Germani.GovtIns

This reading describes the **reasons** for both federal and state governments to participate in insurance. It also covers the extent or **level** of government participation. Two specific government programs are discussed in detail: crop insurance, and WC *(Worker's Compensation)*

Contents

BattleTable

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

- levels of government participation in insurance
- reasons for government involvement in insurance [**FCC(ES)**]
- details of WC program
- details of crop program
- details of Medicare program *(mainly in relation to WC)*
- details of flood program *(see Horn2018.Flood)*
- criteria for evaluating government insurance programs [**W/I-SEAN**]

The source reading is 18 pages and easy to read. Since it's heavily tested, I recommend reading it.

reference	part (a)	part (b)	part (c)
(2018.Fall #9)	**WC**: - advantages of state funds	**WC**: - disadvantages of state funds	**WC**: - state fund vs residual market [2]
(2018.Spring #8)	**reasons**: - for government participation	see Cook.Personal	see Cook.Personal
(2017.Fall #7)	**reasons**: - for government participation	**levels**: - of government involvement	
(2017.Spring #8)	**crop & flood**: - risk transfer program [1]	**crop & flood**: - risk transfer program criticisms [1]	
(2017.Spring #9)	**Medicare**: - interaction with WC	**Medicare**: - rationale for MSAs	**Medicare**: - impact of changes
(2016.Fall #7)	**levels**: - of government involvement (WC)	**levels**: - of government involvement	
(2016.Spring #10)	**state competitor**: - arguments for	**state competitor**: - arguments against	
(2015.Fall #11)	**crop, WC, assigned risk plan**: - motivation for creation:	**crop, WC, assigned risk plan**: - effectiveness of	
(2015.Fall #12)	WC: - rationale for state funds	WC: - why state funds might not be necessary	WC: - options other than state funds
(2015.Spring #7)	**crop, UI, terrorism**: - private coverage	**crop, UI**: - social costs	see Webel.TRIA-1
(2014.Fall #10)	**general**: - from other readings		
(2014.Spring #9)	**reasons**: - for government participation	**program design** : - ratemaking principles	
(2014.Spring #11)	WC: - advantages of state over private	WC: - advantages of private over state	WC: - effectiveness private given state funds
(2013.Fall #12)	**Medicare**: - MMSEA process & benefits	**Medicare**: - cost-reducing features	**Medicare**: - impact of MMSEA on WC freq/sev
(2012.Fall #11)	WC: - fully compare delivery options		
(2012.Fall #12)	**government insurance programs**: - give examples	**government insurance programs**: - evaulate effectiveness	

[1] The flood portion of this question is from a reading that is no longer on the syllabus.

[2] The examiner's report answer for part (c) contains a contradiction. As a *similarity* between a state fund and a residual market, it says that both are administered by the state. But as a *difference*, it says that the state fund is administered by the state but the residual market is administered by private companies. Um...which is it? It can't be both. What they mean to say is that a residual market is set up by the state but then private companies service the policies. This is *explained below*.

In Plain English!

General Facts

The first 5 pages explain the **reasons** for government involvement in insurance, the **levels** of involvement in relation to private insurance, and the **evaluation** of such programs. These 3 items *(see grey boxes below)* don't directly appear on the exam very often. Old exam questions focus more on specific details of government programs such as WC. Nonetheless, these 3 items represent basic information that you have to cover.

Question: describe 5 reasons for governmental participation in insurance and provide examples [Hint: **FCC(ES)**]

for **FILLING NEEDS** unmet by private insurance *(Ex: TRIA - Terrorism Risk Insurance Act)*

- may occur when private insurance is not economically viable *(after 9/11 terrorist attack in NYC, private market withdrew coverage)*

when insurance is **COMPULSORY** *(Ex: WC)*

- if insurance is compulsory but not offered by the private market *(for whatever reason)* then government must be the provider

for **CONVENIENCE** *(Ex: NFIP - National Flood Insurance Program)*

- government may already have necessary structures in place *(government already provides disaster relief after floods)*

for **EFFICIENCY** *(Ex: auto insurance)*

- agent commissions eliminated → lower expense ratio → lower premiums for consumer

for **SOCIAL purposes** *(Ex: Medicare)*

- private market is motivated by profit, sometimes at the expense of social purposes like universal medical coverage for seniors

By now, you know that the red acronym **FCC(ES)** is a memory trick for remembering these 5 reasons. I have a rude way of remembering this: If you say it out loud, it sounds like *feces*, which kind of makes sense since the government is sometimes full of crap! *(I kid, of course. The government does good stuff too.)*

There is another very basic question from this paper, although it hasn't appeared as often on the exam:

Question: what are the 3 levels of government involvement in insurance

- government as **SOLE** provider *(Ex: Social Security, UI - Unemployment Insurance)*
- government as a provider in **PARTNERSHIP** with private insurance *(Ex: NFIP - National Flood Insurance Program)*
- government as a provider in **COMPETITION** with private insurance *(Ex: WC competitive state funds in some states)*

Note that these 3 levels of participation are distinct from the government's usual role as the *regulator* of insurance.

The last item in this introductory section concerns how well these government programs work. This seems important, but the criteria listed have never appeared on the exam. There **have** been questions asking you about the *effectiveness* of certain programs, like **(2015.Fall #11b)** but the answer in the examiner's report didn't specifically refer these criteria. It seemed that they simply wanted you to list the benefits and shortcomings of the programs. Still, it feels like something you shouldn't skip.

Question: what are the criteria for evaluating government insurance programs [Hint: **W/I - SEAN**]

- is the program one of **W**ELFARE or **I**NSURANCE
- does it achieve **S**OCIAL purposes
- is it **E**FFICIENT
- is it **A**CCEPTED by the public
- is it **N**ECESSARY

Crop Insurance

Alice the Actuary has a cousin named *Fanny the Farmer*. Fanny knows that crop insurance is not mandatory for farmers, and last year she was going to take a vacation at the all-inclusive *Sandals* resort in Jamaica instead paying her crop insurance premiums. She called Alice with the "good" news, but Alice majorly chewed her out.

"*Don't be an monumental dumb-ass!*" Alice told her. "*If you don't buy crop insurance and there's a flood, God forbid, you won't be eligible for disaster relief from the government!*"

The next day, Fanny canceled her trip and drove to town to purchase crop insurance from *Andy the Agent*. Andy has a colossal advertising billboard on the state highway because he markets, writes, and services these crop policies. It's a sweet deal because the government sets the rates *(so he doesn't have to do the boring actuarial stuff)*, and the government also acts as a reinsurer. The way the program works, Andy almost always turns a profit because he can cede the lousy portions of business to the government. The government then uses taxes to subsidize the program.

And if that weren't enough, the government also reimburses insurer expenses, and subsidizes premiums. ***I told you it was a sweet deal!***

Anyway, Fanny purchased **2 types of coverage** that protect her against:

- low yields *(yields that fall below a certain baseline)*
- low prices *(prices that fall below a certain $-value)*

This is an example of the government acting in partnership with the private market. It has the **advantage** of providing stability to an important sector of the economy, but it also has **shortcomings**:

- it encourages over-production
- it encourages farming in marginal or risky areas
- private insurers make money while government *(taxpayers)* subsidize the losses

There are steps that can be taken to **mitigate these shortcomings** however. Alice has recommended that the RMA *(Risk Management Agency of the Dept. of Agriculture)* do the following:

1. limit coverage *(to address over-production)*
2. shift balance of loss-sharing more towards private insurers *(to relieve taxpayer burden)*

Conclusion: The overall effectiveness of crop insurance is fair. It has both benefits & shortcomings.

Workers Compensation Insurance

The industrial revolution in Great Britain from 1760 to sometime between 1820 & 1840 was the most important event in the history of humanity since the domestication of animals & plants *(according to Wikipedia!)* It spurred huge growth in human population and wealth. But it had a down-side: *people, often children, frequently got their arms & legs crushed in the machinery*. **Ugh!** And there weren't many options for compensation.

Fast forward to the 21st century: We now have a comprehensive system of Workers Compensation *(as well as vastly improved safety standards.)* Most employees are covered by WC programs enacted by the state. Some categories of workers *(longshoremen, railroad workers)* are covered by federal programs.

Federal WC Programs

There are **3 federal** WC programs: FECA *(Federal Employees Compensation Act)*, Longshore & Harbor WC Act (1927), and BLBA (1969) *(Black Lung Benefit Act)* The details are boring and are in the BattleCards. The only one that's been tested recently is the Longshore Act from **(2015.Fall #11)**.

State WC Programs & Evaluation of WC Programs

These 2 sections are heavily tested. I combined them because they often comprise a single exam question. Links to the old exam questions were already given in the BattleTable, but I've also put them here for ease of reference:

> **(2016.Fall #7)** *This question was discussed above - levels of state government participation in WC.*
>
> **(2016.Spring #10)** *Arguments for and against competitive state funds for auto insurance. (same arguments as for WC competitive state funds)*
>
> **(2015.Fall #12)** *Rationale for state WC funds, arguments against, other WC options. (**terrible exam question** - part (a) just wanted you to memorize the entire 1st paragraph in the state funds section)*
>
> **(2014.Spring #11)** *Advantages of state WC funds over private insurance (and vice-versa). Effectiveness of private insurers.*

Most of the basic facts about State WC programs are pretty simple and are included in the next mini BattleQuiz. There are **2 items**, however, that are worth highlighting. The first is something we've already discussed in more general terms, but the answer here is more specific because it pertains specifically to WC.

Question: **(2016.Fall #7)** what are the levels of state government participation in WC & describe a benefit of each level

PARTNERSHIP: state defines benefits, but private insurers write policies

- more choice for consumer, but still assured of minimum statutory benefits

EXCLUSIVE STATE FUND: state is sole provider, no private WC is permitted

- no advertising or agent commissions means lower cost → pass savings to consumer

COMPETITIVE STATE FUND: state competes with private insurers

- state funds provide a stable source of coverage & competition can help keep costs of private WC down

Since WC is mandatory, the government must ensure that coverage is available to all employers. This can be a problem, however, in states with no state fund, or in states where the state fund is **not** an insurer of last resort. *(That means the state fund can refuse an employer coverage, which kind of sucks.)* A solution is for the state government to set up a **residual market**, which then *does* function as an insurer of last resort.

Question: describe 3 mechanisms that states can use to operate a residual market

[1] state assigns applicants to carriers based on WC market share *(insurers then service policies as if they were voluntary)*
[2] state uses a reinsurance pool *(profits & losses are shared among insurers in proportion to voluntary market share)*
[3] state authorizes a JUA or Joint Underwriting Association *(profit & loss is shared on a pro-rata basis)*

Actuarial Irony: Alice the Actuary once worked for a large private WC insurer, and a company called *Accidents R Us* wanted to buy WC insurance with them. They had a terrible claim history with their previous insurer so Alice told the underwriters to reject them, politely of course! But Alice's state didn't have a state fund, so the government had to assign *Accidents R Us* to a private WC insurer based on market share. Guess who got them!!

ASC (Alice's Snarky Comment): the exam questions from this section are confusing and poorly written

The exam questions are all basically the same: they want you to understand the different types of state funds and the advantages/disadvantages of each. The problem is that they keep asking the same question in different ways, and provide different answers. Also, the examiner's reports give too many alternate answers. It's all just very confusing. I've included the questions & answers in the BattleCards, but here is a quick summary on the essential points:

advantages of state funds:

- lower cost for consumers *(no advertising or commissions for state funds)*
- provides coverage for high-risk customers *(if insurance is mandatory, government should ensure coverage is available by being an insurer of last resort)*

disadvantages of state funds:

- private markets are more innovative *(and private competition drives prices down)*
- private markets can operate efficiently *(about half of states don't have state funds so state funds may not be needed to fill unmet needs)*

Of course, there are other details you can include in your answer to a specific question, but the bulk of the answer often consists just of these few points.

Interaction of WC with Medicare

Medicare was passed by Congress in 1965. *How in the heck did seniors cope with medical issues prior to that? (I'm not a senior, but I'm a dual U.S./Canada citizen and I live in Canada so I don't have to worry about that sort of thing.)* Anyway, this section provides a few examples to illustrate points about how WC and Medicare interact.

Example 1: A 67-year-old is injured on the job. Who pays the medical costs?

Answer: WC
Reason: This person is eligible for Medicare in general, but WC is the primary payer while Medicare is secondary to WC.

Example 2: A 70-year-old is injured by another driver in an auto accident. Who pays the medical costs?

Answer WC
Reason Again, this person is eligible for Medicare in general, but liability insurance is the primary payer while Medicare is secondary to liability insurance.

Example 3: A 63-year-old is injured on the job and expects to need 5 years of medical treatment. Who pays the medical costs?

Answer WC through an MSA *(Medical Set-aside Allowance)*
Reason Same as before. WC is primary and Medicare is secondary, but there's an extra complication. The person is not eligible for Medicare when the injury takes place, but becomes eligible partway through their treatment program. *The concept of an MSA is discussed below.*

Here are some acronyms that are used in this section:

acronym	full name	what is it?
MSA	Medicare Set-aside Allowance	- a portion of the WC *(or liability)* settlement set aside for future medical costs due to the injury - all parties to a settlement must agree & fund the MSA
CMS	Center for Medicare & Medicaid Services	administers Medicare, and establishes guidelines for review & approval of MSAs
MMSEA	Medicare & Medicaid SCHIP Extension Act (2007)	- addressed the problem of CMS being unaware of primary payer responsibilities - primary payers were trying to shift costs to Medicare *(involved MSAs & other payers)* - Act requires RREs to report claim data to CMS *(so that Medicare doesn't start paying when it shouldn't)* - there's a substantial penalty for non-compliance ***(CMS is effin' serious about this)***
RRE	Responsible Reporting Entities	just a fancy term of claim payers

Ok, now let's cut through all the BS:

It's all about the money! Nobody wants to be the primary payer, but Medicare is run by the government, so they can set the rules. They passed a law that said:

- WC is primary
- Medicare is secondary

Great! That takes the burden off of Medicare. *Theoretically.* In practice though, it was easy for WC insurers to shift the cost burden back to Medicare when the injured worker turned 65 and became Medicare-eligible. It was very clever *(said I, dripping with sarcasm)* - they simply didn't tell Medicare that the person's injuries occurred on the job. When the person turned 65 and claimed Medicare benefits, Medicare complied. *(Legally they didn't have to because they were the secondary payer, but they didn't have all the facts.)* So, what happened next?

- Lame Solution: MSAs. The idea was that MSAs provide coverage for all future medical costs. The fatal flaw was that the MSA must be agreed upon and funded by all parties to the settlement. There was no incentive for the parties to comply. They just waited for the injured worker to become Medicare-eligible then passed the remaining costs to Medicare.

- Awesome Solution: MMSEA. They still use MSAs but MMSEA requires that CMS now ***review & approve*** the MSAs. Aha! That worked. The incentive is that Medicare can ***refuse payment*** for any future medical care if the MSA is not approved. The primary payer doesn't want to get stuck paying permanently, so they make sure their MSA is approved.

One downside to this otherwise awesome solution is an increase in administrative costs related to the CMS approval process.

Two Final Exam Problems

Here are a few final old exam questions that didn't fit neatly into any one particular section of the reading:

(2014.Fall #10)

- Covers eligibility of a 70-year-old for various different kinds of insurance. Pretty easy. See examiner's report.

(2014.Spring #9)

- I have to give credit to the exam committee for creating a question that wasn't just memorization. Having said that, I don't think it was a particularly good question.
- If you click the link above and read the question, you'll see that it's about the government providing insurance to **banks** as a way to encourage them to give loans to homeowners who may otherwise be unable to secure one. It's similar to the situation for crop insurance. There, the government acts as reinsurer to private crop insurance to encourage private insurers to accept risks they might not otherwise accept.
- **PART (a)** What you're asked to do is **design** a system of insurance for bank loans. A comprehensive answer to this could be a Ph.D. dissertation! It is not a simple thing. But that part of the question is only worth 0.75 pts. And it turns out that an acceptable answer, according to the examiner's report, was very brief. They provided several answers, but the best one was:
  - create a system that charges actuarially sound rates *(that's really pretty obvious!)*
  - cover any shortfall with taxes *(or borrow from the treasure)*
- In my mind, that isn't much of a *design*. The other part of the question is more straightforward. You can read the answer in the examiner's report. The only quibble I have is the reason they provided for how the design meets the goal of convenience.
  - The source reading states that government participation is convenient because **necessary structures may already be in place**. That's from the point of view of the insurer. But the solution justifies convenience by saying that the customer *(the bank)* doesn't have to shop around. That's from the point of view of the customer, and that was not discussed in the reading.
- **PART (b):** Are basic **ratemaking principles** are satisfied by your design. *(From CAS Principles of Ratemaking #2,4)* My quick answer to that is:

  Principle 2: rate does not cover all costs because government doesn't need to account for cost of capital *(click for definition of cost of capital (http://www.investinganswers.com/financial-dictionary/stock-valuation/cost-capital-112))*

  Principle 4: rate is not actuarially sound for individual risk transfer due to cross-subsidization

BattleCodes

Memorize:

- **5 Reasons** for governmental involvement in insurance. **FCC(ES)** *(with explanation & examples)*
- **3 Levels** of government involvement in insurance *(sole provider, in partnership with private insurers, in competition with private insurers)*
- **5 Criteria** for evaluating the performance of a government insurance program **W/I-SEAN**

Conceptual:

- This reading discusses **general concepts** related to government insurance. But for this reading to be useful, you have to understand how it relates to **specific** programs.
- As you can see from past exams, a good source of questions is the relationship between all of these readings.

Calculational:

- none