Insurance Test Practice

Alabama Insurance Practice Test

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1. A disability policy that covers accidents but not sickness is known as:

A) A limited risk policy
B) An accidental death and dismemberment (AD&D) policy
✔ C) An accident-only disability income policy
D) A comprehensive disability policy

Explanation: An accident-only policy provides coverage for disability resulting from an accident and does not cover disability due to illness or sickness. It has a lower premium than a comprehensive policy.

2. Medicare Part A primarily provides coverage for:

A) Long-term custodial care
✔ B) Hospitalization
C) Prescription drugs
D) Physician services

Explanation: Medicare Part A is often called 'hospital insurance.' It helps cover inpatient care in hospitals, skilled nursing facility care (not long-term custodial care), hospice care, and home health care.

3. Investment subaccounts in a variable life insurance policy may include all of the following EXCEPT:

A) Stock fund subaccounts
B) Money market subaccounts
C) Bond fund subaccounts
✔ D) Real estate directly owned by the insurance company

Explanation: Variable life subaccounts can include a variety of investment options similar to mutual funds: equity (stock) funds, bond funds, balanced funds, money market funds, and index funds. The subaccounts do NOT include direct real estate ownership or other illiquid investments — they must be publicly traded or liquid investment options registered with the SEC.

4. A 'capitation' payment arrangement in managed care means:

✔ A) The provider receives a fixed per-member-per-month payment to provide covered services regardless of utilization
B) The provider is paid per service rendered
C) The insurer caps the maximum benefit paid for any service
D) The patient pays a fixed co-payment for all services

Explanation: Capitation is a payment model where managed care plans pay providers a fixed per-member-per-month (PMPM) amount to provide all covered services to enrolled members, regardless of how much or how little care is actually provided. This creates incentives for providers to manage care efficiently and maintain member health.

5. Under Social Security disability benefits, the 'waiting period' before benefits begin is:

A) 12 months
✔ B) 5 months
C) 3 months
D) 6 months

Explanation: Social Security disability benefits have a 5-month waiting period before benefits begin. The disability must be expected to last at least 12 months or result in death. Benefits begin with the 6th full month of disability. This waiting period is an important gap that private disability income insurance is designed to address — short-term and long-term disability policies can provide income replacement during the Social Security waiting period.

6. The 'probationary period' in a disability income policy refers to the:

A) Time an insured must be disabled before benefits are paid.
✔ B) Time between when the policy is issued and when sickness coverage goes into effect.
C) Maximum time benefits will be paid.
D) Time an employee must wait to be eligible for group coverage.

Explanation: The probationary period is a one-time period that begins on the policy's effective date, typically 15-30 days. It specifies that no benefits will be paid for a sickness that begins during this initial period. This is designed to protect the insurer from adverse selection (people buying a policy because they know they are about to get sick).

7. Variable life insurance is regulated as both an insurance product AND a security because:

A) The insurer invests premiums in government bonds
B) Variable policies are issued only by publicly traded companies
C) Variable insurance can be purchased on stock exchanges
✔ D) The policyowner bears investment risk through subaccount investing

Explanation: Variable life insurance involves the allocation of cash values to separate account subaccounts (similar to mutual funds), where the policyowner bears the investment risk. Because the policy value can decline and the policyowner is subject to investment risk, it is classified as both an insurance product and a security, requiring producers to hold a state insurance license AND FINRA registration.

8. The settlement option that provides payments for the beneficiary's entire life is called:

A) Fixed Period
B) Interest Only
✔ C) Life Income
D) Fixed Amount

Explanation: The Life Income settlement option uses the death benefit to purchase an annuity for the beneficiary, providing them with an income they cannot outlive. There are several variations, such as life with period certain or joint and survivor.

9. The percentage of covered medical expenses that the insured is required to pay after the deductible has been met is known as:

A) The premium
B) The out-of-pocket maximum
✔ C) Coinsurance
D) The copayment

Explanation: Coinsurance is a cost-sharing arrangement where the insured pays a percentage of the bill (e.g., 20%), and the insurer pays the remaining percentage (e.g., 80%).

10. What is partial disability?

A) A disability that is expected to last less than one year.
✔ B) The inability to perform one or more, but not all, of the essential duties of one's occupation.
C) A disability that occurs off the job.
D) A disability that is not covered by the policy.

Explanation: Partial disability benefits are paid when an illness or injury prevents an insured from performing some of their job duties, resulting in a loss of income. The benefit is typically 50% of the total disability benefit and is paid for a limited time.

11. Which annuity feature ensures that the insurer, not the owner, assumes the risk for investment losses?

A) A high participation rate
B) Variable subaccounts
C) The surrender charge
✔ D) The general account

Explanation: In a fixed annuity, the premiums are invested in the insurer's general account. The insurer bears all the investment risk and guarantees the principal and a minimum rate of interest.

12. Under the SECURE Act, a non-spouse beneficiary who inherits a qualified annuity (such as one held in an IRA) must generally distribute the entire account within:

A) 5 years of the owner's death
B) The beneficiary's own life expectancy
✔ C) 10 years of the owner's death
D) 20 years of the owner's death

Explanation: The SECURE Act of 2019 eliminated the 'stretch' option for most non-spouse beneficiaries. They must now distribute the entire inherited account within 10 years of the original owner's death. Exceptions exist for eligible designated beneficiaries such as surviving spouses, minor children, disabled individuals, and beneficiaries not more than 10 years younger than the deceased.

13. What is a 'Special Needs Plan' (SNP)?

A) A Medigap plan for individuals with pre-existing conditions.
B) A state program that supplements Medicaid.
C) A prescription drug plan with no donut hole.
✔ D) A type of Medicare Advantage plan designed for people with specific diseases, disabilities, or limited incomes.

Explanation: SNPs are a special type of Medicare Advantage plan that tailor their benefits, provider choices, and drug formularies to best meet the specific needs of the groups they serve, such as dual eligibles (I-SNP), those with certain chronic conditions (C-SNP), or those in institutions (I-SNP).

14. A physical hazard is best described as:

A) The cause of the loss itself
B) A legal restriction that increases risk
✔ C) A physical condition that increases the chance of loss
D) A person's dishonest tendencies

Explanation: A physical hazard is a tangible condition or characteristic that increases the likelihood of a peril occurring, such as a faulty electrical system in a building or a person's high blood pressure.

15. When an individual A&H policy is reinstated, coverage for accidents is effective:

A) After a 30-day waiting period
✔ B) Immediately upon reinstatement
C) After a 90-day waiting period
D) After a 10-day waiting period

Explanation: Upon reinstatement of an A&H policy, coverage for accidental injuries is effective immediately. However, coverage for sickness does not take effect until 10 days after the date of reinstatement, to prevent individuals from reinstating a policy only when they know they are already ill.

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16. A client age 45 wants to save for retirement but has a very low risk tolerance and wants to protect their principal. Which annuity would be most suitable?

A) Immediate annuity
B) Annuity with a market value adjustment
C) Variable annuity
✔ D) Fixed annuity

Explanation: A traditional fixed annuity would be the most suitable choice. It guarantees the principal against loss and provides a guaranteed minimum interest rate, aligning perfectly with the client's low risk tolerance and goal of safe accumulation.

17. Under the principle of 'reasonable expectations,' courts may interpret insurance policy ambiguities in favor of:

A) The insurance company, as the drafter of the policy
B) Neither party — ambiguities void the entire policy
C) The state insurance commissioner
✔ D) The insured, based on what a reasonable person would expect the policy to cover

Explanation: The reasonable expectations doctrine holds that when insurance policy language is ambiguous or unclear, courts will interpret the ambiguity in favor of the insured's reasonable expectations of coverage. Because insurance contracts are contracts of adhesion (drafted by the insurer), the insured has no ability to negotiate terms. Courts protect insureds by resolving ambiguities against the drafter (the insurer) and in favor of what a reasonable insured would expect to be covered.

18. ACA-compliant health plans must cover the following preventive services at no cost-sharing:

A) All preventive services recommended by the insured's physician
✔ B) Preventive services with an 'A' or 'B' rating from the USPSTF, ACIP immunizations, and preventive care for women
C) Preventive services only for children and pregnant women
D) Only services provided by in-network providers at a hospital

Explanation: Under the ACA, non-grandfathered health plans must cover preventive services rated 'A' or 'B' by the U.S. Preventive Services Task Force (USPSTF), ACIP-recommended immunizations, and preventive care guidelines from HRSA — without any cost-sharing. Examples include mammograms, colonoscopies, and flu shots.

19. What is the primary purpose of reinsurance?

A) To replace a primary insurance policy
B) To sell insurance directly to consumers
C) To provide insurance in foreign countries
✔ D) For an insurer to protect itself against catastrophic losses

Explanation: Reinsurance is a process where an insurance company (the ceding insurer) transfers a portion of its risk to another insurer (the reinsurer). This is done to limit the primary insurer's exposure to very large or catastrophic losses.

20. Reinsurance is a transaction between:

✔ A) Two insurance companies where one transfers risk to the other for a share of premium
B) An insurer and its policyholders to manage large claims
C) A producer and a surplus lines carrier
D) An insurer and the state guaranty association

Explanation: Reinsurance allows a primary insurer (the ceding company) to transfer a portion of its risk to a reinsurer in exchange for a share of the premium. This stabilizes the primary insurer's loss experience and allows it to write more business.

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21. The advantage of life insurance proceeds being paid to a named beneficiary rather than the estate is:

A) Named beneficiaries receive a higher death benefit than the estate
B) Proceeds paid to a named beneficiary are completely exempt from federal estate taxes
C) The insurer waives administrative fees when paying a named beneficiary
✔ D) Proceeds bypass probate and are available more quickly and privately to the beneficiary

Explanation: Naming a specific beneficiary (rather than the estate) means life insurance proceeds avoid the probate process — they pass directly to the beneficiary quickly and privately, without court involvement or public record. Note: proceeds are still subject to estate taxes in the insured's estate if they own the policy, even when paid to a named beneficiary.

22. In order to be insurable, a risk must NOT be:

A) Calculable
B) Part of a large group
C) Accidental
✔ D) Catastrophic

Explanation: Insurers generally will not cover losses that are catastrophic, meaning they could impact a large portion of their policyholders at once, potentially bankrupting the insurer. Events like war or nuclear disasters are typically excluded.

23. Which of the following is a key requirement for recommending an annuity to a senior consumer (age 65+)?

A) The annuity must be variable
B) The annuity must have a surrender period of less than 5 years
C) The agent must offer a rebate
✔ D) The recommendation must be based on a reasonable evaluation of the consumer's financial situation and needs

Explanation: All annuity recommendations, especially for seniors, must be suitable based on the consumer's financial status, tax status, and investment objectives (Suitability & Best Interest standards).

24. Who regulates the sale of variable life insurance products?

A) Only the Department of Insurance
B) Only the SEC
✔ C) Both the Department of Insurance and the SEC/FINRA
D) Only FINRA

Explanation: Variable products are dually regulated by the State Department of Insurance (insurance aspect) and the SEC/FINRA (securities aspect).

25. Which annuity payout option provides the highest monthly income but ceases all payments upon the annuitant's death?

A) Life with Period Certain
B) Joint and Survivor
C) Life with Refund
✔ D) Straight Life

Explanation: The Straight Life (or Life Only) payout option provides income payments for the annuitant's entire life. Because there are no survivor benefits or guaranteed number of payments, it carries the most risk for the annuitant but offers the largest periodic payment.

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26. In a fixed-indexed annuity, the 'annual reset' (ratchet) feature means:

A) The owner must reconfirm their investment selections each year
✔ B) Each year's interest is locked in and the new starting index value is reset at the year-end level, protecting gains from future market declines
C) The index value resets to zero each year and starts fresh
D) The insurer resets the cap rate and participation rate annually based on market conditions

Explanation: The annual reset (ratchet) feature locks in index-linked interest credits at the end of each year. The new starting value for the next crediting period is then set at the year-end index level. This means prior year gains are protected from future index declines — a key consumer benefit of indexed annuities over direct index investing.

27. The process by which an insurer evaluates a life insurance application to determine whether to accept the risk is called:

A) Risk pooling
✔ B) Underwriting
C) Loss reserving
D) Actuarial analysis

Explanation: Underwriting is the process by which the insurer assesses the risk presented by an applicant and decides whether to issue the policy, and at what classification and premium. Underwriters evaluate factors such as age, health history, occupation, lifestyle, and financial need to classify the risk as standard, preferred, or substandard (rated).

28. An agent is recommending a variable annuity to a 72-year-old client who needs liquid access to their savings for medical expenses. Which of the following is the primary suitability concern in this recommendation?

A) Variable annuities do not offer tax-deferred growth
✔ B) The client will face high surrender charges and market risk, which does not match their liquidity needs
C) Variable annuities are only suitable for clients under age 40
D) The death benefit is not guaranteed

Explanation: Variable annuities are long-term investment products that typically feature surrender charges for early withdrawals and expose principal to market fluctuations. They are generally unsuitable for older clients with immediate liquidity needs.

29. Which type of health insurance plan renews automatically but allows the insurer to increase premiums for an entire class?

A) Noncancellable
B) Conditionally renewable
C) Optionally renewable
✔ D) Guaranteed renewable

Explanation: A guaranteed renewable policy guarantees the insured the right to renew coverage until a specified age (usually 65). The insurer cannot cancel the policy individually but CAN increase premiums for an entire class of insureds. This is the most common type of individual health insurance renewability.

30. The concept of 'fortuitous loss' in insurance means:

A) Losses that are certain to occur within the policy period
B) Losses caused exclusively by natural disasters
✔ C) Losses that occur by chance or accident and are unforeseen by the insured
D) Losses that occur due to the insured's intentional acts

Explanation: Insurance requires that losses be fortuitous — meaning they occur by chance and are not certain or intentionally caused. If a loss is certain to occur or is intentionally caused by the insured, it is not insurable. Fortuitous losses are fundamental to the insurance concept because the uncertainty of occurrence is what creates the need for risk transfer.

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31. Under the ACA for plan years beginning on or after January 1, 2014, annual and lifetime dollar limits on:

A) All benefits are prohibited
B) All limits were grandfathered and remain in effect
C) Only inpatient hospital benefits are prohibited
✔ D) Essential health benefits are prohibited; lifetime limits on non-essential benefits may still apply

Explanation: The ACA prohibits annual and lifetime dollar limits on essential health benefits (EHBs) in non-grandfathered plans. Insurers cannot cap the annual or lifetime amount they will pay for EHBs. However, annual and lifetime limits may still be applied to benefits that are not EHBs.

32. Under federal COBRA, what is the maximum period an employee can continue coverage after termination of employment?

A) 36 months
B) 29 months
C) 12 months
✔ D) 18 months

Explanation: For a qualifying event such as termination of employment or a reduction in hours, a former employee and their dependents can continue their group health coverage under COBRA for up to 18 months.

33. An indexed annuity's 'floor' rate means:

A) The lowest surrender charge in the schedule
✔ B) The minimum interest rate that will be credited, ensuring the owner cannot receive negative interest crediting
C) The minimum annuity payment the owner will receive in the payout phase
D) The minimum premium the owner must pay

Explanation: The floor in a fixed-indexed annuity is the minimum interest that will be credited in any given period — typically 0% (meaning the owner will never receive a negative credit and will never lose principal due to index performance). The combination of a 0% floor and a cap rate gives indexed annuity owners participation in index gains with principal protection.

34. A life insurance policy that remains in force for the insured's entire life and builds cash value is known as:

✔ A) Whole Life
B) Term Life
C) Annuity
D) Accident & Health

Explanation: Whole Life insurance provides permanent, lifelong protection. It includes a savings element (cash value) that grows on a tax-deferred basis and is guaranteed to be available to the policyowner.

35. What is the primary difference between a Group Annuity and an Individual Annuity?

A) Individual annuities are always fixed, while group annuities are always variable.
B) Group annuities have higher fees.
✔ C) A group annuity is established by an employer for its employees, typically as part of a retirement plan.
D) Group annuities do not require an annuitant.

Explanation: A group annuity contract is between an insurer and an employer or plan sponsor. It is a funding vehicle for qualified retirement plans (like 401(k)s), holding and managing the contributions for the participating employees.

36. Delayed retirement credits under Social Security increase benefits for each year a worker delays retirement past full retirement age up to age:

A) 72
B) 68
✔ C) 70
D) 67

Explanation: Workers who delay receiving Social Security retirement benefits past their full retirement age earn delayed retirement credits, which increase their benefit by a certain percentage for each year of delay up to age 70. There is no additional credit for delaying beyond age 70.

37. A contract requires that both parties bring something of value to the exchange. This is known as:

A) Competent Parties
✔ B) Consideration
C) Agreement
D) Legal Purpose

Explanation: Consideration is the value that each party gives in the contractual agreement. The insured's consideration is the premium paid and the statements on the application; the insurer's is the promise to pay claims.

38. A consumer, Helen, receives her new individual life insurance policy. What is the standard free-look period under Alabama law for a new individual life policy that does not involve replacement?

✔ A) 10 calendar days from policy delivery
B) 15 calendar days from policy delivery
C) 30 calendar days from policy delivery
D) 10 working days from application date

Explanation: The standard free-look period for life insurance in Alabama is 15 days, starting from the date the policy is delivered to the owner.

39. When an insurer approves an application but issues the policy with different terms than applied for (such as a higher premium or an exclusion rider), this is called a:

A) Policy amendment
B) Conditional receipt
✔ C) Counter-offer
D) Binder

Explanation: When the insurer modifies the terms of coverage from what was originally applied for, the issued policy is considered a counter-offer. The applicant must accept or reject the new terms. The policy does not go into effect until the applicant accepts the counter-offer and pays any required premium.

40. Which type of care is NOT typically covered by a Long-Term Care policy?

A) Skilled nursing care
B) Custodial care
C) Hospice care
✔ D) Acute care in a hospital

Explanation: LTC policies cover a range of services from skilled care to intermediate care and custodial care, which can be provided in various settings (nursing home, assisted living, at home). Acute care for a medical condition in a hospital is covered by standard health insurance or Medicare, not an LTC policy.

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41. An ambiguous term in an insurance contract will be interpreted in favor of the insured. This is because an insurance policy is a:

A) Unilateral contract
B) Aleatory contract
C) Personal contract
✔ D) Contract of adhesion

Explanation: Because the insurer drafts the contract and the insured must accept it as written (a contract of adhesion), courts have held that any ambiguity in the language should be resolved in favor of the party that did not write it—the insured.

42. What is the primary purpose of coordination of benefits (COB)?

✔ A) To prevent duplication of payments when an insured is covered by more than one group plan.
B) To coordinate care between primary and specialty physicians.
C) To determine eligibility for group coverage.
D) To determine which provider a patient must see.

Explanation: The COB provision is used when a person is covered by two or more health plans to determine the order of payment. It ensures that the total payment from all plans does not exceed the total medical expenses, thus preventing overinsurance.

43. The 'recurrent disability' provision in a disability income policy:

A) Allows the insured to receive partial benefits during recovery
B) Provides an additional benefit for each recurrence of a disability
C) Requires a new elimination period for each new episode of disability
✔ D) Treats a disability that recurs within a specified period as a continuation of the original disability, not a new claim

Explanation: The recurrent disability provision protects the insured from losing benefits when a disability recurs. If the same or related disability returns within a specified period (often 6 months) after the insured returned to work, it is treated as a continuation of the original claim — not a new claim requiring a new elimination period.

44. The 'net amount at risk' in a life insurance policy is:

A) The insurer's total risk exposure on all policies
B) The total death benefit minus any unpaid loans
C) The premium amount at risk of not being paid
✔ D) The difference between the face amount and the policy's cash value

Explanation: The net amount at risk is the portion of the death benefit that the insurer is actually 'at risk' for — calculated as the face amount minus the accumulated cash value. As cash value grows, the net amount at risk decreases. In term insurance, there is no cash value, so the entire face amount is the net amount at risk.

45. A producer, Arthur, is terminating his residency in Alabama and moving to another state. Within how many days of terminating residency must Arthur notify Alabama Department of Insurance (ALDOI)?

A) 10 days
✔ B) 30 days
C) 15 days
D) 45 days

Explanation: Producers must notify Alabama Department of Insurance (ALDOI) within 30 days of terminating their residency.

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46. What is a 'Taft-Hartley Trust'?

A) A type of MET for non-profit organizations.
✔ B) A trust established by a labor union and employers to provide health and welfare benefits to union members.
C) A trust used for estate planning.
D) A trust for funding executive retirement plans.

Explanation: Taft-Hartley trusts, or multi-employer plans, are formed through collective bargaining agreements between a labor union and multiple employers. They are managed by a board of trustees with equal representation from labor and management.

47. A currently insured worker under Social Security must have earned at least:

A) 40 quarters of coverage
B) 10 quarters of coverage in the last 20 quarters
✔ C) 6 quarters of coverage in the last 13 quarters
D) 20 quarters of coverage in the last 40 quarters

Explanation: A worker is currently insured if they have earned at least 6 quarters of coverage during the 13-quarter period ending with the quarter of death or disability. Currently insured status provides limited survivor benefits compared to fully insured status.

48. A Point-of-Service (POS) plan combines features of:

A) COBRA and individual coverage
B) Term and whole life insurance adapted for health coverage
✔ C) HMO and PPO — requiring a PCP like an HMO but allowing out-of-network care like a PPO
D) Medicare Part A and Part B

Explanation: A POS (Point-of-Service) plan is a hybrid between an HMO and a PPO. Like an HMO, it requires members to choose a primary care physician and obtain referrals for specialists within the network. Like a PPO, members can go out-of-network but pay higher cost-sharing for doing so.

49. The three primary components used to calculate a life insurance premium are:

A) Death benefit, policy term, and agent commission
✔ B) Mortality cost, interest (investment earnings), and expense loading
C) Risk classification, reinsurance cost, and taxes
D) Age, gender, and health status

Explanation: A life insurance premium is based on three factors: (1) mortality cost — the predicted cost of death claims based on mortality tables, (2) interest — the assumed investment earnings the insurer will make on premiums, which reduces the premium, and (3) expense loading — the insurer's operating costs such as salaries, commissions, and overhead.

50. A morale hazard arises from:

A) A condition of the legal environment
B) A physical condition of the property
✔ C) An individual's carelessness or indifference to loss
D) An individual's dishonest tendencies

Explanation: A morale hazard is a type of hazard that arises from an insured's indifference or carelessness about a potential loss because they know they are insured. For example, leaving car doors unlocked.