

EXAM 6 – UNITED STATES, SPRING 2016

8. (2.5 points)

a. (1 point)

Describe how drivers are assigned to insurers for each of the following residual market automobile insurance programs:

- Reinsurance facilities (RFs)
- Joint Underwriting Associations (JUAs)

b. (1 point)

Describe how profit (or loss) is allocated for each program listed in part a. above.

c. (0.5 point)

Describe why residual market automobile insurance programs are necessary.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 8	
TOTAL POINT VALUE: 2.5	LEARNING OBJECTIVE: B3
SAMPLE ANSWERS	
Part a: 1 point	
<ul style="list-style-type: none"> Reinsurance Facility: Insurers accept the risk and cede premium to the reinsurance facility. Reinsurance Facility: Insurer writes risk and transfers premium to reinsurance facility. Insured does not know they are in the Reinsurance Facility. Joint Underwriting Association: Insurers reject risk and are forwarded to the JUA Joint Underwriting Association: Insured applies to insurer, who finds risk unacceptable and insured then applies to the JUA. 	
Part b: 1 point	
<ul style="list-style-type: none"> Reinsurance Facility: Profit or loss is shared by insurers based on a formula. Reinsurance Facility: Insurer pays loss and is reimbursed by reinsurance facility. Periodically losses and operating expenses are apportioned to all insurers. Joint Underwriting Association: Profit or loss is shared by insurers based on market share. 	
Part c: 0.5 point	
<p><i>At least one item from each group A and group B.</i></p> <p>Group A:</p> <ul style="list-style-type: none"> Automobile insurance is compulsory (mandatory, required). Automobile provides a social good (benefits society). Not having insurance is not good for society. Govt. deems auto insurance should be affordable (available) for all. <p>Group B:</p> <ul style="list-style-type: none"> Some insureds (high risk) may not be accepted into the voluntary market. Some insureds (high risk) may not be able to afford actuarially sound rates. Some insureds will drive without insurance otherwise. 	
EXAMINER'S REPORT	
<p>Candidates were expected to know the underwriting process and pooling mechanisms for various residual market arrangements. The majority of candidates did well on this question, though it was common to have partial credit on part b.</p>	
Part a	
<p>Part a required candidates to know how individual drivers' experience fell into each of the provided residual market mechanisms.</p> <p>The candidate was expected to describe</p>	

SAMPLE ANSWERS AND EXAMINER'S REPORT

- The relationship of the original insurance company to the driver. In both cases, the original insurance company is applied to directly.
- The mechanism of assignment into the residual market. For the Reinsurance Facility, this was a ceded premium and loss relationship. For the Joint Underwriting Association, the application is forward.

Common errors:

- Flipping the Reinsurance Facility and Joint Underwriting Association.
- Incomplete answers; for example “risks are ceded” and “application forwarded” are not complete answers.

Part b

Part b) required candidates to know how each residual market mechanism assess shortfalls.

The candidate was expected to describe:

- Who shared in the losses.
- How the losses were distributed.

Common errors:

- Answered market share for Reinsurance Facility.

Part c

Part c required candidates to be familiar with the justification for residual market programs.

The candidate was expected to describe a reason why insurance is needed as well as why residual markets ensure the need is met. In most cases this was done by stating that there was a government driven requirement or social requirement as well as the fact that the voluntary market will not insure high risk drivers.

Common errors:

- Occasionally candidates failed to provide a complete description, stating only that “auto insurance is mandatory” or that “auto insurance should be affordable for all”.