

APPENDIX B

Risk Management and Insurance

KEY TERMS

Define each term briefly. Writing down the definition and giving an example will help you learn the term.

risk (A15)

speculative risk (A15)

pure risk (A15)

risk management (A15)

self-insurance (A17)

insurer (or insurance company) (A17)

premium (A17)

insurance policy (A17)

insurance (A17)

insurable risk (A17)

uninsurable risk (A17)

principle of indemnity (A19)

stock insurance company (A20)

mutual insurance company (A20)

fire insurance (A21)

coinsurance clause (A21)

extended coverage (A21)

fidelity bond (A22)

automobile liability insurance (A22)

automobile physical damage insurance (A23)

no-fault auto insurance (A23)

public liability insurance (A23)

product liability insurance (A24)

ocean marine insurance (A24)

inland marine insurance (A24)

business interruption insurance (A24)

workers' compensation insurance (A25)

healthcare insurance (A26)

health maintenance organization (HMO) (A26)

preferred provider organization (PPO) (A26)

life insurance (A26)

beneficiary (A26)

term life insurance (A26)

whole life insurance (A27)

cash surrender value (A27)

endowment life insurance (A27)

universal life insurance (A27)

PRACTICE EXAMINATION A

Matching Questions (A-1)

Match each term with a statement.

- | | |
|---|---------------------|
| 1. _____ A fee that is charged for insurance coverage. | a. risk |
| 2. _____ The possibility that a loss will occur. | b. speculative risk |
| 3. _____ A contract between two parties. | c. pure risk |
| 4. _____ The purpose is to minimize the costs of a loss or injury. | d. risk management |
| 5. _____ A decision to market a new product is an example of this type of risk. | e. self-insurance |
| 6. _____ The party that assumes financial responsibility for losses. | f. insurer |
| 7. _____ Insurance companies are willing to assume this type of risk. | g. premium |
| 8. _____ An example of this risk is the possibility of an automobile accident. | h. insurance policy |
| 9. _____ It provides protection through a contract against loss. | i. insurance |
| | j. insurable risk |

10. _____ A monetary fund established to cover the cost of a loss.

Matching Questions (A-2)

Match each term with a statement.

- | | |
|---|-----------------------------|
| 11. _____ A risk category that includes speculative risks. | a. uninsurable risk |
| 12. _____ A firm owned by the policyholders. | b. principle of indemnity |
| 13. _____ The insurer is required to pay only the amount of the loss. | c. stock insurance company |
| 14. _____ Protection is provided against damage caused by smoke. | d. mutual insurance company |
| 15. _____ It includes additional coverage in an insurance policy. | e. fire insurance |
| 16. _____ Losses from fires are covered. | f. coinsurance clause |
| 17. _____ Forcible entry is involved. | g. extended coverage |
| 18. _____ It generally requires coverage for 80 percent of the replacement costs. | h. endorsement |
| 19. _____ A threat of violence is involved in the activities. | i. burglary |
| 20. _____ A firm owned by stockholders. | j. robbery |

True-False Questions (A)

Select the correct answer.

21. T F Driving an automobile carries a potential pure risk.
22. T F Most endowment life insurance policies are in force for 20 years.
23. T F Businesses use smoke alarms, security guards, and safety equipment to avoid risk.
24. T F A premium is a fee charged by the insurer.
25. T F Auto accidents are classified as speculative risks.
26. T F Generally, the greater the risk and the amount to be paid, the smaller the premium.
27. T F The probability of a loss must be predictable for a risk to be insurable.
28. T F A fidelity bond is an insurance policy that protects a business from robbery.
29. T F Most no-fault laws limit the rights of involved parties to sue each other.
30. T F Worker's compensation premiums are paid by the employer.
31. T F Universal life insurance policies were first introduced in the late 1800s.

32. T F Embezzlement is the unlawful taking of property from an individual by force or threat of violence.

Multiple-Choice Questions (A)

Select the most accurate answer.

33. When a jewelry store locks its merchandise in a vault at the end of the day, it is practicing
- risk reduction.
 - risk avoidance.
 - risk assumption.
 - risk shifting
 - none of the above.
34. Risks that insurance firms will not assume are called
- uninsurable risks
 - insurable risks.
 - endorsements.
 - pure risks
 - avoidable risks
35. Costs for injury or death due to hazards at the work place are covered under _____ insurance.
- product liability
 - life
 - malpractice
 - public liability
 - no-fault
36. Insurance that provides protection for a stated period of time is defined as _____ insurance.
- straight life
 - single-payment
 - term
 - limited-payment
 - whole life
37. A state law requires individuals suffering injury or loss from an automobile accident to be reimbursed by their own insurance companies. What type of insurance is this?
- No-fault auto insurance
 - Public liability insurance
 - Automobile physical damage insurance
 - Automobile liability insurance
 - Comprehensive insurance
38. Which of the following is *not* a condition for an insurable loss?
- Using accurate and effective accounting and financial controls to protect the firm's inventories and cash from pilfering
 - Establishing a self-insurance health program that covers all employees
 - Installing burglar alarms, security guards, and even guard dogs to protect warehouses from burglary
 - Purchasing and using safety equipment, from hand guards on machinery to goggles and safety shoes for individuals
 - Installing fire alarms, smoke alarms, and sprinkler systems to reduce the risk of fire and the losses due to fire

39. Which one of the following is *not* a condition for an insurable loss?
- Losses must be under the control of the insured.
 - The insured hazard must be geographically widespread.
 - The probability of a loss should be predictable.
 - Losses must result from an intentional action by the insured person.
 - Losses must be measurable.
40. How much fire insurance must be carried on a \$50,000 building to satisfy the 80 percent coinsurance clause?
- \$50,000
 - \$40,000
 - \$30,000
 - \$20,000
 - \$10,000
41. What is the recommended amount of automobile liability insurance that should be carried?
- 10/30/10
 - 20/50/20
 - 40/100/40
 - 50/100/50
 - 100/300/100
42. A method for reducing the cost of health care by offering the services of doctors and hospitals at discount rates or giving breaks in co-payments and deductibles is offered by
- a health maintenance organization.
 - a major medical plan.
 - Medicare.
 - health-care insurance.
 - a preferred provider organization.

Short-Answer Questions (A)

Complete each question.

43. Compare a **speculative risk** with a **pure risk** and give an example of each.

| SPECULATIVE RISK | PURE RISK |
|------------------|-----------------|
| | |
| Example: | Example: |

44. Explain why **speculative risks** are generally not insurable.

45. Describe how a firm can use each risk management technique to manage risk. Include examples.

| RISK TECHNIQUES | DESCRIPTIONS /EXAMPLES |
|-----------------|------------------------|
| Risk avoidance | |
| Risk reduction | |
| Risk assumption | |
| Shifting risk | |

46. Discuss a situation where **self-insurance** may be practical.

47. Under the **principle of indemnity**, how much will the insurer pay in case of a loss?

48. Identify five conditions that make a **risk insurable**.

- a. _____
- b. _____
- c. _____
- d. _____
- e. _____

49. Discuss how the **price of insurance** is determined.

50. Distinguish between a stock insurance company and a mutual insurance company.

| STOCK INSURANCE COMPANY | MUTUAL INSURANCE COMPANY |
|-------------------------|--------------------------|
| | |

PRACTICE EXAMINATION B

Matching Questions (B)

Match each term with a statement.

- | | | | |
|-----------|---|----|--------------------------------------|
| 1. _____ | Property taken without the owner's knowledge or consent. | a. | larceny |
| 2. _____ | It covers damage to the insured vehicle. | b. | fidelity bond |
| 3. _____ | A method of paying only for the insured owner's losses in an auto accident. | c. | automobile liability insurance |
| 4. _____ | This insurance covers damages caused by the insured vehicle. | d. | automobile physical damage insurance |
| 5. _____ | Insurance that covers damage to a vehicle caused by fire. | e. | collision insurance |
| 6. _____ | It provides protection for embezzlement by employees. | f. | comprehensive insurance |
| 7. _____ | Damages caused by a hit-and-run driver are covered with this type of insurance. | g. | uninsured motorists insurance |
| 8. _____ | It covers the repair costs to the insured owner of a vehicle. | h. | no-fault auto insurance |
| 9. _____ | It employs selected physicians and hospitals in exchange for a fixed premium. | i. | health maintenance organization |
| 10. _____ | Doctors provide services at predetermined fees. | j. | preferred provider organization |

True-False Questions (B)

Select the correct answer.

11. T F The medicare program provides both hospital and medical coverage.
12. T F Wearing automobile seat belts is a way to shift risk.
13. T F Risk assumption is the act of taking on responsibility for the loss or injury that may result from a risk.
14. T F An insurance policy specifies exactly which risks are covered.
15. T F The principle of indemnity states that a building cannot be insured for more than its replacement value.
16. T F Gambling losses are insurable risks.
17. T F Insurers will insure an item for its emotional and sentimental value.

18. T F The “80 percent of the replacement cost” coinsurance clause insures the owner that the property will be fully covered in case of fire.
19. T F Repairs to the automobile of the insured person are covered under automobile liability insurance.
20. T F Marine insurance is the oldest type of insurance.
21. T F Women generally pay higher premiums than males of the same age for life insurance.
22. T F No insurance coverage is available for damage done by a hit-and-run driver.

Multiple-Choice Questions (B)

Circle the letter before the most accurate answer.

23. Which risk-management technique does self-insurance satisfy?
- a. Risk reduction
 - b. Risk assumption
 - c. Risk avoidance
 - d. Shifting risks
 - e. Risk elimination
24. To be insurable, a risk must have potential losses that are
- a. under the control of the insured.
 - b. centrally located.
 - c. predictable.
 - d. unmeasurable.
 - e. nonpredictable.
25. Collision insurance is a type of
- a. automobile physical damage insurance.
 - b. bodily injury liability coverage.
 - c. property damage liability coverage.
 - d. comprehensive insurance.
 - e. no-fault insurance.
26. Which type of insurance protects the policyholder against loss or damage to a ship or its cargo on the high seas?
- a. hazards
 - b. inland
 - c. transportation
 - d. marine
 - e. property
27. A type of insurance that combines protection with an investment plan is called
- a. whole life.
 - b. endowment.
 - c. limited-pay.
 - d. term.
 - e. universal.

28. Choosing not to ride in a car is an example of
 - a. shifting risks.
 - b. risk reduction.
 - c. risk avoidance.
 - d. risk assumption.
 - e. self-insurance.
29. Most firms shift their risks by
 - a. buying an insurance policy.
 - b. establishing a self-insurance fund.
 - c. establishing a safety program.
 - d. installing smoke alarms.
 - e. stopping the questionable activity.
30. Which statement is *not* true about a mutual insurance company?
 - a. It is a cooperative.
 - b. It has stockholders and operates to earn a profit.
 - c. It is owned by its policyholders.
 - d. Surplus of income is distributed to policyholders as a reduction in premium.
 - e. The policyholders elect the board of directors.
31. Extended coverage endorsements normally do not cover damage caused by
 - a. falling aircraft.
 - b. vandalism.
 - c. wind and hail.
 - d. nuclear radiation.
 - e. riots.
32. Which type of insurance policy will protect a business from theft and forgery by its employees?
 - a. burglary insurance
 - b. robbery insurance
 - c. indemnity insurance
 - d. liability insurance
 - e. a fidelity bond
33. What does the third number mean in the liability limits on a policy that carries 100/300/100?
 - a. Up to \$100,000 will be paid for injuries to the insured person.
 - b. Up to \$100,000 will be paid for injuries to the uninsured person in the accident.
 - c. A total of \$100,000 will be paid for medical reasons for each occurrence.
 - d. It pays up to \$100,000 for damage caused to another person's property.
 - e. It will pay up to \$100,000 for repairs to the insured vehicle.
34. Which type of coverage pays for damages intentionally caused by another person, such as breaking a windshield in a parking lot?
 - a. Property damage liability coverage
 - b. Comprehensive coverage
 - c. Collision insurance
 - d. Product liability coverage
 - e. Endowment coverage

Short-Answer Questions (B)

Complete each question.

35. List examples of what is covered under each type of insurance.

| PROPERTY INSURANCE | CAUSALTY INSURANCE |
|--------------------|--------------------|
| | |

36. Explain how the **coinsurance clause** affects the amount of money the insurance company will pay a policyholder for a loss caused by a fire.

37. In the following two scenarios, calculate the amount of money the policyholder will receive from the insurance company for damage caused by a fire.

| SCENARIO NO. 1 | SCENARIO NO. 2 |
|--|--|
| \$120,000 = House value 100,000 = Insurance coverage 80,000 = Fire loss (damage) | \$120,000 = House value 80,000 = Insurance coverage 50,000 = Fire loss (damage) |
| _____ = Amount the policyholder will receive from the insurance company for the damage from the fire | _____ = Amount the policyholder will receive from the insurance company for the damage from the fire |

38. Distinguish among the three illegal acts.

| BURGLARY | ROBBERY | THEFT (LARCENY) |
|----------|---------|-----------------|
| | | |

39. Explain how a business can protect itself from **theft, forgery, or embezzlement** by its employees.

40. Identify several items that can be insured through **extended coverage** (endorsement).

41. Explain the meaning of 100/300/50 found on an automobile insurance policy. What does each number indicate?

| 100 | 300 | 50 |
|-----|-----|----|
| | | |

PRACTICE EXAMINATION C

Matching Questions (C-1)

Match each term with a statement.

- | | |
|--|---|
| <p>1. _____ It covers the cost of hospital care.</p> <p>2. _____ Injury due to hazards at a place of business are covered.</p> <p>3. _____ Insurance that pays benefits at the death of an individual.</p> <p>4. _____ It extends medical coverage beyond standard policy coverage.</p> <p>5. _____ Freight shipped by aircraft is covered.</p> <p>6. _____ It protects customers from damage caused by a defective product.</p> <p>7. _____ It can protect businesses when employees go on strike.</p> <p>8. _____ Protection is provided to employees who are injured on the job.</p> <p>9. _____ Ships and cargo are protected.</p> | <p>a. public liability insurance</p> <p>b. major medical insurance</p> <p>c. product liability insurance</p> <p>d. ocean marine insurance</p> <p>e. inland marine insurance</p> <p>f. business interruption insurance</p> <p>g. workers' compensation insurance</p> <p>h. healthcare insurance</p> <p>i. life insurance</p> |
|--|---|

Matching Questions (C-2)

Match each term with a statement.

- | | |
|---|--|
| <p>10. _____ The policy will accumulate savings.</p> <p>11. _____ A policy that offers a tax-deferred savings account.</p> <p>12. _____ The total premium is paid at the time of purchase.</p> <p>13. _____ The policy matures and pays off</p> | <p>a. beneficiaries</p> <p>b. term life insurance</p> <p>c. whole life insurance</p> <p>d. cash surrender value</p> <p>e. straight life insurance</p> <p>f. limited-payment life insurance</p> |
|---|--|

- after a stated number of years.
14. _____ Premiums are paid until the death of the policyholder.
15. _____ Protection is provided for a stated period of time.
16. _____ Premiums are paid for a stated number of years.
17. _____ They are recipients of life insurance proceeds.
18. _____ It is the savings that accumulate on a whole life insurance policy.
- g. single-payment life insurance
- h. endowment life insurance
- i. universal life insurance

True-False Questions (C)

Select the correct answer.

19. T F Worker's compensation insurance is an employer-sponsored, pretax savings plan.
20. T F A firm that markets a new product assumes the risk of product failure.
21. T F The purpose of unemployment insurance is to provide survivor benefits.
22. T F Term life policies provide protection for the whole life of an individual.
23. T F Actuaries determine the premiums that should be charged.
24. T F A hazard to be insurable must be widespread geographically.
25. T F Policyholders own stock insurance companies.
26. T F Damage caused by smoke would be covered in an extended coverage endorsement.
27. T F Most collision coverages include a deductible amount that policyholders must pay.
28. T F Employee salaries are normally covered by a standard business interruption policy.
29. T F Premiums for endowment policies are generally lower than for whole life policies.
30. T F A major difference between stock and mutual insurance companies is that only mutual insurance companies must maintain cash reserves for future obligations.

Multiple-Choice Questions (C)

Circle the letter before the most accurate answer.

31. Purchasing insurance is a technique used to
- assume risk.
 - shift risk.
 - reduce risk.
 - avoid risk.
 - eliminate risk.

32. A broken window pane is evidence of a
- robbery.
 - larceny.
 - burglary.
 - theft.
 - break in.
33. Which type of insurance covers damage or injury caused by a vehicle with no liability insurance coverage?
- comprehensive insurance
 - uninsured motorists insurance
 - no-fault automobile insurance
 - property damage liability coverage
 - public liability insurance
34. Upon the death of the insured, who receives the proceeds of the life insurance policy?
- beneficiaries
 - actuaries
 - policyholders
 - recipients
 - insurers
35. Dr. Robins chose to stop practicing when malpractice insurance premiums became too high for him to afford. He is managing risk by _____ risk.
- assuming
 - reducing
 - avoiding
 - transferring
 - using
36. When a firm buys insurance to cover losses caused by riots, the firm is
- transferring
 - using risk.
 - avoiding risk.
 - risk. assuming risk.
 - reducing risk.
37. A firm carries \$120,000 of fire insurance on a building valued at \$300,000. The building suffers a fire loss of \$200,000. Under the 80 percent coinsurance clause, how much will the firm recover from the loss?
- \$200,000
 - \$240,000
 - \$100,000
 - \$120,000
 - \$300,000
38. Settlements in product liability cases have caused management to take precautions to reduce both the risk of product liability losses and the cost of liability insurance. Which of the following is *not* a way to reduce product liability risk?
- To include thorough and explicit directions with products.
 - To warn customers about the hazards of using product incorrectly.
 - To design products that use non specified recycled material.
 - To remove from the market those products that are considered hazardous.
 - To test products for safety problems that can arise from proper or improper use.

39. A type of insurance that has been around since the ancient Greeks and Romans is _____ insurance.
- fire
 - marine
 - business liability
 - medical
 - life
40. What type of life insurance policy would you recommend for a young couple, with no children, that would provide the most protection for the smallest premium?
- Term
 - Single-payment life
 - Whole life
 - Endowment
 - Straight life

Short-Answer Questions (C)

Complete each question.

41. Describe each type of **automobile physical damage insurance**. What does each cover?

| COLLISION INSURANCE | COMPREHENSIVE INSURANCE | UNINSURED MOTORISTS INSURANCE |
|----------------------------|--------------------------------|--------------------------------------|
| | | |

42. Describe why a business might need public liability insurance or product liability insurance.

| PUBLIC LIABILITY INSURANCE | PRODUCT LIABILITY INSURANCE |
|-----------------------------------|------------------------------------|
| | |

43. Describe each program that operates under the **Social Security Program**.

| SOCIAL SECURITY PROGRAMS | DESCRIPTIONS OF EACH PROGRAM |
|---------------------------------|-------------------------------------|
| Retirement benefits | |
| Survivor benefits | |
| Disability benefits | |
| Medicare | |

44. Explain the purpose of **unemployment insurance**.

45. Discuss how premiums are determined for **workers' compensation** insurance.

46. Compare a health maintenance organization (HMO) to a preferred provider organization (PPO).

| HMO | PPO |
|-----|-----|
| | |

47. Identify characteristics of each type of **life insurance**.

| TYPES OF LIFE INSURANCE | CHARACTERISTICS |
|-------------------------|-----------------|
| Term life insurance | |
| Whole life | |
| Endowment life | |
| Universal life | |

APPENDIX B STUDY GUIDE ANSWERS

PRACTICE EXAM A

- | | | | | | | |
|-------|-------|-------|-------|-------|-------|-------|
| 1. g | 2. a | 3. h | 4. d | 5. b | 6. f | 7. j |
| 8. c | 9. i | 10. e | 11. a | 12. d | 13. b | 14. g |
| 15. h | 16. e | 17. i | 18. f | 19. j | 20. c | 21. T |
| 22. T | 23. F | 24. T | 25. F | 26. F | 27. T | 28. F |
| 29. T | 30. T | 31. F | 32. F | 33. b | 34. a | 35. d |
| 36. c | 37. a | 38. b | 39. d | 40. b | 41. e | 42. e |

PRACTICE EXAM B

- | | | | | | | |
|-------|-------|-------|-------|-------|-------|-------|
| 1. a | 2. d | 3. h | 4. c | 5. f | 6. b | 7. g |
| 8. e | 9. i | 10. j | 11. T | 12. F | 13. T | 14. T |
| 15. T | 16. F | 17. F | 18. T | 19. F | 20. T | 21. F |
| 22. F | 23. b | 24. c | 25. a | 26. d | 27. e | 28. c |
| 29. a | 30. b | 31. d | 32. e | 33. d | 34. b | |

PRACTICE EXAM C

- | | | | | | | |
|-------|-------|-------|-------|-------|-------|-------|
| 1. h | 2. a | 3. i | 4. b | 5. e | 6. c | 7. f |
| 8. g | 9. d | 10. c | 11. i | 12. g | 13. h | 14. e |
| 15. b | 16. f | 17. a | 18. d | 19. F | 20. T | 21. F |
| 22. F | 23. T | 24. T | 25. F | 26. T | 27. T | 28. F |
| 29. F | 30. F | 31. b | 32. c | 33. b | 34. a | 35. c |
| 36. a | 37. c | 38. c | 39. b | 40. a | | |