Insurance Test Practice

South Dakota Insurance Practice Test

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1. If a life insurance policy is included in the insured's gross estate, it may be subject to:

A) Income tax
B) Property tax
C) Gift tax
✔ D) Federal estate tax

Explanation: While the death benefit is income tax-free to the beneficiary, it may be included in the deceased's taxable estate if the deceased had any incidents of ownership in the policy at the time of death. If the total estate value exceeds the federal exemption amount, estate taxes may be due.

2. Medicare does NOT cover which of the following?

A) Outpatient surgery
B) Doctor's office visits
✔ C) Long-term custodial care in a nursing home
D) Inpatient hospital care

Explanation: A major gap in Medicare coverage is long-term custodial care. Medicare only covers short-term, skilled nursing care for rehabilitation after a hospital stay, not the ongoing assistance with daily living that long-term care entails.

3. 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.

4. 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.

5. The activities of daily living (ADLs) used as benefit triggers in long-term care policies include all of the following EXCEPT:

A) Dressing
B) Eating
✓ C) Working (employment or job duties)
D) Bathing

Explanation: The six standard ADLs used as LTC benefit triggers are: bathing, dressing, eating, continence, toileting, and transferring. 'Working' (the ability to perform job functions) is NOT an ADL. The inability to perform at least 2 of the 6 ADLs is the most common benefit trigger for tax-qualified LTC policies.

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6. Which of the following are considered Activities of Daily Living (ADLs)?

A) Working, exercising, and reading.
B) Paying bills and managing medications.
C) Driving, shopping, and cooking.
✓ D) Bathing, dressing, eating, transferring, toileting, and continence.

Explanation: The six standard ADLs are the basic activities of self-care. The inability to perform a certain number of these (typically two or three) is a common trigger for benefits under an LTC policy.

7. 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.

8. What is the statutory maximum incontestability period for individual life insurance policies in South Dakota?

A) 1 year from the date of policy issue,
B) 3 years from the date of policy issue,
C) 5 years from the date of policy issue,
✓ D) 2 years from the date of policy issue

Explanation: Under SDCL § 58-15-13, a life insurance policy becomes incontestable after it has been in force during the lifetime of the insured for a period of two (2) years from its date of issue.

9. Short-term disability (STD) insurance typically:

A) Has a longer elimination period and benefit period than long-term disability
B) Covers only occupational disabilities
C) Replaces 100% of the insured's pre-disability income
✔ D) Begins paying benefits quickly (after a short elimination period) and pays for a limited period (up to 2 years)

Explanation: Short-term disability insurance typically has a short elimination period (0-14 days) and a benefit period of up to 1-2 years. It is designed to cover brief periods of disability such as recovery from surgery or illness. Long-term disability (LTD) has longer elimination periods but pays for many years or until retirement age.

10. In a staff model HMO, physicians are:

A) Members of an independent practice association who contract with the HMO
✔ B) Salaried employees of the HMO who work exclusively for the plan
C) Part of a multispecialty group that contracts with the HMO
D) Independent contractors who are paid on a fee-for-service basis

Explanation: In a staff model HMO, physicians are directly employed by the HMO and receive a salary. They practice in facilities owned or operated by the HMO and typically see only HMO patients. This gives the HMO the greatest control over utilization and quality but is the most expensive model to operate.

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11. 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.

12. What is a single premium deferred annuity (SPDA)?

✔ A) An annuity funded with one lump sum, with payments starting at a future date.
B) An annuity funded with one lump sum, with payments starting immediately.
C) An annuity funded with flexible premiums over time, with payments starting in the future.
D) An annuity that only pays out a single lump sum.

Explanation: An SPDA is purchased with a single, lump-sum premium. The funds are then left to accumulate on a tax-deferred basis, and income payments are deferred until a later date chosen by the owner.

13. Under South Dakota annuity disclosure rules, what document must be provided to the consumer at or before the time of an annuity application?

A) The insurer's complete corporate charter and board meeting minutes,
✔ B) An approved Annuity Disclosure Document and the NAIC Buyer's Guide to Annuities,
C) A copy of the South Dakota Department of Revenue state tax code,
D) A certified statement from the consumer's personal certified financial planner

Explanation: Under ARSD 20:06:39 (Annuity Disclosure), insurers and producers must provide a comprehensive Annuity Disclosure Document and the NAIC Buyer's Guide to Annuities at or before application.

14. 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.

15. 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.

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16. Under a typical COB 'birthday rule,' if a child is covered by both parents' health plans, which parent's plan is considered primary?

A) The parent who has had their plan longer.
B) The parent who is older.
C) The mother's plan is always primary.
✓ D) The parent whose birthday occurs earlier in the calendar year.

Explanation: The birthday rule is the standard guideline for determining primary coverage for dependent children. The plan of the parent whose birthday (month and day, not year) comes first in the calendar year is the primary plan.

17. If a person has group health coverage through their employer after age 65, when should they enroll in Medicare Part B?

A) They should enroll in Part B and drop their employer coverage.
B) They do not need Part B if they have employer coverage.
C) They must enroll as soon as they turn 65.
✓ D) They can delay Part B enrollment without penalty until the employer coverage ends.

Explanation: If an individual continues to work past 65 and has creditable health coverage through their (or their spouse's) current employer, they can delay enrolling in Part B. They will have a Special Enrollment Period to sign up for Part B later without a penalty when the employer coverage ends.

18. What is custodial care?

A) Rehabilitative therapy.
✓ B) Care to help an individual with personal needs like bathing, dressing, and eating.
C) 24-hour skilled nursing care.
D) Care provided by a licensed medical professional.

Explanation: Custodial care is non-medical assistance with activities of daily living (ADLs). It can be provided by non-licensed individuals and is the most common type of care needed for long-term support.

19. The Waiver of Premium rider ensures that if the policyowner becomes totally disabled:

✔ A) The insurer will waive the premiums for the duration of the disability.
B) The cash value can be withdrawn without a penalty.
C) The policy's face amount is paid out immediately.
D) A monthly income is paid to the insured.

Explanation: With the Waiver of Premium rider, if the insured becomes totally and permanently disabled (after a waiting period), the insurance company will waive all future premium payments for as long as the disability continues. The policy remains in force as if premiums were being paid.

20. A policyowner takes a withdrawal from a universal life policy. Which of the following is true regarding taxation?

A) The withdrawal is taxed on a LIFO basis.
B) The entire withdrawal is taxed.
C) The withdrawal is treated as a loan and is never taxed.
✔ D) The withdrawal is treated as a return of premium up to the policy's cost basis and is not taxed.

Explanation: For non-MEC policies, withdrawals are treated on a FIFO (First-In, First-Out) basis. This means the policyowner can withdraw up to their cost basis (total premiums paid) without incurring any taxes. Withdrawals exceeding the cost basis are taxable as ordinary income.

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21. 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.

22. What is partial disability?

A) A disability that is expected to last less than one year.
✔ B) The inability to perform one or more, but not all, of the essential duties of one's occupation.
C) A disability that occurs off the job.
D) A disability that is not covered by the policy.

Explanation: Partial disability benefits are paid when an illness or injury prevents an insured from performing some of their job duties, resulting in a loss of income. The benefit is typically 50% of the total disability benefit and is paid for a limited time.

23. The 'notice of claims' provision in a health insurance policy requires:

- ✔ A) The insured to give written notice of a claim to the insurer within a specified time after a covered loss
- B) All health claims to be submitted electronically to qualify for reimbursement
- C) Both the insured and the provider to submit separate claim notices
- D) The insurer to notify the insured within 30 days of any claim decision

Explanation: The notice of claims provision requires the insured to notify the insurer of a claim within a specified time period (typically within 20 days of the loss or as soon as reasonably possible). Timely notice allows the insurer to investigate the claim and provide claim forms. Failure to provide timely notice does not necessarily void coverage but may complicate the claims process.

24. 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.

25. In a variable life policy, who bears the investment risk for the separate account?

- ✔ A) The policyowner
- B) The SEC
- C) The insurance company
- D) The state guaranty association

Explanation: In variable life insurance, the policyowner bears the investment risk for the separate account investments. Unlike whole life where the insurer guarantees the cash value, variable life cash value fluctuates based on investment performance. If the investments perform poorly, the cash value and potentially the death benefit can decrease (though variable life typically guarantees a minimum death benefit). This is why variable life producers must hold both insurance and securities licenses.

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26. A divorced spouse may be eligible for Social Security benefits based on their ex-spouse's work record if the marriage lasted at least:

- ✔ A) 10 years
- B) 5 years
- C) 7 years
- D) 15 years

Explanation: A divorced spouse can collect benefits on an ex-spouse's record if the marriage lasted at least 10 years, the divorced spouse is at least age 62, is currently unmarried, and is not entitled to a higher benefit on their own record. The ex-spouse's benefits are not reduced by this claim.

27. What is a Modified Endowment Contract (MEC)?

A) A life insurance policy with a flexible premium.
B) A type of annuity contract.
✔ C) A life insurance policy that has been overfunded according to IRS rules.
D) A policy designed for estate planning.

Explanation: A Modified Endowment Contract (MEC) is a life insurance policy where the cumulative premiums paid during the first seven years exceed a federally set limit (the 7-pay test). This changes the tax treatment of the policy to be less favorable.

28. In a fixed annuity, the interest crediting rate is:

✔ A) Guaranteed at a fixed minimum rate with a current rate that may be higher
B) Determined solely by the owner's investment selections
C) Tied directly to stock market index performance
D) Equal to U.S. Treasury bond rates

Explanation: Fixed annuities credit interest at a current rate that the insurer declares periodically, with a guaranteed minimum rate. The insurer bears all investment risk. This provides principal protection and predictable growth, making fixed annuities less risky than variable annuities.

29. 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.

30. Which type of care is NOT typically covered by a Long-Term Care policy?

A) Skilled nursing care
B) Custodial care
C) Hospice care
✔ D) Acute care in a hospital

Explanation: LTC policies cover a range of services from skilled care to intermediate care and custodial care, which can be provided in various settings (nursing home, assisted living, at home). Acute care for a medical condition in a hospital is covered by standard health insurance or Medicare, not an LTC policy.

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31. To be eligible for a tax-qualified LTC policy, the chronic illness must be expected to last at least:

✔ A) 90 days
B) 180 days
C) 30 days
D) 60 days

Explanation: For a tax-qualified plan, a physician must certify that the individual is chronically ill, meaning they are unable to perform at least 2 ADLs for a period expected to last at least 90 days or have a severe cognitive impairment.

32. How are premiums for an individual disability income policy treated for tax purposes?

A) They are partially deductible.
B) They are tax-deductible.
✔ C) They are not tax-deductible.
D) They are a tax credit.

Explanation: Premiums paid for a personally owned disability income policy are a personal expense and are not tax-deductible.

33. 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.

34. To sell variable annuities, a producer must hold which licenses?

A) A life insurance license only.
✔ B) Both a life insurance license and a securities license (e.g., FINRA Series 6 or 7).
C) A securities license only.
D) A property and casualty license.

Explanation: Because variable annuities involve investments in securities (the separate account), they are regulated by both state insurance departments and the SEC/FINRA. A producer must hold a state life insurance license and a federal securities registration to sell them.

35. Which life insurance product requires a securities license (FINRA Series 6 or 7) in addition to a life insurance license to sell?

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

Explanation: Any 'variable' life insurance or annuity product involves investments in separate accounts (securities). Therefore, a producer must have both a state life insurance license and a federal securities registration (like Series 6 or 7) to sell them.

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36. 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.

37. A 'guaranteed minimum withdrawal benefit' (GMWB) rider on a variable annuity:

A) Guarantees the owner will never lose principal in the subaccounts
B) Converts the variable annuity to a fixed annuity if subaccounts decline below a threshold
C) Guarantees a minimum death benefit equal to the original premium
✔ D) Guarantees the owner can withdraw a specified percentage of the benefit base annually regardless of subaccount performance

Explanation: A GMWB rider guarantees the owner can withdraw a specified percentage (e.g., 5-7%) of the benefit base (often the original premium or a 'high-water mark') annually without triggering the annuity's surrender charges and without depleting the guaranteed withdrawal amount — even if the actual account value falls to zero due to market losses. This provides income security in variable annuities.

38. What is a Qualified Longevity Annuity Contract (QLAC)?

A) An annuity designed to pay for long-term care.
✔ B) An annuity that can be purchased inside a qualified retirement plan (like a 401(k) or IRA) to provide income late in life.
C) An annuity that is only available to qualified financial professionals.
D) A type of variable annuity with high growth potential.

Explanation: A QLAC is a type of deferred income annuity purchased with funds from a qualified retirement plan. It allows a retiree to defer a portion of their required minimum distributions (RMDs) until a later age (up to 85), providing a source of guaranteed income late in retirement.

39. Within how many days must an insurance producer notify the South Dakota Division of Insurance of a change in legal residence or business address?

A) Within 10 days of the change,
B) Within 60 days of the change,
✔ C) Within 30 days of the change,
D) At the next biennial renewal date

Explanation: Under SDCL § 58-30-157, every licensed producer must notify the Director in writing within thirty (30) days of any change in residential, business, or email address.

40. Which element is NOT required for a valid insurance contract?

A) Competent parties
B) Legal purpose
✔ C) A licensed agent
D) Consideration

Explanation: The four essential elements of a valid contract are: offer and acceptance, consideration, competent parties, and legal purpose. A licensed agent is not a legal requirement for contract validity, though agents are required for soliciting insurance.

41. What is the role of the Centers for Medicare & Medicaid Services (CMS)?

- ✔ A) It is a federal agency that administers the Medicare and Medicaid programs.
- B) It is a private insurance company.
- C) It is a consumer advocacy group.
- D) It is a state agency that regulates HMOs.

Explanation: CMS is the federal agency within the U.S. Department of Health and Human Services that oversees the Medicare program, and works in partnership with state governments to administer Medicaid, CHIP, and health insurance portability standards.

42. Under the 'fixed period' settlement option, life insurance proceeds are paid:

- A) Only if the beneficiary survives for a specified period
- B) In fixed amounts until the principal is exhausted
- ✔ C) In equal installments over a specified number of years with interest
- D) For the lifetime of the beneficiary only

Explanation: The Fixed Period (or Installments for a Fixed Period) settlement option pays the death benefit in equal installments over a specified number of years. If the beneficiary dies before the end of the period, remaining installments are paid to a named successor beneficiary. Interest is earned on the remaining balance.

43. A client uses funds from a non-qualified annuity to pay for long-term care insurance premiums. What is the tax implication?

- A) The withdrawal is subject to a 10% penalty.
- B) The withdrawal is fully taxable.
- ✔ C) The withdrawal may be tax-free if transferred directly from the annuity to the LTC insurer under the Pension Protection Act.
- D) The withdrawal is fully tax-free.

Explanation: The Pension Protection Act of 2006 allows for tax-free withdrawals from a non-qualified annuity to pay for long-term care insurance premiums, up to certain limits. This is accomplished via a direct trustee-to-trustee transfer.

44. A business owner buys a life insurance policy on her own life and names the business as the beneficiary. What is the business purpose of this policy?

- A) Split-dollar arrangement
- ✔ B) Business continuation
- C) Key person insurance
- D) Executive bonus plan

Explanation: This arrangement is often used for business continuation, specifically to provide liquidity to a sole proprietorship. Upon the owner's death, the death benefit provides cash for the owner's heirs to pay off business debts and facilitate the orderly transfer or liquidation of the business.

45. 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.

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46. The automatic premium loan (APL) provision in whole life insurance:

- A) Automatically increases the policy's face amount when premiums are not paid
- B) Loans the insured money at no interest to pay premiums
- ✔ C) Automatically borrows from the policy's cash value to pay an overdue premium and prevent lapse
- D) Automatically applies dividend accumulations to pay premiums

Explanation: The Automatic Premium Loan (APL) provision instructs the insurer to automatically use the policy's available cash value to pay any premium that is not paid by the end of the grace period. This prevents the policy from lapsing as long as sufficient cash value is available. Interest is charged on the loan.

47. An increasing term life insurance policy provides:

- A) A level death benefit with increasing premiums
- B) A level death benefit and level premiums
- ✔ C) A death benefit that increases over the policy term while premiums remain level
- D) A cash value that increases while the death benefit decreases

Explanation: Increasing term insurance features a death benefit that grows over the policy period, often to keep pace with inflation or rising financial obligations. It is the opposite of decreasing term. It is sometimes added as a rider (such as a COLA rider) rather than sold as a standalone policy.

48. Can a Long-Term Care insurance policy in South Dakota be cancelled or non-renewed by the insurer solely due to the deteriorating health or advancing age of the insured?

- A) Yes, insurers may terminate LTC coverage once the insured reaches age 80,
- ✔ B) No, LTC policies must be guaranteed renewable or noncancellable and cannot be terminated due to age or health decline,
- C) Yes, if the insured files more than three claims in a 5-year period,
- D) No, but the insurer may double the individual's premium without state rate approval

Explanation: Under SDCL § 58-17B-3, no Long-Term Care insurance policy may be cancelled, nonrenewed, or otherwise terminated on the grounds of the age or the deterioration of the mental or physical health of the insured.

49. To prevent a life insurance policy from lapsing if the policyowner forgets to pay the premium, they should have the _____ provision.

A) Grace Period
B) Waiver of Premium
✔ C) Automatic Premium Loan
D) Reinstatement

Explanation: The Automatic Premium Loan (APL) provision authorizes the insurer to automatically borrow from the policy's cash value to pay any premium in default at the end of the grace period. This keeps the policy active and prevents an unintentional lapse.

50. Short-Term Disability (STD) insurance typically provides benefits for a period of:

A) Up to 5 years
B) To age 65
C) Up to 2 years
✔ D) Up to 6 months

Explanation: Short-Term Disability policies have short elimination periods (e.g., 7-14 days) and short benefit periods, usually ranging from 3 to 6 months, and never more than 2 years.