

Name \_\_\_\_\_

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 1) Traditionally, risk has been defined as \_\_\_\_\_  
A) any situation in which the probability of loss is zero.  
B) the probability of a loss occurring.  
C) uncertainty concerning the occurrence of loss.  
D) any situation in which the probability of loss is one.
- 2) Objective risk is defined as \_\_\_\_\_  
A) the cause of loss.  
B) the probability of loss.  
C) the relative variation of actual loss from expected loss.  
D) uncertainty based on a person's mental condition or state of mind.
- 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 5 percent.  
B) It would remain the same.  
C) It would decrease to 1 percent.  
D) It would increase to 20 percent.
- 4) Uncertainty based on a person's mental condition or state of mind is known as \_\_\_\_\_  
A) objective probability.  
B) subjective probability.  
C) subjective risk.  
D) objective risk.
- 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) subjective risk.  
B) objective probability.  
C) subjective probability.  
D) objective risk.
- 6) Which of the following statements about *a priori* probabilities is correct? \_\_\_\_\_  
A) They are objective probabilities that can be determined by deductive reasoning.  
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 subjective reasoning.  
D) They are subjective probabilities based on ambiguity in the way probability is perceived.
- 7) An individual's personal estimate of the chance of loss is \_\_\_\_\_  
A) a subjective probability.  
B) an *a priori* probability.  
C) an objective risk.  
D) an objective probability.
- 8) A peril is \_\_\_\_\_  
A) a condition which increases the chance of a loss.  
B) the probability that a loss will occur.  
C) the cause of a loss.  
D) a moral hazard.

- 9) An earthquake is an example of \_\_\_\_\_  
 A) a moral hazard. B) an objective risk.  
 C) a physical hazard. D) a peril.
- 10) Dense fog that increases the chance of an automobile accident is an example of \_\_\_\_\_  
 A) a physical hazard. B) a moral hazard.  
 C) a peril. D) a speculative risk.
- 11) Faking an accident to collect insurance proceeds is an example of \_\_\_\_\_  
 A) attitudinal hazard. B) objective risk.  
 C) moral hazard. D) physical hazard.
- 12) Carelessness or indifference to a loss is an example of \_\_\_\_\_  
 A) moral hazard. B) objective probability.  
 C) attitudinal hazard. D) physical hazard.
- 13) Some characteristics of the judicial system and regulatory environment increase the frequency and severity of loss. This hazard is called \_\_\_\_\_  
 A) attitudinal hazard. B) legal hazard.  
 C) physical hazard. D) moral hazard.
- 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 loss are known as \_\_\_\_\_  
 A) legal hazard. B) speculative risk.  
 C) particular risk. D) moral hazard.
- 15) A name that encompasses all of the major risks faced by a business firm is \_\_\_\_\_  
 A) pure risk. B) financial risk.  
 C) speculative risk. D) enterprise risk.
- 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
- 17) One of the speculative financial risks considered in an enterprise risk management program is the risk of loss because of adverse changes in commodity prices, interest rates, foreign exchange rates, and the value of money. This risk is called \_\_\_\_\_  
 A) operational risk. B) strategic risk.  
 C) financial risk. D) property risk.
- 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) enterprise risk management program. B) financial risk management program.  
 C) fundamental risk management program. D) consequential risk management program.

- 19) A pure risk is defined as a situation in which there is \_\_\_\_\_  
A) a possibility of either profit or loss. B) a possibility of neither profit nor loss.  
C) only the possibility of profit. D) only the possibility of loss or no loss.
- 20) The premature death of an individual is an example of \_\_\_\_\_  
A) a speculative risk. B) a pure risk.  
C) a nondiversifiable risk. D) a physical hazard.
- 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 involve only a chance of loss.  
D) They may benefit society even though a loss occurs.
- 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
- 23) All of the following are programs to insure fundamental risks EXCEPT \_\_\_\_\_  
A) Social Security. B) auto physical damage insurance.  
C) federally subsidized flood insurance. D) unemployment insurance.
- 24) All of the following are examples of personal risks EXCEPT \_\_\_\_\_  
A) poor health. B) premature death.  
C) unemployment. D) loss of business income.
- 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
- 26) Which of the following is (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
- 27) Which of the following is an example of consequential (indirect) loss? \_\_\_\_\_  
A) the vandalism of a person's automobile  
B) the destruction of a firm's manufacturing plant by an earthquake  
C) the theft of a person's jewelry  
D) the cost of renting a substitute vehicle while a collision-damaged car is being repaired
- 28) The extra expense incurred by a business to stay in operation following a fire is an example of a(n) \_\_\_\_\_  
A) speculative risk. B) indirect loss.  
C) direct loss. D) fundamental risk.

- 29) Which of the following statements about liability risks is (are) true? 29) \_\_\_\_\_  
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
- 30) All of the following are burdens to society because of the presence of risk EXCEPT 30) \_\_\_\_\_  
A) Risk provides an incentive for people to engage in loss control.  
B) The size of an emergency fund must be increased.  
C) Society is deprived of certain goods and services.  
D) Mental fear and worry are present.
- 31) Loss control includes which of the following? 31) \_\_\_\_\_  
I. Loss reduction  
II. Loss prevention  
A) I only B) II only C) both I and II D) neither I nor II
- 32) Following good health habits can be categorized as 32) \_\_\_\_\_  
A) personal insurance. B) risk retention.  
C) noninsurance transfer. D) loss prevention.
- 33) From the insured's perspective, the use of deductibles in insurance contracts is an example of 33) \_\_\_\_\_  
A) risk control. B) risk transfer. C) risk avoidance. D) risk retention.
- 34) The use of fire-resistive materials when constructing a building is an example of 34) \_\_\_\_\_  
A) risk retention. B) risk control. C) risk transfer. D) risk avoidance.
- 35) All of the following statements about risk retention are true EXCEPT 35) \_\_\_\_\_  
A) It may be used intentionally if commercial insurance is unavailable.  
B) It may be used passively because of ignorance.  
C) Its use results in cost savings if losses are less than the cost of insurance.  
D) Its use is most appropriate for low-frequency, high-severity types of risks.
- 36) Which of the following is an example of a noninsurance risk transfer? 36) \_\_\_\_\_  
A) not engaging in dangerous activities  
B) using nonflammable building material when constructing a house  
C) entering into a hold-harmless agreement  
D) installing smoke detectors in your home
- 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 37) \_\_\_\_\_  
A) adverse selection. B) attitudinal hazard.  
C) nondiversifiable risk. D) moral hazard.

- 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 lost profits that could have been earned while the restaurant was closed for repairs. The lost profits are an example of \_\_\_\_\_
- A) nondiversifiable risk. B) speculative risk.  
C) indirect loss. D) direct loss.
- 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) noninsurance transfer. B) fundamental risk.  
C) risk retention. D) objective risk.
- 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 risk. B) subjective risk.  
C) subjective probability. D) objective probability.
- 41) Williams Company installed smoke detectors, a sprinkler system, and fire extinguishers in its new manufacturing facility. These devices are all examples of \_\_\_\_\_
- A) risk avoidance. B) risk retention.  
C) noninsurance transfer. D) risk control.
- 42) Which of the following statements about hedging is (are) true? \_\_\_\_\_
- I. Hedging is a form of risk transfer.  
II. Hedging is used to address the risk of unfavorable price fluctuations.
- A) I only B) II only C) both I and II D) neither I nor II
- 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) indirect loss. B) physical hazard.  
C) subjective risk. D) peril.
- 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) speculative risk. B) nondiversifiable risk.  
C) subjective risk. D) pure risk.
- 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) liability risk. B) property risk.  
C) nondiversifiable risk. D) speculative risk.
- 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 retention. B) hedging. C) risk avoidance. D) risk transfer.

- 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) attitudinal hazard. D) moral hazard.
- 48) All of the following are characteristics of the liability risk that most people face EXCEPT \_\_\_\_\_
- A) there is no upper limit on the amount of the loss.  
B) substantial legal expenses may be incurred defending the claim.  
C) a lien may be placed on your income and assets to satisfy a legal judgment.  
D) owning liability insurance eliminates the possibility of being held legally liable.
- 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
- 50) A risk that affects only individuals or small groups and not the entire economy is called a \_\_\_\_\_
- A) pure risk. B) nondiversifiable risk.  
C) diversifiable risk. D) speculative risk.
- 51) Which of the following is an example of a commercial risk? \_\_\_\_\_
- A) the risk of being unemployed B) the risk of insufficient retirement income  
C) the loss of business income D) the risk of premature death
- 52) A special form of planned retention by which part or all of a give loss exposure is retained by the firm is called \_\_\_\_\_
- A) self-insurance. B) noninsurance transfer.  
C) hedging. D) passive retention.
- 53) The production facility for ABC Manufacturing is located in a flood plain. Although the risk of flood is low, ABC's risk manager is concerned that a flood could damage the plant and equipment. He got bids on flood insurance from two insurance agents, but decided the cost of coverage was too high relative to the risk. So he did not purchase flood insurance. Which risk management technique is ABC using with respect to the risk of flood? \_\_\_\_\_
- A) active retention B) passive retention  
C) avoidance D) noninsurance transfer
- 54) A student who has skipped many classes and not studied the course material was surprised to learn there was a test when he showed-up for class. The student's mental uncertainty about whether or not he will pass the test is called \_\_\_\_\_
- A) objective risk. B) subjective risk.  
C) subjective probability. D) objective probability.
- 55) Rapid inflation, cyclical unemployment, war, hurricanes, and floods are all examples of \_\_\_\_\_
- A) physical hazards. B) speculative risks.  
C) nondiversifiable risks. D) diversifiable risks.

- 56) Five years ago, Shannon decided to start investing. She likes ABC Telecom Company, and she invests in the company each month. As ABC Telecom is the only company in which she invests, Shannon's financial well-being will be harmed if the price of ABC Telecom stock drops significantly. The risk of investment loss can be reduced if Shannon invests in other companies and other types of financial assets. For Shannon, the risk she faces with regard to her investments is a(n)
- A) nondiversifiable risk.
  - B) enterprise risk.
  - C) pure risk.
  - D) diversifiable risk.

56) \_\_\_\_\_

## Answer Key

Testname: UNTITLED1

- 1) C
- 2) C
- 3) C
- 4) C
- 5) B
- 6) A
- 7) A
- 8) C
- 9) D
- 10) A
- 11) C
- 12) C
- 13) B
- 14) A
- 15) D
- 16) D
- 17) C
- 18) A
- 19) D
- 20) B
- 21) D
- 22) B
- 23) B
- 24) D
- 25) C
- 26) C
- 27) D
- 28) B
- 29) A
- 30) A
- 31) C
- 32) D
- 33) D
- 34) B
- 35) D
- 36) C
- 37) D
- 38) C
- 39) A
- 40) A
- 41) D
- 42) C
- 43) B
- 44) A
- 45) A
- 46) C
- 47) B
- 48) D
- 49) B
- 50) C



## Answer Key

Testname: UNTITLED1

51) C

52) A

53) A

54) B

55) C

56) D