

MID SEMESTER EXAMINATION (REGULAR) (CLOSED BOOK)

Note: Attempt all questions. Answer to the point. The question paper consists of Three PARTS - A, B and C. Closed Book examination.

PART -A: For the following multiple choice questions, choose the correct best answer and put a tick (✓) against that letter (A/B/C/D). Write the corresponding answer A/B/C/D in the space provided. Corrections/overwriting/illegible answers are strictly invalid and carries no weightage.

(20 x ½ = 10.0 Marks)

- 1) Uncertain events are broadly classified as
 - A. Predictable and Unpredictable
 - B. Possible and Impossible
 - C. Natural and Artificial
 - D. Rare and Continuous

- 2) Risk evaluation breaks down into two parts. They are:
 - A. Probability of loss occurring and its severity
 - B. Risk calculation and risk analysis
 - C. Loss calculation and avoidance
 - D. None of the above

- 3) Relative variation of actual loss from expected loss is called ____
 - A. Subjective risk
 - B. Objective risk
 - C. Actual loss
 - D. Expected loss

- 4) An insurance company estimates its objective risk for 10,000 exposures at 10 Per cent. Assuming the probability of loss remains the same, what would happen to the objective risk if the number of exposures were to increase to 1 million?
 - A. It would decrease to 1 percent
 - B. It would decrease to 5 percent
 - C. It would remain the same
 - D. It would increase to 20 percent

- 5) Diversification is one way in which insurance companies can protect themselves against
 - A. The law of large numbers
 - B. Random fluctuation
 - C. Positively correlated risks
 - D. Parameter change

- 6) An oil company, in order to protect itself from future price risk, enters into a future agreement with another party. It is a case of
 - A. Speculation
 - B. Price Protection
 - C. Hedging
 - D. Gambling

- 7) If somebody is setting fire to an insured godown stocked with inventory, with an intention to make undue profits, it is case of
- A. Morale Hazard
 - B. Evil Mind
 - C. Moral Hazard
 - D. Adverse selection
- 8) A's car is damaged in a collision with B's car, such collision is
- A. Hazard
 - B. Peril
 - C. Uncertainty
 - D. Risk
- 9) Risk is a phenomenon closely associated with uncertain events. To be insurable, a risk must be in the nature of a
- A. Pure risk.
 - B. Speculative risk
 - C. Neutral risk
 - D. Catastrophic risk
- 10) Which clause or concept in insurance law provides that when an insurer indemnifies the insured for loss, the insurer has the right to recovery from a negligent third party?
- A. Utmost good faith
 - B. Proof of loss
 - C. The unilateral adhesion clause
 - D. Subrogation
- 11) Insurance is the best risk management tool when the chance of loss is _____ and the loss severity is _____.
- A. high, low
 - B. low, high
 - C. high, high
 - D. low, low
- 12) Which of the following is a definition of insurance?
- A. A savings account designed to protect you in the event of a rainy day
 - B. A financial arrangement whereby an individual pays a small certain payment called the premium in order to be indemnified against large uncertain losses
 - C. A socialist plot to destroy the free enterprise system
 - D. A contractual agreement in which the insurer agrees to pay the insured only if the insured requests the money
- 13) Poor or faulty wiring that may lead to fire is an example of a:
- A. morale hazard
 - B. speculative risk
 - C. physical hazard
 - D. moral hazard
- 14) A pure risk is one where:
- A. The result can only be a loss or no loss
 - B. The result can be a gain or loss
 - C. The result can be only a gain or no gain
 - D. The result cannot be predicted

- 15) One example of the use of risk assumption in insurance is:
 - A. the use of subrogation
 - B. the use of a deductible by the insured
 - C. the use of actual cash value when settling a claim
 - D. the use of contingent claim analysis in determining the amount of coverage available for claim settlement.

- 16) ___ is the process of reducing frequency and severity of losses.
 - A. Loss prevention
 - B. Loss Control
 - C. Avoidance of risk
 - D. None of the above

- 17) Speculative risk is a situation in which ___ is possible
 - A. Loss
 - B. Profit
 - C. Either a profit or loss
 - D. None of the above

- 18) In the context of insurance, moral hazards arise from the
 - A. attitudes and behaviours of policyholders.
 - B. characteristics of the physical risk.
 - C. influence of external circumstances.
 - D. security measures used to protect property.

- 19) Following a risk evaluation exercise a manufacturing company decided to double the size of the deductible under its insurance policy. How is this best explained in terms of the company's risk position?
 - A. Risk retention has increased.
 - B. Risk retention has reduced.
 - C. The risk of an insured event occurring has increased.
 - D. The risk of an insured event occurring has reduced.

- 20) A large company addresses some of its risks by adopting a formal self-insurance approach. This is most likely to involve
 - A. establishing a captive arrangement.
 - B. establishing a hold harmless agreement.
 - C. purchasing a catastrophe bond.
 - D. reducing its policy deductibles.

Question	1	2	3	4	5	6	7	8	9	10
Answer										

Question	11	12	13	15	15	16	17	18	19	20
Answer										

- B1 (a) Write the ideal requirements of an insurable risk.
(b) Earthquake risk is difficult to insure privately because not all of the ideal requirements of an insurable risk are met. Which of the requirements mentioned by you for insurable risk are met? Which are not met? Why not?

- B2 Write one important reason why do we do not transfer all risks by using insurance.

B3 For the sentences, fill the blanks using the appropriate word given below and complete the sentence.

Words:

Negligence, hedging, Underwriting, Estoppel, Insured, Loss control, underwriter, Moral, Speculative risk, Tort, general average loss, Utmost good faith, Rate Making, Group Insurance, Proposer, Interest rate risk, Insured

Corrections/overwriting/illegible answers are strictly invalid.

- i. is a stipulation, which prevents the insurance company from enforcing or claiming a right due to its previous acts, which were in such a way as to forego any desire to preserve that right.

- ii. means those risks which involve a situation where there is a possibility of gain.

- iii. A is the person who sends the proposal form for taking an insurance policy

- iv. is the heart of insurance operations?

- v. _____ hazards refer to the defects that exist in a person's character that may increase the frequency or the severity of loss

- vi. is the process of reducing frequencies and severely of losses.

- vii. The burden of proof of loss within the scope of policy is upon the.....

- viii. A loss may be either a sacrifice or expenditure, extraordinary in nature, voluntarily and reasonably incurred at the time of general peril for the common safety of the maritime adventure.

B4 What is the difference between insurance and reinsurance? Explain

B5 What are the important basic features of an insurance contract? List them.

- B6 (a) What are the steps in the risk management process?
- (b) For each of the following combinations of risk frequency and risk severity, list the appropriate risk management strategy:
- (i) low frequency, low severity
 - (ii) high frequency, low severity
 - (iii) low frequency, high severity
 - (iv) high frequency, high severity

PART –C:

For the following questions explain clearly the answer. Each question carries equal marks and No partial credit. Unnecessary explanation and not relevant answers will be penalised. Write to the point. Please write legibly. (8.0 Marks)

- C1 RAMKI Company insured its building for \$1,400,000 under a replacement cost policy that included an 80 percent coinsurance clause. The policy includes an earthquake endorsement with a 15 percent deductible. The building had a replacement cost of \$2 million when it sustained \$540,000 in damage from a windstorm.
- a) Assuming there is no deductible, how much will RAMKI Group recover from its insurance Group? Explain why.
 - b) Suppose that the damage was due to a sinkhole (earth movement) rather than wind. How much will RAMKI Group recover from its insurance Group? Explain why.

C2 RP CABLE Manufacturing (RPCM) owns a high-rise office building with glass cladding (a protective covering) and adjacent factory premises, and it operates from these factory premises. RPCM refurbishes and sells electric motors. Its processes include stripping down old motors, sandblasting motor casings, armature winding, varnishing, spray-painting and assembly. In order to write a risk management statement, the risk manager will carry out a physical inspection to familiarise himself or herself with the factory layout and processes. The risk management process of identification will consist of listing all manufacturing processes using a checklist to ensure that he or she asks all the relevant questions. The checklist will also include questions such as what flammable liquids are used, in what quantities, and where are they stored?

During the identification step of the risk management process for RPCM, the risk manager identifies the following insurable risks:

Risk	Office building	Factory premises
Fire	Low probability	High probability
Explosions	Low probability	High probability
Storm	High probability of hail damage to glass cladding	Medium probability
Riot and strike	Low to medium probability related to possible labour disputes	Low to medium probability related to possible labour disputes
Theft	Medium probability	Low probability
Personal liability	Low probability	High probability

The next step in the risk management process is to measure the potential risks, or place a value on the impact of the risk.

The measurement process for RPCM reveals the following information:

- **Fire damage to the office building:** The low potential for fire in the office building is further improved by the construction specification that includes fire resistant doors on stairways and the installation of a sprinkler system. In the event of fire, estimates suggest that the damage would be limited to 60% of the building. However, this exercise identified the possibility of damage through accidental activation of the sprinkler system. This risk must be added to the list.
- **Sprinkler leakage:** In the case of leakage, estimates suggest that the damage would be 15% of the insured contents value of the office building.
- **Fire damage to factory premises:** The factory premises contain potential sources of ignition and inflammable material that could feed a fire. Open flames are used to strip old motors. Therefore, the potential for fire damage is high and likely to be 80% of the total value of the contents and building. Fire would also damage the combustible components of the stock of refurbished and new motors.
- **Storm damage:** The potential loss from storm damage is estimated at 25% of the value of the factory premises, and 20% of the value of the office building. The potential damage to the glass cladding must be separately evaluated. The impact of hail damage could be 25% of the total cost of glass replacement, representing one total side of the building. Statistics also show that, on average, five panes of glass break accidentally every year. This equates to R4 000 in total, at a cost of R800 per pane.
- **Riot and strike damage:** The potential loss from riot and strike damage is estimated at 10% of the total value of the factory premises.
- **Theft:** In the case of theft the estimate loss, per event, is R50 000 for the factory and R10 000 for the office.
- **Product liability:** The refurbished products could attract product liability claims against RPCM if RPCM's negligence caused damage to property where the motors are installed. The estimated loss is R2 million, inclusive of legal fees.

- Business interruption: A fire could seriously impact on the ability of the business to continue. In this event, competitors would move into RPCM's market if the company could not provide its services for an extended period. It is estimated that DMG could be affected for at least six months after a serious fire.

As an expert you are hired to make a draft of risk management plan to deal with the following risk that have been identified:

- fire and explosion;
- business interruption; and
- product liability.

