

4. (3.25 points)

a. (0.75 point)

Briefly describe three characteristics of “the business of insurance” as established in the *Royal Drug* case.

b. (0.5 point)

Briefly describe two rationales for the *Southeastern Underwriters Association* decision.

c. (0.5 point)

Briefly describe two exceptions that allow for federal intervention in the regulation of insurance under the McCarran-Ferguson Act.

d. (0.5 point)

Briefly describe two complicating features of the regulation of insurance rates from the perspective of the regulator.

e. (0.5 point)

Identify two types of insurance companies that the Dodd-Frank Act grants the federal government the authority to regulate.

f. (0.5 point)

Briefly describe two actions required of insurance companies subject to federal oversight under the Dodd-Frank Act.

- Candidate did not provide enough details. "RRGs are less regulated"
- Candidate lists the characteristic of RRGs, but failed to draw the connection to part a. "RRGs only need to be licensed in their state of domicile." "RRGs are not subject to guaranteed fund."
- Candidate interpreted the question as forming a RRG entity rather than regulating RRGs. "RRGs insure similar risks. Hence, there is no diversity of perspective".
- Candidate had the wrong information about RRGs. "RRGs are subject to federal regulation." "RRGs do not submit information to non-domicile states."

QUESTION 4	
TOTAL POINT VALUE: 3.25	LEARNING OBJECTIVE: A4
SAMPLE ANSWERS	
Part a: 0.75 points	
<u>Sample Response 1</u>	
<ul style="list-style-type: none"> • Direct or contractual relationship between insurer and insured; it was "transfer of risk"; it's unique & specific only to the insurance industry 	
<u>Sample Response 2</u>	
<ul style="list-style-type: none"> • Sharing or underwriting of risk; contractual relationship or agreement between insurer and insured; activities are exclusive to insurance entities 	
<u>Sample Response 3</u>	
<ul style="list-style-type: none"> • Direct relationship between insurer and policyholder; practices limited only to the insurance industry; transfer of risk from insured to insurer 	
<u>Sample Response 4</u>	
<ul style="list-style-type: none"> • Spreading of underwriting risk; direct connection between insurer and insured; activity specific to ins industry 	
Part b: 0.5 point	
<u>Sample Response 1</u>	
<ul style="list-style-type: none"> • Insurance was deemed to not be unique to each state. It is interconnected and interdependent between states; intangible products other than insurance had been regulated at the federal level 	
<u>Sample Response 2</u>	
<ul style="list-style-type: none"> • Only a small percentage of SEUA companies domiciled in only one state; other intangible products sold across states are subject to Sherman act, so insurance should be as well 	
<u>Sample Response 3</u>	

- Only a few members of SEUA were domiciled in states in the SEUA territory, this looks like interstate commerce; intangibles such as telegrams or bank transactions fall under commerce clause

Sample Response 4

- The Sherman act did not intend to specifically exclude the insurance industry; few of the SEUA were actually domiciled in the states they were writing in

Sample Response 5

- Insurance is not a business that is distinct in each of the states; no other multistate industry is exempt from federal regulation

Sample Response 6

- Companies with sales contracts in states where they don't have headquarters have not escaped Congressional regulation; non-tangible products (such as electrical impulses) have been regulated by Congress

Part c: 0.5 point

Sample Response 1

- If it concerns boycotting, intimidation, collusion; any federal law made specifically to govern insurance supersedes state law

Sample Response 2

- Sherman act still applied to boycott, intimidation, coercion; when congress passes a law specific to insurance it will preempt state law

Sample Response 3

- Fed laws written specifically for business of insurance; Sherman applies if state has no similar law

Part d: 0.5 point

Sample Response 1

- Have to balance goals of insurer solvency and premium affordability; rating plans can be super complex, so understanding all justification of characteristics and rating variables can be difficult

Sample Response 2

- Insurance cost is unknown until the contract end; different lines of business have different risk characteristics, which post a great pressure for regulators to formulate a systematic and useful framework

Sample Response 3

- Price optimization and subject premium are difficult to decipher from rate filings; must balance availability and affordability with adequacy of rates

Sample Response 4

- Regulator may not have access to all the data and details used; lack of resources or personal expertise or time

Sample Response 5

- Info sharing between competitors unique to insurance industry where other industry would deem collusion; insurance industry is unique in losses occur after premium decided

Sample Response 6

- When new insurance pricing technology is used, it is hard to review (“black box”); social pressure to make rates affordable but allow insurers to make a profit

Sample Response 7

- Can't be so restrictive that companies want to exit the market (could cause availability issues); the rates have to be not unfairly discriminatory and regulator must balance outside pressure with actuarially sound rates

Part e: 0.5 point

Sample Response 1

- SIFI (systematically important financial institutions); insurers with banks

Sample Response 2

- SIFI – systemically important financial institutions; insurance holding companies that hold banks

Sample Response 3

- SIFI; Insurance who own banks

Sample Response 4

- Significant Important Finance Institutions; insurance with thrift operation

Sample Response 5

- Those “too large to fail”; those that own banks or thrift

Sample Response 6

- Large insurers where their insolvency could cause broad economic disruption; finance holding companies formed by banks owning insurance companies

Part f: 0.5 point

Sample Response 1

- Develop living will; higher capital requirements

Sample Response 2

- Submit to stress testing; new capital standards

Sample Response 3

- Additional liquidity standards; submit bankruptcy plan

Sample Response 4

- Must meet capital standards; undergo stress testing

Sample Response 5

- Set liquid requirements; develop a will to explain what they do in case of insolvency

Sample Response 6

- Upon request, insurer needs to submit information to the FIO; must meet minimum capital requirement set by fed

Sample Response 7

- Submit data to federal regulator when asked; undergo stress testing

EXAMINER'S REPORT

Candidates were expected to know the characteristics of the business of insurance

Candidates were expected to know the basics of the history of federal and state regulation and the separation between them. Specifics include SEUA and anti-trust law, and Dodd-Frank act.

Candidates were expected to know concerns a regulator would have regarding regulation of rate review

Part a:

Candidates were expected to know the three characteristics of the business of insurance as established in the *Royal Drug*

Common mistakes included:

- Just listing things that insurance companies do, like market policies or pay claims.
- Just listing elements of the risk and loss events involved in insurance (there must be a timing risk, there must be a chance of a large claim payment, etc.)
- The candidate did not acknowledge there was a direct or contractual relationship involved The candidate said something similar to “there is a relationship between two parties”

Part b

Candidates were expected to understand the SEUA decision and the motivation and outcome of the case.

Common errors include candidates only opining that insurance was interstate commerce without any reasoning.

Part c

Candidates were expected to know when federal government law could apply to insurance as exceptions to McCarran-Ferguson

Candidates were expected to know that federal antitrust regulation applies if there is no appropriately equivalent state law.

Regarding the first point above, candidates should note the federal regulation should specifically refer to insurance to be relevant

A common mistake was saying federal law applies when no state law exists since that isn't an exception

Part d

Candidates were expected to know concerns a regulator would have regarding regulation of rate review.

Common errors include

- Candidate said rates must be adequate but not excessive with no other explanation about why that's a concern.
- Candidate said rates must be available and affordable with no other explanation about why that's a concern.
- Candidates said rates must not be unfairly discriminatory with no other explanation about why that's a concern.
- Candidate just listed a duty of being a regulator (i.e. "must review data of multiple filings") without some aspect of expense / resource / experience constraints.

Part e:

Candidates were expected to know what types of companies were subject to federal regulation under Dodd-Frank

A common mistake was stating "large national insurer" without acknowledging the insurer was systemically important / too big to fail / would cause a national economic event upon failure

Part f:
<p>Candidates were expected to understand the role of federal oversight of insurance companies under the Dodd-Frank Act</p> <p>Common errors include:</p> <ul style="list-style-type: none"> • Candidate did not acknowledge that reporting to the federal regulator (FIO) was only necessary upon request • Candidate did not specify that the relevant reporting was to be to the federal government. • Candidate did not understand that the living will applied to a receivership situation and was not a general plan of business to be submitted to the federal government • Confusing the requirements with the elements of a market conduct exam (submitting regular reports to state regulators, open books for audit, etc.) • Confusing the FIO's suggested directive from Dodd-Frank regarding things like international agreements and banking standards as things that the insurance companies are required to be involved in.

QUESTION 5	
TOTAL POINT VALUE: 2.25	LEARNING OBJECTIVE: B2, B3
SAMPLE ANSWERS	
Part a: 0.5 point	
<p><u>Sample 1</u> UEP (unearned premium) and claims</p> <p><u>Sample 2</u></p> <ul style="list-style-type: none"> • Unearned Premiums • Indemnity Payments <p><u>Sample 3</u></p> <ul style="list-style-type: none"> • Refund a portion of unearned premium • Collect on collision and comprehensive claims 	
Part b: 0.75 point	
<p><u>Sample 1</u></p> <ul style="list-style-type: none"> • Only applies to specific lines of business <ul style="list-style-type: none"> ○ Only P&C ○ Excludes lines like ocean marine, mortgage guaranty, title, etc • Unearned premium recovery is limited to a specific recovery amount 	