6. (2.75 points)

   a. (1.5 points)

      Describe each of the following for guaranty funds:

      i. Reason for inception

      ii. Funding mechanism

      iii. Effect on insureds

   b. (0.75 point)

      Identify three coverage limitations of guaranty funds under the Post-Assessment Property and Liability Insurance Guaranty Association Model Act.

   c. (0.5 point)

      Briefly describe two rationales for a state to eliminate its guaranty fund.

CONTINUED ON NEXT PAGE

SAMPLE ANSWERS AND EXAMINER'S REPORT

EXAMINER'S REPORT
Candidates were expected to demonstrate knowledge of various laws / regulations of the insurance industry.
Part a
Candidates were expected to demonstrate knowledge of the Clayton Act and the Robinson-Patman Act. Common mistakes included: • Not tying the Clayton Act to either anti-competitive behavior or monopolies, as this was the main motivation of the act. • Stating that the Robinson-Patman Act prevents tie-in sales. This was part of the Clayton Act.
Part b
Candidates were expected to describe how the McCarran-Ferguson Act regulated federal laws related to insurance. Common mistakes included: • Describing the "business of insurance" rather than how the laws applied to the business of insurance. • Stating that the act "returned regulation to the states"; the act returned the **option** of regulation to the state assuming a state law was in place to regulate.
Part c
Candidates were expected to describe the motivation for the NAIC's *Act Relating to Unfair Methods of Competition and Unfair Deceptive Acts and Practices in the Business of Insurance*. A common mistake was discussing the ways in which the model law would regulate markets, rather than the motivation for the act.

SPRING 2019 EXAM 6US, QUESTION 6	
TOTAL POINT VALUE: 2.75	**LEARNING OBJECTIVES: B1, B2, B3**
SAMPLE ANSWERS	
Part a: 1.5 points	
Sample responses for part (i): • To protect the policyholder when their insurer goes insolvent - claims and some UEP are paid • Guaranty funds were incepted because insurers would go insolvent and leave policyholders without coverage and without reimbursement for claims and unearned premiums • Created to protect policyholders against insurer insolvencies. Guaranty funds provide claim coverage and partial refund of unearned premium when an insurer goes bankrupt.	

SAMPLE ANSWERS AND EXAMINER'S REPORT

<table>
<tr><td>
<u>Sample responses for part (ii):</u>

Makes assessments to insurers in the state. Most popular type is post-insolvency assessments, usually capped at 2% of WP for each insurer each year.
It's mostly funded by post-insolvency assessment, where the other insurers contribute based on their market share. NY (and a few states) are pre-insolvency.
The funding mechanism is to assess other solvent insurers in the market to pay claims. This happens in proportion to the company's premium in the market.
In most states, funded by post-insolvency mechanism, where regulator assesses remaining insurers in marketplace for costs of administering fund and paying out claims. Done by market share proportion.
Remaining insurers pay a portion of their premium into the fund in the event of insolvency. It may take a few years to fully fund due to the cap on the assessment that can be collected each year.
Other insurers in the state fund based on percentage of business in covered lines of business. Insurers pass these costs on to customers in the form of higher premiums.

<u>Sample responses for part (iii):</u>

The insureds are left with having their claims paid in the event of an insolvency. However, some insurers pass the cost of assessments to their insureds, which raises premium.
Insureds are still able to get most of their coverage, but there is cost from the assessments that trickles down to them.
The insureds end up to paying for the insolvency cost through premium. They could benefit through reduced premiums as insurers could lower prices in order to gain market share.
The cost of guaranty funds are passed down to insureds through higher rates. Guaranty funds also remove the incentive for insureds to try to find financially strong insurers because they know they're protected.

</td></tr>
<tr><td>Part b: 0.75 point</td></tr>
<tr><td>
Any three of the following:

Large net worth deductible
Per claim as well as per policy deductible
There may be a separate deductible for the guaranty fund (above any deductible on the original policy)
Only certain lines of business are covered
Does not apply to certain lines of business (such as Ocean Marine)
There may be a maximum limit that is covered by the fund
Limited coverage (except Workers Compensation which is unlimited)
Only a portion of the unearned premium can be returned to the customer
The return of unearned premium is usually subject to stated limits
Most guaranty funds have a post-insolvency coverage trigger – in other words, the fund does not provide coverage until the insurer has been deemed insolvent in the court of law and placed in liquidation

</td></tr>
<tr><td>Part c: 0.5 point</td></tr>
</table>

Any two of the following:

- Forces insurers to be more financially strong knowing insureds will want to go to safer insurers
- Guaranty Funds distort competition by reducing incentive for insureds to seek out financially strong insurers
- State may feel that the fund is overly punitive to insurers that maintain financial strength. They (and by extension their policyholders) bear the burden of insolvencies of weaker mismanaged companies.
- May believe loss assessment costs charged to other insurers are too large and damage marketplace and solvency of other insurers. May prefer state government bailouts on case by case basis.
- Perhaps the assessment fee as a result of one insolvency causes another insurer to go insolvent
- Guarantee funds can distort competition, while they aren't supposed to, some insurers may use the fact that the guaranty fund exists to justify relaxing their underwriting standards to increase market share
- Guaranty funds cause premiums to be higher due to the assessments so if there is no guaranty fund it would lower premiums for insureds
- Use of a guaranty fund is relatively rare and is a waste of resources if pre-funded and never used

EXAMINER'S REPORT

Candidates were expected to know the background and objectives of a guaranty fund, how it is financed, and its impacts/limitations.

Part a

Candidates were expected to identify the goals of a guaranty fund, explain how it is financed, and describe the impacts to insureds.

Common mistakes include:

- Stating that the guaranty fund "provides protection" or "provides a backstop" without elaborating that an insured can collect claim payments and unearned premium in the event of an insolvency.
- Misstating insurers as insureds or vice versa.
- Omitting who specifically is assessed for the fund.

Part b

Candidates were expected to identify three coverage limitations or constraints of a guaranty fund.

Common mistakes include:

- Stating specific lines of business without clarifying whether they were included or excluded.
- Describing that there is a claim deductible without elaborating that there is a deductible in addition to the policy deductible.
- Identifying something unrelated to a limitation of the fund's coverage (e.g., a cap on how

much insurers can pay per year).

Part c

Candidates were expected to identify weaknesses of having a guaranty fund and/or reasons a guaranty fund should be eliminated.

Common mistakes include:

- Explaining that either insolvencies rarely happen or that there is sufficient solvency regulation and therefore a guaranty fund should be eliminated. Since insolvencies can still occur, candidates needed to suggest that a guaranty fund could be eliminated for these reasons if it is pre-funded.
- Describing insurers relaxing underwriting standards and/or lowering premiums without linking this to a market distortion or customer behavior (selecting insurer without regard for financial strength or risk of insolvency).

SPRING 2019 EXAM 6US, QUESTION 7	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVES: B1, B2**

SAMPLE ANSWERS

Part a: 1 point

Sample response for part (i):

- Assigned to an insurer in the state, the proportion of assignment is based on written premium market share of the Insurer.
- All premiums and losses are retained by the assigned insurer for their assigned members.

Sample response for part (ii):

- After rejection insureds are placed by agent/broker into a servicing provider or assigned a servicing provider by the JUA.
- All profits/losses (after servicing provider fees) are apportioned by written premium of all personal auto carriers.

Part b: 1 point

Sample 1

Part (i):

- Allows insurers to write/accept all risk and cede high (aka potentially volatile) risks to the re Facility
- Which pools those prem and losses (less operating expense) with others insurers to stabilize the volatility at the individual level because $\sum Var(X_i) \geq Var(\sum X_i)$

Part (ii):

- It Reinsures losses at (80-85%) above the "Deductible" of 20% eligible commercial lines DWP.