PSI Insurance Practice Exam Sample Study Guide

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Featuring practice questions, answers, and explanations for each question.

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Questions

1. **Compared to basic hospital and medical policies, which type of insurance provides broader coverage?**

   A. Basic health insurance

   B. Major medical insurance

   C. Critical illness insurance

   D. Short-term health insurance

2. **When does insurable interest come into play in a life insurance policy?**

   A. When the application is submitted.

   B. When the applicant for the policy is not the insured.

   C. When the premium is paid.

   D. When a policy matures.

3. **Which of the following is not affected by the time limit on certain defenses in health insurance policies?**

   A. Pre-existing conditions

   B. Fraudulent misstatements

   C. Material misrepresentation

   D. Non-payment of premiums

4. **If a life insurance policy is deemed a Modified Endowment Contract (MEC), how are the withdrawals treated for taxation purposes?**

   A. They are fully taxable.

   B. They are treated as taxable income.

   C. They are on a LIFO (last-in first-out) basis.

   D. They are tax-free.

5. **A Business Disability Buy-Sell Policy is designed to assist with what?**

   A. Retirement of a businessowner

   B. Disability of a businessowner

   C. Sales of stock

   D. Allocation of profits

6. What is the main benefit of having a trust as a beneficiary in a life insurance policy?

A. It simplifies the claims process.

B. It provides direct access to funds.

C. It offers better tax advantages.

D. It helps manage the distribution of proceeds.

7. Offer, acceptance, and consideration are necessary elements of what?

A. A policy document

B. A legal contract

C. Insurance underwriting

D. A claim process

8. What does a payor clause in insurance provide for?

A. Coverage for the insured's dependents

B. Continuation of coverage for a juvenile in case of the payor's death

C. Relief of premium payments during disability

D. Waiving the deductible in the event of death

9. Which of the following is true regarding Medicaid?

A. It is a private program for high-income earners

B. It assists individuals with insufficient income to pay for medical care

C. It requires a premium payment

D. It is only available to elderly individuals

10. Which policy provides benefits for in-hospital medical treatment and surgery, along with certain outpatient expenses?

A. Health insurance

B. Hospitalization insurance

C. Disability insurance

D. Major medical insurance

Answers

1. B
2. B
3. B
4. C
5. B
6. D
7. B
8. B
9. B
10. B

Explanations

1. Compared to basic hospital and medical policies, which type of insurance provides broader coverage?

A. Basic health insurance

B. Major medical insurance

C. Critical illness insurance

D. Short-term health insurance

Major medical insurance is designed to provide a more comprehensive level of coverage compared to basic hospital and medical policies. Basic policies typically cover only a limited number of specific medical services and often have low benefit limits. In contrast, major medical insurance covers a broader range of healthcare expenses, including hospitalization, preventive care, outpatient services, and sometimes even long-term rehabilitation services. Additionally, major medical plans usually feature higher benefit limits and a greater scope of coverage, which can include substantial expenses related to serious illnesses and injuries. The emphasis of major medical insurance is on providing financial protection for significant medical costs, whereas basic health insurance might leave individuals with substantial out-of-pocket expenses for serious medical needs. This comprehensive approach of major medical insurance ensures that policyholders have more robust protection when it comes to their healthcare needs.

2. When does insurable interest come into play in a life insurance policy?

A. When the application is submitted.

B. When the applicant for the policy is not the insured.

C. When the premium is paid.

D. When a policy matures.

Insurable interest must be established at the time the policy is created, which is typically when the application for the life insurance policy is submitted. In the context of life insurance, insurable interest is the legal and financial stake that the policyholder has in the life of the insured. This means that the policyholder should have a legitimate interest in the continued life of the insured; otherwise, the contract could be considered a wager and void under law. The importance of insurable interest is emphasized particularly when the applicant for the policy is not the insured individual. In this situation, it becomes crucial that the applicant can prove a valid insurable interest in the life of the insured at the time the policy is applied for. If the applicant has no insurable interest, the policy may be declared void, as it exists to provide financial protection against the risk of the insured’s death. This concept ensures that life insurance serves its intended purpose, which is to provide financial security for those who have a meaningful relationship or dependency on the insured. In contrast, the other options do not accurately represent the point at which insurable interest must be verified or do not pertain to the overall principles behind insurable interest in a life insurance context.

3. Which of the following is not affected by the time limit on certain defenses in health insurance policies?

A. Pre-existing conditions

B. Fraudulent misstatements

C. Material misrepresentation

D. Non-payment of premiums

In health insurance policies, the time limit on certain defenses is designed to protect policyholders by preventing insurers from contesting claims based on certain grounds after a specific period, usually two years. The options presented relate to various aspects of the insurance contract. Pre-existing conditions are affected by the time limit, as insurers can typically impose limitations on coverage for conditions that existed before the policy was effective, but these limitations often expire after a certain duration. Fraudulent misstatements, however, are not subject to the same time limitations. If a policyholder commits fraud by misrepresenting information to the insurer, the insurer retains the right to deny claims or rescind the policy at any time, without being bound by a time limit. This ensures that policyholders cannot benefit from dishonest actions, reinforcing the importance of truthful declarations in obtaining insurance coverage. Material misrepresentation also falls under the time limit on certain defenses; insurers can only contest claims based on material misrepresentations if raised within the specified period. Non-payment of premiums is a different matter, as it pertains to the ongoing obligations of policyholders. While insurers typically can cancel a policy for non-payment at any time, this issue does not relate directly to the defenses that have time limits. Thus, the

4. If a life insurance policy is deemed a Modified Endowment Contract (MEC), how are the withdrawals treated for taxation purposes?

A. They are fully taxable.

B. They are treated as taxable income.

C. They are on a LIFO (last-in first-out) basis.

D. They are tax-free.

When a life insurance policy becomes classified as a Modified Endowment Contract (MEC), the tax treatment of withdrawals differs from that of a standard life insurance policy. Specifically, withdrawals from a MEC are treated on a last-in, first-out (LIFO) basis. This means that any amount withdrawn is considered to come from the most recent premiums paid into the policy first. Under this LIFO approach, any withdrawals are subject to taxation to the extent that they exceed the total contributions made by the policyholder. For instance, since the earnings (or gains) on the policy are considered to be withdrawn first, they are taxable as ordinary income. This contrasts with non-MEC policies, where withdrawals typically come from the cost basis first and can be tax-free up to the amount of premiums paid. In summary, the treatment of withdrawals from a MEC as LIFO results in a taxation mechanism where the earnings in the policy are taxed upon withdrawal, aligning with tax regulation rules governing Modified Endowment Contracts.

5. A Business Disability Buy-Sell Policy is designed to assist with what?

A. Retirement of a businessowner

B. Disability of a businessowner

C. Sales of stock

D. Allocation of profits

A Business Disability Buy-Sell Policy is specifically designed to provide financial resources to undertake the transfer of ownership of a business when a business owner becomes disabled. The principle behind this type of policy is to ensure that remaining business partners or shareholders can buy out the disabled owner's share of the business without facing significant financial strain. When a business owner becomes disabled and cannot continue to manage their part of the company, the policy facilitates a smooth transition by enabling the business to use the insurance proceeds to purchase the disabled owner's interest. This helps maintain business continuity and avoids potential disputes among partners regarding the management and ownership of the business during the owner's period of incapacity. While options related to retirement, stock sales, and profit allocation are important aspects of business management and finance, they do not specifically pertain to the unique role of a Business Disability Buy-Sell Policy, which focuses solely on the circumstances surrounding a business owner's disability.

6. What is the main benefit of having a trust as a beneficiary in a life insurance policy?

A. It simplifies the claims process.

B. It provides direct access to funds.

C. It offers better tax advantages.

D. It helps manage the distribution of proceeds.

Having a trust as a beneficiary in a life insurance policy primarily helps manage the distribution of proceeds. This structure allows for more precise control over how and when the insurance benefits are allocated to the beneficiaries. Trusts can specify terms for distributions, such as staggered payments over time or conditions that must be met for beneficiaries to receive their inheritance. This can be particularly useful in situations where the beneficiaries are minors or may not be financially responsible, ensuring that the funds are used for their intended purpose. While simplifying the claims process, providing direct access to funds, or offering tax advantages may be relevant considerations, the central strength of naming a trust as a beneficiary lies in its ability to effectively manage and protect the proceeds for the future benefit of the named beneficiaries.

7. Offer, acceptance, and consideration are necessary elements of what?

A. A policy document

B. A legal contract

C. Insurance underwriting

D. A claim process

The necessary elements of offer, acceptance, and consideration are foundational to a legal contract. In contract law, an offer is made by one party, which is then accepted by another party, creating mutual agreement. Consideration refers to something of value that is exchanged between the parties, which is essential for the contract to be enforceable. In the context of insurance, a policy document is indeed a type of legal contract between the insurer and the insured, but the question specifically asks for the broader concept that encompasses these elements. Insurance underwriting relates to the process of evaluating risks and determining the terms of the insurance policy, while the claim process involves the submission and evaluation of claims under the existing policy terms, neither of which fundamentally requires the trio of offer, acceptance, and consideration as core components. Thus, recognizing that these three elements are integral to crafting a legal agreement confirms the choice regarding the answer.

8. What does a payor clause in insurance provide for?

A. Coverage for the insured's dependents

B. Continuation of coverage for a juvenile in case of the payor's death

C. Relief of premium payments during disability

D. Waiving the deductible in the event of death

The payor clause in insurance specifically provides for the continuation of coverage for a juvenile in the event of the payor's death. This clause is often included in life insurance policies or similar products where a parent or guardian is responsible for premium payments on a policy that covers a child. If the payor were to pass away, the payor clause ensures that the policy remains in force without requiring additional premium payments, safeguarding the child's insurance coverage during a critical time. This helps to prevent the loss of coverage due to financial hardship resulting from the death of the payor, ensuring that the juvenile continues to have access to the benefits of the insurance policy.

9. Which of the following is true regarding Medicaid?

A. It is a private program for high-income earners

B. It assists individuals with insufficient income to pay for medical care

C. It requires a premium payment

D. It is only available to elderly individuals

Medicaid is a government program specifically designed to assist individuals and families with insufficient income in accessing necessary medical care. It primarily targets low-income residents, providing coverage for vital health services such as hospital visits, doctor appointments, and long-term care. This program is based on need rather than income level or age, making it an essential safety net for those who would otherwise struggle to afford healthcare. The characteristics of Medicaid include its ability to cover a broad range of medical services and its accessibility to various demographic groups, including low-income children, pregnant women, parents, people with disabilities, and elderly individuals, among others. By focusing on helping those who face financial barriers to obtaining healthcare, Medicaid plays a critical role in the overall healthcare system, helping to ensure that essential medical services are available to the most vulnerable populations.

10. Which policy provides benefits for in-hospital medical treatment and surgery, along with certain outpatient expenses?

A. Health insurance

B. Hospitalization insurance

C. Disability insurance

D. Major medical insurance

The policy that specifically provides benefits for in-hospital medical treatment and surgery, along with certain outpatient expenses, is hospitalization insurance. This type of insurance is designed primarily to cover the costs associated with a patient's stay in a hospital, including surgical procedures and associated expenses that may occur during the outpatient phase, such as follow-up care or certain outpatient treatments. Hospitalization insurance is tailored to ensure that insured individuals can receive necessary medical care when hospitalized without facing overwhelming financial burdens. It is focused on providing coverage for in-patient services and may include provisions for certain outpatient services that closely follow or are necessary for the treatment received during hospitalization. While health insurance encompasses a broader range of healthcare services, including preventive care and outpatient visits, it may not specifically highlight the in-hospital focus like hospitalization insurance does. Major medical insurance tends to cover a wider array of healthcare needs, including catastrophic medical situations and comprehensive benefits, but again, it is not solely focused on hospitalization. Disability insurance, on the other hand, provides income replacement for individuals who are unable to work due to illness or injury, rather than covering medical expenses directly related to hospital stays or outpatient care. In summary, hospitalization insurance is specifically designed to cover expenses incurred during hospital stays and certain outpatient treatments, making it the