3. (3 points)

   a. (0.5 point)

      Briefly describe two circumstances where federal regulation supersedes state regulation with respect to the "business of insurance" under the McCarran-Ferguson Act.

   b. (1 point)

      Following the passage of the McCarran-Ferguson Act, the NAIC approved model bills related to rate regulation. Describe two underlying purposes of the bills.

   c. (1.5 points)

      Fully describe two weaknesses of credit reporting systems that may lead to regulatory concerns about using credit reports in determining premiums.

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SAMPLE ANSWERS AND EXAMINER'S REPORT

FALL 2018 EXAM 6US, QUESTION 3	
TOTAL POINT VALUE: 3	**LEARNING OBJECTIVE: A1,A4**
SAMPLE ANSWERS	
Part a: 0.5 point	

Sample 1
- Sherman Act still applies to the use of boycott, coercion and intimidation.
- When federal passes a law applies only to insurance industry, it supersedes the state laws.

Sample 2
- Sherman Act prohibits boycott, coercion and intimidation
- Federal law that is explicitly written to cover the business of insurance will apply

Sample 3
- When the federal government passes laws pertaining to the "business of insurance"
- To prevent monopoly power (intimidation, coercion)

Part b: 1 point

Sample 1
- Promote adequate and equitable rate by requiring prior approval of rates, publishing guidelines of filing rates, and disallowing rebating.
- Protect competition of insurance market. It encourages cooperative arrangement to set adequate rate as long as it doesn't restrict competition.

Sample 2
- Allow insurers to set rates in concert such that they do not hinder competition
- Ensure that rates are reasonable, not excessive, inadequate or unfairly discriminatory

Part c: 1.5 points

Sample 1
- Many credit reports contain errors. Even though the methodology used to determine premium based on credit report is correct the inaccuracies in credit reports will invalidate it.
- Identity theft would affect insured's credit report. It's not insured's fault, and should not affect the premium the insured being charged.

Sample 2
- Credit scores often contain errors at no fault to the insured. Policyholders may get charged incorrect premiums due to these errors. These rates would be unfair.
- Credit scores are another black box to regulators as the underlying calculation is not well understood. This means it more difficult for regulators to review rates. This is also a

concern to regulators because policyholders may not understand credit scores and how they affect the rates. There could be an increase in complaints.

Sample 3

- Some actions that may be seen as financially responsible may actually hurt credit scores. For example, limiting use of credit. Therefore, people who practice these action may be unfairly penalized leading to unfairly discriminatory rates.
- Credit reports may penalize certain protected classes such as the elderly who typically use very little credit, youth who have no credit history, and certain religious groups who are disallowed using credit. Using credit scores to calculate premiums would result in unfairly discriminatory rates for these groups. It would also likely be disproportionately impact due to low/fixed income.

Sample 4

- Economic crises and sudden shifts in the economy could increase overall premium levels (decrease credit scores) and actuaries may not be able to pick up on it in time to adjust the overall rate levels. This would be unfair and uncontrollable for consumers.
- They have a disproportionate impact on protected classes such as minorities, low income people, elderly, young. It's possible that credit scores are acting as a proxy for socioeconomic status (race, education level, etc.) and even though credit scores are predictive of losses, it wouldn't be fair to use in pricing.

EXAMINER'S REPORT

Part a

Candidates were expected to identify the two exceptions where, after the McCarran-Ferguson Act, federal law superseded state law with respect to regulating the business of insurance.

Common errors include:

- Mention of state laws not existing, as there is no state law to be superseded by the federal law.
- Mention of federal laws unrelated to the business of insurance, e.g. labor laws.

Part b

Candidates were expected to know the purposes of the NAIC's model bills related to rate regulation following passage of the McCarran-Ferguson Act.

Common errors include:

- Identifying outcomes or features of the model bills without describing the underlying purposes. For example, describing anti-rebating laws without explaining that rebating can reduce competition.
- Mention of efficiency in implementation across states. This isn't an explicit purpose of the rate regulation model laws, and, in fact, many states didn't enact the model laws.
- Preventing federal government from stepping in to regulate insurance was also not accepted. This is unrelated to the rate regulation model laws specifically.

SAMPLE ANSWERS AND EXAMINER'S REPORT

Part c
Candidates were expected to know the weaknesses of the credit reporting system and how those led to regulatory concerns for rating purposes. Common errors include: • Omitting the impact to premiums or rates. • Listing privacy as a regulatory concern. This is unrelated to determining premiums.

FALL 2018 EXAM 6US, QUESTION 4	
TOTAL POINT VALUE: 1.75	**LEARNING OBJECTIVE: A3**
SAMPLE ANSWERS	
Part a: 0.25 point	
• It helps to know whether the insurance company is able to pay for my losses as promised and this is not expected of grocery stores • For insurance companies need a high rating (A) to write certain types of insurance (like surety). Grocery stores don't need financial strength ratings to sell certain produce. • Independent agent use the ratings to place business with higher rated insurers. Independent agents do not place business with a grocery store. • Insurance company customers are more uninformed than grocery store customers and thus use financial strength ratings to help them decide where to buy their product (insurance policy)	
Part b: 0.5 point	
• Most reinsurers are not located/domiciled in the U.S. so this can assist in providing an idea of how financially strong a reinsurer is • Insurers may be hesitant to cede business to low rated reinsurers so could affect reinsurer's ability to be competitive in the market • Financial ratings also signal to primary insurers the ability of a reinsurance company to be able to fulfill covered claims in case of a CAT. Many insurers have gone liquidated due to reinsurance uncollectable especially during/after a CAT. • Reinsurers with high financial strength ratings may be able to charge more premium to primary insurers • It directly impacts their collateral required to post to ceding companies. A better rating leads to less collateral needed. • Small reinsurers w/ strong rating can compete against larger reinsurers. • Some insurers require the use of highly rated reinsurers • If a reinsurance company rating drops, the insurers may wish to exercise a commutation • Insurers don't want higher liability on their balance sheet for the provision for reinsurance so may opt for higher ratings. • Insurer's Appointed actuary looks at these when commenting in SAO relevant comments about reinsurance collectability • Investors use them to see if they want to invest in company • So primary insurers can efficiently choose a reinsurer	
Part c: 0.5 point	