

LIFE & HEALTH

Producer Licensing Exam Study Manual

CHAPTER 2

Life Insurance Basics

Exam Weight: This chapter covers approximately 10% of the licensing exam — roughly 15 of 150 questions. This chapter bridges foundational insurance concepts with the specifics of life insurance, covering how policies are sold, underwritten, regulated, and delivered.

Sub-chapters in this chapter:

- 2.1 Personal and Business Uses of Life Insurance
- 2.2 Determining the Amount of Life Insurance Needed
- 2.3 Life Insurance Premiums and Policy Classes
- 2.4 Producer Responsibilities — Field Underwriting & Applications
- 2.5 Individual Underwriting, Risk Classification & Michigan Regulations

Sub-Chapter 2.1

Personal and Business Uses of Life Insurance

Estate Creation · Cash Accumulation · Security · Liquidity · Estate Conservation · Business Applications

Overview

Life insurance serves purposes far beyond simply paying a death benefit. Producers who understand the full range of personal and business applications are better equipped to identify client needs, recommend appropriate coverage, and explain the value of life insurance clearly. This sub-chapter covers both the personal and business sides of life insurance and the specific purposes each application serves.

Personal Uses of Life Insurance

Estate Creation

Life insurance creates an immediate estate — a guaranteed sum of money that comes into existence the moment the first premium is paid and a covered death occurs. This is especially important for young families who have not had time to accumulate significant assets. A \$500,000 life insurance policy creates a \$500,000 estate for beneficiaries from day one, regardless of how long the insured has been paying premiums.

Income Replacement and Family Security

The most fundamental personal use of life insurance is replacing the income lost when a wage earner dies. Life insurance proceeds can replace the insured's earnings for surviving dependents — allowing a family to maintain its standard of living, pay ongoing bills, cover childcare costs, and avoid financial hardship. This is the core reason most individuals purchase life insurance.

Cash Accumulation

Permanent life insurance policies (whole life, universal life) build cash value over time that the policyowner can access during their lifetime. This cash value grows on a tax-deferred basis and can be used for a variety of financial needs — supplementing retirement income, paying for education, or covering emergency expenses. The savings component makes permanent insurance a dual-purpose financial tool: protection and accumulation.

Liquidity

A deceased person's estate may contain valuable but illiquid assets — real estate, business interests, art, or collectibles. Life insurance proceeds provide immediate cash (liquidity) that heirs can use to pay

estate taxes, debts, and other obligations without being forced to sell those assets at a loss or under pressure. Life insurance ensures that heirs receive assets intact rather than being forced into a distressed sale.

Estate Conservation

Without liquidity planning, heirs may lose a significant portion of an estate to federal and state estate taxes, debts, or forced sales. Life insurance is a core estate conservation tool — it provides the cash needed to pay estate taxes and preserve the estate's value for the intended beneficiaries. Large estates in particular rely on life insurance to ensure that what was built over a lifetime passes intact to the next generation.

MEMORY AID

The five personal uses of life insurance: EICLS — Estate creation, Income replacement, Cash accumulation, Liquidity, estate conServation. Think: Every Informed Client Loves Security.

Business Uses of Life Insurance

Life insurance is a critical business planning tool. Businesses use life insurance to protect against the financial impact of losing key personnel and to fund business continuation plans.

Key Person Life Insurance

A business purchases life insurance on an employee whose skills, knowledge, or relationships are essential to the company's success — a key person. If that individual dies, the business receives the death benefit and uses it to:

- Cover the revenue lost during the transition period.
- Recruit and train a qualified replacement.
- Reassure lenders, creditors, and investors during the transition.

The business is both the policyowner and the beneficiary. The key person is the insured. The premiums paid by the business are generally NOT tax-deductible, and the death benefit received is generally tax-free.

EXAM TIP

In key person insurance, the BUSINESS owns the policy and is the beneficiary — not the key employee's family. Premiums are not tax-deductible by the business. Death benefit proceeds are received income-tax-free.

Buy-Sell Agreements

A buy-sell agreement is a legal contract between business co-owners that specifies what happens to each owner's interest in the business upon death, disability, or retirement. Life insurance funds the buyout — when a co-owner dies, the life insurance death benefit provides the cash needed to purchase the deceased owner's interest from their estate at a pre-agreed price.

There are two primary structures for funding a buy-sell agreement with life insurance:

- **Cross-Purchase Plan:** Each owner purchases a life insurance policy on every other owner. When one owner dies, the surviving owners use the death benefit proceeds to purchase the deceased owner's business interest from their estate. Works best with small numbers of owners.
- **Entity Purchase (Stock Redemption) Plan:** The business itself owns policies on each owner. Upon an owner's death, the business uses the proceeds to buy back the deceased owner's interest and redistribute it to the surviving owners. Simpler administratively when there are many owners.

FREQUENTLY TESTED

Buy-sell agreements are frequently tested. Know both structures: cross-purchase (co-owners buy policies on each other) vs. entity purchase (the business buys policies on all owners). The key distinction is who owns the policy — the co-owners or the business entity.

Group Life Insurance as an Employee Benefit

Employers provide group life insurance as part of their employee benefits package. Group life insurance offers employees a meaningful death benefit — typically one to two times annual salary — at group rates that are far lower than individual rates. The employer usually pays all or most of the premium, and employees may be able to convert coverage to an individual policy when they leave the company.

Key Terms — Sub-Chapter 2.1

Term	Definition
Estate Creation	Using life insurance to immediately create a financial estate for beneficiaries, regardless of assets accumulated.
Income Replacement	Using life insurance death benefit proceeds to replace a deceased wage earner's lost income for surviving dependents.
Cash Accumulation	The tax-deferred growth of cash value in permanent life insurance policies, accessible during the insured's lifetime.
Liquidity	The availability of immediate cash from life insurance proceeds to pay debts and taxes without forcing asset sales.
Estate Conservation	Using life insurance proceeds to pay estate taxes and preserve the value of an estate for heirs.
Key Person Insurance	Life insurance purchased by a business on an essential employee; business is owner and beneficiary.
Buy-Sell Agreement	A legal agreement between business owners funded by life insurance, specifying how a deceased owner's interest will be purchased.
Cross-Purchase Plan	A buy-sell structure where each co-owner buys a life insurance policy on every other co-owner.
Entity Purchase Plan	A buy-sell structure where the business entity buys policies on each owner and redeems the deceased owner's interest.
Group Life Insurance	Employer-sponsored life insurance covering employees under a single group contract at group rates.

Quick Quiz — Sub-Chapter 2.1

5 questions · Circle the best answer · Check your work using the Answer Key on the following page

1. A young couple with two children and a recently purchased home buys a \$750,000 life insurance policy on the primary wage earner. This purchase BEST illustrates which personal use of life insurance?
 - A. Estate conservation
 - B. Cash accumulation
 - C. Income replacement and family security
 - D. Liquidity

2. A software company purchases life insurance on its lead developer, who is responsible for the company's flagship product. The company is named as the beneficiary. This is an example of:
 - A. Buy-sell agreement funding
 - B. Key person life insurance
 - C. Cross-purchase plan
 - D. Group life insurance

3. Two physicians who co-own a medical practice each purchase a life insurance policy on the other. Their agreement specifies that upon either physician's death, the survivor will use the death benefit to purchase the deceased's practice interest from their estate. This is a:
 - A. Entity purchase plan
 - B. Group life benefit plan
 - C. Key person arrangement
 - D. Cross-purchase buy-sell plan

4. A wealthy business owner holds most of her estate in commercial real estate. She purchases life insurance to ensure that her heirs can pay estate taxes without being forced to sell the properties at a disadvantageous price. This illustrates which personal use of life insurance?
 - A. Income replacement
 - B. Liquidity and estate conservation
 - C. Cash accumulation

D. Key person protection

5. In a business entity purchase (stock redemption) buy-sell plan, who owns the life insurance policies?
- A. Each co-owner purchases a policy on every other co-owner
 - B. The key person's family owns the policies
 - C. The business entity owns policies on each owner
 - D. An independent trustee owns all policies

Answer Key — Quick Quiz — Sub-Chapter 2.1

Correct answers are shown below each question with a full explanation. Review any missed questions before moving on.

1. A young couple with two children and a recently purchased home buys a \$750,000 life insurance policy on the primary wage earner. This purchase BEST illustrates which personal use of life insurance?

- A. Estate conservation
- B. Cash accumulation
- C. Income replacement and family security**
- D. Liquidity

Explanation: Income replacement is the most fundamental personal use of life insurance — providing survivors with the money needed to maintain their standard of living after the wage earner dies. A young family with dependents and a mortgage is the classic income replacement scenario. Estate conservation addresses wealthy estates; cash accumulation refers to permanent policy cash value; liquidity addresses the need for cash to pay taxes or debts.

2. A software company purchases life insurance on its lead developer, who is responsible for the company's flagship product. The company is named as the beneficiary. This is an example of:

- A. Buy-sell agreement funding
- B. Key person life insurance**
- C. Cross-purchase plan
- D. Group life insurance

Explanation: Key person insurance is life insurance purchased by a business on an employee whose death would cause significant financial harm to the company. The business is both the policyowner and the beneficiary. The death benefit compensates the business for lost revenue, recruitment costs, and transition expenses. A buy-sell agreement addresses ownership succession between co-owners, which is different from protecting against the loss of a key employee.

3. Two physicians who co-own a medical practice each purchase a life insurance policy on the other. Their agreement specifies that upon either physician's death, the survivor will use the death benefit to purchase the deceased's practice interest from their estate. This is a:

- A. Entity purchase plan
- B. Group life benefit plan
- C. Key person arrangement

D. Cross-purchase buy-sell plan

Explanation: In a cross-purchase buy-sell plan, each co-owner purchases a life insurance policy on the other co-owners. Upon a co-owner's death, the surviving owners use the policy proceeds to buy the deceased's business interest from their estate. In an entity purchase plan, the business (not the individual owners) owns the policies and redeems the deceased owner's interest.

4. A wealthy business owner holds most of her estate in commercial real estate. She purchases life insurance to ensure that her heirs can pay estate taxes without being forced to sell the properties at a disadvantageous price. This illustrates which personal use of life insurance?

- A. Income replacement

B. Liquidity and estate conservation

- C. Cash accumulation
- D. Key person protection

Explanation: Life insurance provides immediate liquidity — cash that heirs can use to pay estate taxes and debts without having to sell illiquid assets under pressure. Estate conservation ensures that the estate's value is preserved for heirs. These two purposes work together when the estate is composed primarily of real estate or other assets that cannot be easily or quickly converted to cash.

5. In a business entity purchase (stock redemption) buy-sell plan, who owns the life insurance policies?

- A. Each co-owner purchases a policy on every other co-owner
- B. The key person's family owns the policies

C. The business entity owns policies on each owner

- D. An independent trustee owns all policies

Explanation: In an entity purchase (stock redemption) plan, the business entity owns life insurance policies on each of its owners. When an owner dies, the business receives the death benefit and uses it to buy back the deceased owner's interest. Choice A describes a cross-purchase plan, where co-owners buy policies on each other. The entity purchase plan is simpler administratively when there are many owners, because the business holds all the policies rather than each owner maintaining policies on every other owner.

Sub-Chapter 2.2

Determining the Amount of Life Insurance Needed

Human Life Value Approach · Needs Approach · Lump-Sum Needs · Income Planning

Overview

One of a producer's most important responsibilities is helping clients determine the appropriate amount of life insurance. Two primary methods exist — the Human Life Value approach and the Needs approach. Understanding both approaches and the types of financial needs they address is tested on the exam and essential for professional practice.

The Human Life Value Approach

The Human Life Value (HLV) approach calculates how much a person's future earnings are worth in today's dollars. It treats the individual as an economic asset to their family or business and seeks to replace the financial contribution that would be lost at death.

To calculate HLV, the producer estimates:

- The insured's annual earned income (after taxes and personal expenses).
- The number of remaining productive working years.
- A reasonable discount rate (to calculate the present value of future income).

Example: A 35-year-old earning \$80,000/year after taxes, with 30 remaining working years, has a Human Life Value of approximately \$1.5 to \$2 million depending on the assumed discount rate.

KEY CONCEPT

The Human Life Value approach focuses on the insured as an economic asset. It calculates the present value of future earnings that would be lost at death. This approach tends to produce higher coverage recommendations than the needs approach because it does not net out existing assets or savings.

The Needs Approach

The Needs approach is more comprehensive and client-specific. It identifies the specific financial obligations and goals that life insurance must fund, then calculates the total coverage needed to satisfy all of them. It accounts for existing resources (savings, investments, other insurance) to arrive at the net insurance need.

The Needs approach generally analyzes two categories of need:

Lump-Sum Needs (One-Time Expenses at Death)

These are immediate financial obligations that must be paid when the insured dies:

- **Final expenses:** Funeral, burial, and medical expenses associated with the final illness — typically \$15,000 to \$25,000 or more.
- **Outstanding debts:** Mortgage balance, auto loans, credit card balances, student loans, and other debts that the family would need to retire.
- **Estate settlement costs:** Attorney fees, executor fees, estate taxes, and other probate-related costs.
- **Education funding:** The cost of college or vocational training for dependent children.
- **Emergency fund:** A cash reserve equal to three to six months of income for unexpected expenses.

Income Needs (Ongoing Living Expenses)

These are the recurring expenses the surviving family will face over time:

- **Family income period:** The years during which children are still at home and the surviving spouse has childcare responsibilities — often the largest ongoing income need.
- **Blackout period income:** After the youngest child reaches age 16, a surviving spouse loses Social Security survivor benefits until age 60. Life insurance can replace income during this gap.
- **Retirement income:** The surviving spouse's need for income during retirement, supplementing Social Security and any personal savings.

FREQUENTLY TESTED

Both the Human Life Value and Needs approaches are tested. The HLV approach focuses purely on replacing lost earnings (present value of future income). The Needs approach identifies specific financial obligations and nets out existing assets. The exam may ask which approach produces higher or lower coverage amounts.

EXAM TIP

The 'blackout period' is a key exam concept. It is the period after the youngest child turns 16 and before the surviving spouse reaches age 60, during which Social Security survivor benefits are NOT paid. Life insurance bridges this income gap.

Key Terms — Sub-Chapter 2.2

Term	Definition
Human Life Value (HLV) Approach	A method for determining life insurance needs by calculating the present value of the insured's projected future earnings.
Needs Approach	A method for determining life insurance needs by identifying specific financial obligations and goals, then netting out existing resources.
Lump-Sum Needs	One-time expenses payable at death, including final expenses, debts, estate costs, and education funding.
Income Needs	Ongoing living expenses the surviving family will face over time, including family income and retirement needs.
Blackout Period	The period after the youngest child turns 16 and before the surviving spouse reaches age 60, during which Social Security survivor benefits are suspended.
Family Income Period	The years during which children are at home and dependent — typically the highest ongoing income replacement need.
Final Expenses	Funeral, burial, and final medical costs that must be paid immediately upon death.
Estate Settlement Costs	Attorney fees, executor fees, estate taxes, and probate costs associated with administering a deceased's estate.

Quick Quiz — Sub-Chapter 2.2

5 questions · Circle the best answer · Check your work using the Answer Key on the following page

1. A producer estimates that a client's annual after-tax income is \$90,000 and that the client has 25 remaining working years. The producer calculates the present value of these future earnings to recommend a life insurance amount. This approach is called the:
 - A. Needs approach
 - B. Human Life Value approach
 - C. Income replacement ratio method
 - D. Estate conservation method

2. When using the Needs approach to determine life insurance, which of the following would be classified as a lump-sum need?
 - A. Monthly income to replace the deceased's salary for 15 years
 - B. Ongoing retirement income for the surviving spouse
 - C. Outstanding mortgage balance and other debts at death
 - D. Monthly childcare expenses after the insured's death

3. A client is married with two young children, ages 4 and 7. The client dies unexpectedly. The surviving spouse will receive Social Security survivor benefits until the younger child turns 16. After that, survivor benefits stop until the surviving spouse reaches age 60. The period without benefits is called:
 - A. The elimination period
 - B. The blackout period
 - C. The lapse period
 - D. The income replacement gap

4. Compared to the Needs approach, the Human Life Value approach generally produces a life insurance recommendation that is:
 - A. Lower, because it nets out the insured's existing assets and savings
 - B. Higher, because it focuses on total future earnings without reducing for existing assets
 - C. Identical, because both approaches start with the same income figures

D. Lower, because it ignores lump-sum needs like mortgage payoff

5. A producer is completing a Needs analysis for a client. The producer identifies funeral expenses, credit card debt, the remaining mortgage balance, and college funding for two children as financial needs. These items are all classified as:

A. Ongoing income needs

B. Retirement needs

C. Lump-sum needs

D. Blackout period needs

Answer Key — Quick Quiz — Sub-Chapter 2.2

Correct answers are shown below each question with a full explanation. Review any missed questions before moving on.

1. A producer estimates that a client's annual after-tax income is \$90,000 and that the client has 25 remaining working years. The producer calculates the present value of these future earnings to recommend a life insurance amount. This approach is called the:

- A. Needs approach
- B. Human Life Value approach**
- C. Income replacement ratio method
- D. Estate conservation method

Explanation: The Human Life Value approach calculates the present value of the insured's projected future earnings — treating the person as an economic asset to their family. It focuses solely on replacing the income that would be lost at death. The Needs approach, by contrast, identifies specific financial obligations and goals and nets out existing assets to determine the net insurance need.

2. When using the Needs approach to determine life insurance, which of the following would be classified as a lump-sum need?

- A. Monthly income to replace the deceased's salary for 15 years
- B. Ongoing retirement income for the surviving spouse
- C. Outstanding mortgage balance and other debts at death**
- D. Monthly childcare expenses after the insured's death

Explanation: Lump-sum needs are one-time, immediate financial obligations payable at the time of death — including mortgage payoff, debts, final expenses, and education funding. Choices A, B, and D all describe ongoing or recurring income needs rather than one-time lump sums. The mortgage balance must be paid off immediately (lump sum), whereas replacing monthly salary is an income need.

3. A client is married with two young children, ages 4 and 7. The client dies unexpectedly. The surviving spouse will receive Social Security survivor benefits until the younger child turns 16. After that, survivor benefits stop until the surviving spouse reaches age 60. The period without benefits is called:

- A. The elimination period
- B. The blackout period**
- C. The lapse period
- D. The income replacement gap

Explanation: The blackout period is the gap in Social Security survivor benefits that begins when the youngest child turns 16 and ends when the surviving spouse reaches age 60. During this period, no Social Security survivor benefits are paid, creating a significant income shortfall. Life insurance is the primary tool used to fund income needs during the blackout period.

4. Compared to the Needs approach, the Human Life Value approach generally produces a life insurance recommendation that is:

- A. Lower, because it nets out the insured's existing assets and savings
- B. Higher, because it focuses on total future earnings without reducing for existing assets**
- C. Identical, because both approaches start with the same income figures
- D. Lower, because it ignores lump-sum needs like mortgage payoff

Explanation: The Human Life Value approach calculates the present value of all future earnings without subtracting existing savings, investments, or other insurance. This typically produces a higher recommended coverage amount. The Needs approach nets out existing resources to arrive at the net insurance need, which is usually lower because it accounts for what the client already has.

5. A producer is completing a Needs analysis for a client. The producer identifies funeral expenses, credit card debt, the remaining mortgage balance, and college funding for two children as financial needs. These items are all classified as:

- A. Ongoing income needs
- B. Retirement needs
- C. Lump-sum needs**
- D. Blackout period needs

Explanation: Lump-sum needs are immediate, one-time financial obligations that must be satisfied at the time of death — including funeral/final expenses, outstanding debts, estate costs, and education funding. Ongoing income needs, by contrast, are the recurring expenses survivors face over time, such as monthly living expenses, childcare, and eventual retirement income.

Sub-Chapter 2.3

Life Insurance Premiums and Policy Classes

Premium Factors · Premium Modes · Policy Classes · Participating vs. Nonparticipating · Fixed vs. Variable

Overview

Life insurance premiums are not arbitrary — they are calculated based on actuarial science and must cover the insurer's expected costs. Understanding how premiums are set, the modes available for payment, and the fundamental classifications of life insurance policies prepares producers for client conversations and exam questions on these topics.

How Life Insurance Premiums Are Calculated

Three primary factors determine a life insurance premium:

- **Mortality cost:** The probability of death within a given period, based on actuarial mortality tables. Younger, healthier insureds have lower mortality costs. This is the core component of any life insurance premium.
- **Expense loading:** The insurer's operating costs — agents' commissions, administrative overhead, claims processing, and profit margins — added to the pure mortality cost. Also called the loading factor.
- **Investment income (interest):** The insurer earns investment returns on premiums collected before claims are paid. This anticipated earnings rate reduces the amount that must be collected in premiums. A higher assumed interest rate means lower premiums for the policyowner.

MEMORY AID

The three premium factors: MEI — Mortality, Expenses, Investment income. Mortality drives the baseline cost up. Investment income offsets the cost down. Expenses add back in.

Premium Payment Modes

Policyowners may choose how frequently they pay premiums. The annual mode (once per year) is the least expensive because the insurer receives the full year's premium upfront and can invest it. More frequent payment modes cost slightly more because the insurer bears the risk of losing part of a year's premium if the policyowner stops paying mid-year.

From least to most expensive per-dollar of annual premium:

- **Annual:** One payment per year — least expensive mode.
- **Semi-annual:** Two payments per year — slight additional cost.
- **Quarterly:** Four payments per year — moderate additional cost.
- **Monthly:** Twelve payments per year — most expensive mode on a per-dollar basis.

EXAM TIP

Annual premium mode is the LEAST expensive and monthly is the MOST expensive. The more frequently premiums are paid, the higher the total annual cost because the insurer must add a service charge to compensate for the administrative cost and investment opportunity lost.

Classes of Life Insurance Policies

Group vs. Individual Life Insurance

- **Individual life insurance:** A contract between the insurer and a specific individual. Underwriting is done on a case-by-case basis based on the individual's health, lifestyle, and other risk factors. Coverage is portable — it stays with the individual regardless of employment.
- **Group life insurance:** A single master contract covers all eligible members of a group (typically employees of an employer). Underwriting is done on the group as a whole rather than each individual. Evidence of insurability is generally not required for eligible members. Coverage is typically not portable when an employee leaves — though conversion rights may apply.

FREQUENTLY TESTED

Individual vs. group life is a common comparison. Key distinctions: Individual = case-by-case underwriting, portable, higher premium. Group = group underwriting (no individual evidence required for eligible members), usually employer-sponsored, generally not portable.

Permanent vs. Term Life Insurance

- **Term life insurance:** Provides coverage for a specified period (term). If the insured survives the term, no benefit is paid and the coverage expires. Term has no cash value. It is the least expensive form of life insurance for a given coverage amount. Pure death protection only.
- **Permanent life insurance:** Provides lifelong coverage as long as premiums are paid. Includes a cash value component that grows over time. Examples include whole life, universal life, and

variable life. More expensive than term for the same coverage amount, but builds a cash value asset.

Participating vs. Nonparticipating Policies

- **Participating policy:** Issued by a mutual insurer. May pay policy dividends to policyholders if the company has surplus earnings. Dividends are a return of excess premium — not guaranteed and not taxable income. Higher initial premium than nonparticipating policies, but net cost may be lower if dividends are paid.
- **Nonparticipating policy:** Issued by a stock insurer. Does not pay policy dividends to policyholders. The insurer charges a premium that is set to cover expected costs and profit — no surplus is returned to policyholders.

Fixed vs. Variable Life Insurance

- **Fixed life insurance:** The death benefit and (for permanent policies) the cash value growth rate are guaranteed or set by the insurer. The insurer bears the investment risk. Premiums, death benefit, and (for whole life) cash value are predictable.
- **Variable life insurance:** The policyowner directs the investment of the cash value into separate account subaccounts (similar to mutual funds). The cash value and, in some variable policies, the death benefit fluctuate based on investment performance. The policyowner bears the investment risk. Producers must hold a securities license (FINRA Series 6 or 7) and a state life insurance license to sell variable products.

EXAM TIP

Variable life products require a securities license in addition to a life insurance license. The policyholder bears the investment risk in variable products — not the insurer. If the separate account performs poorly, the cash value (and in variable life, possibly the death benefit) can decrease.

Key Terms — Sub-Chapter 2.3

Term	Definition
Mortality Cost	The actuarial probability of death within a period; the core component of a life insurance premium.
Expense Loading	The insurer's operating costs added to the mortality cost to arrive at the gross premium.

Term	Definition
Investment Income Factor	The assumed rate of return the insurer will earn on collected premiums, which reduces the required premium.
Premium Mode	The frequency of premium payments: annual, semi-annual, quarterly, or monthly.
Individual Life Insurance	A contract covering a specific individual; underwritten individually; portable coverage.
Group Life Insurance	A master contract covering members of a group; group-underwritten; typically employer-sponsored.
Term Life Insurance	Coverage for a specified period only; no cash value; pure death protection.
Permanent Life Insurance	Lifelong coverage with a cash value component; includes whole life, universal life, and variable life.
Participating Policy	A policy that may pay dividends to policyholders from insurer surplus; issued by mutual insurers.
Nonparticipating Policy	A policy that does not pay dividends to policyholders; issued by stock insurers.
Fixed Life Insurance	Coverage with guaranteed or insurer-set death benefit and cash value growth; insurer bears investment risk.
Variable Life Insurance	Coverage with policyholder-directed investments in separate accounts; policyholder bears investment risk; requires securities license to sell.

Quick Quiz — Sub-Chapter 2.3

5 questions · Circle the best answer · Check your work using the Answer Key on the following page

1. The three factors used to calculate a life insurance premium are:
 - A. Age, gender, and occupation
 - B. Mortality cost, expense loading, and assumed investment income
 - C. Term length, face amount, and premium mode
 - D. Underwriting class, state of residence, and medical history

2. A policyowner chooses to pay her life insurance premium on a monthly basis rather than annually. Compared to the annual mode, the monthly mode will:
 - A. Cost less per year because the payments are spread out
 - B. Cost more per year because the insurer adds a service charge and loses investment opportunity
 - C. Cost exactly the same when totaled over the year
 - D. Reduce the death benefit proportionally

3. A producer wants to sell a variable universal life insurance policy to a client. In addition to a state life insurance license, the producer must also hold:
 - A. A property and casualty license
 - B. A surplus lines license
 - C. A FINRA securities license (Series 6 or 7)
 - D. A long-term care insurance certification

4. Which of the following BEST distinguishes group life insurance from individual life insurance?
 - A. Group life provides permanent coverage; individual life provides only term coverage
 - B. Group life requires individual underwriting for each certificate holder
 - C. Group life is underwritten on the group as a whole, with no individual evidence of insurability required for eligible members
 - D. Individual life is less expensive per dollar of coverage than group life

- 5.** A mutual insurer declares a dividend on its participating whole life policies. From the policyowner's perspective, this dividend is BEST described as:
- A. A taxable distribution of insurer profits
 - B. A guaranteed annual interest payment
 - C. A return of excess premium — generally not taxable unless it exceeds premiums paid
 - D. Additional death benefit added automatically to the policy

Answer Key — Quick Quiz — Sub-Chapter 2.3

Correct answers are shown below each question with a full explanation. Review any missed questions before moving on.

1. The three factors used to calculate a life insurance premium are:

- A. Age, gender, and occupation
- B. Mortality cost, expense loading, and assumed investment income**
- C. Term length, face amount, and premium mode
- D. Underwriting class, state of residence, and medical history

Explanation: Life insurance premiums are actuarially derived from three components: mortality cost (the probability of death, from mortality tables), expense loading (the insurer's operating costs added to the premium), and assumed investment income (the earnings rate the insurer expects to earn, which offsets the required premium). Age, gender, and other underwriting factors influence the mortality cost — they are inputs into the calculation, not the calculation components themselves.

2. A policyowner chooses to pay her life insurance premium on a monthly basis rather than annually.

Compared to the annual mode, the monthly mode will:

- A. Cost less per year because the payments are spread out
- B. Cost more per year because the insurer adds a service charge and loses investment opportunity**
- C. Cost exactly the same when totaled over the year
- D. Reduce the death benefit proportionally

Explanation: More frequent premium payment modes cost slightly more on an annualized basis. When a policyowner pays monthly instead of annually, the insurer does not receive the full year's premium upfront — losing the investment income it would have earned. The insurer also incurs higher administrative costs for processing monthly payments. These costs are passed on to the policyowner as a higher total annual premium.

3. A producer wants to sell a variable universal life insurance policy to a client. In addition to a state life insurance license, the producer must also hold:

- A. A property and casualty license
- B. A surplus lines license

C. A FINRA securities license (Series 6 or 7)

D. A long-term care insurance certification

Explanation: Variable life insurance products invest cash value in separate account subaccounts that function like securities. Because the policyholder bears the investment risk and the product involves the purchase of securities, producers must hold a FINRA securities license (Series 6 or 7) in addition to a state life insurance license. Selling variable products without the appropriate securities license is a serious regulatory violation.

4. Which of the following BEST distinguishes group life insurance from individual life insurance?

A. Group life provides permanent coverage; individual life provides only term coverage

B. Group life requires individual underwriting for each certificate holder

C. Group life is underwritten on the group as a whole, with no individual evidence of insurability required for eligible members

D. Individual life is less expensive per dollar of coverage than group life

Explanation: The defining characteristic of group life insurance is group underwriting — the insurer evaluates the group as a whole rather than requiring medical evidence from each individual member. Eligible employees are automatically covered without proving insurability. Individual life insurance requires case-by-case underwriting for each applicant. Group life is typically less expensive per dollar of coverage than individual life, making Choice D incorrect.

5. A mutual insurer declares a dividend on its participating whole life policies. From the policyowner's perspective, this dividend is BEST described as:

A. A taxable distribution of insurer profits

B. A guaranteed annual interest payment

C. A return of excess premium — generally not taxable unless it exceeds premiums paid

D. Additional death benefit added automatically to the policy

Explanation: Policy dividends from a mutual insurer are classified as a return of excess premium — money the policyowner overpaid that is being returned. Because it is a return of the policyowner's own funds, it is generally not taxable income unless the cumulative dividends received exceed the total premiums paid into the policy. Dividends are never guaranteed; they depend on the insurer's actual claims, expenses, and investment performance.

Sub-Chapter 2.4

Producer Responsibilities — Field Underwriting & Applications

Field Underwriting · Application Procedures · Conditional Receipts · Policy Delivery

Overview

The producer's work before and during the application process — known as field underwriting — is critical to the integrity of the insurance placement. Mistakes made at the application stage can result in denied claims, rescinded policies, errors and omissions liability, and regulatory violations. This sub-chapter covers the producer's specific duties from initial contact through policy delivery.

Field Underwriting

Field underwriting refers to the producer's role in pre-screening applicants before submitting an application to the insurer. A skilled producer gathers relevant information, identifies potential underwriting issues, and helps set realistic expectations for both the client and the insurer.

Key field underwriting responsibilities include:

- **Gathering accurate information:** Producers must ask all required application questions completely and honestly. They should never skip or omit questions, even if the answer might negatively affect insurability.
- **Notice of Information Practices:** Producers must inform applicants about the insurer's information-gathering practices, including the use of consumer reports and the Medical Information Bureau (MIB). Most states require this disclosure at or before the application.
- **Identifying red flags:** A producer should recognize when an applicant's health history, occupation, or lifestyle suggests underwriting issues — so they can prepare the client for possible classification as substandard or possible declination.
- **Not coaching answers:** A producer must never suggest or imply that the applicant should omit or soften health information on the application. Doing so constitutes fraud and can void the policy and expose both the producer and the insurer to liability.

EXAM TIP

A producer who helps an applicant conceal or minimize health information on a life insurance application is engaged in fraud — regardless of good intentions. The producer owes a duty of honesty to the insurer as well as to the applicant.

Application Procedures

Completing the Application

The application is the foundation of the insurance contract and forms part of the policy when issued.

Accuracy is essential. The producer should:

- Use the applicant's own words when recording health history answers — do not paraphrase in a way that minimizes disclosed conditions.
- Have the applicant review the completed application before signing.
- Ensure the applicant signs and dates the application personally.
- Retain a copy for the producer's records.

Collecting the Initial Premium

Whether the producer collects the initial premium with the application determines when and how coverage begins:

- **Premium collected with application:** If the initial premium is paid with the application, the producer typically gives the applicant a conditional receipt (also called a binding receipt or premium receipt). This may provide coverage immediately under certain conditions.
- **No premium collected with application:** Coverage does not begin until the policy is issued, delivered to the applicant, and the first premium is paid while the applicant is in good health.

Conditional Receipts

A conditional receipt is given to the applicant when the initial premium is collected with the application.

It provides temporary (interim) coverage, but only on certain conditions:

- **Insurability condition:** The most common type. Coverage is effective as of the application date IF the applicant is found to be insurable at the applied-for rate. If the applicant is not insurable at standard rates, coverage does not attach retroactively.

- **Binding receipt:** Less common. Provides coverage immediately and unconditionally from the date of the receipt, regardless of whether the applicant would qualify for the applied-for policy. The insurer is bound even if the applicant dies before formal underwriting is completed.

FREQUENTLY TESTED

Conditional receipts are heavily tested. The key distinction: an insurability conditional receipt provides coverage retroactive to the application date IF the applicant would have qualified. A binding receipt provides immediate coverage regardless of insurability. Know which is more common (insurability type) and which provides broader protection (binding).

Policy Delivery

Once the insurer approves the application and issues the policy, the producer's delivery responsibilities begin. Proper delivery is not merely handing over a document — it involves several important steps:

Delivery Requirements

- **Deliver the policy promptly:** Most state laws and agency standards require delivery within a reasonable time after issue — typically 10 to 14 days.
- **Collect the first premium (if not already collected):** If no premium was collected at application, the first premium must be collected at delivery for coverage to take effect.
- **Statement of Good Health:** If there was a delay between application and delivery, and the applicant's health may have changed, the insurer may require the applicant to sign a Statement of Good Health confirming they remain insurable before the policy takes effect.
- **Policy review:** The producer should walk the client through the policy — explaining coverage amounts, premium amounts, beneficiary designations, key provisions, and exclusions.
- **Right to Examine (Free Look):** All life insurance policies include a free look period — typically 10 days — during which the policyowner may return the policy for a full premium refund, no questions asked. The producer must inform the client of this right.

KEY CONCEPT

The effective date of coverage depends on when the first premium is paid and good health exists. If premium is paid at application with a conditional receipt, coverage may be retroactive to the application date. If premium is not paid until delivery, coverage begins at delivery — provided the applicant is still in good health.

Key Terms — Sub-Chapter 2.4

Term	Definition
Field Underwriting	The producer's role in pre-screening applicants, gathering accurate information, and identifying underwriting issues before application submission.
Notice of Information Practices	Required disclosure to applicants about how the insurer will collect and use their personal information.
Conditional Receipt	A receipt given when initial premium is collected with the application, providing temporary coverage subject to specified conditions.
Insurability Conditional Receipt	Provides coverage retroactive to the application date if the applicant is found to be insurable at the applied-for classification.
Binding Receipt	Provides immediate, unconditional coverage from the date of the receipt regardless of whether the applicant is ultimately found insurable.
Statement of Good Health	A declaration signed at policy delivery that the applicant's health has not materially changed since the application date.
Free Look Period	A mandatory period (typically 10 days) during which the new policyowner may return the policy for a full premium refund.
Effective Date of Coverage	The date on which life insurance coverage begins — determined by when the premium is paid and whether the applicant meets insurability requirements.
Policy Delivery	The physical or constructive delivery of the insurance policy to the policyowner, completing the contract formation.

Quick Quiz — Sub-Chapter 2.4

5 questions · Circle the best answer · Check your work using the Answer Key on the following page

1. A producer is completing a life insurance application with a client. The client mentions a health condition but asks the producer to "just leave it off" the application to avoid higher premiums. The producer should:

- A. Omit the condition since the client requested it and the client is the applicant
- B. Record the condition accurately — omitting material health information is fraud and can void the policy
- C. Note the condition privately and disclose it to the insurer separately, outside the application
- D. Submit the application without the condition and disclose it only if a claim is filed

2. A producer collects the initial premium with the application and gives the applicant a conditional receipt. The applicant dies three days later before the insurer completes underwriting. The insurer determines that the applicant would NOT have qualified for the policy at standard rates. Under an insurability conditional receipt, the insurer will:

- A. Pay the full death benefit regardless, because the receipt bound coverage from the application date
- B. Deny the claim because the applicant was not insurable at the applied-for rate
- C. Pay a reduced benefit equal to premiums paid plus interest
- D. Refund the premium and automatically issue a substandard policy

3. A life insurance policy was issued and mailed to the producer on March 1. The producer does not deliver it to the client until April 15. During that time, the client was involved in a car accident and suffered significant injuries. Upon delivery, the insurer requires the client to sign a Statement of Good Health. The client should:

- A. Sign the statement — it is a formality with no legal significance
- B. Decline to sign and ask that the policy be backdated to March 1
- C. Consult with the producer about the accident — signing the statement falsely after a material health change would be a misrepresentation
- D. Sign the statement and then disclose the accident to the insurer later

- 4.** Which of the following BEST describes the free look period in a life insurance policy?
- A. A period during which the insurer may rescind the policy for any reason
 - B. A mandatory period during which the policyowner may return the policy for a full premium refund
 - C. A period during which the death benefit is reduced while the insurer completes underwriting
 - D. The period before the first premium is due during which coverage is conditional
- 5.** A life insurance application is submitted without an initial premium payment. Under these circumstances, when does coverage begin?
- A. On the date the application is signed
 - B. On the date the application is received by the insurer
 - C. On the date the policy is issued by the insurer
 - D. When the policy is delivered and the first premium is paid while the applicant is in good health

Answer Key — Quick Quiz — Sub-Chapter 2.4

Correct answers are shown below each question with a full explanation. Review any missed questions before moving on.

1. A producer is completing a life insurance application with a client. The client mentions a health condition but asks the producer to "just leave it off" the application to avoid higher premiums. The producer should:

- A. Omit the condition since the client requested it and the client is the applicant
- B. Record the condition accurately — omitting material health information is fraud and can void the policy**
- C. Note the condition privately and disclose it to the insurer separately, outside the application
- D. Submit the application without the condition and disclose it only if a claim is filed

Explanation: Recording health information accurately is a fundamental producer responsibility. Omitting a known material health condition at the applicant's request is fraud — regardless of who initiates it. A policy issued based on fraudulent information can be voided at any time. The producer's duty of honest disclosure to the insurer cannot be overridden by the applicant's request.

2. A producer collects the initial premium with the application and gives the applicant a conditional receipt. The applicant dies three days later before the insurer completes underwriting. The insurer determines that the applicant would NOT have qualified for the policy at standard rates. Under an insurability conditional receipt, the insurer will:

- A. Pay the full death benefit regardless, because the receipt bound coverage from the application date
- B. Deny the claim because the applicant was not insurable at the applied-for rate**
- C. Pay a reduced benefit equal to premiums paid plus interest
- D. Refund the premium and automatically issue a substandard policy

Explanation: An insurability conditional receipt provides coverage retroactive to the application date ONLY if the applicant would have qualified for the policy at the applied-for rate. If underwriting reveals the applicant was not insurable at standard rates, coverage never attached — even though the receipt was issued. This is the key distinction from a binding receipt, which would provide coverage regardless of insurability.

3. A life insurance policy was issued and mailed to the producer on March 1. The producer does not deliver it to the client until April 15. During that time, the client was involved in a car accident and suffered significant injuries. Upon delivery, the insurer requires the client to sign a Statement of Good Health. The client should:

- A. Sign the statement — it is a formality with no legal significance
- B. Decline to sign and ask that the policy be backdated to March 1
- C. Consult with the producer about the accident — signing the statement falsely after a material health change would be a misrepresentation**
- D. Sign the statement and then disclose the accident to the insurer later

Explanation: A Statement of Good Health is a representation that the applicant's health has not materially changed since the application. Signing it falsely — after a significant accident that may affect insurability — would be a material misrepresentation. The client and producer should disclose the accident to the insurer before the statement is signed. Delivering the policy without disclosing the change in health could expose both the client and producer to fraud liability.

4. Which of the following BEST describes the free look period in a life insurance policy?

- A. A period during which the insurer may rescind the policy for any reason
- B. A mandatory period during which the policyowner may return the policy for a full premium refund**
- C. A period during which the death benefit is reduced while the insurer completes underwriting
- D. The period before the first premium is due during which coverage is conditional

Explanation: The free look period (right to examine) is a mandatory consumer protection provision that gives new policyowners a set number of days — typically 10, though some states require longer — to review the policy and return it for a full premium refund if unsatisfied. The producer must inform clients of this right at delivery. The insurer cannot impose conditions on the return during the free look period.

5. A life insurance application is submitted without an initial premium payment. Under these circumstances, when does coverage begin?

- A. On the date the application is signed
- B. On the date the application is received by the insurer
- C. On the date the policy is issued by the insurer

D. When the policy is delivered and the first premium is paid while the applicant is in good health

Explanation: Without a premium payment at application, no conditional receipt is issued and no coverage exists until the policy is formally delivered and the first premium is collected. Additionally, if there has been a delay between application and delivery, most insurers require the applicant to still be in good health at the time of delivery. The effective date of coverage is the delivery date when the first premium is paid and good health exists.

Sub-Chapter 2.5

Individual Underwriting, Risk Classification & Life Insurance Regulations

Underwriting Sources · Risk Classes · Illustrations · Replacement · Advertising

Overview

Once an application is submitted, the insurer's underwriting department evaluates the risk and makes coverage decisions. This sub-chapter covers the sources of information used in underwriting, how risks are classified, and the regulatory framework governing life insurance marketing — including illustrations, replacement rules, and advertising standards.

Sources of Underwriting Information

The insurer gathers information from multiple sources to assess an applicant's risk profile:

The Application

The application is the primary source of underwriting information. It captures the applicant's health history, family medical history, occupation, hobbies, tobacco use, financial information, and existing insurance. The accuracy of application answers directly affects the insurer's ability to properly classify and price the risk.

Producer Report

The producer submits a separate report to the insurer providing observations about the applicant — including the applicant's appearance, demeanor, and any financial or lifestyle factors relevant to underwriting. The producer's report is a required part of the submission package for most policies.

Attending Physician Statement (APS)

For applicants with significant health histories, the insurer may request an Attending Physician Statement — a report from the applicant's treating physician providing detailed medical records and clinical observations. The insurer pays for the APS; the applicant does not.

Investigative Consumer (Inspection) Report

For larger policies, the insurer may commission an inspection report from an independent investigative agency. This report gathers information about the applicant's lifestyle, habits, finances, and character through interviews with the applicant, neighbors, or associates. The Fair Credit Reporting Act (FCRA) governs the use of consumer reports in underwriting, and applicants must be notified when an investigative consumer report is ordered.

Medical Information Bureau (MIB)

The Medical Information Bureau (MIB) is a nonprofit organization maintained by member insurance companies. When a company underwrites a life or health insurance application, it may report coded information about significant medical conditions or other risk factors discovered during underwriting to the MIB. Future applications to other MIB member companies can then be checked against this database. Applicants must be notified that the MIB may be consulted.

FREQUENTLY TESTED

The MIB is a shared database used by member insurers to identify undisclosed health information across applications. Applicants must be notified that it may be consulted. The MIB does not make underwriting decisions — it only provides coded information that the insurer then evaluates.

Medical Examinations and Lab Tests

For larger face amounts or older applicants, the insurer may require a paramedic exam, full physical, or specific lab tests (blood chemistry, urinalysis, EKG, HIV test). The insurer pays for required exams. HIV testing requires separate informed consent in most states, and results are handled with strict confidentiality requirements.

EXAM TIP

The insurer pays for all required medical exams and lab tests — not the applicant. HIV testing requires informed consent and carries strict confidentiality requirements under state and federal law.

Risk Classification

After gathering all underwriting information, the insurer assigns the applicant to a risk class:

- **Preferred (Preferred Best, Super Preferred):** Applicants with excellent health, no significant health history, healthy lifestyle, favorable family history, and no hazardous occupations or hobbies. Receive the lowest premiums.
- **Standard:** Applicants who meet the insurer's normal underwriting criteria — average health, no major health issues, typical lifestyle. Receive standard rates.
- **Substandard (Rated):** Applicants with health issues, hazardous occupations, dangerous hobbies, or other elevated risk factors. May be offered coverage with a higher premium (table rating), an exclusion rider for the specific condition, or a flat extra premium.

- **Declined:** Applicants who present uninsurable risk — the insurer refuses to issue coverage at any price.

MEMORY AID

Risk classes from best to worst: Preferred → Standard → Substandard → Declined. Preferred = lowest premium. Substandard = rated up (table rating, flat extra, or exclusion rider). Declined = no coverage offered.

Life Insurance Illustrations

A life insurance illustration is a computer-generated projection showing how a policy is expected to perform under specified assumptions — typically including a guaranteed scenario and a non-guaranteed (current) scenario. Illustrations are used as sales and educational tools.

- **Policy Summary:** A written summary of a life insurance policy's key features provided to applicants. Required to be delivered with or before the policy.
- **Buyer's Guide:** A general consumer education document published by state insurance departments or insurers that explains how life insurance works, how to determine how much to buy, and how to compare policies. Required to be provided at or before the time of application.

EXAM TIP

Illustrations must show BOTH guaranteed and non-guaranteed values. Non-guaranteed values (such as projected dividends or interest credits) are based on current assumptions and are not guaranteed. Producers must not imply that non-guaranteed projections are guaranteed outcomes.

Replacement of Life Insurance

Replacement occurs when a new life insurance policy is purchased and an existing policy is lapsed, surrendered, converted, or otherwise terminated in connection with or in anticipation of the new purchase.

Replacement regulations protect consumers from being disadvantaged by unnecessary replacements. Key requirements:

- **Replacement notice:** The producer must provide a written Notice Regarding Replacement to the applicant, disclosing that a replacement is occurring and the potential advantages and disadvantages.
- **Comparison required:** The producer must provide a comparison of the existing and proposed policies so the client can make an informed decision.
- **Insurer notification:** The replacing insurer must notify the existing insurer that a replacement is taking place.
- **Twisting prohibition:** Twisting is the use of misrepresentation or incomplete comparisons to induce a policyowner to replace one policy with another to the policyowner's detriment. Twisting is an unfair trade practice and is prohibited.
- **Churning prohibition:** Churning occurs when a producer replaces the client's existing policy with a new one primarily to generate a new commission, to the client's disadvantage. Also a prohibited practice.

COMMON MISTAKE

Twisting and churning are both replacement-related prohibited practices, but they differ. Twisting involves misrepresentation to induce a replacement. Churning involves replacing a client's own policy unnecessarily to earn another commission — typically within the same insurer. Both harm the consumer and violate state insurance laws.

Advertising and Solicitation Standards

Life insurance advertising is regulated by state insurance departments to ensure that it is truthful, complete, and not misleading. Key standards:

- Advertisements must clearly identify the insurer and the type of product being advertised.
- Illustrations in advertisements must be based on reasonable assumptions and must distinguish guaranteed from non-guaranteed values.
- Advertisements must not use exaggerated claims, misleading comparisons, or incomplete disclosures of costs or limitations.
- Any advertisement that includes a comparison to another insurer or product must be fair, accurate, and complete.

Key Terms — Sub-Chapter 2.5

Term	Definition
Attending Physician Statement (APS)	A detailed medical report from the applicant's treating physician, requested by the insurer for complex health histories.
Investigative Consumer Report	An inspection report gathering lifestyle, character, and financial information about an applicant from interviews and records.
Medical Information Bureau (MIB)	A nonprofit database shared by member insurers to identify undisclosed health information across applications.
Preferred Risk	An applicant with excellent health and lifestyle; qualifies for the lowest available premiums.
Standard Risk	An applicant meeting average underwriting criteria; receives standard rates.
Substandard Risk	An applicant with elevated risk factors; may be offered coverage with a table rating, flat extra premium, or exclusion rider.
Table Rating	A method of pricing substandard risk by adding a percentage surcharge to the standard premium.
Flat Extra Premium	A fixed dollar amount added to the standard premium for a specific hazard (e.g., a dangerous occupation).
Life Insurance Illustration	A projection showing guaranteed and non-guaranteed policy values under specified assumptions; used as a sales tool.
Policy Summary	A written summary of key policy features, required to be provided at or before policy delivery.
Buyer's Guide	A consumer education document explaining life insurance basics, required to be provided at or before application.
Replacement	Purchasing a new life insurance policy while terminating or reducing an existing policy.

Term	Definition
Twisting	Using misrepresentation or incomplete comparisons to induce a policyowner to replace a policy to their detriment — a prohibited practice.
Churning	Replacing a client's existing policy with a new one primarily to generate a new commission — a prohibited practice.

Quick Quiz — Sub-Chapter 2.5

5 questions · Circle the best answer · Check your work using the Answer Key on the following page

1. An insurer orders a report from an independent agency that gathers information about a life insurance applicant's lifestyle, finances, and reputation by interviewing neighbors and associates. The applicant must be notified that this report was ordered. This is called a:
 - A. Medical Information Bureau (MIB) inquiry
 - B. Attending physician statement
 - C. Investigative consumer (inspection) report
 - D. Producer's field report

2. The Medical Information Bureau (MIB) is BEST described as:
 - A. A federal agency that issues underwriting guidelines to all life insurers
 - B. A shared nonprofit database used by member insurers to identify coded health information disclosed on prior applications
 - C. A state insurance department database tracking all life insurance policies issued in the state
 - D. A rating organization that assigns financial strength grades to insurance companies

3. A producer shows a client a life insurance illustration that projects cash values and dividends based on current, non-guaranteed assumptions. The producer states: "These numbers are what you'll definitely have at retirement." This statement:
 - A. Is acceptable because the illustration comes from the insurer
 - B. Is a misrepresentation — non-guaranteed values are projections only and may not materialize
 - C. Is permissible if the illustration also shows guaranteed values
 - D. Is acceptable only for participating policies

4. A producer convinces a client to surrender a fully paid-up whole life policy — which required no further premium payments — and replace it with a new policy that requires significant ongoing premiums. The producer's motivation is to earn a new first-year commission. This is an example of:
 - A. Twisting
 - B. Churning
 - C. Rebating

D. Replacement with proper disclosure

5. An applicant for life insurance is found to have well-controlled Type 2 diabetes and a body mass index slightly above ideal. The insurer issues the policy but charges a premium that is 50% higher than the standard rate. This practice is called:

- A. Declination
- B. Flat extra premium
- C. Table rating (substandard rating)
- D. Exclusion rider

Answer Key — Quick Quiz — Sub-Chapter 2.5

Correct answers are shown below each question with a full explanation. Review any missed questions before moving on.

1. An insurer orders a report from an independent agency that gathers information about a life insurance applicant's lifestyle, finances, and reputation by interviewing neighbors and associates. The applicant must be notified that this report was ordered. This is called a:

- A. Medical Information Bureau (MIB) inquiry
- B. Attending physician statement
- C. Investigative consumer (inspection) report**
- D. Producer's field report

Explanation: An investigative consumer (inspection) report gathers personal information about the applicant through interviews with neighbors, associates, or others — going beyond the application itself to assess lifestyle, character, and financial stability. The Fair Credit Reporting Act requires insurers to notify applicants when such a report is ordered. It is different from an APS (which comes from the treating physician) and from the MIB (a shared database of prior underwriting information).

2. The Medical Information Bureau (MIB) is BEST described as:

- A. A federal agency that issues underwriting guidelines to all life insurers
- B. A shared nonprofit database used by member insurers to identify coded health information disclosed on prior applications**
- C. A state insurance department database tracking all life insurance policies issued in the state
- D. A rating organization that assigns financial strength grades to insurance companies

Explanation: The MIB is a nonprofit cooperative database maintained by member life and health insurance companies. When an insurer underwrites an application, it may submit coded information about significant risk factors to the MIB. Member insurers can then query the MIB when underwriting future applications to identify potentially undisclosed health information. Applicants must be informed that the MIB may be consulted. The MIB does not make underwriting decisions — it only provides information for the insurer's review.

3. A producer shows a client a life insurance illustration that projects cash values and dividends based on current, non-guaranteed assumptions. The producer states: "These numbers are what you'll definitely have at retirement." This statement:

- A. Is acceptable because the illustration comes from the insurer
- B. Is a misrepresentation — non-guaranteed values are projections only and may not materialize**
- C. Is permissible if the illustration also shows guaranteed values
- D. Is acceptable only for participating policies

Explanation: Representing non-guaranteed values as guaranteed outcomes is a misrepresentation — one of the most common violations in life insurance sales. Illustrations must distinguish between guaranteed and non-guaranteed values. The producer must make clear to clients that non-guaranteed projections (dividends, interest credits, excess returns) are based on current assumptions and may not be achieved. Presenting them as certainties is a regulatory violation.

4. A producer convinces a client to surrender a fully paid-up whole life policy — which required no further premium payments — and replace it with a new policy that requires significant ongoing premiums. The producer's motivation is to earn a new first-year commission. This is an example of:

- A. Twisting
- B. Churning**
- C. Rebating
- D. Replacement with proper disclosure

Explanation: Churning occurs when a producer replaces an existing policy with a new one primarily to generate a new commission, to the client's detriment. Surrendering a paid-up policy (requiring no more premiums) to buy a new policy requiring significant ongoing premiums, with the producer's motivation being commission, is a classic churning scenario. Twisting involves misrepresentation to induce replacement. Rebating involves giving back part of the commission as an inducement to purchase.

5. An applicant for life insurance is found to have well-controlled Type 2 diabetes and a body mass index slightly above ideal. The insurer issues the policy but charges a premium that is 50% higher than the standard rate. This practice is called:

- A. Declination
- B. Flat extra premium

C. Table rating (substandard rating)

D. Exclusion rider

Explanation: A table rating (substandard rating) applies a percentage surcharge to the standard premium for applicants who present elevated but still-insurable risk. The additional premium compensates the insurer for the higher expected mortality or morbidity. A flat extra premium adds a fixed dollar amount per \$1,000 of coverage (often used for occupational hazards). An exclusion rider limits coverage for a specific condition without increasing the overall premium. Declination means no coverage is offered.

Master Key Terms — Chapter 2

All key terms from Chapter 2 — formatted for flashcard use.

Term	Definition
Estate Creation	Using life insurance to immediately create a financial estate for beneficiaries.
Income Replacement	Replacing the deceased wage earner's lost income for surviving dependents.
Cash Accumulation	Tax-deferred cash value growth in permanent life insurance, accessible during the insured's lifetime.
Liquidity	Immediate cash from life insurance proceeds to pay taxes or debts without forced asset sales.
Estate Conservation	Using life insurance to pay estate taxes and preserve estate value for heirs.
Key Person Insurance	Business-owned life insurance on an essential employee; business is owner and beneficiary.
Buy-Sell Agreement	Legal agreement between co-owners funded by life insurance to facilitate business ownership transfer at death.
Cross-Purchase Plan	Each co-owner buys a policy on every other co-owner to fund a buy-sell agreement.
Entity Purchase Plan	The business buys policies on each owner and redeems a deceased owner's interest.
Human Life Value Approach	Determines life insurance need by calculating the present value of the insured's projected future earnings.
Needs Approach	Determines insurance need by identifying specific financial obligations and netting out existing resources.

Term	Definition
Lump-Sum Needs	One-time expenses at death: final expenses, debts, estate costs, education funding.
Income Needs	Ongoing living expenses survivors face over time, including family income and retirement needs.
Blackout Period	Period between youngest child turning 16 and surviving spouse reaching age 60, during which Social Security survivor benefits are suspended.
Mortality Cost	The actuarial probability of death — the core component of a life insurance premium.
Expense Loading	The insurer's operating costs added to the mortality cost to produce the gross premium.
Premium Mode	Frequency of premium payment: annual (least expensive) through monthly (most expensive).
Term Life Insurance	Coverage for a specified period only; no cash value; pure death protection.
Permanent Life Insurance	Lifelong coverage with cash value; includes whole life, universal life, and variable life.
Participating Policy	May pay dividends to policyholders from insurer surplus; issued by mutual insurers.
Nonparticipating Policy	Does not pay dividends to policyholders; issued by stock insurers.
Variable Life Insurance	Cash value invested in separate accounts; policyholder bears investment risk; requires securities license to sell.
Field Underwriting	The producer's pre-screening role: gathering accurate information and identifying underwriting issues before submission.
Conditional Receipt	Temporary coverage receipt given when initial premium is collected with the application.

Term	Definition
Insurability Conditional Receipt	Coverage retroactive to application date IF the applicant is found insurable at the applied-for rate.
Binding Receipt	Immediate, unconditional coverage from receipt date regardless of insurability determination.
Statement of Good Health	Declaration signed at delivery that the applicant's health has not materially changed since application.
Free Look Period	Mandatory period (typically 10 days) to return a new policy for a full premium refund.
Attending Physician Statement (APS)	Detailed medical report from treating physician, ordered by insurer for complex health histories.
Investigative Consumer Report	Inspection report on applicant's lifestyle and character gathered through third-party interviews.
Medical Information Bureau (MIB)	Shared nonprofit database of coded underwriting information used by member insurers.
Table Rating	A percentage surcharge above standard premium for substandard risk applicants.
Flat Extra Premium	A fixed dollar amount added to the standard premium for a specific occupational or lifestyle hazard.
Life Insurance Illustration	A projection of guaranteed and non-guaranteed policy values used as a sales and disclosure tool.
Buyer's Guide	Consumer education document on life insurance basics, required at or before application.
Policy Summary	Written summary of key policy features, required at or before policy delivery.
Replacement	Purchasing a new life insurance policy while terminating or reducing an existing one.

Term	Definition
Twisting	Using misrepresentation to induce a policyowner to replace a policy to their detriment — prohibited.
Churning	Replacing a client's policy primarily to generate a new commission — prohibited.

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