Cook.Personal

Reading: Cook, Mary Ann, ed., Personal Insurance, (Second Edition), The Institutes, 2013, pp. 2.13-2.15 and 7.32-7.36.

Synopsis: How insurers deal with high-risk drivers and high-risk property coverage through residual market mechanisms such as *Assigned Risk Plans*, *Joint U/W Associations*, *Reinsurance Facility*, and *FAIR plans*.

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Contents

Study Tips

The topic of high-risk auto insurance cannot be fully covered in a short reading like Cook. The problem is that each state has a fair degree of freedom in setting the rules. When I studied this reading, I saw a lot of gaps in Cook's presentation. For example, how exactly are rates for high-risk drivers set in an *Assigned Risk Plan* versus *Joint Underwriting Association* versus *Reinsurance Facility*. Cook discusses this only in very general/vague terms, and based on past exam questions that's very likely all you need to know.

There is also a short discussion on the topic of FAIR plans and Beachfront/Windstorm coverage which appears on the exam from time to time.

Estimated study time: 2 days *(not including subsequent review time)*

BattleTable

Based on past exams, the **main things** you need to know *(in rough order of importance)* are:

- how the 3 residual market mechanisms for auto insurance work *(this is the bulk of the reading)*
  - many exam questions ask you to compare the 3 mechanisms so you should memorize the similarities and differences
- how *FAIR* and *Beachfront & Windstorm* insurance work *(FAIR = Fair Access to Insurance Requirememts)*

Questions held out from most recent exam: **#9**. *(Skip these now to have a fresh exam to practice on later. For links to these questions, see Exam Summaries.)*

reference	part (a)	part (b)	part (c)	part (d)
E (2019.Spring #7)	**ARP & JUA**: - placement, loss-sharing	**RF**: - market stability	Webel.TRIA-1	
E (2018.Fall #7)	**residual markets**: - placing risks	**residual markets**: - loss sharing	**FAIR plans**: - exposures covered	
E (2018.Spring #6)	**Assigned Risk Plan**: - describe ARPs	**Joint U/W Associations**: - describe JUAs	operational diff of each	
E (2018.Spring #8)	see Germani.GovtIns	**government participation**: - beachfront/windstorm	**FAIR plans**: - rationale, operation	
E (2017.Fall #6)	**JUA *vs* ARP**: - loss-sharing, volatility	**reinsurance facility**: - opns, servicing, profits		
E (2017.Spring #6)	**reducing insurer risk**: - coverage restrictions	**ARP *vs* JUA**: - risk assignment	see NAIC.Telematics	
E (2017.Spring #7)	**rate change disapproved**: - insurer actions	**impact of disapproval**: - on residual market size	**residual vs voluntary mkt**: - policyholder impact	
E (2016.Fall #8)	**high-risk driver programs**: - characteristics	**auto residual market**: - describe 1 program	**FAIR**: - purpose	**FAIR**: - uninsurable risks
E (2016.Spring #8)	**RF *vs* JUA**: - why necessary	**RF *vs* JUA**: - profit allocation [1]	**residual markets**: - why necessary	
E (2015.Spring #8)	**reinsurance facility**: - advantages over ARP	**(b)** RF *vs* JUA similarity **(c)** ARP *vs* JUA similarity	**JUA, RF, ARP** - least preferred	**(e)** state A vs B: res. mkt. **(f)** state A vs B: insurer actions
E (2014.Spring #8)	**ARP *vs* RF**: - residual mkt size	**govt participation**: - auto/retirement	**actuarially sound rates**: - argue for/against	
E (2013.Fall #10)	**ARP**: - calc # policies assigned	**ARP, JUA, RF**: - describe operations		
E (2012.Fall #13)	AIP vs JUA	argue for a program	argue for a program	

[1] The examiner's report says a common candidate error was to state: *profit/loss allocation for Reinsurance Facility is based on market share.* This information is outdated. It is now correct to say that the allocation is based on market share.

Full BattleQuiz **You must be logged in or this will not work.**

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In Plain English!

Intro to Residual Markets (Assigned Risk Plans)

Alice the Actuary likes to drag race her Lamborghini on the streets of Miami & L.A. She's a glamtastic adrenaline junkie and she has often told me,

> "*Live fast, die young, and leave a beautiful corpse!*"

Unfortunately, that makes it hella hard for her get auto insurance on the voluntary market because the voluntary market prefers low & medium-risk drivers. Some insurers *will* voluntarily offer policies to high-risk *(non-standard)* drivers, but often with restrictions.

Question: what coverage restrictions might an insurer place on a high-risk driver before voluntarily providing coverage *(deductibles-limits-exclusions)*

- higher deductibles *(comprehensive or collision)*
- lower limits *(liability)*
- exclusion of certain coverages *(medical, glass coverage)*

This is all in addition to *higher premiums*, often significantly higher.

Alice, being a **very** high-risk driver, would still likely need to find insurance through the residual market instead. Different states have different ways of operating their residual markets.

Question: identify 3 mechanisms for operating a state residual auto insurance market

- ARP *(Assigned Risk Plan)* also sometimes called AIP *(Auto Insurance Plan)*
- JUA *(Joint Underwriting Association)*
- RF *(Reinsurance Facility)*

Our Alice lives in a state with an ARP. She's been on the phone for the 60 days begging agents to sell her a policy, with no luck. She has no choice now but to apply to the ARP. The ARP then assigns her to an insurer based on market share. *(Larger insurers get more high-risk policies assigned to them.)* Once she has been assigned, the insurer services her policy as if it had been voluntarily written, meaning they collect her premiums and pay her claims. The insurer then retains all premiums & losses. **To summarize, this is how an ARP works**:

- **driver** applies & is rejected by the voluntary market
- **driver** applies to the ARP
- **driver** is assigned to an insurer based on insurer's WP market share *(Written Premium)*
    - **regulator** sets uniform rates *(same rates across all insurers)*
    - **insurer** fully services policy as if voluntarily written (collects premiums, pays claims)
- **insurer** retains profits/losses

Note that Alice knows she is in the residual market, and there could be stigma attached to this. Contrast this with a JUA or RF, where the insured doesn't know they have been relegated to the residual market. Note also that these plans must all offer policies with the minimum statutory limits, although the particular insurer may offer higher limits if they wish. Alice declines the higher limits. Even the premiums for the minimum limits are high.

Alice was still a little worried about being rejected by the ARP because she *habitually violates the laws (speeding, reckless driving)* but she managed to squeak by the underwriter.

> **Question**: identify items that may make a driver ineligible, even for an ARP

- no valid driver's licence
- felony conviction within the past 36 months
- habitual violation of the law *<== that's the one Alice was sweating!*

mini BattleQuiz 1 **You must be logged in or this will not work.**

Joint U/W Associations & Reinsurance Facilities

As explained in the previous section, there are generally 3 ways that a state can operate a residual auto insurance market for high-risk drivers: **ARP**, **JUA**, **RF**

> **Question**: identify 2 important differences between an **ARP** and a **JUA/RF**

JUA/RF:
- driver doesn't know they have been placed in the residual market
- premiums, losses & expenses are shared among all auto insurers in the state *(by their share of the voluntary market)*

> **Question**: identify a difference between **JUA** and a **RF**

JUA:
- policy is serviced by *servicing carrier*

RF:
- policy is serviced by *insurer*

Let's tie all the information about **JUAs** and **RFs** together.

> **Question**: describe the details of how a **JUA** works and how a **RF** works *(they are quite similar)*

JUA details:

- **driver** applies to **insurer** in voluntary market
- **insurer** chooses: keep policy or forward to JUA servicing carrier *(**driver** doesn't know if they go to JUA)*
    - JUA sets uniform rates based on pool experience
    - servicing carrier services claims
- **insurer** shares in profits/losses/expenses in proportion to their voluntary business market share
- all **insurers** in state must share EVEN IF they are not in the JUA

RF details:

- **driver** applies to **insurer** in voluntary market
- **insurer** chooses: keep policy or forward to RF *(**driver** doesn't know if they go to RF)*
    - Cook doesn't really explain how RF rates are set but RFs are essentially intended to be non-profit enterprises to fulfill the social good of universal availability of auto insurance *(and rules can vary greatly from state to state anyway)*
    - **insurer** services claims
- **insurer** shares in profits/losses/expenses in proportion to their voluntary business market share
- all **insurers** in state must share

So the **differences** between JUAs and RFs are how rates are set, and who services the policies.

mini BattleQuiz 2 **You must be logged in or this will not work.**

Residual Markets: Test Your Understanding

Here are more old exam problems that test your understanding of the residual market for auto insurance.

mini BattleQuiz 3 **You must be logged in or this will not work.**

FAIR Plans

Certain risks are essentially uninsurable. But lenders often *require* insurance coverage, and that was the motivation for FAIR plans. **FAIR** stands for *Fair Access to Insurance Requirements*. Risks that are often covered under FAIR plans are:

- properties in areas susceptible to crime/riots *(Ex: urban areas after riots of the 1960s)*
- a home in disrepair
- individuals with high number of prior claims

This is a fairly short section of this reading and we can cover it pretty quickly.

Question: describe how the FAIR plan works *(Fair Access to Insurance Requirements)*

rationale:

- property owners in urban areas couldn't find coverage due to crime/riot risk

operation:

- policies are serviced by a syndicate or private company *(who collect premiums, handle claims, & take a cut for their service)*
- premiums & losses are shared by all property insurers in state

eligibility:

- coverage must have been denied by the private market
- property must not be vacant or trespassed onto, must not be damaged or poorly maintained, and must meet building codes

A concept related to FAIR plans is *Difference in Conditions* policy or *DIC*. Such a policy covers *(some)* perils that a standard policy wouldn't. Large organizations might use a DIC policy to fill coverage gaps related to catastrophes.

Alice reminded me to mention an important difference in the way exam questions on this topic are sometimes asked.

Consider the following exam questions:

- part (c) of E **(2018.Fall #7)**

  → asks for exposures that are covered by FAIR plans *(areas susceptible to riots, higher-risk coastal properties subject to windstorm damage, properties in wooded areas subject to brush fires)*

- part (d) of E **(2016.Fall #8)**

  → asks for exposures that are uninsurable under FAIR plans *(vacant properties, poorly maintained properties, properties with building code violations)*

You have to pay attention to the wording of the question because exam-takers often get them mixed up!

Beachfront and Windstorm Plans

These plans are similar to FAIR plans in that they protect at-risk properties that would otherwise be uninsurable in the voluntary market. Note that some states have merged *Beachfront & Windstorm* with their FAIR plans. The next short quiz covers everything you need to know on this topic. Note that since this is a government plan, there is crossover between this and *Germani.GovtIns*. In fact, one of the questions in the quiz requires that you remember the 5 reasons for government participation in insurance. [Hint: **FCC(ES)**]

mini BattleQuiz 4 **You must be logged in or this will not work.**

Other Exam Problems

Many of the exam problems listed in the BattleTable at the top of this article are very similar. If you know how an ARP, JUA, and RF operate, you will be able answer the questions. For that reason, I have not included all old exam problems in the quizzes. If you want more practice, you can access these problems in 3 different ways:

- Use the links in the BattleTable at the top of this article
- Use the *prior exams* link from the *Main Page (shows all old exam questions)*
- Use *BattleCard Filters* under *Custom Battles* on the *Main Page* to access all BattleCards from Cook, which includes all the old exam problems.

Anyway, here is a small selection of old exam problems that were a little different and might be good way to finish this reading.

mini BattleQuiz 5 **You must be logged in or this will not work.**

Full BattleQuiz **You must be logged in or this will not work.**

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