

EXAM 6 – UNITED STATES, SPRING 2016

10. (2.5 points)

Suppose that private passenger auto and homeowners insurance have been highly profitable in a given state. The state's legislature interprets this profitability as a sign that rates are excessive, and therefore drafts legislation to enact competitive state funds for these lines of business.

a. (1.5 points)

Fully describe two arguments in favor of this legislation.

b. (1 point)

Describe two arguments against this legislation.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 10	
TOTAL POINT VALUE: 2.5	LEARNING OBJECTIVE: B2
SAMPLE ANSWERS	
Part a: 1.5 points	
<ul style="list-style-type: none"> • For the purchase of compulsory insurance the government should provide an alternative to private market to ensure that the private market makes only reasonable profits, or alternatively a competitive state fund will enhance price competition. • Competitive state funds have been successful in providing Workers Compensation having significant market share since commissions and marketing costs are reduced it is possible that state funds will provide cheaper coverage than private market • The state fund will provide fair prices for mandated coverage, thereby ensuring that policyholders are paying equitable rates • State fund have lower cost of capital and can offer lower cost products • Competitive state funds can offer enhanced specialization, filling an unmet need for coverage of unique risks that can't be covered in the commercial market 	
Part b: 1 point	
<ul style="list-style-type: none"> • High profitability does not imply that the market is unaffordable and not working so a state fund might not be meeting an unmet need • The situation can be remediated by a number of smaller reforms, such as a mandated rate decrease, implementation of prior approval (if not so already), take measures to increase number of private carriers in the market • Government funds usually created when there is a need for insurer of last resort. High profitability means that this is not likely the case • Competition in the state already exists among existing insurers; the high prices will increase this competition should normally create pressure to reduce rates • Homeowners is highly susceptible to catastrophes so profits in some years are necessarily higher to offset the experience in years when there is a catastrophe • Recent experience may be more profitable than expected because of the cyclic nature of the insurance market place—the high profits may be illusory and short lived. • State fund would not have the surplus and capital requirements of private insurers, thus the rates would be unfairly low. • The enhanced competition of the state fund would at prices below the insurers costs would drive insurers from the market, making insurance less available. • The state fund is not needed as there are a good number of insurers in the market place and there is no unmet need 	
EXAMINER'S REPORT	
<p>Candidates were expected to recognize and give reasons why it might be acceptable to introduce a state fund in a state where the private passenger auto and homeowners lines have been highly profitable. They were also asked to identify and describe reasons why introducing a state fund may not have been an acceptable idea</p>	

SAMPLE ANSWERS AND EXAMINER'S REPORT

Part a

Candidates were expected to give two arguments in favor of introducing a competitive state fund. Many candidates failed to mention the compulsory nature of the lines as one of the driving forces behind the potential need for government action. Common errors included stating that it was government's responsibility to keep these lines affordable, which is a stricter standard than keeping the profit in these lines reasonable. Another incorrect answer that appeared frequently was to say that the state should get involved in order to make additional money for the state in this highly profitable line of business.

Part b

Candidates were expected to provide two arguments against the introduction of a competitive state fund. Incomplete arguments around the following statements were not given credit: (1) the state would not be able to hire the expert staff needed to price the business properly; (2) a competitive state fund would be a burden to the government or to taxpayers.