

Principles of Risk Management and Insurance, 11e (Rejda)

Chapter 1 Risk in Our Society

- 1) Traditionally, risk has been defined as
- A) any situation in which the probability of loss is one.
 - B) any situation in which the probability of loss is zero.
 - C) uncertainty concerning the occurrence of loss.
 - D) the probability of a loss occurring.

Answer: C

Question Status: Previous Edition

- 2) Objective risk is defined as
- A) the probability of loss.
 - B) the relative variation of actual loss from expected loss.
 - C) uncertainty based on a person's mental condition or state of mind.
 - D) the cause of loss.

Answer: B

Question Status: Previous Edition

- 3) An insurance company estimates its objective risk for 10,000 exposures to be 10 percent. 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.

Answer: A

Question Status: Previous Edition

- 4) Uncertainty based on a person's mental condition or state of mind is known as
- A) objective risk.
 - B) subjective risk.
 - C) objective probability.
 - D) subjective probability.

Answer: B

Question Status: Previous Edition

- 5) The long-run relative frequency of an event based on the assumption of an infinite number of observations with no change in the underlying conditions is called
- A) objective probability.
 - B) objective risk.
 - C) subjective probability.
 - D) subjective risk.

Answer: A

Question Status: Previous Edition

6) Which of the following statements about *a priori* probabilities is correct?

- A) They are subjective probabilities based on ambiguity in the way probability is perceived.
- B) They are subjective probabilities that may vary among individuals because of factors such as age, gender, education, and the use of alcohol.
- C) They are objective probabilities that can be determined by deductive reasoning.
- D) They are objective probabilities that can be determined by subjective reasoning.

Answer: C

Question Status: Previous Edition

7) An individual's personal estimate of the chance of loss is

- A) an objective probability.
- B) an objective risk.
- C) a subjective probability.
- D) an *a priori* probability.

Answer: C

Question Status: Previous Edition

8) A peril is

- A) a moral hazard.
- B) the cause of a loss.
- C) a condition which increases the chance of a loss.
- D) the probability that a loss will occur.

Answer: B

Question Status: Previous Edition

9) An earthquake is an example of a

- A) moral hazard.
- B) peril.
- C) physical hazard.
- D) objective risk.

Answer: B

Question Status: Previous Edition

10) Dense fog that increases the chance of an automobile accident is an example of a

- A) speculative risk.
- B) peril.
- C) physical hazard.
- D) moral hazard.

Answer: C

Question Status: Previous Edition

11) Faking an accident to collect insurance proceeds is an example of a

- A) physical hazard.
- B) objective risk.
- C) moral hazard.
- D) attitudinal hazard.

Answer: C

Question Status: Revised

12) Carelessness or indifference to a loss is an example of

- A) physical hazard.
- B) objective probability.
- C) moral hazard.
- D) attitudinal hazard.

Answer: D

Question Status: Revised

13) Some characteristics of the judicial system and regulatory environment increase the frequency and severity of loss. This hazard is called

- A) moral hazard.
- B) physical hazard.
- C) attitudinal hazard.
- D) legal hazard.

Answer: D

Question Status: Revised

14) Taylor Tobacco Company is concerned that the company may be held liable in a court of law and ordered to pay a large damage award. The characteristics of the judicial system that increase the frequency and severity of losses are known as

- A) moral hazard.
- B) particular risk.
- C) speculative risk.
- D) legal hazard.

Answer: D

Question Status: Previous Edition

15) A phrase that encompasses all of the major risks faced by a business firm is

- A) financial risk.
- B) speculative risk.
- C) enterprise risk.
- D) pure risk.

Answer: C

Question Status: Previous Edition

16) Which of the following statements about financial risk is (are) true?

- I. Enterprise risk does not include financial risk.
- II. Financial risk is easily addressed through the purchase of insurance.

- A) I only
- B) II only
- C) both I and II
- D) neither I nor II

Answer: D

Question Status: Previous Edition

17) All of the following are considered financial risks EXCEPT

- A) the decline in the value of a bond portfolio because of rising interest rates.
- B) increased cost of production because of rising commodity prices.
- C) loss of money because of adverse movements in currency exchange rates.
- D) destruction of a production facility caused by an explosion.

Answer: D

Question Status: Previous Edition

18) Katelyn was just named Risk Manager of ABC Company. She has decided to create a risk management program which considers all of the risks faced by ABC-pure, speculative, operational, and strategic-in a single risk management program. Such a program is called a(n)

- A) financial risk management program.
- B) enterprise risk management program.
- C) fundamental risk management program.
- D) consequential risk management program.

Answer: B

Question Status: Previous Edition

19) A pure risk is defined as a situation in which there is

- A) only the possibility of loss or no loss.
- B) only the possibility of profit.
- C) a possibility of neither profit nor loss.
- D) a possibility of either profit or loss.

Answer: A

Question Status: Previous Edition

20) The premature death of an individual is an example of a

- A) pure risk.
- B) speculative risk.
- C) fundamental risk.
- D) physical hazard.

Answer: A

Question Status: Previous Edition

21) Which of the following statements about speculative risks is true?

- A) They are almost always insurable by private insurers.
- B) They are more easily predictable than pure risks.
- C) They may benefit society even though a loss occurs.
- D) They involve only a chance of loss.

Answer: C

Question Status: Revised

22) An automobile that is a total loss as a result of a collision is an example of which of the following types of risk?

- I. Speculative risk
 - II. Diversifiable risk
- A) I only
 - B) II only
 - C) both I and II
 - D) neither I nor II

Answer: B

Question Status: Revised

23) All of the following are programs to insure fundamental risks EXCEPT

- A) federally subsidized flood insurance.
- B) auto physical damage insurance.
- C) Social Security.
- D) unemployment insurance.

Answer: B

Question Status: Previous Edition

24) All of the following are examples of personal risks EXCEPT

- A) poor health.
- B) unemployment.
- C) premature death.
- D) flood.

Answer: D

Question Status: Previous Edition

25) Which of the following is a reason why premature death may result in economic insecurity?

- I. Additional expenses associated with death may be incurred.
 - II. The income of the deceased person's family may be inadequate to meet its basic needs.
- A) I only
 - B) II only
 - C) both I and II
 - D) neither I nor II

Answer: C

Question Status: Previous Edition

26) Which of the following are often consequences of long-term disability?

- I. Continuing medical expenses
- II. Loss or reduction of employee benefits

- A) I only
- B) II only
- C) both I and II
- D) neither I nor II

Answer: C

Question Status: Previous Edition

27) All of the following are examples of direct property losses EXCEPT

- A) the theft of a person's jewelry.
- B) the destruction of a firm's manufacturing plant by an earthquake.
- C) the cost of renting a substitute vehicle while a collision-damaged car is being repaired.
- D) the vandalism of a person's automobile.

Answer: C

Question Status: Previous Edition

28) The extra expense incurred by a business to stay in operation following a fire is an example of a(n)

- A) fundamental risk.
- B) speculative risk.
- C) direct loss.
- D) indirect loss.

Answer: D

Question Status: Previous Edition

29) Which of the following statements about liability risks is (are) true?

- I. Future income and assets can be attached to pay judgments if inadequate insurance is carried.
- II. There is an upper limit on the amount of loss.

- A) I only
- B) II only
- C) both I and II
- D) neither I nor II

Answer: A

Question Status: Previous Edition

30) All of the following are burdens to society because of the presence of risk EXCEPT

- A) The size of an emergency fund must be increased.
- B) Individuals may profit from accepting a speculative risk.
- C) Society is deprived of certain goods and services.
- D) Mental fear and worry are present.

Answer: B

Question Status: Previous Edition

31) Loss control includes which of the following?

- I. Loss reduction
 - II. Loss prevention
- A) I only
 - B) II only
 - C) both I and II
 - D) neither I nor II

Answer: C

Question Status: Previous Edition

32) Following good health habits can be categorized as

- A) loss prevention.
- B) risk retention.
- C) noninsurance transfer.
- D) personal insurance.

Answer: A

Question Status: Revised

33) From the insured's perspective, the use of deductibles in insurance contracts is an example of

- A) risk transfer.
- B) loss control.
- C) risk avoidance.
- D) risk retention.

Answer: D

Question Status: Previous Edition

34) The use of fire-resistive materials when constructing a building is an example of

- A) risk transfer.
- B) loss control.
- C) risk avoidance.
- D) risk retention.

Answer: B

Question Status: Previous Edition

35) All of the following statements about risk retention are true EXCEPT

- A) It may be used intentionally if commercial insurance is unavailable.
- B) It may be used passively because of ignorance.
- C) Its use is most appropriate for low-frequency, high-severity types of risks.
- D) Its use results in cost savings if losses are less than the cost of insurance.

Answer: C

Question Status: Previous Edition

36) All of the following are methods of noninsurance transfer EXCEPT

- A) entering into a hold-harmless agreement.
- B) avoiding dangerous activities.
- C) hedging risk using futures contracts.
- D) incorporating a business.

Answer: B

Question Status: Previous Edition

37) Curt borrowed money from a bank to purchase a fishing boat. He purchased property insurance on the boat. Curt had difficulty making loan payments because he did not catch many fish, and fish prices were low. Curt intentionally sunk the boat, collected from his insurer, and paid off the loan balance. This scenario illustrates the problem of

- A) adverse selection.
- B) moral hazard.
- C) nondiversifiable risk.
- D) attitudinal hazard.

Answer: B

Question Status: Revised

38) Jenna opened a successful restaurant. One night, after the restaurant had closed, a fire started when the electrical system malfunctioned. In addition to the physical damage to the restaurant, Jenna also lost profits that could have been earned while the restaurant was closed for repairs.

The lost profits are an example of

- A) direct loss.
- B) nondiversifiable risk.
- C) speculative risk.
- D) indirect loss.

Answer: D

Question Status: Revised

39) Brad started a pest control business. To protect his personal assets against liability arising out of the business, Brad incorporated the business. Brad's use of the corporate form of organization to shield against personal liability claims illustrates

- A) fundamental risk.
- B) noninsurance transfer.
- C) risk retention.
- D) objective risk.

Answer: B

Question Status: Previous Edition

40) ABC Insurance Company plans to sell homeowners insurance in five Western states. ABC expects that 8 homeowners out of every 100, on average, will report claims each year. The variation between the rate of loss that ABC expects to occur and the rate of loss that actually does occur is called

- A) objective probability.
- B) subjective probability.
- C) objective risk.
- D) subjective risk.

Answer: C

Question Status: Previous Edition

41) Williams Company installed smoke detectors, a sprinkler system, and fire extinguishers in its new manufacturing facility. These devices are all examples of

- A) loss control.
- B) noninsurance transfer.
- C) risk avoidance.
- D) risk retention.

Answer: A

Question Status: Previous Edition

42) Tyndal Products Company produces cereal. The company has entered into contracts to deliver 500,000 boxes of cereal during the next 18 months. The company is concerned that the prices of two ingredients, corn and wheat, may increase over the next 18 months. The company used grain futures contracts to hedge the price risk associated with these commodities. Tyndal's use of hedging illustrates which risk management technique?

- A) noninsurance transfer
- B) risk avoidance
- C) risk retention
- D) risk assumption

Answer: A

Question Status: Previous Edition

43) Cathy's car hit a patch of ice on the road. The car skidded off the road and hit a tree. The presence of ice on the road is best described as a(n)

- A) peril.
- B) subjective risk.
- C) physical hazard.
- D) indirect loss.

Answer: C

Question Status: Previous Edition

44) Jim and Paula Franklin started a dry cleaning business. The business may be successful or it may fail. The type of risk that is present when either a profit or loss could occur is called

- A) pure risk.
- B) subjective risk.
- C) nondiversifiable risk.
- D) speculative risk.

Answer: D

Question Status: Revised

45) Ben is concerned that if he injures someone or damages someone's property he could be held legally responsible and required to pay damages. This type of risk is called a

- A) speculative risk.
- B) liability risk.
- C) nondiversifiable risk.
- D) property risk.

Answer: B

Question Status: Revised

46) MLX Drug Company would like to market a new hypertension drug. While the Food and Drug Administration (FDA) was testing the drug, it discovered that the drug produced a harmful side effect. When MLX learned of the FDA's test result, MLX abandoned its plan to produce and distribute the drug. MLX's reaction illustrates

- A) risk avoidance.
- B) hedging.
- C) risk transfer.
- D) risk retention.

Answer: A

Question Status: Previous Edition

47) ABC Health Insurance Company sells health insurance in one state. Recently, that state's legislature passed a law forbidding health insurers from considering an individual's health history when selecting applicants to insure. This change in law will increase the possibility of unprofitable results for ABC. This type of hazard is an example of

- A) physical hazard.
- B) legal hazard.
- C) moral hazard.
- D) attitudinal hazard.

Answer: B

Question Status: Revised

48) All of the following are characteristics of the liability risk that most people face EXCEPT

- A) a lien may be placed on your income and assets to satisfy a legal judgment.
- B) substantial legal expenses may be incurred defending the claim.
- C) there is no upper limit on the amount of the loss.
- D) owning liability insurance eliminates the possibility of being held legally liable.

Answer: D

Question Status: Previous Edition

49) Which of the following statements about chance of loss and risk is (are) true?

I. If the chance of loss is identical for two groups, the objective risk must be the same.

II. Two individuals may perceive differently the risk inherent in a given activity.

A) I only

B) II only

C) both I and II

D) neither I nor II

Answer: B

Question Status: Previous Edition

50) A risk that affects only individuals or small groups and not the entire economy is called a

A) diversifiable risk.

B) pure risk.

C) speculative risk.

D) nondiversifiable risk.

Answer: A

Question Status: New

51) All of the following are commercial risks EXCEPT

A) the loss of business income.

B) the risk of insufficient retirement income.

C) the risk of being sued.

D) the risk of property damage.

Answer: B

Question Status: New