5. (2.5 points)

a. (0.5 point)

Describe one reason that a rating agency may change the outlook, rather than downgrade the rating, of an insurer whose financial strength has declined.

b. (0.75 point)

Briefly describe three uses for financial strength ratings.

c. (0.75 point)

Briefly describe three differences between RBC requirements and rating agency capital requirements.

d. (0.5 point)

Describe the regulatory consequences for an insurer whose RBC ratio falls from 95% to 60%.

CONTINUED ON NEXT PAGE

Also, they needed to describe receivership and its two possible outcomes (rehabilitation and liquidation), and then define both.
Part a
Candidates were expected to list two examples of mandatory corrective action. Common errors include: • Stating "increase rates", or any variation of that, since that is not something for which insurer and its' domiciliary regulator have complete control. • Giving rehabilitation or liquidation as examples of mandatory corrective action. • Giving two examples of limiting new or renewal business, which was duplicative. • Giving examples of incorrect actions, such as replacing management, requiring rate increases, or removing the license to do business.
Part b
Candidates were expected to describe administrative supervision, and provide a reason why regulators may be reluctant to pursue this course of action. Common errors include: • Describing receivership instead of administrative supervision. • Stating that administrative supervision comes only after corrective action failed, with no description of what it is, and describing it by using the word "supervising" without context explaining the actions. • Use of vague descriptions, such as the regulator is "stepping in", "monitoring", "watching", or "participating" in the company operations (i.e. no clear notion that they are acting in an approval capacity).
Part c
Candidates were expected to describe receivership, and note that its two possible outcomes are rehabilitation or liquidation, defining each of them. Common errors include: • Failing to include outcomes • Defining liquidation by saying assets were liquidated, with no further context.

FALL 2019 EXAM 6U, QUESTION 5	
TOTAL POINT VALUE: 2.5	**LEARNING OBJECTIVES: A3, C2**
SAMPLE ANSWERS	
Part a: 0.5 point	

<u>Sample responses</u>: • The agent may not want to incorrectly downgrade the insurer for fear of losing credibility. • Rating agencies don't want to be too quick to act as an erroneous downgrade may anger their clients. • Insurer whose financial strength has declined may have just had one year of adverse impact due to catastrophes (for example, wildfires in CA). Rating agency could give leeway for company to recover, as a downgrade of rating may harm the insurer's business prospects and worsen its financial strength. • It does not want to overreact, which could cause it to lose customers if it downgrades ratings too easily. Rating agencies want to appear stable with giving ratings.
Part b: 0.75 point
<u>Sample responses (any three)</u>: • Agents will use insurer's ratings to place business. • Insurers will consider reinsurer's ratings when seeking reinsurance. • Banks require homeowner insurance from highly rated insurers to issue mortgages. • Used by investors to determine if they would like to invest in a company or not. • Surety/bond insurance may be required to be written with an A rated company. • Regulators may use them as an indicator that an insurer may be in trouble. • Consumers selecting an insured. • Actuaries use it to evaluate reinsurance collectability when opining on loss reserves. • Reinsurers obtain higher ratings to lower collateral needed. • Reinsurers can charge more because of the lower credit risk associated with a high rating. • Structured settlements may require A rated provider.
Part c: 0.75 point
<u>Sample responses (any three)</u>: • RBC doesn't take into account Catastrophe Risk. • RBC doesn't take into account Operational Risk. • RBC is a quantitative/formulaic measure, where rating agency capital requirements are based on both qualitative and quantitative. • Rating agency capital requirements are very tailored to the individual insurer being evaluated. • RBC can trigger regulatory intervention whereas financial rating can't. • RBC used to monitor solvency for regulators, RAC for company performance for investors. • Rating agency requirements may include TVAR or EPD to assess risks where RBC does not. • RBC uses Annual Statement data available to public, rating agency also can use proprietary insurer info. • The formula for rating agency capital differs significantly by rating agencies, but the RBC formula is the same across insurers. • RBC is consistent across states and lines of business. Rating agency capital requirements may vary by rating agency, line of business etc. • RBC does not consider reserve adequacy.

• RBC does not consider difference in insurer's management, but rating agency does. • Rating agencies meet with management. • RBC is on SAP basis, but RAC are on GAAP.
Part d: 0.5 point
Sample responses: • Goes from Authorized control level to Mandatory control. Now regulator must rehabilitate or liquidate the insurer. • Falls from authorized control level to mandatory control level. The regulators are obligated to take control of the insurer and attempt to increase its capital. • The regulator will need to take mandatory corrective action with the insurer before the ratio gets any lower. The insurer will not be able to write new business and the regulator may take control of their investments as well. • The company goes into receivership. The regulator finds a receiver to then take the next steps for either rehabilitation or liquidation.
EXAMINER'S REPORT
Candidates were expected to understand financial strength ratings from rating agencies, the difference between RBC requirements and rating agency capital requirements, and the impact from a change in the RBC ratio.
Part a
Candidates were expected to demonstrate that the downgrade in rating could be perceived as faulty or temporary and that there would be a negative consequence on the rating agency or insurer as a result of the downgrade. Common errors include: • Briefly describing that the downgrade could be perceived as faulty or temporary without describing the negative consequence that would have. • Briefly describing that downgrading could have a negative consequence without demonstrating why that would be the case.
Part b

Candidates were expected to understand three different uses for financial strength ratings.
 	
Common errors include:
• Not providing three uses
• Providing an answer that was too similar to another answer such as:
    o The consumer uses ratings to select financially strong insurers.
    o The insurers use good ratings to attract more customers.

Part c
Candidates were expected to identify three differences between RBC requirements and rating agency capital requirements. Common errors include:

- Listing examples that were common to both requirements.
- Not providing three differences
- Providing an example too similar to another answer such as:
    - RBC does not consider business strategy or internal governance controls
    - RBC does not include any management input
- Stating something was unique for RBC that should have been for the rating agency requirements or vice versa.

Part d

Candidates were expected to understand that the RBC action level had changed from Authorized Control Level to Mandatory Control Level and that regulators were now required to take corrective action, such as rehabilitate or liquidate the insurer. References to the insurer being placed into a receivership were accepted.

Common errors include:

- Not understanding that the RBC Action Level had changed.
- Not mentioning that regulatory action was required.
- Not mentioning what type of regulatory corrective action was taken.

FALL 2019 EXAM 6U, QUESTION 6	
TOTAL POINT VALUE: 2	**LEARNING OBJECTIVES: A4**
SAMPLE ANSWERS	

Part a: 1 point

Sample 1

- Circumstances: Paul wanted to sell insurance in VA on behalf of an insurer domiciled in NY, but his application was denied. He sold insurance anyway and was arrested.
  Decision: The court ruled in favor of VA and said that insurance did not constitute interstate commerce.
  Impact: Insurance was regulated at the state level.

Sample 2

- Paul was selling insurance in VA from a NY insurer without proper license. Supreme Court upheld his arrest, insurance was deemed not interstate commerce, and insurance was left to state regulators.

Sample 3

- Paul wanted to sell insurance policies in his home state of VA for NY insurers, who had not deposited necessary foreign insurer bonds. He sold policies anyways, got arrested, and appealed to Supreme Court. Result was Paul not allowed to sell policies because insurance is a local product that states could regulate. Therefore, regulation of insurance left up to states.

Part b: 0.5 point

Sample Responses for SEUA: