

**EXAM 6 – CANADA, FALL 2017**

10. (3 points)

a. (0.5 point)

Briefly describe two methods of loss subsidization that a government insurer can use to fill insurance needs unmet by private insurance.

b. (1 point)

Identify and briefly describe two reasons for government participation in insurance, other than to fill insurance needs unmet by private insurance.

c. (0.5 point)

For each of the reasons provided in part b. above, briefly describe one situation in which the reasoning for government participation in insurance may not be justified.

d. (1 point)

Contrast insurance and social welfare programs with respect to:

- i. Source of funding
- ii. Trigger of payment

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**EXAM 6C FALL 2017 SAMPLE ANSWERS AND EXAMINER'S REPORT**

<b>QUESTION 10</b>	
<b>TOTAL POINT VALUE: 3 points</b>	<b>LEARNING OBJECTIVE(S): B1, B2</b>
<b>SAMPLE ANSWERS</b>	
<b>Part a: 0.5 point</b>	
Any response from two of the following categories:	
<p>Taxation related responses:</p> <ul style="list-style-type: none"> <li>• Through general tax revenue, using that to subsidize high risks</li> <li>• Have access to tax revenue in case of deficiency</li> <li>• Increase tax revenue and use it to subsidize</li> <li>• Tax revenue</li> <li>• Use other revenue (such as tax) to ensure affordability of coverage</li> </ul> <p>Charge less than actuarially sound rate related responses:</p> <ul style="list-style-type: none"> <li>• Enter the market and provide insurance for less than actuarially sound rates</li> <li>• Charge less than actual cost</li> <li>• Deficit financing as in Flood loss coverage in USA</li> <li>• Charge lower than actuarially sound rate and filling the gap by government special-purpose fund</li> <li>• The government could create a risk sharing pool for high risk losses with a government backstop</li> </ul> <p>Other sample responses:</p> <ul style="list-style-type: none"> <li>• Increase public debt</li> <li>• Raise funds through legislation</li> <li>• Use government provided fund to subsidize the losses</li> </ul>	
<b>Part b: 1 point</b>	
Any full response from two of the following categories:	
<p>Efficiency:</p> <ul style="list-style-type: none"> <li>• Higher efficiency: lower cost than private market</li> <li>• Cost efficiency: less costly as they don't have the overhead of a private company like advertising</li> <li>• Greater efficiency, since government insurance does not need to pay commissions, thus are able to save and offer at lower cost</li> </ul> <p>Convenience:</p> <ul style="list-style-type: none"> <li>• Convenience: the government can quickly establish a program through legislation or province funding</li> <li>• Convenience: can put in place quickly an insurance plan because has already structure and funding available</li> <li>• Convenience: the government can normally set up an insurance program more easily and more quickly</li> </ul> <p>Compulsory insurance:</p> <ul style="list-style-type: none"> <li>• Mandatory insurer: the government may feel obliged to offer mandatory coverage</li> </ul>	

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- Compulsory insurance: government can operate with limited profit
- Mandatory coverage: allows everyone to obtain mandatory coverage
- Mandatory insurer: to make sure the affordability and availability of the insurance
- Compulsory purchase: for auto insurance in Canada, all drivers must have coverage. Government can leverage tax as subsidy

Social purpose:

- Social purpose: some programs, like unemployment insurance, not only insure people without jobs but also help them to find jobs
- Serve a social purpose. This is the main reason for government participation in insurance, serve a social purpose that can't be attained by private insurers

**Part c:** 0.5 point

*Note that the candidate's response must tie into each of the answers provided by the candidate in part b. above.*

### Sample responses

Efficiency:

- Efficiency: The cost of private market and public market are the same, so not really higher efficiency
- Efficiency: costs savings may be overstated because some costs are excluded from the program
- Efficiency may be overstated if costs of other government departments helping the insurance department are not accounted for
- Efficiency: Having private insurance companies will increase innovation and insurance companies registered at federal level collaborates as well, which increases the efficiency

Convenience:

- Convenience: competitive market is willing and be able to create new coverage/programs

Compulsory insurance:

- Compulsory insurance: excessive benefit/earning/profit can't sustain in long-term due to the market force in a perfectly competitive market
- Mandatory insurance: private insurer can handle this through a residual market or pool (like with Facility Association)
- Mandatory insurance: when the private market can fully serve the need, eg. A take all comers system

Social purpose:

- Social purpose: a strongly regulated private insurer with strict guidance of standards can do the same
- Social purpose: some insurance could be provided by private insurer and in the meantime fulfill social purpose. i.e. Worker Compensation is provided by private insurer in some states in US

**Part d:** 1 point

i. Any response from each of the following two categories:

Insurance

- Insurance: premium

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- Insurance: policyholder
- Social welfare
- Social welfare: taxpayer
  - Social welfare: tax revenue

ii. Any response from each of the following two categories:

Insurance

- Insurance: suffer loss covered by insurance contract
- Insurance: triggered by a monetary loss from a covered event

Social welfare

- Social welfare: when people are in need of money
- Social welfare: when become qualified
- Social welfare: the condition/circumstances of the individual in question

### EXAMINER'S REPORT

Candidates were expected to under the reasons for government involvement in insurance programs and the differences between insurance and welfare.

#### Part a

Candidates were expected to briefly describe two methods of loss subsidization that a government insurer can use to fill insurance needs unmet by private insurance.

Common mistakes include:

- Describing a cross-subsidization method instead of loss subsidization such as:
  - Through government mandated rate, where low risk subsidize high risk
  - Charge a flat rate to all insureds to provide coverage to a group of varying cost
- Describing an insurance program built by government without mentioning the corresponding loss subsidization mechanism or method such as:
  - Provide reinsurance coverage to cover losses above a threshold

#### Part b

Candidates were expected to identify and briefly describe two reasons for government participation in insurance, other than to fill insurance needs unmet by private insurance.

Common mistakes include:

- Listing reasons correctly but not appropriately explained such as:
  - Social purpose. Insurance would help those affected to be better off
  - Compulsory insurance. Either putting in legislation to force people to buy from private insurer, being a provider of insurance itself, or competing with private insurer
- Not providing a description of the reasoning that is related to the reason identified such as:
  - Efficiency. Government has access to more resources and labor than private insurer, allowing the process to occur quicker

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- Convenience. Able to provide compulsory coverage faster than private market and limit profit of insurer for compulsory coverage

### Part c

Candidates were expected to briefly describe one situation in which the reason identified in part b. may not be justified.

Common mistakes include:

- Not adequately describing the situation, for example:
  - Social purpose: with government support, people will just rely on the help by government
  - Mandatory insurance: private market is willing to provide available and affordable coverage

### Part d

Candidates were expected to contrast insurance and social welfare programs in terms of source of funding and trigger of payment.

Common mistakes include:

- Providing a trigger of payment for insurance without specifying that losses/event incurred should be covered by insurance contract, such as:
  - Based on proof of loss
- Providing a description of trigger of payment for social welfare that is not general enough to cover various situations, such as:
  - Low income
  - Unemployment
- Not understanding the difference between the two triggers such as answering:
  - Insurance: when claim occurs
  - Social welfare: when claim occurs as well