Insurance Test Practice

Hawaii Property & Casualty Insurance Practice Test

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1. An applicant cannot negotiate the wording of an insurer's standard policy. If an ambiguity is disputed, which contract characteristic generally causes it to be construed against the insurer?

A) Utmost good faith
✔ B) Contract of adhesion
C) Binder
D) Nonrenewal

Explanation: Contract of adhesion: A contract drafted by one party and generally interpreted against that drafter when wording is ambiguous.

2. An insured may pay a small premium and receive a much larger claim payment if an uncertain loss occurs. Which contract characteristic does this illustrate?

✔ A) Aleatory contract
B) Contract of adhesion
C) Material fact
D) Cancellation

Explanation: Aleatory contract: A contract in which the values exchanged may be unequal because performance depends on an uncertain event.

3. An insurer and applicant are expected to disclose material facts honestly during the insurance transaction. Which principle describes this expectation?

A) Representation
B) Certificate of insurance
✔ C) Utmost good faith
D) Earned premium

Explanation: Utmost good faith: The expectation that insurance parties disclose material facts and deal honestly.

4. The insurer's duty to pay depends on the insured satisfying duties such as giving prompt notice of loss. Which contract characteristic does this illustrate?

A) Aleatory contract
B) Concealment
C) Endorsement
✔ D) Conditional contract

Explanation: Conditional contract: A contract whose performance depends on specified duties or conditions.

5. Why is an insurance policy considered a unilateral contract?

A) Both parties exchange equally enforceable promises
B) The insured may negotiate every policy provision
✔ C) Only the insurer makes a legally enforceable promise to perform
D) The policy transfers ownership of insured property

Explanation: An insurance policy is unilateral because only the insurer makes a legally enforceable promise to pay or perform if covered conditions are met.

6. A false statement on an application that would influence the insurer's decision to issue the policy is known as a:

- ✔ A) Material misrepresentation
- B) Implied warranty
- C) Minor discrepancy
- D) Fraudulent waiver

Explanation: A material misrepresentation is a false statement that is significant enough to alter the insurer's underwriting decision or the premium rate.

7. After a loss, the insured is required to pay premiums and notify the insurer of the loss in order for the insurer to pay the claim. Because only one party (the insurer) makes a legally enforceable promise, the insurance contract is:

- A) Aleatory
- B) Conditional
- C) Personal
- ✔ D) Unilateral

Explanation: Insurance is a unilateral contract because only one party (the insurer) makes a legally binding promise to perform (pay claims). The insured can stop paying premiums at any time.

8. An insurance contract is prepared by the insurer with no room for negotiation by the insured. If there is an ambiguity in the policy wording, a court will likely interpret it in favor of the insured. This characteristic describes an:

- ✔ A) Contract of adhesion
- B) Aleatory contract
- C) Unilateral contract
- D) Personal contract

Explanation: Contracts of adhesion are take it or leave it. Because the insurer wrote the contract, any ambiguity is construed against the insurer and in favor of the insured.

9. An insured intentionally conceals the fact that he runs a home business out of his garage when applying for a standard homeowners policy. This failure to disclose a material fact is known as:

- ✔ A) Concealment
- B) Waiver
- C) Estoppel
- D) Warranty

Explanation: Concealment is the intentional withholding of material information that is crucial to the insurer's underwriting decision.

10. Because both parties must perform certain duties to keep an insurance contract in force, it is considered what type of contract?

A) Unilateral
B) Aleatory
C) Executory
✔ D) Conditional

Explanation: A conditional contract requires that certain conditions be met by both parties (e.g., the insured paying premiums and reporting losses) for the contract to be executed.

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11. Because only the insurer makes a legally enforceable promise to pay covered claims, an insurance contract is a:

✔ A) Unilateral contract
B) Bilateral contract
C) Contract of adhesion
D) Conditional contract

Explanation: Unilateral contract means only one party is legally bound to perform.

12. If an agent tells a client that a specific peril is covered, even though the policy excludes it, the insurance company may be prevented from denying the claim based on the concept of:

A) Subrogation
B) Adhesion
✔ C) Estoppel
D) Indemnity

Explanation: Estoppel is a legal doctrine that prevents a party from asserting a right or fact that contradicts their previous actions or statements (such as the agent's promise).

13. Samantha pays a $500 annual premium for her homeowners policy. During the year, her house burns down, and the insurer pays $250,000. This unequal exchange of value is characteristic of what type of contract?

A) Contract of adhesion
✔ B) Aleatory contract
C) Personal contract
D) Unilateral contract

Explanation: An aleatory contract involves an unequal exchange of value or consideration, dependent upon an uncertain future event (a claim).

14. When Mark submits a completed auto insurance application along with his first premium payment, what essential element of a contract has he fulfilled?

A) Offer
B) Acceptance
C) Consideration
✔ D) Both Offer and Consideration

Explanation: In an insurance contract, the offer is typically made by the applicant when submitting the application. The premium payment serves as the consideration (value given).

15. Which element of a legal contract requires that all parties be of legal age, mentally competent, and not under the influence of drugs or alcohol?

A) Consideration
B) Legal purpose
✔ C) Competent parties
D) Agreement

Explanation: Competent parties is a required element of a legal contract. Minors, intoxicated individuals, and the mentally incompetent generally lack the capacity to enter a binding contract.

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16. Which of the following describes a statement that is guaranteed to be absolutely true?

A) A representation
✔ B) A warranty
C) A concealment
D) An estoppel

Explanation: A warranty is a statement considered to be guaranteed true and becomes part of the contract. A representation is a statement believed to be true to the best of one's knowledge.

17. A mortgage company requires a borrower to carry homeowners insurance. Why does the mortgage company have an insurable interest?

A) Because they are the primary occupant of the home.
B) Because they manage the property taxes.
C) Because they are legally responsible for maintenance.
✔ D) Because they have a financial investment tied to the physical property as collateral.

Explanation: The lender's insurable interest stems from their financial stake in the property; if the house is destroyed, the collateral securing the loan is gone.

18. An insurer pays a $10,000 claim to an insured after their car is rear-ended by a negligent driver. The insurer then demands reimbursement from the negligent driver. What right is the insurer exercising?

- ✔ A) Subrogation
- B) Arbitration
- C) Appraisal
- D) Indemnification

Explanation: Subrogation allows the insurer, after paying a claim, to step into the shoes of the insured and recover the loss from the at-fault third party.

19. David sells his house to Mary on May 1st, but forgets to cancel his homeowners insurance. On May 15th, the house burns down. Why won't David's insurance pay him for the loss?

- A) Because the policy is a contract of adhesion
- B) Because the peril of fire was excluded
- ✔ C) Because David no longer has an insurable interest in the property at the time of loss
- D) Because of the principle of subrogation

Explanation: In Property & Casualty insurance, insurable interest must exist at the time of the loss. Since David sold the house, he no longer faces a financial loss from its destruction.

20. If a $10,000 piece of equipment is stolen and the insurer issues a check for $10,000 to replace it, this perfectly illustrates:

- A) The law of large numbers
- B) Adverse selection
- ✔ C) Indemnity
- D) Subrogation

Explanation: Indemnity is the process of making the insured whole again financially without allowing them to profit.

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21. In Property & Casualty insurance, when must an insurable interest exist for a claim to be valid?

- ✔ A) Only at the time of loss
- B) At the time of application and the time of loss
- C) Only at the time of application
- D) Either at application or at loss, but not both

Explanation: Unlike life insurance (where it must exist at application), P&C insurance requires insurable interest to exist at the specific time of the loss.

22. In commercial building and casualty insurance, Chloe must have an insurable interest in the commercial building at what time?

- A) At the time of application only
- ✔ B) At the time of loss
- C) At both application and loss
- D) Only when the policy is renewed

Explanation: For P&C, insurable interest must exist at the time of loss.

23. The concept that an insured should not be able to buy an insurance policy and intentionally cause a loss for profit is supported by the requirement of:

A) Aleatory contracts
✔ B) Insurable interest
C) Absolute liability
D) Proximate cause

Explanation: Insurable interest ensures the policyholder faces a genuine financial loss if the property is damaged, reducing the moral hazard of intentionally causing a loss for profit.

24. The principle of indemnity states that the insured should:

A) Profit from an insurance claim
✔ B) Be restored to the same financial condition they were in prior to the loss
C) Receive the full face value of the policy regardless of the actual loss amount
D) Only be compensated if the loss is catastrophic

Explanation: The principle of indemnity is designed to restore the insured to their pre-loss financial condition, preventing them from profiting from a loss.

25. What is the primary purpose of the subrogation clause in a property insurance policy?

A) To allow the insured to collect twice for the same loss
✔ B) To prevent the insured from collecting twice for the same loss
C) To waive the insured's deductible
D) To force the insured into arbitration

Explanation: Subrogation upholds the principle of indemnity by preventing the insured from collecting from both their insurer and the at-fault party for the same loss.

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26. Which of the following is NOT an example of someone with an insurable interest in a property?

A) A bank holding a mortgage on the property
B) A tenant renting the property
C) The legal owner of the property
✔ D) A neighbor who frequently visits the property

Explanation: Insurable interest requires a legitimate financial interest in the preservation of the property. A neighbor does not suffer a direct financial loss if the property is damaged.

27. Which of the following scenarios best demonstrates insurable interest?

A) An individual buys a fire policy on a famous historical building they admire.
B) A tenant buys a policy covering the landlord's structure.
✔ C) A dry cleaner purchases bailee's customer insurance to cover clothes left in their care.
D) A person insures a car that belongs to their completely independent adult child.

Explanation: A dry cleaner has temporary custody and financial responsibility for their customers' clothes, establishing a clear insurable interest. The other options lack direct financial risk.

28. A hailstorm occurred just before year-end, but many affected policyholders have not reported claims. Which reserve estimates these losses?

A) Conditions section
B) Transfer of recovery rights
C) Credit-based insurance score
✔ D) IBNR reserve

Explanation: IBNR reserve: A reserve for losses incurred but not yet reported.

29. After a covered claim is reported, an adjuster estimates the amount the insurer will ultimately pay. The insurer records that estimate as what?

A) Exclusions section
B) Recovered property condition
✔ C) Loss reserve
D) Inspection organization

Explanation: Loss reserve: An estimate of amounts needed for claims already incurred.

30. An insurer adds its loss ratio to its expense ratio to evaluate underwriting performance. What is the resulting measure?

A) Risk retention group
B) Excess of loss reinsurance
C) Experience rating
✔ D) Combined ratio

Explanation: Combined ratio: The sum of an insurer's loss ratio and expense ratio.

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31. An insurer has collected annual premiums but has not yet provided all twelve months of coverage. Where is the amount attributable to future coverage recorded?

A) Definitions section
✔ B) Unearned premium reserve
C) No benefit to bailee
D) Application warranty

Explanation: Unearned premium reserve: A liability representing premium for coverage not yet provided.

32. An insurer's earned premiums exceed its incurred losses and underwriting expenses. What has the insurer produced?

✔ A) Underwriting profit
B) Risk purchasing group
C) Catastrophe reinsurance
D) Schedule rating

Explanation: Underwriting profit: The positive result when premiums exceed losses and underwriting expenses.

33. Besides underwriting results, an insurer earns money by investing premiums and surplus. What is this revenue called?

A) Facultative reinsurance
✔ B) Investment income
C) Adverse selection
D) Manual rating

Explanation: Investment income: Income earned by investing premiums and insurer surplus.

34. What is the amount by which an insurer's admitted assets exceed its liabilities called?

✔ A) Policyholders surplus
B) Insuring agreement
C) Concealment or fraud condition
D) Investigative consumer report

Explanation: Policyholders surplus: Assets remaining after an insurer's liabilities are deducted.

35. Which ratio compares incurred losses and loss-adjustment expenses with earned premium?

A) Reciprocal exchange
✔ B) Loss ratio
C) Quota share reinsurance
D) Inspection report

Explanation: Loss ratio: Incurred losses and loss-adjustment expenses divided by earned premium.

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36. Which underwriting measure compares an insurer's operating expenses with premium?

A) Lloyd's association
B) Surplus share reinsurance
✔ C) Expense ratio
D) Loss history

Explanation: Expense ratio: Underwriting expenses divided by written or earned premium under the applicable convention.

37. A large company budgets its own funds to pay predictable losses instead of transferring them to an insurer. Which risk-financing method is it using?

A) IBNR reserve
B) Changes condition
✔ C) Self-insurance
D) Privacy notice

Explanation: Self-insurance: Planned retention in which an organization funds its own losses.

38. A lodge-based membership organization provides insurance benefits to its members. How is this organization classified?

- ✔ A) Fraternal benefit society
- B) Unearned premium reserve
- C) Assignment condition
- D) Adverse action notice

Explanation: Fraternal benefit society: A membership organization providing insurance benefits under a lodge system.

39. A manufacturing company forms an insurance company mainly to cover the risks of itself and its affiliates. What type of insurer is this?

- A) Loss reserve
- ✔ B) Captive insurer
- C) Death condition
- D) Gramm-Leach-Bliley privacy rule

Explanation: Captive insurer: An insurer formed primarily to cover risks of its parent or affiliated organizations.

40. A property owner cannot obtain required coverage from voluntary-market insurers. Which market mechanism may provide access to coverage?

- A) Declarations page
- B) Legal action condition
- C) Consumer report
- ✔ D) Residual market

Explanation: Residual market: A mechanism providing coverage to applicants unable to obtain it voluntarily.

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41. An insurer is owned by investors who hold shares in the company. What type of insurer is it?

- A) Treaty reinsurance
- B) Field underwriting
- ✔ C) Stock insurer
- D) Judgment rating

Explanation: Stock insurer: An insurer owned by shareholders.

42. An insurer is owned by its policyholders, who may elect directors and may receive dividends. What type of insurer is it?

- A) Quota share reinsurance
- B) Inspection report
- C) Loss cost
- ✔ D) Mutual insurer

Explanation: Mutual insurer: An insurer owned by its policyholders.

43. Businesses with similar liability exposures create and own an insurer to cover their members. What type of organization is this?

A) Catastrophe reinsurance
B) Schedule rating
✔ C) Risk retention group
D) Exposure unit

Explanation: Risk retention group: A liability insurer owned by members with similar or related liability exposures.

44. In which insurance market do syndicates or individual underwriters accept portions of a risk?

A) Excess of loss reinsurance
✔ B) Lloyd's association
C) Experience rating
D) Pure premium

Explanation: Lloyd's association: An insurance market in which syndicates or underwriters accept portions of risks.

45. Several businesses with similar liability exposures join together solely to purchase group liability insurance. What have they formed?

A) Adverse selection
B) Manual rating
C) Merit rating
✔ D) Risk purchasing group

Explanation: Risk purchasing group: A group formed to buy liability insurance for members with similar exposures.

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46. Subscribers insure one another through an unincorporated exchange managed by an attorney-in-fact. What is this arrangement called?

✔ A) Reciprocal exchange
B) Surplus share reinsurance
C) Loss history
D) Expense loading

Explanation: Reciprocal exchange: An unincorporated group whose subscribers exchange insurance through an attorney-in-fact.

47. A boldfaced word in a policy has a narrower meaning than its everyday usage. Which policy section should the insured consult?

✔ A) Definitions section
B) Changes condition
C) Adverse action notice
D) Loss prevention

Explanation: Definitions section: The policy section assigning special meanings to defined words and phrases.

48. A contractor provides a document summarizing its liability coverage to a project owner. The document generally does not change the policy. What is it?

A) Endorsement
B) Unearned premium
C) Unilateral contract
✔ D) Certificate of insurance

Explanation: Certificate of insurance: Evidence summarizing coverage that generally does not alter the policy.

49. A repair shop has custody of a customer's insured property when it is damaged. Which provision prevents the shop from using the customer's policy for its own benefit?

✔ A) No benefit to bailee
B) Adverse action notice
C) CLUE report
D) Residual market

Explanation: No benefit to bailee: A provision preventing a custodian of property from benefiting from the owner's insurance.

50. After paying a loss caused by a negligent third party, an insurer seeks recovery from that party. Which condition preserves this right?

A) Privacy notice
B) Loss prevention
✔ C) Transfer of recovery rights
D) Unearned premium reserve

Explanation: Transfer of recovery rights: The condition preserving the insurer's subrogation rights after payment.