Insurance Test Practice

Arizona Insurance Practice Test

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1. In a Lloyd's association, the risk is assumed by:

A) The state Department of Insurance
B) The association as a corporate entity
✔ C) Individual underwriting members or syndicates
D) A single reinsurer

Explanation: In a Lloyd's association (such as Lloyd's of London), individual underwriters or syndicates assume risk individually rather than as a single corporate entity. Each member is personally liable for their share of the risk.

2. Which of the following represents the correct description of proximate cause?

A) The most remote cause of a loss
B) The last event in a chain of events leading to a loss
✔ C) The dominant cause that sets in motion an unbroken chain of events leading to a loss
D) Any contributing factor in a loss

Explanation: Proximate cause is the primary or dominant cause that initiates an unbroken sequence of events that results in a loss. It determines whether a loss is covered under the policy.

3. A client purchases a variable life policy. During the free-look period, the stock market crashes. If the client returns the policy within 10 days, what refund is the client entitled to under Arizona law?

✔ A) A full refund of all premiums paid.
B) The cash value of the policy at the time of return.
C) No refund is allowed for variable policies.
D) A refund of 50% of the premiums.

Explanation: Even for variable policies, returning the policy during the free-look period entitles the purchaser to a full refund of all premiums paid.

4. Disability income insurance is designed to:

A) Supplement Medicare benefits for disabled seniors
B) Provide a lump-sum payment upon permanent disability
✔ C) Replace a portion of the insured's income when totally disabled and unable to work
D) Pay medical bills when the insured is hospitalized

Explanation: Disability Income (DI) insurance replaces a portion of the insured's earned income (typically 60-80%) when the insured becomes disabled and cannot work. This protects the insured's financial stability during a period of disability, allowing them to continue meeting living expenses without drawing on savings.

5. A family policy typically provides what kind of insurance on the children?

A) Universal life insurance
B) Whole life insurance
C) Variable life insurance
✔ D) Term life insurance

Explanation: A family policy is a package policy that usually provides whole life coverage for the primary breadwinner and a smaller amount of convertible term life insurance for the spouse and children.

6. Life insurance is considered a personal contract, which means:

A) The policy must be delivered in person
B) The contract terms are personalized for each insured
C) Only individuals can purchase it
✔ D) The policy insures the person rather than property and cannot be freely transferred to another party

Explanation: Because life insurance is a personal contract, it follows the person rather than insuring a specific piece of property. The policyowner cannot transfer (assign) ownership of the policy to another party without the insurer's consent.

7. A policyowner, Mark, decides to surrender his Whole Life policy after 15 years. He wants to stop paying premiums but wants to maintain a lifetime of coverage, albeit with a reduced face amount. Which nonforfeiture option should he select?

A) Extended Term
B) Cash Surrender
✔ C) Reduced Paid-Up
D) Paid-Up Additions

Explanation: The Reduced Paid-Up nonforfeiture option uses the policy's accumulated cash value as a single premium to purchase a paid-up policy of the same type (whole life) for a reduced face amount, maintaining coverage for life.

8. The risk management technique of taking action to reduce the frequency or severity of a potential loss is known as:

A) Avoidance
✔ B) Reduction
C) Transfer
D) Retention

Explanation: Risk reduction involves implementing measures to minimize the chance or impact of a loss. Examples include installing a sprinkler system to reduce fire damage or wearing a seatbelt to reduce injury in an accident.

9. The 'own occupation' definition of disability is considered the gold standard for professional disability coverage because:

A) It has no maximum benefit period limitation
✔ B) It provides the broadest protection — paying benefits even if the insured can earn income in another occupation
C) It covers both partial and total disability without separate riders
D) It has the shortest elimination period of any DI policy type

Explanation: 'Own occupation' disability policies are the most protective and most expensive type of disability income coverage. They pay full benefits even if the insured can work in a different occupation. A surgeon who loses fine motor skills is totally disabled under 'own occ' even if they could teach medicine. This broad definition is most valuable for high-income professionals.

10. A stock insurance company is owned by its:

A) Board of Directors
B) Policyholders
✔ C) Shareholders
D) Agents

Explanation: A stock insurance company is a corporation owned by its stockholders or shareholders. Profits are distributed to these shareholders as dividends and are taxable.

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11. What is a 'grandfathered' health plan under the ACA?

A) A government-sponsored health plan.
✔ B) A plan that existed before the ACA was enacted (March 23, 2010) and has not undergone significant changes.
C) A plan that only covers senior citizens.
D) A plan that meets all ACA requirements.

Explanation: Grandfathered plans are exempt from many of the ACA's mandates, such as covering preventive care at no cost or adhering to the metal level requirements. However, they can lose this status if they make significant changes that reduce benefits or increase costs for members.

12. Which method of handling risk involves accepting financial responsibility for potential losses without purchasing insurance?

A) Risk sharing
B) Risk transfer
✔ C) Risk retention
D) Risk avoidance

Explanation: Risk retention (self-insurance) means accepting the financial consequences of a potential loss rather than transferring the risk to an insurer. This can be intentional or unintentional.

13. A producer who submits a life insurance application without the initial premium is issuing what type of receipt?

A) Premium receipt
✔ B) An application without any receipt
C) Conditional receipt
D) Binding receipt

Explanation: If no initial premium is collected with the application, no receipt is issued and the insurance does not take effect until the policy is delivered AND the first premium is paid in good health. A conditional receipt provides coverage from the date of the application or exam, whichever is later, IF the applicant is found insurable.

14. If there is a discrepancy between the insured's age on the application and their actual age, the Misstatement of Age or Sex provision allows the insurer to:

A) Charge the beneficiary for the back premiums owed.
B) Void the policy.
C) Deny the claim entirely.
✔ D) Adjust the death benefit to what the premium would have purchased at the correct age.

Explanation: The Misstatement of Age or Sex provision states that if the insured's age or sex was misstated, the insurer will not void the policy but will adjust the benefits. The death benefit will be recalculated to the amount the premium paid would have purchased at the correct age or sex.

15. A term life insurance policy that allows the insured to renew each year without proof of insurability but at increasing premiums is called:

A) Guaranteed level term
✔ B) Annual renewable term (ART)
C) Level term
D) Decreasing term

Explanation: Annual Renewable Term (ART) provides one year of coverage that automatically renews each year. Premiums increase at each renewal to reflect the insured's advancing age. No evidence of insurability is required at renewal — the policy is guaranteed renewable. ART is the basis for most group life insurance because of its simplicity and annual renewal structure.

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16. A major medical policy is designed to cover:

A) Dental and vision expenses.
B) Routine check-ups and preventative care only.
C) Small, predictable medical expenses.
✔ D) Catastrophic medical expenses with high coverage limits, deductibles, and coinsurance.

Explanation: Major medical insurance provides broad coverage and high limits to protect against large, unpredictable medical expenses. It is characterized by deductibles and coinsurance, which require the insured to share in the cost of care.

17. A Modified Endowment Contract (MEC) occurs when:

A) An annuity's interest rate is modified by the insurer
B) A variable annuity includes a guaranteed minimum death benefit rider
C) An annuity's cash value exceeds its death benefit
✔ D) A life insurance policy is over-funded beyond IRS limits based on a 7-pay test

Explanation: A Modified Endowment Contract (MEC) is a life insurance policy that has been funded with cumulative premiums exceeding the IRS 7-pay test limit. MECs lose certain tax advantages of life insurance — withdrawals and loans are taxed on LIFO basis (gains first), and pre-59½ withdrawals face a 10% penalty. MECs are not annuities but share similar tax treatment.

18. A policyholder dies. The insolvent insurer is unable to pay the death benefit. What is the maximum amount the Arizona Life and Disability Insurance Guaranty Association will pay for a single life insurance death benefit?

A) $100,000
B) $250,000
✔ C) $300,000
D) $500,000

Explanation: The Arizona Guaranty Association provides protection up to $300,000 in life insurance death benefits per individual.

19. An annuity purchased with after-tax dollars and not held in a qualified retirement plan is called a:

✔ A) Non-qualified annuity
B) Roth annuity
C) Qualified annuity
D) Tax-sheltered annuity

Explanation: A non-qualified annuity is purchased with after-tax (already taxed) dollars outside of a qualified retirement plan. Only the earnings (gains) are subject to income tax upon distribution, not the return of the original after-tax investment (cost basis). This differs from a qualified annuity where all distributions are taxable.

20. Key person life insurance purchased through a group plan is intended to compensate which party in the event of the key person's death?

A) All employees in the group equally
✔ B) The business or employer for the economic loss caused by the key person's death
C) The state insurance guaranty fund
D) The key person's family exclusively

Explanation: Key person (key employee) life insurance is designed to compensate the business for the financial loss it would suffer upon the death of a crucial employee. The business is both the owner and beneficiary of the policy, and the proceeds help the company recover from the economic impact of losing that individual.

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21. Under Social Security, the blackout period refers to:

A) The 5-month waiting period for SSDI
✔ B) The period when a surviving spouse receives no benefits between the youngest child turning 16 and the spouse reaching age 60
C) The gap between early and full retirement age
D) The time between application and approval for disability benefits

Explanation: The blackout period is the time when a surviving spouse is not eligible for Social Security survivor benefits. It begins when the youngest child turns 16 (ending mother's/father's benefits) and lasts until the surviving spouse reaches age 60 (or 50 if disabled).

22. The ownership provision in a life insurance policy grants the policyowner a bundle of rights, which typically includes all of the following EXCEPT:

A) The right to select a settlement option
✓ B) The right to change the terms of the policy contract unilaterally
C) The right to assign the policy
D) The right to name or change the beneficiary

Explanation: The policyowner has numerous rights, including naming or changing the beneficiary (if revocable), assigning the policy, borrowing against the cash value, selecting dividend and nonforfeiture options, and surrendering the policy. However, the policyowner cannot unilaterally change the terms written in the policy contract — insurance is a contract of adhesion drafted by the insurer.

23. The Law of Large Numbers in insurance means that:

A) Larger policies are more likely to be paid
B) Large companies are more financially stable
C) Insurance premiums increase with policy size
✓ D) As the number of similar exposure units increases, actual losses become more predictable

Explanation: The Law of Large Numbers states that as more similar risks are pooled, the actual loss experience approaches the statistically expected loss rate, allowing accurate premium pricing.

24. Under the ACA's employer shared responsibility provision (employer mandate) which employers are subject to the requirement?

A) Employers with 25 or more full-time equivalent employees
✓ B) Employers with 50 or more full-time equivalent employees
C) Employers with 100 or more full-time equivalent employees
D) All employers regardless of size

Explanation: The ACA's employer mandate, also known as the employer shared responsibility provision, applies to Applicable Large Employers (ALEs), which are employers with 50 or more full-time equivalent employees. These employers must offer affordable, minimum value coverage or potentially face penalties.

25. Which of the following losses would most likely be insurable?

A) A speculative loss from a bad business investment
B) Loss from illegal gambling activity
✓ C) Accidental destruction of a home by fire
D) Loss from a deliberate act of the insured

Explanation: For a loss to be insurable, it must be: pure (not speculative), accidental and unintentional, definite and measurable, not catastrophic to the insurer, and the premium must be economically feasible. Accidental fire loss to a home meets all these criteria, while intentional acts, speculative losses, and illegal activities do not.

26. Which type of insurer issues both participating and non-participating policies?

A) Only risk retention groups
B) Only mutual companies
✔ C) Some stock insurance companies
D) Fraternal benefit society only

Explanation: While mutual companies traditionally issued only participating policies, some stock companies now issue both participating (dividend-paying) and non-participating (no dividends) policies. The distinction between stock and mutual companies relates to ownership structure, not exclusively to whether they issue participating policies.

27. A client age 35 wants to save for retirement, has a high risk tolerance, and wants the potential for high growth. Which annuity would be most suitable?

✔ A) Variable annuity
B) Fixed annuity
C) Annuity certain
D) Immediate annuity

Explanation: A variable annuity would be the most suitable for this client. It allows them to invest directly in the market through subaccounts, offering the potential for higher returns that align with their high risk tolerance and long time horizon.

28. All Medigap policies are:

A) Offered by Medicare
B) Non-cancellable
✔ C) Standardized
D) Guaranteed issue

Explanation: All Medigap policies are standardized by federal law. This means that plans with the same letter designation (e.g., Plan G) must offer the exact same set of basic benefits, regardless of the insurance company selling it. The only difference between companies is the premium and customer service.

29. What is a Life Settlement?

A) A dividend option that purchases more insurance.
B) A settlement option that provides lifetime income.
✔ C) The sale of a life insurance policy by a healthy, typically elderly, individual to a third party.
D) The cash surrender of a policy.

Explanation: A life settlement is similar to a viatical settlement, but the insured is not terminally ill. Typically, it involves senior citizens (e.g., age 65 or older) selling a policy they no longer need for more than its cash surrender value but less than its face amount.

30. Arthur is 66 years old, retired, and enrolled in Medicare Parts A and B. He has group health coverage through his spouse's active employment at a large company (150 employees). If Arthur incurs a medical bill, how is the claim coordinated?

A) Medicare is primary; the group plan is secondary
✔ B) The group plan is primary; Medicare is secondary
C) Medicare pays 100% and the group plan pays nothing
D) The plans split the cost evenly

Explanation: When an individual age 65 or older is covered by an employer group health plan through active employment (either their own or their spouse's) at an employer with 20 or more employees, the group health plan is the primary payer and Medicare is the secondary payer.

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31. The process of evaluating a risk to determine if it is acceptable to an insurer is called:

A) Claims adjusting
B) Reinsurance
✔ C) Underwriting
D) Marketing

Explanation: Underwriting is the process of risk selection, classification, and pricing. Underwriters for the insurance company decide whether to accept or reject applications for insurance.

32. A life insurance policy is delivered to a client in Arizona. The policy does not contain a free-look provision. What is the status of the policy?

✔ A) It is void and violates Arizona insurance laws.
B) It is valid if the client signs a waiver.
C) It is valid for 1 year only.
D) It is allowed if the insurer is a mutual company.

Explanation: The free-look provision is a mandatory provision for individual life insurance policies in Arizona. Excluding it violates state law.

33. In an Independent Practice Association (IPA) model HMO, physicians:

A) Are employed by a single multispecialty medical group
B) Practice only in HMO-owned clinics
✔ C) Maintain their own private practices and contract with the HMO to see its members
D) Are salaried employees of the HMO

Explanation: In an IPA model, independent physicians maintain their own offices and private practices. They contract with the HMO to provide services to its members, typically on a capitated or negotiated fee basis. The physicians also see non-HMO patients, giving them more independence than staff model physicians.

34. The 'notice of conversion rights' under group life insurance must be provided to:

- ✔ A) Employees whose group life coverage terminates for any qualifying reason, notifying them of their right to convert to individual coverage
- B) Only employees who are voluntarily resigning
- C) Only employees who are terminated involuntarily
- D) Employees who have been with the company for more than 5 years

Explanation: When an employee's group life coverage terminates (for any qualifying reason — termination, retirement, reduced hours), the employer or insurer must notify the employee of their conversion rights. The employee has 31 days to exercise the conversion right. Failure to provide notice may extend the time for conversion.

35. Under COBRA, a qualified beneficiary who is disabled at the time of the qualifying event may extend their coverage from 18 months to:

- A) 24 months
- B) 36 months
- C) 48 months
- ✔ D) 29 months

Explanation: If an individual is determined by Social Security to have been disabled at the time of the qualifying event (or within the first 60 days of COBRA), they can extend their continuation coverage for an additional 11 months, for a total of 29 months.

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36. An insurer's ability to take legal action against a responsible third party for a loss paid to an insured is known as:

- ✔ A) Subrogation
- B) Indemnification
- C) Arbitration
- D) Contribution

Explanation: Subrogation allows the insurer, after paying a claim, to step into the shoes of the insured and sue the at-fault party to recover the amount it paid. This prevents the insured from collecting from both the insurer and the at-fault party.

37. A 'window' or 'free withdrawal' provision in a fixed annuity allows:

- ✔ A) The owner to withdraw a specified percentage (often 10%) of the account value annually without incurring a surrender charge
- B) Beneficiaries to withdraw funds without tax consequences at the owner's death
- C) The owner to take loans without interest during the surrender period
- D) The owner to surrender without any charges at any time

Explanation: Most fixed annuities include a free withdrawal provision allowing the owner to take out a certain percentage of the account value (commonly 10%) each contract year without incurring a surrender charge. This provides some liquidity during the surrender charge period. Withdrawals above this amount are subject to surrender charges during the surrender period.

38. The Spendthrift Clause in a life insurance policy is designed to:

- ✔ A) Protect the death benefit proceeds from the beneficiary's creditors.
- B) Prevent the beneficiary from changing the settlement option.
- C) Allow the insurer to hold and manage the death benefit proceeds for the beneficiary.
- D) Protect the policyowner from creditors.

Explanation: The Spendthrift Clause protects the policy proceeds from being claimed by the beneficiary's creditors or being recklessly spent by the beneficiary. When this clause is active, the insurer retains the proceeds and pays them out to the beneficiary in installments according to a settlement option.

39. In an annuity, the 'accumulation value' represents:

- ✔ A) The total amount accumulated inside the annuity before surrender charges or market value adjustments
- B) The account's value if the owner annuitizes immediately
- C) The surrender value net of all charges
- D) The future value of annuity income payments

Explanation: The accumulation value (also called account value or policy value) is the total amount accumulated in the annuity contract, including contributions and credited interest or investment returns. The surrender value is the accumulation value minus any applicable surrender charges or market value adjustments (MVA).

40. Which of the following is NOT a required element of a legal contract?

- A) Offer and Acceptance
- ✔ B) Equal Exchange of Value
- C) Consideration
- D) Competent Parties

Explanation: The four essential elements of a legal contract are: Agreement (Offer and Acceptance), Consideration, Competent Parties, and Legal Purpose. An equal exchange of value is not required; insurance contracts are aleatory by nature.

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41. A moral hazard is characterized by:

- A) An individual's indifference to loss
- B) An unpredictable natural event
- C) A pre-existing physical condition
- ✔ D) A fraudulent or dishonest tendency

Explanation: A moral hazard exists when the character and conduct of an insured person increase the chance of a loss. It involves dishonesty, such as filing a fraudulent claim or intentionally causing a loss.

42. A health insurance plan that provides coverage for dental care is known as:

- A) An indemnity plan
- ✔ B) A dental plan
- C) A dread disease policy
- D) A vision plan

Explanation: Dental insurance is a specific type of health plan designed to pay for a portion of the costs associated with dental care, from preventive services like cleanings to major procedures like crowns and root canals.

43. In group insurance, who is responsible for paying the policy premiums to the insurer?

A) The Third-Party Administrator
✔ B) The employer
C) The agent of record
D) The employee

Explanation: The employer, as the master policyholder, is responsible for collecting the employee's share of the premium (if any) and remitting the total premium to the insurance company on a regular basis.

44. When interest rates rise after an annuity is purchased, an annuity with an MVA provision may:

A) Terminate the contract and return all premiums
B) Increase the surrender value by applying a positive market value adjustment
C) Automatically increase the credited rate to match market rates
✔ D) Reduce the surrender value by applying a negative market value adjustment if the contract is surrendered

Explanation: If interest rates rise after a fixed annuity with an MVA is purchased and the owner surrenders early, a negative MVA may be applied — reducing the surrender value below the accumulation value. This reflects the insurer's loss from having to sell bonds at lower prices in a rising rate environment. Conversely, falling rates may produce a positive MVA.

45. An annuity that does not start making payments until some point in the future (more than one year after purchase) is a(n):

✔ A) Deferred Annuity
B) Life Annuity
C) Immediate Annuity
D) Lump-Sum Annuity

Explanation: A deferred annuity is purchased with either a single premium or flexible premiums over time. The income payments are deferred until a future date chosen by the owner, allowing the funds to accumulate on a tax-deferred basis.

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46. What is the primary tax advantage of an executive bonus plan?

✔ A) The premium paid by the employer is a deductible business expense.
B) The death benefit is not included in the employee's estate.
C) The cash value grows tax-free.
D) The employee receives the benefit tax-free.

Explanation: In an executive bonus plan (Section 162), the employer pays a bonus to an employee, who uses it to pay the premium on a personally owned life insurance policy. The bonus (premium) is tax-deductible for the employer and taxable income for the employee.

47. Which of the following conditions is NECESSARY for a risk to be insurable?

A) The loss must be caused by a government-recognized peril
B) The premium must be equal to the expected loss
✔ C) There must be a sufficiently large number of similar exposure units for accurate loss prediction
D) The potential loss must be catastrophic in nature

Explanation: For risk to be insurable (and priced accurately), there must be a large enough number of homogeneous (similar) exposure units that the Law of Large Numbers can be applied. Without sufficient similar risks, the insurer cannot accurately predict losses and set reasonable premiums. Other requirements include accidental, definite, and non-catastrophic losses.

48. In a group life insurance plan, if the employer pays 100% of the premium, this is known as a:

A) Contributory plan
B) Voluntary plan
C) Executive bonus plan
✔ D) Noncontributory plan

Explanation: In a noncontributory group plan, the employer pays the full premium. 100% of eligible employees must be covered under this arrangement.

49. The 'assignment clause' in life insurance means:

A) The producer is assigned responsibility for the policy after issue
B) The insurer can assign the policy to a new company without the insured's consent
C) The beneficiary can be assigned to another individual upon the insured's death
✔ D) The policyowner can transfer policy rights to another party through either an absolute or collateral assignment

Explanation: The assignment clause gives the policyowner the right to assign (transfer) ownership rights or a portion of them to another party. An absolute assignment transfers all ownership rights permanently. A collateral assignment temporarily transfers specific rights (like the right to the death benefit as loan collateral) while the original owner retains other rights.

50. Can a policyowner name a charity as the beneficiary of a life insurance policy?

A) Yes - but the death benefit is then taxable.
✔ B) Yes - any legally recognized charitable organization can be named.
C) No - beneficiaries must be individuals.
D) Yes - but only if the charity is a religious organization.

Explanation: A policyowner can name a charity as the beneficiary. This is a common way to make a significant philanthropic gift. The death benefit is paid directly to the charity upon the insured's death.