7. (2.25 points)

a. (0.75 point)

Briefly describe the role of each of the following in a Multiple Peril Crop Insurance public-private partnership:

i. Private insurers

ii. The Risk Management Agency (RMA)

iii. The federal government

b. (0.5 point)

Describe how the RMA reduces the risk of adverse selection associated with Multiple Peril Crop Insurance.

c. (1 point)

Briefly describe two characteristics of a social welfare system, and briefly describe whether or not federal involvement in Multiple Peril Crop Insurance meets each criterion.

CONTINUED ON NEXT PAGE

Candidates were expected to understand the Paul v. Virginia case, including the impact of states regulating insurance. Common errors include: • Not mentioning requiring a license or foreign insurer bond to be able to business in another state • Missing the impact of state regulation of insurance
Part b
Candidates were expected to understand if or how Sherman Antitrust Act applies under different situations (state or federal regulation). Common errors include: • Not able to explicitly mention if or how Sherman apply correctly
Part c
Candidates were expected to understand when federal regulation applies other than Antitrust activities. Common errors include: • Stating Antitrust Act • Examples of federal intervention but not regulation of insurance, such as NFIP and TRIA • Gramm-Leach-Bliley (GLB) because states continue to have primary authority over insurance

FALL 2019 EXAM 6U, QUESTION 7	
TOTAL POINT VALUE: 2.25	**LEARNING OBJECTIVES: B2, B3**
SAMPLE ANSWERS	
Part a: 0.75 point	
Any one of the following for Private Insurers: • Act as primary insurer • Handles the transactions of premium & claims • Provide coverage to consumers • Are the group that is responsible for indemnifying the consumer's claims • Servicing carriers *Any one of the following for the Risk Management Association (RMA):* • Will assess how the crop coverage is performing and whether any changes need to be made • They help monitor and control risks, working with private insurers • Offers subsidies to farmers • Helps farmers prevent losses (farming techniques) • RMA administers rules to prevent adverse selection	

- RMA underwrites the crop insurance
- RMA oversees the risk mitigation & management to avoid adverse risk selections in the portfolio

Any one of the following for the Federal Government:

- Act as reinsurer and subsidizes premiums
- The federal government compensates the private insurers for their losses and administrative costs
- The federal government provides the necessary funds for reinsurance and provides additional financial assistance in the case of catastrophes
- Provides a backstop to private insurers
- Regulates the crop program

Part b: 0.5 point

Sample responses include:

- In order to get federal disaster relief you must have crop insurance and you also must purchase prior to planting.
- RMA will aggregate all data available to be able to price accurately. As a result of accurate rates adverse selection can be reduced.
- RMA decides that if farmers want to insure one field they need to insure all fields that grow those crops on that one field to avoid adverse selection.
- They have knowledge and tools like the risk heat map to price premium accurately.
- Names specific crops that are covered by insurance. Limit on amount that can be collected.
- Help to set underwriting guidelines for private insurers that recognize and reduce the risk of adverse selection.
- By being the sole source of rates, there is no competition from any other participant. So there is no adverse selection, just one selection for all policyholders.

Part c: 1 point

Sample responses include:

- Providing insurance that insurers don't want to provide – federal involvement provides crop insurance that would not be profitable to insurance companies due to the catastrophic nature of things like poor weather (freezing can kill crops in the whole area).
- In a social welfare program, participants usually don't pay to participate and it is usually funded by taxes. This is partially met as premiums are partially subsidized but not completely (it's not free to get crop insurance). Premium subsidies help to make it more affordable for everyone to obtain.
- People receiving the benefits are not necessarily the people paying the premiums – this is not the case for crop coverage as farmers do have to buy coverage to get benefits, including disaster relief benefits.
- Benefits are funded by resources of the federal government – crop insurance does meet this criteria because the program gets appropriations from the federal government as needed for claims and disaster relief.

- It serves a social purpose as farming is an important segment of the economy and federal involvement supports farmers staying in industry.
- It is no efficient since it isn't cheaper for the government to insure. They're just providing subsidization bringing premiums below the actuarial cost-based rate.
- Bring stability to a volatile market for society. Society depends on farmers' resources but disasters could leave farmers bankrupt. Crop insurance helps farmers to keep going after a disaster to continue to provide resources to society.
- Protects individuals in circumstances in which they wouldn't otherwise have protection. This is meets the criteria because farmers couldn't find affordable coverage in the private market.
- Provides affordable benefits, so the criteria is met as without government involvement, prices through private market would be extremely high (assuming it was even offered).
- Government intervention meets the criteria as crop insurance is subsidized by the federal government, and the crop insurance market would be much different without the subsidy.
- Social welfare is supposed to only help the less fortunate or be means-tested. MPCI policies are available to farmers based on crops grown, not financial status so MPCI does not meet this criterion.
- A social welfare program is not funded solely by actuarially adequate rates. It meets this criteria because the rates charged are set below actuarially adequate levels, requiring a subsidy from the federal government's funds.
- A social welfare system is in place to avoid large economic impacts. The federal involvement in MPCI helps keep prices stable for food (if yield is low, farmers don't need to charge super high prices to recoup losses) and keeps food affordable to the general public.

EXAMINER'S REPORT

Candidates were expected to demonstrate high-level knowledge of Multiple Peril Crop Insurance (MPCI) and how each entity (Private Insurers, RMA, and FED) works together in a public-private partnership. Additionally, candidate needed to speak to how the design of the insurance program related to broader concepts of adverse selection and social welfare systems.

Part a

Candidates were expected to define the separate roles/duties of the three entities involved in administering crop insurance to farmers – private carriers, the Risk Management Association (RMA) and the federal government.

The RMA is a division of the United States Department of Agriculture (USDA) and, as such, is considered part of the federal government. Thus, roles/duties listed in the reading as distinct for each of RMA and the federal government were treated interchangeably. An activity performed by the RMA was accepted as a correct response for the federal government and vice versa.

<u>Common errors include:</u>

- Stating private insurers are not involved

- Stating private insurers offer crop hail insurance which is not offered by the government and not mentioning specific duties
- Stating private insurers are the insurer who bear the insurance risk since risk is shard
- RMA: regulates the MPCI market since the federal government regulates the market
- RMA: assess crop yields in different parts of the country
- Fed: pays for the premiums instead of saying farmers pay premiums and federal government subsidizes those payments
- Fed: provides the RMA with funding through taxes
- RMA is "intermediary, go-between" between the private market and the government
- RMA assigns risk to private insurers

Part b

Candidates were expected to describe approaches used by the RMA to avoid adverse selection in the program. Descriptions of approaches used for insurance in general (as opposed to those specifically mentioned in the reading for crop insurance) were accepted if adequately supported.

<u>Common errors include:</u>

- A farmer must insure all the perils he has when applying for multiple perils crop insurance
- It helps the insured determine which areas have historically lower crop yields, as this is not an approach for reducing adverse selection
- It helps insurers avoid underpricing high risk insureds and overpricing low risk insureds, as this is not an approach to reducing adverse selection
- RMA does not offer coverage to farmers who sign up for program shortly after moving to high risk areas
- RMA encourages insureds to exhibit best practices in terms of limiting its own exposure to policy, and tiers insured accordingly by hazard level so that insurer is aware of exposure, as this pertains more to loss mitigation than reduction of adverse selection
- Providing approaches that may enhance, rather than reduce adverse selection
- Stating that coverage is mandatory and all farmers must participate
- Stating that coverage is required prior to a "loss" event (disaster, drought, storm, etc.)
- Stating that all crops must be insured rather than all fields of a crop
- Stating that coverage is required in order to get some federal benefit (rather than specifying disaster relief)
- Stating that rates or premiums are subsidized

Part c

Candidate were expected to identify 2 characteristics of Social Welfare program and then support why or why not MPCI met these characteristics.

Common errors include:

- Identifying characteristics and simply stating it 'meets' or 'does not meet' with no justification for that answer
- Stating that Social Welfare and/or MPCI is available to everyone
- Stating that Social Welfare and/or MPCI participation is mandatory

• Stating that Social Welfare and/or MPCI never involves profit

FALL 2019 EXAM 6U, QUESTION 8	
TOTAL POINT VALUE: 3	**LEARNING OBJECTIVE: B2**
SAMPLE ANSWERS	
Part a: 1 point	
• Write-Your-Own: private insurers write and service their own policies but use the NFIP as a reinsurer. NFIP still sets rates/conditions. • Direct Servicing Agent: the NFIP contracts with third parties who directly sell NFIP coverage to consumers	
Part b: 1 point	
<u>Sample responses for part (i)</u> • If insurers provide more flood coverage, they will share in disaster relief costs (i.e. (home rebuilding) after a flood, which will reduce federal expenditures. If coverage is more widely available and more affordable (increased competition), it may also cause federal expenditures to decrease due to fewer uninsured homes. • Federal expenditures will increase. Private flood insurance (without a subsidy) will cause the NFIP to experience adverse selection. Its share of insureds will be higher risk on average and disaster relief in flood prone areas will be costly. • Federal expenditures will increase since FEMA won't be as involved in flood plain management and making sure disaster relief plans are in place prior to an actual disaster. *<u>Sample responses for part (ii)</u>* • Homeowners who desire flood insurance may have better access to insurance with the expansion of the private market. The private insurers may be able to provide better prices for the low risk insureds because some insureds must be paying more than actuarially sound rates under the NFIP to subsidize others' rates. • Homeowners will have more insurance choices in the market. This could mean higher limits, additional coverages (business interruption, etc.), and more carriers to purchase from. • There will be more products and coverages available. Although rates from private insurers will most likely be higher since they are not subsidized and also need to charge a profit provision.	
Part c: 1 point	
<u>Sample Responses (any two):</u> • NFIP subsidies cause lower rates to be charged for some through NFIP versus what a private insurer may charge. NFIP doesn't charge actuarially sound rates because of these subsidies – this is a disadvantage for private insurers who need to charge adequate rates. • Continuous coverage – for NFIP subsidies to apply, insured must have continuous flood coverage through NFIP. If the insured goes to private insurer and then decides to go back to NFIP, then subsidies would be lost because private insurance would not be considered	