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CPCU® 500 Practice Exam



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1

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The Institutes Becoming a Leader in Risk Management and Insurance Sample Questions (Q19-Q24):

NEW QUESTION # 19

Risks that arise from property, liability, or personnel loss exposures and are generally the subject of insurance are known as

- **A. Hazard risk.**
- B. Strategic risk.
- C. Operational risk.
- D. Financial risk.

Answer: A

Explanation:

CPCU 500 distinguishes among several broad categories of risk, including hazard risk, financial risk, operational risk, and strategic risk. The question focuses specifically on risks arising from property, liability, or personnel loss exposures, which are traditionally the core subjects of insurance coverage. These exposures involve accidental losses such as fire damage to buildings, liability claims from third-party injuries, or employee injuries and illnesses.

These types of exposures fall under hazard risk. Hazard risk refers to risks arising from property damage, legal liability, or personnel-related losses that typically involve only the possibility of loss or no loss. They are accidental in nature and are the primary domain of property-casualty insurance. Insurers are structured to pool and finance these risks because they can be analyzed in terms of frequency and severity and are generally fortuitous.

The other options describe different risk categories in CPCU 500. Strategic risk involves high-level decisions that affect an organization's long-term objectives and competitive position. Operational risk relates to failures in internal processes, systems, or people that disrupt business operations. Financial risk concerns market factors such as interest rates, credit risk, or liquidity. Because property, liability, and personnel loss exposures are the traditional insurable hazards addressed by insurance policies, they are correctly classified as hazard risk.

NEW QUESTION # 20

Company 1 sells Company 2 a piece of farm equipment. The sales contract specifies that Company 2 buys the equipment in an "as is" condition, with no promises made regarding the durability or performance of the equipment. This language in the warranty is known as

- **A. A disclaimer of warranties.**
- B. A disavowal.
- C. A limitation of liability.
- D. An exculpatory clause.

Answer: A

Explanation:

In CPCU 500, understanding risk and insurance solutions includes recognizing how contracts manage risk through provisions that allocate responsibility. In sales transactions, one major legal exposure is warranty liability. Warranties can be expressed (affirmations or promises about quality/performance) or implied by law (such as implied warranty of merchantability or fitness for a particular purpose, depending on the situation). If a seller wants to reduce or eliminate warranty-based responsibility, the contract may include language that disclaims warranties.

The phrase "as is" is a classic example of a disclaimer of warranties. It communicates that the buyer accepts the equipment in its current condition and that the seller is not making promises about durability, performance, or quality. The purpose is to prevent the buyer from later claiming the seller breached implied warranties when the equipment fails or does not perform as expected. In other words, it attempts to shift the risk of defects or poor performance from the seller to the buyer.

The other options do not match as precisely. An exculpatory clause generally attempts to release a party from liability for negligence (often in service or activity contexts), not specifically to negate sales warranties.

A limitation of liability typically caps the amount or types of damages recoverable rather than stating no warranties exist. "Disavowal" is not the standard contract term used for "as is" warranty language in this context.

NEW QUESTION # 21

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

- A. Litigation-driven cost inflation
- B. Coronavirus pandemic
- C. Climate change
- D. Threat of terrorism

Answer: C

Explanation:

In CPCU 500, anticipating what could go wrong requires recognizing emerging and evolving risk drivers that can change both the frequency and severity of loss. The actions described—tightening underwriting for risk concentration, recalibrating models to reflect recent event experience, and advocating for stronger building codes—are hallmark responses to climate change and related catastrophe trends.

Climate change is associated with shifting hazard patterns and more volatile weather-related loss experience, which creates problems for insurers that rely on historical loss data and stable probability assumptions. When recent catastrophe experience changes materially, insurers often adjust catastrophe and pricing models to better reflect updated conditions. They also pay closer attention to accumulation and concentration risk, because correlated events (for example, hurricanes, wildfires, convective storms, or flood) can produce many losses at once within the same geographic area or portfolio segment, stressing capacity and surplus.

Building code advocacy fits the same challenge: as hazards intensify or expand, improving resiliency reduces expected losses by making structures better able to withstand wind, fire, flood, and other catastrophe perils.

From a risk management perspective, stronger codes are a form of loss control that can improve long-term insurability and affordability.

The other options do not match as well. Pandemic responses focus more on business interruption disputes, exclusions, and operational continuity. Litigation-driven inflation is addressed through claims strategies and tort risk management. Terrorism responses center on terrorism modeling and specialized coverage programs.

NEW QUESTION # 22

An earthquake destroyed the facilities of the main supplier of mufflers for an auto manufacturer. This is an example of which one of the following types of operational risk for the auto manufacturer?

- A. Systems risk
- B. Performance risk
- C. Process risk
- D. External event risk

Answer: D

Explanation:

CPCU 500 emphasizes anticipating breakdowns in how an organization operates, including disruptions that originate outside the organization but still affect its ability to deliver products and services. Operational risk commonly includes categories such as systems risk, process risk, performance risk, and external event risk. The key to this question is identifying that the trigger is not an internal failure at the auto manufacturer, but a disruptive event occurring in the external environment that impacts operations through the supply chain.

Here, an earthquake destroys the facilities of the manufacturer's main supplier of mufflers. A natural disaster is an external event, and the resulting interruption is a classic supply chain disruption. Even though the loss physically occurs at the supplier's site, the auto manufacturer experiences operational consequences such as production delays, inability to meet delivery schedules, increased costs to source alternative parts, potential penalties, and reputational harm. This aligns directly with external event risk, which includes losses caused by events outside the organization's direct control (for example, natural catastrophes, political events, terrorism, or major third-party outages).

By contrast, systems risk relates to failures of IT systems or infrastructure, process risk involves breakdowns in internal procedures and controls, and performance risk focuses on failures to meet objectives due to people or execution issues. Because the initiating cause is an external catastrophe affecting a third party, the correct classification is external event risk.

NEW QUESTION # 23

The commercial lines unit at ABC Insurance has been given several objectives as a result of senior management's strategic planning

discussions. ABC wants to become a leader in professional liability insurance, offering not only specifically tailored insurance products, but also consulting services to assist insureds in reducing their professional liability loss exposures. The goal is to become recognized as a specialist insurer and to be able to charge appropriately higher rates for the coverage. This is an example of which one of the following business-level strategies?

- A. Differentiated harvest strategy
- B. Focused cost leadership
- C. Differentiated cost leadership
- **D. Focused differentiation**

Answer: D

Explanation:

CPCU 500 explains business-level strategy as how an organization competes in a particular market to create value and achieve an advantage. A key framework distinguishes cost leadership from differentiation, and whether the firm targets a broad market or a narrow focus segment. A focused differentiation strategy means competing in a specialized niche by offering unique value that customers perceive as superior, allowing the organization to command premium pricing.

ABC's objectives align directly with focused differentiation. The company is not trying to be the lowest-cost provider. Instead, it aims to become a specialist in professional liability insurance and to deliver tailored products plus consulting services that help insureds reduce loss exposures. That combination increases perceived value through expertise, customized coverage, and risk management support. In CPCU 500 terms, this is differentiation because ABC is enhancing the product-service bundle beyond standard insurance, and it is focused because it targets a specific line of business and customer need rather than the entire commercial market. The ability to "charge appropriately higher rates" is an expected outcome of differentiation when the market recognizes the insurer's specialized expertise and added services. The other choices do not fit: focused cost leadership emphasizes low cost in a niche, while harvest strategies are about maximizing cash flow from mature offerings rather than building leadership through superior value.

NEW QUESTION # 24

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