Finance 3055 Insurance Operations
Dr. A. Frank Thompson Sample Exam 1

Directions: Please answer the following 33 questions designed to test your knowledge of the basic definitions of risk management and insurance, insurance organizations, fundamental principles and regulatory framework of insurance, types of insurers and legal concepts related to insurance. Each question is weighted equally. Choose the best possible answer from the given responses.

1. Which of the following would constitute an insured peril for an insurance operation: (a) loss due to fire (b) loss of income due to pre-mature death (c) damage to your car due to collision with a deer on an icy road in Iowa (d) all of the above (e) only a and c

2. An insured who has a swimming pool in their backyard and fails to secure it with a fence and lock represents an example of: (a) named peril (b) moral hazard (c) physical hazard (d) homogeneous risk (e) indirect loss

3. All of the following are direct losses EXCEPT: (a) a bike is stolen (b) a house loses shingles during a windstorm (c) you have to rent a car while your own auto is being repaired for damage caused by running into a deer (d) you are sued for $50,000 following an auto accident with another driver (e) a friend sustains a broken arm due to slipping on a piece of ice from your refrigerator requiring medical treatment

4. A particular risk is defined as (a) a risk that impacts an entire population all at once (b) a risk that produces a loss where the outcome is either a loss, no loss, or gain (c) the proximate cause of loss (d) a risk that produces losses that impact only one or a few insured units at a point in time (e) a risk that produces indirect loss that is consequential to physical damage from a insured peril.

5. Which of the following is an example of a pure risk? (a) potential loss of your owned condo by fire (b) potential theft of a your 2005 Honda Accord (c) potential loss of $5,000 in the stock market (d) all of the above (e) only a and b

6. Which of the following is a suitable definition of "insurance?" (a) a debit card available to protect you in the event of an emergency (b) a financial arrangement whereby an individual pays a small certain payment called a premium, in exchange for being indemnified against large uncertain losses, referred to as the contingency insured against (c) a financial arrangement that redistributes the costs of expected losses amongst the owners of an insurance company (d) an investment contract designed to allow the insured to earn a fair rate of return on investment commensurate with risk (e) a contractual agreement in which the insurer agrees to pay the insured only if the insured sustains a loss and requests the money

7. Risk transfer, an insurance technique, is the best risk management tool when the chance of loss is _____and the loss severity is _____. (a) high, high (b) low, low (c) low, high (d) high, low (e) certain, low

8. Adverse selection represents a case where: (a) an insured attempts to obtain coverage at substandard rates (b) individuals who are poorer than average risks will attempt to obtain insurance at standard rates (c) the federal government must provide coverage (d) a buyer of an interest rate futures contract loses money as interest rates rise (e) an employer is held responsible for the actions of his/her employees

9. One measure of a casualty insurer's ability to cover its incurred losses, loss adjustment expenses and incurred underwriting expenses out of earned premiums is: (a) the financial basis combined ratio (b) the trade basis loss ratio (c) the incurred cost operating ratio (d) the Herfendahl combined ratio (e) the profitability ratio

10. Insurance underwriting might best be defined as: (a) the process of selling stock under an IPO using an investment banker (b) the selection of who is to be insured and the determination of an appropriate premium based on risk (c) the determination of coverage after an insured files a claim (d) the process of examining the accounting records of an insurer prior to filing the statutory statement (e) determination of how much to pay on a particular loss based on the principle of indemnification

11. A type of insurance agency system whereby the agent owns the list of clients, and receives income primarily from commissions is: (a) a direct writing agency system (b) a dependent commission system (c) a field service agency system (d) an independent agency system (e) an e-market agency arrangement

12. A mutual insurance company is: (a) an insurer that is owned by the policyholders, and may pay dividends to them (b) owned by shareholders who purchase stock in the business (c) a non-profit business organization (d) not required to file a statutory accounting statement with the insurance commissioner (e) required to abide by a file and use provision in order to set new premium rates

13. Lloyd's of London: (a) is a large property-liability insurance company with headquarters in London (b) sells insurance directly to the public through the mail (c) sells only inland and outland marine coverage to insure transportation risks (d) specializes in life insurance coverage (e) is a marketplace where separate underwriting syndicates accept risk exposures for their own accounts providing surplus lines coverage on unusual insurance coverages

14. The largest liability on an insurer's balance sheet is: (a) notes payable (b) accounts payable (c) policyholder surplus (d) policyholder reserves (e) policyholder asset share financing

15. The direct writing agency system for selling insurance: (a) involves agents who are salaried employees of an insurer who can only sell their policies to the public (b) requires that the agents pay for their training, office and marketing expenses (c) allows agents to own their list of clients which they can take to a new agency office at any time (d) creates an agency relationship in which an agent can bind coverage and waive portions of an insurance contract (e) only a and d

16. The unique characteristic of an insurance contract that allows there to be unequal dollar amounts exchanged with the insurance policy [e.g. small premium, large claim] is the fact that an insurance policy is: (a) an aleatory contract (b) a contract of adhesion (c) a unilateral contract (d) reciprocal arrangement (e) an estoppel agreement

17. The principle of utmost good faith: (a) holds only the insurer to a higher standard of honesty in the execution of the insurance contract (b) generally does not apply in health insurance since these covers are administered under group underwriting (c) requires that the insurer fulfill on the promises made in the insurance contact, and that the insured provide accurate information on the insurance application and avoid any material misrepresentation (d) means that there will be an inequality between the actual value of payments amongst the policy participants (e) requires that the insurer provide the insured with a written contract in order for the policy to come into existence

18. If a property insurance agent knocks on the door of I.M. Covered, explains the contract, and receives a check for the policy that is cashed the following day. Which one of the following most closely has occurred? (a) offer, acceptance, consideration (b) offer, counter offer, acceptance (c) offer, consideration, subrogation (d) offer, acceptance (e) rejection, dejection, ejection

19. Taking a $500 deductible on your individual health insurance policy is an example of: (a) risk avoidance (b) loss reduction (c) risk assumption (d) risk transfer (e) hedging

20. A type of accounting statement filed with the state insurance commissioner that focuses on an insurer's ability to meet it's long term financial commitment to policyholders is called: (a) a GAAP financial statement (b) a 10-K statement (c) a file and use statement (d) a statutory statement (e) only a and d

21. The principle of indemnity in insurance means: (a) a person has the right to sue an insurer for loss when they are not satisfied with the payment of a claim (b) that a person may not collect more than his/her actual financial loss in the event of damage caused by an insured peril (c) that a person will not be reimbursed for a loss unless he can show proof of loss (d) an employer is always responsible for the careless acts on an employee (e) a adjusters may not be held liable for twice the claim if a settlement has already been reached on a policy

22. An admitted asset is: (a) a marketable asset on an insurer's balance sheet that is used to back up its reserve position (b) a type of derivative position that allows the insurer to hedge its interest rate risk exposure (c) a liquid asset that is used to back up the insurer's surplus lines coverages (d) a non-liquid asset that may be used by the insurer to back up its unearned premium reserve position (e) a type of asset that an insurer admits to owning that may be used to pay dividends to policyholders

23. Within an insurer's operations, the person responsible for developing premium rates, creating new policies, determining the adequacy of insurance reserves to meet future claim experience is: (a) an actuary (b) an independent agent (c) a direct writing agent (d) a certified public insurance accountant (e) an underwriter

24. The U.S. Supreme Court Case that established that insurance was interstate commerce, and could be federally regulated, was: (a) Paul versus Virginia (b) Munn versus Virginia (c) The Southeastern Underwriter's case (d) Townsend versus New Hampshire (e) the McCarran-Ferguson case of 1944

25. The US Supreme Court decision that determined insurance was not interstate commerce and therefore could not be federally regulated was: (a) Paul versus Virginia (b) Brown versus Topeka Kansas Board of Insurance (c) The Southeastern Underwriter's case (d) Roe versus Wade Insurance (e) none of the above, the US Supreme Court never ruled that insurance was not interstate

26. A material misrepresentation in insurance involves: (a) concealment of a known fact which resulted in a policyholder making an uniformed decision when purchasing a policy (b) the misstatement of a known fact or concealment of information by the insured which, if the true facts had been known, would have resulted in the insurer either not offering the policy or providing it on a substantially different basis (c) the misstatement of any fact regarding insurance (d) failure to stay at the scene of an automobile accident (e) misstating financial information on a statutory

27. Under the principle of contract of adhesion, and fact that insurance policies are unilateral contracts in insurance: (a) the insured has the opportunity to help write up the insurance contact (b) policy language ambiguities are always construed against the insurer writing up the insurance contract in favor of the insured (c) the insurance company writes the contract with the approval of the state legislature in each jurisdiction where a policy is sold (d) there is an unequal amount of dollars changing hands in the insurance contact (e) the insured is entitled to only the amount of financial loss sustained and no more

28. Loss adjusters do all of the following EXCEPT:
(a) investigate claims to determine if fraud is involved (b) negotiate with the insured on the amount of damage claims paid under the policy (c) recommend denial of claims where there is no insurable interest (d) act as the company’s lawyer if the case goes to court (e) interpret the policy provisions covering the loss

29. The department within the insurance organization responsible for the filing of statutory financial statements with the state insurance commissioner is: (a) the underwriting (b) the claims department (c) the investments department (d) the accounting department (e) paid loss retrospective

30. A stock insurance company is: (a) an insurer that is owned by the policyholders, and may pay dividends to them (b) owned by shareholders who purchase stock in the business and are entitled to receive dividends on the basis of profitable underwriting (c) a non-profit business organization (d) not required to file a statutory accounting statement with the insurance commissioner (e) required to abide by a file and use provision in order to set new premium rates

31. A law passed by Congress restricting the federal government’s right to regulate insurance was: (a) Public Law 15 (b) the Glass Steagall Act (c) Garn St. Germain (d) the Gramm Leach Bliley Act (e) Dodd Insurance Reform

32 The author of the book <u>FIASCO</u>: (a) shows how highly educated, businessmen treated women as objects, and their clients as gullible prey to make money off of by withholding or misstating information on financial derivative contracts (b) tells how Wall Street traders when leaving one firm to go to another routinely took proprietary documents, policies, records and computer files from their previous employer to benefit and ingratiate themselves with their new employer (c) received degrees in mathematics and economics from the University of Kansas, obtained a law degree from Yale University, witnessed sexual harassment of women, discrimination of minorities, the withholding of vital investment information on derivative contracts from investors while serving as a Wall Street trader and yet, did nothing about it (d) provides information on derivative contracts, some to insurers, where the investment bankers did not know how to value them or understand under what conditions a holder could make or lose money (e) all of the above

33. According to the book <u>FIASCO</u> from a Wall Street Trader's perspective making the unethical decision to withhold information or misrepresent the true nature of a derivative contract: (a) was difficult because there was very little money in it (b) was very rarely done because of the enforcement of regulations with stiff penalties for failing to meet one's fiduciary duties to an investor (c) was highly profitable, and usually led to promotion if the trader earned enough bars (d) did not happen because the traders had degrees from Ivy League schools where business ethics was taught (e) resulted in unethical traders going to jail and doing serious time in a maximum security prison, like anyone who steals money from a convenience store

Sample Exam 1

Answer Key:

1. D 2. C 3. C 4. D 5. E 6. B 7. C 8. B 9. A 10. B
11. D 12 A 13. E 14.D 15. E 16. A 17. C 18. A
19. C 20. D 21. B 22. A 23. A 24. C 25 A 26. B
27. B 28. D 29. D 30. B 31. A 32. E 33. C