INTRODUCTION TO GENERAL INSURANCE
EXAM STUDY MANUAL

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ASSIGNMENT 1

OVERVIEW OF INSURANCE OPERATIONS

I. CLASSIFICATIONS OF INSURERS

A. Introduction
1. Insurance – system where participants (e.g. individuals, families, businesses), make payments in exchange for commitment to reimburse specific types of losses in certain circumstances
2. Insured – participants in system who benefit from reimbursement of covered losses
3. Insurer – organization or entity that facilitates pooling funds and paying benefits
    a. The principal function of insurers: acceptance of risks that others transfer through insurance
    b. Core operations: 1) underwriting, 2) claims, and 3) marketing

B. Four Ways of Classifications of Property-Casualty Insurers
1. Legal form of ownership
2. Place of incorporation
3. Licensing status
4. Insurance distribution systems and channels

C. Classification Summary
1. Legal form of ownership
    a. Proprietary
        i. Stock insurers
        ii. Lloyd's of London and American Lloyds
        iii. Insurance exchange
    b. Cooperative
        i. Mutual insurers
        ii. Reciprocal insurance exchanges
        iii. Fraternal organizations
        iv. Other cooperatives – captive insurers, risk retention groups, purchasing groups
    c. 691701Pools
        i. Pools
        ii. Government insurers
2. Place of incorporation
    a. Domestic
    b. Foreign
    c. Alien
3. Licensing status
    a. Admitted
    b. Nonadmitted
4. Insurance distribution systems and channels
    a. Independent agency and brokerage marketing system
    b. Direct write marketing system
    c. Exclusive agency marketing system

D. Legal Form of Ownership
1. Proprietary insurers
    a. Stock insurers – Owned by their stockholders, most prevalent type of propriety insurer in US

- b. Lloyds associations – Lloyd's of London and American Lloyds
    - i. Lloyd's of London is a marketplace, similar to stock exchange
    - ii. Provides the physical and procedural facilities for members to write insurance
    - iii. In the past, insurance each member wrote was backed by his/her personal fortune; now, more members are corporations and have only limited liabilities
    - iv. Provides coverage for many unusual or difficulties loss exposure and underwrites much of global marine and aviation insurance
    - v. American Lloyds associations are smaller and most are domiciled in Texas because of the favorable regulatory climate
    - vi. Most were formed or have been acquired by insurers.
    - vii. Members (underwriters) are not liable beyond their investment in the association
- c. Insurance exchange – similar to Lloyds associations. Members can be individuals, partnerships, or corporations, and have limited liability

2. Cooperative Insurers – owned by policyholders and includes mutual insurers, reciprocal insurance exchanges, fraternal organization, and other cooperatives.
    - a. Mutual insurer – an insurer that is owned by its policyholders and is formed as a corporation for the purpose of providing insurance to policyholders.
        - i. Policyholders have voting rights
        - ii. Some profit is retained to increase surplus
        - iii. Excess profit is usually returned to policyholders
        - iv. Includes some large national/regional insurers
    - b. Reciprocal insurance exchange – an insurer owned by policyholders and is formed as an unincorporated association for the purpose of providing insurance coverage to its members (called subscribers), and managed by an attorney-in-fact.
        - i. Members agree to mutually insure each other
        - ii. Members share profits/losses in proportion of their purchased insurance
        - iii. May be formed to receive favorable tax treatment
    - c. Fraternal organizations resemble mutual companies, but they combine a lodge or social function with their insurance function. They write primarily in life and health insurance.
    - d. Other cooperative insurers include captive insurers, risk retention groups, and purchasing groups
        - i. Captive insurer – a subsidiary company formed by a business organization or a group of affiliated organizations to provide all or part of its insurance
            - a) "Formalized self-insurance"
            - b) May also be formed to cover losses that other insurers will not cover at any price
            - c) Some states encourage the formation and operation of captive insurers, while others do not permit the formation of captive insurers
        - ii. Risk retention groups and purchasing groups usually organized so that a limited group or type of insured is eligible to purchase insurance from them
            - a) Can be formed as stock companies, mutual, or reciprocal exchanges
            - b) Becoming more significant in the evolving insurance market place
3. Other insurers include pools and government insurers
    - a. Pools – A pool consists of several insurers, not otherwise related, that join together to insure lose exposures that individual insurers are not willing to insure: losses that occur too frequently or are too severe (e.g. airplane crashes or nuclear meltdowns)
        - i. Pools formed voluntarily or to meet statutory requirements
        - ii. Pools operate either
            - a) As syndicate – Insured has contractual relationship with pool members and can sue any or all of them directly
            - b) Through reinsurance – Insured has a contractual relationship only with the member that issued the policy. Policyholder has no legal rights against the other members of the pool and may not even know that they exist
        - iii. Many pools are required by law
            - a) Virtually all states require some kind of pooling arrangement to provide auto

liability insurance for drivers who cannot obtain insurance in the standard market
- b) Fair Access to Insurance Requirements (FAIR) plans – an insurance pool through which private insurers collectively address an unmet need for property insurance on urban properties (in more than half the states)
- c) Windstorm coverage in southeastern states

b. Federal government offered insurance
- i. National Flood Insurance Program (NFIP)
- ii. Terrorism Risk Insurance Act
- iii. All states offer some forms of government insurance (e.g. workers' compensation insurance)

E. Place of Incorporation
1. A domestic insurer is incorporated within a specific state or, if not incorporated, is formed under the laws of that state – insurance is regulated at the state level
   - a. Reciprocal insurance exchanges are the only unincorporated insurers permitted in most states
   - b. Insurance exchanges and Lloyd's organizations are permitted under law in only a few states
2. A foreign insurer is a domestic insurer licensed to do business in states other than its domiciled state
3. Alien insurers are incorporated or formed in another country

F. Licensing Status
1. A licensed insurer (admitted insurer) – an insurer that has been granted a license to operate in a particular state
2. An unlicensed insurer (nonadmitted insurer) – has not been granted a license to operate in a given state
3. Surplus lines broker is a person or firm that places business with insurers not licensed (nonadmitted) in the state in which the transaction occurs but that is permitted to write insurance because coverage is not available through standard market insurers
4. Producers for primary insurance (except for surplus lines brokers) are licensed to place business only with admitted insurers
5. License status is also important for reinsurance

G. Insurance Distribution Systems and Channels
1. Independent agency and brokerage marketing system – an insurance marketing system where producers (agents or brokers), who are independent contractors, sell insurance, usually as representatives of several unrelated insurers
2. Direct writer marketing system – an insurance marketing system that uses sales agents (or sales representatives) who are direct employees of the insurer
3. Exclusive agency marketing system – an insurance marketing system under which agents contract to sell insurance exclusively for one insurer (or an associated group of insurers).
4. Distribution channel –The channel used by the producer of a product or service to transfer that product or service to the ultimate customer

II. INSURANCE GOALS

A. Earn Profit
1. Profit goal is most commonly associated with proprietary, or for-profit, insurers
2. Not primary goal for cooperative insurers, but they should also earn a profit

B. Meet Customer Needs
1. Provide products and services customers seek at competitive prices
2. Prompt services

3. Quick and professional assistance
4. May conflict with profit goal

C. Comply with Legal Requirements – One of an insurer's greatest responsibilities is compliance with state regulations

D. Diversify Risk
1. Emerging goal for property-casualty insurers.
2. Meeting this goal complements the insurer's goal of earning a profit and fulfilling its duty to society

E. Fulfill Duty to Society – all corporations are obligated to promote the well being of society

III. CONSTRAINTS ON ACHIEVING INSURER GOALS

A. Internal Constraints
1. Efficiency – Inefficiency might prevent insurers from meeting their profit and service goal, which can lead to the inability to meet societal goal
2. Expertise – Lack of expertise could prevent an insurer from making a profit or meeting customers' needs, or it could eventually cause the insurer to fail to attain any of its goals.
3. Size – a small insurer, that may be able to respond more quickly to an emerging trend, has more challenges than a large insurer in terms of available resources
4. Financial resources – When financial resources become strained, insurers are unable to effectively train staff, make new capital investments, or reach new markets
5. Other internal constraints – lack of name or brand recognition or a damaged reputation

B. External Constraints
1. Regulation
2. Rating agencies
3. Public opinion
4. Competition
5. Economic condition
6. Insurance marketing and distribution
7. Other external constraints

IV. MEASURING INSURANCE PERFORMANCE

A. Meeting Profitability Goals
1. Premiums and investment income
    a. Premium growth – not always a positive indicator of an insurer's success; should consider whether growth resulted from a competitive advantage, relaxed underwriting, inadequate insurance rates, or a combination of these factors
    b. Rate of premium growth over time – helps determine insurer profitability
2. Underwriting performance
    a. Net underwriting gain or loss = earned premium – (incurred losses + underwriting expenses)
    b. Three ratios are used to measure an insurer's underwriting performance:
        i. Loss ratio = incurred losses / earned premium
        ii. Expense ratio = incurred underwriting expenses / written premium
        iii. Combined ratio (trade basis) = Loss ratio + Expense ratio

3. Overall operating performance –Net underwriting gain or loss plus net investment gain or loss for specific period
   a. Investment income ratio = net investment income / earned premiums
   b. Overall operating ratio = combined ratio (trade basis) – investment income ratio
   c. Return on equity = net income / owners' equity
   d. It is important to analyze the gain or loss from operations for several years.
4. Estimation of loss reserves
   a. Loss reserves are generally the largest liability in the insurer's balance sheet and can have a significant effect on the insurer's overall profitability
   b. One of the biggest problems in measuring insurer profitability arises from errors in estimating loss reserves

B. Meeting Customer Needs
1. Complaints and praise
2. Customer satisfaction data
   a. Retention ratio – the percentage of expiring insurance policies that an insurer renews; can be measured by policy count, premium volume, or both.
   b. Lapse ratio
      i. Calculated by dividing the number of policies that lapse during the period by the total number of policies written at the beginning of the period
      ii. A lapse in insurance is defined as a point in time when a policy has been canceled or terminated for failure to pay the premium, or when the policy contract is void for other reasons
3. Insurer-producer relationships – Insurers that market products through independent agents and brokers usually view this network of producers as their customers, in addition to the ultimate insurance customer
4. State insurance department statistics
5. Consumer reports

C. Meeting Legal Requirements
1. Success or failure indicated by the number of criminal, civil, and regulatory actions taken against the insurer
2. Market conduct regulation – State insurance departments monitor the treatment of insureds, applicants for insurance, and claimants, overseeing four insurer operational areas: sales and advertising, underwriting, ratemaking, and claim settlement

D. Meeting Social Responsibilities
1. No standards exist
2. Workplace safety programs
3. Support of community projects
4. Employee benefits

V. FUNCTIONAL VIEW OF INSURANCE

A. Core Functions
1. Marketing and distribution – Determining what products or services customers want and need, advertising the products, and delivering them to customers
2. Underwriting – The process of selecting insureds, pricing coverage, determining insurance policy terms and conditions, and then monitoring the underwriting decisions made
3. Claims – The purpose of claim function is to fulfill the insurer's promise to make a payment to, or on behalf of, the insured if a covered event occurs

B. Supporting Functions
   1. Risk control
   2. Premium auditing
   3. Actuarial
   4. Reinsurance
   5. Information technology

C. Other Common Function Areas
   1. Investments
   2. Accounting and finance
   3. Customer service
   4. Legal and compliance
   5. Human resources
   6. Special investigation units

Sample Exam Questions

1. Which of the following is NOT an operating goal of an insurer? (SOA GIINT February 2014)
   A. Comply with legal requirements.
   B. Concentrate risk.
   C. Meet customer needs.
   D. Earn a profit.
   E. Fulfill its duty to society.

2. What are the three core functions that exist within a typical insurer? (SOA GIINT February 2014)
   A. Accounting, actuarial, and underwriting.
   B. Actuarial, claims, and underwriting.
   C. Accounting, marketing and distribution, and sales.
   D. Claims, marketing and distribution, and underwriting.
   E. Actuarial, marketing and distribution, and sales.

3. Which of the following errors is the most significant problem in measuring insurer profitability? (SOA GIINT February 2014)
   A. Errors in setting adequate rates.
   B. Errors in estimating future investment returns.
   C. Errors in estimating loss reserves.
   D. Errors in estimating sales growth.
   E. Errors in classification of loss exposure units.

4. Which of the following is false?
   A. A foreign insurer is an insurer that is incorporated under the laws of a country outside of the United States.
   B. An insurer incorporated in state A is a domestic insurer in state A.
   C. Mutual companies include some large national/regional insurers.
   D. Nowadays a large portion of Lloyd's of London members are corporations and have only limited liabilities.
   E. Fraternal organizations resemble mutual companies, and they write primarily in life and health insurance.

5. Which of the following is a proprietary insurer?
   I. Fraternal organizations
   II. Reciprocal exchanges
   III. American Lloyds associations

   A. I
   B. II
   C. III
   D. I and II
   E. I, II, and III

Sample Exam Question Answers

1. B
2. D
3. C
4. A
5. C
6. D
7. E
8. B
9. D
10. E

ASSIGNMENT 6

HOMEOWNERS LIABILITY, CONDITIONS, COVERAGE FORMS, AND ENDORSEMENTS

I. HO-3 SECTION II–LIABILTIY COVERAGES

A. Coverage E–Personal Liability
1. Provide coverage if a claim is made or a suit is brought against insured because of bodily injury or property damage arising from a covered occurrence during policy period
2. Occurrence can be sudden or gradual/continuous
3. Insurer pays up to liability limit
4. Basic personal liability limit is \$100,000 per occurrence, with higher limits available for additional premium
5. Defense cost coverage, which is additional to liability limit, is provided even if a suit is groundless
6. Insurer's obligation to defend ends only when the liability limit is exhausted by payment of settlement or judgment

B. Coverage F–Medical Payments to Others
1. Covers medical expenses incurred by others (not insured or regular household residents) within three years
2. Limit is generally \$1,000 per person for a single accident
3. Applies to these conditions:
   a. Injury occurs to a person who has insured's permission to be at insured location
   b. Injured person is away from insured location, and bodily injury arises out of a condition at insured location or on property immediately adjoining insured location
   c. A person is injured while away from insured location by an activity performed by insured

C. Section II–Additional Coverages
1. Claim expenses
   a. "Expenses we incur" – i.e., legal representation
   b. Premiums on bonds – premium on bonds if bond value does not exceed Coverage E limit
   c. Reasonable expenses – up to \$250 per day if insured is requested in assisting claim investigation or defense
   d. Post-judgment interest – interest accrued after judgment has been made against insured
2. First aid expenses
   a. Covers expenses of first aid to others
   b. Insurer will not reimburse for first aid to injured insured
3. Damage to property of others
   a. Pays up to \$1,000 for damage to property of others caused by insured regardless of fault or legal liability
   b. Insurer will not pay
      i. Intentionally caused damage by insured 13 years old or older
      ii. Property owned by insured
      iii. Property owned by or rented to a tenant
      iv. Damage arises out of insured's business
      v. Damage is result of an act or omission in connection with premises that insured owns, rents, or controls (other than insured location)
      vi. Damage arises out of ownership and use of motor vehicle, watercraft, aircraft or hovercraft
4. Loss assessment – insurer pays up \$1,000 for loss assessment billed by homeowners association

II. HO-3 SECTION II–EXCLUSIONS

A. Motor Vehicle and Other Motorized Craft – Exclusions
1. Motor vehicle liability
2. Watercraft liability
3. Aircraft and hovercraft liability

B. Coverage E–Personal Liability and Coverage F–Medical Payments to Others
1. Expected or intended injury
2. Business
   a. No coverage for bodily injury or property damage relating to a business operated from residence premises or another insured location
   b. Exceptions
      i. Activities which received $2,000 or less in previous year
      ii. Volunteer activities
      iii. Home daycare not involving compensation, but possibly exchanges of services
      iv. Home daycare services rendered to a relative
   c. Exceptions of rental property
3. Other Coverage E and Coverage F exclusions
   a. Professional services
   b. Insured's premises not an insured's location
   c. War
   d. Communicable disease
   e. Sexual molestation, corporal punishment or physical or mental abuse
   f. Controlled substance

C. Exclusions That Apply Only to Coverage E
1. Loss assessment and contractual liability
2. Damage to insured's property
3. Damage to property in insured's care
4. Bodily injury to persons eligible for workers compensation benefits
5. Nuclear liability
6. Bodily injury to insured

D. Exclusions That Apply Only to Coverage F
1. Residence employee off premises
2. Bodily injury eligible for workers compensation benefits
3. Nuclear reaction
4. Injury to residents

III. HO-3 SECTION II–CONDITIONS

A. Conditions Applicable to Section II
1. Limit of liability
   a. Coverage E limit is the total limit for any one occurrence
   b. Continuous or repeated exposure to same harmful conditions is considered to be one occurrence
2. Severability of insurance
   a. Works as if each insured is separately covered
   b. Policy covers claims brought by one insured against another insured
3. Duties after "occurrence"
   a. Give written notice to insurer as soon as practical
   b. Cooperate with insurer

   c. Forward legal documents promptly to insurer
   d. Provide claim assistance to insurer
   e. Submit evidence for damage to property
   f. Do not make voluntary payment
4. Duties of injured person for Coverage F–Medical Payments to Others
   a. Give insurer written proof of claim as soon as possible
   b. Authorize insurer to obtain copies of medical reports and records
   c. Submit to physical exam as required by insurer
5. Payment of claims for Coverage F–Medical Payments to Others
   a. The purpose is to prevent suits or reduce potential damage
   b. Not admission of liability of insured or insurer
6. Suit against insurer – insurer cannot be sued until certain provisions have been met
   a. Insured has met all of its obligations under Section II of the policy
   b. Insurer cannot be joined as a party to any action against insured
   c. Obligation of insured has been determined by final judgment or agreement signed by insurer
7. Bankruptcy of insured – insurer is not relieved of any obligations by insured's financial status
8. Other insurance – Coverage E is excess unless other insurance is specifically excess, i.e. umbrella policy
9. Policy period – Bodily injury or property damage need occurred during policy period to be covered
10. Concealment or fraud
    a. Exclude coverage only for insured(s) involved in concealment or fraud
    b. Other innocent insureds would not be excluded from liability coverage
    c. Note: under Section I, concealment or fraud by any insured bars property coverage for all insureds

B. Conditions Applicable to Section I and II
1. Liberalization clause
   a. All existing policies automatically include additional coverage if it is included in the new policies
   b. Only same edition of a policy subsequently changed by insurer are affected
2. Waiver or change of policy provisions
   a. Need in-writing to be effective
   b. Courts have permitted use of oral waivers by claim representatives
   c. Claim representatives have apparent authority to modify policy condition
   d. Insurance agents have binding authority to make policy change through oral binder
3. Cancellation
   a. Insured can cancel policy anytime
   b. Insurer can cancel policy only for certain stated reasons with written notice within certain days (both reasons and days are determined by state regulation)
4. Nonrenewal
   a. Insurer has right not to renew
   b. Need written notice to insured at least 30 days in advance
5. Assignment – Any assignment without insurer's written consent is invalid
6. Subrogation
   a. Insured can waiver all rights to recovery against any person, if the waiver is in writing and made before loss
   b. In the absence of such pre-loss waiver, insurer can require insured to assign all rights of recovery against another person to insurer
7. Death – Insurer agrees, in case named insured or spouse should die, to cover the decedent's legal representative as insured

SAMPLE EXAM QUESTIONS

1. Which of the following is NOT an exclusion in Section II of the Homeowners HO-3 policy? (SOA GIINT February 2014)
   A. Intentional injuries.
   B. Business activities.
   C. Transmission of a communicable disease.
   D. The gradual yet accidental seepage of pollutants from the insured's septic system into the neighborhood water supply.
   E. Injuries caused by operation of a motor vehicle registered for use on public roads.

2. Which of the following statements regarding the "severability of insurance" condition in the HO-3 Special Form insurance policy is true? (SOA GIINT February 2014)
   I. The condition applies insurance separately to each insured.
   II. The condition does not increase the insurer's limit of liability for any one occurrence.
   III. The condition allows the policy to cover a claim brought by one insured against another insured.

   A. I only.
   B. I and II only.
   C. I and III only.
   D. II and III only.
   E. I, II, and III.

3. Which of the following motor vehicles is NOT covered under Section II – Liability coverage in the ISO HO-3 policy? (SOA GIINT February 2014)
   A. Motor vehicle in dead storage on an insured location.
   B. Motor vehicle powered by one or more batteries that cannot exceed five miles per hour on level ground that is designed as a toy for use by children under the age of seven.
   C. Motor vehicle used solely to service a residence.
   D. Motor vehicle used for snow removal on public roads within one mile of an insured location.
   E. Motor vehicle designed for assisting people who are handicapped

4. Which of the following statements is NOT true?
   A. Medical payment under ISO HO-3 policy is subject to a $1,000 limit that applies to each person in one accident.
   B. The limit of liability under ISO homeowners policy applies to any one occurrence.
   C. Legal fees to defend the policyholder are subject to the limit of liability for Coverage E of the ISO unendorsed HO-3 policy.
   D. Medical expenses incurred up to three years after the accident are covered under the ISO unendorsed HO-3 policy.
   E. Medical payment under ISO HO-3 medical payment coverage is not considered an admission of liability.

5. Which of the following is NOT covered under Section II–Additional Coverage of an ISO homeowners policy?
   A. Claim expenses.
   B. First aid expenses.
   C. Damage to property of others.
   D. Loss assessment
   E. Loss of use.

SAMPLE EXAM QUESTION ANSWERS

1. D
2. E
3. D
4. C
5. E
6. A
7. E
8. B
9. D
10. E