Insurance Test Practice

Illinois Insurance Practice Test

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1. In a fixed-indexed annuity, the 'participation rate' means:

A) The percentage of premiums used to purchase the index
B) The surrender charge as a percentage of the premium
✓ C) The percentage of the index gain that is credited to the policy
D) The minimum rate of return guaranteed by the insurer

Explanation: The participation rate in an indexed annuity determines what percentage of the index's gain will be credited to the annuity. For example, if the S&P 500 gains 10% and the participation rate is 80%, the annuity would be credited 8%. Participation rates, caps, and floors together determine the actual crediting rate.

2. An agent, Arthur, tells a client that a competitor's insurance policy has exclusions that do not exist, in order to convince the client to switch. What unfair trade practice is Arthur guilty of?

A) Twisting
B) Rebating
✓ C) Defamation
D) Misrepresentation

Explanation: Making false, maliciously critical, or derogatory statements about the financial condition or policy terms of an insurer or agent is defamation.

3. A collateral assignment of a life insurance policy is used when the policyowner:

A) Transfers the policy to a trust for estate planning
B) Wants to permanently give the policy to another person
✓ C) Pledges the policy as security for a loan while retaining ownership
D) Assigns the policy to a charity as a tax-deductible gift

Explanation: A collateral assignment is a temporary, partial transfer of policy rights to a lender as security for a debt. The policyowner retains all ownership rights except those assigned to the lender. When the loan is repaid, the assignment is released. If the insured dies, the lender is paid the outstanding loan balance from the death benefit, and the remainder goes to the named beneficiary.

4. A policyowner who stops paying premiums on a whole life policy and chooses the Cash Surrender option will receive:

A) A paid-up term policy.
B) The total premiums paid back.
✓ C) The accumulated cash value, less any outstanding loans.
D) A reduced paid-up whole life policy.

Explanation: The Cash Surrender Value nonforfeiture option allows the policyowner to terminate the policy and receive the net cash value (cash value minus any surrender charges and outstanding loans).

5. Under group life insurance, the 'master policyholder' is the:

A) State insurance department that approves the group policy
B) ERISA-appointed trustee who holds the policy in trust
C) Insured employee with the highest death benefit
✔ D) Employer or organization that enters into the contract with the insurer

Explanation: The master policyholder (or policy sponsor) in group life insurance is the employer or organization that contracts with the insurer and receives the master policy. Individual employees are not parties to the insurance contract — they are certificates holders who receive evidence of their coverage under the group plan.

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6. An insurer delays a health claim settlement because the policyholder filed an appeal. The insurer refuses to discuss the claim until the appeal is completed. Is this allowed?

✔ A) No, they must act in good faith and attempt to resolve undisputed parts of claims.
B) Yes, appeals suspend all actions.
C) Only if the amount is over $5,000.
D) Only for life insurance.

Explanation: Insurers must attempt in good faith to settle claims, and cannot delay undisputed payments just because an appeal or dispute exists on other parts.

7. An agent, Karen, is helping a client replace an existing life insurance policy. In addition to the Notice Regarding Replacement, what else must Karen leave with the applicant?

✔ A) Copies of all sales proposals and illustrations used during the presentation
B) The agent's licensing certificate
C) A copy of the existing insurer's financial statement
D) A cash refund of the old policy's value

Explanation: The producer must leave with the applicant copies of all sales proposals, illustrations, and marketing materials used in the presentation.

8. Which of the following distribution systems uses agents who represent only one insurance company?

A) Surplus lines system
B) Direct writing system
✔ C) Exclusive or captive agency system
D) Independent agency system

Explanation: In an exclusive (captive) agency system, agents have a contract with and represent only one insurer or group of affiliated insurers. The insurer typically owns the policy expirations and renewal rights.

9. 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.

10. 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.

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11. In most group life insurance plans, an employee becomes eligible for coverage after completing a:

A) Series of training courses
B) Financial background check
C) Medical examination
✔ D) Waiting or probationary period

Explanation: Most group plans require new employees to complete a probationary or waiting period (commonly 30 to 90 days) before they become eligible for coverage. This requirement helps reduce administrative costs and ensures that only committed employees are enrolled.

12. What is the tax status of a transfer-for-value?

A) It has no impact on the taxability of the death benefit.
B) It makes the death benefit fully taxable.
C) It makes the death benefit subject to capital gains tax.
✔ D) It makes the death benefit partially taxable as ordinary income.

Explanation: The transfer-for-value rule states that if a life insurance policy is sold or transferred for valuable consideration, a portion of the death benefit becomes subject to income tax. The taxable portion is the death benefit minus the new owner's cost basis.

13. When a variable annuity is annuitized, how are the payments taxed?

A) Each payment is fully tax-free.
B) Each payment is fully taxable.
C) The tax treatment depends on the performance of the subaccounts.
✔ D) Each payment is partially tax-free and partially taxable, based on the exclusion ratio.

Explanation: Just like with a fixed annuity, when a variable annuity is annuitized, an exclusion ratio is calculated. A portion of each payment is considered a tax-free return of principal, and the rest is taxable as ordinary income. However, the total payment amount will fluctuate.

14. 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.

15. If an individual pays the premiums for their own disability income policy, how are the benefits received treated for tax purposes?

- A) They are partially taxable.
- B) They are fully taxable.
- C) They are taxed as capital gains.
- ✔ D) They are received income tax-free.

Explanation: Because the premiums were paid with after-tax dollars, any disability benefits received by the individual are not subject to income tax.

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16. The levels of long-term care, ranked from most intensive to least intensive, are:

- A) Home health care, custodial care, intermediate care, skilled nursing care
- B) Intermediate care, skilled nursing care, home health care, custodial care
- C) Custodial care, intermediate care, skilled nursing care, home health care
- ✔ D) Skilled nursing care, intermediate care, custodial care, home health care

Explanation: Skilled nursing care is the highest level, requiring licensed medical professionals providing 24-hour care. Intermediate care is periodic skilled care (not 24-hour). Custodial care is non-medical assistance with ADLs. Home health care provides skilled or custodial services in the insured's home.

17. Who is required to be a member of the Illinois Life and Health Insurance Guaranty Association?

- ✔ A) All licensed insurers transacting life, accident, and sickness insurance in Illinois as a condition of their license.
- B) Only domestic Illinois insurers.
- C) Insurers with over $10 million in assets.
- D) Membership is voluntary.

Explanation: All insurance companies authorized to transact life, accident, and sickness insurance in Illinois must be members of the Guaranty Association.

18. The 'own occupation' disability definition is typically available:

A) For all employees under standard group LTD plans
B) Only in short-term disability policies
✔ C) For professionals such as physicians, attorneys, and dentists who need maximum income protection
D) Only through government-sponsored disability programs

Explanation: 'Own occupation' disability definitions are typically found in individual disability income policies for high-income professionals (physicians, dentists, attorneys, etc.) who want maximum protection for their specific occupation's income. Most group LTD policies use a hybrid definition (own occ for the first 24 months, then any occ thereafter), which is less protective.

19. The 'level' in level term insurance refers to:

A) Only the premium remaining constant while the death benefit increases
B) A level risk that never changes over the term
C) The policy being available at multiple coverage levels
✔ D) Both the premium and the death benefit remaining constant throughout the entire term

Explanation: Level term insurance provides a constant (level) death benefit and a constant (level) premium for the entire specified term period. This is the most common and simplest form of term life insurance. It provides predictable, stable costs and protection.

20. An Accidental Death and Dismemberment (AD&D) policy pays benefits according to a schedule. A 'capital' loss (such as loss of life or loss of both hands) typically pays what percentage of the principal sum?

A) 50%
✔ B) 100%
C) 75%
D) 25%

Explanation: A capital loss is the most severe type covered under an AD&D policy and pays the full principal sum (100%). Capital losses include loss of life, loss of both hands, loss of both feet, loss of sight in both eyes, or any combination of two. Loss of one hand, one foot, or sight in one eye typically pays 50% (the 'capital' sum).

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21. In a Medicare Advantage PPO plan, a member can:

✔ A) See both in-network and out-of-network doctors, but with higher costs for out-of-network care.
B) Not get any coverage for out-of-network services.
C) Only see doctors in the plan's network.
D) See any doctor without a referral, with no difference in cost.

Explanation: Similar to a standard PPO, a Medicare Advantage PPO plan offers the flexibility to see providers outside the network. However, the member's out-of-pocket costs (copays, coinsurance) will be lower if they stay within the plan's preferred provider network.

22. An agent, Mark, is replacing an existing life insurance policy for a client. Mark must present a specific notice to the applicant at the time of application. What is this notice called?

- ✔ A) Notice Regarding Replacement
- B) Consumer Protection Notice
- C) Free-Look Notice
- D) Fiduciary Disclosure Notice

Explanation: The producer must present and leave with the applicant a copy of the 'Notice Regarding Replacement of Life Insurance or Annuities.'

23. An insurer refuses to issue a health policy to a person solely because they possess the sickle-cell trait. Under Illinois law, what is this action classified as?

- ✔ A) Unfair discrimination
- B) Acceptable underwriting practice
- C) Redlining
- D) Boycott

Explanation: Refusing to issue a policy or charging higher premiums solely because an individual has genetic traits like sickle-cell (without actuarial data) is illegal unfair discrimination.

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. A Multiple Employer Welfare Arrangement (MEWA) is similar to a MET but can also be:

- A) Regulated exclusively by the state.
- B) Only available to public-sector employees.
- ✔ C) A self-funded arrangement.
- D) Offered by a single employer.

Explanation: MEWAs are arrangements where multiple employers pool their contributions to offer health and welfare benefits to their employees. Unlike METs, which are typically fully insured, MEWAs can be either fully insured or self-funded, which subjects them to dual regulation by both state and federal (ERISA) authorities.

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26. An absolute assignment of a life insurance policy means the policyowner has:

- ✔ A) Permanently transferred all rights of ownership to another party
- B) Designated the assignee as a revocable beneficiary
- C) Temporarily pledged the policy as collateral for a loan
- D) Authorized the insurer to assign the policy to a reinsurer

Explanation: An absolute assignment is the complete, irrevocable transfer of all policy rights and ownership from the current policyowner to a new owner (the assignee). The original owner retains no rights. This is commonly used to transfer a policy into an Irrevocable Life Insurance Trust (ILIT).

27. 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.

28. Which of the following best describes the principle of indemnification?

A) To provide a guaranteed return on investment
B) To punish the party that caused the loss
✓ C) To restore the insured to the same financial position as before the loss
D) To allow the insured to profit from a loss

Explanation: The principle of indemnification aims to make the insured 'whole' again by restoring them to their approximate financial condition prior to the loss, without allowing for financial gain.

29. Which of the following would NOT be considered a rebate in Illinois?

✓ A) Offering a client a promotional pen valued at $5 with the agency logo during a sales presentation
B) Offering to pay the client's first monthly premium
C) Sharing half of the commission with the client
D) Offering a $100 cash back promotion to new policyholders

Explanation: Illinois law allows agents to distribute advertising novelties of nominal value (typically under $25) without it being considered rebating.

30. Premium tax credits under the ACA are available to individuals and families with household incomes:

A) Only below $50,000 per year regardless of family size
B) At any income level
C) Below 100% of the federal poverty level (FPL)
✓ D) Between 100% and 400% of the FPL (expanded to no upper limit through 2025)

Explanation: ACA premium tax credits (subsidies) are available to individuals and families with incomes between 100% and 400% of the federal poverty level who purchase coverage through an ACA marketplace. Enhanced subsidies temporarily removed the income cap through 2025. Medicaid-eligible individuals do not qualify for marketplace subsidies.

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31. What is a Medicare Supplement (Medigap) policy designed to do?

A) Provide long-term care benefits
✓ B) Pay for some or all of the out-of-pocket costs (gaps) in Original Medicare
C) Replace Original Medicare
D) Provide prescription drug coverage

Explanation: Medigap policies are sold by private insurance companies to fill the 'gaps' in Original Medicare, such as deductibles, copayments, and coinsurance. They work alongside Original Medicare, not as a replacement for it.

32. An insurance company charges different premium rates for individuals of the same class and equal life expectancy without any actuarial justification. What violation is this?

- ✔ A) Unfair discrimination
- B) Defamation
- C) Twisting
- D) Redlining

Explanation: Unfair discrimination is charging different rates or offering different benefits to individuals of the exact same risk class and life expectancy without statistical justification.

33. A licensed producer, Steven, has his resident license suspended in Illinois. What is the impact of this suspension on Steven's non-resident licenses in other states?

- A) Other states are unaffected unless Steven moves.
- ✔ B) The suspension must be reported to all other states where Steven holds a license, and those licenses will likely be suspended or revoked.
- C) Other states will automatically renew Steven's licenses to help him.
- D) Steven's non-resident licenses will be converted to resident licenses.

Explanation: Under the NAIC reciprocity rules, actions taken against a producer's resident license must be reported to other licensing jurisdictions and will lead to reciprocal action.

34. The 'payor benefit' rider in a juvenile life insurance policy:

- A) Guarantees the policy pays a benefit to the juvenile regardless of who pays the premium
- ✔ B) Waives future premiums if the policy payor (usually a parent) dies or becomes totally disabled before the insured child reaches a specified age
- C) Pays a benefit directly to the payor when the insured child reaches adulthood
- D) Automatically converts the policy to the child's name when they turn 18

Explanation: The Payor Benefit rider is added to juvenile life insurance policies to protect the coverage if the premium-paying parent or guardian dies or becomes totally disabled before the child reaches the policy's protection age (usually 21 or 25). The insurer waives future premiums until the child reaches the specified age or the payor recovers.

35. If a policyowner designates a beneficiary as 'irrevocable,' what is required to change the designation?

- ✔ A) The written consent of the irrevocable beneficiary
- B) A court order
- C) A notarized letter from the policyowner
- D) Approval from the insurance company

Explanation: An irrevocable beneficiary designation gives the named beneficiary a vested interest in the policy. The policyowner cannot change the beneficiary, take a policy loan, or surrender the policy without the written consent of the irrevocable beneficiary.

36. In a contributory group life insurance plan, what is typically required for the plan to remain in effect?

A) At least 50% of eligible members must participate
✓ B) At least 75% of eligible members must participate
C) Only the employer must contribute
D) 100% of eligible members must participate

Explanation: Contributory plans require employees to pay a portion of the premium. To prevent adverse selection, a minimum of 75% of eligible members must typically participate. Noncontributory plans require 100% participation since the employer pays the full premium.

37. The party who funds the annuity contract by making premium payments is the:

A) Annuitant
✓ B) Owner
C) Contingent annuitant
D) Beneficiary

Explanation: The owner is the person who purchases and funds the annuity by making premium payments. The owner has all contract rights including: changing the beneficiary, taking withdrawals, surrendering the contract, and naming the annuitant and beneficiary. The annuitant is the person whose life expectancy determines income payments; these roles may be held by the same person or different people.

38. What is the purpose of the Automatic Premium Loan (APL) provision?

✓ A) To automatically pay a premium from the policy's cash value to prevent a lapse.
B) To allow the insurer to increase the premium automatically.
C) To provide a loan to the policyowner for any purpose.
D) To provide a loan to pay for a different insurance policy.

Explanation: The Automatic Premium Loan (APL) provision is an optional feature that authorizes the insurer to use the policy's cash value to pay a premium that is past due. It is essentially a loan against the cash value to prevent an unintentional policy lapse.

39. What is the tax implication of an accelerated death benefit paid to a terminally ill insured?

✓ A) It is generally received income tax-free.
B) It is fully taxable as income.
C) It is subject to a 10% penalty.
D) It is taxed as a capital gain.

Explanation: Under HIPAA, accelerated death benefits paid to a terminally or chronically ill insured are generally received income tax-free, just like a regular death benefit. This allows individuals to access their benefits without a significant tax burden.

40. The mandatory 'Legal Actions' provision states that the insured cannot bring a lawsuit against the insurer:

- ✔ A) Until at least 60 days after proof of loss and no later than 3 years
- B) At any time after the claim is denied
- C) Until at least 30 days after proof of loss and no later than 5 years
- D) Until at least 90 days after proof of loss and no later than 2 years

Explanation: This provision sets a window for legal action. The insured must wait at least 60 days after submitting proof of loss before suing (to give the insurer time to process), and cannot sue more than 3 years after the time proof of loss is required.

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41. 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 Illinois 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.

42. Fixed-indexed annuities are regulated as:

- A) Banking products subject to FDIC oversight
- B) Securities by the SEC and FINRA
- C) Both insurance and securities products requiring dual licensing
- ✔ D) Insurance products by state insurance departments; they are NOT securities

Explanation: Fixed-indexed annuities are regulated as insurance products by state insurance departments — they are NOT securities. The SEC and FINRA do not have jurisdiction over fixed-indexed annuities. Producers need only a state life insurance license to sell them. This contrasts with variable annuities, which are both insurance products and securities.

43. A Medicare SELECT plan is a type of:

- ✔ A) Medigap policy that requires the use of a network of providers
- B) Special Needs Plan
- C) Prescription drug plan
- D) Medicare Advantage HMO

Explanation: Medicare SELECT is a type of Medigap policy that functions like a PPO. In exchange for a lower premium, the policyholder must use specific network hospitals and, in some cases, doctors to get full benefits. Out-of-network care may be more expensive or not covered (except in emergencies).

44. Under the mandatory 'Proof of Loss' provision, the insured must submit written proof of loss to the insurer within how many days after the loss?

- ✔ A) 90 days
- B) 120 days
- C) 60 days
- D) 30 days

Explanation: Written proof of loss must be furnished to the insurer within 90 days after the date of the loss. If it is not reasonably possible to give proof within 90 days, the claim is not invalidated if proof is given as soon as reasonably possible, but no later than one year (unless the insured is legally incapacitated).

45. 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.

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46. What is a 'formulary' in a Medicare Part D plan?

- A) The list of network pharmacies.
- B) The application for enrollment.
- C) The schedule of benefits.
- ✔ D) The list of covered prescription drugs.

Explanation: A formulary is the list of prescription drugs covered by a Part D plan. Each plan has its own formulary, and they are often organized into tiers, with drugs in lower tiers having lower copayments.

47. 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.

48. A 'common disaster clause' in a life insurance policy:

A) Requires the insurer to investigate all death claims involving accidents

✔ B) Provides that if the beneficiary dies within a specified period after the insured, the proceeds are paid as if the beneficiary predeceased the insured

C) Provides extra coverage if both the insured and beneficiary die simultaneously

D) Excludes coverage if death results from a common disaster

Explanation: A common disaster clause (or short-term survivorship clause) states that if the primary beneficiary dies within a specified period (e.g., 60-90 days) after the insured, the proceeds are paid as if the beneficiary had predeceased the insured — meaning proceeds go to the contingent beneficiary or the insured's estate. This prevents proceeds from passing through two estates and being subject to double probate costs.

49. What does a 'bed reservation' benefit in an LTC policy provide?

A) It allows the insured to reserve a bed in a specific facility years in advance.

B) It pays for a private room in a nursing home.

✔ C) It pays to hold a nursing home bed for the insured if they need to be hospitalized temporarily.

D) It guarantees a bed will be available in any nursing home.

Explanation: If an LTC patient in a nursing home needs to go to a hospital for a short stay, the nursing facility will not hold their bed for free. The bed reservation benefit pays the nursing home to keep the insured's bed available for their return for a limited number of days.

50. An insured has a health plan with a $2,000 deductible and 80/20 coinsurance. If the insured has a covered medical bill of $12,000, how much will the INSURER pay?

✔ A) $8,000.00

B) $12,000.00

C) $9,600.00

D) $10,000.00

Explanation: First, the insured pays the $2,000 deductible, leaving a balance of $10,000. Then, the coinsurance applies to this balance. The insurer pays 80% of $10,000, which is $8,000. The insured pays the remaining 20% ($2,000) plus the initial deductible, for a total of $4,000.