

QUESTION PAPER NO. **11**

THE INSURANCE INSTITUTE OF CANADA

EXAMINATIONS — APRIL 2001

- Subject:** PRINCIPLES AND PRACTICE OF INSURANCE
(Course No. 11)
- Time:** 3 hours
- Marks:** The total marks are based on FORTY (40) multiple-choice questions, worth TWO (2) marks each, and SEVEN (7) other questions, the marks for which are as stated.
Total marks — 200

This examination paper must be handed in to the supervisor when the candidate leaves the examination room together with any paper used for rough work. Failure to comply may result in disqualification.

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

- Question 1. In the following multiple choice questions, indicate by letter (a), (b), (c), or (d) whichever ONE (1) identifies the most correct answer.
1. Insurance is based on the existence of
 - (a) consideration.
 - (b) indemnity.
 - (c) loss.
 - (d) risk.
 2. Which of the following is true of risk?
 - (a) A business operation is an example of pure risk.
 - (b) Insurance prevents risks.
 - (c) Some risks present the possibility of either a profit or a loss.
 - (d) There can be no risk without insurance.
 3. Which of the following is NOT true of insurance?
 - (a) Insurance is the undertaking to indemnify someone against loss or liability.
 - (b) Insurance prevents losses.
 - (c) Insurance reduces the uncertainty related to possible losses.
 - (d) Insurers can be said to be managers of the fund from which losses are paid to those who have paid into it.
 4. Insurance can best be described as
 - (a) a method of sharing the losses of the few among the many.
 - (b) protection from hazards.
 - (c) protection from perils.
 - (c) the assumption of the liability of others.

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5. Which of the following does NOT fall into the category of general insurance?
 - (a) Business interruption
 - (b) Crime insurance
 - (c) Health insurance
 - (d) Hail insurance

6. Insurers try to achieve a balance of premiums to losses by
 - (a) having a good spread of risk.
 - (b) insuring a small number of superior risks.
 - (c) specializing in one or two kinds of risk.
 - (d) writing as much business in one location as possible.

7. An insured spreads his risk by
 - (a) diversity of location of risk.
 - (b) diversity of type of risk.
 - (c) buying insurance.
 - (d) volume.

8. The law of large numbers
 - (a) affects the reliance to be placed on a given probability.
 - (b) identifies loss exposures.
 - (c) improves loss prevention and safety.
 - (d) reduces the chance that an event may happen.

9. Which of the following is true of the ratemaking process?
 - (a) A large sampling of past loss experience over a long period of time provides a reliable resource for ratemaking purposes.
 - (b) The law of averages is applied to past statistics to determine who will have losses in the future.
 - (c) The premium is the price of a unit of insurance.
 - (d) Statistics gathered for rating purposes are classified according to location and insurability of risks.

10. In insurance terminology, a peril is
 - (a) a condition that may aggravate a loss.
 - (b) an event that may cause a loss.
 - (c) an exclusion under a policy.
 - (d) usually uninsurable.

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11. Which of the following is true of an insurance policy that covers all risks of direct physical loss or damage?
- (a) Every possible type of loss and damage is covered.
 - (b) In actual fact, the extent of the coverage is determined by the exclusions.
 - (c) Such policies contain no exclusion.
 - (d) The perils covered are listed and all types of resulting damage are covered.
12. The physical hazards of a property are determined by the
- (a) amount of insurance on the property.
 - (b) character of the insured.
 - (c) construction of the property and its location with respect to fire-fighting facilities.
 - (d) cost of renovating the entire property.
13. Which of the following is known for its support of sophisticated fire research and engineering?
- (a) Factory mutuals
 - (b) Farm co-operatives
 - (c) Fraternal societies
 - (d) Government insurance organizations.
14. Insurance company income comes from
- (a) investment income and dividends.
 - (b) premiums and investment income.
 - (c) reserves.
 - (d) all of the above
15. Insurance companies that operate through the independent brokerage system
- (a) appoint independent agents and brokers to bring clients to them.
 - (b) contract with a general agent who has authority to manage all of their business.
 - (c) employ agents to secure contracts for their employers in contractual matters.
 - (d) hire, train and licence their own employees to be their sales force.

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16. Insurance agents and brokers are regulated in which of the following areas?
- (a) Licencing
 - (b) Operating requirements
 - (c) Qualification
 - (d) All of the above
17. What is the purpose of an agency/brokerage contract?
- (a) It is not a valid contract but merely an informal agreement between insurers and their agents.
 - (b) It sets out the terms of an agreement between an insurance broker and an insurer wherein the broker agrees to bring business to that insurer.
 - (c) It sets out the terms of the contract between an insured and his insurance agent.
 - (d) Its sole purpose is to state the amount of commission to be paid to the broker.
18. An express contract between an insurer and an intermediary is one in which
- (a) all terms have been specifically stated and agreed to by both parties.
 - (b) confirmation of insurance coverage is given and can be written or oral.
 - (c) one party, in return for a consideration, agrees to indemnify another party.
 - (d) the parties have acted in such a way that it is understood an agreement exists.
19. Common Law
- (a) applies across Canada.
 - (b) consists of Statute Law.
 - (c) is often referred to as Case Law.
 - (d) is written law.
20. A precedent is
- (a) a legal decision serving as an authoritative rule in future similar cases.
 - (b) an act of the legislature declaring, commanding or prohibiting something.
 - (c) the equivalent of a statute.
 - (d) written law.

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21. When judges in Quebec try a case, they ascertain which article of the Civil Code applies to that case, and then
- (a) are bound to follow the decisions made by judges of equal or higher authority.
 - (b) follow the decisions of other judges with regard to that article.
 - (c) make their decision based on that article.
 - (d) need only determine the appropriate fine, restitution or punishment required.
22. Which of the following is NOT true of Statute Law?
- (a) It cannot override common law dealing with the same point.
 - (b) It is used to change existing law when the latter no longer serves society.
 - (c) It is used to clarify existing law.
 - (d) It is written law.
23. In contract law, the rules of offer and acceptance state that
- (a) an offer, once accepted, can be revoked provided neither party has fulfilled any of the terms.
 - (b) contracts cannot be entered into lightly and are binding even if there are mistakes about the intent.
 - (c) the acceptance must be definite and communicated.
 - (d) the offer can be accepted at any time as long as it has not been withdrawn.
24. Under Common Law, consideration with respect to a legal contract
- (a) can be in return for some service to be determined sometime in the future.
 - (b) is the careful deliberation each party goes through before entering into the contract.
 - (c) is whatever the two parties agree upon provided it has some monetary value.
 - (d) must be adequate with respect to the value of the contract as between the parties.
25. Which of the following is a true statement?
- (a) Losses that occurred before a policy was declared void must be paid.
 - (b) Non-disclosure is a form of misrepresentation.
 - (c) To void a policy is the same as terminating it.
 - (d) When an insurer terminates a policy, the return premium is calculated on a short rate basis.

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26. Under the Civil Code of Quebec, the four requirements for a valid contract are
- (a) acceptance, agreement, capacity, and offer.
 - (b) acceptance, cause, consent, and mutual agreement.
 - (c) capacity, cause, consent, and object of contract.
 - (d) capacity, consideration, co-operation, and lesion.
27. Persons who stand in such a legal relationship to property that they may be financially prejudiced by its loss and may financially benefit from its continued existence are said to have
- (a) a right of subrogation in the property.
 - (b) insurable interest in the property.
 - (c) legal capacity in the property.
 - (d) legal liability in the property.
28. When someone is placed back in the same financial position that they were in just prior to a loss, that is
- (a) actual cash value.
 - (b) consideration.
 - (c) contribution.
 - (d) indemnity.
29. The agreed value of property insured on a valued basis is
- (a) an amount of insurance that corresponds to the appraisal value of the property.
 - (b) the actual cash value of the property.
 - (c) the actual cash value of the property plus appreciation.
 - (d) the value of the property agreed to after a loss.
30. Utmost good faith
- (a) can void an insurance policy.
 - (b) implies a high standard of honesty.
 - (c) is a mystical faith in the goodness of people.
 - (d) is a requirement of all legal contracts.
31. Written applications
- (a) are preferable to avoid misunderstanding.
 - (b) are required by statute in all classes of insurance.
 - (c) have no advantage over oral applications.
 - (d) must be signed by the applicant and sent to the insurer within 5 working days.

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32. A binder
- (a) is a memorandum of an agreement to insure.
 - (b) is an all-inclusive insurance package.
 - (c) cannot be terminated once it has been issued.
 - (d) must always be in writing.
33. A document issued as evidence of temporary insurance need NOT contain which of the following?
- (a) Amount of insurance bound
 - (b) Amount of premium
 - (c) Deductibles
 - (d) Time and date of coverage inception and expiry
34. The Statutory Conditions (Common Law) are
- (a) determined and designed by each individual insurer.
 - (b) required on all policies.
 - (c) required on policies covering certain classes of risk only.
 - (d) binding on the insurer but not on the insured.
35. Temporary insurance
- (a) may be terminated by a telephone call to the broker who issued it.
 - (b) must be terminated by registered letter when a policy is issued.
 - (c) must be terminated in the same way as a policy of similar type would be terminated.
 - (d) once issued, cannot be terminated. It remains in force until a policy replaces it.
36. First party losses apply to the
- (a) property of persons outside the policy under which they will be paid.
 - (b) property of the insured.
 - (c) property of the insurer.
 - (d) all of the above
37. The time after which a cause of action ceases is known as the
- (a) expiry period.
 - (b) inception date.
 - (c) prescription date.
 - (d) statute of limitations.

38. The proximate cause of a loss is the
- (a) cause that sets a remote cause into action.
 - (b) last cause in a chain of events that results in the loss.
 - (c) immediate and effective cause of the loss.
 - (d) suspected cause of the loss.
39. When an insurance company passes a part of its liability to a reinsurer, the amount reinsured is called
- (a) a retrocession.
 - (b) its retention.
 - (c) reinsurance.
 - (d) the cession.
40. Which of the following organizations is a joint venture between brokers and insurers to work toward better computer communications in order to avoid duplication of work?
- (a) Centre for Study of Insurance Operations
 - (b) Insurance Brokers Association of Canada
 - (c) Insurance Bureau of Canada
 - (d) Insurance Institute of Canada
- (2 marks each = 80 marks)

Question 2. Identify and discuss FIVE (5) ways in which insurance benefits society. In each case, indicate what would happen if insurance did not exist. (20 marks)

Question 3. Describe briefly how an insurer determines the rates to be charged for particular classes of insurance. (10 marks)

Question 4. Agents and brokers are often the physical link between the insurers and the consumers. Discuss fully the importance of the role of an intermediary and the responsibilities of agents and brokers to their clients. (10 marks)

Question 5. (a) Because of Canada's varied historical origins, two systems of laws operate side by side. Explain the origin of these TWO (2) legal systems and contrast the ways in which they operate and reach decisions. (14 marks)

(b) Using examples, describe TWO (2) purposes of Statute Law. (6 marks)

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- Question 6. (a) One the basic elements of a contract is agreement (offer and acceptance). Discuss each of the following related points:
- (i) Communication of an offer (4 marks)
 - (ii) Acceptance of an offer (4 marks)
 - (iii) Counter-offer (4 marks)
 - (iv) Lapsing or revocation of an offer (4 marks)
- (b) To what extent is consideration an important element of a contract? What would constitute consideration? When is consideration not essential? (4 marks)
- Question 7. (a) It is said that the doctrines of salvage, subrogation, and contribution reinforce the principle of indemnity. Explain each of these terms and, by the use of examples, demonstrate the truth of this statement. (15 marks)
- (b) Contrast a contract of indemnity with a contract of compensation. (5 marks)
- Question 8. Identify and explain FIVE (5) reasons why an insurance company may wish to reinsure some of its business. (20 marks)

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