Becoming a Leader in Risk Management and Insurance

The Institutes CPCU-500

Version Demo

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QUESTION NO: 1

Improving assessment and underwriting for concentrations of risk, recalibrating predictive models to add more weight to recent events, and advocating for building code updates to enhance property resiliency are some of the insurance industry's responses to which one of the following major challenges?

A. Climate change

B. Coronavirus pandemic

C. Litigation-driven cost inflation

D. Threat of terrorism

ANSWER: A

Explanation:

Climate change is the major challenge addressed by these insurance-industry actions. Changing climate conditions can alter the frequency, severity, geographic distribution, and correlation of weather-related losses. This creates particular difficulty for insurers because catastrophe models and underwriting decisions have traditionally depended substantially on historical experience. Giving more weight to recent events helps insurers update assumptions when loss patterns from hurricanes, wildfires, flooding, severe convective storms, or other natural hazards appear to be changing. Improved assessment of concentrations of risk is also essential because a single catastrophe can affect many insured properties in the same area at the same time, creating substantial accumulation losses for an insurer or reinsurer.

Advocacy for stronger building codes is a complementary resilience and loss-control response. More resilient construction can reduce physical damage and improve a community's ability to recover after a catastrophe, supporting long-term availability and affordability of insurance. The Insurance Information Institute discusses how climate-related weather risks affect insurance and the importance of mitigation and resilience at https://www.iii.org/article/background-on-climate-change-and-insurance-issues. The Federal Emergency Management Agency also describes the loss-reduction value of building codes and mitigation at https://www.fema.gov/emergency-managers/risk-management/building-science/building-codes.

QUESTION NO: 2

Blithe Insurance is a large commercial lines insurer that has been in business for over thirty years. Blithe's corporate goals are simply stated and have remained fairly constant over the years:

Maintain a superior financial rating

Respond to customer needs

Operate with a high degree of integrity

Blithe's senior management team develops business strategies on an annual basis to direct the organization toward meeting these goals. Which one of the following strategies would help the organization accomplish its goal of maintaining a superior financial rating?

A. Acknowledge every claim within twenty-four hours of receiving notification

B. Achieve an all lines combined ratio of 95% or less

C. Achieve an "exceeded expectations" rating on at least 90% of customer service surveys

D. Conduct internal market audits twice a year

ANSWER: B

Explanation:

Achieve an all lines combined ratio of 95% or less is the strategy most directly connected to maintaining a superior financial rating. The combined ratio measures underwriting performance by comparing incurred losses and loss-adjustment expenses, plus underwriting expenses, with earned premium. A ratio below 100% indicates that the insurer is earning an underwriting profit before investment income. Establishing a 95% or lower target therefore promotes a meaningful underwriting margin and provides a cushion against adverse loss development, catastrophe activity, or shifts in investment returns.

Consistently favorable underwriting results help preserve and grow policyholder surplus, support liquidity, and demonstrate disciplined pricing, risk selection, claims management, and expense control. Those characteristics are central to an insurer's financial strength. Financial-strength rating organizations assess an insurer's balance-sheet strength, operating performance, business profile, and enterprise risk management when evaluating its ability to meet policyholder obligations. A sustained all-lines combined ratio at this level is a concrete, measurable operating objective that supports those assessments and the company's long-term capacity to pay claims.

The National Association of Insurance Commissioners provides financial-analysis resources at https://content.naic.org/industry/financial-analysis. AM Best describes the financial-strength rating process and its evaluation criteria at https://www.ambest.com/ratings-services/rating-methodology.

QUESTION NO: 3

A new vice president receives a report showing that one branch has substantially lower claim severity than comparable branches. Before adopting the branch's practices throughout the organization, the vice president learns that the branch handles a much higher proportion of low-limit claims and closes a greater percentage of files without payment. Which one of the following conclusions is most appropriate?

A. The branch's lower severity proves that its claims practices should be adopted immediately

B. The report should be disregarded because claim severity always varies among branches

C. The severity comparison should be adjusted for relevant differences in claim mix before the branch's practices are treated as superior

D. The branch should be evaluated only on the number of files it closes each month

ANSWER: C

Explanation:

The severity comparison should be adjusted for relevant differences in claim mix before the branch's practices are treated as superior is correct. Raw severity results can be misleading when branches handle materially different types of claims, limits, or exposures. The vice president should determine whether the apparent performance difference remains after considering comparable claim characteristics and claim outcomes.

Lower reported severity alone does not prove better claim management. Copying the branch's practices immediately could spread an ineffective process, while disregarding the report entirely would ignore a potentially useful indication that warrants further analysis.

QUESTION NO: 4

A law firm has operated out of an old farmhouse for many years. The building and business personal property are insured under a Building and Personal Property Coverage Form with replacement cost coverage. A lightning strike damaged part of the building. Because of the age of the building, ordinances required that several of the damaged windows be replaced with larger more expensive windows as a means of egress. Which one of the following Building and Personal Property Coverage Form additional coverages would provide coverage in addition to the policy limit to help pay for this added expense?

A. Improvements and Betterments

B. Debris Removal

C. Increased Cost of Construction

D. Preservation of Property

ANSWER: C

Explanation:

Increased Cost of Construction is the applicable additional coverage because the lightning strike caused direct physical damage to an insured building, and the repair of that covered damage triggered a building-code requirement. The larger windows are required to meet current egress standards, creating a cost above the amount needed simply to replace the damaged windows with equivalent windows. This is precisely the ordinance-or-law gap addressed by increased-cost-of-construction coverage.

Under the Building and Personal Property Coverage Form, this coverage helps pay the increased cost necessary to repair or replace damaged portions of a building in compliance with an ordinance or law. It applies as an additional amount of insurance, rather than reducing the Building limit, subject to the form's stated sublimit and conditions. The coverage is therefore responsive when a covered loss necessitates code-required construction changes, such as enlarging windows for compliant means of egress. Replacement cost coverage establishes the basis for replacing covered property without depreciation, while Increased Cost of Construction specifically addresses the extra expense caused by the legal requirement to upgrade the repair. For background on this coverage concept, see IRMI's Increased Cost of Construction Coverage definition and the Insurance Information Institute's ordinance-or-law coverage overview.

QUESTION NO: 5

Which one of the following statements is correct about the enterprise-wide risk management process?

A. The risk management process is typically established by the organization's senior management.

B. The primary focus of the risk management framework is to reduce negative risk.

C. The risk management process occurs within and is supported by the risk management framework.

D. The first step of the risk management process is to identify risk owners and their roles in the organization.

ANSWER: C

Explanation:

The risk management process occurs within and is supported by the risk management framework. In enterprise-wide risk management, the framework is the organizational foundation that enables risk management to be applied consistently and integrated into decision making. It establishes such elements as leadership commitment, governance, assigned responsibilities, communication, reporting, resource allocation, and integration with organizational objectives. The process is the repeatable operational method used within that foundation to identify, analyze, evaluate, treat, monitor, and communicate risks. Thus, the process supplies the practical activities for managing uncertainty, while the framework supplies the authority, structure, accountability, and support that allow those activities to work throughout the enterprise. This relationship is important because risk management is not a stand-alone departmental exercise; it must be embedded in governance and management practices so risk information can inform strategic and operational choices. ISO 31000 describes the framework as helping organizations integrate risk management into significant activities and functions, and its principles and guidance distinguish the framework from the risk management process. See the ISO 31000 risk-management overview and COSO's Enterprise Risk Management guidance.

QUESTION NO: 6

Paradox Contractors has been invited to bid on a major bridge project in Maryland. Senior management believes that the successful completion of this project could place the organization in the position to meet its strategic goal of being a premier bridge contractor in the Mid-Atlantic region. They also know that there will be a lot of competition for the project, and their bid will have to be aggressive. Before bidding on the project, senior management met with project managers and suppliers to understand their perspectives on the most pressing risks. Paradox Contractors is completing which one of the following essential activities of the risk management process?

A. Analyze risks

B. Identify risks

C. Treat risks

D. Monitor risks

ANSWER: B

Explanation:

Identify risks is correct because Paradox Contractors is gathering information from people with direct knowledge of the proposed work to surface the uncertainties that could affect its objectives. Before committing to an aggressive bid, management needs to recognize and describe exposures associated with the bridge project, including construction conditions, scheduling, material availability, subcontractor performance, contractual requirements, safety, and potential cost escalation. Project managers and suppliers are especially valuable sources because they can identify practical, project-specific concerns that senior management might otherwise overlook.

Risk identification establishes the foundation for sound bid and project decisions. Its purpose is to develop an informed view of events, circumstances, or conditions that could help or hinder the organization's strategic objective of successfully completing the project and strengthening its market position. Stakeholder interviews and consultations are well-established identification techniques because they draw on diverse operational expertise. Once the relevant risks have been identified, Paradox can evaluate their likelihood and potential consequences and then select appropriate responses. This sequence is consistent with the risk-management principles and process described in ISO 31000:2018 Risk Management and the overview provided by IRMI's risk management guidance.

QUESTION NO: 7

Omicron Technologies Inc. designs robotic assembly systems for use in manufacturing operations. It decides to acquire a controlling interest in two other local companies. One of the companies is a toy manufacturer, and the other is a small chain of hardware stores. Which one of the following corporate strategies is Omicron pursuing?

A. Unrelated diversification

B. Related diversification

C. Turnaround strategy

D. Vertical integration

ANSWER: A

Explanation:

Unrelated diversification is the correct corporate strategy because Omicron is acquiring controlling interests in businesses outside its established robotic assembly-system operations. Its current business involves designing industrial technology used by manufacturers, whereas a toy manufacturer and a retail hardware-store chain operate in distinctly different industries, serve different markets, and use substantially different capabilities and operating models. There is no stated link through a common supply chain, distribution channel, customer group, or production technology. This is the defining feature of unrelated diversification: expansion into lines of business that lack a meaningful strategic relationship to the organization's existing core business.

At the corporate-strategy level, unrelated diversification can allow an organization to place capital in different markets and potentially diversify sources of revenue and earnings. The acquired entities remain separate businesses under common ownership rather than being natural extensions of the acquiring company's existing value chain. A controlling interest is also consistent with this approach because it gives Omicron the ability to direct the acquired companies' strategic and financial decisions while retaining them as distinct business operations. The general strategic-management concept of diversification and corporate scope is discussed in OpenStax's corporate-level strategy overview and the Encyclopaedia Britannica discussion of corporate diversification.