Insurance Test Practice

Michigan Insurance Practice Test

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1. A universal life policy's 'planned periodic premium' is best described as:

A) The premium that guarantees the death benefit will remain level throughout the policy
B) The premium set by the state insurance commissioner
✓ C) The premium amount the policyowner intends to pay — but UL allows flexibility to pay more or less (within limits)
D) The minimum premium required by law to keep the policy in force

Explanation: In a universal life policy, the planned periodic premium is the premium amount the policyowner designs to pay, but UL's flexible premium feature allows the policyowner to pay more or less. As long as the policy's cash value covers monthly deductions, the policy remains in force even if no premium is paid. Paying less than planned can risk lapse if the cash value is depleted.

2. Which of the following is an advantage of term life insurance?

A) It provides lifelong coverage.
B) The premium never increases.
✓ C) It has the lowest initial premium for a given face amount.
D) It builds cash value.

Explanation: The primary advantage of term life insurance is its affordability. It provides the largest amount of death benefit for the lowest initial premium, making it an accessible option for temporary, high-need situations like protecting a young family.

3. An agent, Brian, convinces a client to replace a life insurance policy they bought last year with a new policy from the same insurer, solely to generate a new first-year commission for himself. What is this practice called?

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

Explanation: Churning is the practice of replacing existing policies within the same company repeatedly for the primary purpose of generating commissions for the agent.

4. A Health Reimbursement Arrangement (HRA) differs from a Health Savings Account (HSA) in that an HRA is:

A) Funded exclusively by the employee
B) Portable when the employee changes jobs
✓ C) Funded exclusively by the employer
D) Owned and controlled by the employee

Explanation: An HRA is funded solely by the employer. Unlike an HSA, the employee cannot make contributions to an HRA. The employer decides how much to contribute and what expenses are eligible for reimbursement.

5. A stock insurance company is characterized by which of the following?

✓ A) It is owned by shareholders who may receive dividends from profits
B) It is owned by its policyholders
C) It is managed by an attorney-in-fact
D) It issues assessable policies

Explanation: A stock insurer is a corporation owned by its stockholders (shareholders). Profits may be distributed to shareholders as taxable dividends, and policyholders have no ownership interest.

6. 'Secondary guarantee' (no-lapse guarantee) UL policies are also called:

- ✔ A) Guaranteed universal life (GUL) policies
- B) Variable life insurance policies
- C) Permanent term insurance
- D) Current assumption whole life policies

Explanation: Guaranteed Universal Life (GUL) policies use a secondary guarantee that keeps the death benefit in force as long as the minimum required premium is paid — even if the cash value is zero or negative. GUL policies function similarly to permanent term insurance, providing guaranteed death benefit at a predictable cost without significant cash value accumulation.

7. The principle that requires both parties to an insurance contract to disclose all material facts is known as:

- ✔ A) Utmost Good Faith
- B) Proximate Cause
- C) Indemnity
- D) Subrogation

Explanation: Utmost Good Faith (Uberrima Fides) requires both the insurer and insured to deal honestly and disclose all material information. It is the foundation for misrepresentation and concealment rules.

8. A Guaranteed Lifetime Withdrawal Benefit (GLWB) rider on a deferred annuity provides that the owner can:

- A) Annuitize the contract at a future date.
- B) Receive a guaranteed minimum interest rate.
- C) Withdraw the entire contract value at any time without a charge.
- ✔ D) Withdraw a specified percentage of the contract value each year for life, even if the actual account value drops to zero.

Explanation: A GLWB rider is a popular feature that offers a form of lifetime income without forcing the owner to annuitize the contract. It guarantees that the owner can take systematic withdrawals for life, providing income security while maintaining access to the underlying account value.

9. The 'pre-existing condition' definition has been most significantly changed by which legislation?

- ✔ A) The ACA (2010)
- B) COBRA (1985)
- C) Medicare (1965)
- D) HIPAA (1996)

Explanation: The ACA (Affordable Care Act, 2010) eliminated pre-existing condition exclusions entirely for most non-grandfathered health insurance plans. HIPAA (1996) previously limited — but did not eliminate — pre-existing condition exclusions for group plans. The ACA represents the most comprehensive pre-existing condition protection in U.S. insurance history.

10. A 'bonus' annuity adds a percentage (such as 3-5%) to the owner's initial premium or subsequent premiums. What is a common trade-off associated with bonus annuities?

- ✔ A) They typically have longer surrender charge periods and higher ongoing fees to offset the bonus
- B) They do not allow annuitization
- C) They are only available as immediate annuities
- D) They offer no death benefit

Explanation: While the upfront bonus appears attractive, insurers recover the cost through longer surrender charge periods (often 10+ years) and higher annual fees such as mortality and expense charges. Agents must ensure that a bonus annuity is suitable and that the client understands these trade-offs.

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11. The party who receives the income payments from an annuity is called the:

- A) Beneficiary
- B) Owner
- C) Contingent annuitant
- ✔ D) Annuitant

Explanation: The annuitant is the person whose life expectancy determines the income payments and the duration of payments. The annuitant receives the income payments. The owner of the annuity contract may or may not be the same person as the annuitant.

12. A foreign insurer is found to have committed a series of intentional violations of rate regulations in Michigan. What is the maximum civil penalty the Director can impose for each intentional violation?

- A) Up to $1,000 per violation
- ✔ B) Up to $5,000 per violation
- C) Up to $10,000 per violation
- D) Up to $50,000 per violation

Explanation: Under Michigan law, the Michigan Department of Insurance and Financial Services (DIFS) may impose a civil penalty of up to $5,000 per intentional violation.

13. Which rider allows the policyowner to purchase additional amounts of insurance at future dates without evidence of insurability?

- A) Cost of Living Rider
- ✔ B) Guaranteed Insurability Rider
- C) Accidental Death Benefit Rider
- D) Payor Benefit Rider

Explanation: The Guaranteed Insurability Rider (GIR) gives the policyowner the right to buy specified amounts of additional life insurance on the insured at stated intervals (e.g., every three years or at marriage/childbirth) without having to prove insurability.

14. To be eligible for Medicare due to disability, an individual must have been receiving Social Security disability benefits for:

A) 12 months
✓ B) 24 months
C) 6 months
D) 36 months

Explanation: Individuals under age 65 can become eligible for Medicare if they have been entitled to Social Security disability benefits for 24 months. Medicare coverage starts in the 25th month of disability.

15. A variable annuity's 'sub-account' value is calculated using:

A) The insurer's general account performance
B) The credited interest rate declared each year
✓ C) The daily NAV (Net Asset Value) of the units
D) The guaranteed minimum value set by the insurer

Explanation: Variable annuity subaccounts are priced daily based on the Net Asset Value (NAV) of the underlying investment portfolio. The owner's account value = number of accumulation units × current NAV per unit. NAV fluctuates with market performance of the underlying securities held in the subaccount.

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16. The 'entire contract' provision in an insurance policy states that:

✓ A) The policy and the attached application constitute the entire agreement.
B) All oral statements are part of the contract.
C) The contract includes the insurer's marketing materials.
D) The policy can be changed by the agent at any time.

Explanation: The entire contract provision stipulates that the written policy, along with a copy of the signed application, forms the complete contract between the policyowner and the insurer. This prevents either party from claiming that other verbal or written agreements exist.

17. A disability buy-sell agreement funded by a disability policy is designed to:

✓ A) Provide funds for the able partners to buy out the business interest of a disabled partner.
B) Provide income to a disabled partner.
C) Pay for a disabled partner's medical bills.
D) Cover the overhead expenses of the business.

Explanation: Similar to a life insurance-funded buy-sell, a disability buy-out policy provides the funds needed for the business or remaining partners to execute the buy-sell agreement and purchase the disabled partner's share of the business.

18. Long-Term Care (LTC) insurance is designed to provide coverage for:

A) Hospital stays and major surgery.
B) Short-term disabilities.
✓ C) Services for individuals who are unable to perform essential activities of daily living.
D) Routine doctor visits and prescription drugs.

Explanation: LTC insurance provides benefits for custodial and personal care services for individuals who need assistance with activities of daily living (ADLs) or who have a severe cognitive impairment like Alzheimer's disease.

19. Reinsurance is a transaction between:

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

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

20. Michigan Department of Insurance and Financial Services (DIFS) schedules a formal hearing regarding complaints against agent Thomas. Under Michigan law, how many days' advance notice must Michigan Department of Insurance and Financial Services (DIFS) give Thomas before the hearing?

- ✔ A) At least 10 days
- B) At least 15 days
- C) At least 20 days
- D) At least 30 days

Explanation: Michigan law requires Michigan Department of Insurance and Financial Services (DIFS) to give at least 10 days' written notice of the time, place, and matters to be heard to all parties in a formal hearing.

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21. 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.

22. 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.

23. Mortality and expense (M&E) charges in a variable annuity:

- ✔ A) Compensate the insurer for mortality risk and administrative expenses associated with the variable annuity guarantees
- B) Pay for investment management of the subaccounts
- C) Are optional charges that the policyowner can choose to waive
- D) Are charged only when the policyowner receives income payments

Explanation: The mortality and expense (M&E) charge is a percentage assessed annually against the variable annuity's subaccount assets. It compensates the insurer for: (1) mortality risk (guaranteeing the death benefit regardless of investment performance) and (2) general expense and profit charges. M&E charges typically range from 0.5% to 1.5% annually and are disclosed in the prospectus.

24. Under what condition may a producer share a commission with another person in Michigan?

- A) The other person is an unlicensed referral source.
- ✔ B) Both persons are licensed producers for the same line of insurance.
- C) The other person is the client.
- D) Under no condition; sharing commissions is illegal.

Explanation: A producer may only share commissions with another producer who is licensed and appointed in the same line of authority.

25. The 'net single premium' for a life insurance policy represents:

- ✔ A) The lump-sum amount needed today to fund the present value of all future death benefit payments
- B) The minimum premium required to keep the policy in force
- C) The premium after removing agent commissions
- D) The monthly premium after deducting dividends

Explanation: The net single premium is a theoretical calculation representing the lump sum needed at policy inception to fund all projected death benefit payments, using assumed interest rates and mortality tables (without expense loading). It forms the actuarial basis for pricing life insurance. In practice, policyowners typically pay premiums in periodic installments rather than a single lump sum.

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26. 'Incidents of ownership' in a life insurance policy include all of the following EXCEPT:

- A) The right to borrow against the policy
- B) The right to assign the policy
- C) The right to change the beneficiary
- ✔ D) The right to receive the death benefit as a named beneficiary

Explanation: Incidents of ownership refer to the economic and legal rights a person holds in a policy, such as the right to change the beneficiary, assign the policy, borrow against it, or surrender it. Simply being the named beneficiary does not constitute an incident of ownership. If the insured retains any incidents of ownership at death, the policy proceeds are included in the taxable estate.

27. An agent, Sarah, delivers a policy to a client. What is the best practice for Sarah to document that the free-look period has started?

- ✔ A) Obtain a signed and dated policy delivery receipt from the client.
- B) Send a text message to the client.
- C) File a notice with Michigan Department of Insurance and Financial Services (DIFS).
- D) Keep the policy in her own office.

Explanation: Obtaining a signed and dated policy delivery receipt documents the exact date the policy was delivered, which marks the start of the free-look period.

28. The section of an insurance policy that identifies the specific risks being covered is the:

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

Explanation: The Insuring Clause (or Insuring Agreement) is the core of the policy. It contains the insurer's fundamental promise to pay for covered losses and specifies the perils covered.

29. Modified premium whole life insurance is characterized by:

- A) A death benefit that decreases over time
- B) Premiums that decrease after the first year
- ✔ C) Lower premiums in the early years that increase after a specified period
- D) A policy that becomes paid-up after 10 years automatically

Explanation: Modified premium whole life (or Modified Whole Life) charges lower premiums during an initial period (usually the first 3-5 years) that then increase to a higher level premium for the remainder of the policy. This appeals to buyers who expect their income to increase over time but want permanent coverage now.

30. A survivorship life insurance policy, also known as a 'second-to-die' policy, pays the death benefit when:

- ✔ A) The second insured dies.
- B) Either insured dies.
- C) Both insureds die simultaneously.
- D) The first insured dies.

Explanation: A survivorship life policy insures two or more lives and pays the death benefit upon the death of the last insured. These policies are often used for estate planning purposes to pay federal estate taxes.

31. An agent, Sarah, publishes an advertisement indicating that her agency's policies are guaranteed by the Michigan Life and Health Insurance Guaranty Association. What is true regarding this advertisement?

A) It is a required disclosure in all advertisements.
✓ B) It is an unfair trade practice to use the Guaranty Association's existence to sell insurance.
C) It is permitted only for term life policies.
D) It must be approved by the Governor.

Explanation: Michigan law prohibits insurers and agents from using the existence of the state Guaranty Association in advertisements or sales presentations.

32. For dependents, a qualifying event under COBRA can include all of the following EXCEPT:

A) Death of the covered employee
B) Divorce from the covered employee
✓ C) The dependent child getting married
D) The covered employee becoming eligible for Medicare

Explanation: Qualifying events for dependents include the death of the employee, divorce or legal separation, the employee's termination or reduction in hours, the employee becoming eligible for Medicare, or a dependent child ceasing to be a 'dependent child' under the plan's rules. Marriage of a dependent child is not itself a qualifying event, but losing dependency status is.

33. A health plan that only covers services from providers within its network (except in an emergency) is a(n):

✓ A) EPO
B) PPO
C) HMO
D) POS

Explanation: An Exclusive Provider Organization (EPO) requires members to use doctors, specialists, or hospitals in the plan's network. There is no coverage for out-of-network care, except in true emergencies.

34. 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.

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

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

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

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36. The SEC regulates variable life insurance products because:

A) Variable life is issued only by federally chartered insurance companies
B) The SEC regulates all life insurance sold across state lines
C) Variable life involves the FDIC-insured separate account
✓ D) The policyowner bears investment risk and the separate account is considered a security

Explanation: Variable life insurance is regulated by the SEC (Securities and Exchange Commission) as a security because the policyowner bears investment risk through the separate account. Variable life prospectuses must be registered with the SEC, and producers must be registered with FINRA. The insurance component is still regulated by state insurance departments.

37. The 'target premium' in a universal life policy:

A) Is the minimum premium required to keep the policy in force
B) Is the premium suggested by the producer to maximize commissions
✓ C) Is the planned premium that is expected to keep the policy funded as illustrated under current assumptions
D) Is the maximum premium allowed under IRS guidelines before MEC status

Explanation: The target premium in a UL policy is the amount that, if paid regularly, is expected to keep the policy performing as illustrated under current (not guaranteed minimum) assumptions. Paying the target premium does not guarantee performance — if interest rates or mortality costs change significantly, the policy may need higher premiums to remain in force.

38. 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.

39. An agent claims that his insurance company is 'approved and backed by the federal government.' What is the status of this claim under Michigan law?

✔ A) It is a prohibited misrepresentation.
B) It is allowed if the insurer sells crop insurance.
C) It is allowed if the insurer is a member of the NAIC.
D) It is a standard sales pitch.

Explanation: Representing that an insurer or its policies are sponsored, endorsed, or guaranteed by any government entity is a prohibited misrepresentation.

40. In a whole life policy, the relationship between cash value and death benefit is:

A) Directly proportional — both increase together at the same rate
B) Inverse — as cash value grows, the death benefit decreases by the same amount
C) There is no relationship between cash value and death benefit
✔ D) The total death benefit is level; as cash value grows within the total, the net amount at risk decreases

Explanation: In a whole life policy with a level death benefit (most common structure), the policy's total value stays constant at the face amount. As the cash value component grows, the 'net amount at risk' (pure insurance) shrinks proportionally, since: face amount = cash value + net amount at risk.

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41. The cash value in a whole life policy grows on a:

A) Taxable basis
✔ B) Tax-deferred basis
C) Annual taxable distribution basis
D) Capital gains tax basis

Explanation: Cash value accumulation inside a whole life policy grows on a tax-deferred basis — meaning no income tax is owed on the growth as long as it remains inside the policy. This tax advantage makes whole life a potentially attractive long-term financial planning tool.

42. Medicare Part A primarily provides coverage for:

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

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

43. Under a Point-of-Service (POS) plan, the member avoids higher cost-sharing by:

A) Using out-of-network providers covered at the in-network rate
B) Using only specialists without referrals
✔ C) Staying in-network and using their PCP for referrals when seeing specialists
D) Paying the full cost upfront and requesting reimbursement later

Explanation: In a POS plan, members pay lower cost-sharing when they use in-network providers and follow the HMO-like requirement of getting referrals from their PCP for specialist visits. If they go out-of-network or see a specialist without a referral, they pay significantly higher cost-sharing (similar to a PPO's out-of-network rate).

44. A 'per stirpes' beneficiary designation means that if a beneficiary predeceases the insured:

- ✔ A) Their share of the proceeds is passed down to their living children (the beneficiary's heirs).
- B) Their share is divided equally among the other surviving beneficiaries.
- C) Their share of the proceeds is forfeited.
- D) The entire death benefit goes to the contingent beneficiary.

Explanation: 'Per stirpes' (by the root) is a distribution method where the descendants of a deceased beneficiary inherit their share. For example, if a son who was a beneficiary dies, his children would split his portion of the death benefit.

45. Which rider would waive the premiums on a child's life insurance policy if the parent who pays the premiums dies or becomes disabled?

- A) Spousal Rider
- ✔ B) Payor Benefit
- C) Waiver of Premium
- D) Guaranteed Insurability

Explanation: The Payor Benefit rider is specifically designed for juvenile policies. It ensures that the policy will not lapse if the premium payor dies or becomes disabled before the child reaches a specified age (e.g., 21 or 25).

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46. A customer returns a life insurance policy to the insurer within the 10 days free-look period. What is the insurer's obligation?

- A) Refund all premiums paid, less a $50 processing fee.
- ✔ B) Refund all premiums paid within a reasonable time.
- C) Keep the premium and convert the policy to term life.
- D) Refuse the return unless the client is sick.

Explanation: If a policy is returned during the free-look period, the contract is void from the beginning, and the insurer must refund all premiums paid.

47. A mutual insurance company is owned by its:

- ✔ A) Policyholders
- B) Shareholders
- C) Officers
- D) Agents

Explanation: A mutual insurance company is owned by its policyholders. Any profits or surplus may be returned to the policyholders in the form of non-taxable dividends.

48. Social insurance offset riders in disability income policies:

- ✔ A) Reduce the disability benefit by the amount received from Social Security or workers' compensation
- B) Increase the benefit when Social Security disability is also paid
- C) Allow benefits to be collected before Social Security eligibility
- D) Provide additional coverage for federal employees only

Explanation: A Social Insurance Offset (or Social Security offset) rider reduces the disability income benefit by the amount the insured receives from Social Security disability or similar government programs. This coordination prevents over-indemnification and allows the insurer to lower premiums while still providing adequate total income replacement.

49. The primary purpose of an annuity is to:

- ✔ A) Provide a systematic income stream, particularly to protect against outliving one's assets
- B) Replace health insurance for retirees
- C) Create a death benefit for the insured's beneficiaries
- D) Fund a child's education expenses

Explanation: The primary function of an annuity is to liquidate (distribute) an accumulated sum through periodic income payments. Annuities protect against longevity risk — the risk of outliving one's savings. Life insurance protects against dying too soon; annuities protect against living too long.

50. A husband and wife are both covered by their respective employers' group health plans. The husband files a medical claim for himself. Under the Coordination of Benefits (COB) guidelines, which plan is primary?

- A) The wife's plan
- B) The plan that has been in force the longest
- ✔ C) The husband's own plan
- D) The plans share the cost 50/50

Explanation: Under Coordination of Benefits (COB) rules, the plan in which the individual is enrolled as an employee (main policyholder) is always primary for that individual's own claims. The spouse's plan acts as secondary coverage.