5. (2.25 points)

   a. (0.75 point)

      Briefly describe three functions of the Federal Insurance Office (FIO) as created by the Dodd-Frank Act.

   b. (1.5 points)

      Describe one potential impact of the Dodd-Frank Act on each of the following:

      i. Cost of insurance to policyholders

      ii. Customization of insurance products

      iii. Companies with both banking and insurance functions

CONTINUED ON NEXT PAGE

question to mean why rating agency would rate a stable insurer more highly than a responsive insurer.

Common errors include:

- Stating that a downgrade would be harmful for the insurer or other stakeholders tied to the insurer, without noting any consequences for the rating agency.
- Stating that a changing a rating would be more expensive for the rating agency than maintaining the rating for an insurer.
- Not being able to define what a "responsive insurer" is, what they would be responding to, or what action they would take that would be viewed unfavorably.
- Implying a causal relationship between the fact that markets are already responsive and that rating agencies prefer stability. For example, stating that markets can respond quicker so therefore rating agencies prefer to keep their ratings stable.

Part d

Candidates were expected to briefly describe one reason why an insurer would want to disclose a potential material adverse deviation to their rating agency, and one reason why they would not want to disclose this.

Common errors include:

- Confusing rating agencies and regulators or indicating that not fully disclosing information to a rating agency was illegal.
- Stating that allowing the rating agency to come to a lower rating is a reason to disclose.

FALL 2018 EXAM 6US, QUESTION 5	
TOTAL POINT VALUE: 2.25	**LEARNING OBJECTIVES: A3, A4**
SAMPLE ANSWERS	
Part a: 0.75 point	

Bolded sample answers indicate unique subject responses, any one of which was required.
Italicized sample answers are common variations on the unique response.

Assembles insurance data from various organizations

- *Collect data on insurance industry*
- *Gather data on insurance from insurers and even NAIC*
- *Aggregate/gather data for insurance industry*

Identifies insurance activities that could contribute to a broader US financial systemic crisis

- *ID activities that could lead to a systemic financial crisis*
- *Help identify practices that could lead to systemic crisis*
- *They compile/aggregate insurance information from multiple sources*
- *Monitors the insurance industry*

Develops federal policy regarding nationally or internationally important insurance issues

- *Keep up with insurance-related issues or national or international importance*
- *Help US with international matters of regulation*
- *Negotiate international treaty related to insurance industry*

Consults with state governments on insurance matters

- *Consult with state regulators on national and international issues and topics*
- *Confer with states/state regulators about the state of the insurance industry*
- *Consult with state regulators on insurance issues of national importance*

Monitor the affordability and availability of insurance with the exception of health care coverage

- *Monitor the availability and affordability of insurance*
- *The FIO monitors the insurance industry for the affordability and availability of insurance*
- *Monitor insurance industry and affordability and availability*

Work with the U.S. Trade Representative to negotiate covered agreements with foreign regulators that could alter state law

- *Act as representative for trade agreements with foreign insurers/regulators*
- *Work with US Trade Representatives on covered agreements with foreign regulators*

Report to congress annually

- *Reports to Senate and House annually on matters in the insurance industry*
- *Present annually to congress about the State of the Business of Insurance*

State insurance measures shall be pre-empted if and only if the director of the FIO determines that a Covered Agreement receive disparate or unfavorable treatment of a non-US insurer domiciled in a foreign jurisdiction

- *The FIO can preempt state regulations when they violate the covered agreements*
- *Ensure the covered agreements with other countries are not preempted by state law*

To assist the Secretary of the Treasury in administering the Terrorism Insurance Program

- *Help the treasury in administration of TRIA*

Part b: 1.5 points

Bolded sample answers indicate unique subject responses, any one of which was required. Italicized sample answers are common variations on the unique response.

Sample Responses for b)-i)

Dual Regulation causes increase in policyholder costs

- *Dodd-Frank could lead to dual regulation of the insurance company (state and federal) and the compliance cost will be passed to the policyholder.*
- *Increased Regulation increases administrative costs which are then passed down to the policyholder.*

- *Increase cost for insured purchasing from SIFIs or insurance companies that own banks because the insurers will be subject to dual regulation which may increase their policyholder's premiums.*

More Uniform regulation causes decrease in policyholder costs

- *Cost of insurance to policyholders could be lower because it promoted the uniformity among the states which could reduce insurer's cost.*
- *Potentially lower rate. More uniform regulation saves costs for insurers and insureds.*

States maintain regulation causing no change in policyholder costs

- *Three is no effect as the states are responsible for making sure rates are adequate and insureds are treated fairly.*
- *Insurance costs to policyholders should not be affected, since state regulation of rates is preserved under Dodd-Frank.*

Increased affordability monitoring causes decrease in policyholder costs

- *Making cost of more equitable, and making insurance more affordable and available to policyholder overall.*
- *Cost of insurance for policyholders would decrease as the FIO is monitoring the affordability of insurance,*

Regulation allows more insurers causing decrease in policyholder costs

- *Dodd-Frank likely reduced the cost of surplus and excess lines by reducing reporting requirements by removing the "diligent search" requirement for exempt commercial purchasers.*
- *Lesser cost because reinsurance and surplus lines have to be licensed only in their home state: less compliance cost so cost won't go down to policyholder anymore.*

Sample Responses for b)-ii)

Increased Regulation leads to less customization of insurance products

- *Discourages innovative products because of the increased regulation.*
- *Could reduce customization if the federal government creased policy forms or sets uniform standards.*
- *The federal government could impose restriction on forms and rates that are charged. If they prescribe too much, this would lead to the commoditization of the industry and would decrease the ability for customization.*

The monitoring of affordability and availability of insurance may lead to increased customization of insurance products

- *Since Dodd-Frank gives the FIO power to ensure available and affordable coverage, this may force insurers to allow more customization of products such that their needs are met.*

Surplus line laws changes (brokers are now exempt from due diligence search, changes in premium tax), and this will increase customization of insurance products

- *Increased customization of insurance products because DFA permits non-admitted insurer to be regulated by the home state of the insureds only.*
- *More possibilities, based on changes made to surplus lines, market likely to expand, gives more incentive to meet needs so products are more customized.*

Regulations for companies with banks may reduce customization

- *Dodd-Frank made restrictions for banking companies to provide insurance. Therefore, customization of insurance and banking related products are reduced.*

Sample Responses for b)-iii)

Companies with banking and insurance functions may have increase operating cost due to additional or dual regulation.

- *Companies with both banks & insurance products will have to spend a lot more money & time on regulation since subject to dual regulation.*
- *Companies with banks and insurance functions will face additional regulation from the federal level and may incur additional costs as they strive to meet this new regulation.*

Companies with banking and insurance functions may divest the two operations to avoid additional/dual regulation

- *Companies with both banking and insurance functions will decrease because banks are subject to a lot more regulation due to Doff-Frank, specifically those with insurer operations as well are subject to even stricter rules. Companies will separate as not to be subject to more unnecessary regulatory burden.*
- *These companies were subject to increased regulation so a lot of companies sold off or reduced their banking operations*

Companies with banking and insurance functions may face additional regulation

- *Potentially will need to carry more capital & surplus as regulation for banks would apply and they are more heavily regulated*
- *Insurance holding companies that own banks would receive significantly more regulation. They have to develop living wills, hold increased capital along with many other additional requirements.*

EXAMINER'S REPORT

Candidates were expected to:

- Describe the functions of the Federal Insurance Office
- Describe the potential impact of the Dodd-Frank Act on the insurance industry with respect to the cost and customization of insurance products
- Describe the impact of the Dodd-Frank Act on Companies with both banking and insurance functions

Part a

Candidates were expected to list three functions of the Federal Insurance Office as part of the Dodd-Frank Act.

Common errors include: • The FIO monitors SIFIs, insurance companies with banks, or insurance companies. The FIO does not monitor individual companies. • The FIO regulates insurance companies. The FIO is not a regulator. • The FIO preempts state regulation. This is true but is very specific and the answer needed to include if the state regulation interferes with foreign covered agreements. • The FIO creates model laws. The FIO does not create model laws. • The FIO designates SIFIs. The Financial Stability Oversight Council designates insures as subject to regulation as a nonbank company supervised the Board of Governors. • Not unique – Day-to-day oversight of the insurance industry and help identify practices that could lead to systemic crisis.
Part b
Candidates were expected to describe the impact of Dodd Frank on three aspects of the insurance industry. Common errors for include: • Compliance costs will be passed onto the policyholder. This answer does not make it clear that the compliance costs are due to the dual or increased regulation. • Discussing the impact of other acts (not Dodd-Frank) on banking and insurance.

FALL 2018 EXAM 6US, QUESTION 6	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVE: B2**
SAMPLE ANSWERS	
Part a: 1 point	
<u>Sample Responses for Write-Your-Own Policy (WYO)</u> • WYO program: Private companies sell policy through "WYO" program and are reimbursed for administrative expenses by NFIP. • Through write-your-own program where private insurers write and service policy but risk is reinsured completely by federal government. • "Write your own" program, where insurers market and issue the policies and are 100% reinsured by NFIP • Through the write-your-own program private carriers may write and market NFIP policies to consumers *<u>Sample Responses for Direct Servicing Agent (DSA)</u>* • Direct Servicing Agent: private service agents/companies contracted with NFIP (contractor company) and sell policies. • Through direct specialized agents who are in charge of selling the insurance on behalf of the federal government. • Servicing agents who assign customers to the NFIP • Direct through a contractor of NFIP/FEMA which serves as intermediary	