Four assignments:

- Insurance Principles
- Insurance Coverages: Life and Health
- Insurance Coverages: Property and Casualty
- Insurance Regulation and Legislation
Insurance Regulation and Legislation

Topics

- Insurance Regulation and the Role of the NAIC
- Activities of Insurance Regulators
- State Government Insurance Programs
- Market Conduct and Solvency Regulation
- Insurance Rate and Form Regulation
- Insurer Licensing
- Issues Around Insurance Fraud
States regulate insurer formation, financing, investment, and taxation. They also regulate insurance rates, producer licensing, and marketing and claims practices.
The Role of the NAIC

The National Association of Insurance Commissioners

• Encourages states’ cooperation
• Drafts model laws and regulations
• Has no direct regulatory authority
State insurance departments enforce laws passed by legislators.
Insurance Department Activities

• Approve policy forms
• Review rate filings and hold hearings
• License new insurers
• License some insurance professionals
• Investigate policyholder complaints
• Rehabilitate or liquidate insolvent insurers
Insurance Department Activities

- Issue cease-and-desist orders
- Audit insurers
- Evaluate solvency information
- Perform market-conduct examinations
- Publish consumer information
Insurance Commissioners

- In some states, title may be insurance superintendent or director.
- Depending on state, they may be appointed by governor or elected.
- Many have expertise and experience in insurance business.
State governments provide or operate insurance programs for public policy reasons.
Common State Programs

- Workers compensation funds
- Unemployment insurance
- Automobile insurance plans
- Fair Access to Insurance Requirements (FAIR) plans
- Beachfront and windstorm pools
• Monopolistic funds are the only source of coverage.
• Competitive funds compete with private insurers.
• Residual market plans are for employers who cannot obtain voluntary coverage from insurers.
Unemployment Insurance

- Not available from private insurers.
- Benefits vary by state.
- Minimum federal standards apply.
Automobile Insurance Plans

- Cover those who cannot get auto liability coverage from private insurers (the residual market).
- Costs spread among insurers.
- Typically administered by private insurers.
• Property insurance unavailable in private market.
• Costs spread among property insurers.
• Cover exposures over which property owners have no control.
• Examples: urban riots, brush fires.
Beachfront and Windstorm Plans

- Insure property against wind damage caused by hurricanes.
- Available in hurricane-prone areas.
- Some states provide coverage through FAIR plans.
Guarantee Funds

- Pay claims of insolvent insurers
- Funded by assessments against private insurers
To protect policyholders and the public, states regulate how insurers conduct business and monitor their financial strength.
Most states have unfair trade practices laws that apply to insurer:

- Sales
- Underwriting
- Claims handling
Penalties for unfair trade practices

• Agents/brokers—license suspension or revocation

• Insurers—fines; license suspension or revocation
Insurers and claim representatives can be fined for

- Offering unfairly low settlements
- Failing to explain claim denials
- Misrepresenting policy provisions
- Unreasonably delaying claims resolution
Insurer Solvency

- The insurer’s ability to meet financial obligations as they become due
- Includes obligations that might be claimed several years in the future
To verify solvency, regulators:

- Set financial requirements
- Conduct field examinations
- Review financial requirements
- Administer IRIS
Financial Requirements

- Minimum requirements to maintain solvency
- Apply to all similarly licensed insureds
- Vary by state
Field Examinations

- On-site review of insurer activities
- Every three to five years
- Focus on financial records
Annual Statements

- Submitted to state insurance departments
- Follow prescribed NAIC format
- Include data on premiums, expenses, investments, losses, and reserves
- Indicate insurers’ financial strength
IRIS

- Early warning system
- Applies ratios to financial statement data to assess financial condition
- Helps identify insurers with potential financial problems
- Designed by the NAIC
- Administered by regulators
Dealing With Insolvency

If an insurer is determined to be insolvent, state regulators may:

• Place it in receivership for rehabilitation
• Partially or completely take over its operation
• Dissolve it and assign policies to another insurer
States regulate insurance rates and policy forms because insurance consumers need to be able to afford insurance and to understand the policies they purchase.
To be approved by regulators, insurance rates must be:

- Adequate
- Not excessive
- Not unfairly discriminatory
Types of Rate Regulation

- Mandatory
- Prior approval
- File and use
- Use and file
- Flex rating
- Open competition
Policy-form review

• To ensure that policies are clear and readable
• To detect unfair or unreasonable provisions
Some states control policy content and structure:

- Specific provisions
- Readability standards
Regulatory Exemptions

- Surplus lines insurers
- Coverages for unique or hard-to-place risks
- Commercial coverages for large, sophisticated purchasers
States require that insurance companies be licensed. Most states also require that certain individual insurance professionals, such as producers and claim representatives, be licensed.
Insurer Licensing Status

- Domestic
- Foreign
- Alien
### Forms of Insurer Ownership

<table>
<thead>
<tr>
<th>Type of Insurer</th>
<th>Form of Ownership</th>
<th>Managed by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock insurer</td>
<td>Corporation owned by its stockholders</td>
<td>Board of directors, elected by the stockholders</td>
</tr>
<tr>
<td>Mutual insurer</td>
<td>Corporation owned by its policyholders</td>
<td>Board of directors, elected by the policyholders</td>
</tr>
<tr>
<td>Reciprocal insurance exchange</td>
<td>Unincorporated association of subscribers</td>
<td>Attorney-in-fact chosen by the subscribers</td>
</tr>
</tbody>
</table>
Admitted and Nonadmitted Insurers

- Admitted insurers—licensed in state
- Nonadmitted insurer—not licensed in state
Surplus lines laws permit nonadmitted insurers to operate in a state.

– Restricted to selling insurance not available in admitted market

– Must do business only through licensed surplus lines producer
Licensing of Individuals

- States require licensing of some insurance workers.
- Examples: agents, brokers, claim representatives.
- Must pass an examination.
- Continuing education required for renewal.
The billions of dollars insurers pay out annually for fraudulent claims are reflected in higher insurance premiums for all policyholders.
Costs of Insurance Fraud

• Costliest white collar crime, next to tax evasion
• 10 percent of property-casualty insurance losses and loss expenses
• $32 billion per year (property-casualty)
• $400-$700 higher annual premiums per household
Types of Insurance Fraud

- False claims
- Exaggerated claims (padding)
- False statements on insurance applications (rate evasion)
Insurance Fraud: Attitudes

Trends in Attitudes Toward Claim Padding

- Increase claim amount to make up for deductible
- Increase claim amount to make up for premium

2012 data are from an online survey.
1997–2002 data are from telephone interviews.
Pre-1997 data are from in-home interviews.

[DA10560]
Insurance Fraud: Attitudes

Respondents Who View Padding as Acceptable to Cover Premiums, by Age and Sex

<table>
<thead>
<tr>
<th>Population</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall</td>
<td>18</td>
</tr>
<tr>
<td>Men age 18-34</td>
<td>23</td>
</tr>
<tr>
<td>Women age 18-34</td>
<td>8</td>
</tr>
<tr>
<td>Men over 34</td>
<td>5</td>
</tr>
</tbody>
</table>
Federal Fraud Laws

• Violent Crime Control and Law Enforcement Act of 1994
• Federal Mail Fraud Statute
• Racketeer Influenced and Corrupt Organization Act (RICO)
State Fraud Laws

- Reporting statutes
- Immunity statutes
Summary

- States regulate insurance
  - Rates
  - Policy forms
  - Market conduct
  - Solvency
  - Professional licensing
  - Insurer licensing
- Both federal and state laws apply to insurance fraud.
RISK MANAGEMENT INSURANCE FUNDAMENTALS
INSURANCE REGULATION AND LEGISLATION

PART 4 OF 4

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