Insurance Test Practice

Maryland Insurance Practice Test

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1. The 'uniform simultaneous death act' affects life insurance by:

A) Splitting proceeds equally between both estates
B) Requiring equal distribution among all beneficiaries when deaths occur simultaneously
C) Voiding the policy when both insured and beneficiary die simultaneously
✔ D) Presuming the insured survived the beneficiary when both die simultaneously, causing proceeds to pass to the contingent beneficiary

Explanation: The Uniform Simultaneous Death Act provides that when an insured and beneficiary die simultaneously (or the order of death cannot be determined), the insured is presumed to have survived the beneficiary for insurance purposes. This causes proceeds to pass to the contingent beneficiary, preventing the proceeds from going through the primary beneficiary's estate.

2. A policy loan from a life insurance policy is:

✔ A) Not considered taxable income.
B) Treated as a dividend.
C) Taxable as income.
D) Tax-deductible.

Explanation: Policy loans are not considered taxable distributions because they are treated as debt against the policy. As long as the policy remains in force, the loan is not taxed. If the policy lapses or is surrendered with a loan outstanding, the loaned amount may become taxable.

3. An employer wants to insure a key executive under the company's group life plan with a benefit amount significantly higher than other employees. Which group insurance principle could this potentially violate?

A) The doctrine of adhesion
B) The law of large numbers
✔ C) The requirement that benefit amounts be determined by a formula that precludes individual selection
D) The principle of indemnity

Explanation: A fundamental principle of group underwriting is that benefit amounts must be determined by a formula related to factors such as salary, position, or length of service. This prevents individual selection (adverse selection) by not allowing specific individuals to choose disproportionately high coverage.

4. Coinsurance in health insurance means:

A) The insured pays a fixed dollar amount per service
B) The insurer pays 100% of all expenses after a certain date
C) Two insurers share coverage on the same risk
✔ D) After the deductible, the insured pays a percentage of covered expenses while the insurer pays the remainder

Explanation: Coinsurance requires the insured to pay a percentage of covered expenses after the deductible is satisfied. A common arrangement is 80/20 (the insurer pays 80%, the insured pays 20%) until the out-of-pocket maximum is reached, after which the insurer pays 100%.

5. 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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6. What is a Flexible Spending Account (FSA)?

A) A savings account for retirement medical expenses.
✔ B) An employer-sponsored account that allows employees to set aside pre-tax dollars for medical expenses.
C) A portable health savings account owned by the employee.
D) An account funded solely by the employer.

Explanation: An FSA is an employer-established benefit. Employees contribute pre-tax dollars through payroll deductions. A key feature is the 'use-it-or-lose-it' rule, where most unused funds at the end of the plan year are forfeited.

7. 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.

8. A level premium policy means that the premium:

A) Decreases each year.
✔ B) Remains the same for the life of the policy.
C) Is flexible and can be changed by the policyowner.
D) Increases each year.

Explanation: Level premium is a characteristic of most permanent life insurance policies, like whole life. The premium is calculated based on the insured's age at issue and is guaranteed to remain fixed for the entire payment period.

9. 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.

10. A client is replacing their policy. The replacing insurer must provide a free-look period for the new policy. What is the minimum free-look period required for a replacement life policy in Maryland?

A) 10 days
✔ B) 20 days
C) 30 days
D) 45 days

Explanation: Under Maryland replacement regulations, replacing insurers must provide a 20-day free-look period for policies involving replacement.

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11. 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.

12. Which policy allows the policyowner to adjust the premium payments, death benefit, and cash value accumulation?

A) Variable Life
B) Term Life
C) Whole Life
✔ D) Universal Life

Explanation: Universal Life (UL) is a flexible premium policy. The policyowner can increase or decrease premium payments and even skip payments, as long as there is enough cash value to cover the monthly mortality and expense charges.

13. The provision that allows a policyowner to restore a lapsed policy to its original status is the:

A) Grace Period Provision
✔ B) Reinstatement Provision
C) Incontestability Clause
D) Free Look Provision

Explanation: The Reinstatement Provision allows the owner of a lapsed policy to put it back in force, provided certain conditions are met, such as paying back premiums with interest and proving continued insurability. This is usually allowed within 3 to 5 years of lapse.

14. A group permanent life insurance plan differs from a group term life insurance plan in that group permanent life insurance provides which additional feature?

✔ A) A cash value or savings element that accumulates over time
B) Lower premiums in all cases
C) Coverage only for accidental death
D) Automatic waiver of premium for all members

Explanation: Group permanent life insurance includes a cash value component that builds over time, similar to individual whole life or universal life policies. Group term life provides only a death benefit with no cash accumulation. Group permanent plans are less common due to higher costs.

15. An unlicensed resident, Kyle, is found to have knowingly sold life insurance policies to seniors in Baltimore. Under Maryland law, what is the maximum penalty Maryland Insurance Administration (MIA) can impose for transacting insurance without a license?

A) $1,000 per violation
B) $2,500 per violation
✔ C) $5,000 per violation
D) $10,000 per violation

Explanation: Knowingly transacting insurance business in Maryland without a license carries a civil penalty of up to $5,000 per violation.

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16. Which type of insurer is organized to provide insurance benefits to members of a specific religious or social organization?

A) Stock insurer
B) Reciprocal exchange
C) Mutual insurer
✔ D) Fraternal benefit society

Explanation: A fraternal benefit society is a nonprofit organization that provides life and health insurance exclusively to its members, who share a common bond such as religion, ethnicity, or occupation.

17. What is the main difference between a revocable and an irrevocable beneficiary?

A) Their relationship to the insured
B) Their age
✔ C) Whether the policyowner can change the designation without the beneficiary's consent
D) Whether the beneficiary can be a trust

Explanation: A revocable beneficiary can be changed at any time by the policyowner. An irrevocable beneficiary has a vested right in the policy, and their designation cannot be changed without their written permission.

18. The conversion privilege in group life insurance allows a departing member to do which of the following?

A) Continue the group policy without any changes
✔ B) Convert to an individual policy without evidence of insurability
C) Receive a full refund of all premiums paid
D) Convert to a group policy with another employer automatically

Explanation: The conversion privilege grants a terminating group member the right to convert their group coverage to an individual life insurance policy without providing evidence of insurability, provided they apply within the required time period.

19. 'Blending' or 'loading' in a participating whole life policy refers to:

A) Blending both fixed and variable components in the same policy
B) Loading higher premiums onto smoker-rated policies
✔ C) Mixing whole life with paid-up additions to increase cash value and reduce net premium cost
D) Adding term insurance rider to increase coverage at a lower cost

Explanation: In participating whole life, 'blending' (or 'overfunding') refers to combining base whole life with paid-up additions (PUAs) to maximize the ratio of cash value to death benefit. This strategy is used in Infinite Banking and Bank On Yourself concepts where the policy is designed primarily for its cash value accumulation efficiency.

20. A 'nonforfeiture benefit' in an LTC policy ensures that:

A) The benefits will be paid for life.
B) The premium will never increase.
✔ C) If the policy lapses, the policyowner will receive some value back, such as a shortened benefit period or reduced paid-up coverage.
D) The policy can never be cancelled.

Explanation: The nonforfeiture benefit provides a safety net if the policyowner stops paying premiums after a certain number of years. It ensures that the policyowner doesn't lose all the value from the premiums they've paid. Options can include a reduced paid-up policy or a shortened benefit period.

21. 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).

22. A licensed producer, Steven, has his resident license suspended in Maryland. 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.

23. 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.

24. An individual health insurance policy that the insurer cannot cancel and cannot increase the premium on is classified as:

A) Optionally renewable
✔ B) Non-cancellable
C) Conditionally renewable
D) Guaranteed renewable

Explanation: A non-cancellable policy provides the strongest protection for the insured. The insurer cannot cancel the policy, raise the premium, or reduce benefits, as long as premiums are paid on time. This is the most expensive type of renewability provision.

25. A surplus lines broker is licensed to:

A) Sell standard insurance products for admitted insurers
B) Underwrite and approve applications for all types of insurance
C) Adjust claims on behalf of the insurer
✔ D) Place coverage with non-admitted insurers when coverage is unavailable from admitted insurers

Explanation: A surplus lines broker is specially licensed to place insurance with non-admitted (unauthorized) insurers when the needed coverage cannot be obtained from any admitted insurer in the state. This provides a market for unusual or high-risk exposures.

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26. An agent is assisting a client with a claim. Maryland Insurance Administration (MIA) requests information from the agent about the transaction. What is the agent's primary obligation?

A) Respond within 15 working days.
✔ B) Cooperate fully and provide all requested documentation.
C) Keep files confidential from Maryland Insurance Administration (MIA).
D) Referral to the insurer.

Explanation: All licensees must cooperate fully with investigations by Maryland Insurance Administration (MIA) and provide requested books and records.

27. A client, age 55, takes a $10,000 withdrawal from his non-qualified annuity. His cost basis is $50,000 and the current value is $70,000. How much of the withdrawal is taxable, and what is the penalty?

✔ A) $10,000 is taxable, plus a $1,000 penalty.
B) The taxable amount is zero, but there is a $1,000 penalty.
C) The taxable amount is $2,857, plus a $285 penalty.
D) The entire $10,000 is a tax-free return of basis.

Explanation: Under LIFO rules, the withdrawal comes from the $20,000 of earnings first. So, the entire $10,000 withdrawal is taxable as ordinary income. Because the client is under age 59 1/2, a 10% penalty applies to the taxable amount, which is 10% of $10,000 = $1,000.

28. Which of the following is NOT a primary factor in underwriting a life insurance policy?

✔ A) Marital status
B) Gender
C) Age
D) Health history

Explanation: Key underwriting factors for life insurance include age, gender, health history, occupation, hobbies, and habits (like smoking). Marital status is generally not a primary factor in determining risk or premium.

29. In group life insurance, the concept of a 'flow of insureds' is important because it helps to ensure which of the following?

A) That only healthy individuals remain in the plan
✔ B) That the group maintains a stable and predictable risk pool through regular entry and exit of members
C) That the insurance company can deny claims from long-term members
D) That premiums increase each year to cover older members

Explanation: The flow of insureds refers to the continual entry of new, typically younger members and the exit of older members from a group. This natural turnover helps maintain a stable average age and predictable risk level for the insurer, which is a key principle of group underwriting.

30. Dividends from a participating whole life policy left to 'accumulate at interest' result in:

A) All accumulated amounts being tax-free until the policy matures
B) Tax-free accumulation of both dividends and interest
✔ C) Dividends remaining tax-free but the interest earned on accumulated dividends being taxable annually
D) Conversion of the accumulation into paid-up additions

Explanation: When dividends are left to accumulate at interest with the insurer, the dividends themselves (as returns of premium) are not taxable. However, the interest credited by the insurer ON the accumulated dividends IS taxable as ordinary income each year as it is credited — it must be reported by the policyowner annually.

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31. The ownership clause in a life insurance policy grants the policyowner all of the following rights EXCEPT:

✔ A) Right to change the insurer
B) Right to change the beneficiary (if revocable)
C) Right to assign the policy
D) Right to take policy loans

Explanation: The policyowner has broad rights including: assigning the policy, borrowing against cash value, changing the revocable beneficiary, surrendering the policy, and selecting settlement options. The policyowner CANNOT change the insurer — insurance is not transferable from one insurer to another without the insurer's consent.

32. The primary risk that annuities are designed to mitigate is:

A) Catastrophic medical expenses in old age
B) Market losses in a retirement investment portfolio
✔ C) Living longer than expected and outliving one's financial resources
D) Dying prematurely before accumulating enough savings

Explanation: Annuities are specifically designed to address longevity risk — the risk of outliving one's savings. Life insurance addresses mortality risk (dying too soon). An annuity that pays income for life ensures the retiree will have income no matter how long they live, transferring the longevity risk to the insurance company.

33. Sarah wants to purchase a life insurance policy on her business partner, David, to protect the business. Which of the following is TRUE regarding when Sarah must have an insurable interest in David's life?

- ✔ A) Only at the time the policy application is made
- B) Only at the time of David's death
- C) Both at the time of application and at the time of David's death
- D) Throughout the entire term of the policy

Explanation: In life insurance, insurable interest must exist only at the time of application. It does not need to continue throughout the policy or exist at the time of the insured's death, unlike property insurance.

34. What is the main risk for the policyowner in a Variable Life insurance policy?

- A) The risk that the premium will increase.
- B) The risk that the policy will be cancelled.
- C) The risk of the insurer becoming insolvent.
- ✔ D) The risk that the cash value and death benefit may decrease due to poor investment performance.

Explanation: In a variable life policy, the policyowner bears the investment risk. Poor performance in the chosen separate accounts can cause the cash value to decrease. While the death benefit typically has a guaranteed minimum, it can also fluctuate based on investment results.

35. A producer's license was terminated for failing to meet CE requirements. Gary wants to get his license back. Within what period can he apply for reinstatement without retaking the licensing exam?

- A) Within 30 days
- B) Within 90 days
- ✔ C) Within 12 months
- D) Within 2 years

Explanation: A producer may apply for reinstatement within 12 months of termination by completing the CE hours and paying a processing fee.

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36. If a corporation owns a non-qualified annuity, how is the growth taxed?

- A) It is tax-free.
- ✔ B) It is taxed annually as ordinary income.
- C) It grows tax-deferred.
- D) It is taxed at corporate capital gains rates.

Explanation: The tax-deferral benefit of annuities generally does not apply when the contract is owned by a non-natural person, such as a corporation. In this case, the annual growth in the contract is treated as taxable ordinary income to the corporation each year.

37. What is the 'exclusion ratio' used for?

A) To calculate the agent's commission.
✔ B) To determine the portion of each annuity payment that is a tax-free return of principal.
C) To determine the surrender charge on a withdrawal.
D) To determine the annuity's participation rate.

Explanation: When an annuity is annuitized, the exclusion ratio is used to calculate how much of each income payment is taxable. It is calculated by dividing the total investment in the contract (cost basis) by the expected total return. This ratio represents the portion of each payment that is a non-taxable return of principal.

38. What is a 'dread disease' or 'limited risk' policy?

A) A comprehensive policy covering all illnesses.
B) A policy designed for individuals with pre-existing conditions.
✔ C) A policy that covers only specific illnesses, such as cancer or heart disease.
D) A short-term medical policy.

Explanation: A limited risk policy, such as a cancer policy, provides benefits only for the diagnosis and treatment of a specific disease named in the policy. It is not a substitute for comprehensive health coverage.

39. 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.

40. A false statement of a material fact on an application is known as:

✔ A) Misrepresentation
B) Concealment
C) Waiver
D) Estoppel

Explanation: A misrepresentation is an untrue statement made by the applicant on the application. If it is material to the risk, meaning the insurer would have made a different decision had it known the truth, it can be used to void the policy.

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41. An agent, Jessica, suggests that a prospect drop their existing disability policy and buy a new one because the old company is 'going bankrupt,' though she has no evidence of this. What violation has she committed?

✔ A) Defamation and twisting
B) Rebating
C) Churning
D) Unfair discrimination

Explanation: Making unsubstantiated derogatory claims about a competitor's financial state to convince a client to replace a policy is defamation and twisting.

42. An independent insurance agent represents:

- ✔ A) Multiple insurers and owns their own book of business
- B) The state insurance department in regulatory proceedings
- C) Only one insurer exclusively
- D) The insured exclusively as a fiduciary

Explanation: An independent agent represents multiple insurance companies and owns the expirations (renewals) on the policies they write. They can place business with any insurer they are appointed with and typically work on a commission basis.

43. Variable annuity 'mortality and expense risk charges' (M&E fees) compensate the insurer for:

- A) State premium taxes on annuity premiums
- B) The cost of crediting interest to the fixed account option
- C) Investment management expenses for the separate account funds
- ✔ D) The risk of paying guaranteed death benefits and income guarantees, and for general administrative expenses

Explanation: M&E (mortality and expense risk) charges in a variable annuity compensate the insurer for: (1) the mortality risk — guaranteeing the minimum death benefit even if the account value has declined; (2) the expense risk — guaranteeing not to raise administrative charges; and (3) general administrative expenses. M&E charges are deducted daily from the separate account as a percentage of assets (typically 1.0–1.5% annually). They are separate from fund management fees.

44. Under what circumstances are life insurance premiums paid by a business deductible as a business expense?

- A) When the business is the beneficiary of the policy.
- B) Premiums are never deductible.
- C) When the policy is a term life policy.
- ✔ D) When the employee's family is the beneficiary and the premium is treated as a bonus.

Explanation: If a business pays the premium for an employee's life insurance policy where the employee's family is the beneficiary (e.g., in an executive bonus plan), the premium is considered compensation to the employee. It is deductible for the business and taxable income for the employee.

45. How are employer-paid premiums for group life insurance treated for tax purposes for the employee?

- A) The premium for the first $100,000 of coverage is tax-free to the employee.
- B) They are always taxable income to the employee.
- ✔ C) The premium for the first $50,000 of coverage is tax-free to the employee.
- D) They are always tax-free to the employee.

Explanation: The value of employer-paid premiums for the first $50,000 of group term life insurance coverage is not considered taxable income to the employee. The value of the premium for coverage above $50,000 is considered taxable income, based on an IRS table.

46. A reciprocal insurance exchange is managed by a(n):

A) Lead underwriter
✔ B) Attorney-in-fact
C) Chief Executive Officer
D) Board of Directors

Explanation: A reciprocal insurance exchange is an unincorporated group of individuals or organizations (subscribers) that agree to share each other's losses. It is managed by an attorney-in-fact.

47. A disability policy with a 'return of premium' rider provides that:

A) The beneficiary will receive a refund of premiums if the insured dies.
B) Premiums are refunded if the policy is cancelled.
✔ C) The insurer will refund a portion of the premiums paid if the insured has not had any claims after a stated period.
D) All premiums will be returned at age 65.

Explanation: The return of premium rider is an expensive option that provides a refund of a large percentage (e.g., 80%) of the premiums paid over a period (e.g., 10 years), minus any claims paid out during that time. It is a benefit for those who stay healthy and do not use their policy.

48. Purchasing insurance is an example of which risk management technique?

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

Explanation: Insurance is the most common method of risk transfer. An individual or entity transfers the financial risk of a potential loss to an insurance company in exchange for a premium.

49. An investor has an Equity Indexed Annuity tied to the S&P 500. The index rises by 15% during the year. The policy has a participation rate of 80% and a cap rate of 10%. What index interest rate will be credited to the investor's annuity?

A) 15%
B) 12%
✔ C) 10%
D) 8%

Explanation: The participation rate would yield 12% (80% of 15%). However, because the policy has a cap rate of 10%, the maximum interest that can be credited is limited to the cap of 10%.

50. 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.