3. (3.25 points)

   a. (1 point)

      Briefly describe four factors to consider when assessing the effectiveness of an insurance regulatory framework.

   b. (0.75 point)

      Briefly describe each of the following reasons for regulatory failure:

      i. Regulatory fallibility

      ii. Regulatory forbearance

      iii. Regulatory capture

   c. (1.5 points)

      Briefly describe three strengths of the U.S. insurance regulatory system, and briefly describe how each addresses a reason for regulatory failure listed in part b. above.

CONTINUED ON NEXT PAGE

- Listing items that were incomplete and needed further discussion to determine if it was an advantage or applied to surplus lines regulations.
  For example: "Do not have to participate in state guaranty funds" or *"Offer cheaper insurance because of lower cost"*

- Listing items that are also true for the admitted market.
  For example: "*By offering on a direct to consumer basis, a surplus lines carrier can cut costs*" or "*They are able to service a different market that may be in lines with their business goals"*

- Listing items that were advantages to consumers rather than the surplus lines insurer.
  For example: "*Can make unique coverages available and affordable*" or "*Surplus lines carrier benefit from writing to insureds that need insurance not found in the admitted market therefore the insurance is highly specialized*"

Part b

Candidates were expected to list four surplus lines regulatory requirements and explain whether or not the start-up insurer, described in the question, could meet the four requirements.

Common errors include:
- Describing surplus lines insurers in general rather than the specific example provided in the question. For example stating that insurer could appoint specialty licensed producers when the example company intended to use direct writers.
- Discussing items common to admitted and surplus lines insurance such as financial reporting and financial examination.
- Discussing regulatory requirements for surplus lines brokers rather than the surplus lines insurer.
- Discussing items that would be beneficial to a start-up insurer but not a surplus lines regulatory requirement (e.g. discussing lack of actuarial and underwriting expertise).

FALL 2019 EXAM 6U, QUESTION 3	
TOTAL POINT VALUE: 3.25	**LEARNING OBJECTIVE: A2**
SAMPLE ANSWERS	
Part a: 1 point	

<u>*Sample Responses - Any four of the following*</u>:
- Frequency and extent the regulator was able to identify and rectify potential issues before they could cause harm to policyholders (i.e. Taking actions to prevent insolvencies)
- Rate of insolvencies and payments to policyholders in those insolvencies (i.e. Effectiveness of guaranty funds)
- Effectiveness and efficiency of rehabilitation actions
- Healthy, competitive insurance market
  Sample responses – Any one of the following:

o *Market health* o *Competitive market* o *Financial stability and reliability of insurers* o *Breadth and depth of insurance industry* o *Availability and affordability of insurance* o *Rates adequate, not excessive or unfairly discriminatory* • Perceived & actual costs vs benefits of regulation (i.e. Efficiency of regulatory framework) • How well the regulatory regime achieves its intended purpose • Fair and equitable treatment of consumers (e.g. Number of consumer complaints, Consumer lawsuits)
Part b: 0.75 point
i. Fallibility – regulators are human beings and humans make mistakes ii. Forbearance – failure to take prompt and/or stringent action in the face of a potentially troubled company iii. Capture – regulators tend to take the mindset of an interest group/the industry being regulated
Part c: 1.5 points
Candidates must provide three of the following: • Duplication/peer review – system of state regulation (or between states and NAIC FAD/FAWG) means if a regulator in one state misses something another is likely to catch the mistake, reducing fallibility • Peer review/peer pressure – other states or the NAIC may pressure the domiciliary state to act quickly, reducing forbearance • Peer review/peer pressure – other states or the NAIC may pressure another state into not siding with interest groups, reducing capture • Diversity of perspective among regulators will lead to fewer extreme policies and more centrist solutions, reducing the likelihood of capture • Moral hazard may help to reduce forbearance as the lack of a federal financial backstop may give regulators more incentive to take action • Formulaic standards such as IRIS tests & RBC – may reduce forbearance since they have required action levels • Formulaic standards such as IRIS tests & RBC – may reduce capture since they have required action levels
EXAMINER'S REPORT
Candidates were expected to demonstrated knowledge of how the US system of regulation works including its strengths and weaknesses
Part a

Candidates were expected to be able to list four distinct factors that might be used to assess the effectiveness of an insurance regulatory framework. Common errors include: • Stating "protect policyholders" as the top priority of insurance regulation but not describing a factor for assessing effectiveness • Simply stating "act in the public interest" without explaining further and describing a factor for assessing effectiveness • Listing multiple factors that describe the same general concept. For example a candidate might list "a competitive insurance market", "insurance availability and affordability", and "financial strength and stability of insurers". Each of these is an acceptable answer, but they all describe a healthy insurance market. • Listing features that might exist within a strong regulatory framework but are not used to assess effectiveness, such as checks and balances, standardized procedures, and data quality.
Part b
Candidates were expected to describe/define the three reasons for regulatory failure. A common mistake included writing something for fallibility that did not convey simple human error. For example: "regulators fail in their assessment of financial indications" or "did not detect an insolvency".
Part c
Candidates were expected to provide three strengths of the US regulatory system with a brief description explaining how the strength might mitigate one of the causes of failure from part b. Common errors include: • Stating "most insurance commissioners are elected" as a strength. The vast majority of states appoint their commissioners. • Answers relating to guaranty system. Guaranty funds are in place to benefit policyholders after a company fails and the question asked for strengths that could help to prevent failures. • Listing a strength, but failing to describe it and/or linking it to part b. • Listing "duplication", "peer review" and "peer pressure" as three separate strengths.

FALL 2019 EXAM 6U, QUESTION 4	
TOTAL POINT VALUE: 2	**LEARNING OBJECTIVE: A2**
SAMPLE ANSWERS	
Part a: 0.5 point	