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Arkansas Insurance Practice Test

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1. Which rider would pay a monthly income to an insured who becomes totally and permanently disabled?

A) Waiver of Premium Rider
B) Guaranteed Insurability Rider
C) Accidental Death Benefit Rider
✔ D) Disability Income Rider

Explanation: The Disability Income Rider provides a monthly benefit payment to the insured if they become totally disabled. This benefit is separate from and in addition to the policy's death benefit.

2. Industrial life insurance (also known as debit insurance) is characterized by:

A) Investment-linked cash value growth
B) Large face amounts and annual premium payments
C) Group coverage provided through an employer
✔ D) Small face amounts with premiums collected weekly or monthly at the insured's home by an agent

Explanation: Industrial (debit) life insurance features small face amounts (often $1,000 to $10,000), with premiums collected on a weekly or monthly basis at the policyholder's home by a debit agent. It was historically designed for low-income individuals who could not afford standard policies.

3. Social Security retirement benefits are funded primarily through:

✔ A) FICA payroll taxes paid by employees and employers
B) State income taxes
C) Federal income taxes
D) Voluntary contributions by workers

Explanation: Social Security (OASDI) is funded through the Federal Insurance Contributions Act (FICA) payroll tax, which is split equally between the employee and employer. Self-employed individuals pay both portions through the Self-Employment Contributions Act (SECA) tax.

4. 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.

5. In a fixed-indexed annuity, 'downside protection' means:

- ✔ A) The annuity will never lose value due to index declines; the floor rate (typically 0%) protects against negative crediting
- B) The insurer will never let the annuity value fall below the original premium
- C) The insurer guarantees returns will match market performance even when markets decline
- D) The annuity owner receives compensation for any year the index falls

Explanation: Downside protection in FIAs means the annuity owner's account value is protected from loss when the index performs negatively. The floor rate (typically 0%) means the credited rate is never negative — a declining index results in zero credit for that period, not a loss of principal. This principal protection distinguishes FIAs from direct index investing.

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6. The 'cash refund' life annuity payout option provides that if the annuitant dies before receiving payments equal to the principal:

- ✔ A) The beneficiary will receive a lump-sum payment of the remaining principal.
- B) The beneficiary will continue to receive payments for life.
- C) Payments will continue to a beneficiary for a fixed period.
- D) All payments will cease.

Explanation: The cash refund option guarantees that, at a minimum, the total amount paid into the annuity (the principal) will be paid out. If the annuitant dies before this happens, their beneficiary receives the difference in a single cash payment.

7. A limited-pay whole life policy (such as 20-Pay Life) differs from straight whole life because:

- A) The death benefit decreases each year premiums are paid
- B) Cash value does not accumulate in limited-pay policies
- C) Coverage terminates after 20 years
- ✔ D) Premiums are paid for a limited number of years but coverage lasts for the insured's entire life

Explanation: In a limited-pay whole life policy, premiums are concentrated into a shorter payment period (e.g., 20 years), but the coverage remains in force for the insured's entire life. Because premiums are paid over a shorter period, they are higher than straight whole life premiums but the policy becomes fully paid-up after the payment period.

8. An applicant wants to sell insurance in Arkansas. Which statement is most accurate?

- ✔ A) The applicant must meet the requirements administered by Arkansas Insurance Department
- B) A license from an unrelated profession is sufficient
- C) A producer license is optional for all solicitation
- D) National advertising approval replaces state licensing

Explanation: The applicant must meet the requirements administered by Arkansas Insurance Department

9. A 'participating' whole life policy allows the policyowner to use dividends to purchase a 'one-year term' option. This option:

A) Provides an additional year of double the death benefit
B) Purchases a one-year extension of the policy at no cost
C) Converts the policy to term insurance for one year using the dividend
✔ D) Uses the dividend to purchase one year of additional term life insurance equal to the policy's cash value

Explanation: The 'fifth dividend option' (term purchase) uses the dividend to purchase one year of additional term life insurance. The amount of term purchased typically equals the policy's cash value. This option temporarily increases the total death benefit (base policy plus the term amount) without increasing the permanent premium. It is commonly used in high-cash-value policies.

10. The intentional failure to disclose a known, material fact on an insurance application is known as:

A) Fraud
B) Misrepresentation
C) Breach of warranty
✔ D) Concealment

Explanation: Concealment is the willful withholding of material information that would affect an underwriting decision. If discovered, it can be grounds for the insurer to void the policy.

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11. A 'benefit period' in a major medical health plan is:

A) The time period during which disability benefits are paid
✔ B) The time period within which all covered expenses must be incurred to apply to the same deductible
C) The waiting period before coverage begins
D) The maximum years of coverage under the plan

Explanation: In a major medical health plan, the benefit period (usually a calendar year) is the period within which all covered expenses must be incurred to apply toward the same deductible and out-of-pocket maximum. At the end of the benefit period, these amounts reset. Most plans use January 1 to December 31 as the benefit period.

12. 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.

13. A 'market value adjustment' (MVA) provision in a fixed annuity:

- ✔ A) Applies a positive or negative adjustment to the surrender value based on changes in interest rates since the contract was issued
- B) Guarantees the annuity owner receives at least market-rate returns
- C) Adjusts the insurer's reserve requirements based on market conditions
- D) Automatically resets the credited rate to match current market rates

Explanation: An MVA provision adjusts the surrender value of a fixed annuity based on changes in interest rates since the contract was issued. If rates have risen since purchase, an early surrender may result in a downward adjustment (penalty). If rates have fallen, the adjustment may be positive. MVAs reflect the insurer's ability to reinvest at different rates.

14. A fixed dollar amount that an insured pays for a specific covered service, such as a doctor's visit, is a(n):

- ✔ A) Copayment
- B) Premium
- C) Deductible
- D) Coinsurance

Explanation: A copayment (or copay) is a set fee paid by the insured at the time of service. For example, a plan might require a $30 copay for each office visit.

15. COBRA applies to employers with how many employees?

- A) 10 or more
- B) 100 or more
- ✔ C) 20 or more
- D) 50 or more

Explanation: The federal COBRA law applies to private-sector employers with 20 or more employees. Public-sector employers are also subject to COBRA.

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16. Which section of an insurance policy lists the perils, property, or persons not covered by the contract?

- A) Insuring Clause
- ✔ B) Exclusions
- C) Conditions
- D) Declarations

Explanation: The Exclusions section explicitly states what the policy does not cover. This is done to clarify the scope of coverage and eliminate coverage for uninsurable risks.

17. In which type of annuity does the owner bear the investment risk?

- A) Immediate Annuity
- ✔ B) Variable Annuity
- C) Deferred Annuity
- D) Fixed Annuity

Explanation: In a variable annuity, the contract owner directs their premium payments into various investment subaccounts (similar to mutual funds). The contract's value and the future income payments depend on the performance of these investments, so the owner assumes all investment risk.

18. Which of the following statements about paid-up additions (PUAs) is CORRECT?

A) PUAs reduce the policy's total death benefit to offset new cash value growth
B) PUAs require additional premium payments to remain in force
✔ C) PUAs are small single-premium whole life policies that earn dividends and increase the total death benefit and cash value
D) PUAs are temporary coverage that expires if dividends are insufficient

Explanation: Paid-Up Additions (PUAs) are small amounts of fully paid-up whole life insurance purchased with policy dividends. Each PUA itself earns future dividends, creating a compounding effect. PUAs increase both the death benefit and cash value of the base policy and are fully paid-up — no additional premium is required.

19. Which of the following is NOT a common exclusion in a disability income policy?

A) Losses from committing a felony
B) Losses from war or acts of war
C) Intentionally self-inflicted injuries
✔ D) Disabilities arising from a covered accident

Explanation: Disability policies are designed to cover disabilities from accidents and sicknesses. Common exclusions include losses due to war, self-inflicted injuries, participation in a felony, aviation (other than as a commercial passenger), and sometimes pre-existing conditions.

20. 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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21. 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.

22. A client, age 62, wants to take a lump-sum distribution from their annuity. What are the tax consequences?

A) The earnings portion is taxed as a capital gain.
B) The entire distribution is tax-free.
✓ C) The earnings portion is taxable as ordinary income, but there is no IRS penalty.
D) The earnings portion is tax-free, but subject to a penalty.

Explanation: The client is over age 59 1/2, so the 10% early withdrawal penalty does not apply. However, the earnings portion of the distribution (the amount exceeding the cost basis) is still fully taxable as ordinary income.

23. In a Variable Life insurance policy, where is the cash value invested?

A) In the insurer's general account
B) In government bonds only
C) In a guaranteed interest-bearing account
✓ D) In separate accounts chosen by the policyowner

Explanation: The cash value in a Variable Life policy is invested in separate accounts, which are similar to mutual funds. The policyowner chooses the investment subaccounts and bears the investment risk.

24. 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.

25. A Silver plan on the health insurance exchange has an actuarial value of approximately what percentage, meaning the plan pays that share of average covered medical costs?

✓ A) 70%
B) 60%
C) 90%
D) 80%

Explanation: The ACA established four metal tiers based on actuarial value: Bronze (60%), Silver (70%), Gold (80%), and Platinum (90%). The actuarial value represents the percentage of average total costs for covered benefits that the plan will pay, with the insured responsible for the remaining percentage through cost-sharing.

26. A 'health reimbursement arrangement' (HRA) is characterized by:

A) A health insurance policy that reimburses providers directly
B) An employee-funded account that reimburses medical expenses
C) A retirement account that can only be used for healthcare costs after age 65
✔ D) An employer-funded account used to reimburse employees for qualifying medical expenses and premiums tax-free

Explanation: An HRA is a tax-advantaged arrangement funded ENTIRELY by the employer (no employee contributions). Employers reimburse employees for qualifying medical expenses and health insurance premiums on a tax-free basis. Unused HRA funds may roll over (at the employer's discretion). HRAs are employer-controlled and not portable.

27. What is a contingent beneficiary?

✔ A) A beneficiary who receives the death benefit if the primary beneficiary predeceases the insured.
B) A beneficiary who is under the age of 18.
C) A beneficiary who receives payments over a contingent period.
D) A beneficiary that cannot be changed.

Explanation: A contingent (or secondary) beneficiary is entitled to the policy proceeds only if the primary beneficiary dies before the insured, or if both die in a common disaster. It is a backup designation.

28. A surviving spouse caring for a deceased worker's child under age 16 is eligible for a mother's or father's benefit equal to what percentage of the worker's PIA, assuming the worker was fully or currently insured?

✔ A) 75%
B) 100%
C) 66 2/3%
D) 50%

Explanation: A surviving spouse who is caring for a child under age 16 (or a disabled child) is entitled to a mother's or father's benefit equal to 75% of the deceased worker's Primary Insurance Amount. These benefits end when the youngest child reaches age 16.

29. A Section 125 (Cafeteria) plan allows employees to:

A) Select from multiple insurance carriers
B) Purchase food in the workplace cafeteria at a discount
✔ C) Choose between taxable and nontaxable benefits using pre-tax dollars
D) Opt out of all employer benefits for a cash payment

Explanation: A Section 125 plan (also called a cafeteria plan or premium-only plan) allows employees to pay for certain qualified benefits, such as health insurance premiums, FSA contributions, and dependent care, on a pre-tax basis. This reduces the employee's taxable income.

30. John named his two children, Amy and Ben, as his primary beneficiaries on a per capita basis. Ben dies before John. When John dies, who receives the death benefit?

A) Amy receives 50% and Ben's children receive 50%.
✔ B) Amy receives the entire death benefit.
C) Amy receives 50% and Ben's 50% goes to John's estate.
D) The entire death benefit is paid to John's estate.

Explanation: Under a 'per capita' (by the head) distribution, the proceeds are divided equally only among the surviving members of the named class. Since Ben is deceased, his share is redistributed to the other surviving beneficiary, Amy. Ben's children receive nothing.

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31. A traditional fee-for-service health plan is also known as a(n):

✔ A) Indemnity Plan
B) Capitation Plan
C) HMO Plan
D) Managed Care Plan

Explanation: An indemnity plan is a traditional plan that pays a set percentage of charges for services, allowing the insured to see any medical provider they choose. The insurer reimburses the insured or pays the provider directly after a claim is filed.

32. Which of the following is covered as a preventive service at no cost-sharing under the ACA?

✔ A) Vaccines recommended by the Advisory Committee on Immunization Practices (ACIP)
B) All prescription medications regardless of purpose
C) Elective cosmetic procedures
D) Dental fillings for adults

Explanation: ACA requires non-grandfathered health plans to cover ACIP-recommended vaccines at no cost-sharing. Other no-cost preventive services include USPSTF 'A' and 'B' rated screenings (mammograms, colonoscopies, blood pressure checks) and HRSA guidelines for preventive care for women. Cosmetic procedures, prescription drugs generally, and adult dental are NOT required preventive services.

33. In a noncontributory group life insurance plan:

A) Employees can opt out without affecting others' coverage
✔ B) The employer pays 100% of the premium and 100% participation is required
C) Employees contribute a portion of the premium and 75% participation is required
D) The government contributes to the premium

Explanation: In a noncontributory group plan, the employer pays the entire premium and all eligible employees must enroll (100% participation is required). This universal participation prevents adverse selection. In a contributory plan, employees share the premium cost and at least 75% participation is typically required.

34. An insurance policy is an aleatory contract, which means:

- ✔ A) It involves an unequal exchange of value.
- B) The terms are take-it-or-leave-it.
- C) Only one party makes a promise.
- D) It is based on utmost good faith.

Explanation: Aleatory contracts involve an unequal exchange of value between the parties. The insured may pay premiums for years and never file a claim, or they may pay a small premium and receive a large claim payment.

35. The 'nursing home benefit rider' or 'accelerated benefit for chronic illness rider' allows the insured to:

- A) Designate a nursing facility as the beneficiary
- ✔ B) Access a portion of the life insurance death benefit early if the insured requires long-term care or meets chronic illness triggers
- C) Receive nursing home care at no cost when added to a life policy
- D) Automatically convert the life policy to a long-term care policy at age 65

Explanation: The accelerated benefit for chronic illness rider (also called a long-term care rider) allows the insured to access the life policy's death benefit early when they require long-term care or meet chronic illness triggers (inability to perform 2 of 6 ADLs or cognitive impairment). The advance reduces the final death benefit. This is a hybrid life/LTC solution.

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36. Group life insurance usually requires evidence of insurability for employees who:

- A) Have had any health conditions in the past 5 years
- B) Work part-time fewer than 20 hours per week
- C) Are over age 55
- ✔ D) Enroll late (after the initial enrollment period) without a qualifying life event

Explanation: In group life insurance, late enrollees (those who did not enroll during the initial or open enrollment period without a qualifying life event) are typically required to provide evidence of insurability (a medical statement or exam). This requirement prevents adverse selection by people who only seek coverage when they know they need it.

37. 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.

38. Which of the following represents a pure risk?

- ✔ A) The chance of a house fire
- B) The potential gain from a stock investment
- C) The outcome of a sports bet
- D) The chance of winning the lottery

Explanation: Pure risk involves only the possibility of loss or no loss, with no chance for financial gain. A house fire is an example, whereas gambling and investments are speculative risks.

39. A 'cap rate' in an indexed annuity limits:

- A) The maximum surrender charge that can be assessed
- ✔ B) The maximum interest rate that will be credited regardless of how high the index performs
- C) The maximum premium that can be paid into the annuity
- D) The maximum benefit period for income payments

Explanation: The cap rate (or interest rate cap) in an indexed annuity sets the maximum amount of index-linked interest that will be credited in a given period, regardless of how well the index actually performs. For example, if the index gains 20% but the cap is 8%, only 8% is credited. Caps limit upside potential in exchange for downside protection.

40. The 'nondiscrimination rules' under ACA Section 1557 prohibit:

- ✔ A) Discrimination in health programs or activities receiving federal financial assistance based on race, color, national origin, sex, age, or disability
- B) Charging different premiums to employees based on their claims history
- C) Offering wellness program incentives that vary by health status
- D) Employers from offering different benefit tiers to different employee groups

Explanation: ACA Section 1557 prohibits discrimination in health programs or activities receiving federal financial assistance on the basis of race, color, national origin, sex, age, or disability. This includes Medicaid, Medicare, and plans offered through the ACA marketplace. Insurance companies and providers receiving federal funding must comply.

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41. The 'misstatement of age' provision in a life insurance policy states that if the insured's age was misstated:

- A) The policy is void from inception
- B) The policy will be cancelled and all premiums refunded
- C) The insured must pay back premiums for the difference in age
- ✔ D) The death benefit will be adjusted to the amount the premium paid would have purchased at the correct age

Explanation: The Misstatement of Age (or Sex) provision prevents policy rescission when the insured's age or sex was incorrectly stated. Instead, the benefit is adjusted to what the actual premium paid would have purchased at the correct age. This is a mandatory policy provision that protects both parties.

42. A mutual insurance company is owned by:

A) The state insurance department
B) Stockholders who receive dividends
C) Federal banking regulators
✔ D) Policyholders who may receive dividends from surplus

Explanation: A mutual insurance company is owned by its policyholders. Profits (surplus) may be returned to policyholders as dividends, which are considered a non-taxable return of excess premium. Mutual companies have no stockholders.

43. A 'family term rider' on a life insurance policy provides:

A) Separate individual policies for each family member
B) Permanent coverage for all family members at a single premium
C) Coverage only for the insured's spouse
✔ D) Term life coverage on the spouse and children of the insured under a single rider premium

Explanation: The Family Term Rider (also called Family Rider or Spouse and Children's Rider) provides term life coverage on the policyowner's spouse and children under a single rider. It is cost-efficient — one rider covers multiple family members for a flat premium. Children's coverage typically ends at age 25, and the spouse's coverage can often be converted to individual policies.

44. Which of the following best describes the payment model used by Health Maintenance Organizations (HMOs)?

✔ A) Prepaid or capitation model where providers receive a fixed amount per member per month
B) Indemnity-based reimbursement after services are rendered
C) Cost-plus pricing based on actual expenses incurred
D) Fee-for-service with no discounts

Explanation: In an HMO, providers are typically paid through capitation, meaning they receive a fixed, prepaid amount per enrolled member per month regardless of whether the member uses services. This incentivizes preventive care and cost control.

45. Utilization review in managed care is the process of:

A) Reviewing an insured's driving record to determine health risk
✔ B) Evaluating the appropriateness and necessity of healthcare services before, during, or after care is provided
C) Reviewing a claimant's employment history to determine premium rates
D) Auditing insurance companies for regulatory compliance

Explanation: Utilization review (UR) is a systematic process used by health insurers and managed care organizations to evaluate the appropriateness and medical necessity of healthcare services. UR can occur prospectively (prior authorization before services), concurrently (during ongoing treatment), or retrospectively (after services are rendered).

46. An annuity is designed primarily to provide:

A) A death benefit
B) Coverage for medical expenses
✓ C) Protection against outliving one's income
D) Short-term savings

Explanation: Annuities are financial contracts issued by life insurance companies that are designed to protect against the risk of 'superannuation' or outliving your money. They provide a stream of income, typically during retirement.

47. A 'life income with period certain' settlement option guarantees:

A) Interest payments for a period, followed by a lump sum.
B) Payments for a fixed number of years, and then for life.
✓ C) Payments for life, with a guarantee that a minimum number of payments will be made.
D) A fixed amount paid for a fixed period.

Explanation: This option provides the beneficiary with a guaranteed income for life. If the beneficiary dies before a specified 'period certain' (e.g., 10 or 20 years), the payments will continue to a secondary beneficiary until the end of that period.

48. An employee has both a limited-purpose FSA and an HSA. The limited-purpose FSA may only be used for which of the following expenses, while preserving HSA eligibility?

A) Mental health expenses only
B) All medical expenses including doctor visits
✓ C) Dental and vision expenses only
D) Prescription drug expenses only

Explanation: A limited-purpose FSA (also called a post-deductible FSA) restricts reimbursement to dental and vision expenses. This structure allows an employee to maintain HSA eligibility while still using an FSA for specific non-medical health expenses.

49. Which of the following is a key feature of a Health Savings Account (HSA)?

A) It can only be used to pay deductibles.
B) Contributions are made with after-tax dollars.
C) Unused funds are forfeited at the end of the year.
✓ D) It is owned by the individual and is portable.

Explanation: An HSA is owned by the individual, not the employer. Contributions are tax-deductible, growth is tax-deferred, and withdrawals for qualified medical expenses are tax-free. The account is portable, meaning the individual keeps it even if they change jobs or health plans.

50. Walter purchases a single premium deferred annuity. Five years later, he needs to withdraw $20,000 from the account. The policy has a 7-year surrender charge schedule starting at 7% and decreasing by 1% each year. What will the surrender penalty be on his withdrawal?

A) 7%
✓ B) 3%
C) 2%
D) 0%

Explanation: surrender charges typically decrease by 1% each year the policy is in force. For a schedule starting at 7% in Year 1, the charges are: Year 1 (7%), Year 2 (6%), Year 3 (5%), Year 4 (4%), Year 5 (3%). Thus, in the fifth year, a 3% penalty applies.