

# 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

# Early Origins of Ins Regulation

- Dates back to first insurance cos in colonies
  - Companies were subject to British Law
  - Companies chartered under British Crown
- In 1800's states enacted sporadic ins regulations
- Paul v Virginia, in 1869, tested concept of state regulation
  - Argued only Congress could regulate interstate commerce
  - Supreme Court held up that ins contract is delivered locally and not interstate commerce
  - Upheld state regulation of insurance

# 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.**

# 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

# Regulation Today

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

# 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
- Vary by type of filing
  - Rate
  - Form
- 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
- Three commonly ‘discussed’ themes:
  - 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 any “desk drawer rules”?
  - Policyholder impacts
  - Profit provision
  - Geographic 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

- Do you have an exit strategy?
- 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 Volunteer Insurance  
with its chief actuary,  
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