14. (1.25 points)

An insured purchases a $400,000 policy on a property valued at $500,000.

- The coinsurance requirement for the policy is 90% of property value.
- No deductible applies.

a. (0.25 point)

Calculate the coinsurance penalty for a $300,000 loss.

b. (0.25 point)

Calculate the maximum coinsurance penalty.

c. (0.25 point)

Calculate the coinsurance apportionment ratio, assuming the property is valued at $425,000 instead of $500,000.

d. (0.5 point)

Briefly describe two issues associated with underinsured properties.

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EXAM 5 FALL 2016 SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 14	
TOTAL POINT VALUE: 1.25	**LEARNING OBJECTIVE: A10**
SAMPLE ANSWERS	
Part a: 0.25 point	
400000/(0.9*500000) = 0.889 (1-0.889)*300000 = 33,300	
Part b: 0.25 point	
0.9*500000 = 450000 400000*(1-0.889) = 44,400	
Part c: 0.25 point	
a = min (F / (c * V), 1) = min (400,000/(425,000 * 0.9), 1) = 1	
Part d: 0.5 point	
Sample Answer 1 Insured's will not be fully insured for a loss Expected losses are higher for underinsured policies when partial losses are possible *Sample Answer 2* Premium will not be equitable for underinsured vs. fully insured policies Premium will not be adequate for underinsured policies *Sample Answer 3* Regulator might force an insurer to pay above the policy limit for underinsured policies in the event of a catastrophe The insurance payment will not be sufficient to cover loss amounts that exceed the policy face value. Therefore, the insured will not be returned to the pre-loss condition.	
EXAMINER'S REPORT	
Candidates were expected to show an understanding of the problems associated with underinsurance, as well as performing co-insurance calculations.	
Part a	
Candidates were expected to know how to calculate a coinsurance penalty. A common mistake was a calculation error.	
Part b	
Candidates were expected to know how to calculate a coinsurance penalty. A common mistake was a calculation error.	

Part c

Candidates were expected to know how to correctly calculate a coinsurance apportionment ratio.

A common mistake was stating that there would be no insurance penalty, but not writing that the apportionment ratio = 1.

Part d

Candidates were expected to demonstrate an understanding of the issues associated with underinsurance.

Common mistakes included:

- Stating that premium would be inequitable but didn't specify that this meant underinsured properties with respect to fully insured properties
- Stating "loss not covered for underinsured policies" vs. "loss not *fully* covered for underinsured policies"
- "Insurer needs to be careful when inflation causes property value to increase" – this is an issue for both underinsured and fully insured properties, and was not awarded credit