



SOCIETY OF FINANCIAL EXAMINERS®

Supplemental Background Material

NAIC Examiner Project

Course AFE 2

Property and Liability Insurance Fundamentals

(Passing grade for this exam is 70)

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The following textbooks are required for this course:

- *Fundamentals of Risk and Insurance*
Emmett J. Vaughan & Therese M. Vaughan, (11th Edition)
- *Insurance Operations (SOFE)*
Must be ordered directly through [The Institutes](#) using Stock Number SABI25

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Property and Liability Insurance Fundamentals

Unit # per this study guide	Name
	Section # 1 - (14 questions)
	Fundamental of Risk and Insurance
1	Chapter 1: Problem of Risk
1	Chapter 2: Introduction to Risk Management
1	Chapter 3: The Insurance Device
3	Chapter 5: The Private Insurance Industry
2	Chapter 6: Regulation of the Insurance Industry
4	Chapter 7: Functions of Insurers
	Insurance Operations
4	Chapter 1: Overview of Insurance Operations
2	Chapter 2: Insurance Regulation
	Section # 2 - (7 questions)
	Insurance Operations
6	Chapter 3: Insurance Marketing and Distribution
7	Chapter 4: the Underwriting Function
	Chapter 5: Risk Control and Premium Auditing
	Section # 3 - (10 questions)
	Insurance Operations
8	Chapter 6: The Claim Function
5	Chapter 7: Actuarial Operations
9	Chapter 8: Reinsurance Principles and Concepts
	Section # 4 - (5 questions)
	Fundamental of Risk and Insurance
11	Chapter 9: The Legal Framework
	Insurance Operations
10	Chapter 10: Insurer Strategic Management
	Section # 5 - (8 questions)
	Fundamental of Risk and Insurance
12	Chapter 24: The Homeowners Policy - General Provisions
12	Chapter 25: The Homeowners Policy - Forms
13	Chapter 28: General Liability Insurance for the Individuals
14	Chapter 29: The Automobile and its Legal Environment
14	Chapter 30: Personal Auto Policy
	Section # 6 - (6 questions)
	Fundamental of Risk and Insurance
15	Chapter 31: Commercial Property Insurance
15	Chapter 32: Commercial Liability Insurance

Property and Liability Insurance Fundamentals

Unit: 1

Topic: Insurance Risk Mechanisms and Risk Management

Learning Objectives: Become familiar with the principles of the insurance mechanism

Assigned Readings: *Fundamentals of Risk and Insurance*

Chapter 1 - The Problem of Risk

Chapter 2 – Introduction to Risk Management

Chapter 3 – The Insurance Device

The Problem of Risk – Learning Objectives to Master:

- Define and explain the meaning of the term *risk*
- Distinguish among the terms *risk, peril, and hazard*
- Identify and explain the classes of hazards
- Differentiate between pure risk and speculative risk
- Differentiate between fundamental and particular risk
- Describe the categories into which pure risk may be subdivided
- Identify and explain the principal methods of handling risk

Introduction to Risk Management – Learning Objectives to Master:

- Describe the evolution of modern risk management and identify the developments that led to the transition from insurance management to risk management
- Define and explain what is meant by the term *risk management*
- Identify the various reporting relationships that the risk management function may assume in an organization
- Identify the two broad approaches to dealing with risk that are recognized by modern risk management theory
- Identify the four techniques that are used in risk management
- Describe risk management's contribution to the organization
- Distinguish risk management from insurance management and general management

The Insurance Device – Learning Objectives to Master:

- Define insurance from the viewpoint of the individual and of society
- Identify and explain the two essential features in the operation of insurance
- Explain how the law of large numbers supports the operation of the insurance mechanism
- Explain what is meant by *adverse selection* and why it is a problem for insurers
- Explain the economic contributions of insurance

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AFE 2

Unit: 2

Topic: Insurance Regulation

Learning Objectives: An introduction to the history and nature of insurance regulation in the United States

Assigned Readings:

Fundamentals of Risk and Insurance

Chapter 6 - Regulation of the Insurance Industry

Insurance Operations

Chapter 2 – Insurance Regulation

Regulation of the Insurance Industry – Learning Objectives to Master:

- Identify and explain the reasons why insurance is subject to regulation
- Identify the major areas of insurer operations that are regulated
- Trace the history of insurance regulation and identify the landmark cases and laws that led to the current regulatory environment
- Identify the major aspects of insurance company operations that are subject to regulation
- Identify and explain the statutory requirements that exist with respect to insurance rates
- Describe the different approaches the states have taken toward the regulation of insurance rates
- Identify the arguments favoring state or federal regulation of insurance

Insurance Regulation – Learning Objectives to Master:

- Explain how insurance regulation protects consumers, contributes to maintaining insurer solvency, and assists in preventing destructive competition.
- Identify the regulatory activities of state insurance departments and the duties typically performed by state insurance commissioners.
- Describe the licensing requirements for insurers and insurance personnel.
- Describe the methods that regulators use to maintain the solvency of insurers and to manage insolvencies, and the reasons why insurers become insolvent.
- Describe the goals of insurance rate regulation, the major types of state rating laws, and the reasons supporting and opposing rate regulation.
- Explain how the contract language contained in insurance policies is regulated.
- Explain how the market conduct areas in insurance are regulated and how regulatory activities protect consumers.
- Explain how organizations that act as unofficial regulators affect insurance activities.

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Unit: 3

Topic: The Private Insurance Industry

Learning Objectives: Become aware of the various types of insurance enterprises, how they developed, and the reasons they exist

Assigned Readings:

Fundamentals of Risk and Insurance

Chapter 5 - The Private Insurance Industry

The Private Insurance Industry – Learning Objectives to Master:

- Identify the categories of insurers classified by type of product
- Identify the major categories of insurers classified according to form of ownership
- Identify and describe the distinguishing characteristics of the different categories of insurers by form of ownership
- Identify the different distribution systems that are used in property and liability insurance
- Describe the major areas in which members of the insurance industry cooperate
- Identify and describe the major areas in which insurers cooperate
- Describe the evidences that indicate the extent of competition in the insurance industry

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Unit: 4

Topic: The Functions of Insurance, Ratemaking

Learning Objectives: Develop an understanding of the principles of insurance ratemaking

Assigned Readings:

Insurance Operations

Chapter 1 – Overview of Insurance Operations

Fundamentals of Risk and Insurance

Chapter 7 – Functions of Insurers

Overview of Insurance Operations – Learning Objectives to Master:

- Explain how insurers have organized to provide property-casualty insurance
- Describe insurers' major goals and the constraints that impede insurers from achieving them
- Describe and calculate the measurements used to evaluate insurer performance
- Describe the core and supporting functions performed by insurers.

Functions of Insurers – Learning Objectives to Master:

- Identify and differentiate between the two broad approaches to ratemaking
- Explain the purpose of underwriting and describe the steps in the underwriting process
- Identify the principal sources of information on which an underwriter may rely
- Identify and differentiate among the various types of adjusters
- Identify and explain the steps in the loss adjustment process

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Unit: 5

Topic: The Functions of Insurance, Ratemaking

Learning Objectives: Develop an understanding of the principles of insurance ratemaking

Assigned Readings:

Insurance Operations

Chapter 7 – Actuarial Operations

Actuarial Operations – Learning Objectives to Master:

- Describe the goals and ideal characteristics of ratemaking
- Explain how actuaries are involved in the ratemaking process
- Describe rate components and ratemaking terms
- Describe factors that affect ratemaking
- Describe the following ratemaking methods:
 - Pure premium
 - Loss ratio
 - Judgement
- Describe the steps in the ratemaking data development process
- Describe the policy-year, calendar-year, and accident-year data collection methods
- Explain why and how ratemaking data are adjusted
- Explain how to prepare rate filings
- Explain how ratemaking varies by type of insurance
- Explain why and how increased limit factors are used

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Unit: 6

Topic: The Marketing Function

Learning Objectives: Develop an understanding of the marketing process in property and liability insurance companies

Assigned Readings:

Insurance Operations

Chapter 3 – Insurance Marketing and Distribution

Insurance Marketing and Distribution – Learning Objectives to Master:

- Describe the following attributes of the competitive property-casualty insurance marketplace: distinguishing characteristics of insurance customers, insurer marketing differentiations, and unique factors in the insurance marketplace.
- Explain how typical insurer marketing activities are performed and why they are performed.
- Describe the main types of insurance distribution systems and channels, including the principal characteristics that distinguish one distribution system from another.
- Describe the functions performed by insurance producers.
- Describe the key factors an insurer should evaluate during the distribution-system and distribution-channel selection process.

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Unit: 7

Topic: The Underwriting Function

Learning Objectives: Become familiarized with the process of underwriting and the factors which are considered in insurance company underwriting

Assigned Readings:

Insurance Operations

Chapter 4 – The Underwriting Function

Chapter 5 – Risk Controls and Premium Auditing

Underwriting – Learning Objectives to Master:

- Describe the purpose of underwriting
- Describe the six steps in the underwriting process and the purpose of each.
- Contrast the responsibilities of staff underwriters with those of line underwriters
- Explain how underwriting results are measured
- Describe the importance of compliance with underwriting authority in individual account selection.
- Describe the constraining factors considered in the establishment of underwriting policy.
- Describe the purposes that underwriting guidelines and underwriting audits perform.
- Identify and differentiate among the various risk control services provided by insurers

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Unit: 8

Topic: The Claim Function, Loss Reserving & Claims Adjusting

Learning Objectives: Develop an understanding of the claims operations

Assigned Readings:

Insurance Operations

Chapter 6 - The Claim Function

The Claim Function – Learning Objectives to Master:

- Explain how an insurer’s claim function achieves its primary goals, provides valuable information to other departments, and interacts effectively with its outside contracts.
- Describe claims departments in terms of the following:
 - How they can be structured
 - The types and functions of claims personnel
 - How their performance can be measured
- Explain how the following measures are used to ensure regulatory compliance:
 - Claims guidelines, policies, and procedures
 - Controls
 - Supervisor and manager review
 - Claim audits
- Summarize the activities performed in the claim handling process and the purpose of each
- Describe the framework for coverage analysis and the information obtained by following it.
- Given a claim scenario, demonstrate how a claim representative can use the claim handling process and the framework for coverage analysis to resolve a claim.

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Unit: 9

Topic: The Reinsurance Function

Learning Objectives: Develop an understanding of the functions of reinsurance, the types of reinsurance, and the nature of the reinsurance transaction

Assigned Readings:

Insurance Operations

Chapter 8 – Reinsurance Principles and Concepts

Reinsurance – Learning Objectives to Master:

- Describe reinsurance and its principal functions.
- Describe the three sources of reinsurance.
- Describe treaty reinsurance and facultative reinsurance
- Summarize the types of pro-rata reinsurance and excess of loss reinsurance
- Describe finite risk reinsurance and other methods that rely on capital markets as alternatives to traditional and nontraditional reinsurance.
- Describe the factors that should be considered in the design of a reinsurance program.
- Describe the factors affecting reinsurance limit selection.

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Unit: 10

Topic: Insurer Strategic Management

Learning Objectives: Become familiar with the strategic management process

Assigned Readings:

Insurance Operations

Chapter 10 – Insurer Strategic Management

Insurer Strategic Management – Learning Objectives to Master:

- Describe the stages in the strategic management process.
- Explain how the Five Forces and SWOT methods can be used to analyze the environment in which an insurer operates.
- Explain how strategies are developed at the corporate, business, functional, and operational level.
- Describe the strategic reasons, considerations, and approaches for insurers to expand their operations globally.

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Unit: 11

Topic: The Legal Basis of Insurance Contracts

Learning Objectives: Understand legal concepts relevant to specific insurance contracts and their interpretation

Assigned Readings:

Fundamentals of Risk and Insurance
Chapter 9 - The Legal Framework

The Legal Framework – Learning Objectives to Master:

- Identify and explain the essential elements of a contract
- Explain how the general law of contracts applies to insurance contracts
- Explain why the principle of indemnity is important to the operation of the insurance mechanism
- Explain the ways in which the principle of indemnity is enforced in insurance contracts
- Explain what is meant by the statements that insurance contracts are contracts of adhesion, aleatory contracts, conditional contracts, unilateral contracts, and contracts of utmost good faith
- Define and explain the nature of waiver and estoppel
- Explain the application of the doctrines of concealment and misrepresentation in the insurance transaction

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Unit: 12

Topic: Homeowners Insurance

Learning Objectives: Understand the essential features of homeowners insurance policies

Assigned Readings:

Fundamentals of Risk and Insurance

Chapters 24 - The Homeowners Policy – General Provisions

Chapters 25 - The Homeowners Policy – Forms

The Homeowners Policy – General Provisions – Learning Objectives to Master:

- Explain the general nature of the homeowners program
- Identify and distinguish among the homeowners forms and describe the individual for whom each form is designed
- Explain the difference between named-peril and open-peril coverage
- Identify the coverage parts of the homeowners policy
- Identify coverage features of each Section I coverage part

The Homeowners Policy Forms – Learning Objectives to Master:

- Interpret loss-settlement provisions
- Recognize significant exclusions and limitations in the homeowners Section I coverage
- List and describe the optional coverages available to broaden the homeowners forms

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Unit: 13

Topic: General Liability Insurance for Individuals

Learning Objectives: Understand the essential features of general liability insurance for individuals

Assigned Readings:

Fundamentals of Risk and Insurance

Chapter 28 – General Liability Insurance for the Individual

General Liability Insurance for the Individual – Learning Objectives:

- Explain the distinction between a denial of payment by an insurer because there is no liability and denial because there is no coverage
- Identify the coverage features under Section II of the homeowners forms
- Describe the insuring agreements of liability insurance contracts generally and explain the insurer's obligation to defend the insured
- Explain the insuring agreement of the Section II Personal Liability coverage
- Explain the insuring agreement of the Section II Medical Payments coverage
- Recognize significant exclusions under the homeowners Section II
- Describe the personal umbrella liability contracts, including qualification requirements and typical exclusions
- List the available endorsements for broadening Personal Liability coverage

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Unit: 14

Topic: Automobile Insurance Coverage

Learning Objectives: An introduction to automobile insurance contracts

Assigned Readings:

Fundamentals of Risk and Insurance

Chapter 29 - The Automobile and its Legal Environment

Chapter 30 - The Personal Auto Policy

The Automobile and Its Legal Environment – Learning Objectives to Master:

- Explain the special provisions of tort law applicable to automobiles
- Explain the principles of vicarious liability and the special provisions applicable to guests
- Explain the legal requirements imposed by the states regarding automobile liability insurance
- Explain the no-fault concept and the basic philosophy on which this concept is based, and evaluate the arguments for and against no-fault laws
- Explain the differences among the approaches to reform of the automobile reparations system that have been adopted by the states
- Discuss the various systems for providing insurance to high-risk drivers
- Discuss the automobile insurance classification system and how rates are affected by various underwriting factors

The Personal Auto Policy – Learning Objectives to Master:

- Determine if an automobile is eligible for coverage under the Personal Auto Policy (PAP)
- Identify and explain the four coverage sections of the PAP
- Describe the coverage features of the PAP liability coverage, including the persons and automobiles for which coverage is provided
- Describe the scope of coverage under the medical payments coverage of the PAP, including the persons to whom the coverage is applicable
- Describe the scope of coverage under the uninsured motorists coverage of the PAP, including the persons to whom the coverage is applicable
- Describe the scope of coverage under the Damage to Your Auto coverage of the PAP
- Identify and explain the Duties after Loss and general provisions of the PAP

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Unit: 15

Topic: Commercial Property Insurance

Learning Objectives: An introduction to commercial property insurance contracts

Assigned Readings:

Fundamentals of Risk and Insurance

Chapter 31 - Commercial Property Insurance

Commercial Property Insurance – Learning Objectives to Master:

- Identify the seven broad classes of property and liability insurance for business firms
- Identify and distinguish among the four broad classes of commercial property insurance, and explain the distinguishing characteristics of each class
- Describe the general nature of coverage available to business firms with respect to fixed location property
- Distinguish between direct damage property insurance coverages and indirect loss coverages
- Identify and explain the general nature and uses of indirect loss (time element coverages) and explain the circumstances in which each type of coverage is needed
- Describe the general nature of the coverage available to business firms with respect to property that is not at a fixed location
- Explain the principal features of boiler and machinery insurance and the feature that distinguishes it from other types of insurance
- Identify the two broad classes of commercial crime insurance

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Unit: 16

Topic: Commercial Liability Insurance Coverage

Learning Objectives: An introduction to commercial liability insurance contracts

Assigned Readings:

Fundamentals of Risk and Insurance
Chapter 32 - Commercial Liability Insurance

Commercial Liability Insurance – Learning Objectives to Master:

- Identify and differentiate among the three broad categories into which liability insurance for business firms may be divided
- Identify the coverage elements in a Workers Compensation and Employers Liability Policy and explain the exposure that each is designed to cover
- Identify and explain the general liability exposures facing a business
- Identify the major coverages of a Commercial General Liability Policy
- Explain the purpose and intent of each of the exclusions in a Commercial General Liability Policy
- Explain the difference between an occurrence general liability policy and a claims-made liability form
- Describe the coverages offered in ISO's Information Security Protection Policy
- Identify and differentiate among the four types of commercial automobile insurance policies
- Identify and differentiate among the three broad classes of automobiles that may be insured under a Business Auto Policy
- Explain the liability of a common carrier and explain how this exposure is generally insured
- Identify and differentiate among the types of bailment and explain the liability associated with each class
- Explain how bailee liability coverages differ from other forms of liability insurance
- Describe the characteristics of commercial excess liability policies and commercial umbrella liability policies