

CPCU® 520

Study Guide and Practice Exam



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CPCU® 520 Study Guide



Study guide includes a breakdown of each CPCU® 520 chapter, a list of the most important topics for each chapter, and study tips to help you master each chapter.

See your practice exam on page 15

Chapter 1 - Insurer Operations

Chapter Overview: Section one is important. It builds a foundation on which the rest of the course will be based; the rest of this course will build on top of these core concepts in more detail. If you don't understand these concepts you will have trouble with the rest of the course. So, make sure to focus on this section.

Chapter 1: Studying Focus

Know the three types of insurer ownership.

Know the three types of insurer incorporation.

Memorize the three primary functions of the insurer.

Memorize are the five main goals of an insurer.

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Chapter 2 - Regulating Insurance

Chapter Overview: Prepare yourself for the longest section of the CPCU® 520 course. Luckily, the content of this section is not overly difficult. The chapter may be long but most of the content is straightforward and definition based.

Chapter 2: Studying Focus

Understand the purpose of regulators.

Understand the purpose of the insurance commissioner.

Memorize the five functions of the insurance regulator.

Understand the three goals regulators consider when reviewing rates.

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Chapter 3 - Marketing and Distribution

Chapter Overview: Prepare to see a lot of questions from section three on your CPCU® 520 exam. We found section three to be one of the most important sections. You'll see a lot of questions on your exam from this section.

Note: Out of the ten sections in the CPCU® 520 Comprehensive course, we rank this as the 2nd most important section.

Chapter 3: Studying Focus

The different type of distribution systems.

Difference between an independent agent and broker.

Characteristics of insurance customers.

Functions of the producer.

The six distribution channels.

Factors affecting the selection of distribution channel and system.

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Chapter 4 - Underwriting

Chapter Overview: Section four is one of the less important sections. Some of the topics are a bit difficult (like calculating combined ratio) but we've never heard of this being an overly important chapter. That being said, the section still needs to be studied. You can expect to see 4-5 questions from section four on your exam.

Chapter 4: Studying Focus

The purpose of underwriting.

Difference between line underwriter and staff underwriter.

Purpose of underwriting guidelines.

Cause of misleading combined ratios.

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Chapter 5 - Risk Control and Auditing

Chapter Overview: Section five is one of the most important sections. In our opinion, this is one of the most referenced sections on the CPCU® 520 exam. The concepts from this section are a bit difficult because premium auditing is a new concept to most students. Pay close attention to this section, you'll likely have a lot of questions from section five on your exam.

Chapter 5: Studying Focus

The reason for premium auditing.

The process for conducting a premium audit.

The types of premium audit.

Goals of risk control.

Importance of an accurate audit.

Note: Out of the ten sections in the CPCU® 520 Comprehensive course, we rank this as the 3rd most important section. You'll see a lot of questions from section five on your exam.

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Chapter 6 - Claims

Chapter Overview: Section six is one of the easier sections. The topics of this chapter are relatively straightforward, nothing too difficult.

Chapter 6: Studying Focus

The two primary goals of the claims function.

The six members of the claims function.

The six-step claims process.

Access security.

Authority level.

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Chapter 7 - Actuarial

Chapter Overview: Section seven is, in our opinion, the most difficult section of the CPCU® 520. This chapter includes a lot of difficult concepts including ratemaking, reserving, and loss development. Although this is one of the harder sections, it's also one of the least important sections. The concepts are difficult, but you will likely only see 4-5 questions from this section on your exam.

Note: Out of the ten sections in the CPCU® 520 Comprehensive course, we rank this as the most difficult section. This section is tough, take some extra time to master this section.

Chapter 7: Studying Focus

The three methods of ratemaking.

Difference between case reserve and bulk reserve.

Methods of estimating loss reserve.

Effect of overestimate and underestimate of reserves.

Characteristics of rate.

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Chapter 8 - Reinsurance

Chapter Overview: Section eight is important. In our opinion, this is the most referenced section on the CPCU® 520 exam. Not only is this section important, but it's also one of the most difficult sections of the exam. Pay close attention to this section, you'll likely have a lot of questions from section eight on your exam.

Chapter 8: Studying Focus

Purpose of reinsurance.

The three methods of ratemaking.

Calculate how much the reinsurer will pay.

Types of excess of loss reinsurance and the differences between each.

Types of pro rata reinsurance and the differences between each.

Types of reinsurance agreements and the differences between each.

TIP: You must know how to calculate the amount of reinsurance to be paid. You will see this type of question as a Part B case question on your exam.

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Chapter 9 - Information Technology

Chapter Overview: Section nine is, in our opinion, the least important section of the CPCU® 520 exam. It's also one of the easiest sections to comprehend. Like we've mentioned in earlier sections, you still need to fully study this chapter. Don't pass it over; you can expect to see 3-4 questions from section nine on your exam.

Chapter 9: Studying Focus

The purpose of IT.

Difficulties in aligning IT with the insurer strategy.

Types of business information systems.

Types and causes of security risk.

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Chapter 10 - Strategic Management

Chapter Overview: Section ten is the easiest section of the CPCU® 520 course. Like we've mentioned in earlier sections, you still need to fully study this chapter. Don't pass it over; you can expect to see 3-4 questions from section ten on your exam.

Chapter 10: Studying Focus

SWOT Analysis.

Five Forces Analysis.

Four corporate level strategies.

Vision statement vs. Mission statement.

Organization structures.

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CPCU® 520 Practice Exam



Presented by: AssociatePI

1. XYZ insurance is insured with a per policy excess of loss reinsurance agreement with a \$200,000 attachment point.

During the past month, XYZ incurred the following liability losses:

Policy A: \$50,000

Policy B: \$10,000

Policy C: \$170,000

Policy D: \$200,000

How much will XYZ's reinsurance contract pay?

A. \$0

B. \$230,000

C. \$430,000

D. \$200,000



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2. ABC Mutual Insurance submits a proposal to the Department of Insurance to increase their homeowner liability rates by 7%. Without a response from the Department of Insurance, ABC Mutual Insurance implements their rate change after 30 days. This is an example of which rating law?

- A. File and use
- B. Use and file
- C. Flex rating
- D. Prior approval



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3. Matrix Insurance has \$100,000 written premium, \$90,000 earned premium, and \$10,000 investment income for the year.

Matrix incurred \$50,000 in losses, \$10,000 in underwriting expenses, and \$25,000 in total expenses for the same year. Total net income for the year was \$30,000.

What is Matrix's operating ratio rounded to the nearest whole number?

- A. 66%
- B. 87%
- C. 55%
- D. 120%



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4. Regulators monitor producer practices and conduct to protect the insurance consumer. Producers can be penalized or fined if they act illegally and in an unethical manner. Illegal and unethical practices include discrimination, rebating, and twisting. Which of the following is an example of twisting?

- A. Mac, an independent agent, entices his customer to switch their coverage to XYZ Insurance Company because XYZ offers a higher commission.
- B. Jason, an independent agent, entices his client to purchase insurance with ABC Company by falsely claiming that ABC's auto policy will also insure his home.
- C. Macy, a producer for TNT Insurance Company, offers her customer 1% of her commission if they purchase insurance from TNT Insurance.
- D. Danny, an underwriter, chose to use old underwriting rules when assigning a rate to a new customer because it would give them a lower premium.



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5. Jack, a homeowner in Florida, lives only 100 feet from the coast and needs \$750,000 dwelling coverage. Because Jack needs such high dwelling coverage and lives so close to the coast, he is unable to obtain homeowner coverage. Which insurance system would Jack use to find insurance coverage?

- A. Exclusive agent
- B. Surplus lines broker
- C. Managing general agent
- D. Independent agent network



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6. The purpose of underwriting is to develop and maintain a profitable book of business for the insurance organization. The underwriting policy and underwriting guidelines are used to effectively develop a profitable book of business. All of the following are true in regards to the underwriting policy and underwriting guidelines except?

- A. The underwriting policy guides underwriter decision making by explaining the acceptable level of risk an insurer is willing to insure.
- B. The underwriting policy is used to form the underwriting guidelines.
- C. Staff underwriters are responsible for revising the underwriting guidelines.
- D. The underwriting guideline is updated frequently to reflect changes in the underwriting policy.



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7. Premium audits are intended to determine the correct policy premium of insurance accounts. This can result in a premium increase or a premium decrease. All of the following are reasons for premium audits, except?

- A. Audits help to gather the necessary information for the insurer's statistical report sent to rating organizations and regulators.
- B. Premium audits allow the insurer to adjust new business premiums to an accurate level.
- C. Premium audits help to compare renewal premium estimates to the expected loss exposures.
- D. Deters policyholders from committing fraud.



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8. A safety management program is a service offered by insurers to help customers analyze and reduce their risk of loss. All of the following are steps in the safety management program, except?

- A. Dan, the risk control representative, helps his client monitor the success of a new fire sprinkler system installed last year.
- B. Ian, the risk management representative, analyzes his client's office and determines that they are in need of a fire escape plan.
- C. Jerry, the risk management representative, sets the goal for his client to install a new security system within 3 months. The goal is to reduce theft loss by \$150,000.
- D. Marry, the risk control representative, installs a new burglar alarm in her client's office and contracts a third party to train employees on workplace safety.



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9. If an insurer underestimates loss reserves,

- A. Insurance rates will be priced too high.
- B. Rates will not be adequate.
- C. Regulators will assess fines.
- D. The insurer will face federal charges.



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10. IT is a crucial resource to drive business operations. IT is important for all of the following reasons, except?

- A. Increase efficiency
- B. Assist risk and compliance programs
- C. Gain competitive advantage
- D. Support industry technological advances



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CPCU® 520 Exam Answers



Presented by: AssociatePI.com

1. A) \$0

Answer Explanation: Under per policy excess of loss, the reinsurer pays the total amount of loss per policy that exceeds the attachment point. The attachment point and reinsurance limit apply individually to each policy. The reinsurer will pay if a policyholder's loss exceeds the attachment point. This is primarily used for liability insurance. In this case, since no single loss exceeds XYZ's attachment point of \$200,000, the reinsurer will pay \$0

2. D) Prior Approval

Answer Explanation: This is an example of a prior approval laws with a deemer provision. This provision states that if the insurer has not heard from the state insurance department within a set amount of time (usually 30-90 days), then the filing is considered to be approved and can be implemented

3. C) 55%

Answer Explanation: Operating ratio = combined ratio – investment income ratio (66% - 11% = 55%)
To determine operating ratio you must first calculate combined ratio and investment income ratio

Combined ratio = loss ratio + expense ratio = 66%

- Loss ratio = Incurred loss ÷ earned premium ($\$50,000 \div \$90,000 = 56\%$)
- Expense ratio = underwriting expense ÷ written premium ($\$10,000 \div \$100,000 = 10\%$)

Investment income ratio = net investment income ÷ earned premium = 11%

- Investment income ratio = $\$10,000 \div \$90,000 = 11\%$



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4. A) Mac, an independent agent, entices his customer to switch their coverage to XYZ insurance company because XYZ offers higher commission

Answer Explanation: Twisting is the act of an insurer inducing an insured to replace one policy with another.

5. B) Surplus lines broker

Answer Explanation: Jacks' insurance needs are not met by any insurer in the state; he is unable to find insurance from a licensed insurer in Florida. Jack should use a surplus lines broker. A surplus lines broker gives consumers the option to purchase insurance from an insurance company not licensed in the state if the consumer's insurance needs are not met by licensed insurers within the state. This helps customers with unmet needs to obtain insurance.

6. A) The underwriting policy guides underwriter decision making by explaining the acceptable level of risk an insurer is willing to insure

Answer Explanation: Underwriting guidelines are a means of communicating an insurers underwriting policy to the underwriters. The underwriting policy forms the underwriting guidelines, underwriters use the underwriting guidelines to determine the acceptable level of risk an insurer is willing to insure.



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7. B) Premium audits allow the insurer to adjust new business premiums to an accurate level

Answer Explanation: A premium audit calculates renewal business premium. It does not calculate the premium for new business. The insurer charges a premium at the beginning of the policy period based on an estimate of the insured's exposures, the insurer cannot actually know the correct premium that should have been charged until the end of the policy period.

8. D) Marry, the risk control representative, installs a new burglar alarm in her client's office and contracts a third party to train employees on workplace safety.

Answer Explanation: The insured is responsible for implementing the risk control measures. The insurer will not actually implement the selected measures; this is the responsibility of the insured.

9. B) Rates will not be adequate

Answer Explanation: If reserves are too low, then rates will not be adequate to remain profitable

10. D) Support industry technological advances

Answer Explanation: Support industry technological advances is not one of the reasons that IT is crucial to drive business operations. There are four main purposes of IT:

- Gain competitive advantage
- Increase operational efficiency
- Support strategy and decision making
- Assist governance, risk and compliance programs



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