

1. (2.5 points)

An insurer is considering changing the exposure base for boat owners line of business from boat-years to the insured value of the boat.

The insurer offers the following coverages for boat owners:

- i. Liability coverage pays for damages to another boat or injuries of people not on the insured's boat.
- ii. Physical damage coverage pays for damages to the insured's boat caused by common risks, such as sinking, fire, storms, theft, and collision.

Using three criteria for a good exposure base, evaluate the effectiveness of the proposed change in exposure base for both liability and physical damage coverages and provide a recommendation for the preferred exposure base.

EXAM 5 FALL 2018 SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 1	
TOTAL POINT VALUE: 2.5	LEARNING OBJECTIVE(S): A1
SAMPLE ANSWERS	
<p><u>Sample 1</u></p> <ol style="list-style-type: none"> i. Liability Coverage <ol style="list-style-type: none"> a. Proportional to Expected Loss: Value of the boat is not proportional to the damages it causes to others b. Practical: It is not easy to obtain and verify the value of the boat. If we take the insured's word for the value, it is subject to manipulation. Also, it is not objective as to what we define as the value of the boat: is it the price in the market today or the original sale price? c. Considerate of Historical Precedence: It could be costly for the insurer to change the exposure base both from an IT standpoint and modification of the data. It could also result in large premium swings for the insured. ii. Physical Damage Coverage: <ol style="list-style-type: none"> a. Proportional: Yes, there is a logical relationship between the severity of claims and the value of the boat. b. Practical: same as liability c. Historical Precedence: same as liability <p>I would recommend continuing to use boat-years because:</p> <ol style="list-style-type: none"> 1. It is proportional to expected loss (more boats = more claims) 2. Objective, easy to verify and obtain 3. No change needed, so no cost to implement new exposure base <p><u>Sample 2</u></p> <ol style="list-style-type: none"> 1. Practical – Insured value of the boat can be clearly defined and measured and would be a value already on-record by the insurance company 2. Proportional to Loss – IV is proportional to loss for physical damage, because a higher value boat will cost more to the insurer to fix or replace. However, the value of the boat is not proportional to liability coverage because injuries to people not on the boat is not dependent on how expensive the boat is and damages to another boat will not vary based on the insured's own boat value 3. Considerate of Historical Precedence – Changing the exposure base is both expensive for the insurer due to the changes in reporting/systems required and disruptive to the insured due to premium swings from the change in how the policy is rated. <p>I would recommend sticking with boat-years as the preferred exposure base due to the disruption that changing the base would cause and the limited benefit, since insured value is not proportional to liability loss.</p>	
EXAMINER'S REPORT	
<p>Candidates were expected to:</p> <ul style="list-style-type: none"> • List and define the 3 criteria of a good exposure base • Justify how insured value meets each of these criteria for both Liability and Property damage coverages • Recommend and justify an appropriate exposure base that meets these criteria 	

EXAM 5 FALL 2018 SAMPLE ANSWERS AND EXAMINER'S REPORT

Common mistakes include:

- Not accurately listing or defining 3 criteria of a good exposure base
- Not evaluating the differences between Liability and Property Damages Coverages
- Not recommending an exposure base or recommending a base that was not supported by the justification