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## CPCU® 500 Practice Exam

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## The Institutes Becoming a Leader in Risk Management and Insurance Sample Questions (Q50-Q55):

### NEW QUESTION # 50

Which one of the following best summarizes the forces that drive competition in the insurance industry, as analyzed under the Five Forces Model?

- A. Financial institution involvement, insurance regulation, and economic downturns
- **B. Bargaining power of customers and reinsurers, threat of new entrants, and rivalry among existing firms**
- C. Threat of new entrants, economic downturns, and rivalry among the insurer's management team
- D. Customer buying power, customer loyalty, and changes in customer preferences

**Answer: B**

Explanation:

CPCU 500 uses Porter's Five Forces Model to explain what shapes competitive intensity and profitability in an industry. The model focuses on five structural forces: rivalry among existing competitors, threat of new entrants, threat of substitutes, bargaining power of buyers, and bargaining power of suppliers. In insurance, buyers are typically policyholders (often working through agents/brokers), while key suppliers can include capital providers and, importantly, reinsurers, because reinsurance capacity and pricing influence an insurer's cost structure and risk-taking ability.

Option B best summarizes the model because it explicitly includes multiple core Five Forces elements:

bargaining power of customers (buyers), bargaining power of reinsurers (suppliers), threat of new entrants, and rivalry among existing firms. Even though it does not list all five forces (it omits substitutes), it is the only choice that accurately reflects the Five Forces framework and applies it appropriately to insurance by identifying a major supplier-side force.

Option A contains business factors, but not the Five Forces structure. Option C incorrectly includes "rivalry among the insurer's management team," which is not an industry force. Option D lists environmental influences (regulation, economic downturns) that can matter, but they are not the Five Forces and do not describe the model's competitive drivers. Therefore, B is the correct answer.

### NEW QUESTION # 51

The spouse of an employee sues the employer for loss of companionship and care resulting from the employee's work-related injury. What coverage, if any, is provided by the Workers Compensation and Employers Liability Insurance Policy for this claim?

- A. Other States Insurance
- B. Not covered by the workers compensation or employers liability policy
- C. Workers Compensation Liability Insurance
- **D. Employers Liability Insurance**

**Answer: D**

Explanation:

CPCU 500 coverage analysis stresses identifying who is making the claim, the legal theory involved, and which insuring agreement responds. Workers Compensation and Employers Liability Insurance contains two distinct parts that address different obligations. Workers Compensation Insurance applies to the employer's statutory duty to pay workers compensation benefits to an injured employee under the applicable workers compensation law. Those benefits are typically exclusive and are paid to or for the benefit of the employee, not to third parties bringing separate tort claims.

A spouse's lawsuit for loss of companionship and care is a classic "loss of consortium" or "consequential damages" claim. It is not a statutory workers compensation benefit claim by the employee; rather, it is a civil claim by a third party alleging damages that arise because of bodily injury to the employee. That type of claim is addressed under Employers Liability Insurance, which covers sums the employer becomes legally obligated to pay as damages because of bodily injury to an employee arising out of and in the course of employment, including certain derivative claims brought by others. In other words, the injury is to the employee, but the damages being sought are a consequence of that injury.

Other States Insurance is designed to extend workers compensation obligations to states not listed in Item 3.A.

when conditions are met; it does not convert a third-party consortium claim into a workers compensation benefit. Therefore, the applicable coverage is Employers Liability Insurance.

### NEW QUESTION # 52

Ann's Cards and Gift Shop was insured for \$30,000 under a Business Income and Extra Expense Coverage Form with a 70 percent coinsurance clause. Ann estimated her net income and all operating expenses to be

\$50,000 for the coming year. A fire at the shop caused damage that took one month to repair. During that month, Ann lost \$2,000 in net income and continuing expenses and incurred \$800 to rent space for temporary operations. How much did Ann's insurer pay for the loss under her Business Income and Extra Expense Coverage Form?

- A. \$1,400
- B. \$2,400
- C. \$800
- D. \$2,800

**Answer: B**

Explanation:

Under CPCU 500 coverage analysis, Business Income and Extra Expense coverage is subject to both a policy limit and the coinsurance condition. Coinsurance is designed to encourage the insured to carry an amount of insurance that is proportional to the exposure, measured as the expected annual business income value. Here, Ann's annual business income value is given as net income plus operating expenses of \$50,000. With a 70 percent coinsurance requirement, the minimum required limit is  $\$50,000 \times 0.70 = \$35,000$ .

Ann carried only \$30,000, so she did not meet coinsurance. The coinsurance fraction is the limit carried divided by the limit required:  $\$30,000 \div \$35,000 = 0.857142857$ . The covered loss consists of two parts during the one-month restoration period: \$2,000 of business income loss plus \$800 of extra expense, for a total of \$2,800. Under the Business Income and Extra Expense form, the coinsurance penalty applies to the amount payable for the covered business income loss and necessary extra expense, subject to the policy limit.

Applying the coinsurance fraction:  $\$2,800 \times 0.857142857 = \$2,400$ . This amount is below the \$30,000 policy limit, so the insurer pays \$2,400.

#### NEW QUESTION # 53

The owner of Toto Industries is evaluating various workers compensation plans for their ability to meet the organization's risk financing goals. The guaranteed cost policy is less effective than other programs in meeting which one of the following goals?

- A. Comply with legal and regulatory requirements
- B. Manage uncertainty
- C. Minimize the cost of risk
- D. Pay for losses

**Answer: C**

Explanation:

In CPCU 500, risk financing programs are evaluated by how well they help an organization (1) pay for losses, (2) comply with legal requirements, (3) manage uncertainty, and (4) minimize the cost of risk. A workers compensation guaranteed cost policy is the most traditional arrangement: the insured pays a fixed premium (subject to audit), and the insurer assumes the uncertainty of claim frequency and severity. This structure is very effective for paying for losses and managing uncertainty because the organization trades a known premium for the insurer's promise to fund covered claims. It also supports legal compliance, since workers compensation insurance (or an approved alternative) is required in most jurisdictions.

Where guaranteed cost is typically less effective in minimizing the total cost of risk compared with more risk-sensitive plans. The guaranteed cost premium includes insurer expenses, profit provisions, and risk charges for volatility—costs that may exceed the organization's ultimate loss experience. In contrast, programs such as large-deductible, retrospective rating, or self-insurance (where permitted) can reduce frictional costs and align the organization's payments more closely with its actual losses, especially for firms with strong safety performance and predictable loss results. Those alternative plans also strengthen financial incentives for loss control because improved results can translate more directly into lower net costs.

#### NEW QUESTION # 54

Which one of the following quadrants of risk deals with uncertainties associated with the organization's procedures, systems, and policies?

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

**Answer: C**

Explanation:

CPCU 500 categorizes enterprise risks into four primary quadrants: hazard, financial, operational, and strategic. Understanding these distinctions is fundamental to properly identifying, assessing, and managing risk across an organization.

Operational risk refers to uncertainties that arise from an organization's internal processes, people, systems, and day-to-day procedures. This includes failures in internal controls, technology breakdowns, inadequate policies, human error, fraud, or inefficient workflows. Because the question specifically references uncertainties associated with procedures, systems, and policies, it directly aligns with the definition of operational risk. These risks typically affect an organization's ability to execute its business plan effectively and efficiently.

By contrast, hazard risk involves accidental losses such as property damage, liability claims, or injuries—generally insurable exposures. Financial risk relates to market fluctuations, credit risk, liquidity issues, or changes in interest rates and capital structure. Strategic risk stems from high-level business decisions that affect long-term direction, such as mergers, acquisitions, or entering new markets.

CPCU 500 emphasizes that operational risks are often controllable through strong governance, internal controls, employee training, and effective system design. Proper identification and management of operational risk help ensure consistency, reliability, and regulatory compliance within the organization. Therefore, the correct quadrant in this case is Operational risk.

## NEW QUESTION # 55

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
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