ACTEX Learning

Introduction to General Insurance Study Manual

1st Edition

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An SOA Exam

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INTRODUCTION TO GENERAL INSURANCE
EXAM STUDY MANUAL

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NOTES:

The manual is based on the textbooks for Introduction to General Insurance Exam (GIINT) developed for the Society of Actuaries by the American Institute for Chartered Property Casualty Underwriters.

Past exam questions and answers have been taken from SOA's Introduction to General Insurance Exam (GIINT – February 2014), which are identified with "(SOA GIINT February 2014)" in the manual. The past exam questions and answers are copyrighted by the Society of Actuaries and are reproduced in this study manual with the permission of the SOA solely for the purpose of assisting students studying for the actuarial exams. I am very grateful to the SOA for its permission to use this material. The SOA, however, is in no way responsible for the structure or accuracy of the manual.

The past exam questions have been attached to the assignment on which the questions are most likely based. Note that some exam questions may make use of materials from multiple assignments of the textbooks.

There are altogether 202 quiz questions. Questions without identification of "(SOA GIINT February 2014)" are original questions based on the required study materials. Although I have made a conscientious effort to eliminate mistakes in questions and answers, errors may exist. I encourage students who find errors to bring them to my attention. Any other feedback is also very welcome.

Max C. Tang

Section 1 – Insurance Company Operations

ASSIGNMENT 1

OVERVIEW OF INSURANCE OPERATIONS

I. INSURANCE GOALS AND CONSTRAINTS ON ACHIEVING INSURER GOALS

A. Insurer Goals
1. Earn Profit
   a. Profit goal is most commonly associated with proprietary, or for-profit, insurers
   b. Not primary goal for cooperative insurers, but they should also earn a profit
2. Meet Customer Needs
   a. Provide products and services customers seek at competitive prices
   b. Prompt services
   c. Quick and professional assistance
   d. May conflict with profit goal
3. Comply with Legal Requirements – One of an insurer's greatest responsibilities is compliance with state regulations
4. Diversify Risk
   a. Emerging goal for property-casualty insurers.
   b. Meeting this goal complements the insurer's goal of earning a profit and fulfilling its duty to society
5. Fulfill Duty to Society – all corporations are obligated to promote the well being of society

B. Constraints on Achieving Insurer Goals
1. Internal Constraints
   a. Efficiency – Inefficiency might prevent insurers from meeting their profit and service goal, which can lead to the inability to meet societal goal
   b. Expertise – Lack of expertise could prevent an insurer from making a profit or meeting customers' needs, or it could eventually cause the insurer to fail to attain any of its goals.
   c. Size – a small insurer, that may be able to respond more quickly to an emerging trend, has more challenges than a large insurer in terms of available resources
   d. Financial resources – When financial resources become strained, insurers are unable to effectively train staff, make new capital investments, or reach new markets
   e. Other internal constraints – lack of name or brand recognition or a damaged reputation

2. External Constraints
   a. Regulation
   b. Rating agencies
   c. Public opinion
   d. Competition
   e. Economic condition

II. CLASSIFICATIONS OF INSURERS

A. Introduction
1. Insurance – system where participants (e.g. individuals, families, businesses), make payments in exchange for commitment to reimburse specific types of losses in certain circumstances
2. Insured – participants in system who benefit from reimbursement of covered losses

3. Insurer – organization or entity that facilitates pooling funds and paying benefits
    a. The principal function of insurers: acceptance of risks that others transfer through insurance
    b. Core operations: 1) underwriting, 2) claims, and 3) marketing

B. Four Ways of Classifications of Property-Casualty Insurers
1. Legal form of ownership
2. Place of incorporation
3. Licensing status
4. Insurance distribution systems and channels

C. Classification Summary
1. Legal form of ownership
    a. Proprietary
        i. Stock insurers
        ii. Lloyd's of London and American Lloyds
        iii. Insurance exchange
    b. Cooperative
        i. Mutual insurers
        ii. Reciprocal insurance exchanges
        iii. Fraternal organizations
        iv. Other cooperatives – captive insurers, risk retention groups, purchasing groups
    c. Other
        i. Pools
        ii. Government insurers
2. Place of incorporation
    a. Domestic
    b. Foreign
    c. Alien
3. Licensing status
    a. Admitted
    b. Nonadmitted
4. Insurance distribution systems and channels
    a. Independent agency and brokerage marketing system
    b. Direct write marketing system
    c. Exclusive agency marketing system

D. Legal Form of Ownership
1. Proprietary insurers
    a. Stock insurers – Owned by their stockholders, most prevalent type of propriety insurer in US
    b. Lloyds associations – Lloyd's of London and American Lloyds
        i. Lloyd's of London is a marketplace, similar to stock exchange
        ii. Provides the physical and procedural facilities for members to write insurance
        iii. In the past, insurance each member wrote was backed by his/her personal fortune; now, more members are corporations and have only limited liabilities
        iv. Provides coverage for many unusual or difficulties loss exposure and underwrites much of global marine and aviation insurance
        v. American Lloyds associations are smaller and most are domiciled in Texas because of the favorable regulatory climate
        vi. Most were formed or have been acquired by insurers.
        vii. Members (underwriters) are not liable beyond their investment in the association
    c. Insurance exchange – similar to Lloyds associations. Members can be individuals, partnerships, or corporations, and have limited liability

2. Cooperative Insurers – owned by policyholders and includes mutual insurers, reciprocal insurance exchanges, fraternal organization, and other cooperatives.
    a. Mutual insurer – an insurer that is owned by its policyholders and is formed as a corporation for the purpose of providing insurance to policyholders.
        i. Policyholders have voting rights
        ii. Some profit is retained to increase surplus
        iii. Excess profit is usually returned to policyholders
        iv. Includes some large national/regional insurers
    b. Reciprocal insurance exchange – an insurer owned by policyholders and is formed as an unincorporated association for the purpose of providing insurance coverage to its members (called subscribers), and managed by an attorney-in-fact.
        i. Members agree to mutually insure each other
        ii. Members share profits/losses in proportion of their purchased insurance
        iii. May be formed to receive favorable tax treatment
    c. Fraternal organizations resemble mutual companies, but they combine a lodge or social function with their insurance function. They write primarily in life and health insurance.
    d. Other cooperative insurers include captive insurers, risk retention groups, and purchasing groups
        i. Captive insurer – a subsidiary company formed by a business organization or a group of affiliated organizations to provide all or part of its insurance
            a) "Formalized self-insurance"
            b) May also be formed to cover losses that other insurers will not cover at any price
            c) Some states encourage the formation and operation of captive insurers, while others do not permit the formation of captive insurers
        ii. Risk retention groups and purchasing groups usually organized so that a limited group or type of insured is eligible to purchase insurance from them
            a) Can be formed as stock companies, mutual, or reciprocal exchanges
            b) Becoming more significant in the evolving insurance market place
3. Other insurers include pools and government insurers
    a. Pools – A pool consists of several insurers, not otherwise related, that join together to insure lose exposures that individual insurers are not willing to insure: losses that occur too frequently or are too severe (e.g. airplane crashes or nuclear meltdowns)
        i. Pools formed voluntarily or to meet statutory requirements
        ii. Pools operate either
            a) As syndicate – Insured has contractual relationship with pool members and can sue any or all of them directly
            b) Through reinsurance – Insured has a contractual relationship only with the member that issued the policy. Policyholder has no legal rights against the other members of the pool and may not even know that they exist
        iii. Many pools are required by law
            a) Virtually all states require some kind of pooling arrangement to provide auto liability insurance for drivers who cannot obtain insurance in the standard market
            b) Fair Access to Insurance Requirements (FAIR) plans – an insurance pool through which private insurers collectively address an unmet need for property insurance on urban properties (in more than half the states)
            c) Windstorm coverage in southeastern states
    b. Federal government offered insurance
        i. National Flood Insurance Program (NFIP)
        ii. Terrorism Risk Insurance Act
        iii. All states offer some forms of government insurance (e.g. workers' compensation insurance)

E. Place of Incorporation
    1. A domestic insurer is incorporated within a specific state or, if not incorporated, is formed

under the laws of that state – insurance is regulated at the state level
    a. Reciprocal insurance exchanges are the only unincorporated insurers permitted in most states
    b. Insurance exchanges and Lloyd's organizations are permitted under law in only a few states
2. A foreign insurer is a domestic insurer licensed to do business in states other than its domiciled state
3. Alien insurers are incorporated or formed in another country

F. Licensing Status
1. A licensed insurer (admitted insurer) – an insurer that has been granted a license to operate in a particular state
2. An unlicensed insurer (nonadmitted insurer) – has not been granted a license to operate in a given state
3. Surplus lines broker is a person or firm that places business with insurers not licensed (nonadmitted) in the state in which the transaction occurs but that is permitted to write insurance because coverage is not available through standard market insurers
4. Producers for primary insurance (except for surplus lines brokers) are licensed to place business only with admitted insurers
5. License status is also important for reinsurance

G. Insurance Distribution Systems and Channels
1. Independent agency and brokerage marketing system – an insurance marketing system where producers (agents or brokers), who are independent contractors, sell insurance, usually as representatives of several unrelated insurers
2. Direct writer marketing system – an insurance marketing system that uses sales agents (or sales representatives) who are direct employees of the insurer
3. Exclusive agency marketing system – an insurance marketing system under which agents contract to sell insurance exclusively for one insurer (or an associated group of insurers).
4. Distribution channel –The channel used by the producer of a product or service to transfer that product or service to the ultimate customer

III. MEASURING INSURANCE PERFORMANCE

A. Meeting Profitability Goals
1. Premiums and investment income
    a. Premium growth – not always a positive indicator of an insurer's success; should consider whether growth resulted from a competitive advantage, relaxed underwriting, inadequate insurance rates, or a combination of these factors
    b. Rate of premium growth over time – helps determine insurer profitability
2. Underwriting performance
    a. Net underwriting gain or loss = earned premium – (incurred losses + underwriting expenses)
    b. Three ratios are used to measure an insurer's underwriting performance:
        i. Loss ratio = incurred losses / earned premium
        ii. Expense ratio = incurred underwriting expenses / written premium
        iii. Combined ratio (trade basis) = Loss ratio + Expense ratio

3. Overall operating performance –Net underwriting gain or loss plus net investment gain or loss for specific period
    a. Investment income ratio = net investment income / earned premiums
    b. Overall operating ratio = combined ratio (trade basis) – investment income ratio

        c. Return on equity = net income / owners' equity
        d. It is important to analyze the gain or loss from operations for several years.
    4. Estimation of loss reserves
        a. Loss reserves are generally the largest liability in the insurer's balance sheet and can have a significant effect on the insurer's overall profitability
        b. One of the biggest problems in measuring insurer profitability arises from errors in estimating loss reserves

B. Meeting Customer Needs
    1. Complaints and praise
    2. Customer satisfaction data
        a. Retention ratio – the percentage of expiring insurance policies that an insurer renews; can be measured by policy count, premium volume, or both.
        b. Lapse ratio
            i. Calculated by dividing the number of policies that lapse during the period by the total number of policies written at the beginning of the period
            ii. A lapse in insurance is defined as a point in time when a policy has been canceled or terminated for failure to pay the premium, or when the policy contract is void for other reasons
    3. Insurer-producer relationships – Insurers that market products through independent agents and brokers usually view this network of producers as their customers, in addition to the ultimate insurance customer
    4. State insurance department statistics
    5. Consumer reports

C. Meeting Legal Requirements
    1. Success or failure indicated by the number of criminal, civil, and regulatory actions taken against the insurer
    2. Market conduct regulation – State insurance departments monitor the treatment of insureds, applicants for insurance, and claimants, overseeing four insurer operational areas: sales and advertising, underwriting, ratemaking, and claim settlement

D. Meeting Social Responsibilities
    1. No standards exist
    2. Workplace safety programs
    3. Support of community projects
    4. Employee benefits

IV. FUNCTIONAL VIEW OF INSURANCE

A. Core Functions
    1. Marketing and distribution – Determining what products or services customers want and need, advertising the products, and delivering them to customers
    2. Underwriting – The process of selecting insureds, pricing coverage, determining insurance policy terms and conditions, and then monitoring the underwriting decisions made
    3. Claims – The purpose of claim function is to fulfill the insurer's promise to make a payment to, or on behalf of, the insured if a covered event occurs

B. Supporting Functions
    1. Risk control
    2. Premium auditing
    3. Actuarial
    4. Reinsurance

   5. Information technology

C. Other Common Function Areas
   1. Investments
   2. Accounting and finance
   3. Customer service
   4. Legal and compliance
   5. Human resources
   6. Special investigation units (SIUs)

V. THE DIGITIZATION OF INSURANCE

A. The best way to navigate this period of unprecedented uncertainty and opportunity in risk management and insurance starts with understanding how we got here – the rapid evolution of the three fundamental building blocks of the industry: data capture, data storage, and data analytics.
   1. Data Capture: Expanding Data Sources
      a. Much of data is generated and leveraged on devices connected through the internet of things (IoT)
      b. Losses can be more effectively prevented
      c. Insurers' underwriting can be more effective, and rates can be more accurate
      d. Claim process can be more efficient
   2. Data Storage: The Blockchain. Examples of its effects on the insurance chain:
      a. Insurance products, pricing, and distribution
      b. Underwriting, risk management, and reinsurance
      c. Policyholder acquisition and servicing
      d. Claim management
      e. Finance, payments, and accounting
      f. Insurance regulation and compliance
   3. Data Analytics: Advanced Analytics
      a. Telematics
      b. Network analysis
      c. Clustering

SAMPLE EXAM QUESTIONS

1. Which of the following is NOT an operating goal of an insurer? (SOA GIINT February 2014)
   A. Comply with legal requirements.
   B. Concentrate risk.
   C. Meet customer needs.
   D. Earn a profit.
   E. Fulfill its duty to society.

2. What are the three core functions that exist within a typical insurer? (SOA GIINT February 2014)
   A. Accounting, actuarial, and underwriting.
   B. Actuarial, claims, and underwriting.
   C. Accounting, marketing and distribution, and sales.
   D. Claims, marketing and distribution, and underwriting.
   E. Actuarial, marketing and distribution, and sales.

3. Which of the following errors is the most significant problem in measuring insurer profitability? (SOA GIINT February 2014)
   A. Errors in setting adequate rates.
   B. Errors in estimating future investment returns.
   C. Errors in estimating loss reserves.
   D. Errors in estimating sales growth.
   E. Errors in classification of loss exposure units.

4. Which of the following is false?
   A. A foreign insurer is an insurer that is incorporated under the laws of a country outside of the United States.
   B. An insurer incorporated in state A is a domestic insurer in state A.
   C. Mutual companies include some large national/regional insurers.
   D. Nowadays a large portion of Lloyd's of London members are corporations and have only limited liabilities.
   E. Fraternal organizations resemble mutual companies, and they write primarily in life and health insurance.

5. Which of the following is a proprietary insurer?
   I. Fraternal organizations
   II. Reciprocal exchanges
   III. American Lloyds associations

   A. I
   B. II
   C. III
   D. I and II
   E. I, II, and III

6. Which of the following statements are true?
   I. Under a syndicate pool policy, the insured has a contractual relationship with each member of the pool.
   II. A reciprocal exchange is owned by its policyholders.
   III. A foreign insurer operating in a given state is an insurer incorporated in another country.

   A. I only
   B. II only
   C. III only

D. I and II only
E. I, II, and III

7. Which of the following is NOT an internal constraint on achieving insurer goals?
   A. Efficiency
   B. Expertise
   C. Size
   D. Financial resources
   E. Insurance marketing and distribution

8. Which of following is NOT a cooperative insurer?
   A. Captive insurer
   B. Lloyd's of London
   C. Mutual insurance company
   D. Reciprocal exchange
   E. Risk retention group

9. Unincorporated associations that enable individuals to write insurance as individuals and whose members insure one another are called:
   A. Lloyd's associations
   B. Proprietary insurers
   C. Captive insurers
   D. Reciprocal exchanges
   E. Mutual insurers

10. Which of the following statements are true?
    I. Under a reinsurance pool policy, the policyholder has no legal rights against the other members of the pool and might not even know that they exist.
    II. Virtually all states require some kind of pooling arrangement to provide auto liability insurance for drivers who cannot obtain such insurance in the standard market.
    III. Cooperative insurers include captive insurers, risk retention groups, and purchasing groups.

    A. I only
    B. II only
    C. III only
    D. I and II only
    E. I, II, and III

11. Which one of the following is an external constraint faced by insurers?
    A. Regulation
    B. Expertise
    C. Size
    D. Lack of name and brand recognition
    E. All above

SAMPLE EXAM QUESTION ANSWERS

1. B
2. D
3. C
4. A
5. C
6. D
7. E
8. B
9. D
10. E
11. A

ASSIGNMENT 2

INSURANCE REGULATION

I. REASONS FOR INSURANCE REGULATION

A. Three Primary Reasons
1. To protect consumers
2. To maintain insurer solvency
3. To prevent destructive competition

B. Protect Consumers
1. Review insurance policy forms to determine whether they benefit consumers and comply with laws
2. Disapprove policy forms that are inconsistent with consumer protection laws
3. Set coverage standards and specify language for certain coverage
4. Protect consumers against fraud and unethical market behavior
5. Try to ensure insurance readily available

C. Maintain Insurer Solvency – Insurance regulators try to maintain a sound financial condition of private insurers for several reasons:
1. Insurance provides future protection
2. Regulation is needed to protect public interest
3. Insurers hold substantial funds for the ultimate benefit of insureds
4. Insurers have become insolvent despite regulatory reviews – needs to minimize the number of insolvencies

D. Prevent Destructive Competition
1. Insurance rates should be high enough to prevent destructive competition
2. Underpricing of some insurers would drive down the price levels in the whole market
3. Some insurers can become insolvent and others might withdraw from the market
4. Shortage can then develop and individuals and firms might be unable to obtain coverage

II. INSURANCE REGULATORS

A. Introduction
1. Insurance is regulated primarily by the state insurance departments
2. Every state insurance department is headed by an insurance commissioner, who can be elected or appointed
3. State insurance departments are partly funded by state premium taxes, audit fees, filing fees, and licensing fees
4. State insurance departments are member of the NAIC – a nonprofit corporation that has no regulatory authority of its own
5. Insurers are also subject to federal regulations that affect noninsurance businesses

B. State Insurance Departments
1. State insurance department regulatory activities include:
   a. Licensing insurers
   b. Licensing producers, claim representatives, and other insurance personnel
   c. Approving policy forms

d. Holding rate hearings and reviewing rate filings
e. Evaluating solvency information
f. Performing market conduct examinations
g. Investigating policyholder complaints
h. Rehabilitating or liquidating insolvent insurers
i. Issuing cease-and-desist orders
j. Fining insurers that violate law
k. Regulating insurance policies
l. Publishing shoppers' guides and other consumer information (in some states)
m. Preventing fraud

2. The insurance department is headed by the insurance commissioner. Most commissioners are appointed, some states elect their commissioner. Insurance commissioner duties include:
   a. Overseeing the insurance department
   b. Declaring orders, rules, and regulations
   c. Determining whether to issue license to new insurers, producers, and other insurance entities
   d. Reviewing price and coverage
   e. Conducting financial and market examination
   f. Holding hearing on insurance issues
   g. Taking actions when insurance laws are violated
   h. Issuing annual reports
   i. Maintaining department records
3. State regulation funding –
   a. Funded by state premium taxes, audit fees, filing fees and licensing fees
   b. Premium taxes are the major source
   c. Only a small proportion of premium is spent on insurance regulation
   d. Premium taxes are designed primarily to raise state revenues.

C. The National Association of Insurance Commissioners (NAIC)
1. Coordinates insurance regulation activities among the insurance departments but has no direct regulatory authority
2. Develop uniform financial forms that all states require insurers to file
3. Collect and compile financial information
4. Share financial information on potentially insolvent insurers
5. Develop model laws and regulations
6. Implement accreditation program

D. Federal Regulation
1. State governments, rather than the federal government, hold the regulatory power over insurers, but some federal regulations still apply:
   a. Federal employment laws
   b. Stock regulations
2. Federal Insurance Fraud and Prevention Act

III. INSURANCE REGULATORY ACTIVITIES: LICENSING INSURERS AND INSURANCE PERSONNEL

A. Licensing Insurers
1. Regulators developed the Uniform Certification of Authority Application (UCAA) –
   a. Each state still performs its own independent review of each application,
   b. Need to file different applications in different formats has been eliminated
2. Domestic insurer – An insurer licensed in its home state; the license generally has no expiration date

3. Foreign insurers – both the requirements of the insurer's domestic state and the foreign state where the insurer is applying for a license must be met
4. Alien insurers – Insurers domiciled outside of the United States
   a. Must satisfy the requirements imposed on domestic insurers
   b. Must usually establish a branch office
5. Nonadmitted Insurers – A nonadmitted insurer is not licensed (not authorized) in the insured's home state
   a. Typically a surplus lines insurer
   b. Might be permitted to transact business through a specially licensed surplus lines producer
6. Risk retention group – Once licensed as a commercial liability insurer under the laws of at least one state, a risk retention group can write insurance in other states without license
7. A domestic insurer's license generally has no expiration date. Licenses of foreign insurers and alien insurers generally must be renewed annually

B. Licensing Insurance Personnel
1. Producers – must be licensed in each state where they do business
   a. Gramm-Leach-Bliley (GLB) Act led to greater licensing reciprocity among states
   b. National Insurance Product Registry (NIPR) eliminated many inconveniences from multistate regulation
   c. National Association of Registered Agents and Broker Reform Act of 2015 (NARAB II)
2. Claim representatives – must be licensed in some states
3. Insurance consultants – must be licensed in some states

IV. INSURANCE REGULATORY ACTIVITIES: MONITORING INSURANCE SOLVENCY

A. Primary Reason – Insurers hold large sums of money for the benefit of consumers.

B. Two Broad Goals
1. Reducing the insolvency risk
2. Protecting the public against loss when insurers fail

C. Methods to Maintain Solvency – The regulatory framework relies on an extensive system of peer review, featuring frequent communication and collaboration to provide the necessary checks and balances needed to make the system work
1. NAIC accreditation program
2. Solvency requirements for insurers
3. Insurers must submit annual and quarterly financial statements to regulators
4. Insurers are required to NAIC's Accounting Practices
5. Most insurers must submit their financial statements to a CPA for audit
6. Most insurers must have their reserves evaluated and attested by an actuary
7. Insurers must perform a risk-based capital (RBC) calculation and report the results to regulators
8. Insurers are required to adhere to state minimum capital and surplus requirements
9. State investment laws limit the types and quantity of an insurer may make
10. State laws specify limitations on the amount of a single risk an insurer may underwrite
11. Treatment of reinsurance is governed by NAIC Credit for Reinsurance Model Law

D. Liquidation of Insolvent Insurers
1. If an insurer falls into insolvency, the insurance commissioner places it in the receivership
2. Successful rehabilitation might be possible with proper management
3. The insurer is liquidated according to the state's insurance codes if it cannot rehabilitated

4. Many states now liquate insolvent insurers according to the Uniform Insurers Liquidation Act drafted by NAIC

E. State Guaranty Funds
   1. Guaranty funds do not prevent insurer insolvency, but they mitigate its effect
   2. All states have property-casualty insurance guaranty funds that pay some of the unpaid claims
   3. Insolvency assessment is used to raise the necessary funds to pay the claims
   4. Some common characteristics of state guaranty funds
      a. Assessments are made only when an insurer fails (except in New York)
      b. Policies usually terminate within 30 days after the failure dates
      c. Claim coverage varies by state and is subject to maximum limits
      d. Most states provide a refund for unearned premium
      e. Most states apply a $100 deductibles for unpaid claims

F. Reasons for Insolvency
   1. Rapid premium growth
   2. Inadequate insurance rates
   3. Inadequate reserves
   4. Excessive expenses
   5. Lax controls over managing general agents
   6. Uncollectible reinsurance
   7. Fraud

V. INSURANCE REGULATORY ACTIVITIES: REGULATING INSURANCE RATES

A. Primary Goals of Rate Regulation
   1. Insurer financial stability
   2. Consumer protection

B. Three Major Goals of Rate Regulation
   1. Adequate
   2. Not Excessive
   3. Not unfairly discriminatory

C. Types of Rating Laws
   1. Prior-approval laws require rates and supporting rules to be approved by the state insurance department before they can be used
   2. File-and-use laws allow the insurer to use the new rates immediately after filing with the state insurance department
   3. Use-and-file laws allow insurers to use the new rates and later submit filing information
   4. No-filing laws (information filing or open competition) do not require insurers to file rates with the state insurance department
   5. Flex rating laws require prior approval only if the new rates exceed a certain percentage above (sometimes below) the rates filed previously

VI. INSURANCE REGULATORY ACTIVITIES: REGULATING INSURANCE POLICIES

A. Reasons
   1. Insurance policies are complex documents
   2. Contract languages contained in insurance policies are almost always drafted by insurers
   3. Consumers may not understand their policies

B. Major Steps and Process

1. Insurance policy regulation starts with a state legislature passing laws regarding insurance policy form and content
2. State insurance departments implement specific directives from the legislature or exercise their general authority to regulate insurance policies through administrative rules, regulations, and guidelines
3. Courts influence insurers by determining whether insurance laws are constitutional and by interpreting insurance policy provisions

VII. INSURANCE REGULATORY ACTIVITIES: MARKET CONDUCT AND CONSUMER PROTECTION

A. Three Key Traditional Areas of Market Conducts
   1. Producer practices
   2. Underwriting practices
   3. Claim practices

B. Producer Practices
   1. Dishonesty or fraud – a producer might embezzle premiums or misappropriate some claim funds
   2. Misrepresentation – a producer might misrepresent the losses that are covered by an insurance policy, which might induce a client to purchase that policy under false pretenses
   3. Twisting – a produce might induce an insured to replace one policy with another, to the insured's detriment
   4. Unfair discrimination – a producer might engage in any number of acts that favor one insured unfairly over another
   5. Rebating – Giving a portion of producer's commission or some other financial advantage to an individual as an inducement to purchase a policy. Rebating is currently illegal in almost all states

C. Underwriting Practices
   1. Examples of unfair underwriting practices
      a. Discriminating unfairly when selecting loss exposures
      b. Misclassifying loss exposures
      c. Canceling or non-renewing policies contrary to statutes, rules, and policy provisions
      d. Using underwriting rules not on file or not approved
      e. Failing to apply newly implemented underwriting and rating factors to renewals
      f. Failing to use the correct policy forms and insurance rates
      g. Failing to use rules that are state specific
   2. Regulators' actions to protect consumers
      a. Constrain insurers' ability to accept, modify, or decline applications for insurance
      b. Establish allowable classification

D. Claim Practices – Examples of unfair claims settlement practices include:
   1. Knowingly misrepresenting important facts or policy provisions
   2. Failing to properly investigate and settle claims
   3. Failing to make a good-faith effort to pay claims when liability is reasonably clear
   4. Attempting to settle a claim for less than it should be
   5. Failing to approve or deny coverage of a claim within a reasonable period after a proof-of-loss statement has been completed

E. Market Analysis – Insurance regulators are moving away from traditional market conduct examinations and toward market analysis

1. One of fundamental components of market analysis is the collection of regulatory information from insurers using the Market Conduct Annual Statement (MCAS)
2. Market analysis allows regulators
    a. To identify general market disruptions
    b. To promote uniform analysis
    c. To facilitate communication and collaboration among regulators from different states

F. Ensuring Consumer Protection
1. Most state insurance departments investigate and follow up on consumer complaints
2. Many states computer complaint ratios and some made them available to public

SAMPLE EXAM QUESTIONS

1. Which of the following is NOT a reason insurers are subject to governmental regulation? (SOA GIINT February 2014)
   A. Protect consumers against fraud.
   B. Guarantee insurer profit.
   C. Maintain insurer solvency.
   D. Prevent unfair discrimination.
   E. Protect consumers against unethical marketing behavior.

2. Which of the following is the primary reason insurer solvency is monitored by regulators? (SOA GIINT February 2014)
   A. Insurers hold large sums of money for the benefit of consumers.
   B. Insurers are inherently financially unstable.
   C. The cost of insurer insolvencies is shifted to taxpayers.
   D. Solvency of insurers is easily measured without much cost.
   E. The claims-paying ability of insurers can be analyzed by most consumers and businesses.

3. Which of the following are the three major goals of insurance rate regulation? (SOA GIINT February 2014)
   A. Ensure that rates are adequate, are not excessive, and are unfairly discriminatory.
   B. Ensure that rates guarantee insurance company solvency, are affordable, and are not overly complex.
   C. Ensure that rates do not allow insurers excessive or unreasonable profits, are high enough to pay all claims and expenses, and result in fair, consistent, and equitable charges among all insured groups.
   D. Ensure that rates are not affected by competition, are not excessive, and are not discriminatory.
   E. Ensure that rates are actuarially sound, are affordable to all, and are equitable.

4. Reasons for regulation of insurance include which of the following?
   I. To protect consumers
   II. To maintaining insurer solvency
   III. To prevent destructive competition

   A. I
   B. I and II
   C. II and III
   D. I and III
   E. I, II, and III

5. The right of the states to regulate the business of insurance was first established by
   A. the South-Eastern Underwriters Association case
   B. Paul v. Virginia
   C. the Financial Modernization Act
   D. the Sherman Act
   E. the National Association of Insurance Commissioners

6. The basis for current state regulation of insurance is
   A. the McCarran-Ferguson Act
   B. Paul v. Virginia
   C. the South-Eastern Underwriters Association case
   D. the National Association of Insurance Commissioners
   E. the Sherman Act

7. Which of the following statements about insurance regulators is NOT true?
   A. All states have insurance laws that regulate the operations of insurers.
   B. Insurers are totally exempt from regulation by federal agencies and laws.
   C. The courts regulate insurance in many ways, including the interpretation of policy clauses and provisions.
   D. State insurance commissioners, through administrative rulings, have considerable power over insurers doing business in their states.
   E. The National Association of Insurance Commissioners (NAIC) coordinates insurance regulation activities among the insurance departments but has no direct regulatory authority.

8. Under what type of rate regulation are insurers required to obtain approval of rates before using them if the rate change exceeds a specified predetermined range?
   A. flex-rating law
   B. prior-approval law
   C. file-and-use law
   D. open competition law
   E. use-and-file law

9. Advantages cited by proponents of state regulation of insurance include all of the following except
   A. uniformity of laws by the NAIC
   B. greater opportunity for innovation
   C. greater responsiveness to local needs
   D. more competent regulators
   E. decentralization of political power

10. The major reasons for insurer insolvency include all of the following except
    A. Rapid premium growth
    B. Inadequate reserves
    C. Excessive expenses
    D. Inadequate insurance rates
    E. Inadequate insurance

11. The common characteristics state guaranty funds include all of the following except
    A. Assessments are made only when an insurer fails (except in New York)
    B. Policies usually terminate within 30 days after the failure dates
    C. Claim coverage varies by state and are subject to maximum limits
    D. Most states have no deductibles for unpaid claims
    E. Most states provide a refund for unearned premium

12. FOB Insurance Company would like to purchase a bank. For many years, FOB was not permitted under federal law to enter into banking operations. Which of the following legislative acts or court decision eliminated the prohibition that prevented banks, insurers, and investment firms from entering into one another's markets?
    A. The McCarran-Ferguson Act
    B. Gramm-Leach-Bliley Act
    C. The Tax Reform Act
    D. The Consolidated Omnibus Budget Reconciliation Act
    E. The ISO and the Attorneys General Lawsuit

13. The regulation of insurers in areas that affect consumers, which include claims practices, underwriting practices, producer practices is called
    A. Solvency surveillance
    B. Market conduct regulation
    C. Combined ratio analysis
    D. Market share regulation
    E. Market trend analysis

14. Which of the following statements about state insurance guaranty funds is (are) true?
    I. Most states provide a refund for unearned premium.
    II. They are usually funded by general revenues of the states.
    III. Claim coverage are subject to maximum limits

    A. I
    B. I and II
    C. II and III
    D. I and III
    E. I, II, and III

15. Which of the followings are cited advantages of federal regulation of insurance?
    I. greater efficiency
    II. greater opportunity for innovation
    III. more competent regulators

    A. I
    B. I and II
    C. II and III
    D. I and III
    E. I, II, and III

16. Mary, a claim manager, is training new claims representatives and talking to them about regulations that apply to their job. Mary wants them to understand the primary source of insurance regulation. Which one of the following should Mary therefore focus on?
    A. State insurance departments
    B. The NAIC
    C. Federal regulation
    D. Model laws and acts
    E. None of above

17. To be licensed in an additional state, which one of these types of insurers must show that it has satisfied the requirements imposed by the its home state (its state of domicile) and generally must satisfy the minimum capital, surplus, and other requirements imposed on the domestic insurers of the

state in which it applying?
A. Alien insurer
B. Foreign insurer
C. Admitted insurer
D. Nonadmitted insurer
E. None of the above

18. ABC Insurance is experiencing rapid premium growth because of its recently lowered personal lines rates. Which one of the following is reduced for ABC because of this growth?
A. Fraud
B. Reinsurance
C. Margin of error
D. Chance of insolvency
E. None of above

19. Which one of the following types of rate regulation laws allows an insurer to use a new rate immediately after filing it with the state, although it may be disapproved if found to violate state law or be unjustifiable?
A. Prior-approval laws
B. No filing laws
C. Flex rating laws
D. File-and-use laws
E. None of above

20. Emily is a new producer working at a small agency. Feeling pressure to increase her sales numbers, she considers offering a portion of her commissions back to new clients who purchase a policy from her as an incentive for them to close the deal with her. What unfair trade practice would Emily be engaging in if she went through with this action?
A. Twisting
B. Fraud
C. Misrepresentation
D. Rebating
E. None of above

SAMPLE EXAM QUESTION ANSWERS

1. B
2. A
3. C
4. E
5. B
6. A
7. B
8. A
9. D
10. E
11. D
12. B
13. B
14. D
15. D
16. A
17. B
18. C
19. D
20. D