

EXAM 6 – UNITED STATES, FALL 2015

5. (3 points)

a. (0.5 point)

Describe an A.M. Best interactive rating.

b. (1 point)

Briefly describe two advantages and two disadvantages for a mid-size mutual insurance company to obtain an interactive rating from A.M. Best.

c. (1.5 points)

Fully describe one argument in favor of and one argument against the following statement:

“A.M. Best is, effectively, a regulator of the insurance industry.”

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 5	
TOTAL POINT VALUE: 3	LEARNING OBJECTIVE: A3
SAMPLE ANSWERS	
Part a: 0.5 point	
<p>Any one of the following:</p> <ul style="list-style-type: none"> • This is when an insurer pays for their rating, which allows them to have more control over their rating by having discussions with the rating agency, providing helpful proprietary data, and answering inquiries from the agency. • Insurer's senior management has an interactive meeting with rating analysts, so analysts can understand the company's business strategy, experience with adverse conditions and integrity. Insurer also submits proprietary info to rating analysts. Analysts determine rating based on findings from meeting, background research and proprietary info. • Rating agency requires insurers to give proprietary information in a high level interactive meeting to give the right rating. Information can include: U/W, pricing, reserving and investment, etc. 	
Part b: 1 point	
<ul style="list-style-type: none"> • Advantages (any two of the following)(: <ul style="list-style-type: none"> ○ Insurer has some control over information reviewed ○ Easier to obtain credit for the company ○ Fewer chances of error ○ Third parties often rely on the assessment ○ It is less expensive to pay for a rating than to demonstrate financial strength individually to others ○ Agents may be wary of insurers without an interactive rating ○ Unrated reinsurers may not be considered as viable by primary insurers placing business ○ Certain lines of business can't easily be sold by companies w/o high ratings (for example: reinsurance, surety, structured settlements, homeowners, and specialty lines) ○ Individual and corporate policyholders want to be sure the insurer will be able to pay their claims ○ Rating process can give management insight into areas that need improvement ○ Ability to purchase reinsurance may be easier if they have an interactive rating • Disadvantages (any two of the following): <ul style="list-style-type: none"> ○ It has a cost ○ It requires time, effort, and personnel ○ It is intrusive 	
Part c: 1.5 points	
<ul style="list-style-type: none"> • In favor: Since ratings play such an important part in the insurance industry (agents may use rating for placement, insurer may require a certain rating of their reinsurers, etc.) AM Best can bring pressure on companies to provide strong incentive for them to take corrective action, much like a regulator. Against: However, AM Best does not have regulatory authority. It can't reject filings, approve/reject rate changes, respond to consumer complaints, etc. It can't force the company to act as a regulator could, it can only exert pressure. Nor can AM Best take control of the company in case of financial 	

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difficulty as a regulator could.

- Argument for: It can have huge impact on insurers as consumers, and agents with limited information on the company rely heavily on financial strength ratings. Argument against: Realistically, all AM Best can do is adjust its ratings. It does not have the regulatory power to control or prohibit insurers to take certain actions.
- In favor: Insurers care greatly about their rating for AM Best because it can affect who is willing to do business with them and can also affect which lines they write (insurers need high rating to offer homeowners, surety, etc.) This can affect how the insurer does business, its capital structure, etc. So AM Best has a certain amount of regulatory authority over the insurance industry. Against: Ratings Agencies have no real regulatory authority over insurers. For example, they can't approve or disapprove filings. Also, there are multiple agencies that the insurer can choose to do business with. Insurers can't really choose which regulator they like to do business with. So AM Best has no real regulatory authority over the insurance industry.
- In favor: AM Best issues financial strength ratings which indicate the insurer's ability to pay claims. Without a rating the insurer will not be able to write certain kinds of business or agents may not place business with the insurer. As such AM Best is effectively phasing out financially weak insurers. Against: AM Best has no legal authority to regulate the industry and cannot require insurers to act in a certain way. Their ratings are also slow to respond to changes for fear of upsetting clients, so they don't downgrade quickly which could mask a company that is close to insolvency.
- For: Market pressure: If a company receives a poor rating, insureds may be reluctant to purchase insurance. This will encourage the company to do better. To remain competitive the company will need to improve its practices. Against: Rating agency can not intervene. If agency finds a risk of insolvency, the agency cannot require the insurance company to make changes. The agency can only publish findings to the public.
- In favor – Rating agency implicitly regulates through market pressure. By giving a negative review, the insurer will have to increase financial strength or risk losing business as agents don't place business there. Against – Rating agencies do not have power to force changes to the insurer's practices, such as prohibit entry into new lines, adjust investments, or place an insurer into receivership.

EXAMINER'S REPORT

Part a

Candidates should provide multiple facts in the answer to demonstrate knowledge of what an interactive rating entailed. General statements about BCAR or financial solvency were not sufficient to receive full credit; an interactive rating includes more than just the calculation of capital requirements.

Part b

A common mistake for disadvantages was to state that the interactive rating may result in a poor rating; these answers focused on the rating outcome and not on advantages/disadvantages of an interactive rating as requested.

Part c

Candidates had some difficulty with this part, with many candidates not fully explaining their answers. For instance in the Against section, several candidates just said that AM Best does not have real regulatory or legal power, without describing some of the regulatory powers that

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regulators do have. Others in the For section mentioned that insurance companies needed a good rating to write a particular line of business, without any further information. The question asked to fully describe, which requires more explanation than a question asking for a brief description