Insurance Institute
Canada

CIP PROGRAM
EXAMINATION
APRIL 2003

C11 PRINCIPLES AND PRACTICE OF INSURANCE

IMPORTANT

The time allowed for this exam is 3 hours.

Total marks: 200

You must hand in this paper and any paper used for rough work to the supervisor when you leave the examination room. Failure to do so may result in disqualification.

Section A: Multiple-Choice Questions

Question 1. For the following multiple-choice questions, fill in the circle of the letter that identifies the most correct answer.

Example: (A) (B) ● (D)

DO **NOT** MARK THE ANSWERS ON THESE PAGES.
USE THE **FIRST PAGE** OF YOUR ANSWER BOOK.

1. **Unearned premium** is the portion of the policy premium that

(A) covers the policy period that has not yet expired.
(B) has not been paid out as losses.
(C) has not been paid out as agent or broker commission.
(D) is left over after the payment of all losses, commissions and expenses.

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2. The first responsibility of a risk manager is to

(A) identify the possible causes of loss.
(B) remove all hazards.
(C) measure the risk.
(D) buy the very best insurance at the best possible price.

3. Which of the following best describes a **peril?**

(A) The chance of a loss
(B) An insured risk
(C) The cause of a hazard
(D) An event that may cause a loss to occur

4. In the insurance business, **reserves** are

(A) the investment of shareholders in an insurance company.
(B) funds required to pay for the operation and management of the business.
(C) funds required by regulators to be set aside for specific purposes.
(D) the premium funds remaining after payment of claims.

5. Which of the following is NOT used by insurers to achieve spread of risk?

(A) Volume
(B) Loss prevention
(C) Diversity of type of risk
(D) Diversity of location

6. The main function of insurance is to

(A) make profits for stockholders.
(B) provide a mechanism to spread risk.
(C) generate capital investment.
(D) create employment.

7. An insurer's calculation of **pure premium** should consider

(A) broker's commissions.
(B) loadings for inflation.
(C) advertising costs.
(D) frequency of loss statistics.

8. Liability insurance provides coverage for claims arising from

(A) insolvency.
(B) dishonest acts of employees.
(C) negligent acts.
(D) all risks.

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9. An insurer's **retention** on any one risk can be defined as being the

(A) portion of premium it intends to keep as profit.
(B) portion of premium it requires to cover production and administration expenses.
(C) amount of insurance it will keep for its own account.
(D) minimum amount of insurance that it can write in a particular class of risk.

10. **Underwriting** can best be described as the

(A) calculation of the rate of premium to be charged.
(B) drafting of policy wordings.
(C) selection of risks to insure.
(D) reduction of hazards of a risk.

11. The price of a unit of insurance for a period of one year is called the

(A) rate.
(B) premium
(C) loading.
(D) classification.

12. The term **multi-peril** is often used to describe

(A) a named-perils policy.
(B) policies that combine fire and casualty coverages.
(C) a fire policy that also covers explosion.
(D) inland marine insurance.

13. The directors of a stock insurance company report to the

(A) Chief Executive Officer.
(B) company's shareholders.
(C) Chairman of the Board.
(D) President of the company.

14. Which of the following statements about Lloyds of London is TRUE?

(A) It does not itself accept insurance risks.
(B) It only deals in Marine and Aviation insurance.
(C) It is a commodities exchange.
(D) It is owned by its syndicates.

15. Which of the following is responsible for regulating federally-licensed insurance companies to ensure that they are solvent?

(A) The Minister of Finance
(B) The Office of the Superintendent of Financial Institutions
(C) The President and Board of Directors of each individual insurance company
(D) The Superintendent of Insurance of the province in which the insurance company's head office is located

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16. Which of the following best describes **statute law**?

(A) It can be changed by common law decisions.
(B) It can override any rule within the Civil Code of Quebec.
(C) It is codified law enacted by Federal or Provincial government.
(D) It is the law of precedent.

17. An **insurance pool** is a

(A) reserve fund set up by an insurance company to pay for future losses.
(B) reinsurance arrangement.
(C) joint underwriting arrangement for high hazard risks.
(D) central rating organization.

18. An independent business person who may place business with any number of insurers is called

(A) an agent.
(B) a broker.
(C) a sole proprietor.
(D) a principal.

19. Insurance premiums collected by a broker

(A) belong to the broker until remitted to the insurer.
(B) must be remitted, in full, to the insurer.
(C) must be held in trust until remitted to the insurer.
(D) must be placed in an interest- bearing operating account by the broker.

20. An agency/broker agreement or contract with an insurance company should include

(A) the types of business that the insurer can write.
(B) the types of risks that will be reinsured.
(C) a list of the broker's contracts with other insurers.
(D) premium collection and credit terms.

21. A **legal precedent** can be described as being

(A) a legal procedure that must precede the commencement of a legal action.
(B) a decision that must be rendered by a court prior to the payment of legal damages.
(C) a legal decision given in a past case, which could influence the decision given in a current case.
(D) a statutory rule that must be followed in all cases.

22. The Supreme Court of Canada

(A) is the final court of appeal from the provincial supreme court appeal divisions.
(B) only deals with Constitutional issues.
(C) handles matters that fall under federal jurisdiction.
(D) hears appeals only in cases against the Crown.

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23. A tort can be described as

(A) a breach of contract.
(B) an obligation imposed by statute.
(C) procedural law.
(D) a civil wrong.

24. A **material fact** is information that

(A) an insurer should know without being told about it by the applicant.
(B) could affect how an underwriter assesses a particular risk.
(C) is applicable to all risks of the same general class.
(D) an applicant for insurance must disclose only if asked.

25. Which of the following is a means of discharging a contract under Common Law?

(A) Frustration
(B) Mistake
(C) Misrepresentation
(D) Concealment

26. During contract negotiations, a counter-offer has what effect?

(A) It creates a voidable contract.
(B) It invalidates the previous offer.
(C) It nullifies the contract.
(D) It creates two offers from which to choose.

27. Under the Civil Code of Québec, a **determinate** person is

(A) one who has no legal authority to form a contract.
(B) the public at large.
(C) a general group.
(D) a specific individual.

28. Which of the following is required to form a binding contract under the Civil Code of Québec?

(A) Object of Contract
(B) Revocation
(C) Emancipation
(D) Novation

29. **Indemnification** can best be described as

(A) the main purpose of the insurance business.
(B) provision of agreed compensation.
(C) returning the insured to his or her pre-loss financial position.
(D) payment of losses out of pooled premiums.

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30. Which of the following would NOT have an insurable interest in an automobile?

(A) The lien holder
(B) The lessee
(C) The owner of the automobile
(D) The insurer of the automobile

31. The **actual cash value** of a dining room table that has been destroyed in a fire, can best be described as the

(A) original cost of the table plus an inflation index factor.
(B) replacement cost of the table.
(C) value of a similar table of the same material, age, condition and style.
(D) wholesale price of a similar table made from different material.

32. Which of the following best describes an insurance **binder?**

(A) It is an implied contract of insurance.
(B) It is never bound by Statutory/General Conditions.
(C) It must always be in writing.
(D) It is also known as a cover note.

33. In insurance terminology, a **warranty** is a(n)

(A) promise by the insurer to pay certain types of claims in certain circumstances.
(B) undertaking by the insured that a specified state of affairs will continue to exist for the duration of the insurance contract.
(C) statement of existing fact at the time the contract was made.
(D) representation that certain things have not happened in the past that would affect the acceptability of a risk.

34. The term **contra proferentem** means

(A) without prejudice.
(B) a counter-offer made in connection with a proposed contract.
(C) the voluntarily acceptance of a known risk.
(D) that a court will interpret ambiguity in a contract against the person who drew up the contract.

35. **Short rate cancellation** of an insurance policy is used when

(A) a policyholder cancels a policy before expiry of the contract.
(B) a policyholder fails to pay the premium.
(C) an insurer finds that a breach of the duty of good faith has occurred.
(D) an insurer cancels a policy before expiry of the contract.

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36. The time after which a cause of action ceases is known as the

(A) expiry period.
(B) inception date.
(C) prescription date.
(D) ultimate deadline.

37. The legal decision, **Scott** v. **Shepherd (1771)**, set an important precedent dealing with the proximate cause of a loss. In its decision, the court

(A) found the defendant liable for injury because of malicious intent.
(B) found that the last person to throw the firecracker was liable.
(C) found that the first event in an unbroken chain of events was the proximate cause of loss.
(D) established that the proximate cause of loss is always the last event in a sequence of events.

38. Facultative reinsurance

(A) is less flexible than treaty reinsurance.
(B) is placed with a reinsurer on an individual case basis.
(C) is automatic insurance on a class of risks.
(D) requires that the reinsurer accept all ceded risks.

39. **Retrocession** occurs when

(A) a reinsurer returns unearned premium to an insurer.
(B) an insurer cedes part of its business to a reinsurer.
(C) a reinsurer cedes part of its business to another reinsurer.
(D) facultative reinsurance is cancelled.

40. What organization works to improve communication between insurance companies and the public?

(A) The Centre for Study of Insurance Operations
(B) The Surety Association of Canada
(C) Insurance Bureau of Canada
(D) The Property and Casualty Insurance Compensation Corporation

(2 marks each = 80 marks)

Section B: Narrative Questions

Question 2. (a) Distinguish between speculative risk and pure risk. (5 marks)

(b) Insurers use various means of spreading risk. Explain how this is achieved. (10 marks)

(c) Distinguish between rate and premium. (5 marks)

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Question 3. (a) One of the benefits of insurance is its generation of capital. Explain how capital is generated and the influence of government on an insurer's investment decisions. (7 marks)

(b) Describe the factors that can affect the reliability of statistics used in the calculation of an insurance rate. (8 marks)

(c) Identify the FIVE (5) essential elements of a valid contract in the common law provinces. (5 marks)

Question 4. (a) Discuss how the federal government regulates the financial operations of Canadian insurance companies. (10 marks)

(b) Discuss how the law of principal and agent is applicable to the relationship between insurers and their brokers or agents. (10 marks)

Question 5. (a) Define **tort**. Provide TWO (2) examples of a tort. (5 marks)

(b) Briefly describe the differences between the application of common law and that of the Civil Code of Québec. (5 marks)

(c) Distinguish between substantive and procedural law. (5 marks)

(d) What are the differences between an independent adjuster and a public adjuster? (5 marks)

Question 6. (a) Briefly outline the type of coverage provided by the following and explain how these contracts affect the principle of indemnity:

(i) Contracts of compensation (5 marks)
(ii) Valued contracts (5 marks)

(b) Describe the differences between facultative and treaty reinsurance. (10 marks)

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Section C: Application Question

Question 7. A broker submits an application for automobile insurance to an insurance company on behalf of a client. The broker is unaware that although his client is the registered owner of the vehicle to be insured, his client's adult son is the actual owner and operator of the vehicle. This means that the client has provided false information on the insurance application.

(a) You are the underwriter on this risk and it comes to your attention that the insured's son is the owner and operator of the insured vehicle. What issues should you consider when you discover the actual facts about the ownership and operation of the insured automobile? (5 marks)

(b) Before the underwriter discovers that the insured has provided false information on his application, a claim is reported. The actual owner of the car lost control of his vehicle on the highway and drove his vehicle into a ditch. You are the adjuster assigned to this claim. When you become aware of the coverage dispute, what should you do to protect the insurer's interest? What are the consequences of not taking the proper steps to protect the insurer's interest? (15 marks)

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