

CHAPTER 2

DEFINING THE INSURABLE EVENT

1. The 2004 hurricane season caused how much damage in Florida?

- a) \$7 billion
- b) \$11 billion
- c) \$22 billion
- d) \$33 billion

Answer: c

Difficulty: easy

Type: MC

2. How did the 2005 hurricane season compare to the 2004 hurricane season in terms of resulting damages?

- a) 2005 was much worse than 2004
- b) 2005 was much better than 2004
- c) 2005 and 2004 were about the same in terms of hurricane damage
- d) None of the above.

Answer: a

Difficulty: moderate

Type: MC

3. Mrs. Barker has a poodle that she loves very much. The poor little dog is killed in a house fire, and Mrs. Barker asks her homeowners insurance company to pay \$100,000 for the loss of the dog. The insurer denies the claim. On what grounds would it be able to do this?

- a) Too much moral hazard potential exists with the loss of pets
- b) It's impossible to measure, economically, the value of a beloved pet
- c) Animals are never insurable items
- d) The insurer could not legally deny the claim

Answer: b

Difficulty: moderate

Type: MC

4. Adverse selection results in which of the following?

- a) no underwriting is necessary
- b) applicants for insurance have a higher probability of loss than the average group of insureds
- c) the federal government must write the insurance
- d) better insureds are attracted to the group

Answer: b

Difficulty: moderate

Type: MC

5. Catastrophic losses are not insured by the private insurance industry because:
- a) if a truly catastrophic loss occurs, it can threaten the solvency of the insurer
 - b) catastrophic losses can result from an individual's moral hazard
 - c) the federal government wants to insure catastrophic losses
 - d) the losses require foreign reinsurance companies to operate in the U.S.

Answer: a

Difficulty: moderate

Type: MC

6. The ideal insurance system:
- a) reduces the probability of accidental and fortuitous losses due to increased predictability
 - b) requires the transfer of a large number of exposures to loss to a pool, where a fund exists in advance of losses having to be paid
 - c) works best when a large proportion of the participants in the pool submits a claim
 - d) eliminates all hazards

Answer: b

Difficulty: moderate

Type: MC

7. Why is a large number of exposure units required for a risk to be insurable?
- a) it allows the insurer to accurately predict the aggregate dollar amount of loss
 - b) it allows for at least some losses to occur
 - c) it reduces the moral hazard
 - d) it reduces both the moral and the morale hazard

Answer: a

Difficulty: moderate

Type: MC

8. The use of an applicant's personal opinions by underwriters for rating criteria directly violates which guiding principle of underwriting?
- a) separation and class homogeneity
 - b) reliability
 - c) incentive value
 - d) social acceptability

Answer: b

Difficulty: difficult

Type: MC

9. An insurance applicant dying from cancer is not likely to be insured because:
- a) the loss is not definite as to time and place
 - b) the probability of loss varies daily, ultimately reaching 1.0
 - c) the loss would be catastrophic for the insurer
 - d) the loss is certain to occur and the price for coverage would be uneconomical

Answer: d
Difficulty: moderate
Type: MC

10. All the following are necessary for an ideally insurable loss exposure except:
- a) large number of homogeneous exposures
 - b) losses must be accidental and unintentional from the point of view of the insured
 - c) losses must be measurable
 - d) low probability of loss

Answer: d
Difficulty: moderate
Type: MC

11. On average, women live longer than men. If an applicant's gender is ignored in determining life insurance prices:
- a) men will subsidize women
 - b) women will subsidize men
 - c) no subsidization will occur because only group longevity results are valid
 - d) morale hazard will increase significantly

Answer: b
Difficulty: moderate
Type: MC

12. Given the requisites of an insurable risk, which of the following exposures would make the best subject of a profitable insurance pool? (Assume a premium appropriate to the exposure is charged, and analyze the exposure from an insurer's standpoint.)
- a) insuring college students against their GPA falling below a 3.0
 - b) insuring all the dorms on a single college campus against property damage
 - c) insuring all the lives of college seniors in the U.S. for \$10,000 each, without an initial medical exam
 - d) insuring students against the theft or disappearance of textbooks

Answer: c
Difficulty: difficult
Type: MC

13. Which of the following is not an example of a speculative risk?

- a) purchase of an insurance policy
- b) investment in common stocks
- c) operating a business for profit
- d) investment in banana futures

Answer: a

Difficulty: easy

Type: MC

14. Why is the National Flood Insurance Program (NFIP) not actuarially sound?

- a) Flood is such a catastrophic peril that no one can ever accurately predict the expected losses
- b) The private insurance market charges rates that are inadequate to fully pay for flood losses
- c) Congress authorized inadequate insurance rates to encourage participation in the program
- d) Congress authorized inadequate insurance rates due to political pressure from elderly Floridians

Answer: c

Difficulty: Moderate

Type: MC

15. FEMA stands for

- a) Flood Emergency Management Agency
- b) Federal Emergency Management Agency
- c) Federal Environmental Management Association
- d) Flood and Environmental Management Agency

Answer: b

Difficulty: easy

Type: MC

16. FEMA estimates that for every \$3 of flood insurance claims paid from the NFIP, it saves about _____ in disaster assistance payments

- a) \$1
- b) \$2
- c) \$5
- d) \$7

Answer: a

Difficulty: moderate

Type: MC

17. The Norris and Manhart cases resulted in which of the following outcomes?

- a) made insurance intrastate commerce
- b) made it illegal to charge men and women different life insurance premiums
- c) equalization of pension payments between men and women
- d) made it illegal to use gender as an underwriting factor in any type of insurance

Answer: c

Difficulty: moderate

Type: MC

18. From the viewpoint of an insurer, the prerequisites of an ideally insurable risk include all the following except:

- a) the loss must be capable of being determined and measured
- b) there must be a large, homogeneous group of exposure units
- c) the loss should not be subject to catastrophic hazard
- d) the peril should be such that the probability of loss is high

Answer: d

Difficulty: moderate

Type: MC

19. "Subsidization" in an insurance pool means:

- a) the bad risks pay more for insurance than good risks
- b) the premiums collected by the insurers don't adequately cover the losses experienced by the pool
- c) those who experience losses have their premiums raised
- d) exposures that should be charged higher insurance rates are averaged in a pool so that the good as well as bad exposures pay the same rate

Answer: d

Difficulty: moderate

Type: MC

20. In which of the following insurance pools would there be no subsidization?

- a) fire insurance
- b) life insurance
- c) automobile insurance
- d) there would be subsidization in all of these pools

Answer: d

Difficulty: moderate

Type: MC

21. All of the following are federally-sponsored insurance activities in the U.S. except:

- a) Social Security
- b) National Flood Insurance Program
- c) Federal Deposit Insurance Corporation
- d) Universal Health for Children Organization

Answer: d

Difficulty: moderate

Type: MC

22. All of the following legal doctrines result in more individuals being held liable for negligence except:

- a) last clear chance rule
- b) contributory negligence
- c) comparative negligence
- d) vicarious liability

Answer: b

Difficulty: difficult

Type: MC

23. Nearly all policies of insurance exclude loss caused intentionally by the insured. This is necessary to meet which of the following requisites of an ideally insurable exposure?

- a) to control the moral hazard
- b) to control the morale hazard
- c) the loss must not be subject to the catastrophic hazard
- d) the loss must be definite and measurable

Answer: a

Difficulty: moderate

Type: MC

24. You are applying for homeowners' insurance, and the application for coverage asks if you have ever been convicted of a crime. Why does the insurer care if you have a criminal record?

- a) It tarnishes the company's image to sell to former convicts
- b) By law, convicted criminals are not entitled to own property, and thus cannot be issued property insurance policies
- c) A criminal background, especially one involving destruction or theft of property, indicates that you are a potential moral hazard
- d) Underwriters are notorious for asking personal questions

Answer: c

Difficulty: moderate

Type: MC

25. Credit insurance provides coverage for which of the following parties?

- a) a lender who is not repaid by borrowers
- b) an investor who experiences stock market losses
- c) a borrower who files for bankruptcy because of a job loss
- d) an employer that loses business because of labor union strikes

Answer: a

Difficulty: easy

Type: MC

26. In a world without underwriting, insurance would become _____ because of _____.

- a) unfeasible; adverse selection
- b) unfeasible; homogeneity of exposures
- c) inexpensive; adverse selection
- d) prohibitively expensive; moral hazard

Answer: a

Difficulty: difficult

Type: MC

27. If insurers didn't practice underwriting, what would happen?

- a) They would save a lot of time and money by not asking all those nosey questions
- b) They would make a handsome profit since they would get to sell a lot of insurance to a lot of people
- c) The insurance mechanism would become unfeasible
- d) The insurance mechanism would become the largest money-making venture in the United States

Answer: c

Difficulty: moderate

Type: MC

28. Underwriting might best be defined as:

- a) The process of taking other people's money under the table and writing it off as a business expense
- b) The selection of insureds and the pricing of insurance for each insured
- c) The determination of coverage after an insured has a claim
- d) The process of determining whether an insurance company wishes to sell a particular type of insurance coverage

Answer: b

Difficulty: easy

Type: MC

29. If you were a life insurance underwriter, which of the following underwriting criteria would you MOST prefer to use because of its reliability?
- a) the applicant's response to the question AHave you ever tested positive for HIV?
 - b) the applicant's response to the question AHave you smoked any tobacco products within the last year?
 - c) the opinion of the patient's family doctor as to the overall health of the patient
 - d) the results of blood and urine tests taken by your company's own physicians

Answer: d

Difficulty: moderate

Type: MC

30. If you were a life insurance underwriter, asking which of the following underwriting questions would probably be socially unacceptable to an insurance applicant?
- a) Have you ever tested positive for HIV?
 - b) Have you smoked any tobacco products within the last year?
 - c) Are you heterosexual, homosexual or bisexual?
 - d) Have you traveled to a foreign country within the last ten years?

Answer: c

Difficulty: moderate

Type: MC

31. If you were an underwriter of personal auto insurance, which of the following underwriting criteria would you MOST prefer to use because of its incentive value?
- a) gender
 - b) age
 - c) driving record
 - d) health

Answer: c

Difficulty: moderate

Type: MC

32. If you were an underwriter of homeowners insurance coverage, asking which of the following underwriting questions would probably be socially unacceptable to the homeowner applicant?
- a) What religious beliefs do you have?
 - b) Does anyone in your family smoke cigarettes in the house?
 - c) Do you have an alarm system installed and working?
 - d) Do you have a swimming pool?

Answer: a

Difficulty: difficult

Type: MC

33. Which of the following reasons for canceling a wedding would likely NOT be covered by a typical wedding insurance policy?
- a) bride gets food poisoning
 - b) church suffers a fire loss the day before the wedding
 - c) groom decides he doesn't want to get married
 - d) caterer is unable to provide food for the reception

Answer: c

Difficulty: moderate

Type: MC

34. To prove in court that a defendant was negligent, the plaintiff must show all of the following except:
- a) a law was broken
 - b) a legal duty to protect existed
 - c) an injury resulted directly from a breached duty
 - d) a person did not act reasonably

Answer: a

Difficulty: easy

Type: MC

35. All of the following adds to the defense or provides an excuse for the defendant in a legal liability claim except:
- a) showing that there was no legal duty to protect the plaintiff
 - b) showing that the plaintiff assumed the risk
 - c) showing that the plaintiff had the last clear chance to avoid the accident
 - d) showing that the defendant did not mean to cause the loss

Answer: d

Difficulty: difficult

Type: MC

36. In a negligence lawsuit, jury's primary function is to:
- a) assist the judge in interpreting the law
 - b) determine the facts
 - c) decide guilt or innocence
 - d) make sure neither plaintiff nor defendant cheats in presenting their case

Answer: b

Difficulty: moderate

Type: MC

37. You have been sued for negligence. Which of the following would not be an effective legal defense for you to use?
- a) contributory negligence on the part of the plaintiff
 - b) res ipsa loquitur
 - c) the plaintiff assumed the risk
 - d) the plaintiff suffered no injury as a direct result of your actions

Answer: b

Difficulty: difficult

Type: MC

38. A plaintiff will generally collect for negligence when all the following characteristics are present except:
- a) injury is suffered by the plaintiff
 - b) plaintiff breaches a contract with the defendant
 - c) breach of duty owed the plaintiff
 - d) the breach of the duty caused the injury to the plaintiff

Answer: b

Difficulty: easy

Type: MC

39. Landlord Jones did not replace the broken ladder in the pool of his apartment complex, even though it had been broken for two years and there was a sign posted to indicate that the ladder was broken. Manuel, a tenant of Mr. Jones', is seriously injured by the ladder while trying to exit the pool. Manuel sues Jones. Jones' best legal defense would be:
- a) res ipsa loquitur
 - b) assumption of the risk - a reasonable person would get a flashlight or take other precautions
 - c) Burton did not intend the injury
 - d) the tenant always has the duty to change the light bulbs

Answer: b

Difficulty: difficult

Type: MC

40. Assume a person is severely injured by electricity while trying to remove a kite from the power line after having climbed a power pole without the utility's permission. The injured party sues the power company. All of the following would add to a good defense from the standpoint of the power company except:
- a) contributory negligence
 - b) assumption of the risk
 - c) the utility company lacked the intention to harm the plaintiff
 - d) last clear chance rule under common law

Answer: c

Difficulty: difficult

Type: MC

41. Assume Gerald is injured because his landlord, Barbara, fails to replace burned-out light bulbs in the hallway of his apartment building. If Gerald trips and falls and then sues Barbara for his injuries, the basis of his suit most likely will be:
- a) negligence
 - b) intentional interference
 - c) res ipsa loquitur
 - d) breach of contract (lease)

Answer: a

Difficulty: moderate

Type: MC

42. Which one of the following lists presents the three major categories of "legal liability"?
- a) breach of contract, res ipsa loquitur, torts
 - b) criminal wrongs, product liability, intentional interference
 - c) torts, breach of contracts, liability without fault
 - d) breach of a contract, tort, criminal wrongs

Answer: d

Difficulty: moderate

Type: MC

43. Damages awarded to compensate for pain and suffering are called:
- a) punitive damages
 - b) personal injuries
 - c) non-bodily injury damages
 - d) exemplary damages

Answer: d

Difficulty: moderate

Type: MC

44. The "reasonable person" standard changes based upon which one of the following factors?
- a) the extent and dollar amount of the injury that occurs
 - b) the defendant's professional status relative to the event causing the injury
 - c) the defendant's criminal record
 - d) the insurer's duty to defend the policyholder

Answer: b

Difficulty: moderate

Type: MC

45. Kim's automobile is struck by a negligent motorist. She suffers bodily injuries that cause her to have \$73,000 in medical expenses. She is unable to work for several weeks and loses \$10,000 in wages. The repair bill to fix her car is \$20,000. Choose the true statement from the following answer choices:
- a) Her medical bills and lost wages are personal injuries
 - b) Her repair bill for her automobile is an example of property damage
 - c) Her lost wages are personal injuries, while her medical bills are bodily injuries
 - d) ALL of her losses in this scenario are classified as personal injuries, since they were caused by another person

Answer: b

Difficulty: difficult

Type: MC

46. Damas went to a hair salon to get his hair dyed blonde. He had bad reaction to the dye used on his hair, and all his hair fell out. He further developed a horrible skin infection that almost killed him. Damas sued the salon for his injuries. Damas's attorney was unable to show exactly what the salon did wrong, but the jury ruled in favor of Damas anyway. What legal doctrine would have allowed this verdict?
- a) Res ipsa loquitur
 - b) Workers' compensation laws
 - c) Vicarious liability
 - d) Attractive Nuisance

Answer: a

Difficulty: difficult

Type: MC

47. Chandy is suing Bill and they are in a contributory negligence state. Chandy's total injuries are \$100,000, and the jury finds that he was 5% at fault in the incident. How much money will Chandy be entitled to collect?
- a) \$100,000
 - b) \$95,000
 - c) \$0
 - d) \$90,000

Answer: c

Difficulty: difficult

Type: MC

48. Foster is suing Geraldine and they are in a contributory negligence state. Foster's total injuries are \$100,000, and the jury finds that he was 5% at fault in the incident. How much money will Foster be entitled to collect?
- a) \$100,000
 - b) \$95,000
 - c) \$0
 - d) \$90,000

Answer: c

Difficulty: difficult

Type: MC

49. Which of the following is NOT a tort?

- a) Battery
- b) Assault
- c) Negligence
- d) Breaking a contractual agreement

Answer: d

Difficulty: moderate

Type: MC

50. The Terrorism Risk Insurance Act of 2002:

- a) requires that all life and health insurance policies exclude terrorism from coverage
- b) is triggered when the Secretary of Defense certifies that an act of terrorism has occurred
- c) requires property and casualty insurers to offer terrorism insurance to all policyholders
- d) expires in the year 2030

Answer: c

Difficulty: difficult

Type: MC

51. Shanelle travels to Las Vegas, and puts \$5,000 on the roulette table, hoping to win big. Which of the following statements is true about this situation?

- a) Her bet is no different than the one we all make when we buy insurance policies
- b) She created a risk where none existed before, so this transaction is not insurance
- c) If she called her homeowners' insurance agent before she left on her trip, she could have bought a policy against losing money at the roulette table
- d) Her bet represents a pure risk

Answer: b

Difficulty: difficult

Type: MC

52. Res ipsa loquitur means "the thing speaks for itself."

Answer: True

Difficulty: moderate

Type: TF

53. You can collect for your own injuries under a liability policy.

Answer: False

Difficulty: difficult

Type: TF

54. One reason insurable losses must be definite is to allow measurability of the losses

Answer: True

Difficulty: moderate

Type: TF

55. Insurance works best when it is sold to those who expect the greatest losses.

Answer: False

Difficulty: moderate

Type: TF

56. Competition would totally eliminate subsidization in insurance pools if there were no regulator restricting competition between insurance companies.

Answer: True

Difficulty: difficult

Type: TF

57. Most speculative risks are insurable.

Answer: False

Difficulty: easy

Type: TF

58. A person can be found negligent even though his failure to perform some act was unintentional.

Answer: True

Difficulty: moderate

Type: TF

59. An insurance pool needs a small group of similar exposures for predictive accuracy.

Answer: False

Difficulty: moderate

Type: TF

60. The items in an insurance pool must be similar to reduce subsidization.

Answer: True

Difficulty: moderate

Type: TF

61. Insured losses ideally should be accidental losses.

Answer: True
Difficulty: easy
Type: TF

62. One reason catastrophes are difficult to insure is because the damage is so unpredictable.

Answer: True
Difficulty: moderate
Type: TF

63. Subsidization in insurance pools occurs if a 40 year-old male is charged the same life insurance premium as a 20 year-old male.

Answer: True
Difficulty: moderate
Type: TF

64. Volcanoes have catastrophic loss potential because they are limited in geographic impact.

Answer: True
Difficulty: moderate
Type: TF

65. A breach of contract legally is known as a "tort."

Answer: False
Difficulty: moderate
Type: TF

66. The plaintiff in a negligence suit is the party who allegedly injured the defendant.

Answer: False
Difficulty: easy
Type: TF

67. The last clear chance is a modification of the statutory contributory negligence rule.

Answer: False
Difficulty: moderate
Type: TF

68. If assumption of the risk is established it means the defendant usually must pay for damages.

Answer: False
Difficulty: moderate
Type: TF

69. Given a broad definition of legal liability, what are the three legal categories for describing situations in which one person injures another? Which ones are generally insurable?

Answer: The three categories are: torts (a civil wrong done to another), breach of contract (breaking a legally enforceable contract), and criminal wrongs (crimes against society). Many torts are insurable. Criminal wrongs and breaches of contracts are not.

Difficulty: moderate

Type: Essay

70. What are the requirements for a plaintiff to prove negligence against a defendant?

Answer: The plaintiff must show 1) the defendant had a legal duty to protect the plaintiff, 2) the defendant failed to perform that duty, 3) an injury was the result of the defendant's failure to do his or her duty.

Difficulty: moderate

Type: Essay

71. What is the difference between compensation for personal injuries and punitive damages?

Answer: Personal injury damages pay for damages to a person's rights, such as a loss of reputation or release of confidential information. Punitive damages are awards made to plaintiffs as a means of punishing defendants for outrageously offensive acts. Punitive damages imply gross negligence or the total disregard for the plaintiff's safety.

Difficulty: moderate

Type: Essay

72. What are the requirements for an "ideally" insurable group of exposures?

Answer: There are four requirements, from the point of view of the insurer, to make an "ideal" pool of exposures. 1) there must be a large number of homogeneous exposures (characteristics and dollar size) 2) losses have to be accidental and unintentional 3) losses must be measurable, and definite in time and place and of sufficient severity to cause economic hardship, 4) losses cannot have catastrophic potential (point of view of insurer).

Difficulty: moderate

Type: Essay

73. What is adverse selection? Explain why insurers are concerned about adverse selection.

Answer: Adverse selection occurs when insurance coverage is purchased and all relevant information is not disclosed, (asymmetric information) causing rates to be inadequate. Insurers are concerned about it because it causes subsidization. Applicants would apply for coverage if the rates were low relative to the exposure causing future premium increases and discouraging good insureds to stay.

Difficulty: moderate

Type: Essay

74. List and briefly explain the principles of risk classification.

Answer: 1) separation and class homogeneity - the pool should be characteristically the same and not inter-mixed with other classes, 2) reliability - the criteria should not be subject to easy manipulation, 3) incentive value - the criteria should encourage good behavior (to produce lower losses and premiums), 4) social acceptability - the criteria does not violate societal norms of classification.

Difficulty: moderate

Type: Essay

75. What are the two broad categories of the private insurance industry? Break down the broad categories into their main parts.

Answer: The private insurance industry is broken into two main industries- the life industry and the non-life industry. The life insurance industry is broken into life insurance, annuities and health insurance. The non-life area is broken into fire, marine, bonding, and casualty.

Difficulty: moderate

Type: Essay