produce one rationale for each element in a state insurance solvency system. Common errors included:
Minimum capital requirements

- Mentioning that it provides protection if premiums charged are not enough to cover losses
- Stating that it provides protection/additional funding in case an insurer becomes insolvent

State guaranty fund

- Mentioning that funds are available in case of insurer insolvency, without including the uses for the funds
- Mentioning that it provides protection against insolvency, without including what/who is protected
- Describing an assigned risk plan rather than a state guaranty fund
- Mentioning that it helps companies remain solvent during adverse scenarios by helping them pay claims

Reinsurance transactions require regulatory approval

- Referring to assessing the reinsurer's strength without referencing the transaction or the impact on the ceding company

Part b

Candidates were asked to demonstrate knowledge of the reinsurance framework, but this proved challenging. Common errors included:

- Confusing the framework with the provisions of other acts such as the Non-Admitted and Reinsurance Reform Act
- Asserting the framework applied to all reinsurer types
- Stating that too many reinsurer insolvencies prompted action for more stringent regulation
- Mentioning that lessons learned from the recent financial crisis prompted action
- Stating that it ensures that reinsurance transactions actually transfer risk

Part c

The question asked for two provisions in the Non-admitted and Reinsurance Reform Act. Since the question asked candidates to 'Describe', this means that full credit answers contained the provision as well as some other supporting/additional verbiage. Common errors included:

- Omitting key elements of responses
    - Example: Only home state can collect tax
        - No reference to insured's home state
        - No reference to non-admitted business
        - No reference to premium tax
    - Example: If home state gives credit, then no other state can deny credit
        - No reference to ceding insurer's home state
        - No reference to reinsurance credit
        - No specification of home state being NAIC accredited or similar standard
    - Example: Elimination of the due diligence search
        - No reference to exempt commercial purchaser / sophisticated purchaser
        - No reference to actions that must be taken prior to being waived
- Stating that it allowed an insurer/reinsurer to be licensed in one state and conduct business in all states
- Interchanging the terms licensing & regulating
- Interchanging the terms broker & insurer
- Referring to 'certified' reinsurers