

Ch 2 Insurance and Risk

Questions and discussions

QUESTION ONE (Multiple Choice)

- 1- All of the following are characteristics of insurance except
 - a) Risk avoidance
 - b) Pooling of losses
 - c) Payment of fortuitous losses
 - d) Indemnification

- 2- Which of the following is implied by the pooling of losses?
 - a) sharing of losses by an entire group
 - b) inability to predict losses with any degree of accuracy
 - c) substitution of actual loss for average loss
 - d) increase of objective risk

- 3- According to the law of large numbers, what happens as the number of exposures increase?
 - a) Actual results will increasingly differ from probable results
 - b) Actual results will more closely approach probable results
 - c) Fundamental risk will decrease
 - d) Objective risk will increase

- 4- Characteristics of a fortuitous loss include which of the following?
 - I - The loss is certain to occur
 - II- The loss occurs as a result of chance
 - a) I only b) II only c) both I and II d) neither I nor II

- 5- From the viewpoint of the insurer , all of the following are characteristics of an insurable risk except
 - a) The loss must be accidental
 - b) The loss must be catastrophic
 - c) The premium must be economically feasible
 - d) There must be a large number of exposure units

6- From the standpoint of the insurer , all of the following are characteristics of an insurable risk except

- a) The loss must be unintentional
- b) The chance of loss must be calculable
- c) The loss must be indeterminable
- d) The loss must be measurable

7-why is a large number of exposure units generally required before a pur risk is insurable ?

- a) It prevents the insurer from losing money
- b) It eliminate intentional looses
- c) It minimizes moral hazard
- d) It enables the insurer to predict losses based on the law of large numbers

8-The requirement that losses should be accidental in order to be insurable results in which of the following

- i- Decrease in moral hazard
 - ii- More accurate prediction of future losses
- a) I only b) II only c) both I and II d) neither I nor II

9- Which of the following is implied by the requirement that a loss should be determinable and measurable to be insurable?

- I- The loss must be definite as to place
 - II- The loss must be definite as to amount
- a) I only b) II only c) both I and II d) neither I nor II

10-Methods by which insurers may minimize or avoid catastrophic losses include which of the following?

- I- the use of reinsurance
 - II- concentrating coverage written in one or a small number of geographic locations
- a) I only b) II only c) both I and II d) neither I nor II

11- Which of the following types of risks best meets the requirements for being insurable by private insurers?

- a) Market risks
- b) Property risks
- c) Financial risks
- d) Political risks

12- Reasons why market, financial, and production risks are often uninsurable include which of the following?

I – The potential to produce a catastrophic loss is great.

II - The chance of loss cannot be accurately estimated

- a) I only
- b) II only
- c) both I and II
- d) neither I nor II

13- Which of the following types of risks is normally uninsurable by private insurers?

- A) Personal risks
- B) Property risks
- C) Liability risks
- D) Market risks

14- Which of the following is a result of adverse selection

- A) The insurer's financial results will be substantially improved.
- B) Those persons who are most likely to have losses are also the most likely to seek insurance at standard rates.
- C) It is unnecessary for the insurance company to use underwriting
- D) Insurance can be written only by the federal government

15- The tendency for unhealthy people to seek life or health insurance at standard rates is an example of

- a) Moral hazard
- b) Fundamental risk
- c) Morale hazard
- d) Adverse selection

16- Which of the following statements regarding insurance and gambling is (are) true?

- I- Insurance is used to handle existing pure risks, while gambling creates a new speculative risk.
- II- Insurance usually involves risk avoidance, while gambling typically involves only risk reduction.

a) I only b) II only c) both I and II d) neither I nor II

17- In addition to providing death benefits, life insurers sell which of the following products?

- I- Retirement plans
- II- Disability income coverage

a) I only b) II only c) both I and II d) neither I nor II

18- Inland marine insurance provides coverage for

- a) Goods being shipped on land
- b) Ships designed to carry cargo
- c) Goods being shipped on ocean going vessels
- d) Goods being shipped by bages to foreign countries

19- All of the following can be classified as casualty insurance except

- a) marine insurance
- b) general liability insurance
- c) workers compensation insurance
- d) burglary and theft insurance

20- Which of the following is a form of casualty insurance ?

- a) fire insurance
- b) general liability insurance
- c) Inland marine insurance
- d) Ocean marine insurance

21- All of the following are benefits to society that result from insurance except

- a) Less worry and fear
- b) Elimination of moral hazard
- c) Indemnification for loss
- d) Loss prevention

22- Which of the following statements about the insurance industry as a source of investments funds is (are) true?

- I- These funds result in a cost of capital that is lower than it would be in the absence of insurance
 - II- These funds tend to promote economic growth and full employment.
- a) I only b) II only c) both I and II d) neither I nor II

23- All of the following are social costs associated with insurance except

- a) The expense of doing business
- b) Fraudulent claims
- c) Inflated claims
- d) Increased cost of capital

24- A group of farmers in an isolated rural area agreed that if any farmer suffered a property loss, the loss would be spread over the entire group. In this way, each farmer is responsible for the average loss of the group rather than the actual loss that the farmer sustained. Which characteristic of insurance is embodied in this agreement?

- a) Pooling of losses
- b) Fortuitous losses
- c) Risk avoidance
- d) Indemnification

25 - XYZ insurance company writes coverage for most perils that can damage property. It .however does not write flood insurance on property located in the flood plains. which requirements of an insurable risk might be violated if XYZ INSURANCE COMPANY WROTE FLOOD INSURANCE ON A LARGE NUMBER OF PROPERTY RISKS LOCATED IN FLOOD PLAINS?

- a) There must be a large number of similar exposure units
- b) The loss should be catastrophic
- c) The chance of loss must be calculable
- d) The premium must be economically feasible

26- Wekaia Insurance Company insures a broad range of risks, including whatever is not covered by fire, marine, and life insurer. Which term best describe the wide range of risks written by Wekaia Insurance?

- a) Fidelity Insurance
- b) Casualty Insurance
- c) Social Insurance
- d) Marine Insurance

27- ABC Insurance company specializes in marketing homeowners insurance .

The ABC homeowners insurance policy combines Property and casualty insurance in the same contract are called

- a) Mono-line policies
- b) Multi-year policies
- c) Multiple-line policies
- d) Manuscript policies

28- Hiatham Al Motary would like to purchase a house. He will pay 10% of the cost of the house as a down payment and borrow the other 90% from a mortgage lender. The home will serve as collateral for the loan. The mortgage lender requires Hiatham Al Motary to purchase property insurance on the home so that the collateral supporting the loan will be protected. This scenario illustrates which of the following benefits of insurance to society?

- a) Enhancement of credit
- b) Reduction if fear and worry
- c) Source of investment funds
- d) Incentives for loss prevention

29- ABC Auto Insurance COMPANY CALCULATED THE AMOUNT THAT IT EXPECTED TO PAY IN CLAIMS UNDER EACH POLICY SOLD. Rather than selling the coverage for the amount that it expected to pay in claims per policy ,ABC Auto Insurance added an allowance to

cover the cost of doing business ,including commissions ,premiums taxes and acquisition expenses. This allowance is called a(n)

- a) Policyowner dividend
- b) Premium
- c) Expense loading
- d) Rate credit

30- XYZ Insurance company estimate that 14 out of every 100 homeowners that it insures will file a claim each year. Last year XYZ insured 200 homeowners. According to the law of large numbers, what should happen if XYZ insures 2000 homeowners this year?

- a) The total number of claims filed by XYZ policyowners should decrease
- b) The total dollar value of claims settle should decrease
- c) The average size of loss should decline in value
- d) The actual results will more closely approach the expected results

31- KLM Insurance company wrote a large number of property Insurance policies in an area where earthquake could occur. When the president of KLM Insurance company was asked if she feared that a catastrophic earthquake might put the company out of business, she responded, Not a chance. We transferred most of that risk to other Insurance companies. The shifting of part or all of the insurance originally written by one Insurance company to another Insurance company is called.

- a) Hedging
- b) Speculating
- c) Reinsurance
- d) Loss avoidance

QUESTION TWO (TRUE False)

TRUE FALSE QUESTIONS

1-from the standpoint of the individual ,insurance is a system in wich a small certain cost is substituted for a large uncertain loss

2- Insurance cannot be used to deal with exposures that lack one of the elements of an insurable exposure

- 3- For the economy as a whole ,insurance increase the cost of losses
- 4- One of the most important of the elements of an insurable risk is “economically feasible insurability”
- 5- Insurance is similar to gambling in the sense that both involve the transfer of risk
- 6-Sickness can be considered both a peril and hazard
- 7- From the perspective of an insurer .adverse selection is uncontrollable phenomenon
- 8- Insurance may involve the sharing of losses or it may involve the transfer of risk
- 9- Through the law of large number and a reduction in uncertainty ,insurers are able to charge each individual a premium that is less than the expected value of his or her loss
- 10- Both speculative risks and pure risks are a source of gain for the economy as a whole at least in the long run .

QUESTION THREE (DEFINITIONS)

DEFINE THE FOLLWING:-

- 1-Insurance
- 2- Insurance is a source of investment funds by example
- 3- Health insurance
- 4- Life insurance policies
- 5- Indemnification in insurance
- 6- Risk transfer in insurance

7- Law of Large Numbers

QUESTION FOUR

Fill in

- 1- Basic Characteristics of Insurance are 4 characteristics , they are -----,-----,-----
-----,
- 2- Characteristics of an Ideally Insurable Risk are -----,-----,-----,-
-----,
- 3- The loss must be fortuitous means, -----
- 4- Adverse selection means ----- For example
- 5- Hedging means -----
- 6- Marine insurance covers -----, but inland insurance covers -----
- 7- Casualty insurance refers to-----
- 8- Aviation insurance provides protection for-----
- 9- Social insurance Programs are financed entirely or in large part by -----
- 10- Major social insurance programs include ----,----,-----,-----,-----
- 11- Benefits of insurance can be summarized in -----,-----,-----,-----
-----,-----,

Question Five

Applied Case

Building in flood zones are difficult to insure by private insurers because the ideal requirements of an insurable risk are difficult to meet

- a- Identify the ideal requirements of an insurable risk
- b- Which of the requirements of an insurable risk are met by the flood peril

Solution

