CHAPTER 2:
INSURANCE BASICS GUIDE

OVERVIEW — this chapter explains insurance basics and principles that are common to all property lines of insurance. To properly understand insurance basics, the following information must be understood and properly applied.

COMMON CONTRACT ELEMENTS

A contract is a legally enforceable agreement that is entered into by two parties (insured and insurer). The contract transfers the risk flow the individual or business entity (the insured) to the insurer in consideration for the payment of a premium and the insured's promise to comply with all policy's provisions. The insurer must agree to pay claims by indemnifying the insured in the event of a covered loss. For the contract to be enforceable, it must include the following contractual elements. If any of these contractual elements are missing, it is void.

An **AGREEMENT** refers to the offer by one party and the acceptance by a second party. The offer and acceptance negotiation usually takes place between the insurance agent and the prospective insured. The acceptance takes place when the insurance agent places coverage into effect (binds coverage) or when the insurer issues the insurance policy. During negotiations, if the second party makes a counteroffer, the initial offer is voided. Both offer and acceptance must be communicated to each other and must not be under any undue influence, fraud or duress. There is no requirement that the agreement be in writing. For example, if an insurance agent binds coverage verbally, coverage applies even if a loss occurs before the policy is actually written and delivered to the insured.

CONSIDERATION refers to the bargaining elements of the agreement. In a contract of insurance, the insured's consideration is the representations made at application and the premium paid. The consideration the insurer gives is to promise to perform in accordance with provisions of the policy.

COMPETENT PARTIES refers to legal capacity. That is, neither party is restricted by under age, insanity, or under the influence.

LEGAL PURPOSE refers to the lawful purpose of the contract. This means the contract is consistent with public policy.

DISTINCT CHARACTERISTICS OF AN INSURANCE CONTRACT

The following features are included within insurance contracts:

CONTRACTS OF ADHESION are insurance contracts which are drawn up by the insurance company and presented to the insured to be either adhered to or rejected by.

CONDITIONAL CONTRACTS are contracts that are contingent upon certain acts performed by the claimant or insured (ex. Payment of a premium is a condition precedent to coverage).

ALEATORY CONTRACTS- contracts stating that the insured may collect a larger amount than the premium payments (ex. Insurance contract).

UNILATERAL CONTRACTS- these are contracts in which a payment is exchanged for a promise of payment in the event of a loss.

PERSONAL CONTRACTS- Personal nature between parties requiring a high degree of good faith.

WHAT ARE LEGAL INTERPRETATIONS WHICH AFFECT AN INSURANCE CONTRACT?

AMBIGUITIES- found in contracts of adhesion. These are interpreted against the party who wrote the contract. Any unclear language of the contract is interpreted against the insurance company and favors the insured.

- REASONABLE EXPECTATIONS- doctrine that states that the insured is entitled to the coverage under a policy that he or she is expected to provide, especially in the case of a mass-marketed contract

- UTMOST GOOD FAITH- dealing in accordance with the utmost honesty and sincerity
- INDEMNITY- restoring one to the extent of their loss. This is used in the property and casualty fields
- REPRESENTATIONS- written or oral statements made by the applicant whose intent is to secure insurance coverage
- MISREPRESENTATIONS- false statements that insurer relied on in issuing coverage. These will not generally affect the policy, unless the misrepresentation is material. This is a misrepresentation that would cause that insurer to reject coverage based on the fact of misrepresentation
- WARRANTY- promises contained in an insurance contract that voids the policy if untrue. 3 types of warranties include:
    1. Implied Warranty- the product is legal, merchantable and fit for public use.
    2. Promissory or Continuing Warranty- requires certain facts to be promised and continued during the policy term.
    3. Affirmative Warranty- requires certain facts to be affirmed
- BREACH OF WARRANTY- A warranty is a policy condition, based either on information given by the insured in an application or inserted by the insurer in the policy.

  Example: in an ocean marine policy a clause warrants that the ship is in good condition. An incorrect statement by the insured (a breach of warranty) may void coverage.
- CONCEALMENT- The failure of the insured to reveal relevant facts known to the insured when applying for insurance.
- FRAUD- An intentional act designed to deceive and induce another party to part with something of value.

WHAT IS INSURABLE INTEREST?

This is a type of interest an individual has in property or life that may cause the possibility of financial loss. It is the basic term in an insurance policy. The main reason for this term is to avoid the possibility of speculative wagering on another's property in which the individual has no interest.

Example- An individual may not be able to collect insurance proceeds on a property unless he or she owned the property or had an insurable interest in that property. Insurable interest, in property or casualty insurance, must exist at the time of loss for coverage to be afforded.

WHAT IS A HAZARD?

This term refers to any exposure or condition that increases the possibility of loss. Hazards can be classified as:

- Physical- these are physical in nature and include such conditions as storing of explosive materials within a building, or defective stairs a person could slip and fall on
- Moral- Conditions that increase the likelihood of loss such as an applicant with poor financial history or a person with an extensive police record
- Morale- "I don't care" attitude reflected since the insured is covered

PROPERTY INSURANCE vs. LIABILITY INSURANCE: CLASSIFICATIONS

These are the two broad categories of insurance coverages.

Property Insurance- covers personal and building property.

Liability Insurance- is referred to as "third party" coverages since it protects the insured from claims brought on by third party claimants.

Examples:

- Property policy will cover a house and contents if damaged by a fire.
- A liability policy covers the homeowner if a guest slips or falls on the premises.

WHAT ARE CAUSES OF LOSS?

Below are the perils insured against in the three most commonly sold homeowners policies. Property insurance policies are written on Basic Form, Broad Form, or Special Form. The Basic Form is the most limited, while the Special Form is the most comprehensive.

Name of Perils	Basic (HO-1/HO-8)	Broad (HO-2)	Special (HO-3)
Volcanic Action	x	x	X
Sinkhole Collapse	x	x	X
Sprinkler Leakage	x	x	X
Vandalism	x	x	X
Riot	x	x	X
Aircraft or Vehicles	x	x	X
Smoke	x	x	X
Windstorm or Hail	x	x	X
Explosion	x	x	X
Lightning	x	x	X
Fire	x	x	X
Falling Objects		x	X
Weight of ice or snow		x	X
Water Damage		x	X
Special Open Peril Coverage			X*

*Special Form policies provide risk of direct physical loss coverage unless the loss is specifically excluded.

Basic causes of loss forms offer the fewest covered perils and also charge the lowest premium. The special causes of loss forms offer the most perils and charges the highest premium

SPECIFIED vs. SPECIAL FORM

Specified, or Named Perils, are policies that list the perils insured against in the policy. Coverage applies if the cause of loss is listed in the policy. Special Form, or Open Peril policies list the exclusion from coverage. If the cause of loss is excluded, coverages do not apply.

Named Peril Examples: lighting, explosion, fire, smoke, vehicles, aircraft, riot, vandalism, sinkhole collapse, etc.

Special Form Exclusion Examples: Deterioration, wear & tear, latent defect, rust, smog, corrosion, pollutants, bulging, cracking of pavements, foundations, walls or floors, etc.

SPECIFIC vs. BLANKET vs. SCHEDULED INSURANCE

- Specific Insurance- provides a single amount for a specific location
- Blanket Insurance- a single amount of insurance that is provided to all locations
- Scheduled Insurance- a variation of specific and blanket insurance. Scheduled properties have specific amounts provided for each location or item

DIRECT vs. INDIRECT LOSS

- Direct Loss- losses that are the direct physical result of an insured peril including fire, vandalism, etc.
- Indirect Loss- losses that are the result of a direct loss, including damage to an individual's home or business that owner would incur the consequential loss of renting another place to reside or conduct business.

WHAT ARE REPORTING FORMS?

These are forms that are used to vary the amount of coverage in force to reflect certain fluctuations in the property. Through the use of reporting forms, coverages can mirror the exposure and avoid overinsurance or underinsurance problems.

Example- A seasonal business may have variances in his or her inventory during different times of years. Similar to the seasonal business, a building going through construction may have variations from beginning of construction to completion. These exposures would be accounted for through Reporting Forms. Features include:

- Timely Reporting- Requires timely reporting. If a reporting form is filed late, or not at all, the previous reporting form will be considered still in effect. Reporting forms require very close monitoring
- Full Reporting- penalizes the insured if their values are underreported in the form. In the case of underreporting, the company will pay the pro-rated portion of values to actual values

WHAT ARE THE TYPES OF CONSTRUCTION?

Determining the type of construction is an important element in the underwriting and rating of property insurance. Here are two important reasons:

1. Allows the underwriter to assign a rating factor used in calculating the policy premium
2. Type of construction may be a factor in the decision to accept the risk

Here are some of the basic construction types encountered in the risk selection process:

- Masonry- buildings where the exterior walls are of masonry materials like brick, concrete and stone. Premiums are lower for masonry construction
- Frame- buildings where the exterior walls are wood or a similar construction material including aluminum, stucco, and brick veneer. Premiums for frame construction are higher

Other construction categories include Joisted Masonry, Noncombustible Masonry, and Fire Resistive Masonry.

WHAT IS A LOSS VALUATION?

Insureds have the right to choose a policy with one of several loss valuation provisions at the time of application. These provisions address how the insured property is valued at the time of loss. Here are the primary ways a property can be valued for insurance purposes:

- Replacement Cost Value- Provides the insured with a loss settlement or betterment in the excess of the property's actual cash value. This cost type is defined as the cost to replace with like, kind and quality at today's replacement cost
- Actual Cash Value- This is defined as replacement cost less depreciation
- Stated Amount- this establishes coverage amounts on the property at inception of policy Stated amount pays the insured the least of:
    1. The stated amount
    2. The actual cash value or its replacement cost value
    3. The cost of repair
- Agreed Value- an alternate method of writing property coverage. With an agreed value, the coinsurance clause is suspended as the insured and insurer agree to the amount of coverage to be written for the policy term. Coverage is provided up to the agreed amount
- Market Value- The price an individual would pay for the property based on free market conditions

WHAT IS THE STRUCTURE OF A PROPERTY CASUALTY POLICY?

- Definitions- these are specific terms used in the policy. These are used to clearly set forth the meanings of terms as used throughout the entire policy
- Insuring Agreement- this is the contractual clause of the policy that sets forth the agreement between the insurance company and the insured. The agreement provides coverage for the insured in return for payment of premium and compliance with all policy provisions that apply
- Declarations Page- This page indicates the named insured and address, amount of insurance, policy terms, policy forms, deductible, premium, and related information. This page customizes the policy to the insured
- Additional Coverage and Supplemental Extensions- provides coverage beyond principle coverages of insurance policy. Ex. Additional coverages in a Homeowners Policy includes property coverage in the case of debris removal, reasonable repairs, damage caused by trees, or other plants, charges stemming from fire department charges, etc
- Endorsements- these are used to change a policy's original conditions, terms or coverages. Endorsements may be included in the policy or added on later. They typically add or delete coverage or are used to change names and addresses
- Exclusions- These eliminate coverage for specific occurrences which may have been deemed uninsurable or not calculated in the policy premium. Ex. International acts, war, floods, smog, nuclear hazards, rust and corrosion. Also excluded are the activities or conditions which are in control of the insured. Ex. Wear and tear, deterioration, and marring

- Conditions- These set forth the duties, rules, obligations and provisions on the insurance company and the insured. Ex. Duty of the insured to pay the premium and to report the losses promptly and cooperate fully in the adjustment process. The insurer is required to adjust all losses according to the policy conditions. Other conditions are used to address possible problem areas such as a policy provision which addresses how claims will be settled if multiple policies are in effect at the time of loss. The policy conditions attempt to eliminate these problem areas

THE DEFINITION OF AN INSURED

- Insured- anyone who is covered by the policy including those who are not named in the policy such as minor children, relatives, residents, or nonrelated individuals who are carrying out a task at the location of the insured
- Named Insured- the individual or business named in the policy declaration page
- Additional Insureds- individuals or businesses who are not named as an insured in the policy declaration page
- First Named Insured- the individual, partnership or joint venture to whom the insurance policies are issued. The first person named insured holds the responsibility for maintaining the insurance policy including paying premiums, cancelling the policy or reporting losses

DEDUCTIBLES

Deductibles are defined as the initial amount, or the first dollar cost paid or absorbed, by the insured in the event of a loss. 3 deductible types include:

- Time- expressed in a number of hours or days that must elapse prior to the beginning of payment period. Ex. Business income coverage is subject to a 72-hour time deductible
- Percentage- expressed as the percentage amount of the loss. These may apply to property perils like windstorm or earthquake
- Dollar- expressed in a dollar amount. This is the most common type of deductible

POLICY TERRITORY

The location where coverage will be provided. Ex. The Homeowners Policy and Dwelling Policy cover property losses on a global basis. On the other hand, the Commercial Property Policy and the Business owners Policy limit the coverage territory to Puerto Rico and Canada, along with the United States.

POLICY PERIOD

This is the time period indicated in the Declarations Page, This period represents the duration of time coverage will be provided. A policy typically begins and ends at 12:01 AM Standard Time on the date and location indicated in the declaration page. A policy period typically last one year.

MORE INSURANCE PROVISIONS

Policies often include other insurance provisions that are used to address the apportionment of coverages in the event that more than one policy is written on the same risk at the time of loss, whether it occurs by design or by oversight. Nonconcurrent coverage is coverage that is written to cover the property and is not the same coverage basis. Concurrent coverage is coverage that is written to cover the property and same coverage basis. When concurrent coverage applies, a loss will be prorated. When nonconcurrent coverage applies, coverage is excess. 3 specific types of other insurance provisions include:

- Primary- pays first. Ex. If a person has an auto policy, homeowners policy and personal umbrella policy, either the homeowners policy or auto policy pays first and the umbrella policy pays second as excess coverage
- Excess- A policy covering the insured against certain hazards and applying only to loss or damage in excess of a stated amount
- Pro Rata (Proration Coverage)- prorates loss payments among concurrent policies. Pro Rata may be by face amounts or amounts payable depending upon the language of the policy. The formula used to determine proration by face amount is: A's policy limit/A's policy limit + B's policy limit x loss = A's obligation

POLICY LIMITS

Refers to the maximum amount of money that the insured can recover after a loss. They include specific limits, changing limits, blanket limits, sub limits and no dollar limits in some instances. Ex. A Homeowners Policy may cover a building with a limit of $100,000 for fire, but may provide a sublimit on jewelry and money.

RESTORATION OF LIMITS

Limits of property policies are automatically restored after a loss. If a home is completely destroyed by a fire, the insured's Homeowners Policy is restored and available to pay subsequent losses.

COINSURANCE

This is a common commercial property provisions that requires the insured party to carry insurance coverage that is equal to a specific percentage of a property's actual cash value, in return for a reduced rate. If a building had an Actual Cash Value of $200,000, the insured would be required to carry a minimum of $160,000. If the insured carries less than that amount, a reduced settlement, based upon the percentage underinsured, would be paid. Coinsurance is used to promote insurance to value.

The following procedure assists in determining the applicable payment amount in loss situations:

1. Multiply by building value by 80%
2. Inset this amount as the amount required
3. Insert the amount carried by the insured
4. Apply this fraction, or convert to a percentage, and multiply by the loss amount
5. Subtract the deductible from the final coinsurance settlement amount

Amount Carried/Amount Required x Loss = Settlement

Before a property is insured, the property's value is determined. This requires an appraisal of the building's replacement cost and actual cash value to determine the amount of coverage to which coinsurance is applied. To determine a replacement cost, a dollar amount is applied to the building's square footage to project the building's replacement cost. The dollar amount will vary depending on construction type and location.

Example: A building that is constructed of stone with plaster walls, slate roof, unique wood finishings and plaster walls, would cost more to replace that a frame building with carpeted floor, asphalt shingle roof, standard wood finishing's and drywall walls.

WHAT DOES UNOCCUPIED AND VACANT MEAN?

Un-occupancy and vacancy have different meanings, however, are important upon the settlement.

- Unoccupied means the absence of people from the insured home or building. Unoccupied does not affect the coverage under most policies.

- Vacant means the absence of both people and furniture. Vacant provides a greater exposure to loss, which is why coverage is excluded outright for certain perils.

POLICY NAME	UNOCCUPIED	VACANT
Businessowners	No effect	If vacant more than 60 consecutive days, no coverage applies to loss caused by malicious mischief and vandalism, water damage, building glass breakage, theft/attempted theft. All other covered losses reduced by 15%
Commercial Property	No effect	If vacant more than 60 consecutive days, no coverage applies to loss caused by malicious mischief and vandalism, water damage, building glass breakage, theft/attempted theft. All other covered losses reduced by 15%
Homeowner	No effect	If vacant more than 60 consecutive days, no coverage applies to loss caused by malicious mischief and vandalism, water damage, building glass breakage, theft/attempted theft. All other covered losses reduced by 15%
Dwelling	No effect	If vacant more than 60 consecutive days, no coverage applies to loss caused by malicious mischief and vandalism, water damage, building glass breakage, theft/attempted theft. All other covered losses reduced by 15%

Failure to maintain heat will eliminate coverage due to subsequent water damage. Buildings going through the construction process are not considered vacant.

Special Note: Un-occupancy requires a residential home to contain enough basic content to support its intended use. Likewise, a commercial property must have enough business personal property to conduct customary operations. If the building is occupied, at least 31% of the total-square-footage of the building must be rented/occupied for customary operations. If it is not, it will be considered vacant.

THIRD PARTY PROVISIONS

These address the rights of third parties in the insurance contract, including mortgage companies that may have a secured interest in real property, or a Bailee who may seek coverage under a policy.

LIBERALIZATION CLAUSE

This clause is used if the insurance company makes changes which adds coverage to an edition of the policy, and no additional premium will be charged. These charges will automatically apply to the insurance policy as of the date the insurance company implements them in the state, depending on the policy.

STANDARD MORTGAGE CLAUSE

This is a basic provision of all property policies covering real property. A standard mortgage clause reflects the legitimate interest that mortgage holders have in real property they have a financial interest in. Mortgage holders are allowed to receive payments for losses and can act in the absence of the insured.

Example: If an insurer does not pay his or her homeowners insurance on time, the mortgage company can pay the premium or secure replacement coverage. If an insured fails to adhere to the loss conditions, the mortgage company can act for the insured to protect its interest in the damaged property.

LOSS PAYMENT CLAUSE

This is a basic provision of all property policies covering personal property including leased equipment. This clause reflects the legitimate interest that the finance company has in personal property which it has a financial interest in.

NO BENEFIT to BAILEE PROVISION

This is a basic condition found in all property policies. The purpose of this provision is to exclude any assignment or granting of any policy provision to any person or organization holding, storing or moving property for a fee.

Example: If an insured has clothes taken to the cleaners, no coverage will be assigned under the insured's homeowners policy to benefit that cleaner because it is not in their possession.

PENNSYLVANIA REGULATUIONS, LAWS AND OTHER PROVISIONS TO CONSIDER

BINDERS

- Temporary insurance contracts that are made orally or in writing for a period not exceeding 30 days

BASIC PROPERTY INSURANCE – DEATH OF THE NAMED INSURED

- This provision limits the insurer's ability to cancel a risk due to the death of the insured occupant. It requires basic property insurance to remain in effect for 180 days after the death of the insured, or until the end of the policy period (whichever event happens later)

PENNSYLVANIA INSURANCE GUARANTY ASSOCIATION ACT

- Created as a means of covering claims for certain property and casualty insurance policies. Insureds, who are covered by admitted/authorized carriers, are provided protection. Coverage is provided up to $300,000 per covered claim and $10,000 per policy for a covered claim for the return on unearned premium. This act does not cover annuities, life insurance, accident insurance, health insurance, title insurance, credit insurance, workers compensation insurance and ocean marine insurance.

INSURANCE CONSULTATION SERVICES EXEMPTION ACT

- The insurer, insurance agents, employees or service contractors are not liable for damages resulting in injury, loss, or death occurring as the result of any act relating to surveys, consultations or inspections. The act does not apply if the injury, loss, or death happened during the actual performance of the service.

TERRORISM RISK INSURANCE ACT of 2002

This federal program provides a maximum of $100 billion in the event of a terrorist attack. The government will pay 90% of the insured losses in excess of the insurer's deductible. The Secretary of State, Secretary of the Treasure, or Attorney General must trigger Federal participation. To qualify, the certified act must be a violent act, result in damage in the United States or US carrier or ship, must be committed by someone acting on behalf of foreign interest and results in the excess of $5 million worth of losses.

TERRORISM RISK INSURANCE EXTENSION ACT of 2005

An extension of the federal program.

NON-RENEWAL AND CANCELLATION REGULATIONS

Insurance policies allow non-renewal and cancellation by an advanced written notice, which can be mailed or delivered in person to the insured. Policies can be cancelled by the insurer or insured. In the event of cancellation, policies are cancelled as either:

- Pro Rate- this means the insurer requested the cancellation. The actual proportion of the unearned premium will be returned to the insured.
- Short Rate- the insured requested the cancellation. A penalty will be charged against the return premium.

Policies, issued by the company that are not taken and returned are cancelled flat rate. This means that no premium is exchanged and no coverage is provided.

CANCELLATION AND RENEWAL REQUIREMENTS

	15 Days	30 Days	60 Days
Homeowners Policy (1) Dwelling Policy (owner occupied) (1)			
Nonpayment of Premium		•	
Material misrepresentation increase in hazards		•	
Commercial Policies Dwelling Policies (nonowner occupied)			
In effect for less than 60 days		•	
In effect for more than 60 days			
Nonpayment of premiums	•		
Material misrepresentation	•		
Underwriting reasons (2)			•

After the policy is in effect for 60 days, cancellation/nonrenewal is permitted due to increase in hazard.

-Increase in risk factor, failure to comply with policy conditions and loss of reinsurance

-See specific policy chapters for respective detailed cancellation/nonrenewal provisions

WHAT IS THE STANDARD FIRE POLICY?

This policy and its predecessor policies were developed by the fire insurance industry to provide uniform fire coverages. They were standardized into the 1943 New York Standard Fire Policy and has since been replaced with the Homeowners Policy, Dwelling Policy, Business Owners Policy and Commercial Property Policy. The conditions of the original Standard Fire Policy have become the basis of most property policies.

Courts define the peril of fire as “oxidation sufficiently rapid to cause a flame or glow.” The definition excludes charring, scorching and related occurrences.

CHAPTER 2

PRACTICE EXAM #2

1. Under the Pennsylvania Insurance Guaranty Associations Act, certain property policies are covered up to:
   A. Policy's limits
   B. $500,000
   C. $300,000
   D. $100,000
2. Which of the following losses would NOT be covered if a property is vacant beyond 60 days?
   A. Damage caused by aircraft
   B. Wind Damage
   C. Lightning Damage
   D. Damage cause by Burglary
3. What policy provision provides that in the event the insurer broadens coverage without an additional premium charge, the broadened coverage will apply to all insureds immediately?
   A. Liberalization Clause
   B. Subrogation Clause
   C. Loss Payable Clause
   D. No Benefit to Bailee Clause
4. The Pro-Rata Clause Provides:
   A. Contribution by equal shares when two or more policies apply
   B. Primary coverage to losses when two or more policies apply
   C. Excess coverage to losses when two or more policies apply
   D. Proportional coverage to losses when two or more policies apply
5. The insured under a contract of insurance includes:
   A. Anyone who advises the insurer in writing
   B. Only the owners of the property insured
   C. Anyone who may be covered by the insurance
   D. Only the named insured as listed in the declarations
6. All of the following are true concerning first named insureds EXCEPT:
   A. They are responsible for cancelling the policy
   B. They are responsible for pursuing subrogation
   C. They are responsible for paying insurance premiums
   D. They are the primary person responsible for contractual duties
7. Which of the following losses would be covered if a property is vacant beyond 60 days?
   A. Water damage from a pipe when no heat was maintained.
   B. Glass breakage by a rock thrown through a window.
   C. Vandalism Damage
   D. Auto hitting a building.

8. Determine the payment of the following situation with an 80% coinsurance clause: Building value $100,000 – Coverage amount $90,000 – Loss Amount $90-000.
    A. 80,000
    B. 90,000
    C. 100,000
    D. 5,000
9. Which of the following describes the Agreed Value method of insuring property?
    A. Insurance required when you purchase broad form coverage.
    B. Provides special "all risk" type coverage regardless of coinsurance clause
    C. A type of insurance that waives the coinsurance clause
    D. A predetermined value is placed on the risk and the coinsurance clause is waived
10. Policies that cover the same property but on a different coverage basis is:
    A. Open Peril Coverage
    B. Non-concurrent Coverage
    C. Concurrent Coverage
    D. Similar Coverage
11. Excess coverage would apply to a loss after:
    A. Agreed Value Coverage
    B. Special Form Coverage
    C. Primary Coverage
    D. Named Peril Coverage
12. Determine the payment of the following situation with an 80% coinsurance clause: Building value $100,000 – Coverage amount $40,000 – Loss amount $10,000
    A. $80,000
    B. $10,000
    C. $5,000
    D. $7,500
13. Determine the payment of the following situation with an 80% coinsurance clause: Building value $100,000 – Coverage amount $40,000 – Loss amount $20,000
    A. $40,000
    B. $10,000
    C. $5,000
    D. $7,500
14. Which of the following describes the relationship to determine the loss settlement under a typical coinsurance clause?
    A. Replacement cost minus depreciation
    B. 80% of insurance amount times loss
    C. Insurance required over insurance carried times loss amount
    D. Insurance carried over insurance required times loss amount

15. A primary purpose of the coinsurance requirement is to:
    A. Help the insured pay less of a premium.
    B. Eliminate the necessity of determining the ACV
    C. Promote adequate amounts of insurance coverage
    D. Make the insured a co-insurer
16. All of the following are true of the coinsurance clause EXCEPT:
    A. Guarantees full payment regardless of coinsurance requirement
    B. Promotes insured to value.
    C. Usually requires insurance to 80% of the property's ACV
    D. Penalizes the insured for not satisfying the coinsurance requirement
17. What is a deductible?
    A. The amount absorbed by an insurer at time of loss
    B. The amount absorbed by the insured in the event of a covered loss
    C. The amount waived for compliance of the coinsurance provisions
    D. The amount paid if underinsured
18. Which of the following policy structure components provides coverages in addition to the covered perils of the policy?
    A. Proof of Loss
    B. Supplemental Extensions
    C. Declarations
    D. Conditions
19. Which of the following policy structure components sets forth the insurer's items that are not covered?
    A. Declarations
    B. Conditions
    C. Exclusions
    D. Insuring Agreement
20. Which of the following policy components alters the initial policy?
    A. Endorsements
    B. Definitions
    C. Conditions
    D. Insuring Agreement
21. Which of the following policy structure components specifically eliminates coverage?
    A. Insuring Agreement
    B. Exclusions
    C. Definitions
    D. Declarations
22. Which of the following policy structure components indicates the named insured, address, and amount of insurance coverage?
    A. Exclusions
    B. Endorsements
    C. Declarations
    D. Insuring Agreement

23. Which of the following policy structure components describes insurance terms?
    A. Definitions
    B. Declarations
    C. Insuring Agreement
    D. Exclusions
24. Which of the following are the primary components that make up the typical property casualty insurance policy?
    A. Definitions, Insuring Agreement, Conditions and Exceptions
    B. Declarations, Insuring Agreement, Conditions, and Exclusions
    C. Declarations, Implied Agreement, Conditions, and Exclusions
    D. Declarations, Insuring Agreement, Conditions, and Exemptions
25. The valuation type that after a loss occurs will replace damaged property with like kind and quality at today's cost is:
    A. Guaranteed Value
    B. Replacement Value
    C. Actual Cash Value
    D. Market Value
26. Actual Cash Value is:
    A. Determined in a court of law
    B. Market value minus depreciation
    C. Replacement cost minus depreciation
    D. Arbitration value
27. All of the following are methods to value property EXCEPT:
    A. Market Value
    B. Actual Cash Value
    C. Replacement Value
    D. Excluded Value
28. All of the following are true of insurable interest EXCEPT:
    A. It reduces the possibility of the speculative wagering
    B. In property insurance, it is required to exist at time of application
    C. In property insurance, it is required to exist at the time of loss
    D. It is the financial interest one has in property
29. The primary purpose of the full reporting or honesty clause is to what?
    A. Eliminate correspondence between the insured and company
    B. Promote proper values and proper coverage amounts
    C. Provide excess coverage for inventories
30. All of the following are true of timely reporting requirements of reporting forms EXCEPT:
    A. Reporting requirements may be waived by the insured
    B. Reporting forms contain a full reporting clause
    C. If reports are not processed timely, the most recent report may be used
    D. A penalty may apply for failure of timely reporting.

31. All of the following are characteristics of Reporting Forms EXCEPT:
    A. Requires timely reporting
    B. To provide excess insurance
    C. Used when business has fluctuating inventories
    D. To report accurate values for insurance
32. Under a Business Owners Policy, if the insured property is vacant beyond 60 consecutive days:
    A. Claim is paid in full
    B. Loss settlement is reduced by 25%
    C. Loss settlement is reduced by 15%
    D. Claim is denied
33. Which of the following definitions best describes an indirect or consequential loss?
    A. The intentional damage to covered property
    B. The named perils of the policy
    C. The results or consequences of a direct loss
    D. Actual physical damage to an insured risk
34. All of the following are direct losses EXCEPT:
    A. Vandalism to a building
    B. Loss of rental income to the apartment
    C. Lightning to an apartment building
    D. Windstorm to a house
35. Which of the following would be an example of a direct loss?
    A. Extra expense incurred due to a covered peril
    B. Water Damage from a pipe bursting
    C. Additional living expenses due to a fire
    D. Loss of business income due to a covered peril
36. Which of the following definitions best describes a direct loss?
    A. An unintentional act
    B. Any covered peril is a direct loss
    C. Actual physical damage to an insured risk
    D. Consequential damages to a building
37. Which of the following definitions best describes Specific Coverage?
    A. Only perils listed in the policy are covered
    B. Provides coverage for direct physical loss unless specifically excluded
    C. Provides coverage for "all risks"
    D. None of the above
38. Which of the following best describes Special Coverage?
    A. Provides coverage on an all risks basis, minus exclusions
    B. Provides coverage for direct loss unless specifically excluded
    C. Only perils listed in the policy are covered
    D. None of the above

39. The perils covered in a policy may be described as:
    A. The uncertainty of loss
    B. The cause of loss
    C. The certainty of a loss
    D. Something that increases the possibility of loss
40. I have insurance, if I felt tired and fell asleep and a cigar falls out of my hand and causes a fire in my house. What type of hazard is this?
    A. Psychology
    B. Morale
    C. Moral
    D. Physical
41. Which of the following would not be considered a hazard?
    A. Overloaded electrical wiring
    B. Broken steps and hand railings
    C. Paint and related solvents stored in original containers
    D. Trash and debris in the basement of the home
42. Which of the following is NOT a common type of hazard?
    A. Ethical
    B. Morale
    C. Moral
    D. Physical
43. How will a court of law interpret an Insurance contract that contains policy language that is ambiguous?
    A. Find in favor of the insured since the policy is a contract of adhesion
    B. Find in favor of both insured and company by apportioning each party's fault at 50% of the total
    C. Find in favor of the insured since the insured had no duty to read the policy
    D. Find in favor of the company since the insured should have read the policy
44. Under an insurance contract, both the insured and insurer give up something of value. This is called?
    A. Estoppel
    B. Subrogation
    C. Consideration
    D. Reasonable expectations
45. To place insurance coverage into effect:
    A. Coverage may only be bound by an insurance broker
    B. Coverage may be verbally bound with no premium by an appointed insurance agent
    C. A policy must always be issued and a premium collected by the insurer
    D. A policy must always be issued by an insurer
46. The principle of insurance that restores one to approximately the same condition that they enjoyed prior to their loss is called:
    A. Indemnification
    B. Retention
    C. Subrogation
    D. Valued Contracts

47. If a property is determined to be unoccupied at the time of loss, then:
    A. Coverage will apply subject to a 15% penalty
    B. Coverage will be denied
    C. Coverage will apply
    D. Coverage will be voided
48. What term describes the insured's failure to disclose a fact in the application for insurance that helps him get a better rate?
    A. Aleatory
    B. Concealment
    C. Misrepresentation
    D. Representation
49. Which of the following is NOT a type of warranty?
    A. Guaranteed warranty
    B. Implied warranty
    C. Continuing or promissory warranty
    D. Affirmative warranty
50. The legal right of an insurance company to seek reimbursement from a negligent third party is:
    A. Adhesion
    B. Subrogation
    C. Warranty
    D. The covered negligent third party rule
51. All of the following are characteristics of insurance contracts EXCEPT:
    A. A contract of understanding
    B. Adhesion
    C. Aleatory
    D. Conditional contract
52. An insurance contract feature that permits all ambiguous areas to be construed in favor of the insured is:
    A. Fraud
    B. Utmost good faith
    C. Adhesion
    D. Aleatory
53. What term describes the statements made by an individual at application?
    A. Representation
    B. Misrepresentation
    C. Warranty
    D. Concealment
54. All of the following are essential elements of a contract EXCEPT:
    A. Agreement
    B. Incompetent parties
    C. Legal purpose
    D. Consideration

CHAPTER 2 ANSWER KEY

1.c

2.d

3.a

4.d

5.c

6.b

7.d

8.b

9.d

10.b

11.c

12.c

13.b

14.b

15.c

16.a

17.b

18.b

19.c

20.a

21.b

22.c

23.a

24.b

25.b

26.c

27.d

28.a

29.b

30.a

31.b

32.c

33.c

34.b

35.b

36.c

37.a

38.a

39.b

40.b

41.c

42.a

43.a

44.c

45.a

46.a

47.c

48.b

49.a

50.b

51.a

52.c

53.a

54.b

THIS PAGE IS INTENIONALLY LEFT BLANK