2. (3.75 points)

   a. (2.25 points)

      For each of the following lines of insurance, briefly describe the degree of rate regulatory scrutiny and provide two reasons in support of that degree of scrutiny.

      - Surplus Lines
      - Ocean Marine
      - Workers Compensation

   b. (1.5 points)

      For each of the following situations, provide three reasons in support of the regulator's decision.

      - The regulator decides not to review rates or forms for property catastrophe coverage for large commercial risks.
      - The regulator decides to heavily scrutinize the rates and forms for private passenger liability coverage.

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QUESTION 2	
TOTAL POINT VALUE: 3.75	**LEARNING OBJECTIVE: A1, A3**
SAMPLE ANSWERS	
Part a: 2.25 points	

Surplus Lines

Degree of Scrutiny

- Low regulatory scrutiny
- No rate scrutiny

Reasons

- Not related to a large number of voters interest
- Highly individualized risk
- Knowledgeable buyers and sellers
- High layers of losses, hard to price
- Must be versatile to cover non-standard risks quickly
- Do not qualify for guaranty fund coverage
- Not sufficient data to support rating regulation
- Surplus lines insurers not subject to a state's regulation
- Risks are difficult to place in the admitted market

Ocean Marine

Degree of Scrutiny

- Low regulatory scrutiny

Reasons

- The purchaser is sophisticated and knowledgeable
- Highly individualized risk
- Not sufficient data to support rating regulation
- Buyers are sophisticated and should be in a better position to self-regulate the market
- No detailed stat plan
- Risks require high capacity
- Ocean marine risks have difficult underwriting characteristics

Workers Compensation

Degree of Scrutiny

- High regulatory scrutiny

Reasons

- Affect almost every worker
- Complex rating and classification system
- Have sufficient data to support rating regulation
- Coverage is mandatory for all businesses
- Impact of rates had direct impact on business operations and employees

Part b: 1.5 points
Property Catastrophe for Large Commercial Risks *Reasons:* • Risks are unique/individualized • Risks require high capacity/limits • Risks may have difficult underwriting characteristics • Policyholders are knowledgeable or employ a Risk Manager • Underlying CAT models are difficult for regulators to review • Reinsurance potentially offsets underpricing and imbalanced CAT-exposed books by spreading the risk between the insurer(s) and reinsurer(s), and therefore mitigates insurance company failures/insolvencies. • Large risks have power to negotiate rates • Difficult to understand for policymakers • Lack of data to review rates/no statistical rating plan • Affects relatively few insureds in the total marketplace/does not generate voter interest • Market is well functioning and regulators believe competition will drive accurate rates • Large risks can self-insured/have the capital to absorb a loss/have non-insurance methods of mitigating the risk • Better for regulators to use resources on other lines that affect general public more • Coverage not mandated by law • Allows for insurer flexibility in rates/forms to meet needs of the market • The regulator's jurisdiction has minimal CAT exposure Private Passenger Liability Reasons: • It is legally required of these drivers and/or leasing companies • It is socially desirable for consumers to purchase • Uninformed or not knowledgeable consumers • Risks do not require high capacity/limits, so the rates should be relatively easier to quantify • Systemic losses may pose a threat to insurer solvencies • Sophisticated models are used to justify rates/complex rating plan • The rate could affect many consumers • Reinsurance may not be available, affordable and/or sufficient to mitigate the insurer's exposure to catastrophes like hailstorms • Credible data is available due to uniformity of risk • Generates significant voter interest/political pressure • Due to mandatory coverage, availability and affordability is important • Desire to protect consumers from discriminatory rating variables/practices • Coverage is well understood by regulators • Coverage is subject to guaranty fund so increased scrutiny
EXAMINER'S REPORT
This question required candidates to understand regulatory scrutiny for various lines of business. Candidates generally scored well on this question.

Part a

Candidates were expected to know the degree of rate regulatory scrutiny and provide two reasons to support that level of scrutiny for three lines of business. Candidates generally did well on this part. A common error was stating that surplus lines or ocean marine has a medium level of scrutiny.

Part b

The candidate was expected to know that rate regulation can differ greatly between diverse lines of business and reasons in support of the decision to regulate differently. A common error was to provide multiple reasons that were essentially the same, such as:

Example 1 – Property CAT:

- Companies know the types of coverage they are looking for so don't need scrutiny
- They are knowledgeable about insurance and risk
- They have a dedicated risk manager
    - ➢ This doesn't add anything to the earlier points, or complete the thought on what a risk manager would do for the company

Example 2 – Property CAT:

- Rates rely heavily on individual experience
- Historically these rates can be priced in wide ranges due to the level of risk involved
- Highly variable pricing
    - ➢ This doesn't add anything beyond the second point

Example 3 – Personal Auto Liability:

- Regulator heavily scrutiny because public is unhappy with excessive rates
- Regulator heavily scrutinizes because rating variables used are unfairly discriminatory
- Regulator scrutinizes because there are insurers who are uncompliant to regulatory practices and the states need to catch this
    - ➢ This is a generalization of the first two points