

RPM Product Development Workshop

Regulation

By

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Agenda

- Purpose Of Regulation
- Issues Facing Regulators
- Issues when Working with Regulators
- Presentation of new Product and Regulatory Questions

Overview of Regulation

Purpose of Regulation

- Exists to
 - Protect insurance consumers
 - Prevent insurer insolvency
- Given market imperfections resulting from
 - Imperfect information
 - Barriers to entry and exit
 - Various externalities

A means toward achieving the market outcomes of perfect competition.

Regulation Today

- Most notable factors influencing the development of modern insurance regulation:
 - Insurer insolvencies
 - Availability and affordability problems
 - Inequitable treatment of insurance consumers

Regulatory Functions of DOI

- Licensing insurers
- Regulating coverage and pricing
- Conducting examinations
- Licensing producers
- Regulating claim adjusters
- Preventing fraud
- Determining the need for insurer receivership
- Providing consumer services
- Monitoring sales of insurance securities

The Commissioner

- Appointed or elected
- Duties include (but not limited to):
 - Organize and manage DOI
 - Execute duties of the insurance code
 - Enforce insurance code
 - Hold hearings
 - Take action when violations of law occurs
 - Issue annual reports

Licensing

- DOI must approve and license new insurers before they can write insurance coverages in a state
- The DOI will examine
 - Initial capital and surplus sources
 - Pro forma financial statements
 - Biographical affidavits of the insurer's proposed board members, officers, and key employees

Filing Laws

- Vary by state and line of insurance
- General categories include:
 - State-mandated
 - Prior-approval
 - File-and-use
 - Use-and-file
 - No-file

Rate Regulation

- Most visible and controversial function of a regulator
- “Rates shall not be excessive, inadequate, or unfairly discriminatory”
- Widely divergent interpretations from state to state
 - Consumer complaints
 - Special interest lobbying groups
- Personal lines insurance gets the most regulatory attention
- Focus in on three broad themes today:
 - Whether the classification systems are appropriate
 - Whether provisions for profit are fair to consumers
 - Whether the rate loadings for catastrophic losses are adequate

Form Regulation

- DOI approval needed for:
 - Policy forms (both new and revised)
 - Insurance applications
 - Policy jackets
 - Declarations page
 - Policies and endorsements
- Form filing law can be different than that for rates
- Requirements regarding readability to insurance forms
- DOI's looking for:
 - Policy cancellation provisions
 - Loss reporting requirements
 - Claim settlement practices
 - Subrogation provisions
 - Fraud and dishonest definitions and penalties
 - Dispute resolution procedures

Solvency Regulation

- Arguably the most important activity regulators perform
- Frequent reviews of insurers' financial condition through analyzing statements filed with regulators and the NAIC
- Monitoring insurer policyholders' surplus to ensure adequacy and liquidity
- Risk based capital (RBC) requirements
- Periodic on-site financial examinations

Issues Facing Regulators

Issues Facing Regulators, Part I

- Staffing
 - Usually never enough credentialed (if any) actuaries
- Massive number of filings
 - How to decide which ones to really get in-depth on versus just peripheral review or reliance on the filing forms
 - How do you maintain consistency in reviewing all the filings?
- Deemer provisions
 - Acts as a ticking clock to get review done in time before the insurer can simply deem a filing approved

Issues Facing Regulators, Part II

- Reviewers are different between rates and forms
 - How to coordinate the two reviews for consistency and understanding
- Intervention of consumer watchdog groups
 - Added stress for more review
 - Complicated if regulatory opinion differs from watchdog
- Review of rates and forms may get political
 - Actuarial review may suggest rates are appropriate, but it is ultimately up to the commissioner as to what gets approved

Issues Facing Regulators, Part III

- Each filing looks different
 - Managing through the different styles and levels of support can prove to be challenging
 - Leads to lots of questions given back to the insurer
- Pricing sophistication has taken over
 - How do you effectively regulate a GLM?
 - Key variables may be statistically sound, but don't make sense (no causal relationship)
 - DOI budgets don't often allow for much continuing education opportunity, so regulator's may need more time to absorb advances in pricing sophistication

Issues Facing Regulators, Part IV

- Public heat
 - Cries of redlining and availability issues
 - Price increases are unpopular
- Commissioner heat
 - It could be an election year
- Legislative heat
 - DOI could be called to ask for data calls or testify on insurance matters
 - Size of residual markets may be getting out of control
- Insurer heat
 - Going to a time and labor-intensive rate hearing

Issues When Working with Regulators

Issues When Working with Regulators, Part I

- How much detail do you include in the filing?
 - Do you meet with the DOI beforehand?
 - Do you put minimal support in to see if they ask questions?
 - Do you use the filing to educate the DOI?
 - Competitive concerns
- Does your company have existing filings pending in the DOI
 - Do they contain the same level of support?
 - Do the filings complement one another or contradict one another?

Issues When Working with Regulators, Part II

- Do you understand the desk drawer rules?
 - Policyholder impacts
 - Profit provision
 - Use of zip code rating
- Understanding the burden of proof
 - If it is your duty to prove that rates are not inadequate, not excessive, and not unfairly discriminatory, how do you prove that?

Issues When Working with Regulators,

Part III

- What is the current political situation in the state?
 - Do you raise rates along the coast right after a major hurricane?
 - Do you ask for a large rate increase months before an election for commissioner?
- What is Plan B?
 - If you get outright disapproval, what is the rate hearing process?
 - Many times, the commissioner can be the judge in a rate hearing

Issues When Working with Regulators, Part IV

- How much can you rely on an approved competitor rate filing?
 - Will the DOI hold you to a different standard to support a rating variable?
- Timing of the rate filing and accompanying form filing
 - Form filing usually takes longer
 - Disputes on the forms side are not easily resolved

Issues When Working with Regulators, Part IV

- Have you considered these three broad themes?
 - The appropriateness of your classification system
 - Correlation v causal relationship
 - GLMs
 - Impacts on sensitive groups
 - Profit provision
 - Is the return on equity underlying the profit provision supported?
 - Excessive profits statutes or claims
 - Rate loadings for catastrophic losses
 - What models are you using?
 - Impacts along the coasts or fault lines
 - Reinsurance

Q&A With Teams

Welcome to Stolland with its two
top chief actuaries, Chris Stoll and
Patrick Causgrove