

C72 INTRODUCTION TO RISK MANAGEMENT AND COMMERCIAL LINES 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)

<p>DO NOT MARK THE ANSWERS ON THESE PAGES.</p> <hr/> <p>USE THE FIRST PAGE OF YOUR ANSWER BOOK.</p>

1. For an organization to achieve peace of mind it must operate within its tolerance level for uncertainty, which is the
- (A) measure of value an organization places on safety as opposed to physical assets.
 - (B) degree to which a business can fail to satisfy a customer demand and survive.
 - (C) extent to which a company feels it can self-insure a portion of risk with little real chance of loss.
 - (D) threshold beyond which an organization cannot survive financially.

2. An organization analyzes a particular loss exposure, determines that the risk of loss is not too serious and fairly predictable and decides to retain it. This is
 - (A) a residual activity.
 - (B) a passive retention.
 - (C) a captive insurance technique.
 - (D) an active retention.

3. Change in consumer taste is an example of a(n)
 - (A) economic peril.
 - (B) physical peril.
 - (C) human peril.
 - (D) natural peril.

4. **Vicarious liability** makes an individual responsible for
 - (A) the failure to use the degree of care that a reasonable person would use in the same situation to avoid injury to another.
 - (B) loss or injury arising from engaging in inherently dangerous activities regardless of the degree of care used.
 - (C) intentional and deliberate acts provided bodily injury or property damage were not expected or intended.
 - (D) the negligent actions or omissions of another who is under the individual's care or control at the time.

5. The post-loss objective for a business that cannot survive even a few days of downtime is
 - (A) stable earnings.
 - (B) sustained growth.
 - (C) profit.
 - (D) operational continuity.

6. It is more difficult to evaluate the severity of losses for liability exposures because
 - (A) it is impossible to predict nuisance-type liability claims with any accuracy.
 - (B) unlike property, there is no fixed value and therefore no maximum possible loss.
 - (C) some liability exposures are so remote that the probability of loss approaches zero.
 - (D) the large loss principle makes it clear that predicting devastating losses is impossible.

7. The financial effect of all losses in any given period of time can be calculated by
 - (A) using the Prouty Measures.
 - (B) applying the Law of Large Numbers.
 - (C) multiplying the loss frequency by the loss severity.
 - (D) dividing the total losses by a key factor.

8. The creation of a funded reserve by an organization to provide for retained losses
- (A) provides significant tax benefits to an organization.
 - (B) may be viewed as incurring opportunity costs.
 - (C) creates tax liabilities for an organization.
 - (D) is financed from current income, with no cash or other asset specifically earmarked.
9. **Personal property** refers to
- (A) one's character and reputation in the community.
 - (B) property that is movable or separable from real property.
 - (C) land, buildings and other permanent structures on the land.
 - (D) the right a person has in property that has commercial or business value.
10. The **insurance method**, as a technique to minimize the effects of exposures, involves
- (A) sorting the kinds of insurance as essential, desirable, and available and then buying coverage starting with the essential, until the budget is used up.
 - (B) calculating the minimum and maximum expected losses and buying coverage starting with the minimum, until the budget for insurance is used up.
 - (C) considering the cost of each risk management technique and estimating the results of applying each technique to potential losses.
 - (D) evaluating other risk management alternatives to determine the potential for saving premium dollars through their use.
11. **Unbundled services** is a term used to describe the selection, by a large organization, of
- (A) a number of speciality insurers, each handling the portion of the risk for which they have a particular expertise.
 - (B) a blend of risk management strategies used concurrently to manage its risks.
 - (C) a transfer of the financial consequences of loss without any active participation in loss control or prevention activities.
 - (D) the services it will purchase from an insurer as a way of customizing the services it needs, thereby reducing premium costs.
12. An adjustable stock insurance policy is a reliable and efficient way to insure stock
- (A) when the limit fluctuates as a high limit can be shown on the policy and the premium adjusted according to actual amounts reported.
 - (B) when increases in coverage are required and occur automatically at specified times during the year.
 - (C) where constant levels of stock are maintained year-round.
 - (D) for large risks that have only incidental stock to cover.

13. An employee negligently carries out an assigned task and injures a third party. The employer is
- (A) not responsible for an act that is carried out in a negligent way.
 - (B) not responsible if the manner in which the task was completed was expressly forbidden.
 - (C) responsible for the employee's negligence along with the employee.
 - (D) solely responsible for the acts of the employee.
14. Extra expense as a business interruption coverage includes
- (A) additional expense incurred by a business that must remain in operation despite a loss.
 - (B) additional cost to rent premises when the building will not be rebuilt following a loss.
 - (C) expense of paying sales staff to retain them when they temporarily have nothing to sell following a loss.
 - (D) costs that continue to accrue following a loss even though business operations stop.
15. Professional bailees owe a greater degree of care than do gratuitous bailees because
- (A) of a reliance on their expertise by the public.
 - (B) goods placed in their care are usually high in value and the resulting risk requires greater care.
 - (C) they hold other people's property for a fee.
 - (D) liability is assumed under contract.
16. In the risk management sales approach, the sales interview
- (A) is an opportunity for the producer to impress the potential client with his or her knowledge to show the client risk management is better left to the experts.
 - (B) allows the producer to begin learning the special language and investigate the general nature of the exposures associated with the potential client's industry.
 - (C) is discarded as it represents the primary activity of the traditional method of simply selling a client insurance coverage.
 - (D) becomes a team process as the producer and potential client define goals and develop information to attain the goals.
17. Modern management generally recognizes that an organization's most valuable asset is
- (A) an abundant labour pool.
 - (B) the ability to respond quickly to a changing marketplace.
 - (C) contingency planning for downturns in the economy.
 - (D) trained personnel.

18. Insuring a building on a stated amount basis avoids the
- (A) portion of a loss an insured may have to pay due to depreciation.
 - (B) effects of inflation on buildings insured to full value.
 - (C) possibility of a coinsurance penalty if values increase due to inflation.
 - (D) possibility of the insured having to pay additional costs following a loss to comply with local building laws.
19. An organization has a number of sources of funds to choose from to meet the costs of retained losses. When an account is set up on the balance sheet of the organization allocating funds for retained losses, but no cash or other assets are earmarked for it, the source is known as
- (A) loss expense.
 - (B) unfunded reserve.
 - (C) funded reserve.
 - (D) loss loan.
20. The Peak Season Endorsement, used to increase stock coverage at specified times of the year, is most effective for
- (A) small retail risks where stock values fluctuate seasonally.
 - (B) manufacturers where the product may be in various stages of completion.
 - (C) large retail risks where the stock amount fluctuates frequently.
 - (D) retail risks where the amount of stock throughout the year is fairly stable.
21. The operating expenses that continue or may continue in the event of a partial or total shutdown of business covered under Profits business interruption coverage are called
- (A) average daily value.
 - (B) standing charges.
 - (C) daily indemnity.
 - (D) extra expense.
22. Under the Commercial Building, Equipment and Stock – Named Perils form, items required for maintenance and building services are covered under the
- (A) building section of coverage.
 - (B) equipment section of coverage.
 - (C) stock section of coverage.
 - (D) tenant's improvements section of coverage.
23. The operation of a coinsurance clause is designed to
- (A) penalize those insureds that do not carry insurance close to full value.
 - (B) protect the insurer from paying the policy limits.
 - (C) index policy limits according to inflation rates.
 - (D) increase policy premiums mid-term.

24. Rental value insurance indemnifies
- (A) the owner of a property if the owner's rental income is interrupted by an insured peril.
 - (B) tenants whose long-term lease is expiring and who must pay an increase, in excess of a stated percentage, under new rental terms.
 - (C) the owner/occupier of a property if the building becomes unusable and they must rent other quarters.
 - (D) tenants who enjoyed a low rent, if the premises are damaged and they must find substitute premises at prevailing market prices.
25. Select the group of property that is confronted by the most perils and most severely endangered by those perils.
- (A) Buildings, bridges, dams and towers
 - (B) Furniture, fixtures and large display cases
 - (C) Office equipment, cash registers and books of account
 - (D) Contractor's equipment, factory work in progress and watercraft
26. Written applications
- (A) are not specifically required for any policies.
 - (B) are required by law for some property coverages such as commercial property floaters.
 - (C) aid a producer's efforts to minimize misunderstandings between the insurer and the applicant.
 - (D) may not be required to quote a risk but must form part of the policy if coverage is bound.
27. Personal injury coverage on a liability policy covers liability arising from
- (A) material that slanders or libels a person or organization.
 - (B) injury or property damage to a third party when the insured is legally liable.
 - (C) a moral obligation for injury that occurs on the insured's premises.
 - (D) injury, sickness or disease sustained by a person, including death resulting from any of these.
28. The amount of insurance for a Builders' Risk or Course of Construction policy is usually
- (A) the full estimated completed value of the project from the start.
 - (B) increased on request, as the work progresses.
 - (C) adjusted on a monthly reporting basis.
 - (D) increased at specified times by set amounts.
29. Under the Commercial Building, Equipment and Stock form, similar merchandise belonging to others, that the insured is under obligation to insure, is included under the definition of
- (A) equipment.
 - (B) building.
 - (C) legal liability.
 - (D) stock.

30. The Non-owned Automobile Policy exists because
- (A) a company car may occasionally need to be replaced by a temporary substitute automobile.
 - (B) an employee may drive his or her car to and from work even though it is not insured.
 - (C) when an automobile is used on an employer's behalf, the employer can be held accountable for its operation.
 - (D) an employer has a responsibility to hire drivers that are capable and competent.
31. A typical package policy covers
- (A) property insurance, business interruption, general liability and crime.
 - (B) property insurance, general liability, employee dishonesty and crime.
 - (C) property insurance, general liability, boiler and machinery and crime.
 - (D) property insurance, general liability, errors and omissions, and boiler and machinery.
32. A fire clause in a lease agreement
- (A) allows the landlord to cancel a lease if premises suffer a specified percentage of damage or will take more than a specified time period to repair.
 - (B) provides that if the premises are rendered wholly or partly untenantable, the rent either ceases or reduces in proportion to the damage.
 - (C) appears on long-term leases where a reduced rent has been agreed to and requires that rent continue unaffected should the premises be damaged.
 - (D) provides that rent continue unaffected should the premises be damaged as a result of the tenant's negligence.
33. Select the statement that is true of package policies.
- (A) Generally speaking, the types of risks eligible for package policies have simple exposures to loss and the coverages offered are quite adequate.
 - (B) With the available optional features of most package policies it is possible to tailor an insurance policy for a particular client.
 - (C) Although package policies are not standardized, a typical standard policy provides full crime coverage.
 - (D) The typical standard coverages on a package policy designed to avoid gaps in coverage are business interruption, general liability, crime and glass.
34. Umbrella liability policies are generally designed to
- (A) provide broader coverage in addition to increased limits.
 - (B) rely on the wording of the primary policy in determining the extent that coverage is provided.
 - (C) provide coverage that is either identical to or more restrictive than the primary policy.
 - (D) provide the same coverage as the primary policy with a cushion of limits at a higher level.

35. Which of the following would cover loss to maps and drawings including the cost of reworking them?
- (A) Building, Equipment and Stock form
 - (B) Office Contents Floater
 - (C) Valuable Papers and Records policy
 - (D) Commercial Property Floater
36. Liability policies may be written on a claims-made basis. Such policies usually include a retroactive date to
- (A) extend the claims reporting period to ensure there is no gap in coverage.
 - (B) limit coverage to accidents that occur within the prescribed period.
 - (C) exclude losses reported during the current term that occurred in the previous term, when coverage was on an occurrence basis.
 - (D) ensure that coverage continues for a period should the policy be cancelled or not renewed.
37. Stock insured on a Stock Form (with Premium Adjustment Option) gives an insured the flexibility of
- (A) reporting stock values and having the premium adjusted after year-end, but does not penalize the insured if he or she does not do so.
 - (B) increasing the stock coverage at specified times by set amounts.
 - (C) paying 75% of the premium initially, reporting stock values monthly and adjusting the premium after year-end based on the average value.
 - (D) a newly acquired stock provision allowing automatic increases up to a specified limit provided such increases are reported within 14 days.
38. A policy is issued to a landlord containing a clause in which the insurer agrees not to take over any right the landlord may have against the tenant. This clause
- (A) serves to forfeit any rights the tenant may have against the insurance.
 - (B) makes the tenant responsible for the cost of repairs for damage arising out of the tenant's carelessness.
 - (C) waives the insurer's right of recovery should damage be caused to the building through the tenant's negligence.
 - (D) reserves the landlord's right to seek recovery directly from the tenant if the landlord so chooses.
39. Insurance against the loss of earnings resulting from the delayed opening of a business because of insured damage during construction
- (A) is not available because it is not an insurable risk.
 - (B) is covered under Advance Profits on a Gross Earnings policy.
 - (C) is covered under Delayed Opening on a Profits policy.
 - (D) would also apply if a major supplier created the delay as a result of an insured peril.

40. The loss of sales commission, by a selling agent who has nothing to sell as a result of direct damage to a manufacturer's warehouse,
- (A) is a non-insurable loss.
 - (B) may be insured under the manufacturer's business interruption insurance.
 - (C) would be automatically covered under a business interruption Profits form.
 - (D) would be automatically covered under a business interruption Extra Expense form.

(2 marks each = 80 marks)

Section B: Narrative Questions

- Question 2. Describe the objectives of an organization's risk management program. (20 marks)
- Question 3. (a) Describe how you would identify and analyze the rental value exposure for a tenant occupying a suite in a building under a long-term lease agreement. (5 marks)
- (b) How does an independent contractor differ from an employee with respect to vicarious liability? Under what circumstances will a principal have a liability exposure arising out of the acts of a contractor? (5 marks)
- (c) Discuss the reason for and the effect of coinsurance in property insurance. (10 marks)
- Question 4. Electronic data processing equipment is exposed to various perils that are not covered under all-risk policies. Describe the coverage provided by an all-risk policy and outline the additional coverages that should be provided to an insured in order to ensure adequate protection. (20 marks)
- Question 5. Using examples, discuss in detail how loss exposures of a potential client could be identified using:
- (a) the flow chart method. (10 marks)
 - (b) financial statement analysis. (10 marks)

continued over

- Question 6. (a) What property is covered by a Commercial Property Floater? (4 marks)
- (b) Discuss the need for and coverage provided by the Bylaws Endorsement to property insurance. (10 marks)
- (c) What purpose is served by a Stated Amount clause in a property policy? (6 marks)

Section C: Application Question

- Question 7. Morgan Manufacturing Inc. operates from two adjacent buildings. Morgan owns and partially occupies one of the buildings and rents the remaining space to others. Morgan leases the other building from its owner under a 20-year lease signed five years ago. Morgan's monthly lease payments are considered a bargain in the current real estate market. Morgan's premises experience a disastrous fire and both buildings burn to the ground. Rebuilding is estimated to take one year. Morgan's lessor exercises a condition of the lease that allows for cancellation of the lease, if the building is damaged to more than 50% of its value. Morgan's tenant is not obligated to pay rent as a result of the fire. The company is committed to resuming operations and has two options. It can suspend all operations until the buildings are rebuilt in a year or it can resume production at 50% of its pre-loss level by renting other premises and obtaining the necessary machinery from other sources.
- (a) Describe the business interruption losses Morgan Manufacturing can expect to incur, regardless of the option chosen. In your answer, describe any business interruption insurance that could compensate Morgan for its losses. (15 marks)
- (b) Outline a business interruption loss that Morgan would incur if it resumes production immediately at 50% of its pre-loss levels. (5 marks)

